AozoraStep

Entry & Exit Smiths News: Cash flows that support a +10% dividend yield

Company:	Smiths News (SNWS LN)	**Market Cap:**	£80mio
Industry:	Newspaper print & distributor	**Net Debt:**	£38.8mio
Country:	UK	**Revenue:**	£1.1bn
Date:	6th October 2022	**Net Income:**	£20mio (1.8%)
Dividend:	£10mio (14%)	**Free Cash Flow:**	£20mio (1.8%)
Entry:	£70mio	**Exit:**	£78mio

A turnaround

Smiths News is the UK's largest Newspaper & magazine print & distributor with a 55% market share. The contracts are renewed on a 5-year basis with 95% of current contracts running until 2024 and 60% until 2025. This enables stable revenues into the near future and growth potential from 2024/25 onwards. The key about the business is the declining newspaper industry which is shrinking by about 3% annually and this is why investors shun the sector and why there is value in the business… The sale of their logistics business, Tuffnells, and the winding up of the WHSmith Pension Trust has generated extra cash flows including in the current FY (£6.5mio + £7.5mio from Tuffnells, £8.1mio from WHSmith), which has helped accelerating a reduction in debt. This in turn is reducing interest expenses and ultimately makes this a compelling turnaround story. The enterprise value has mostly been around £150mio, but is currently only £110mio, which enables upside of over 50% for the equity (although given the nature of the decline in the newspaper business, my target market cap would be £100mio for now, or £130mio enterprise value in 3-6 months. Net debt is also volatile due to working capital requirements, and hence might turn out to be somewhat higher at £40-£45mio due to the early receipt of £20mio ahead of the interim results).

Smiths News: Financial turnaround

57 Lansdowne House, Berkeley Square, London W1J 6ER
www.aozorastep.com · david@aozorastep.com

Variable	2017	2018	2019	2020	2021	2022*
Revenue	1412.2	1361.6	1303.5	1164.5	1109.6	1100
Adjusted EBITDA (excl IFRS16)	50.1	46	48.8	39.1	42.6	41
Interest expense	5.2	5.8	5.1	8	9.5	5.5
Adjusted net income	39.1	24.2	19.4	10.6	26.3	25
Bank net debt	82.1	83.4	73.9	79.5	53.2	30
Market capitalisation	276	98	89	71	96	81
Dividends per share (p)	9.80p	3.10p	1.00p	0.00p	1.65p	4.1p

*expected

Source: Smiths News

The nitty gritty of the financials

Below are two tables showing Smiths News debt repayment plan and resulting cash flows under £40mio EBITDA assumptions for 2023. With EBITDA of £40mio a £10mio dividend can be maintained while declining interest expenses can be offset with higher capital spending, which is currently at depressed levels and should eventually raise back to around £7mio. The McColl administration, however, has led to £4.4mio bad debt, which in turn would immediately eat into the dividends, if the company had not received the additional receipts from the WHSmith pension trust and the Tuffnells disposal. Therefore, the below calculation is the ideal case and hence subject to revision that could easily appear in the current macroeconomic environment.

Smiths News Debt Repayment Plan

Debt facility	Sonia+4.25% (in £mio)
RCF	13.3
Loans	46.9
Repayment schedule	Facility A (£46.9mio)
FY 2022	3
FY 23	8
FY 24	10
FY 25	10
Final bullet payment	15.9
Repayment schedule	RCF (£13.3mio)
Nov-22	5
Feb-23	2.5
Aug-23	2.5
Feb-24	2.5

57 Lansdowne House, Berkeley Square, London W1J 6ER
www.aozorastep.com · david@aozorastep.com

Aug-24	0.8

Source: Smiths News

Smiths News 2023 Cash Flow estimate

£ mio cash flow 2023 estimate	Component
40	EBITDA
-6	Interest expense
-7	Leases
-4	Capex
-10	Dividend
-13	Bank debt repayment
0	Net cash flow

Source: Smiths News, own estimate

Early exit

When I bought shares in Smiths News I was putting a limit buy order in right at the close at high volume, expecting that not much will likely get filled. To my surprise, the entire order got filled with a size of the usual daily total volume. The liquidity of shares in Smiths News is quite low and this made me sell shares after a quick 10% gain out of fear that when volatility increases the valuation could suffer and I would be unable to sell in the current macroeconomic environment. Nonetheless, the business remains undervalued at £40mio EBITDA, which is the reason I filed this report in order to revisit it again in the future. Smiths News remains a turnaround candidate, but there is a reason why the valuation is so cheap: Margins are low and small downside in earnings would immediately affect dividend payouts and hence the valuation.

57 Lansdowne House, Berkeley Square, London W1J 6ER
www.aozorastep.com · david@aozorastep.com

Legal Disclaimer

The contents of this publication have been prepared solely for the purpose of providing information about AozoraStep Capital LLP and the services and products it intends to offer, which are targeted for professional investors only. The opinions and views expressed are those of AozoraStep, may change without notice and should not be construed as investment, tax, legal or other advice. AozoraStep does not guarantee the completeness and accuracy of the information provided and all content can become out of date. Products or services mentioned on this site are subject to legal and regulatory requirements in applicable jurisdictions and may not be available in all jurisdictions. Accordingly persons are required to inform themselves and observe any such restrictions. In respect to investments described on this website, past performance is not a guide to future performance. The value of investments and the income of any financial instruments mentioned on this website may fall as well as rise and may have tax consequences. The performance of AozoraStep is based on a personal track record and approved by Sedulo for the time period Q1 2019 - Q1 2021 only with further examinations being done on an occasional basis. AozoraStep Capital LLP is currently not authorized by the FCA, but is in the process of authorization. AozoraStep Capital LLP is registered in England and Wales with registered number OC436835. Registered Office: 57 Lansdowne House, Berkeley Square, London W1J 6ER, United Kingdom. Reproduction or distribution of any materials obtained in this presentation or linking to this presentation without written permission is prohibited.

57 Lansdowne House, Berkeley Square, London W1J 6ER
www.aozorastep.com · david@aozorastep.com