



CATÓLICA
LISBON

SCHOOL OF BUSINESS & ECONOMICS

UNIVERSIDADE CATÓLICA PORTUGUESA

Equity Valuation

Atresmedia Corporación de Medios de Comunicación, S.A.

ATRESMEDIA



Francisco Barbosa Varandas Fernandes
152413021

Advisor: José Carlos Tudela Martins

February 2015

*Dissertation submitted in partial fulfilment of requirements for the degree of MSc in Finance at
Universidade Católica Portuguesa*

Abstract

It is essential that we align theory and practice in order to provide a robust and relevant equity valuation. By discussing the relevant methodologies in valuation literature we select the Adjusted Present Value and multiples approaches to value Atresmedia Corporación de Medios de Comunicación, S.A., a leading Spanish media group. Both methodologies lead us to conclude that Atresmedia is currently overvalued at €14,01 per share, which directs our recommendation to a Sell. Our target price is €11,45, which is based on our probability weighted average of three scenarios, which are built based on regulatory uncertainties and average cycle EBITDA margins. BESI's equity research is presented as a basis for comparison, where they use another approach to value the company, a WACC-based DCF.

Preface

The present dissertation was extremely important to further enhance my knowledge of firm valuation and equity research, perfectly combining theory and practice. I would like to express my gratitude to Professor José Carlos Tudela Martins for the invaluable insights and constant availability. I would also like to thank BESi analyst José Cravo for being able to provide crucial information for the development of this thesis. Finally, I would like to express my gratefulness to the Investor Relations Team of Atresmedia for being available to clarify my queries.

Contents

Abstract	ii
Preface.....	iii
1. Introduction	1
2. Literature Review	2
2.1 Overview	2
2.2 Discounted cash flow methodology (DCF).....	4
2.2.1 Cost of equity	4
2.2.2 Cost of debt	9
2.2.3 WACC.....	9
2.2.4 DCF valuation methods – Enterprise vs. Equity cash flows	10
2.2.5 Adjusted Present Value	12
2.3 Relative Valuation – Multiples.....	13
2.4 Contingent claim valuation – Options Theory	14
2.5 A note on cross border and emerging markets’ valuation	15
2.6 A note on valuing cyclical companies.....	16
2.7 Conclusion.....	16
3. Company Overview.....	17
3.1 Atresmedia Televisión.....	18
3.2 Atresmedia Radio	19
3.3 Other divisions – Atresmedia Cine, Digital, Publicidad and Diversificación	20
3.4 Shareholder structure.....	21
3.5 Share price historical performance.....	21
4. Macroeconomic outlook and Industry drivers.....	22
4.1 Macroeconomic outlook.....	22
4.2 The advertising industry – A global perspective.....	25
4.3 The advertising industry – The Spanish case	27
4.3.1 TV advertising market.....	31
4.3.2 Radio advertising market.....	34
5. Valuation Overview	34
5.1 Adjusted Present Value approach.....	35
5.1.1 The peer group.....	35
5.1.2 Unlevered cost of equity.....	36
5.1.3 Cost of debt	37

5.1.4	Revenues	37
5.1.5	Operating expenditures.....	39
5.1.6	Net Working Capital	41
5.1.7	CAPEX and Depreciations & Amortisations	42
5.1.8	Tax matters	42
5.1.9	Unlevered firm value	43
5.1.10	Leverage side effects and market value of debt	45
5.1.11	Other balance sheet assumptions.....	47
5.1.12	Valuation summary	47
5.1.13	Sensitivity analysis	48
5.2	Relative Valuation – Multiples.....	49
6.	Valuation Comparison with BESi equity research.....	50
6.1	Methodology	50
6.2	Discount rate.....	51
6.3	Forecasts.....	51
6.3.1	Revenues	51
6.3.2	EBITDA margins and FCFF	51
6.4	Comparison Summary.....	52
7.	Investment Case	52
8.	Conclusion.....	53
9.	Appendices	55
	Appendix 1 – Breakdown of advertising market by medium.....	55
	Appendix 2 – Income Statement as reported (2007 – 2014E).....	57
	Appendix 3 – Balance Sheet as reported (2007 – 2014E).....	58
	Appendix 4 – TV and Radio advertising market forecasts.....	59
	Appendix 5 – Forecasted Income Statement (2014E – 2025E) (Base case)	60
	Appendix 6 – Forecasted Balance Sheet (2014E – 2025E) (Base case)	61
	Appendix 7 – EBITDA estimation (Base case).....	62
	Appendix 8 – Net Working Capital (Base Case).....	62
	Appendix 9 – CAPEX and Depreciations & Amortisations (Base case)	63
	Appendix 10 – Tax matters, Effective tax rates (Base case)	63
	Appendix 11 – Debt package and interest tax shields (Base case).....	64
	Appendix 12 – Forecasted Income Statement (High-Growth case)	65
	Appendix 13 – Forecasted Income Statement (Low-Growth case).....	65
	Appendix 14 – Free cash flows (High-Growth case)	66
	Appendix 15 – Free cash flows (Low-Growth case).....	66

Research Note 67
10. Bibliography 75

1. Introduction

The present dissertation aims to value Atresmedia Corporación de Medios de Comunicación, S.A. (“Atresmedia”, “the company”), a leading media group operating in the Spanish market. The valuation is supported by an adjusted present value approach and a multiples analysis, and in the end, an investment recommendation is provided, based on our conclusions.

Prior to developing our valuation, we start by reviewing in Section 2, the relevant literature in the field of valuation, where several approaches and methodologies are considered and analysed. Several methodologies are presented including discounted cash flows, relative valuation and contingent claim analysis. The most appropriate method to value Atresmedia is discussed and selected based on this analysis.

In Section 3 we present a company overview to the reader by giving a brief introduction on its operations, discussing its divisions and background. Moreover we discuss the company’s current and historical financials, its shareholder structure and share price historical performance.

Section 4 includes a macroeconomic analysis, focused on Spain, and discusses the advertising industry in detail, both on a worldwide basis and the Spanish case in particular. We focus on the industry key drivers and main trends to develop our forecasts.

In Section 5 we conduct our valuation based on the methodologies previously reviewed in Section 2 and present our assumptions, which will drive the final results and consequently our recommendation. In order to compare our results and methodologies with those of a credible source, we use an equity research report from BESi. The conclusions from the comparison are presented in Section 6.

Finally, in Section 7 we present our investment recommendation with a price target and a brief review of the main arguments supporting it.

2. Literature Review

2.1 Overview

Valuation plays a key role in several areas of finance, including corporate finance, mergers and acquisitions, investments and portfolio management. Behind every company's decision of whether to invest in R&D, enter a strategic partnership or build a new factory, lies some calculation of what it is worth. In fact, it is also one of the most discussed topics in the financial literature. A multitude of valuation models have emerged in the last few decades, ranging from the simple to the sophisticated. With all these models at our disposal an understandable question surges – Which model should we chose to value a specific business or company?

Young, et al. (1999) argue that most models used in the field are different approaches of expressing the same underlying model, thus being mathematically equivalent. By recognising this, we can infer some powerful implications. First, a consistency analysis could be performed on the valuation assumptions in order to arrive at a more robust result. Second, different valuation models could be directly compared allowing a precise identification of which assumptions are causing the models to diverge. And third, we could reach a final unique fair value estimate, based on our assumptions, independently of the approach used.

However, the previous argument does not imply that every model is appropriate in any circumstances. Due to the nature of the company or data imperfections when making crucial assumptions, some model might prove to be more robust when compared to others. Moreover, different models highlight different sources of value or some relevant aspects, thus it is important that we engage in a careful analysis when deciding which valuation method to use. It is also important to mention that no single approach is expected to be consistently more reliable than others (Young, et al. (1999)).

Damodaran (2006) presents a proposal to classify all those models into four broad categories – discounted cash flow valuation, liquidation and accounting, relative valuation and contingent claim valuation.

The discounted cash flow (“DCF”) valuation approach relies on the present value of expected future cash flows, discounted at a rate that reflects the riskiness of these cash flows. It is one of the most widely used approaches in the financial industry and one of the most discussed

valuation methods in academia. Variants of this type of method have emerged such as excess return models where we separate the cash flows into normal return cash flows, earning the risk adjusted required return (i.e cost of capital), and excess return cash flows that can be either positive or negative, depending on whether the business earns a higher or lower return than the cost of capital, respectively. Although there are numerous models within this approach, the Economic Value Added (“EVA”) and the Dynamic ROE are the most discussed in the literature. As a reference, Stewart (1991) and Young and O’Byrne (2000) provide an extensive analysis and cover the computation of these models, particularly the EVA approach, but we will not focus upon these variants of the DCF valuation method.

The liquidation and accounting valuation method is based on the existing assets of a firm, with accounting estimates, such as book value, often used as a starting point. Daniels (1934) lays the ideal that an investor should be able to know the value of a company by looking at the book value or the equity value figure in the balance sheet. Book value could indeed serve as a proxy for true value in mature firms with predominantly fixed assets, little or no growth opportunities and no potential for excess returns (Damodaran (2006)). However, we will not focus on this approach in this work as it is not suitable to value Atresmedia.

The relative valuation method or the multiples approach estimates the value of an asset based on the prices of comparable assets in the market relative to a common variable such as earnings, sales, cash flows or book value. According to Goedhart et al. (2005) a properly executed multiples analysis can support a thorough DCF valuation and help understand whether a company is strategically positioned to create more value than other industry competitors. But what is a properly executed multiples approach? And how do we select a truly comparable set of companies? We will address these questions in more detail further below.

Finally, contingent claim valuation uses option pricing models to value assets that show option’s characteristics. This approach is particularly relevant when valuing managerial flexibility, which refers to choices between alternative opportunities that managers may make in response to events. Other types of models such as DCF or relative valuation usually do not take flexibility into account and to perform this analysis it is essential to be able to describe the set of specific decisions the management could make. It is mostly used in commodities’ companies, particularly in Oil & Gas E&P, as managers have the option to extract if it proves economically profitable, at the cost of depleting their reserves, or do not extract otherwise.

We will now address the different approaches in more detail, discussing their strengths and weaknesses, and their applicability to the valuation of Atresmedia Corporación de Medios de Comunicación, S.A.

2.2 Discounted cash flow methodology (DCF)

As mentioned earlier, a discounted cash flow methodology is based on the present value of expected future cash flows, discounted at a rate that represents the riskiness of these cash flows. Put simply, a company is valued based on its capacity to generate cash.

We will start by addressing the discount rate factor or cost of capital (subdivided into cost of equity and cost of debt) and how to compute it, and then we will discuss the main approaches used within the discounted cash flow methodology to value a firm, either by taking a firm or an equity perspective.

Koller et al. (2010) define the cost of capital as the opportunity cost that investors face when investing in a particular business or firm instead of others with a similar risk profile.

2.2.1 Cost of equity

According to Koller et al. (2010) three different methods can be applied to estimate the cost of equity of a particular company or stock. The most widely used model is the capital asset pricing model (CAPM), but alternatively we could also use the Fama-French three factor model or the arbitrage pricing theory (APT). These models differ mainly in how they define risk, but as most practitioners use the CAPM due to its simplicity in estimating the risk factor defined as “Beta” (β) and on getting a rough estimate of the cost of capital, we will follow the CAPM method.

CAPM

The capital asset pricing model (CAPM) was first introduced by Sharpe (1964), Lintner (1965) and Merton (1973), and is based on Markowitz modern portfolio theory. The CAPM defines the expected rate of return on any security through the following equation:

$$E(R_i) = R_f + \beta_i [E(R_m) - R_f] \quad (\text{Eq. 1})$$

$$\beta_i = \frac{\text{Cov}(R_i, R_m)}{\text{Var}(R_m)} \quad (\text{Eq. 2})$$

The expected return of security i ($E(R_i)$) equals the risk-free rate (R_f) plus the security's beta (β_i) multiplied by the market risk premium (MRP), defined as the difference between the expected market returns ($E(R_m)$) and the risk-free rate. The beta is defined as the only source of risk and measures the covariance of the specific security with the market portfolio. The intuition behind the model is that an investor should only be rewarded by the contribution of the stock to market risk, as stock specific risks can be diversified away and are therefore not rewarded with extra return.

Several critics have emerged since the model was first introduced. Roll (1977) states that as we do not observe the true market portfolio, only a proxy, the CAPM cannot be tested and thus the estimates of the betas could be inconsistent. Furthermore, Fama and French (1992) find no positive correlation between betas and average stock returns and propose a three-factor model based on their findings.

Nevertheless, Damodaran (2002) argues that the CAPM is still "*the most effective way of dealing with risk in modern corporate finance*" and more complex models have failed to deliver significant improvement in estimating expected returns. According to the author, the CAPM remains an intuitive, useful and simple model. Moreover, despite its controversies in the financial literature, the capital asset pricing model is still the most widely used by practitioners. Accordingly, we will follow this approach for the purpose of our valuation.

Beta (β)

As defined before in Equation 2, the beta (β) represents the non-diversifiable or systematic risk of a stock. In other words, it shows how much the stock and the whole market move together.

It is usual to consider two ways of estimating a firm's beta – through an historical regression or through a peer group analysis (i.e. industry betas).

In the first approach, according to Koller et al. (2010), the most common used regression is the market model, defined in Equation 3 below.

$$R_i = \alpha + \beta R_m + \varepsilon \quad \text{(Eq. 3)}$$

In this model, we are regressing the market's return (R_m) on the stock's return (R_i). Although the process is not very complex, we face three decisions to set up the regression described. What length for the estimation period should we use? Should we use weekly, monthly or yearly returns? And how do we define the market portfolio?

Koller et al. (2010) proposes a set of solutions to these questions. Although there is no standard for the appropriate estimation period, they propose a five year window. The five year estimation period to determine beta has been supported by Black, Jensen and Scholes (1972) in early tests of the CAPM and later by Alexander and Chervany (1980). However, it is important to keep in mind the trade-off between a longer estimation period that provides more data, and the structural changes the firm might have incurred during that period that might change the risk characteristics and therefore the beta.

The second issue is concerned with the frequency of returns, since usually we have yearly, monthly, weekly, daily or even intra-day returns at our disposal. The authors propose the use of monthly returns as a rule of thumb. Using higher frequency might result in a downward bias in illiquid stocks, as they may not even be traded in every period and appear to be not moving with the market.

The third and final decision to be made relates to the choice of the market index to be used as a proxy for the whole market. The standard practise is to use a well-diversified index such as the S&P 500 or the MSCI Europe Index or even the MSCI World Index. Using local indexes might be problematic as sometimes a specific market might be heavily weighted in one or two industries.

The second approach to estimate beta focuses on a peer group analysis to compute the industry-derived unlevered beta, which is then relevered to the company's target capital structure. At this point, it is important to distinguish a levered from an unlevered beta. While the levered beta takes into account the financial leverage of the firm, the unlevered excludes the effects of the capital structure. The relation between the two betas is commonly defined as shown in Equation 4.

$$\beta_{unlevered} = \frac{\beta_{levered}}{1 + (1 - T) \times \frac{D}{E}} \quad (\text{Eq. 4})$$

This formula was originally developed by Hamada (1972) and later presented by several authors, including Damodaran (2002) and Koller et al. (2010). To come to that relation, it is assumed that the debt beta (β_D) equals zero, since usually there is no correlation between the debt payments and the overall market.

In order to compute the industry unlevered beta it is crucial to select an appropriate set of comparables. A comparable firm is commonly defined as a firm that operates in the same business or industry, as firms in the same industry should have similar operational risks (Koller et al. (2010)). If we have a large enough set of companies in that condition we can go further and select companies for instance, with similar size or growth prospects. Damodaran (2002) argues that narrowing the definition of comparable firms comes with a large cost because each additional criterion added will mean that fewer firms make the list and the savings in standard error become smaller.

Koller et al. (2010) state that: *“As long as estimation errors across companies are uncorrelated, overestimates and underestimates of individual betas will tend to cancel, and an industry median (or average) beta will produce a superior estimate.”* As a result, and since firm-specific betas computed using historical regressions tend to vary too widely, we will use an industry beta for the purpose of our valuation.

Risk-free rate

The risk-free rate is defined as the return of a security or portfolio that has no covariance with the market, thus implying a beta of zero (Koller et al. (2010)). Moreover, the actual returns on the risk-free asset should be equal to the expected returns and there can be no default risk.

Typically, we look to default-free government bonds, such as US or German bonds, in order to measure the risk-free rate. As Damodaran (2002) argues, private firms cannot be considered as risk-free, not because governments are better run than companies, but because usually governments control the printing of currency, which should at least in nominal terms let them be able to fulfil their obligations.

Koller et al. (2010) state that ideally, each cash flow should be discounted using a government bond with the same maturity, but in reality most practitioners chose a single maturity, typically 10-year government bonds. Short-term bonds should not be used because usually they misestimate the opportunity cost of a specific investment for longer-term projects, as a bondholder might reinvest at higher rates when the short-term bond matures.

As a result, for US valuations we should use the 10-year US government bond yield as the risk-free rate, and for European valuations, as is our case, the 10-year German bund yield. As Koller et al. (2010) stress, it is crucial to use government bond yields denominated in the same currency as the firm's cash flows.

Market Risk Premium (MRP)

The market risk premium (MRP), also known as equity risk premium (ERP) represents the excess return that the overall equity market provides compared to a risk-free rate. This excess return is a way of compensating investors for taking a higher risk. This intuition that investors should have higher expected returns from riskier investments, in order to be considered good investments, is central to risk-return models in finance, and in particular to the CAPM.

Damodaran (2014) presents three methods to estimate the market risk premium. The first method consists on a survey to institutional and individual investors and managers to understand their expectations. The second approach, and the most widely used by practitioners, is to use the historical premium as reference for future expectations. This historical premium is inferred through the difference between historical returns on stocks and historical yields on the risk-free asset, usually government bonds. The third approach is based on implied premiums from current traded assets, where we can infer what rate of return investors are requiring today. The advantage of this last approach is that it is forward-looking, as opposed to the backward-looking historical premiums.

Although there is no consensus in the financial literature on how to measure the MRP, some authors present what they consider to be an appropriate range – Van Horne (1992) recommends using a MRP between 3 and 7%, while Koller et al. (2010) indicate that it should be in the 4,5 to 5,5% range.

2.2.2 Cost of debt

The cost of debt represents the current cost to the firm of borrowing funds to finance its activities. It is the theoretical cost the company would bear to issue new debt at the moment. Damodaran (2002) proposes three alternatives to estimate that cost depending on whether the firm has long term debt securities outstanding or has a rating attributed from a rating agency.

The first approach, in case the firm has long-term bonds quoted on the market that trade regularly, is to use the yield to maturity (YTM) of that security. As Koller et al. (2010) argue, to use this approach the YTM should only be calculated on liquid, option-free, long-term debt, as yields might be distorted by illiquidity and options like callability, and short-term bonds do not match the duration of the firm's cash flows.

The second approach can be used when the conditions mentioned do not verify and the company has a credit rating, which can be associated with a default spread to estimate the cost of debt. If, however, the company chooses not to get rated, we are left with two alternatives – either we use the recent borrowing history of the company or we calculate a synthetic rating by using financial ratios as the interest coverage ratio.

2.2.3 WACC

As most companies use a combination of debt and equity to finance its activities we must consider a weighted average cost of capital, most commonly known as WACC, which includes both the cost of equity and the cost of debt.

The following equation demonstrates how the WACC is computed.

$$WACC = \frac{D}{V} \times r_D \times (1 - T) + \frac{E}{V} \times r_E \quad (\text{Eq. 5})$$

We already mentioned previously how to estimate most of these variables. However, it is important to refer that we should use target debt and equity to enterprise value ratios with market values and not book values (Koller et al. (2010)).

A WACC-based DCF is the most common valuation method in finance and we will address this approach in more detail in the next section.

2.2.4 DCF valuation methods – Enterprise vs. Equity cash flows

The Free Cash Flow (FCF) is a measure of financial performance that represents the cash that the company has available for both its debt and equity holders. It differs from the earnings measure in that it does not include non-cash charges such as depreciation and amortisation (D&A) and includes the investment activities of the firm (investment in working capital and capital expenditures). We can define the Free Cash Flow to Equity (FCFE) and the Free Cash Flow to the Firm (FCFF), where the former is the cash available to equity holders and the latter includes the cash flow available for both debt and equity holders.

$$FCFF = EBIT (1 - T) + D\&A - \Delta Working\ Capital - CAPEX \quad (\text{Eq. 6})$$

$$FCFE = FCFF - Interest (1 - T) + New\ Debt - Debt\ Repayments \quad (\text{Eq. 7})$$

When valuing directly the equity stake in a company it is usual to consider two models: the Dividend Discount Model (DDM) and the Free Cash Flow to Equity (FCFE) model. In fact it can be argued that the latter is just an extension of the former because we discount potential dividends rather than actual dividends (Damodaran (2006)). The link between equity value and expected dividends was first mentioned by Williams (1938). The author states that a stock should be worth the present value of all expected dividends to be paid and that other variables such as the financial condition of a firm or the earnings should only be used to estimate those dividends.

$$Value\ of\ stock = \sum_{t=1}^{t=\infty} \frac{E(DPS_t)}{(1 + cost\ of\ equity)^t} \quad (\text{Eq. 8})$$

As we can see from the equation above, there are two main inputs – the expected dividends and the cost of equity. The cost of equity represents the riskiness of the dividend and is usually computed with the CAPM as we already discussed in a previous section. To estimate expected dividends we need to make assumptions about the company's payout ratios and earnings' growth rates. While the model is very simple and intuitive, since it can be argued that dividends are the only tangible cash flow to equity investors, it presents a serious limitation. Companies usually define a dividend policy that might not be related with the cash flows it is generating through its activities. Many firms might choose not to distribute their cash and hold it for some other purpose, building large piles of cash in their balance sheet. The DDM fails to recognise that cash and can be undervaluing the shareholders' stake, since

shareholders do own a share of that cash and it should be reflected on their equity value. The opposite may also occur when a company chooses to keep the dividend constant even if they are not generating enough cash flows, raising either debt or equity to pay those dividends, and thus, the DDM would generate a valuation that could be too optimistic.

An alternative to the DDM is to use the present value of the FCFE, which is known as the FCFE model. This approach presents a broader perspective on equity cash flows that is not restricted to dividends. Koller et al. (2010) argue that equity cash flow models, such as the FCFE model, can be difficult to implement because capital structure is embedded in the cash flow, which increases the difficulty in forecasting these cash flows. The cost of equity used should be appropriately adjusted for different leverage ratios to reflect the change in risk imposed on equity holders. The authors state that these models are more appropriate to value financial institutions, where capital structure is part of operations. Moreover, equity cash flow models should yield the same results as enterprise cash flow models when applied correctly and consistently. As a result, we will not consider these models for the purpose of our valuation analysis.

When valuing the firm as a whole, a WACC-based DCF, also known as enterprise DCF is the most widely used approach. We use the Free Cash Flow to the Firm (FCFF), computed as in Equation 6, and the weighted average cost of capital as the discount rate.

$$Value\ of\ Firm = \sum_{t=1}^{t=n} \frac{FCFF_t}{(1 + WACC)^t} + \frac{FCFF_{n+1}}{(1 + WACC)^n - g} \quad (\text{Eq. 9})$$

To arrive at the equity value from the enterprise value we just need to subtract the market value of debt and debt equivalents¹ and add excess cash and other non-operating assets. Enterprise value is thus defined as the value of the operating assets of the firm. Alternatively, we can value a company through an Adjusted Present Value (APV) approach, where we start by valuing the firm as if it was all-equity financed (unlevered firm value) and then separately we add the leverage side effects. We will address the APV approach in more detail in the next section.

¹ Debt equivalents typically include operating leases, unfunded pension liabilities and hybrid securities such as convertible debt and employee options.

Explicit forecast period and terminal value

A commonly used DCF analysis comprises two-stages. The first stage is the explicit forecast period whereas the second stage comprises the terminal value or continuing value. The terminal value usually accounts for a large part of the total firm value and thus we should carefully define our explicit period. For the explicit forecast period we should consider a timeframe long enough for the firm to reach a steady-state from which it should grow at a constant rate g . This perpetual growth rate is usually in line with GDP long-term growth rates or inflation.

Although we can estimate that perpetual growth rate in order to compute the terminal value, Koller et al. (2010) propose an alternative based on multiples. According to the authors it is usual to assume that a firm will be worth a multiple of earnings, EBITDA or book value based on the multiple for the company today. The ratio would be reflecting the economic prospects of the industry during both the explicit period and the terminal value period, but the prospects at the end of the first-stage can be very different from today's. As a result, Koller et al. (2010) argue that the first approach is usually more appropriate as it is very difficult to estimate a multiple that reflects the company's prospects after the explicit forecast period.

In the special case of a cyclical company, whose earnings exhibit a repeating pattern of increases and decreases, the choice of the explicit forecast period is even more relevant since we might be calculating the terminal value at either the peak or the bottom of the cycle and thus overstating or understating the value of the firm, respectively. In a later section we will discuss in more detail the issues that arise when valuing a cyclical company.

2.2.5 Adjusted Present Value

The current form of the Adjusted Present Value (APV) approach was first presented by Myers (1974) and it surged as an alternative to the traditional WACC-based DCF approach. As Luehrman (1997) notes, the latter is only suitable for simple and static capital structures as it can become a complex task to adjust the discount rate to exotic debt, costs of financial distress and a changing capital structure. The APV approach, through the use of the principle of value additivity, decomposes value into two parts – the unlevered firm value and the value from leverage side effects.

$$\text{Value of Firm} = \text{Unlevered Firm Value} + \text{Leverage side effects} \quad (\text{Eq. 10})$$

$$\text{Leverage side effects} = \text{PVITS} - E(\text{Bankruptcy Costs}) \quad (\text{Eq. 11})$$

$$\text{Present value of ITS} = \sum_{t=1}^{t=\infty} \frac{\text{Tax rate}_t \times \text{Interest Rate}_t \times \text{Debt}_t}{(1 + \text{cost of debt})^t} \quad (\text{Eq. 12})$$

To estimate the unlevered firm value we use the FCFE and discount it at the unlevered cost of equity, which can be computed with the CAPM model using an unlevered beta as we showed previously in Equation 1.

Leverage side effects can be either positive or negative. While increasing the debt level to fund a company's operations creates a tax benefit (i.e. interest tax shields), as interest expenses are tax deductible, it also increases expected bankruptcy costs. There is no consensus in the financial literature as to which discount rate should be applied to compute the present value of ITS. Fernandez (2004) argues that the present value of ITS should not be computed directly as the present value of a stream of cash flows, but rather as the difference between the levered and the unlevered firm value. However, Cooper and Nyborg (2006) do not agree and argue that interest tax shields should indeed be discounted back with the cost of debt.

The most significant problem in the APV approach emerges when we try to estimate the expected bankruptcy costs, since they cannot be estimated directly. Damodaran (2006) proposes using the bond rating to estimate the probability of bankruptcy, by using the associated empirical estimates of default probabilities. The author also proposes to estimate the expected bankruptcy costs through previous empirical studies on the costs of actual bankruptcies, as a percentage of firm value. The equation below shows the computation of the expected bankruptcy costs, according to the author.

$$E(BC) = \text{Probability of default} \times \text{Cost of Bankruptcy}(\%) \times \text{Firm value} \quad (\text{Eq. 13})$$

2.3 Relative Valuation – Multiples

In relative valuation we are no longer trying to estimate the intrinsic value as in a DCF analysis, rather, we are estimating the value of a firm based on how similar firms are priced in the market. This valuation method is strongly dependant on the set of comparable companies

(i.e peer group) we select and thus, it is crucial to define what a similar firm really is. For the purpose of this analysis it is crucial that investors use their judgement and critical thinking.

Goedhart et al. (2005) propose a way to identify similar firms by starting to identify the company's industry players. Sometimes firms list their competitors in their annual report. After compiling this initial list the authors suggest using as peers, companies with similar prospects for returns on invested capital (ROIC) and growth.

Another relevant issue when performing a multiples analysis is the choice of which multiple we are going to use. Several authors argue that an Enterprise Value to EBITDA (EV/EBITDA) multiple should be more appropriate, as it excludes capital structure effects and non-operating items, when compared to earnings multiples, such as the widely used P/E multiple. Furthermore, Goedhart et al. (2005) recommend the use of forward-looking multiples based on empirical evidence² and to avoid distortion caused by historical or one-time events. Koller et al. (2010) stress the importance of computing the multiple in a consistent manner, since often investors and analysts fail to do it. Considering the EV/EBITDA multiple, it is important that the enterprise value only includes the portion of investor's capital attributable to assets that generate EBITDA.

2.4 Contingent claim valuation – Options Theory

Traditionally, real options' valuation methods are most suitable to value Oil & Gas E&P or mining companies as they can decide whether to drill or mine, at any point in time, given their economic benefit to do so. However, valuing this flexibility can also be applied theoretically to other industries and in particular to the broadcasting industry, as is the case for Atresmedia.

Bughin (2001) suggests that executives in the broadcasting industry should use real options to value programming purchasing and production alternatives. The production and broadcasting of radio and television programs has embedded real options such as: (i) switching options are the options to shift a program position in the grid, meaning that managers can opt to air a show at different times or days; (ii) scale options involve the option to extend a program's life; (iii) kill options, which involve stopping a program that is under-performing.

² Liu et al. (2001) provide empirical evidence on forward-looking multiples, concluding that they are more accurate predictors of value when compared to historical multiples.

While it seems intuitive to apply this model to value the flexibility described above, it can become a very complex task when considering a whole company with several programs and business areas, as is the case of Atresmedia. Moreover, it is very difficult to assess with accuracy the inputs we would need to apply a real options model in our case. As a result, it will not be the purpose of our thesis to estimate the value of Atresmedia through real options.

2.5 A note on cross border and emerging markets' valuation

Valuation in emerging markets poses new risks which we have to deal with and include in our valuation correctly. It is easy to understand that issues such as the risk associated with war, corruption, expropriation or high volatility should influence the value of a firm operating in these markets. However, there is no consensus among academics and practitioners on how to adjust for these risks and thus, there is no single solution.

Although the basics of estimating a DCF valuation are the same as in developed economies, we should, nevertheless, stress the increased importance of being consistent between the cost of capital and cash flow projections in terms of inflation and currency when conducting a valuation in emerging economies. The currency one chooses to conduct the valuation should have no impact on value, which means we should use foreign-currency cash flows and discount them at the adequate foreign-currency discount rate or apply the same rationale with home-currency. This is particularly relevant when conducting a cross border valuation.

Damodaran (2014) supports the use of a country risk premium in order to adjust the discount rate factor. The author argues that country risk is not diversifiable most of the times and thus it should be added to the market risk premium in order to reflect the higher macroeconomic and geopolitical risks in some countries. Sovereign ratings provided by rating agencies or default spreads can be used to estimate the risk premium.

On the other hand, Koller et al. (2010) propose adjusting the cash flows instead of adjusting the discount rate as the authors believe that country risk can be diversifiable and thus should not be included in the cost of capital. According to the authors, using a scenario DCF approach, simulating alternative trajectories depending on whether specific risks materialise or not, provides a more robust understanding of the value creation process.

However, as Atresmedia does not operate in foreign countries nor is operating in emerging markets, we will not go into further detail on the issues mentioned.

2.6 A note on valuing cyclical companies

It is very challenging to predict precisely the earnings cycle for an industry or any specific firm. Based on past cycles we might be expecting that the industry will turn down soon, or there might be signs that the industry is about to break out of the old cycle. Koller et al. (2010) argue that a possible solution to value that uncertainty in a cyclical company is to develop scenarios and weight their values using a probabilistic approach. According to the authors, by following that approach we can avoid the traps of a single forecast and explore a wider range of outcomes and their consequences. We should use historical performance of past cycles to construct and value the normal cycle scenario and then construct and value other scenarios based on our expectations and recent developments. It is crucial that the terminal value is based on a normalised level of profits and cash flows, not a peak or trough.

Damodaran (2009) does not agree that the previous approach is the best solution to value a cyclical company and argues that it is better to normalise earnings and cash flows across the cycle, thus, not trying to model future cycles.

2.7 Conclusion

After reviewing the relevant literature on valuation models and understanding the industry and company specific characteristics of Atresmedia, we can answer the first question we presented - Which model should we choose to value Atresmedia?

We decided to use the Adjusted Present Value model, firstly because Atresmedia does not present a stable capital structure, as it will have repaid all of its debt by 2017 – from a Debt to Equity ratio of 33% in 2014 to 0% – and secondly because it decomposes the value of the firm into the value of the unlevered firm and the value from its leverage side effects. This way we can have a better understanding of where the value resides. Additionally, as Luehrman (1997) states *“[The APV model] always works when WACC does, and sometimes when WACC doesn't, because it requires fewer assumptions”*.

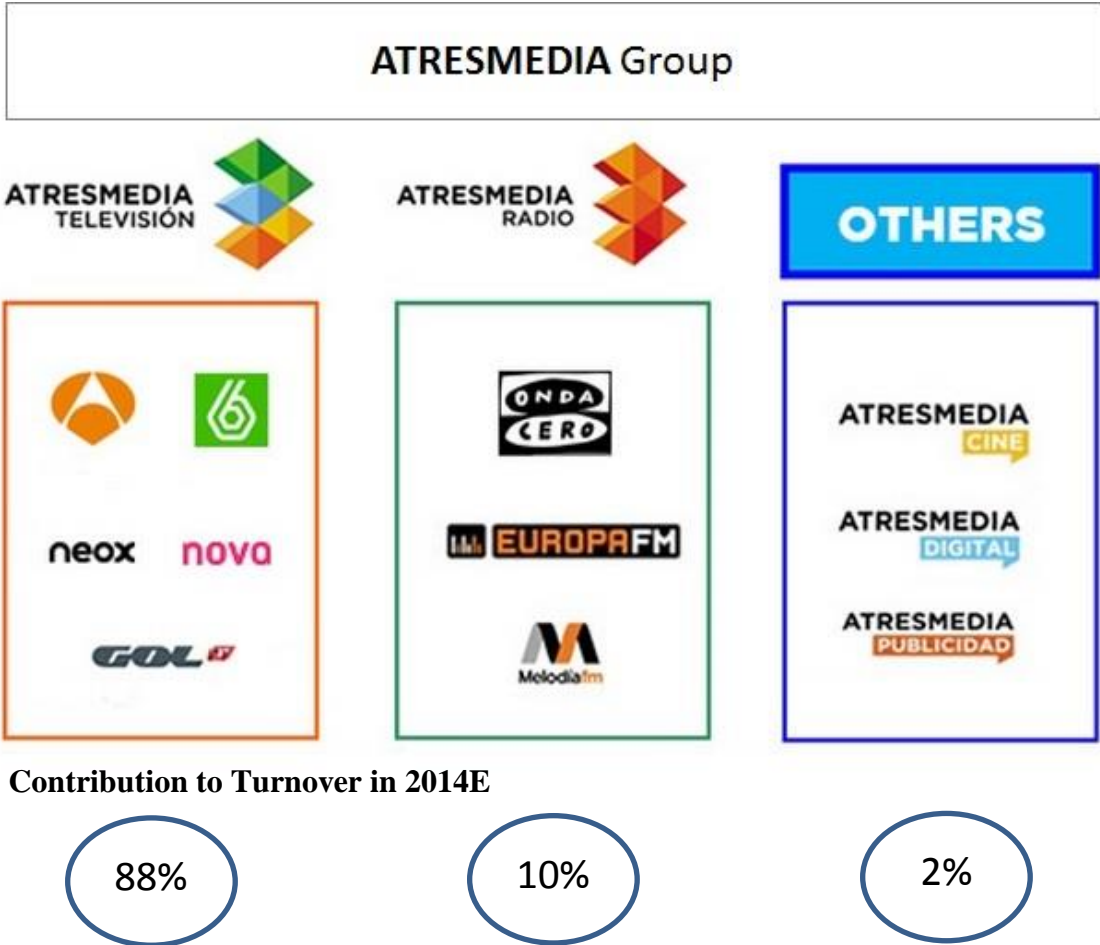
In order to support our DCF valuation we also perform a multiples analysis, as it can be very useful to understand how the market is valuing similar firms. For this purpose we use the EV/EBITDA forward multiple as it excludes capital structure effects and non-operating items and to avoid distortion caused by historical or one-time events.

As we will discuss in a later section, Atresmedia operates in a cyclical industry, and as so, we follow the approach proposed by Koller et al. (2010) that we described above. We develop three scenarios and use a probabilistic approach in order to reach a final value, while modelling a complete cycle in the explicit period.

3. Company Overview

Atresmedia Corporación de Medios de Comunicación, S.A., formerly Antena 3 de Televisión, S.A. or just Grupo Antena 3, was established in 1988 and is currently one of the leading media groups in Spain. Operating in a wide range of segments through its various subsidiaries – Television, radio, cinema, internet and advertising – it is active in the most relevant means of communication as of today (see Figure 1). 97% of the group’s revenues are from advertising, while only 3% are related to non-advertising activities, such as the sale of content.

Figure 1: Atresmedia operations’ diagram



Source: Company information

In the second half of 2012, Atresmedia completed a merger with Gestora de Inversiones Audiovisuales La Sexta, S.A., where the audiovisual communication license held by the latter was transferred to the former, along with all its assets and liabilities. This contributed to boost the results of the Group in 2013 (EBITDA grew more than 100%), the first year in which it consolidated a full year of La Sexta's results.

Due to the nature of the industry where Atresmedia operates, the company exhibits a high operating leverage. What this means is that the company has a high proportion of fixed costs, thus EBITDA margins tend to fluctuate a lot with revenues. Although it is very challenging to cut on programming costs, given that the company wants to remain a market leader with excellent viewer ratings, the company has tackled its staff costs for the last seven years by reducing its workforce from a peak of 2.300 in 2007 to a bottom of 1.700 recently. This cost reduction will help the company leverage its revenues as the market improves.

In terms of capital structure, the company has relied mostly on equity financing, with a small portion of bank debt on its balance sheet. Its Net Debt to EBITDA ratio in 2014 was less than 1.0x. One of the reasons is because the company does not have very stable cash flows, being highly reliant on how the market behaves. Another reason is because the company has some tax advantages due to the audiovisual productions' tax reliefs, paying effective tax rates that are consistently lower than the statutory tax rate, which lowers the value of its interest tax shields.

See Appendix 2 and 3 for the complete historical income statement and balance sheet, respectively (from 2007 to 2014E).

3.1 Atresmedia Televisión

The TV division is the most important asset of the Group, representing more than 85% of the total revenues consistently over the years. The group operates seven free-to-air (FTA) channels: Antena 3, La Sexta, Neox, Nova, Nitro, Xplora and La Sexta3. The first two are Atresmedia's main channels and present generalist programming. Neox is geared towards a younger audience, particularly children and teenagers. Nova and Nitro are aimed at a female and male audience respectively; while the first displays lifestyle programmes, such as cookery, the second presents a sports-oriented programming. Finally, Xplora, which replaced

La Sexta2 in 2012 because of its low viewer ratings, presents a programming based on documentaries and reality shows and La Sexta3 only broadcasts cinema.

The company has one additional channel, GolT, which is currently leased to Mediapro for €6Mn a year. The contract is set to expire on December 2015.

On the main channels, namely Antena 3 and La Sexta, in-house production predominate with 69%, while the vast majority of programmes broadcasted on the other channels are produced by others (78%).

Atresmedia has always focused on improving its viewer ratings and has recently acquired the rights to broadcast the UEFA Champions League for the seasons 2015/2016, 2016/2017 and 2017/2018. This includes the broadcast of the grand final and the UEFA Super cup. In Spain, the UEFA Champions league has been historically the most watched event with the 2013/2014 season averaging an audience of 36% and 6.839.000 viewers.

On May 5, 2014, Nitro, Xplora and La Sexta3 ceased broadcasting as a consequence of a Supreme Court ruling that annulled the concessions of nine channels broadcasting in DTT because they were granted, without the required tender process, thus not complying with the Audiovisual Law in Spain. Other channels that were closed include La Siete, La Nueve, MTV, Intereconomía, AXN and Veo7.

3.2 Atresmedia Radio

The radio division is the second most important asset of the Group, representing around 10% of the total revenues in 2013. The group operates three radio stations – Onda Cero is a generalist radio station and the second largest in Spain by the number of listeners; Europa FM focus on broadcasting both national and international music hits from the 90's onwards; Melodía FM, relaunched in 2014, focus on broadcasting music, but also some local and regional programmes.

Onda Cero alone represents around 80% of the segment revenues and has reached around 2,6 million listeners by the end of 2014, while Europa FM and Melodía FM reached 2 million and 255.000 listeners, respectively. These figures are based on average number of listeners per week.

3.3 Other divisions – Atresmedia Cine, Digital, Publicidad and Diversificación

Atresmedia Cine is responsible for producing films, which have been recognised several times in the Goya Awards³. *La Isla Mínima* is the most recent film, produced in 2014, that is now nominated to 17 Goya Awards. Besides the film mentioned Atresmedia Cine has produced 9 more films during 2014.

Atresmedia Digital manages all the web content of the group. It has launched Atresplayer in October 2013, a digital platform with all the TV and Radio contents, which can be used on smartphones, tablets and the web. Although this segment is still very recent, Atresplayer has already reached 1,4 million registered users one year after inception and the digital contents have been visited on average by 16,3 million monthly unique users compared to 11,1 million in 2013.

Atresmedia Publicidad is an integrated advertising agency that is dedicated to creating, planning, and handling advertising for its clients. It leverages its position by using Atresmedia TV channels and radio stations.

Atresmedia Diversificación is a newly created division that has the purpose of providing some diversification to the ad-oriented business, the TV and radio divisions, avoiding declining markets in those sectors and increasing growth potential. Its strategy is based on three pillars – (a) adjacent, based on licensing, music rights and teleshopping; (b) International, based on three pay TV channels that are expanding rapidly around the world, with a total 23 million subscribers; (c) Media for Equity⁴ (MxE), which targets Spanish multimedia start-ups. Atresmedia Diversificación was created with the intent to bring more recurring and stable revenues complementary to the advertising revenues, but it is still too early to assess the success of this strategy.

Despite the large growth in the digital contents managed by Atresmedia Digital, the large user base increase and all other projects in place, these divisions still represent only a fraction of the overall sales figure – around 2% in 2014.

³ Goya Awards are Spain's most prestigious annual film awards. They are considered by many as the Spanish equivalent of the American Academy Awards.

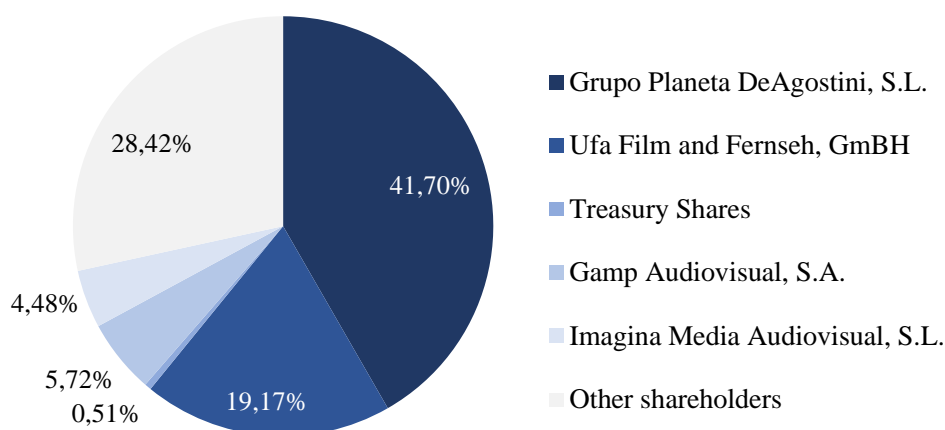
⁴ Media for Equity (MxE) is an alternative investment model where media groups use unsold advertising space in exchange for stock in start-ups that would not otherwise have capital to invest in advertising by themselves.

3.4 Shareholder structure

As part of the terms and conditions agreed upon the merger with Gestora de Inversiones Audiovisuales La Sexta, S.A, the shareholders of that company were given rights over a further 7% of the share capital of Atresmedia, subject to the financial performance in the years 2012 to 2016. During 2014, a renewed agreement was signed adjusting the contribution payable to Gamp Audiovisual S.A and Imagina Media Audiovisual S.L, transferring to those companies 2,079% and 1,631%, respectively, of Atresmedia's share capital, charged to treasury shares.

In March 2014, the Company sold the equivalent of 2,790% of its share capital (treasury shares), realising 79,7 million euros. The current shareholding structure is presented below.

Figure 2: Shareholding structure in 2014

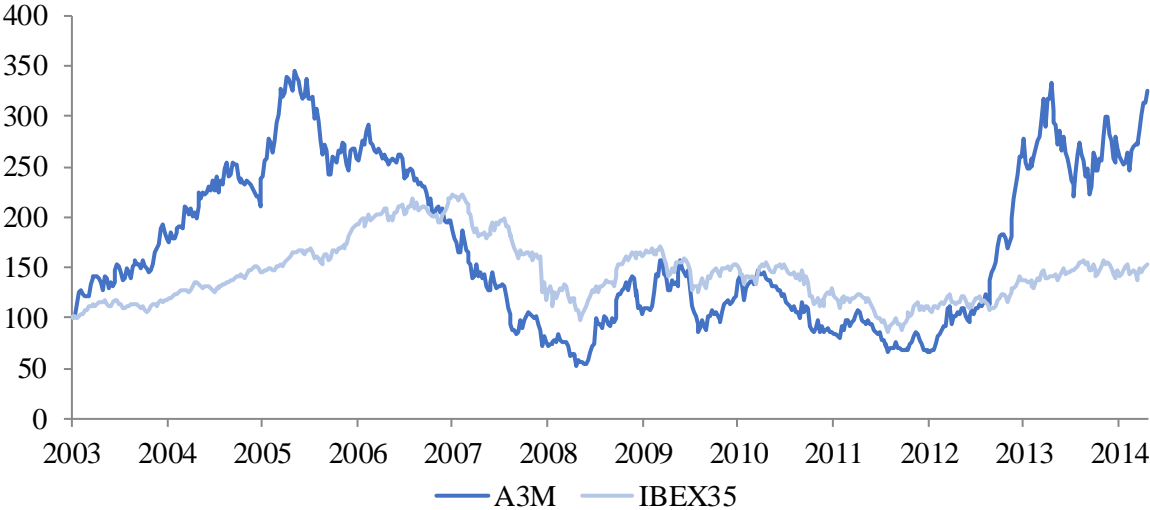


Source: Company information

3.5 Share price historical performance

On 29 October 2003, Atresmedia's shares started trading on the Spanish stock market interconnection system. All shares issued carry the same voting and dividend rights. The historical performance can be observed in Figure 3 below.

Figure 3: Atresmedia share price performance vs. IBEX35 (29/10/2003 – 20/02/2015)



52 week High	14,01	YTD return	19,1%	Current Price	14,01
52 week Low	9,51	Return since IPO	225%	Annualised Stdev	41,06%

Source: Bloomberg

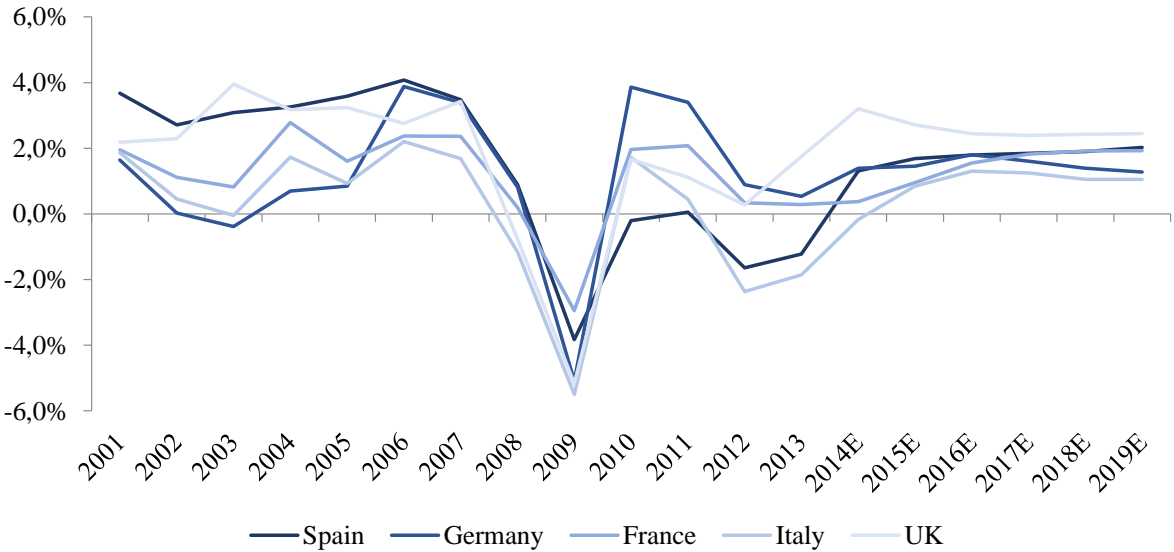
As we can observe in the figure above, Atresmedia stock has always exhibited a higher volatility than the market, outperforming it when the economic environment is favorable and underperforming when it is adverse. The stock is currently trading at €14,01, which compares with its all-time high of €14,90.

4. Macroeconomic outlook and Industry drivers

4.1 Macroeconomic outlook

The Spanish economy was one of the most severely hit after the collapse of the real-estate boom in 2008 and after the Eurozone debt crisis in 2012. However, the economy is showing positive signs in 2014: real GDP is expected to grow by 1,3%, the highest level since 2008; the labour market is also improving, with the unemployment rate decreasing to 23,67% in the third quarter of 2014, the lowest level since 2011; and private consumption is undoubtedly recovering, with consumers showing more confidence. From Atresmedia’s perspective, an economic recovery is crucial to boost advertising revenues, as the industry is highly dependent on macroeconomic factors such as GDP and private consumption.

Figure 4: Real GDP growth rates (2001 – 2019E)



Source: IMF

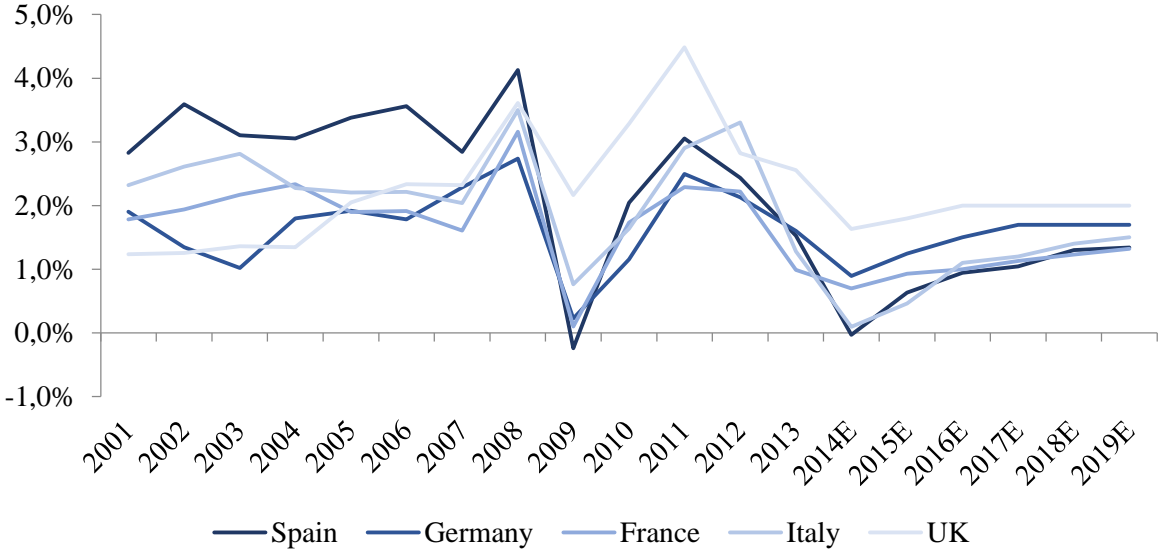
As we can observe in Figure 4, Spain has lagged behind its European peers on recovering from the crisis. However, it is expected that Spain will get out of the recession in 2014, with a 1,4% real GDP growth, and by 2015 it will have surpassed most of its peers on that measure.

Prior to the collapse of the real estate bubble, Spanish debt levels were relatively low compared to the Eurozone average (as percentage of GDP). After the collapse, bank bailouts and the economic downturn increased the country’s deficit and indebtedness to alarming levels and its credit rating was lowered. This led the government to adopt a series of austerity measures in 2011, raising taxes and cutting government spending, which led to a continued drop in household disposable income and subsequently in private consumption. As a result, private consumption has been decreasing in real terms for the last six years (except for 2010, when it was stagnated), which had a strong negative impact in most businesses in several industries throughout the country, and in particular, in the advertising industry.

The advertising industry is particularly sensitive to economic cycles and in particular to GDP and private consumption, because companies are only willing to advertise their products, as long as consumers have the means to buy them. Moreover, as consumers lower their spending and the whole economy slows down, companies’ revenues get under pressure and they react accordingly by cutting costs, which include advertising and marketing costs. In fact, we observe high correlations (around 80% for the last 30 years) between GDP and advertising spending in Spain. A more detailed analysis on this relation will be conducted when discussing the advertising industry in the next section.

High rates of unemployment throughout the country, above 25% in 2013, significantly contributed for the decrease in consumer spending described above. As more and more people lost their jobs, household’s disposable income kept decreasing, thus, reducing consumption.

Figure 5: Inflation rates (2001 – 2019E)

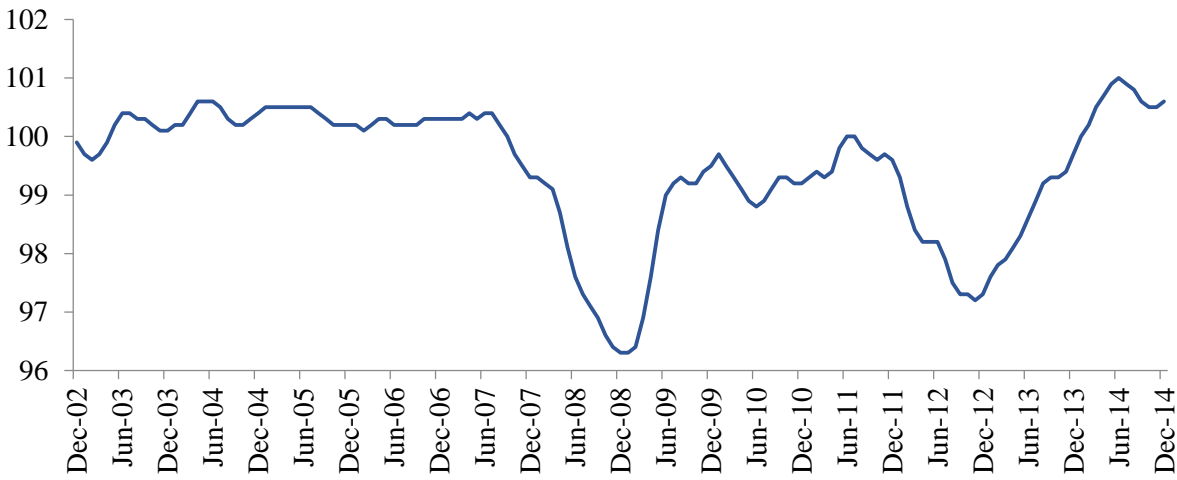


Source: IMF

Low levels of inflation in Eurozone in general and Spain in particular are posing a challenge to European leaders. Current levels of inflation are far from the 2% target set by the ECB. Figure 5 shows historic and expected inflation rates for the next five years. As we can observe, Spain is one of the most affected countries, showing a slight deflation in 2014. This presents a challenge for the economy because in case of a deflation environment, private consumption could be deeply affected, as consumers would probably postpone spending. However, the ECB already announced a quantitative easing (QE) program that, along with other structural reforms, could help raise inflation levels in Eurozone. We expect inflation in Spain to turn positive in 2015 and to be at the 1 – 1,5% range by 2018.

The consumer confidence index at historic highs represents that Spanish consumers are optimistic with respect to the Spanish economy in the next few years. The consumers being optimistic means that they will be willing to purchase more goods and services, which in turn will help improve the economy, increasing private consumption. Figure 6 presents these results.

Figure 6: OECD – Consumer Confidence Index (2002 – 2014)



Source: OECD

Concluding, it is important to note that the Spanish economy was one of the most affected in the Eurozone during the crisis, with private consumption decreasing by 11% in the last six years. However, it seems that the economy is at a turning point, with real GDP expected to increase by 1,4% in 2014, consumer confidence levels at historic highs and the labour market showing positive signs since the beginning of 2014. We expect these developments to represent an improvement in the advertising industry in Spain as well.

4.2 The advertising industry – A global perspective

As mentioned earlier, the advertising industry is highly sensitive to economic cycles, particularly to GDP and private consumption. In fact, these two indicators represent the main drivers of the advertising industry.

In Table 1 we can observe the advertising spending growth by regions and globally. As expected, in 2008 and 2009 we observe the largest drops worldwide due to the burst of the real estate bubble that started in the United States and led to a worldwide recession. By 2010, all regions were already gaining momentum and recouping from that crisis with the advertising industry growing 8,76% worldwide. However, Western Europe (WE) has clearly lagged other regions the following years, on recovering from the crisis, due to the Eurozone debt crisis that emerged in 2011, which had a significant impact on these economies. We assisted to a series of bailouts not only on banks but also on governments that were unable to control their budget deficits and comply with their debt repayments, thus surging concerns for

defaults. These series of events were reflected in the advertising industry in WE, which decreased 2,69% in 2012 and was practically unaltered in 2013.

Table 1: Global advertising spending growth by region (%)

(%)	2007	2008	2009	2010	2011	2012	2013	2014E	2015E
North America (NA)	0,6	-4,6	-15,4	6,7	3,1	4,9	2,0	4,0	2,8
EMEA	9,1	1,4	-9,5	8,0	4,4	0,2	2,1	3,2	3,2
Western Europe (WE)	6,7	-0,7	-10,4	6,8	2,3	-2,7	0,1	3,0	2,8
Asia Pacific (APAC)	6,2	1,8	-4,6	10,9	7,0	7,0	7,1	6,9	6,4
Latin America (Latam)	8,0	8,5	2,5	16,4	14,8	11,4	13,1	14,9	12,9
Worldwide	4,7	-0,7	-10,0	8,8	5,3	4,5	4,3	5,5	4,8

Source: Magna Global, Bloomberg

Advertising spending growth varies widely among the various regions. During 2012, while Western Europe was in recession, North America, and the US in particular, were growing its advertising spending by almost 5%, one of the largest growth rates in the region of the last decade, benefiting from a boost in TV advertising associated with the presidential elections and the Olympics. It is important to note that such major events have a large impact in the advertising industry and in TV advertising in particular, due to the large increase in audiences. Other events include the FIFA World Cup or the UEFA European Championship; the latter, in 2012, was not enough to counter the negative impact of the debt crisis in WE.

Latin America provided the best growth story as a region, registering double digit growth rates for the last five years and avoiding the generalised recession in 2009. The region's growth is explained by the fact that it is at an earlier stage of development when compared to other regions of the world.

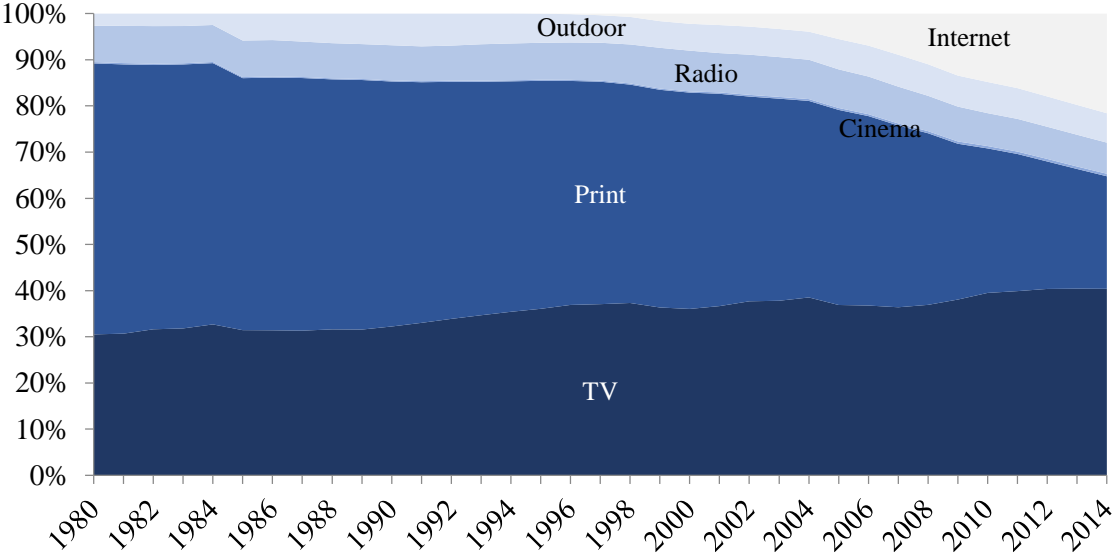
Over the next few years, we expect global spending on media to grow at a modestly faster rate – 5 to 5,5% – than the rates observed since 2012, reflecting an improving economic environment, particularly in Europe. North America and Western Europe are expected to remain the slowest growing regions, with low-to-mid single digit gains.

Among the several categories of media, TV has the largest share of the market, representing 40% of the global ad expenditure. The rising evolution of the internet does not seem to be affecting TV's weight in ad spending; instead, it has taken a large share of the market from print media, which includes newspapers and magazines. While the internet is at different stages of development among the different regions of the world, we have verified that even in

an advanced stage country, such as the US, TV is maintaining its position as the most important medium of advertising revenue⁵.

As a result, although internet is expected to grow at double digits, TV is still expected to keep its share of the market, as it has done in the past, for the foreseeable future.

Figure 7: Global advertising market breakdown by medium



Source: Zenith Optimedia, Bloomberg

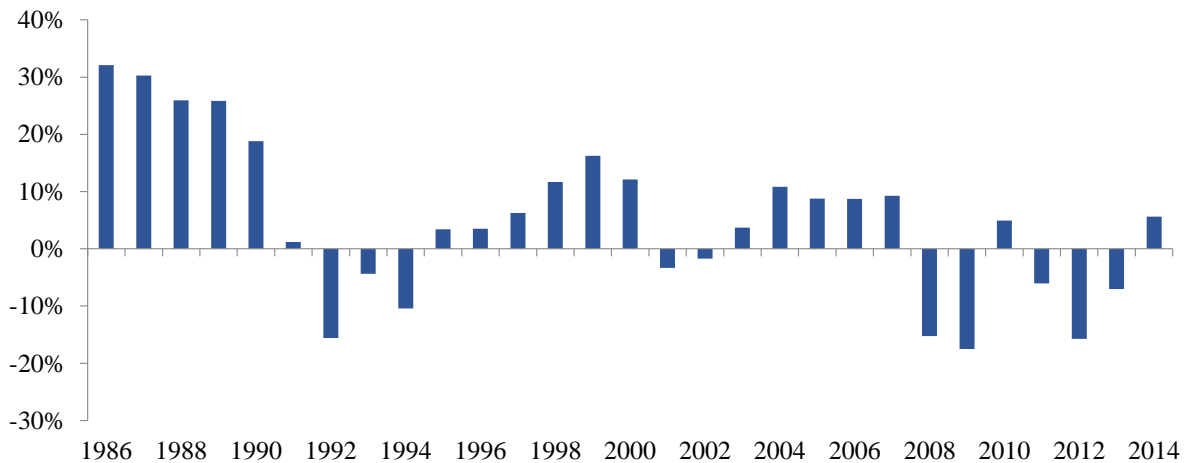
4.3 The advertising industry – The Spanish case

After the burst of the real estate bubble in 2008, the advertising industry in Spain collapsed and by the end of 2014 it is still around 40% below its 2007 peak. In fact, this reduction represented the largest drop among its European peers.

It is important to note that the advertising industry has exhibited a cyclical pattern throughout the years due to its large dependence on broader macroeconomic trends. To illustrate, during the recent crisis advertising budgets were cut due to the economic meltdown, driving advertising prices down and consequently, media groups’ revenues down. As broadcasters, such as Atresmedia, operate under a fairly fixed cost base, particularly considering programming and staff costs, we can easily spot a high degree of operating leverage in the industry and observe EBITDA margins fluctuating.

⁵ See Appendix 1 for a breakdown of the advertising market by medium in Italy, France, United Kingdom, United States and Germany.

Figure 8: Conventional advertising market evolution – Growth rates (%) (1986 – 2014)



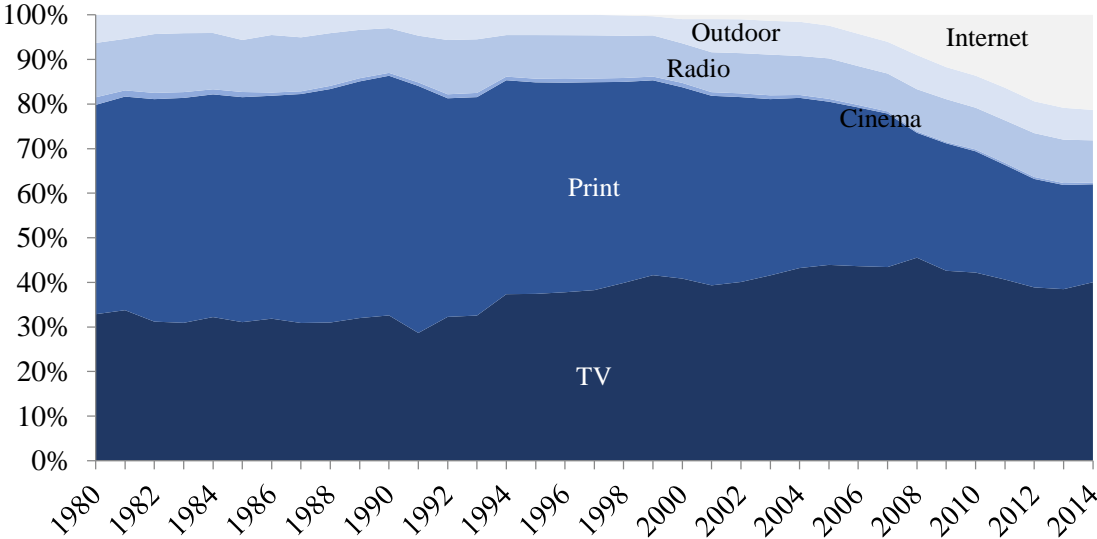
Source: Company data, Bloomberg

In Figure 8 we can identify clearly the three drops in the advertising industry that occurred in the last 30 years with an average cycle of 10 years.

- a) The crisis of the early 1990s coincided with a macroeconomic backdrop that was quite similar to the most recent one, with falling private consumption and a sharp rise in unemployment, reaching 24,55% in 1994. Between 1991 and 1994, the advertising market decreased 28%, a total reduction of €1,3Bn. As for the recovery, the pre-crisis investment levels were not reached until four years later.
- b) In 2001-2002, following the bursting of the technology bubble, the advertising market entered a two year contraction period that resulted in a 5% drop (€300Mn).
- c) The third crisis observed is the one we already discussed before that started with the bursting of the real estate bubble in 2008. This was the most severe one, with an accumulated drop of 46% (€3,7Bn), which means it was almost three times larger than the one in the early 1990s.

As already discussed on a worldwide basis in the previous section, TV has remained the most relevant medium of advertising in Spain, with around 40% of the market. Print media has not been surpassed yet by internet advertising in terms of market share, currently representing 22% and 21%, respectively. Although radio did not significantly lose its relevancy on the market, it currently represents 9%, from 13% back in 1980. Finally, outdoor and cinema represent only a fraction of the market with 6,5% and 0,5% respectively.

Figure 9: Spanish advertising market breakdown by medium

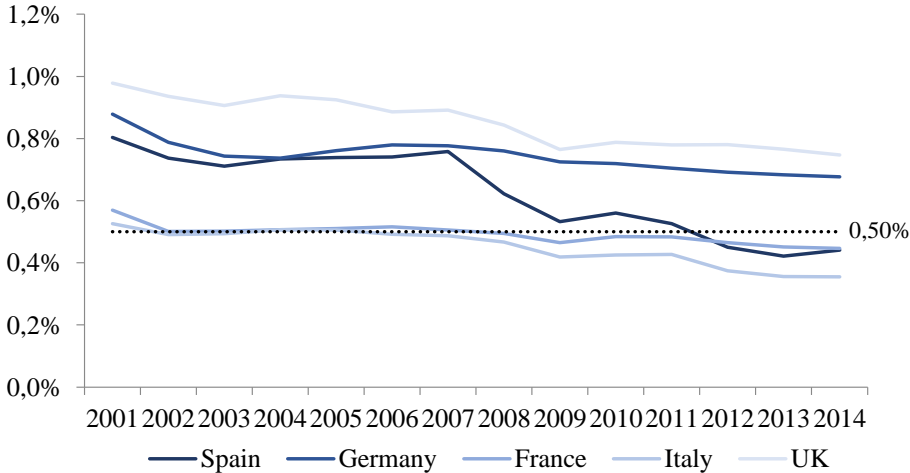


Source: Zenith Optimedia, Bloomberg

Outlook

As GDP remains the main driver of the industry we compared the Spanish market to its European peers, particularly, Germany, France, Italy and the United Kingdom, in terms of advertising spending as % of GDP. As we can see in Figure 10 it seems that the indicator is fairly stable through time in most of the countries we analysed. However, we can also notice a slightly downwards trend, which means that even after the recovery from the crisis we probably will not observe the same values as in the beginning of the decade. The Spanish industry has exhibited a higher volatility than its peers and it seems that it still has some room for growth, since traditionally the advertising industry represented more than 0,60% of the GDP.

Figure 10: Total Ad Spending % of GDP

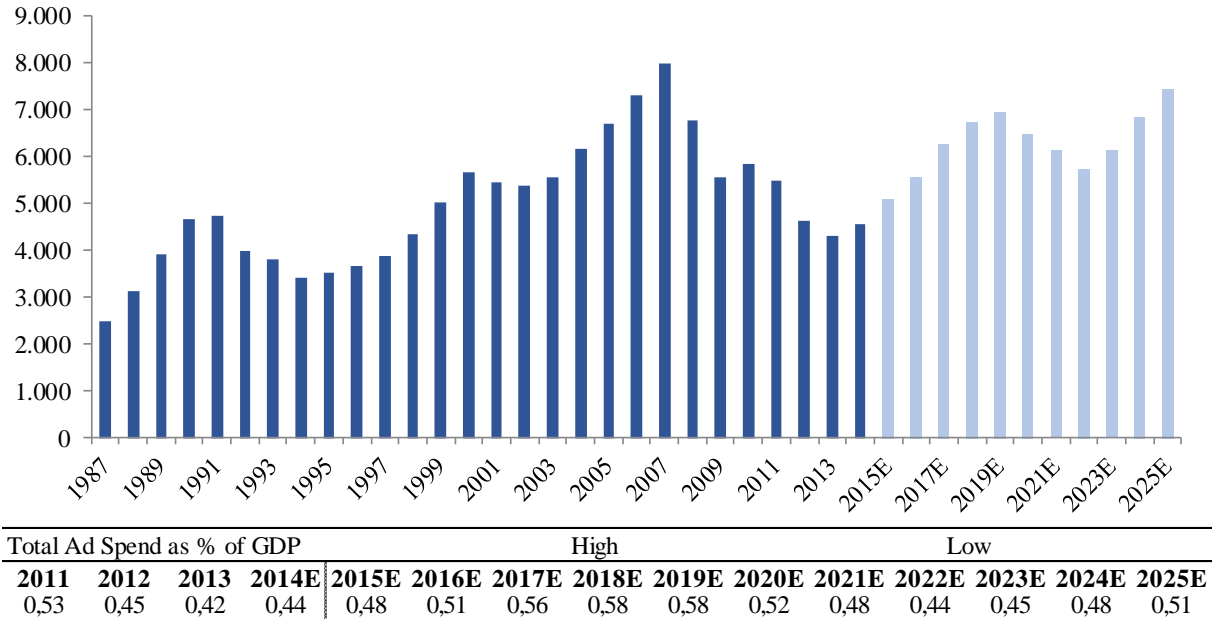


Source: Zenith Optimedia, IMF

As the economy improves, we expect the advertising industry in Spain to regain strength and trend to a long term average of around 0,50% of GDP, which compares with the current figure of 0,44%. We will not assume that it will stabilise at that long term average, but rather, that it will fluctuate around the average as we can draw from its historical performance. This means that in periods of economic boom we can observe figures above the 0,50% threshold and in periods of recession we might observe lower values such as the ones we observe at the moment.

As mentioned before, the industry is cyclical and thus it is of utmost importance that we establish an average cycle life, so that we can replicate it in our estimations. Again, from historical performance we observe an average cycle of 10 years and thus, to model future market assumptions we will assume 10 year cycles.

Figure 11: Conventional Ad market forecasts (2015E – 2025E) (€Mil)



We are assuming a CAGR of 3,91% for the period 2015E-2025E, a slightly larger growth rate than long term GDP, as we expect the advertising industry to outperform GDP in coming years. The industry just suffered from the worst recession of all time and is still around 40% below its 2007 peak, thus we see room for growth.

As approximately 90% of Atresmedia revenues are originated from TV advertising and most of the other 10% are from radio advertising it is important that we discuss the TV and the Radio ad markets’ outlook in particular.

4.3.1 TV advertising market

After the full liberalisation of television with the law of 1989 in Spain, which permitted the establishment of private commercial channels, several private channels were launched, including Antena 3 (from Atresmedia) and Telecinco (from Mediaset España), thus ending with the state-owned Radio y Televisión Española, S.A. (RTVE) monopoly.

As the Digital Terrestrial Television (DTT) took over analogue television, which was discontinued in 2010, each of the six companies that were awarded free-to-air (FTA) TV licenses at the time (Telecinco, Antena 3, Cuatro, La Sexta, Net TV and Veo TV) were assigned one digital multiple that allowed them to broadcast up to four TV channels. It is important to note that in 2009 Mediaset, owner of Telecinco, merged with Cuatro, and in 2012 Antena 3 merged with La Sexta. The corresponding TV licenses were thus transferred to the merged companies.

On May 2014, following the Supreme Court ruling, nine channels were closed down, of which three belonged to Atresmedia and two to Mediaset, its largest competitor. The following chart presents the current utilisation of the digital multiples in Spain, after the reorganisation and the implementation of the New Technical Plan for TDTV.

Figure 12: Current distribution of digital multiplexes by company

Multiplex distribution by company						
MP1	MP2	MP3	MP4	MP5	Reg.2	Reg.1
Net TV	A3M	TL5	A3M	Vacant (HD)	TVE (HD)	TVE (SD)
Net TV	A3M	TL5	TL5	Vacant (HD)	TVE (HD)	TVE (SD)
Veo	A3M	TL5	TL5	Vacant (HD)		TVE (SD)
Veo	A3M	TL5	Vacant (SD)	Vacant (HD)	Vacant (HD)	TVE (SD)

Source: Intermoney Valores Research

The five vacant slots are to be put out for tender and there should be a resolution on who is going to control these five channels on the first half of 2015 and they should be broadcasting again in the second half of the year.

Another eight channels, of which two belong to Atresmedia and four belong to Mediaset, could be taken off the air in 2015, depending on a Supreme Court ruling. However, industry experts and analysts see a very small chance of that happening and even expect the government to intervene in case the Supreme Court decides that the channels should cease broadcasting.

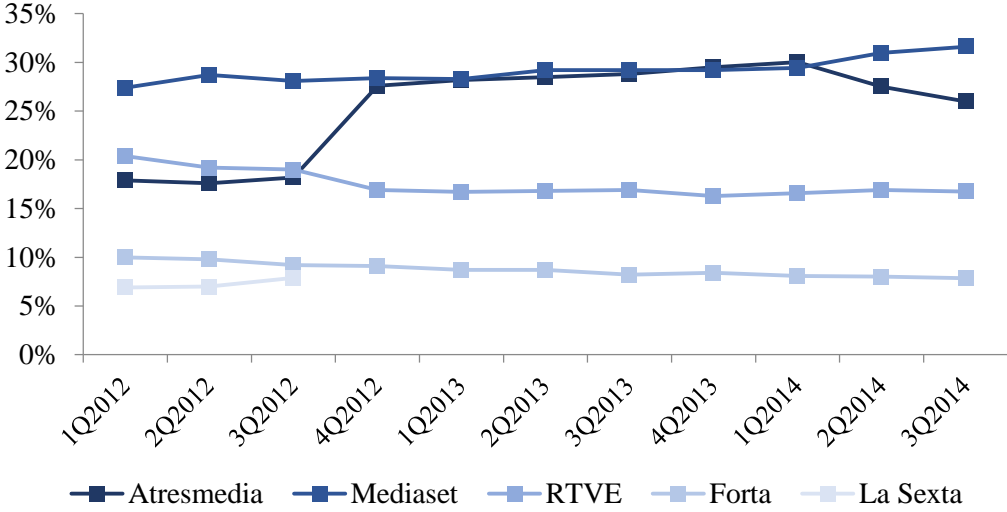
In the past few months, the government has been reviewing the RTVE financing model, as the company is running a deficit of €100Mn per year. Although it is unlikely that the company will return to the advertising market in a meaningful way, there is some uncertainty on how it would affect the other TV operators, particularly Atresmedia and Mediaset.

These issues present risks to Atresmedia valuation that we will take into account.

Performance of audience shares

After the Supreme Court ruling on May 2014, Atresmedia was the most affected broadcasting group in terms of audiences, with three closed channels, when compared to its competitors that had to cease broadcasting in just two channels. The three channels closed represented audiences of 5%, whereas the two channels Mediaset, its most direct competitor, had to close only represented 1,7%. The audiences of the closed channels were redistributed among the existing channels.

Figure 13: Audience shares by company (% of total viewers)



Source: Atresmedia and Mediaset information

We can observe two important events on Figure 13. The first is the boost in audiences in the second half of 2012 of Atresmedia, due to its merger with Gestora de Inversiones Audiovisuales La Sexta. The second is after the Supreme Court ruling in May 2014, where we can observe Atresmedia's audience figures coming down, as explained above.

Although audience figures are important for a broadcaster, what is really important is how the company leverages those audiences to bolster advertising revenues. And Atresmedia, even with fewer channels and audiences, was able to increase its power ratio⁶ in the first nine months of 2014 from 1,46 to 1,54 which compare with a Mediaset decrease from 1,45 to 1,42.

Given that RTVE, since January 2010, has been financed solely by government subsidies, thus, not engaging in competition for advertising revenues, Atresmedia and Mediaset have clearly dominated the market. Spanish TV advertising market is highly concentrated, with the two largest players having a joint market share of around 90%.

In terms of TV consumption it is usual to consider average daily viewings in minutes. Although in the last two years TV viewing has decreased 6 minutes per person per day on average we can still observe an increase of an average of 30 minutes per viewer daily since the year 2000. During 2014 the average daily viewing in minutes per person was 240.

Outlook

As we observed in Figure 9, TV has remained resilient even after the rapid growth of internet advertising. Since around 1995, TV has represented around 40% of the overall conventional advertising market and we expect it to remain that way. As we observed the market breakdown by medium in several countries, we reached the conclusion that the rise in internet advertising is mainly taking market share from print media and TV has remained resilient in most developed countries.

Therefore, in order to estimate the TV advertising spending market in Spain we considered a stable market share of 40%. Appendix 4 shows the estimated TV ad market.

Therefore, we are assuming the TV market will grow with the overall market, growing at a 3,91% CAGR from 2015 to 2025.

⁶ The power ratio is a measure of a media company's revenue performance, representing how a company leverages its audiences to earn more revenues. A ratio equal to 1 indicates that the company is at its expected revenue levels, given its audiences and market share.

It is computed as: $\text{Company Revenue} / (\text{Audience Share} \times \text{Total Market Revenue})$

4.3.2 Radio advertising market

In the 1980s radio represented around 13% of the conventional advertising market, while in 2014 that figure dropped to 9%. By analysing its historical performance, we expect radio to keep losing its market share slowly as we progress. We considered radio's market share to decrease at the same average pace as it has done in the past and thus it will decrease another percentage point until 2025, progressively.

Our assumption is that radio should underperform the overall market and grow at a CAGR of 2,98% for the period 2015 – 2025. Appendix 4 shows the estimated radio ad market.

5. Valuation Overview

In this section, we analyse the assumptions we developed in order to estimate the various figures of the three financial statements (income statement, balance sheet and cash flow statement) and reach a final valuation for Atresmedia. As explained in the literature review section, we use the APV approach followed by a multiples analysis (EV/EBITDA 2015E) in order to support our results and understand how the market is valuing similar firms.

Additionally we use a probabilistic approach, with three scenarios. These scenarios will be based on different assumptions regarding regulatory issues related to the recoverability of the closed channels on May 2014, the net effect of GolT recovery on December 2015, the uncertainty with the RTVE financing model and different EBITDA margins. This approach will yield a more robust final valuation and will also allow us to see what the value of Atresmedia would be under different scenarios. The base case assumes the most likely scenario as discussed by analysts, the company and the media.

Base case:

- a) Atresmedia is assumed to recover two of the channels it lost on the tender process that will take place on the first half of 2015;
- b) The recovery of GolT in December 2015 will have no real effect on operating revenue as the company also loses the €6Mn from the leasing contract;
- c) RTVE will return to the ad market on a limited basis with advertising outside prime time.
- d) EBITDA margin average throughout the cycle is 20,4%, as we observed during the previous cycle 2002-2012.

High-Growth case: a) Atresmedia is assumed to recover two of the channels it lost on the tender process that will take place on the first half of 2015;
b) The recovery of GolT in December 2015 will have a positive effect on operating revenue;
c) RTVE will not return to the ad market and will be funded via sponsorship revenues and cost cutting;
d) EBITDA margin average throughout the cycle is 22,6%.

Low-Growth case: a) Atresmedia will not recover any channels on the tender process that will take place on the first half of 2015;
b) The recovery of GolT in December 2015 will have no real effect on operating revenue;
c) RTVE will return to the ad market with no restrictions;
d) EBITDA margin average throughout the cycle is 18,4%.

For the purpose of our valuation we use an explicit period that captures a full cycle of the advertising market – from 2015 to 2025.

See Appendix 5 and 6 for the complete forecasted income statement and balance sheet, respectively.

5.1 Adjusted Present Value approach

5.1.1 The peer group

It is important that we start by selecting an appropriate peer group as we will not only use it to perform a multiples valuation, but also to compute the cost of capital.

Our peer group was selected from an initial screening of the companies that operated in the same sector as Atresmedia – The Media Industry. From that initial list of companies we selected the ones that operate specifically in the broadcasting of FTA Television and Radio, where most of the revenues are advertising revenues. This criterion excluded companies where most of the revenues come from subscriber-based models like Pay-TV, as their revenues are not advertisement dependent. Additionally, we excluded companies that were either too large or too small in terms of enterprise value, because as we analysed those

companies in more detail, we noticed that the largest ones were too diversified and the smallest ones had different cost structures as some of them did not have significant in-house production. The final peer group we selected can be seen in Table 2.

5.1.2 Unlevered cost of equity

Our aim in this section is to compute the unlevered cost of equity through the CAPM model, which will be needed to discount future cash flows in order to reach the unlevered firm value. For a further theoretical discussion on different models and a deep analysis of CAPM and its inputs see the literature review section.

In the CAPM equation we need three inputs: the risk-free rate (R_f), the beta (β), which in this case is the unlevered, and the market risk premium (MRP). The risk free rate used is the German Bunds 10y yield, which is currently 0,34%. The unlevered beta is computed through a bottom-up approach, meaning, we use our peer group to estimate an industry beta. Thus, we estimate a levered beta for each comparable firm using the STOXX Europe 600 as the reference index and using five years of monthly data, as argued by Koller et al. (2010) and other authors. Then, we unlevered the betas with the formula discussed in the literature review section, using each firm's capital structure and effective tax rate. The peer group average unlevered beta, 1,36, is the beta we use as an input to the CAPM equation. Finally, the MRP we use is 5,5%, as it represents the consensus between academics and practitioners.

Using the inputs we just discussed, we compute an unlevered cost of equity for Atresmedia of 7,85%.

Table 2: Peer group

Name	Country	Mkt Cap (€Millions)	EV (€Millions)	Levered Beta	Effective Tax rate	D/E	Unlevered Beta
ATRESMEDIA	Spain	3.013	3.113	1,88	4%	0,35	1,41
ITV PLC	UK	12.550	12.879	1,30	24%	0,59	0,90
TELEVISION FRANCAISE (T.F.1)	France	3.139	2.738	1,99	31%	0,00	1,99
M6-METROPOLE TELEVISION	France	2.146	1.974	1,30	43%	0,01	1,29
MEDIASET SPA	Italy	5.034	6.684	2,00	77%	0,47	1,81
MODERN TIMES GROUP-B SHS	Sweden	1.725	1.780	1,12	29%	0,18	0,99
MEDIASET ESPAÑA	Spain	4.455	4.249	1,76	0%	0,01	1,75
NEXTRADIOTV	France	430	456	1,07	0%	0,36	0,79
Average		4.062	4.234	1,55	26%	0,25	1,36
Median		3.076	2.925	1,53	27%	0,26	1,35
Min		430	456	1,07	0%	0,00	0,79
Max		12.550	12.879	2,00	77%	0,59	1,99

Source: Bloomberg

5.1.3 Cost of debt

Atresmedia neither has issued bonds quoted on the market nor is rated by a credit rating agency. As discussed in the literature review we are thus left with the option to calculate a synthetic rating by using financial ratios such as the interest coverage ratio. To compute the cost of debt we use a tool provided by Damodaran, where based on some characteristics of the firm we can assess its synthetic rating and estimate its default spread.

For a smaller non-financial services company with a market capitalization inferior to \$5Bn, such as Atresmedia, and with a normalised interest coverage ratio of 5,40x we estimated a credit rating of A-, which corresponds to a default spread of 1,20%. The interest coverage ratio was computed using an average EBIT and average interest expenses from 2012 to 2014 because it is more consistent and avoids over or underestimations due to extraordinary figures.

With a risk free rate of 0,34% correspondent to the German bund 10y yield, we reach a cost of debt of 1,54%. Although this figure might seem too low it is important that we take into consideration the current economic environment with extremely low interest rates.

5.1.4 Revenues

The revenues estimation is the most important assumption in our model because many other figures are directly related to them. In order to be as detailed as possible we estimate net revenues for each division of Atresmedia – Television, Radio and Others. It is important to note that we are estimating net revenues, which means that we are already taking into account volume rebates and other discounts provided, which are typical in broadcasting companies.

Our method is to start by estimating the advertising market as a whole at every year of the explicit period and then multiply by the market share of each relevant medium, in this case Television and Radio to get our estimates for each sub market. Television's market share is assumed to remain stable over the years, while Radio's is assumed to decrease progressively as it has done in the past, thus following its trend. Further details in the estimation of these two markets (TV and Radio) can be found in Section 4.3 "The Advertising Industry – The Spanish case" of this dissertation.

After having our estimates for each market until 2025 we consider the TV, Radio and Others divisions separately in order to arrive at more robust estimates, since the three divisions are not expected to have the same growth profile.

For the TV division we consider the three scenarios that we discussed, in order to estimate Atresmedia's market share, which we then use to multiply by our estimates of the market.

- a) In the Base case, where we assume that the company will recover two channels during the first half of 2015 and that RTVE will return to the ad market on a very limited basis, outside prime time, we assume that Atresmedia would retain a 43% market share from 2015 onwards. By looking at historical market shares we can observe that in 2013, when Atresmedia controlled three more channels, the market share was 44% and that in the third quarter of 2014 it reduced to 42% with the closure of Nitro, Xplora and La Sexta 3. This means that with a recovery of two channels Atresmedia should get close to the 44% market share again, but we discount this number to 43% to account for the limited entrance of RTVE in the advertising market.
- b) In the High-Growth case, as the effect of the recovery of two channels kicks in the second half of 2015 and GolT's positive impact will start from 2016 onwards, we assume a market share of 43% during 2015 and an increase to 45% from 2016 onwards.
- c) In the Low-Growth case, Atresmedia is assumed not to recover any channels on the tender process in the first half of 2015 and RTVE is assumed to enter the ad market without restrictions. In 2015 we assume that Atresmedia should retain the 42% market share that we observed in 3Q2014, but as other players take the channels up for tender and RTVE enters the market, we think it should decrease to 40% in 2016 and 39% from 2017 onwards.

Table 3: Forecasted Atresmedia TV market share and corresponding net revenues

	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
TV Market Share (%)												
Base Case	43	43	43	43	43	43	43	43	43	43	43	43
High-Growth case	43	43	45	45	45	45	45	45	45	45	45	45
Low-Growth case	43	42	40	39	39	39	39	39	39	39	39	39
TV Net Revenues (€Mil)												
Base Case	785	874	955	1080	1163	1198	1115	1054	990	1056	1177	1283
High-Growth case	785	874	999	1130	1217	1254	1167	1103	1036	1105	1232	1342
Low-Growth case	785	874	955	1080	1163	1198	1115	1054	990	1056	1177	1283

For the Radio division of Atresmedia, as we do not think there are any material risks to the company's market position, we assume a constant market share in line with previous year of 19,7%. We do not model different scenarios for this item.

Table 4: Forecasted Atresmedia Radio market share and corresponding net revenues

	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Market Share (%)	19,7	19,7	19,7	19,7	19,7	19,7	19,7	19,7	19,7	19,7	19,7	19,7
Net Revenues (€Mil)	85	94	101	114	121	124	114	107	100	105	116	126

Finally, the company's management team forecasts that the Others division should reach €100Mn of revenues before 2020, but as we observed that it would be necessary to grow at a CAGR higher than 40% during the next few years, we believe the target to be unrealistic. As a result, we assume that the company should meet its target by the end of our explicit period (2025), thus growing at a CAGR of 15,5%.

5.1.5 Operating expenditures

Operating expenses are composed by programme amortisation & other procurements (also called programming costs), staff costs and other operating expenses. As we mentioned throughout this dissertation, most of these costs are considered to be fixed costs, as the company still has to maintain the quality of its contents and programmes and cannot just fire most of its staff during a crisis period. This also allows Atresmedia to benefit from operating leverage during booms.

What we just explained translates into volatile EBITDA margins and cyclicity in profitability as revenues increase or decrease due to market environment. Thus, as we are estimating the three items in operating expenditures, particularly programming costs, we are always concerned in replicating the EBITDA margin of the previous cycle (2002-2012). It is important to note that the previous cycle included an abrupt rise until 2007 and one of the largest crises of all time, which means that EBITDA margins were extreme in both ways. For this reason, we do not seek to replicate exactly previous cycle margins, but rather, we smooth the variations we observed.

What we noticed is that our smoothing assumption, in the end, does not have a significant impact on value as long as we keep the cycle EBITDA margin average and use the maximum and minimum values as reference points as we model the cycle. In fact, as we used our model

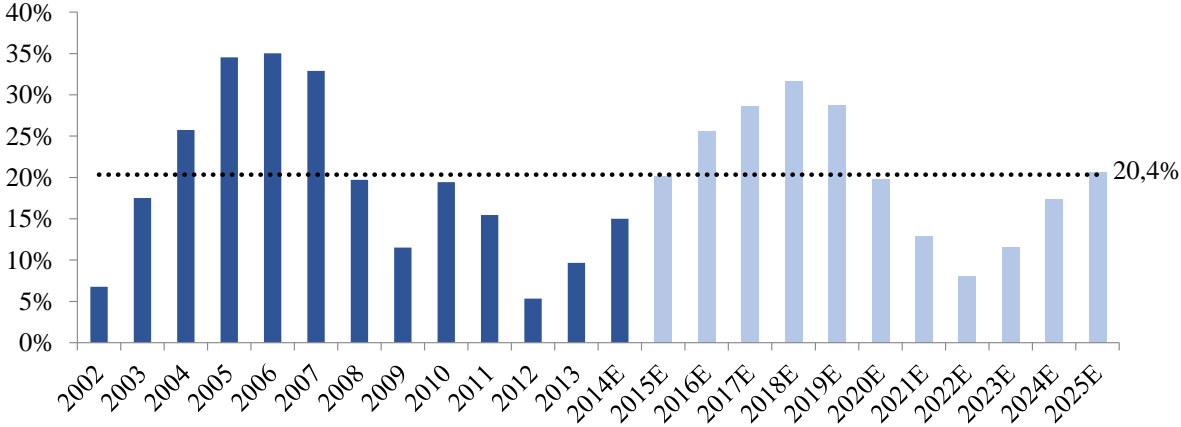
to replicate exactly the previous cycle's margins to observe the results, we got a very similar final value, but programming costs were highly volatile in order to obtain such differences between the years, which we consider to be unreasonable. Our results are shown in Figure 14.

- a) Other operating expenses: by observing historical values of this item as percentage of revenues we observed a fairly stable pattern, thus we use the long term historical average as a driver – 22,6%.
- b) Staff costs: from 2007 to 2013 the company has reduced its headcount, effectively decreasing it from a peak of 2.316 to 1.723. Thus, staff costs both as a percentage of revenues and as absolute values have decreased during that period. According to company information they will now try to keep the headcount constant depending on their needs. We compute this item as a percentage of revenues, with the driver fluctuating according to the cycle stage as we have observed in the previous cycle, but with lower absolute values as we are starting from a lower cost base. It was also taken into account the fact that these costs should not vary largely through the years in absolute terms and should increase on average at a rate similar to GDP, since the company is not planning any new hires for the next few years.
- c) Programme Amortisation & Other Procurements (PA&OP): computed as percentage of revenues in a way that we can model the cycle EBITDA margins, which was explained above, having in mind these driver's historical pattern. It is important to note that PA&OP are fairly fixed costs and thus, should not vary widely. Above all, they should not decrease greatly, as it would have an impact in the company's audience figures and consequently on its ability to generate revenues. Programming costs represent the larger portion of total operating costs, around 60%, and thus are used to model EBITDA margins, without overlooking the factors we mentioned previously.

Additionally, we make different assumptions for our three scenarios because it would not make sense to keep the EBITDA margins constant as the company faces different revenue assumptions. Moreover, it is important to understand how different margins would affect the value of the business as we are dealing with uncertainty and we cannot be sure that the company will have similar margins in the future, compared with the previous cycle. We assume an average EBITDA margin from 2015 to 2025 of 20,4% for the Base case, 22,6% for

the High-Growth case and 18,4% for the Low Growth case. See Appendix 7 for a detailed computation of each input to calculate the EBITDA margins for the base case.

Figure 14: Forecasted EBITDA margins (%) for the Base case



Note: dashed line represents the average EBITDA margin for the cycles

5.1.6 Net Working Capital

Net Working Capital (NWC) is computed by the difference between current operating assets and current operating liabilities. While the first includes programme rights & inventories and trade and other receivables, the second includes trade and other payables, operating provisions related to volume rebates and other operating liabilities.

The drivers we consider are:

- a) Programmes Rights & Inventories: computed as percentage of programme amortisation and other procurements. As the company merged with La Sexta in 2012 and went through a restructure process during that year, we used an average of the last two years (2013 and 2014) as a driver.
- b) Trade and other receivables: computed as days of annual sales. An average of the last two years is used for the same reasons described above.
- c) Trade and other payables: computed as days of annual programming costs. An average of the last two years is used.
- d) Operating provisions: computed as percentage of revenue, as these provisions are related to volume rebates and other discounts made. An average of the last two years is used.

- e) Other operating liabilities: this item is mostly related to extraordinary trade payables maturing at more than one year. As we got access to the payments due in 2015, we assume those amounts to be paid. Then we compute days of programming costs of the amount left and assume as a driver.

See Appendix 8 for a detailed calculation of the inputs and main drivers in the net working capital calculation for the base case.

5.1.7 CAPEX and Depreciations & Amortisations

We compute capital expenditures (CAPEX) as percentage of revenues historically and use the average of the last two years as the driver. It is important to mention that capital expenditures do not represent a very significant figure in Atresmedia's financials as all the relevant investments in programming are considered costs and are included under programme amortisation and other procurements in the income statement.

As the company merged with La Sexta in 2012, around €90Mn in intangible assets were added to the merged company balance sheet. However, depreciation & amortisation figures did not follow that increase because most of these intangibles are trademarks and licenses that have no definite useful life and are thus, non-amortisable. As a result, we computed D&A as a percentage of PP&E and intangibles of the previous year and used the average of only the last two years as a driver. Otherwise, D&A would have been incorrectly inflated in our estimations.

Our estimations of PP&E and intangible assets will be the previous year PP&E and intangibles plus CAPEX minus D&A of the current year.

See Appendix 9 for a detailed calculation of these items.

5.1.8 Tax matters

There are two important issues that we have to consider in terms of taxation. First, due to the merger with La Sexta in 2012, the company has accumulated €221Mn in tax loss carry

forwards, which can be used to offset future profits and reduce the effective tax rate⁷. Second, it is important to note that due to Atresmedia's activities in the production of audiovisual content, the company benefits from tax credits granted by the Spanish government.

Traditionally, the firm does not accumulate these tax credits and uses them every year to pay lower taxes. However, the recent low profitability and the merger with La Sexta have created a temporary limitation (from 2010 to 2015), which has caused some tax credits to accumulate, more specifically €105Mn as of 2014.

Based on this information, which was provided by the company, we assume:

- a) Tax loss carry forwards are used to offset earnings before taxes (EBT) or taxable income up to the allowed limit until they either expire or are all used up;
- b) As soon as the temporary limitation ends, in 2016, unused tax credits will be used to offset taxable income. Furthermore, the company will continue to earn these tax credits as a percentage of programming costs – we use the historical average of 4,91%.

As a result, the company is assumed to never pay the statutory tax rate of 30% in Spain.

Table 5: Effective tax rates for the three scenarios (%)

(%)	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Base Case	21,6	22,0	5,3	20,4	27,7	27,9	26,3	23,1	16,2	21,9	25,5	26,5
High-Growth case	21,6	22,0	7,5	22,1	28,4	28,1	26,9	24,6	19,3	23,9	26,2	27,2
Low-Growth case	21,6	21,9	1,4	20,0	24,5	27,6	25,8	22,2	8,7	19,8	24,4	25,8

In 2016E we have a very low effective tax rate because as we explained previously a temporary limitation should expire and the company should be able to use its unused tax credits. We assume that the company will always use the maximum allowed as it maximises value. See Appendix 10 for a detailed calculation of the effective tax rates.

5.1.9 Unlevered firm value

After having computed all the necessary inputs to arrive at the Free Cash Flow to the Firm (FCFF) we can now compute the unlevered firm value. Table 6 presents our results for the FCFF from 2015 to 2025.

⁷ According to a report by KPMG on Spanish taxation, for companies or tax groups whose turnover during the 12 months preceding the beginning of the year was €60Mn or more, carried forward losses may only be used to offset up to 25 percent of the taxable income (before applying the carry forward).

Table 6: FCFF and Unlevered Firm Value – Base case (€Mil)

	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	TV	
EBIT	113	183	260	332	398	371	231	134	69	118	216	285	236	
Taxes	25	40	14	68	110	103	61	31	11	26	55	75	59	
NOPLAT	89	143	246	264	288	267	171	103	58	92	161	210	177	
D&A	18	17	17	18	19	20	22	23	23	24	24	25	26	
Investment in WC	25	55	21	19	18	-8	-40	-28	-18	16	25	18	7	
Capex	18	25	27	31	33	34	32	30	29	31	34	38	31	
FCFF	64	79	216	232	256	262	200	124	70	69	125	179	165	
NPV of Explicit Period				1.223									Unlevered cost of equity (K_e)	7,85%
Terminal Value				1.481									Perpetuity Growth rate (g)	3,0%
Unlevered Firm Value				2.703										

We reach an unlevered firm value of 2,7 Billion Euros for the base case, based on the present value of FCFF in the explicit period, discounted at the unlevered cost of equity, plus the terminal value that will be discussed below. In order for us to reach a final Enterprise Value, Equity Value and price per share of Atresmedia we still need to compute the net leverage side effects (net present value of interest tax shields minus expected bankruptcy costs).

Terminal Value

As already discussed in the literature review it is essential that we do not compute the Terminal Value at the peak or the bottom of the cycle. As a result, we use the average from a complete cycle (2015-2025) of the FCFF. In order to reach the average FCFF we compute average values of the inputs, namely, EBIT, effective tax rate, investment in working capital and CAPEX. In the calculation of the average effective tax rate we excluded the effects from the use of tax loss carry forwards, as they will not persist in the future. Depreciation & Amortisations are an exception, as they are computed as percentage of PP&E and other intangibles of the previous year (2025), because it does not make sense to assume an average, since we have a higher asset base in 2025.

Another important assumption we need to make is regarding the perpetuity growth rate “g”. We assume a rate of 3%, as we consider this to be the long-term nominal GDP growth rate and traditionally the industry is highly correlated with that variable. The results are shown in Table 6 above.

5.1.10 Leverage side effects and market value of debt

As we are valuing the firm using the APV approach, we have to value the leverage side effects, particularly, interest tax shields and expected bankruptcy costs, separately.

It is important to note that we are assuming that the company will have repaid its debt by the end of 2017, as is scheduled. This means the company will be fully equity financed from 2017 onwards.

See Appendix 11 for a detailed analysis of the debt package, the computation of its market value and interest tax shields.

Market Value of debt

The computation of the market value of debt raises some issues, as the firm does not have its debt in the form of bonds trading in the market. Atresmedia only owns non-traded debt, more specifically, bank debt, which is stated in book value terms on the balance sheet and not in market value terms.

Our method to estimate the market value of debt outstanding was to forecast interest expenses based on the implied historical rates and assume that the firm complies with the debt repayment schedule, mentioned on the annual report. With these figures we can compute the debt service (interest expenses plus debt repayments) until it is totally repaid in 2017 and discount these cash flows at the cost of debt we estimated previously in this dissertation. We reach a market value of debt of 176,53 million euros.

Interest tax shields

Interest expenses were computed based on implied average historical interest rates of the last two years (6,59%), because the company arranged a new syndicated loan in 2013, which is now the only interest bearing debt the company holds.

The effective tax rates that we computed previously are used in order to obtain the tax shield associated with the interest expenses. In the end, the tax shields are discounted using the cost of debt of 1,54%, which was discussed previously in this dissertation.

As the tax rates are relatively small, and the company only holds debt until 2017, it is easy to understand that the present value of interest tax shields represents only a very small portion of firm's value. Moreover, as effective tax rates change in the three scenarios, due to lower or higher income before taxes, the present value of interest tax shields also changes between scenarios.

Expected bankruptcy costs

Expected bankruptcy costs present a significant estimation problem, since neither the probability of default nor the bankruptcy cost itself can be estimated directly. In order to estimate these two inputs we use some estimation ranges provided by some authors.

We find two relevant ways of estimating the probability of default of Atresmedia. First, from the synthetic rating that we estimated for the firm we can draw a probability of default by using a table provided by Altman and Kishore (1998), which associates credit ratings with their probability of default based on empirical studies – 1,41% for a A- rated firm. Second, Moody's Investors Service (2011) have studied corporate default and recovery rates from 1920-2010 and estimate a default probability of 3,6% for companies operating in the media industry. As we believe that both probabilities of default are reasonable we assume a simple average, thus we use 2,505%.

Regarding bankruptcy costs as percentage of pre-distressed firm value, Altman (1984) argues that the total costs amount to about 15%. However, Korteweg (2007) argues that the value can rise as high as 31%. Once again, our approach is to do a simple average of these two values, thus reaching a value of 23% of pre-distressed firm value (enterprise value).

Using these two inputs we estimated the expected bankruptcy costs for the three scenarios. As the enterprise value changes between scenarios, the costs are also expected to change. Table 7 presents our results.

Table 7: Expected bankruptcy costs for each scenario (€Mil)

	Low-Growth case	Base case	High-Growth case
Unlevered Firm Value	2.706	3.108	2.250
Probability of default (%)	2,505	2,505	2,505
Bankruptcy costs (%)	23	23	23
Expected bankruptcy costs	15,6	17,9	13,0

5.1.11 Other balance sheet assumptions

These assumptions are only used so we can forecast a complete balance sheet and it is important to note that they do not have a significant impact on the firm's value.

Atresmedia discloses its intention to pay 80% of free cash flow as dividends. Based on this information, we assume that the company will pay 80% of its FCFE, which until 2017 will be lower than FCFE because of debt repayments and interest.

As per our calculations of FCFE, the company can meet its debt service, which means that they will not need to issue new debt. After accounting for debt service and dividend payments we can compute the change in cash & cash equivalents.

Retained earnings are computed using the previous year value, plus the year's net income, minus dividends. The final forecasted balance sheet for the base case can be seen in Appendix 6.

5.1.12 Valuation summary

As we have formulated three scenarios throughout this valuation, it is now essential that we estimate reasonable probabilities to the likelihood of these. The base case has a probability of 50% since it is the most likely scenario among the three. Both other scenarios have a weight of 25% each. These scenarios are thus equally likely due to their dependency on uncertain variables, such as the recoverability of the channels and the uncertainty around the RTVE funding model. While the High-Growth scenario represents a very positive outcome, the Low-Growth represents a very negative one.

Table 8: Valuation summary (€Mil, except per share values)

	Low-Growth case (25%)	Base case (50%)	High-Growth case (25%)
NPV of Explicit Period	1.032	1.223	1.388
Terminal Value (TV)	1.216	1.481	1.717
Unlevered Firm Value	2248	2.703	3.105
Present value of ITS	2,6	2,8	3,0
Expected bankruptcy costs	13,0	15,6	17,9
Enterprise Value (EV)	2.237	2.691	3.090
Market value of debt	180	180	180
Cash & cash equivalents	87	87	87
Equity Value	2.145	2.598	2.997
# Shares	225,7	225,7	225,7
Price per Share	9,50	11,51	13,28

All in all, our estimate of the intrinsic value of Atresmedia Corporación de Medios de Comunicación, S.A. is €11,45 per share, based on a probability weighted average of the price per share of the three scenarios we modelled. Comparing to its current price of €14,01 we see an upside of -18,3%.

5.1.13 Sensitivity analysis

Performing a sensitivity analysis to our model and assumptions is an important exercise to understand the impact of certain assumptions on value and share price.

Two variables that are particularly impactful on valuations are the discount rate or the unlevered cost of equity in this case, and the perpetuity growth rate “g”. To perform this analysis we will also assume the three scenarios we considered during this dissertation, which means that the values per share presented are the result of the weighted average of the three scenarios with probabilities of 50%, 25% and 25% for the Base, High-Growth and Low-Growth case, respectively.

Table 9: Sensitivity analysis on price – unlevered cost of capital vs. long term growth rate

$K_e \setminus g$	1,5%	2,0%	2,5%	3,0%	3,5%	4,0%	4,5%
6,35%	12,87	13,79	14,88	16,28	18,22	20,91	24,98
6,85%	11,73	12,41	13,24	14,28	15,64	17,47	20,01
7,35%	10,75	11,28	11,92	12,71	13,70	14,99	16,73
7,85%	9,90	10,33	10,84	11,45	12,20	13,15	14,38
8,35%	9,20	9,54	9,95	10,43	11,01	11,72	12,62
8,85%	8,58	8,87	9,20	9,58	10,04	10,59	11,26
9,35%	8,05	8,28	8,55	8,86	9,23	9,66	10,18

It is important to note that the extreme values are highly unlikely to materialise. However, this analysis is still relevant to note the importance of the consistency in computing the unlevered cost of equity and the assumptions supporting the perpetuity growth rate.

Additionally, as we consider the computation of expected bankruptcy costs to be an imprecise exercise, since the variables used were not directly applicable to the media industry or the

firm's characteristics, we performed another sensitivity analysis to observe the impact of these assumptions on the firm's price per share. The two variables in question are the probability of default, which we considered to be in the interval between 1,41 – 3,6% and the expected bankruptcy costs as percentage of the pre-distressed firm value, which should be in the interval between 15 – 31%.

Table 10: Sensitivity analysis on price – probability of default vs. bankruptcy costs

PD \ BC	15,0%	23,0%	31,0%
1,4%	11,49	11,48	11,47
2,5%	11,47	11,45	11,42
3,6%	11,45	11,42	11,38

As we observe in Table 10, expected bankruptcy costs do not have a significant impact on the firm's share price value.

5.2 Relative Valuation – Multiples

As we discussed in the literature review, when performing a valuation, it is always important to analyse how the market is valuing similar firms to complement a DCF thorough analysis. As a result we use the peer group we have previously selected and use an EV/EBITDA forward multiple. We prefer to use an Enterprise value multiple to avoid capital structure distortions that we might observe in earnings multiples for example. A more detailed analysis on the theoretical aspects of this method can be found in the literature review.

As we can observe in Table 11, Atresmedia and Mediaset España are currently trading at a premium over the sector. Atresmedia currently trades at an EV/EBITDA_{2014E} of 23,29x versus a sector average of 13,22x and an EV/EBITDA_{2015E} of 16,17x versus a sector average of 10,73x. Based on an EV/EBITDA_{2015E} average multiple Atresmedia is currently valued at €9,06 per share, which compares with our DCF valuation of €11,45 and with the stock's current price of €14,01.

In order to comprehend this value, it is crucial that we understand that, as this industry is cyclical, companies outside of Spain might be at a different stage of the cycle and thus the premium at which Atresmedia and Mediaset are trading might be justified.

Table 11: Peer group valuation - Multiples

Company	Market Cap (€Mil)	Enterprise Value (€Mil)	EV/EBITDA 2014E	EV/EBITDA 2015E	P/E 2014E	Net Debt/EBITDA
ATRESMEDIA	3.013	3.113	23,29	16,17	46,66	0,84
ITV PLC	12.550	12.879	12,82	11,63	23,57	0,30
TELEVISION FRANCAISE (T.F.1)	3.139	2.738	15,31	11,03	52,97	-3,48
M6-METROPOLE TELEVISION	2.146	1.974	7,10	6,89	17,33	-0,57
MEDIASET SPA	5.034	6.684	8,09	7,70	N/A	0,72
MODERN TIMES GROUP-B SHS	1.725	1.780	10,04	9,25	14,05	0,29
MEDIASET ESPAÑA	4.455	4.249	26,04	18,38	627,83	-0,61
NEXTRADIOTV	430	456	13,14	10,25	34,99	0,77
Average (Excluding Atresmedia)			13,22	10,73	128,46	-0,37
Median			12,98	10,64	34,99	0,29
Min			7,10	6,89	14,05	-3,48
Max			26,04	18,38	627,83	0,84

6. Valuation Comparison with BESi equity research

In order to put this valuation in perspective we compare it with an equity research from a well-known investment bank, BESi, former Espíritu Santo Investment Bank. The report was prepared by the analyst Nuno Estácio on December 15th, 2014.

6.1 Methodology

In terms of methodology used for the purpose of the valuation of Atresmedia, there is a clear difference between our analysis and theirs – BESi uses a WACC-based DCF, while we use an Adjusted Present Value (APV) approach. Theoretically, both methods are equivalent, given consistent assumptions, but as we will discuss further, our assumptions also differ.

It is important to note that as we build three scenarios to model regulatory uncertainties that would have a direct impact on the company's valuation, BESi only assumes a base case where RTVE does not enter the market and Atresmedia's market share is stable.

Additionally, both BESi and our valuation include a multiples analysis in the end, using forward Enterprise Value multiples, to triangulate results.

The explicit forecast period is the same in both valuations – from 2015 to 2025.

6.2 Discount rate

Regarding the discount rate used, due to the choice of methodology, BESi uses a weighted average cost of capital (WACC) to discount future cash flows. However, they do not assume a constant capital structure, which means, they use a different WACC for each year. Their assumptions regarding capital structure are actually the same as ours, as the information was provided by the company, which means that they assume a full repayment of the outstanding interest bearing debt until the end of 2017.

As we use an APV approach, we do not face the same issue of having to change the discount rate as the capital structure changes. We value the leverage side effects separately and add them in the end.

As a result, it is important to note that the discount rates cannot be compared directly, as they serve different purposes. For reference, BESi uses an average WACC of 9,5%, which compares with an unlevered cost of equity of 7,85% in our valuation.

6.3 Forecasts

6.3.1 Revenues

In order to estimate Atresmedia's revenues, BESi uses a top-down approach similar to the one used on this dissertation. By forecasting the market value for the next years and through the company's market share they compute the revenues. One major difference between their approach and the one used on this dissertation is that they do not consider the cyclicity in the market and forecast a consistent growth in the advertising spending market and consequently, in revenues growth.

6.3.2 EBITDA margins and FCFF

The major difference between this dissertation and BESi research resides in the forecast of EBITDA margins and consequently, Free Cash Flows to Firm. As BESi does not consider the cyclicity in margins it assumes that they should grow to a long term target of 27%, which compares with an average cycle margin of 20,4% in our base case, the same as the previous historical cycle average (2002-2012).

This difference is also reflected in FCFF as BESi considers a steady growth in the explicit period, reaching around €300 Million in the terminal year.

6.4 Comparison Summary

In sum, it is easy to understand that the target price per share of BESi for Atresmedia is higher than the one we reached in our dissertation – €13,9 vs. €11,45. The fact that BESi did not consider cyclicity on free cash flows and assumed a higher than the historical average EBITDA margin is the main reason we found to explain the difference. It is important to note that BESi's price estimate is not even higher because they use a perpetuity growth rate of only 2% and use a high discount rate of 9,5%.

Table 12: Comparison summary (€Mil, except per share values)

	Disse rtation (base case)	BESi
Methodology	APV	WACC-DCF
Disount rate	$K_e = 7,85\%$	WACC = 9,5%
EBITDA margin	20,4%	27,0%
Terminal year FCFF	165	306
Perpetuity growth rate (g)	3,0%	2,0%
Enterprise Value (EV)	2.691	3.131
Net Debt	-93	-107
Tax assets	0	141
Equity Value	2.598	3.165
# Shares	225,7	227,4
Price per Share	11,51	13,92

7. Investment Case

All in all, Atresmedia stock is, in our view, overvalued and presents a sell opportunity to either short the stock or realise the gains of the position by exiting the investment.

- a) Atresmedia is a leading media group in Spain, with a strong position on the TV and radio advertising markets – market shares of 43% and 20% in 2014, respectively. After the merger with La Sexta in 2012, the company has taken advantage of cost synergies, mainly reducing staff costs.

- b) The advertising industry seems to be at a turning point in the cycle, after dropping more than 40% from its peak in 2007 to the bottom in 2013. The TV industry is expected to grow by 11% in 2015 vs. 10% in 2014.
- c) However, we see some regulatory risks regarding the RTVE funding model and the recoverability of the closed channels on May 2014. These events are likely to weigh in and put some pressure on Atresmedia's stock price.
- d) We developed three scenarios in our valuation in order to understand the change in value given different outcomes from regulatory uncertainties and the evolution of EBITDA margins during the next cycle. We reached a central value of €11,45 per share, which compares with a market price of €14,01 as February 20, 2015. Even considering our High-Growth case price target of 13,28, we still perceive the current price as overvalued.
- e) Multiples are also demanding, with a peer group EV/EBITDA2015E average of 10,73x vs. Atresmedia's 16,17x. However, as the advertising industry has historically exhibited a cyclical pattern, we might be comparing companies in different stages of the cycle.
- f) Concluding, we see a target price for Atresmedia's stock of €11,45, in line with our APV valuation, which we consider to be a better estimate than the one we observe in the relative valuation. This value yields an upside of -18,3%.

8. Conclusion

In this dissertation we endeavored to provide some insights on the best valuation techniques that align theory and practice. We believe it was crucial to the formulation of this valuation, to review the relevant literature not only to understand and learn core valuation techniques but also to ground our valuation in solid theoretical knowledge.

The adjusted present value methodology was used to value Atesmedia due to its sound theoretical support and applicability to the firm characteristics, namely, a changing capital structure. Three scenarios were modeled, which enabled us to understand how different outcomes would impact Atresmedia's intrinsic value and reach a more robust final price per

share. Additionally, as advocated by most academics and practitioners we used a multiples valuation to support our discounted cash flow analysis.

Both the APV and multiples approaches led us to conclude that Atresmedia is currently overvalued at €14,01 per share, which directed our recommendation to a Sell. Our target price is €11,45, based on our probability weighted average of the three scenarios using the APV approach. Given that we considered Atresmedia to be a cyclical company, we believe the multiples approach might under or overestimate the value of the company, as the peers can be in different stages of the cycle, thus exhibiting different growth profiles and different multiples.

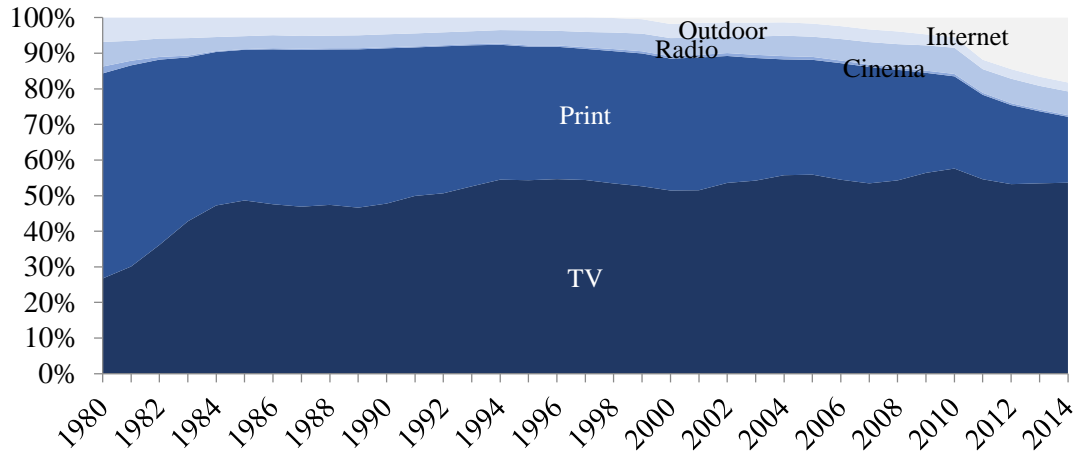
Finally, we carried out a comparison with BESi equity research on Atresmedia, which presents another approach to value the company. It was important to conduct this analysis to understand what assumptions are driving the valuation in hand.

Concluding, this dissertation allowed a comprehensive analysis of firm valuation methods, a deep understanding of the advertising industry, particularly in Spain, and Atresmedia's business model, leading us to a Sell recommendation on the stock at current prices.

9. Appendices

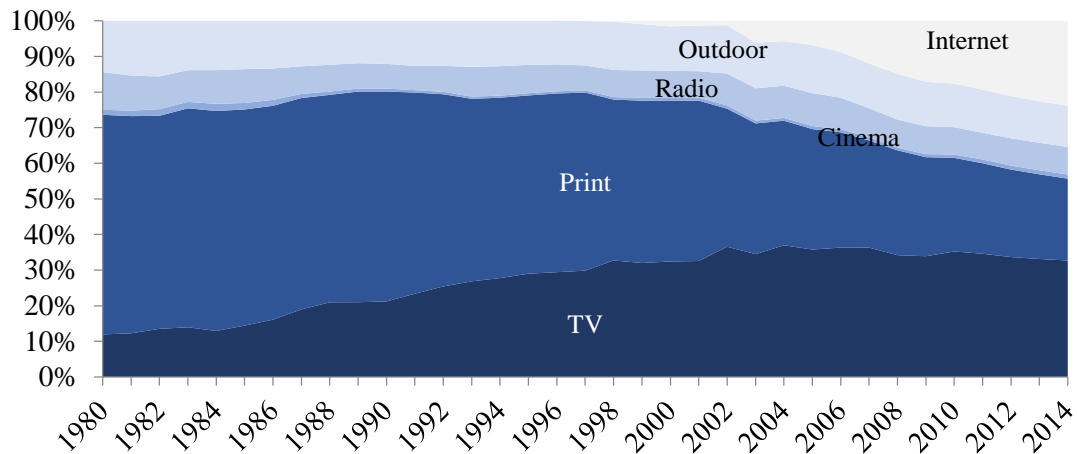
Appendix 1 – Breakdown of advertising market by medium

Italy



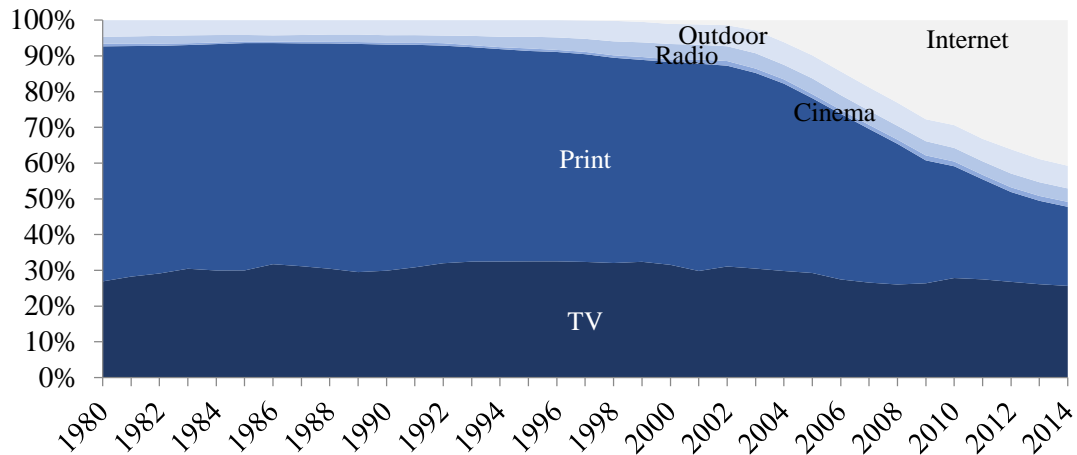
Source: Zenith Optimedia, Bloomberg

France



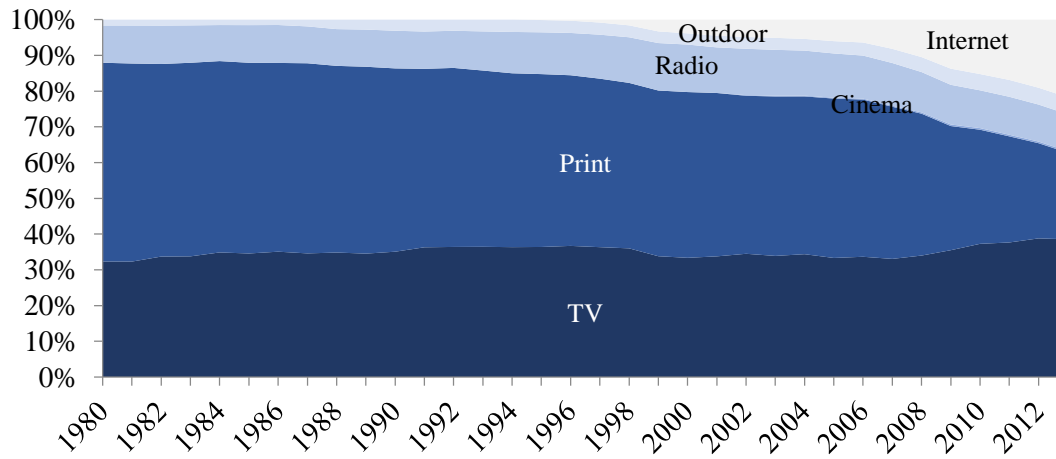
Source: Zenith Optimedia, Bloomberg

United Kingdom



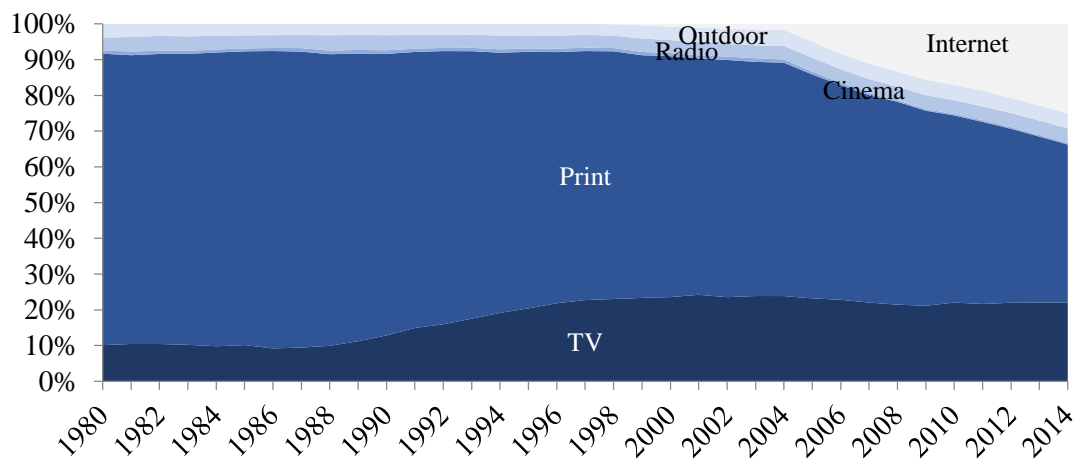
Source: Zenith Optimedia, Bloomberg

United States



Source: Zenith Optimedia, Bloomberg

Germany



Source: Zenith Optimedia, Bloomberg

Appendix 2 – Income Statement as reported (2007 – 2014E)

Millions of EUR	2007	2008	2009	2010	2011	2012	2013	2014E
Net Revenue	1.015,9	833,5	703,9	807,7	805,2	741,2	829,8	890,0
Programme amortisation and other procurements	-337,6	-352,6	-320,6	-324,4	-375,4	-406,5	-448,5	-451,3
Staff costs	-137,7	-135,4	-134,9	-128,8	-123,2	-120,3	-110,9	-115,8
Other operating expenses	-206,6	-181,3	-167,2	-197,5	-182,2	-174,9	-190,3	-189,3
Profit from Operations (EBITDA)	334,0	164,2	81,2	156,9	124,4	39,5	80,2	133,6
Depreciation and amortisation charges	-18,0	-16,7	-17,1	-15,9	-15,8	-16,6	-17,3	-18,0
Gains on bargain purchases arising on business combinations	0,0	0,0	0,0	0,0	0,0	19,5	0,0	0,0
Net impairment losses	-12,3	-1,8	-3,8	-5,5	-4,0	0,0	-3,8	0,0
Impairment and losses on disposals of non-current assets	0,0	0,0	0,0	0,0	0,0	-25,4	0,0	0,0
Net gain/loss on changes in the value of financial instruments at fair value	0,3	5,7	-0,6	0,9	2,4	4,9	-1,0	-0,5
Exchange differences	0,2	-7,0	-0,4	-1,1	-3,5	4,1	6,4	0,0
Share of results of associates	0,0	0,2	0,4	0,7	0,6	-1,1	-1,1	-1,4
Gains /losses on disposals of financial assets	0,9	0,8	1,3	0,0	0,3	-3,2	0,0	-0,2
EBIT	305,3	145,4	61,0	136,1	104,5	21,7	63,5	113,5
Financial loss	-31,4	-42,3	-9,6	-4,4	-4,8	-9,8	-15,7	-12,2
EBT	273,9	103,1	51,4	131,7	99,7	11,9	47,8	101,3
Income tax	-73,8	-12,0	9,3	-22,5	-6,2	20,0	-1,8	-21,9
Effective tax rate	27,0%	11,7%	-18,1%	17,1%	6,2%	-168,1%	3,7%	21,6%
Net income	200,0	91,0	60,7	109,1	93,4	31,9	46,1	79,4
Gain/Loss attributable to non-controlling interests	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Profit attributable to the parent	200,0	91,0	60,8	109,1	93,4	31,9	46,1	79,4

Source: Annual reports

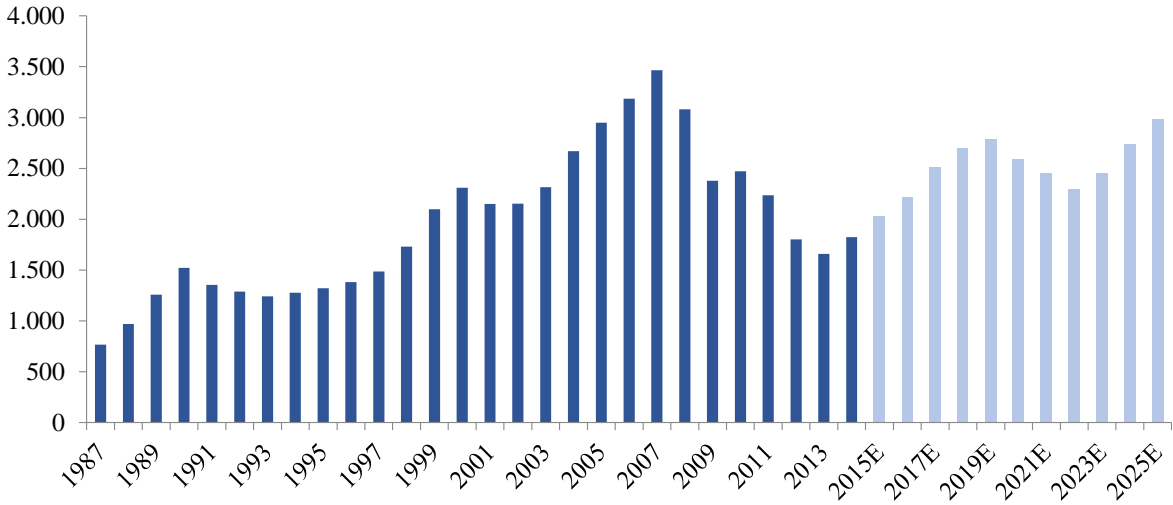
Appendix 3 – Balance Sheet as reported (2007 – 2014E)

Millions of EUR	2007	2008	2009	2010	2011	2012	2013	2014E
Assets								
Programme rights & Inventories	262,5	214,9	184,4	171,3	206,3	241,9	283,1	310,1
Trade and other receivables	264,4	204,0	221,8	252,9	215,7	229,0	228,6	201,3
Current financial assets	0,0	0,5	0,5	0,8	2,3	1,2	4,4	14,9
Other current assets	7,5	10,4	5,4	2,5	5,1	3,4	1,9	2,2
Cash and cash equivalents	20,1	2,8	3,1	1,6	8,1	5,0	56,3	64,3
Total current assets	554,5	432,5	415,2	429,1	437,5	480,5	574,2	592,7
Goodwill	200,1	175,4	175,9	175,9	175,9	150,0	153,2	153,2
Other intangible assets	43,2	69,2	69,8	56,6	38,2	140,8	142,7	133,1
PP&E	74,3	73,9	62,5	61,1	62,9	57,4	52,0	51,0
Investments in associate companies	1,5	13,1	13,7	9,5	6,0	0,1	0,5	0,5
Deferred tax assets	48,8	56,5	58,1	49,6	60,8	322,5	327,2	329,1
Other non-current assets	0,6	0,6	0,9	0,9	1,3	13,1	1,8	0,0
Financial instruments	0,2	0,3	0,1	0,1	0,7	7,4	9,4	7,2
Non-current assets held for sale	0,5	6,4	0,0	0,0	0,0	2,0	0,0	0,0
Total non-current assets	369,2	395,5	380,9	353,7	345,7	693,3	686,8	674,1
Total Assets	923,6	828,0	796,1	782,8	783,2	1.173,8	1.261,0	1.266,8
Liabilities								
Bank borrowings	156,2	123,2	168,7	100,3	86,8	137,7	6,6	1,7
Trade and other payables	212,6	211,8	228,2	256,1	295,8	479,3	443,1	426,3
Derivative financial instruments	6,4	67,0	1,0	0,3	0,0	0,5	3,0	3,0
Other current financial liabilities	0,0	0,0	0,0	0,0	0,0	0,0	35,4	0,0
Other Provisions	39,7	50,5	51,6	52,9	33,3	43,5	38,8	32,3
Operating provisions	37,0	34,6	39,1	40,6	40,3	35,7	34,2	36,7
Current tax liabilities	32,9	8,7	11,2	13,5	12,3	13,6	15,7	14,7
Other current liabilities	26,4	58,8	14,0	13,1	19,2	26,0	1,9	1,9
Total current liabilities	511,3	554,6	513,7	476,7	487,6	736,2	578,8	516,7
Financial instruments	0,0	0,1	0,2	0,1	0,0	0,2	0,2	0,0
Bank borrowings	0,1	20,0	14,6	1,1	0,5	0,2	200,1	162,7
Provisions	0,8	0,1	0,0	0,0	0,0	0,0	2,3	0,0
Other non-current financial liabilities	0,0	0,0	0,0	0,0	0,0	68,5	0,5	0,0
Deferred tax liabilities	0,0	0,0	0,0	0,0	0,1	31,5	31,3	31,3
Other non-current liabilities	84,8	3,4	2,6	1,0	0,7	0,9	63,7	52,8
Liabilities associated with assets held for sale	1,0	0,1	0,1	0,0	0,0	0,0	0,0	0,0
Total non-current liabilities	86,7	23,5	17,4	2,2	1,3	101,4	298,2	246,8
Total liabilities	598,0	578,1	531,1	478,9	488,9	837,6	877,0	763,5
Stockholder's Equity								
Share capital	158,3	158,3	158,3	158,3	158,3	169,3	169,3	169,3
Share Premium	0,0	0,0	0,0	0,0	0,0	38,3	38,3	38,3
Restricted reserves	43,7	40,3	40,3	40,3	40,3	40,3	42,5	42,5
Retained Earnings	252,6	185,2	161,1	224,0	227,2	166,0	189,9	255,5
Tresury shares	-45,6	-67,7	-78,7	-78,7	-87,9	-99,5	-99,5	-7,2
Interim dividends	-83,4	-66,2	-16,0	-40,1	-43,7	-21,4	0,0	0,0
Other equity instruments	0,0	0,0	0,0	0,0	0,0	42,6	42,6	3,1
Valuation adjustments	0,0	0,0	0,0	0,0	0,0	0,5	0,8	1,9
Non-controlling interests	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Total Stockholder's Equity	325,6	249,9	265,0	303,9	294,3	336,2	384,0	503,3
Total Liabilities and Stockholder's Equity	923,6	828,0	796,1	782,8	783,2	1.173,8	1.261,0	1.266,8

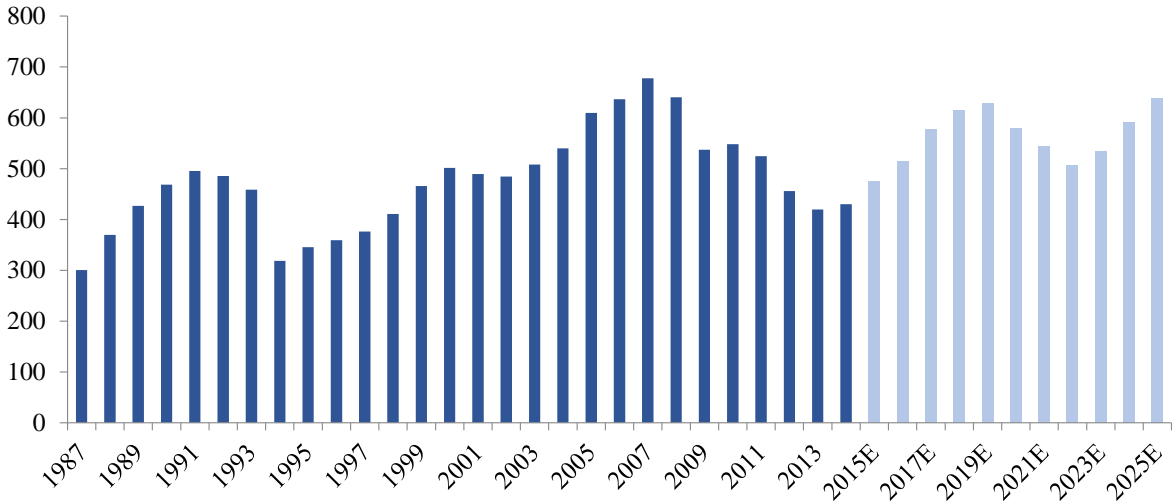
Source: Annual reports

Appendix 4 – TV and Radio advertising market forecasts

TV ad spending market (1987 – 2025E) (€Mil)



Radio ad spending market (1987 – 2025E) (€Mil)



Appendix 5 – Forecasted Income Statement (2014E – 2025E) (Base case)

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Net Revenue	890,0	991,2	1.083,2	1.224,3	1.319,7	1.363,2	1.277,3	1.216,4	1.153,2	1.235,5	1.378,9	1.506,8
Programme amortisation & Other procurements	-451,3	-449,0	-445,2	-473,8	-479,1	-527,6	-588,9	-632,5	-645,8	-648,6	-661,9	-685,6
Staff costs	-115,8	-118,9	-115,9	-123,7	-125,4	-136,3	-146,9	-152,0	-154,5	-165,6	-165,5	-170,3
Other operating expenses	-189,3	-224,0	-244,8	-276,7	-298,2	-308,1	-288,7	-274,9	-260,6	-279,2	-311,6	-340,5
Profit from Operations (EBITDA)	133,6	199,2	277,3	350,2	417,0	391,3	252,9	156,9	92,3	142,1	239,9	310,4
EBITDA margin (%)	15,0%	20,1%	25,6%	28,6%	31,6%	28,7%	19,8%	12,9%	8,0%	11,5%	17,4%	20,6%
Depreciation and amortisation charges	-18,0	-16,5	-17,3	-18,1	-19,3	-20,5	-21,7	-22,6	-23,3	-23,8	-24,4	-25,3
EBIT	113,5	182,7	260,0	332,0	397,8	370,8	231,2	134,3	69,0	118,3	215,5	285,1
Financial loss	-12,2	-9,6	-6,3	-2,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
EBT	101,3	173,2	253,8	329,9	397,8	370,8	231,2	134,3	69,0	118,3	215,5	285,1
Income tax	21,9	38,1	13,5	67,3	110,2	103,5	60,7	31,0	11,2	25,9	54,9	75,4
Effective tax rate (%)	21,6%	22,0%	5,3%	20,4%	27,7%	27,9%	26,3%	23,1%	16,2%	21,9%	25,5%	26,5%
Net income	79,4	135,1	240,3	262,7	287,6	267,3	170,5	103,3	57,8	92,3	160,6	209,6

Appendix 6 – Forecasted Balance Sheet (2014E – 2025E) (Base case)

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Assets												
Programme rights & Inventories	310,1	296,0	293,4	312,3	315,8	347,7	388,1	416,9	425,7	427,5	436,3	451,9
Trade and other receivables	201,3	248,6	271,7	307,1	331,0	341,9	320,4	305,1	289,3	309,9	345,9	377,9
Current financial assets	14,9	14,9	14,9	14,9	14,9	14,9	14,9	14,9	14,9	14,9	14,9	14,9
Cash and cash equivalents	64,3	70,9	100,4	133,8	184,9	237,3	277,3	302,0	316,1	329,9	354,9	390,7
Total current assets	590,5	630,4	680,4	768,0	846,6	941,8	1.000,7	1.038,9	1.045,9	1.082,2	1.152,0	1.235,4
Goodwill	153,2	153,2	153,2	153,2	153,2	153,2	153,2	153,2	153,2	153,2	153,2	153,2
PP&E & other intangibles	184,1	192,4	202,2	214,6	228,3	241,9	252,1	259,9	265,4	272,4	282,4	294,7
Investments accounted for using the equity method	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5	0,5
Deferred tax assets	331,2	307,0	120,0	37,5	30,6	30,6	30,6	30,6	30,6	30,6	30,6	30,6
Financial instruments	7,2	7,2	7,2	7,2	7,2	7,2	7,2	7,2	7,2	7,2	7,2	7,2
Total non-current assets	676,3	660,3	483,1	413,1	419,9	433,5	443,7	451,4	456,9	464,0	474,0	486,3
Total Assets	1.266,8	1.290,7	1.163,5	1.181,1	1.266,5	1.375,3	1.444,3	1.490,4	1.502,8	1.546,1	1.625,9	1.721,7
Liabilities												
Bank borrowings	1,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Trade and other payables	426,3	433,9	430,2	457,9	462,9	509,8	569,0	611,3	624,1	626,8	639,6	662,5
Derivative financial instruments	3,0	3,0	3,0	3,0	3,0	3,0	3,0	3,0	3,0	3,0	3,0	3,0
Operating Provisions	36,7	40,9	44,7	50,5	54,4	56,2	52,7	50,1	47,5	50,9	56,8	62,1
Other current liabilities	49,0	67,8	67,7	69,0	69,2	71,5	74,3	76,3	76,9	77,1	77,7	78,8
Total current liabilities	516,7	545,7	545,5	580,3	589,6	640,5	699,0	740,7	751,6	757,8	777,2	806,5
Bank borrowings	162,7	126,3	63,7	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Other non-current liabilities	84,1	31,3	31,3	31,3	31,3	31,3	31,3	31,3	31,3	31,3	31,3	31,3
Total non-current liabilities	246,8	157,6	95,0	31,3	31,3	31,3	31,3	31,3	31,3	31,3	31,3	31,3
Total liabilities	763,5	703,3	640,6	611,6	620,9	671,8	730,3	772,0	782,9	789,1	808,5	837,8
Stockholder's Equity												
Share capital	169,3	169,3	169,3	169,3	169,3	169,3	169,3	169,3	169,3	169,3	169,3	169,3
Share Premium	38,3	38,3	38,3	38,3	38,3	38,3	38,3	38,3	38,3	38,3	38,3	38,3
Restricted reserves	42,5	42,5	42,5	42,5	42,5	42,5	42,5	42,5	42,5	42,5	42,5	42,5
Retained Earnings	255,5	339,6	275,1	321,6	397,7	455,6	466,2	470,5	472,1	509,2	569,6	636,1
Tresury shares	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2	-7,2
Other equity instruments	3,1	3,1	3,1	3,1	3,1	3,1	3,1	3,1	3,1	3,1	3,1	3,1
Valuation adjustments	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,9	1,9
Total Stockholder's Equity	503,3	587,4	522,9	569,5	645,6	703,5	714,0	718,3	719,9	757,0	817,5	884,0
Total Liabilities and Stockholder's Equity	1.266,8	1.290,7	1.163,5	1.181,1	1.266,5	1.375,3	1.444,3	1.490,4	1.502,8	1.546,1	1.625,9	1.721,7

Appendix 7 – EBITDA estimation (Base case)

Millions of EUR	2007	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Programming costs	337,6	352,6	320,6	324,4	375,4	406,5	448,5	451,3	449,0	445,2	473,8	479,1	527,6	588,9	632,5	645,8	648,6	661,9	685,6
% Revenue	33,2%	42,3%	45,5%	40,2%	46,6%	54,8%	54,0%	50,7%	45,3%	41,1%	38,7%	36,3%	38,7%	46,1%	52,0%	56,0%	52,5%	48,0%	45,5%
Staff costs	137,7	135,4	134,9	128,8	123,2	120,3	110,9	115,8	118,9	115,9	123,7	125,4	136,3	146,9	152,0	154,5	165,6	165,5	170,3
% Revenue	13,5%	16,2%	19,2%	16,0%	15,3%	16,2%	13,4%	13,0%	12,0%	10,7%	10,1%	9,5%	10,0%	11,5%	12,5%	13,4%	13,4%	12,0%	11,3%
Other operational expenses	206,6	181,3	167,2	197,5	182,2	174,9	190,3	189,3	224,0	244,8	276,7	298,2	308,1	288,7	274,9	260,6	279,2	311,6	340,5
% Revenue	20,3%	21,8%	23,8%	24,4%	22,6%	23,6%	22,9%	21,3%	22,6%	22,6%	22,6%	22,6%	22,6%	22,6%	22,6%	22,6%	22,6%	22,6%	22,6%
EBITDA margin (%)	32,9	19,7	11,5	19,4	15,5	5,3	9,7	15,0	20,1	25,6	28,6	31,6	28,7	19,8	12,9	8,0	11,5	17,4	20,6

Appendix 8 – Net Working Capital (Base Case)

Millions of EUR	2007	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Current Assets																			
Programme rights & Inventories	262,5	214,9	184,4	171,3	206,3	241,9	283,1	310,1	296,0	293,4	312,3	315,8	347,7	388,1	416,9	425,7	427,5	436,3	451,9
% Programming costs	77,8%	60,9%	57,5%	52,8%	55,0%	59,5%	63,1%	68,7%	65,9%	65,9%	65,9%	65,9%	65,9%	65,9%	65,9%	65,9%	65,9%	65,9%	65,9%
Trade and other receivables	264,4	204,0	221,8	252,9	215,7	229,0	228,6	201,3	248,6	271,7	307,1	331,0	341,9	320,4	305,1	289,3	309,9	345,9	377,9
Days of Sales	95,0	89,4	115,0	114,3	97,8	112,8	100,6	82,5	91,6	91,6	91,6	91,6	91,6	91,6	91,6	91,6	91,6	91,6	91,6
Current Liabilities																			
Trade and other payables	212,6	211,8	228,2	256,1	295,8	479,3	443,1	426,3	433,9	430,2	457,9	462,9	509,8	569,0	611,3	624,1	626,8	639,6	662,5
Days of costs	229,9	219,3	259,8	288,1	287,6	430,4	360,6	344,8	352,7	352,7	352,7	352,7	352,7	352,7	352,7	352,7	352,7	352,7	352,7
Other liabilities	111,2	62,1	16,6	14,1	19,9	26,9	65,6	54,8	20,8	20,6	21,9	22,1	24,4	27,2	29,2	29,8	30,0	30,6	31,7
Days of costs	120,2	64,3	18,9	15,8	19,3	24,1	53,4	44,3	16,9	16,9	16,9	16,9	16,9	16,9	16,9	16,9	16,9	16,9	16,9
Operating Provisions	37,0	34,6	39,1	40,6	40,3	35,7	34,2	36,7	40,9	44,7	50,5	54,4	56,2	52,7	50,1	47,5	50,9	56,8	62,1
% Revenue	3,6%	4,2%	5,5%	5,0%	5,0%	4,8%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%	4,1%
Working Capital	166,0	110,4	122,4	113,5	66,1	-71,0	-31,3	-6,4	49,1	69,7	89,2	107,3	99,3	59,6	31,4	13,5	29,7	55,1	73,5
Investment in Working Capital		-55,7	12,0	-8,9	-47,4	-137,1	39,7	24,9	55,4	20,6	19,5	18,1	-8,0	-39,7	-28,2	-17,9	16,2	25,4	18,4

Appendix 9 – CAPEX and Depreciations & Amortisations (Base case)

Millions of EUR	2007	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
PP&E and Intangible assets	117,6	143,2	132,3	117,7	101,0	198,2	194,7	184,1	192,4	202,2	214,6	228,3	241,9	252,1	259,9	265,4	272,4	282,4	294,7
Depreciation&Amortization	18,0	16,7	17,1	15,9	15,8	16,6	17,3	18,0	16,5	17,3	18,1	19,3	20,5	21,7	22,6	23,3	23,8	24,4	25,3
% PP&E & Intangible assets ^(t-1)		14,2%	11,9%	12,0%	13,5%	16,5%	8,7%	9,2%	9,0%	9,0%	9,0%	9,0%	9,0%	9,0%	9,0%	9,0%	9,0%	9,0%	9,0%
CAPEX	35,0	61,4	34,6	41,3	41,1	23,7	25,0	17,6	24,8	27,1	30,6	33,0	34,1	31,9	30,4	28,8	30,9	34,4	37,6
% Revenues	3,4%	7,4%	4,9%	5,1%	5,1%	3,2%	3,0%	2,0%	2,5%	2,5%	2,5%	2,5%	2,5%	2,5%	2,5%	2,5%	2,5%	2,5%	2,5%

Appendix 10 – Tax matters, Effective tax rates (Base case)

Millions of EUR	2007	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Tax credits earned	12,5	20,7	15,7	18,7	24,3	18,9	13,2	22,1	22,0	21,8	23,2	23,5	25,9	28,9	31,0	31,7	31,8	32,5	33,6
% Programming costs	3,7%	5,9%	4,9%	5,8%	6,5%	4,7%	2,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%	4,9%

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Contabilistic EBT	101,3	173,2	253,8	329,9	397,8	370,8	231,2	134,3	69,0	118,3	215,5	285,1
(-) Tax loss carry forwards	25,3	43,3	63,4	82,5	6,9	0,0	0,0	0,0	0,0	0,0	0,0	0,0
(-) tax credits used	3,0	3,0	145,4	23,2	23,5	25,9	28,9	31,0	31,7	31,8	32,5	33,6
(=) Taxable EBT	73,0	126,9	45,0	224,2	367,4	344,9	202,3	103,3	37,3	86,5	183,0	251,4
Taxes @ Statutory tax rate (30%)	21,9	38,1	13,5	67,3	110,2	103,5	60,7	31,0	11,2	25,9	54,9	75,4
Effective tax rate	21,6%	22,0%	5,3%	20,4%	27,7%	27,9%	26,3%	23,1%	16,2%	21,9%	25,5%	26,5%

Appendix 11 – Debt package and interest tax shields (Base case)

Millions of EUR	2013	2014E	2015E	2016E	2017E
Drawn down Balance:					
Syndicated Financing	200,1	162,7	126,3	63,7	0,0
Revolving credit facility	6,6	1,7	0,0		
Repayments:					
Syndicated Financing		37,4	36,4	62,6	63,7
Revolving credit facility		4,9	1,7		
Interest:					
Syndicated Financing		12,0	9,5	6,3	2,1
Revolving credit facility		0,3	0,1	0	0
Tax shields (@ Effective tax rate)		2,6	2,1	0,3	0,4
Debt Service		54,6	47,6	68,9	65,8
Discount factor		1,00	0,98	0,97	0,96
Discounted Debt Service		54,6	46,9	66,8	62,9
Discounted tax shields		2,6	2,1	0,3	0,4
Interest rate	6,59%				
Cost of debt	1,54%				
Market value of debt	176,5				
NPV of Interest Tax Shields	2,8				

Appendix 12 – Forecasted Income Statement (High-Growth case)

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Net Revenue	890,0	991,2	1.127,6	1.274,5	1.373,8	1.419,0	1.329,2	1.265,4	1.199,3	1.284,6	1.433,7	1.566,5
Programme amortisation & Other procurements	-451,3	-426,2	-439,8	-465,2	-480,8	-525,0	-578,2	-626,4	-653,6	-642,3	-659,5	-657,9
Staff costs	-115,8	-118,9	-120,6	-128,7	-130,5	-141,9	-152,9	-158,2	-160,7	-172,1	-172,0	-177,0
Other operating expenses	-189,3	-224,0	-254,8	-288,0	-310,5	-320,7	-300,4	-286,0	-271,0	-290,3	-324,0	-354,0
Profit from Operations (EBITDA)	133,6	222,0	312,3	392,6	452,0	431,4	297,8	194,9	113,9	179,9	278,1	377,5
EBITDA margin (%)	15,0%	22,4%	27,7%	30,8%	32,9%	30,4%	22,4%	15,4%	9,5%	14,0%	19,4%	24,1%
Depreciation and amortisation charges	-18,0	-16,5	-17,3	-18,2	-19,5	-20,8	-22,1	-23,1	-23,9	-24,4	-25,1	-26,1
EBIT	113,5	205,5	295,1	374,3	432,5	410,6	275,6	171,8	90,1	155,4	253,0	351,5
Financial loss	-12,2	-9,6	-6,3	-2,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
EBT	101,3	196,0	288,8	372,2	432,5	410,6	275,6	171,8	90,1	155,4	253,0	351,5
Income tax	21,9	43,2	21,8	82,3	122,7	115,4	74,2	42,3	17,4	37,2	66,2	95,8
Effective tax rate (%)	21,6%	22,0%	7,5%	22,1%	28,4%	28,1%	26,9%	24,6%	19,3%	23,9%	26,2%	27,2%
Net income	79,4	152,8	267,0	289,9	309,8	295,1	201,5	129,5	72,7	118,3	186,8	255,7

Appendix 13 – Forecasted Income Statement (Low-Growth case)

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Net Revenue	890,0	970,9	1.016,5	1.123,9	1.211,6	1.251,8	1.173,6	1.118,3	1.061,2	1.137,2	1.269,4	1.387,5
Programme amortisation & Other procurements	-451,3	-456,3	-447,3	-460,8	-472,5	-513,2	-557,5	-592,7	-614,5	-616,4	-639,7	-661,8
Staff costs	-115,8	-116,5	-108,8	-113,5	-115,1	-125,2	-135,0	-139,8	-142,2	-152,4	-152,3	-156,8
Other operating expenses	-189,3	-219,4	-229,7	-254,0	-273,8	-282,9	-265,2	-252,7	-239,8	-257,0	-286,9	-313,6
Profit from Operations (EBITDA)	133,6	178,7	230,8	295,6	350,2	330,5	216,0	133,1	64,6	111,5	190,6	255,3
EBITDA margin (%)	15,0%	18,4%	22,7%	26,3%	28,9%	26,4%	18,4%	11,9%	6,1%	9,8%	15,0%	18,4%
Depreciation and amortisation charges	-18,0	-16,5	-17,2	-17,9	-18,9	-19,9	-20,9	-21,7	-22,2	-22,6	-23,1	-23,9
EBIT	113,5	162,1	213,5	277,6	331,3	310,6	195,1	111,4	42,4	88,8	167,4	231,4
Financial loss	-12,2	-9,6	-6,3	-2,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
EBT	101,3	152,6	207,3	275,5	331,3	310,6	195,1	111,4	42,4	88,8	167,4	231,4
Income tax	21,9	33,4	2,9	55,2	81,3	85,6	50,3	24,7	3,7	17,6	40,8	59,7
Effective tax rate (%)	21,6%	21,9%	1,4%	20,0%	24,5%	27,6%	25,8%	22,2%	8,7%	19,8%	24,4%	25,8%
Net income	79,4	119,1	204,4	220,3	250,0	225,0	144,7	86,7	38,7	71,3	126,6	171,7

Appendix 14 – Free cash flows (High-Growth case)

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
EBIT	113,5	205,5	295,1	374,3	432,5	410,6	275,6	171,8	90,1	155,4	253,0	351,5
(-) Taxes	24,5	45,3	22,3	82,8	122,7	115,4	74,2	42,3	17,4	37,2	66,2	95,8
NOPLAT	89,0	160,2	272,8	291,5	309,8	295,1	201,5	129,5	72,7	118,3	186,8	255,7
(+) D&A	18,0	16,5	17,3	18,2	19,5	20,8	22,1	23,1	23,9	24,4	25,1	26,1
(-) Investment in WC	24,9	62,4	23,8	21,7	15,2	-6,3	-37,7	-30,5	-23,6	21,9	25,1	28,4
(-) Capex	17,6	24,8	28,2	31,8	34,3	35,4	33,2	31,6	30,0	32,1	35,8	39,1
FCFF	64,4	89,6	238,2	256,2	279,7	286,7	228,1	151,5	90,1	88,7	151,0	214,2

Appendix 15 – Free cash flows (Low-Growth case)

Millions of EUR	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
EBIT	113,5	162,1	213,5	277,6	331,3	310,6	195,1	111,4	42,4	88,8	167,4	231,4
(-) Taxes	24,5	35,5	3,0	55,6	81,3	85,6	50,3	24,7	3,7	17,6	40,8	59,7
NOPLAT	89,0	126,6	210,6	222,0	250,0	225,0	144,7	86,7	38,7	71,3	126,6	171,7
(+) D&A	18,0	16,5	17,2	17,9	18,9	19,9	20,9	21,7	22,2	22,6	23,1	23,9
(-) Investment in WC	24,9	48,9	12,8	17,7	14,2	-5,9	-32,0	-24,0	-19,7	15,3	19,5	16,9
(-) Capex	17,6	24,3	25,4	28,1	30,3	31,3	29,3	27,9	26,5	28,4	31,7	34,7
FCFF	64,4	70,0	189,6	194,1	224,4	219,5	168,3	104,5	54,1	50,2	98,5	144,0

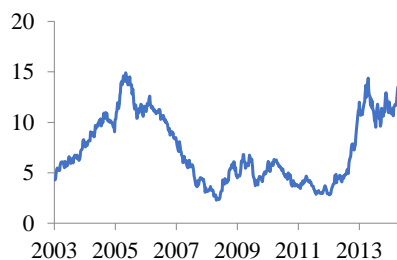
Francisco Fernandes
MSc in Finance

CATÓLICA-Lisbon
School of Business & Economics

Price Target € 11,45
Upside -18,3%
Recommendation Sell

Current price 14,01
Market Cap (€Mil) 3.163
52w high 14,01
52w low 9,51
YTD (%) 19,1%

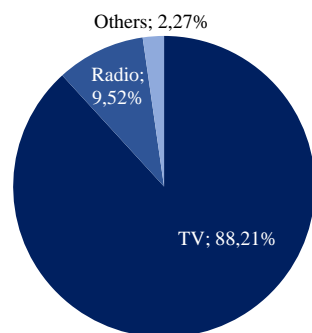
Share price performance:



Shareholders:

Grupo Planeta DeAgostini, S.L.	41,70%
Ufa Film and Fernseh, GmbH	19,17%
Treasury Shares	0,51%
Gamp Audiovisual, S.A.	5,72%
Imagina Media Audiovisual, S.L.	4,48%
Other shareholders	28,42%

Revenue breakdown 2014E:



Advertising market recovery does not justify its price

1) Summary

Atresmedia is a leading media group in Spain, with a strong position on the TV and radio advertising markets – market shares of 43% and 20% in 2014, respectively. After the merger with La Sexta in 2012, the company has taken advantage of cost synergies, mainly reducing staff costs.

The advertising industry seems to be at a turning point in the cycle, after dropping more than 40% from its peak in 2007 to the bottom in 2013. The TV industry is expected to grow by 11% in 2015 vs. 10% in 2014.

However, we see some regulatory risks regarding the RTVE funding model and the recoverability of the closed channels on May 2014. These events are likely to weigh in and put some pressure on Atresmedia's stock price.

We developed three scenarios in our valuation in order to understand the change in value given different outcomes from regulatory uncertainties and the evolution of EBITDA margins during the next cycle. We reached a central value of €11,45 per share, which compares with a market price of €14,01. Even considering our High-Growth case price target of 13,28, we still perceive the current price as overvalued.

Multiples are also demanding, with a peer group EV/EBITDA_{2015E} average of 10,73x vs. Atresmedia's 16,17x. However, as the advertising industry has historically exhibited a cyclical pattern, we might be comparing companies in different stages of the cycle.

Table 1: Summary of financials

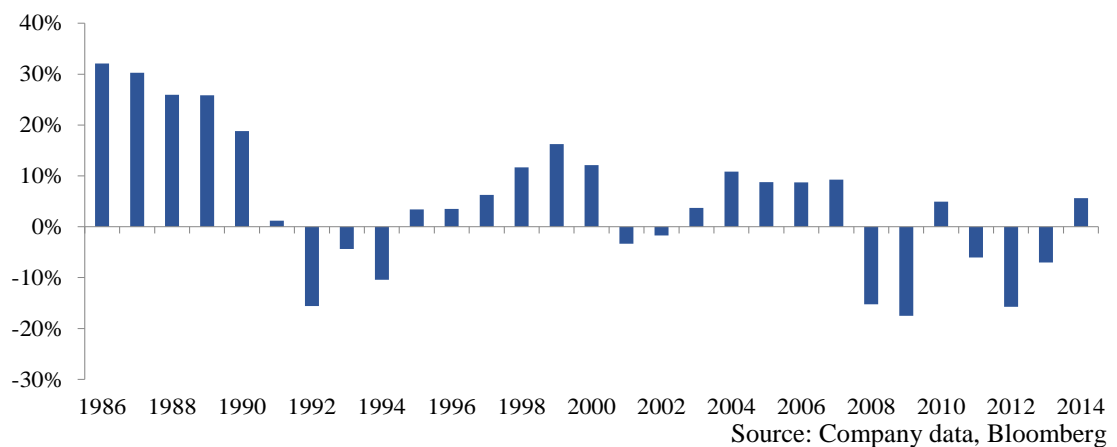
Millions of EUR	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E
Net Revenues	741,2	829,8	890,0	991,2	1.083,2	1.224,3	1.319,7	1.363,2
TV	638,9	728,3	785,1	874,3	954,9	1.079,6	1.162,6	1.197,9
Radio	82,3	80,7	84,7	93,6	101,3	113,6	121,2	123,8
Others	19,9	20,8	20,2	23,3	26,9	31,1	35,9	41,5
EBITDA	39,5	80,2	133,6	199,2	277,3	350,2	417,0	391,3
EBITDA margin	5,3%	9,7%	15,0%	20,1%	25,6%	28,6%	31,6%	28,7%
Net Income	31,9	46,1	79,4	135,1	240,3	262,7	287,6	267,3
Net Debt	200,7	185,0	88,2	43,6	-48,5	-145,6	-196,8	-249,1

2) Advertising market

After the burst of the real estate bubble in 2008, the advertising industry in Spain collapsed and by the end of 2014 it is still around 40% below its 2007 peak. In fact, this reduction represented the largest drop among its European peers.

It is important to note that the advertising industry has exhibited a cyclical pattern throughout the years due to its large dependence on broader macroeconomic trends.

Chart 1: Conventional advertising market evolution – Growth rates (%) (1986 – 2014)

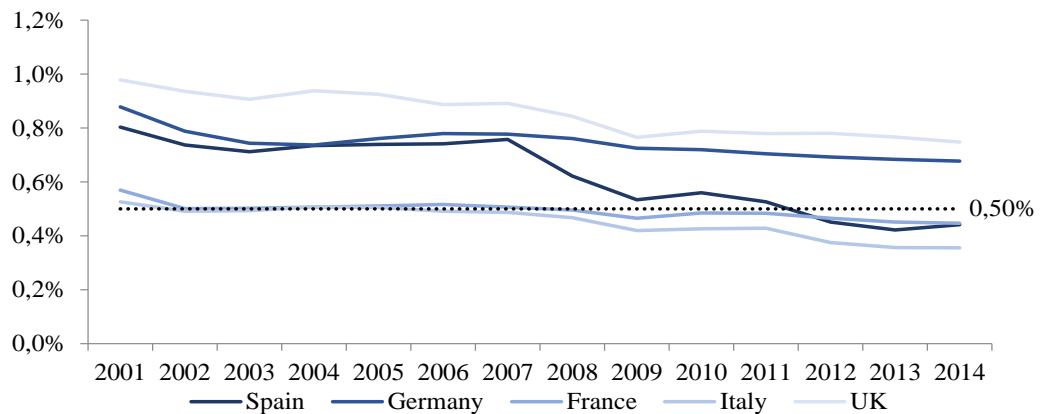


In Figure 1 we can identify clearly the three drops in the advertising industry that occurred in the last 30 years – average cycle of 10 years.

- a) The crisis of the early 1990s coincided with a macroeconomic backdrop that was quite similar to the most recent one, with falling private consumption and a sharp rise in unemployment. Between 1991 and 1994, the advertising market decreased 28% (€1,3Bn).
- b) In 2001-2002, following the bursting of the technology bubble, the advertising market entered a two year contraction period that resulted in a 5% drop (€300Mn).
- c) The third crisis observed started with the bursting of the real estate bubble in 2008. This was the most severe one, with an accumulated drop of 46% (€3,7Bn), which means it was almost three times larger than the one in the early 1990s.

As GDP remains the main driver of the industry we compared the Spanish market to its European peers, in terms of advertising spending as % of GDP. The indicator is fairly stable through time in most of the countries we analysed. However, we can also notice a slightly downwards trend, which means that even after the recovery from the crisis we probably will not observe the same values as in the beginning of the decade.

Chart 2: Total Ad spending % of GDP

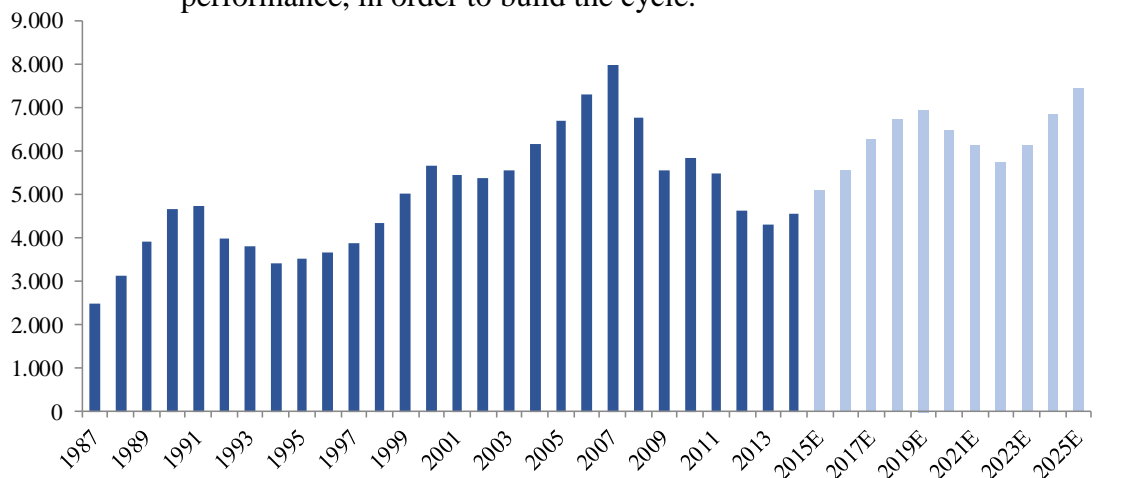


Source: Zenith Optimedia, IMF

As the economy improves, we expect the advertising industry in Spain to regain strength and trend to a long term average of around 0,50% of GDP, which compares with the current figure of 0,44%. We will not assume that it will stabilise at that long term average, but rather, that it will fluctuate around the average as we can draw from its historical

Chart 3: Conventional Ad market forecasts (2015E – 2025E) (€Mil)

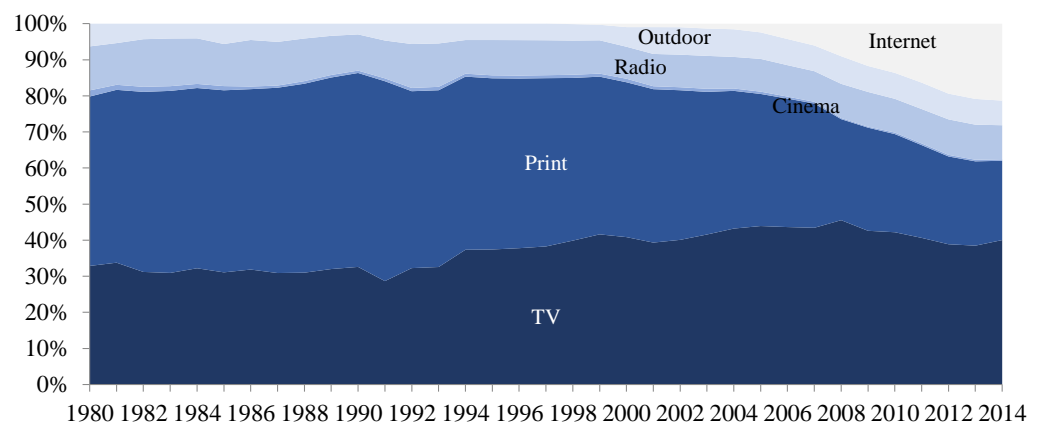
performance, in order to build the cycle.



Total Ad Spend as % of GDP				High								Low		
2011	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
0,53	0,45	0,42	0,44	0,48	0,51	0,56	0,58	0,58	0,52	0,48	0,44	0,45	0,48	0,51

Among the several categories of media, TV has the largest share of the market, representing 40% of the ad expenditure. The rising evolution of the internet does not seem to be affecting TV's weight in ad spending; instead, it has taken a large share of the market from print media, which includes newspapers and magazines. By analysing its historical performance, we expect radio to keep losing market share slowly as we progress.

Chart 4: Spanish advertising market breakdown by medium



Source: Zenith Optimedia, Bloomberg

Thus, we assume a constant TV market share of 40% and a decreasing Radio market share, from 9,5% in 2014 to 8,5% in 2025E. These implies a CAGR of 3,91% and 2,98% for the TV and Radio markets, respectively (2015E – 2025E).

3) Valuation

To value Atresmedia we use an Adjusted Present Value (APV) approach, separating the unlevered firm value from its leverage side effects. Moreover, we develop three scenarios, which account for different outcomes regarding regulatory issues and EBITDA margin's evolution.

Base case (50% as it is the most likely scenario):

- Atresmedia is assumed to recover two of the channels it lost on the tender process that will take place on the first half of 2015;
- The recovery of GolT in December 2015 will have no real effect on operating revenue as the company also loses the €6Mn from the leasing contract;

TV market share:

	Base	High-Growth	Low-Growth
2013	44%	44%	44%
2014E	43%	43%	43%
2015E	43%	43%	42%
2016E	43%	45%	40%
2017E	43%	45%	39%
2018E	43%	45%	39%

Radio market share:

2013	2014E	2015E-2025E
19,2%	19,7%	19,7%

Other divisions:

2015E-2025E CAGR of 15,5%

c) RTVE will return to the ad market on a limited basis with advertising outside prime time.

d) EBITDA margin average throughout the cycle is 20,4%, as we observed during the previous cycle 2002-2012.

High-Growth case (25%):

a) Atresmedia is assumed to recover two of the channels it lost on the tender process that will take place on the first half of 2015;

b) The recovery of GoT in December 2015 will have a positive effect on operating revenue;

c) RTVE will not return to the ad market and will be funded via sponsorship revenues and cost cutting;

d) EBITDA margin average throughout the cycle is 22,6%.

Low-Growth case (25%):

a) Atresmedia will not recover any channels on the tender process that will take place on the first half of 2015;

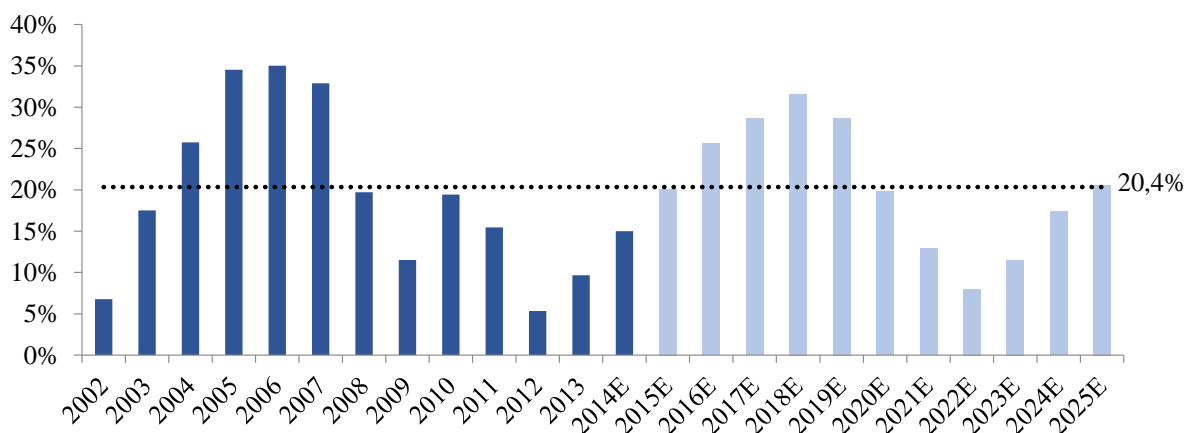
b) The recovery of GoT in December 2015 will have no real effect on operating revenue;

c) RTVE will return to the ad market with no restrictions;

d) EBITDA margin average throughout the cycle is 18,4%.

Operating expenses are composed by programme amortisation & other procurements (also called programming costs), staff costs and other operating expenses. As these costs are mostly fixed in their nature, the company benefits from high operating leverage, which translates into volatile EBITDA margins. Thus, we estimate OPEX in order to replicate EBITDA margins of the previous cycle (2002-2012).

Chart 5: Forecasted EBITDA margins – Base case



We make different assumptions for our three scenarios because it would not make sense to keep the EBITDA margins constant as the company faces different revenue assumptions. Moreover, it is important to understand how different margins would affect the value of the business. We assume an average EBITDA margin from 2015 to 2025 of 20,4% for the Base case, 22,6% for the High-Growth case and 18,4% for the Low Growth case.

For the purpose of our valuation we use an explicit period that captures a full cycle of the advertising market (10 years) – from 2015 to 2025.

Table 2: FCFF and unlevered firm value – Base case (€Mil)

	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	TV	
EBIT	113	183	260	332	398	371	231	134	69	118	216	285	236	
Taxes	25	40	14	68	110	103	61	31	11	26	55	75	59	
NOPLAT	89	143	246	264	288	267	171	103	58	92	161	210	177	
D&A	18	17	17	18	19	20	22	23	23	24	24	25	26	
Investment in WC	25	55	21	19	18	-8	-40	-28	-18	16	25	18	7	
Capex	18	25	27	31	33	34	32	30	29	31	34	38	31	
FCFF	64	79	216	232	256	262	200	124	70	69	125	179	165	
NPV of Explicit Period				1.223									Unlevered cost of equity (K_e)	7,85%
Terminal Value				1.481									Perpetuity Growth rate (g)	3,0%
Unlevered Firm Value				2.703										

We reach an unlevered firm value of 2,7 Billion Euros for the base case, based on the present value of FCFF in the explicit period, discounted at the unlevered cost of equity, plus the terminal value.

Due to the merger with La Sexta in 2012, the company has accumulated €221Mn in tax loss carry forwards. Additionally, due to Atresmedia's activities in the production of audiovisual content, the company benefits from tax credits granted by the Spanish government. This makes Atresmedia to pay an average effective tax rate lower than the statutory tax rate in perpetuity.

Leverage side effects

In order to value leverage side effects it is important to note that the company is expected to fully repay its outstanding debt in 2017 and, from then on, remain fully equity financed.

As the company only holds debt until 2017 and tax rates are relatively small, Interest Tax Shields represent only a fraction of the firm's value.

Additionally, expected bankruptcy costs are computed based on a probability of default of 2,5% and bankruptcy costs of 23% of firm value.

Valuation summary

Table 3: APV valuation summary (€Mil, except per share values)

	Low-Growth case (25%)	Base case (50%)	High-Growth case (25%)
NPV of Explicit Period	1.032	1.223	1.388
Terminal Value (TV)	1.216	1.481	1.717
Unlevered Firm Value	2248	2.703	3.105
Present value of ITS	2,6	2,8	3,0
Expected bankruptcy costs	13,0	15,6	17,9
Enterprise Value (EV)	2.237	2.691	3.090
Market value of debt	180	180	180
Cash & cash equivalents	87	87	87
Equity Value	2.145	2.598	2.997
# Shares	225,7	225,7	225,7
Price per Share	9,50	11,51	13,28

We reach a central value of €11,45 per share, based on a probability weighted average of the three scenarios, which compares with a market price of €14,01. Even considering our High-Growth case price target of €13,28, we still perceive the current price as overvalued.

Relative valuation

Table 4: Peer Group

Company	Market Cap (€Mil)	Enterprise Value (€Mil)	EV/EBITDA 2014E	EV/EBITDA 2015E	P/E 2014E	Net Debt/EBITDA
ATRESMEDIA	3.013	3.113	23,29	16,17	46,66	0,84
ITV PLC	12.550	12.879	12,82	11,63	23,57	0,30
TELEVISION FRANCAISE (T.F.1)	3.139	2.738	15,31	11,03	52,97	-3,48
M6-METROPOLE TELEVISION	2.146	1.974	7,10	6,89	17,33	-0,57
MEDIASET SPA	5.034	6.684	8,09	7,70	N/A	0,72
MODERN TIMES GROUP-B SHS	1.725	1.780	10,04	9,25	14,05	0,29
MEDIASET ESPAÑA	4.455	4.249	26,04	18,38	627,83	-0,61
NEXTRADIOTV	430	456	13,14	10,25	34,99	0,77
Average (Excluding Atresmedia)			13,22	10,73	128,46	-0,37
Median			12,98	10,64	34,99	0,29
Min			7,10	6,89	14,05	-3,48
Max			26,04	18,38	627,83	0,84

As we can observe, Atresmedia and Mediaset España are currently trading at a premium over the sector. Atresmedia currently trades at an EV/EBITDA_{2014E} of 23,29x versus a sector average of 13,22x and an EV/EBITDA_{2015E} of 16,17x versus a sector average of 10,73x.

4) Sensitivity analysis

Two variables that are particularly impactful on valuations are the discount rate or the unlevered cost of equity in this case, and the perpetuity growth rate “g”.

To perform this analysis we assume the three scenarios we considered during this valuation, which means that the values per share presented are the result of the weighted average of the three scenarios.

Table 5: Sensitivity analysis on price (€)

K_e \ g	1,5%	2,0%	2,5%	3,0%	3,5%	4,0%	4,5%
6,35%	12,87	13,79	14,88	16,28	18,22	20,91	24,98
6,85%	11,73	12,41	13,24	14,28	15,64	17,47	20,01
7,35%	10,75	11,28	11,92	12,71	13,70	14,99	16,73
7,85%	9,90	10,33	10,84	11,45	12,20	13,15	14,38
8,35%	9,20	9,54	9,95	10,43	11,01	11,72	12,62
8,85%	8,58	8,87	9,20	9,58	10,04	10,59	11,26
9,35%	8,05	8,28	8,55	8,86	9,23	9,66	10,18

5) Conclusion

Concluding, we see a target price for Atresmedia’s stock of €11,45, in line with our APV valuation, which we consider to be a better estimate than the one we observe in the relative valuation. This value yields an upside of -18,3%.

10. Bibliography

Alexander, G. and Chervany, N. (1980), "On the Estimation and Stability of Beta", *Journal of Financial and Quantitative Analysis*, 15, pp 123-137.

Altman, E. (1984), "A further empirical investigation of the bankruptcy cost question", *Journal of Finance*, pp. 1067-1089.

Altman, E. and Kishore, V. (1998), "Defaults & Returns on high yield bonds: analysis through 1998 and default outlook for 1999-2001", NYU working paper.

Black, F., Jensen, M. and Scholes, M. (1972), "The Capital Asset Pricing Model: Some Empirical Tests". Michael C. Jensen, *Studies in the theory of capital markets*, Praeger Publishers Inc.

Bughin, J. (2001), "Managing real options in broadcasting", *Communications & Strategies*, Number 41, pp. 63-78.

Cooper, I.A. and Nyborg, K.G. (2006), "The value of tax shields is equal to the present value of the tax shields", *Journal of Financial Economics*, v81, 215-225.

Damodaran, A. (2002), "Investment Valuation: Tools and Techniques for Determining the Value of Any Asset", Second Edition, John Wiley & Sons.

Damodaran, A. (2006), "Valuation Approaches and Metrics: A Survey of the Theory and Evidence", Stern School of Business, New York University.

Damodara, A. (2009), "Ups and Downs: Valuing Cyclical and Commodity Companies", Stern School of Business, New York University.

Damodaran, A. (2014), "Equity Risk Premiums (ERP): Determinants, Estimation and Implications", The 2014 Edition.

Daniels, M.B. (1934), "Principles of Asset Valuation", *The Accounting Review*, v9, 114-121.

Fama, E., French, K. (1992), "The cross-section of expected stock returns", *The Journal of Finance*, volume XLVII, No. 2, pp. 427-465.

Fernandez, P. (2004), "The value of tax shields is not equal to the present value of the tax shields", *Journal of Financial Economics*, v73, 145-165.

Goedhart, M. H., Koller, T. and Wessels, D. (2005), “The right role for multiples in valuation”, *The McKinsey Quarterly*.

Hamada, R. (1972), “The effect of the Firm’s Capital Structure on the Systematic Risk of Common Stock”, *Journal of Finance*, Vol. 27, pp. 435-452.

Koller, T., Goedhart, M. & Wessels, D. (2010), “Valuation – Measuring and Managing the Value of Companies”, 5th edition, New York, Wiley.

Korteweg, A. (2007), “The costs of financial distress across industries”, Dissertation to obtain the PhD degree at the Graduate School of Business, University of Chicago.

Lintner, J. (1965), “The valuation of risk assets and the selection of risky investments in stock portfolios and capital budgets”, *Review of Economics and Statistics* 47, 13-37.

Liu, J., Nissim, D., and Thomas, J. (2001), “Equity valuation using multiples”, *Journal of Accounting Research*, v40, Number 1, pp. 135–172.

Luehrman, T.A. (1997), “What’s it worth? A General Manager’s Guide to Valuation”, *Harvard Business Review*.

Merton, R. C. (1973), “An intertemporal capital asset pricing model”, *Econometrica* 41, 867-887.

Myers, S. (1974), “Interactions in Corporate Financing and Investment Decisions — Implications for Capital Budgeting”, *Journal of Finance*, v29,1-25.

Roll, R. (1977), “A Critique of the Asset Pricing Theory's Tests' Part I: On Past and Potential Testability of the Theory”, *Journal of Financial Economics*, pp. 129-176.

Sharpe, W. F. (1964), “Capital asset prices: A theory of market equilibrium under conditions of risk”, *Journal of Finance* 19, 425-442.

Stewart , G. B. (1991), “The Quest for Value”, *The EVA Management Guide*, Harper Business.

Van Horne, J. C. (1992), “Financial Management and Policy”, 9th edition, Englewood Cliffs, NJ: Prentice-Hall.

Young, S.D and O’Byrne, S.F. (2000), “EVA and Value-Based Management”, McGraw Hill.

Young, M., Sullivan, P., Nokhasteh, A. and Holt, W. (1999), “All Roads lead to Rome”, Research, v11, 661-687.

Williams, J.B. (1938), “Theory of Investment Value”, Fraser Publishing Company (reprint).

Equity Research

BESi Research, “Media – the long and the short of it”, October, 7, 2013.

BESi Research, “Spanish Media”, December 15, 2014.

Intermoney Valores SV, “Atresmedia valuation update”, January 28, 2015.

J.P Morgan Cazenove, “Spanish Broadcasters”, December 12, 2014.

Natixis, “Atresmedia – continued excellent advertising trends”, October 24, 2014.

Company data (<http://www.atresmediacorporacion.com/en/>)

Company annual reports and management presentations to analysts and investors from 2007 to 2014.

Other Research

Bloomberg – www.bloomberg.com

Instituto Nacional de Estadística (Spanish Statistical Office) – www.ine.es

Intermoney Valores SV, “Media sector: change in cycle”, October 21, 2014.

International Monetary Fund (IMF) – www.imf.org

Magna Global Intelligence, “Media economy report”, 2014.

Mckinsey & Company, “Global media report”, 2013.

Moody’s Investors Service, “Corporate Default and Recovery Rates, 1920-2010”, February 28, 2011.