Kingston Smith

MEDIA OUTLOOK SURVEY 2019

Introduction

Once again, we have conducted our annual outlook survey to ascertain the expectations of finance and managing directors of marketing services, media and consulting businesses on the financial prospects of their industries. The majority of the responses we received were from independent companies; however, our survey also includes the responses from listed and private equity backed creative businesses. We have also gained the insight from mixed disciplines across the marketing services sector and the wider media and consultancy businesses.

The outlook for 2019 based on our survey results is positive with most businesses expecting to see revenue growth. However, the forecast is definitely more cautious than last year. Unsurprisingly the sector seems to be expecting industry and economic pressures to have an impact on results.

Our survey results are positive with most businesses expecting to see revenue growth.

Growth agenda

Historic results show that, on average, businesses on a growth curve deliver higher margins and so agencies that can increase revenues in spite of industry and economic pressures are more likely to deliver stronger financials. That said, growth within the sector over the last few years hasn't been easy with a tough economic climate, changing demands from clients as a result of digital disruption and continued fee pressure from clients.

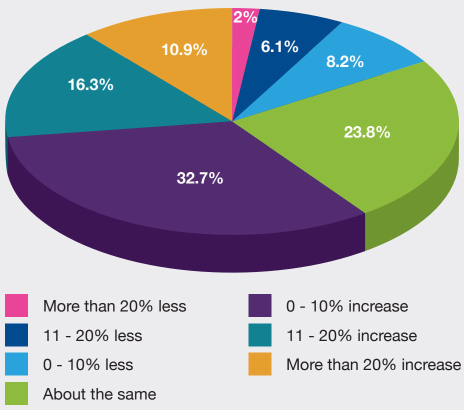
Some 60% of respondents expect revenue growth this year, down from 70% last year. Just over 10% expect to see growth above 20%, which again is slightly down on last year but still encouraging with the majority expecting growth of up to 10%.

Forecast growth reported was well spread across the various individual disciplines which continues the trend seen over the past few years.

Nearly a quarter of respondents expect revenues to be about the same as 2018, which isn't surprising given the economic uncertainty. Unfortunately, 16% expect to see revenues fall, although fortunately very few were concerned that they would fall by more than 20%.

It is becoming increasingly difficult for agencies to forecast revenues; retainer fees are declining, client contracts have shorter notice periods and zero based budgeting is becoming more the norm. The wide range of results received are indicative of the uncertainty within the industry.

How much better or worse do you think revenue levels will be in the calendar year 2019 compared to 2018?



Profit focus

So, how is the expected change to the top line in 2019 predicted to impact on profit levels and margins?

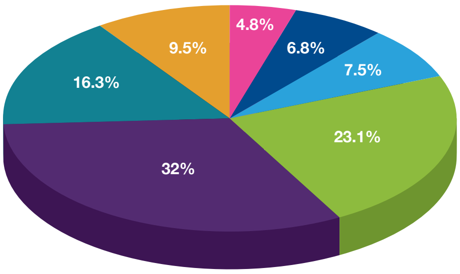
Over half of respondents (58%) expect that profit levels will improve this year. This is only slightly less than the percentage expecting revenue growth, which suggests that most of the forecast growth in revenues is expected to feed through to the bottom line. This is particularly encouraging given that a number of the key challenges for the sector are around capacity management and controlling people costs.

Some 10% of respondents expect profits to increase by more than 20%. This is down on the 15% last year but, given the slower revenue growth forecast, is to be expected. PR agencies were the most optimistic with their profit forecasts, followed by media buyers and design sectors, which follows actual results reported last year.

Unfortunately, nearly 20% of respondents expect profits to decline in 2019, which is a big increase on the 10% who had such concerns last year and reinforces the reality of the challenges facing the sector. However, of these, 14% expect the decline

Media outlook survey 2019

How much better or worse do you think your profit levels will be in the calendar year 2019 compared to 2018?



More than 20% less
11 - 20% less
0 - 10% less
About the same
0 - 10% increase
11 - 20% increase
More than 20% increase

to be less than 10%, which for most should be manageable. The key is to ensure that such a decline doesn't continue and strategies are put in place to get profits back on track.

With 20% of respondents expecting decreases in operating profits it's encouraging that 39%, down from 41% last year, are still expecting to achieve at least a 15% pre-tax profit margin.

Some 15% of respondents expect to achieve a margin over 20% this year with the highest margins expected by advertising and PR agencies and those that considered themselves to be more of a consulting firm.

We suggest that a well-run agency should aim to generate a profit margin of between 15% and 20% so, whilst the forecast results are slightly better than expected, the majority of respondents are still some way off reaching our target. In order to meet this benchmark, it's critical that agencies manage their people closely. We suggest that they should aim to spend no more than 60% of revenues on people costs, including freelancers. However, as historic results for the sector show, many find this difficult to achieve. Nevertheless, those that do, almost without exception, generate healthy margins.

However, whilst the numbers expecting to meet our target profit margins have remained fairly consistent, just over a third of respondents expect to generate a margin of less than 10% - up from a quarter of respondents last year. These pessimistic margin predictions were well spread across the various marketing disciplines. Those consistently generating less than 10% profit margin, and thus in survivor mode, need to closely examine each area of the business, including clients and business development, people, finances, and strategy, to see where the weak spots are. This is something we regularly help clients with in our half day KS360 workshops as part of our Strategic Growth Services for clients.

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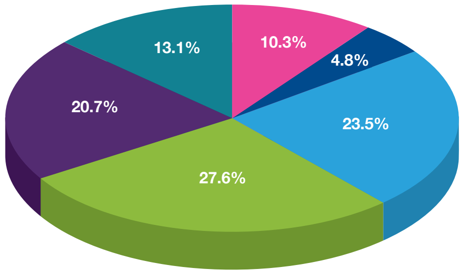
What do you think your net profit margin (i.e. profit before tax as a proportion of fee income/revenues) will be for 2019?



More than 25%
21-25%
16-20%
11-15%
6-10%
0-5%

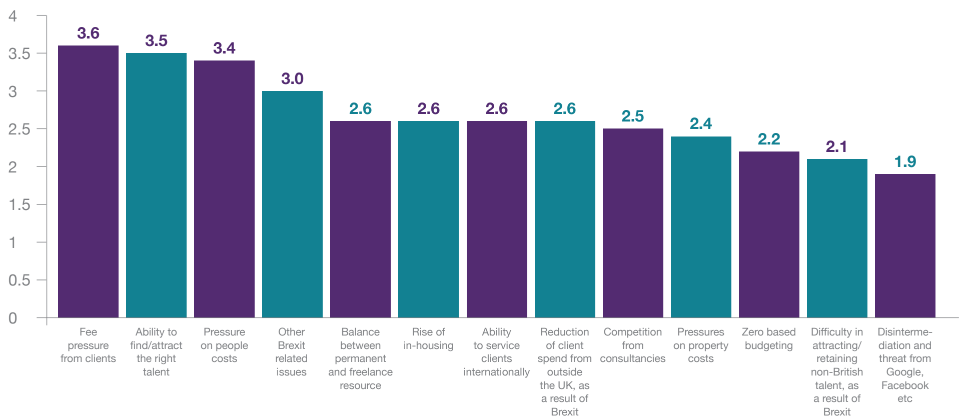
Challenges to the sector

Our survey asked where the greatest challenges were for agencies; the most highly rated pressure was that from clients over fees. This ties into the slow down on the growth forecasts reported as agencies continue to struggle with managing procurement and getting paid properly for their work. Economic pressures are being felt by clients and unfortunately in a lot of cases this is impacting marketing budgets and putting pressure on agencies to try and deliver the same scope for reduced fees. In order to insulate themselves as far as possible during inevitable fee discussions it's vital that agencies have a strong proposition which differentiates their offering and is clear on how they are delivering value to their clients. This is important in shifting the conversation from cost to value.

Unsurprisingly, the second greatest challenge expected for 2019 is having the ability to find and attract talent. Changing skill set requirements have pushed up the price and availability of talent and it is more important than ever for agencies to engage and incentivise their teams in order to retain talent. The cost of people ranked as the third most significant challenge and so trying to work on non-monetary incentives for key team members will be critical in order to limit the impact on profit margins.

Last year, only 10% of respondents saw Brexit related challenges as being significant for their business. However, this year they are seen as more of a real concern which will likely add further pressure to the issues already raised. A large proportion of respondents expect to see a reduction in spend from clients outside the UK as a result of Brexit. However, only 30% of respondents are planning on setting up overseas this year. Indeed, some of our clients have already set up European hubs in places like Amsterdam or Ireland. As part of international association MKSi we are well placed to help clients do this. Of course some respondents may already have an international presence but it will be interesting to see if the way agencies service international clients in a post Brexit Britain will change.

On a scale of 0-5, rate each of the following challenges for 2019 (1 is lowest; 5 is highest)



Managing the assets

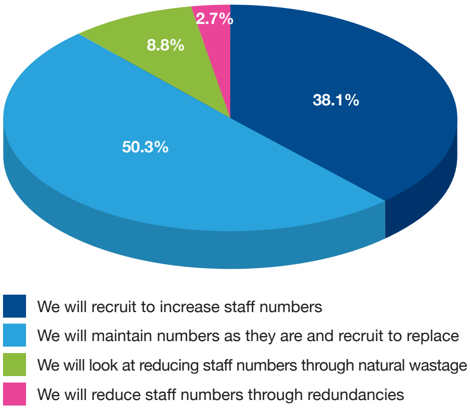
As the largest cost and most important asset for agencies, talent will always be critical to success. Unprecedented changes in technology and economic pressures mean that agencies need to prioritise attracting, retaining and motivating talent in order to stay ahead of their competition.

In line with the more cautious growth forecasts in this year's survey, just over half of respondents expect to maintain their staff numbers and only recruit to replace leavers. Some 38% expect to increase staff numbers compared with 48% last year. This suggests that some agencies are expecting to service new revenues with their current talent pools or by using freelancer resource. One would therefore hope this translates to higher profit margins.

Over the past few years the marketing services sector has increased its reliance on the use of freelancers as changing digital and AI demands have required new skill sets. Whilst they offer greater flexibility than full time employees they are often more expensive. Therefore, it is crucial that agencies control spend on freelancers carefully in line with capacity planning. If this resource is managed badly it can have a significant negative impact on profit margins. The prospect of having to put freelancers onto the payroll from 2020 is unlikely to help relieve pressures on margins or help with the availability of talent. Alongside this is the fact that we're yet to see how a post Brexit Britain will affect access to talent.

Given the level of competition in the market and the pressure profit margins are under, companies need to look for different ways to attract new talent and incentivise their current staff. We regularly work with our clients to put in bonus and share incentive schemes to ensure they retain their competitive edge.

How do you think your staffing requirements will change in 2019 compared to 2018?



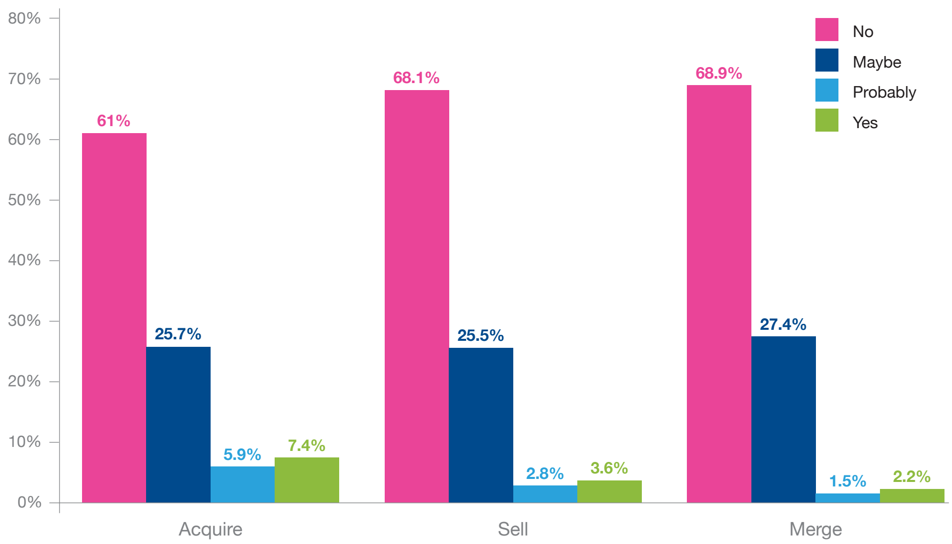
M&A activity

As previously reported in our quarterly M&A updates, 2018 continued to be a busy year for mergers and acquisitions activity within the marketing and media sectors, with 273 deals reported. Digital businesses were the most sought-after sub-sector, accounting for over 42% of the deals in the year. As Britain's withdrawal from the EU materialises along with other global concerns, such as escalating trade tension between the US and China, 2019 is likely set to be a quieter year with over 66% of respondents expecting no M&A activity at all within their business.

That said, nearly a quarter of respondents answered 'maybe' to M&A activity which suggests that they may be open to offers, presumably at the right price! Regardless of the market there will always be some deal activity and, as you would expect, the positive responses mainly came from digital agencies.

What we usually see after a flat period of activity is a busy few years thereafter – so it's likely that 2020 and 2021 may be busy on the M&A front. In order to achieve the highest possible valuation it's important to understand the key drivers of enterprise value and know what buyers are looking for. Businesses need to prioritise and focus the management on these as well as improvement initiatives well ahead of any sale date – ideally two to three years out. We have extensive experience of working with clients in this way before taking them to market. If you are thinking of selling in the next three years, we would love to meet with you to explain how we can help you realise your aspirations.

Are you looking to undergo any M&A activity in 2019?



Conclusion

Whilst headline growth forecasts are positive, our outlook survey results are less optimistic than last year.

Encouragingly, there are still some agencies forecasting excellent results but for most this isn't the case. Fee pressures from clients are set to be even more significant in 2019 in the face of zero based budgeting, the threat of in-housing, and general fee pressure from clients as the economic conditions remain tough. Faster, better, cheaper!

At the same time, it's more important than ever to try and keep ahead of the competition with a differentiated offering. As always, it will be interesting to see how agencies perform in 2019 relative to these forecasts. Those agencies that are agile and can quickly capitalise on opportunities presented by the challenges will be the ones that prosper and become thrivers rather than survivors.

About Kingston Smith

Kingston Smith LLP is one of the UK's Top 20 audit and advisory firms, and has been helping clients build their businesses for more than 90 years. We are a founding member of the international association Morison KSi, which allows us to offer our clients the strength and experience of 375 partner offices all around the world to support them globally.

Kingston Smith's West End office, with its team of six partners and 80 staff, specialises in advising media businesses. As a multidisciplinary practice we are able to provide a full range of audit, tax, outsourcing and corporate finance services, as well as legal and business advisory services. Such specialist areas of advice include employee incentive schemes, benchmarking, succession planning, exit planning, business valuations, profit improvement reviews, business plans, preparing for sale, pre sale tax planning, mergers and acquisitions. In addition to providing media businesses with traditional accountancy, tax and corporate finance services, we also provide strategic support to business owners and managers who are serious about growing their business, by helping them to take a step back and think strategically about how to dramatically improve business performance. The key areas we cover include: business development, people management, finance & operations and strategy & planning.

Our clients are spread across the media sector, covering all the key disciplines within marketing services, TV and commercial production, theatre, media technology, publishing, consulting and music.

Our services have been developed to advise growing, successful businesses at every stage of their growth, with our clients ranging from start ups and sizeable independents through to multinationals and AIM listed groups.

International expansion is of increasing significance to our clients' growth plans. At Kingston Smith, we support our clients as they move into new markets, providing commercial and timely advice throughout the transition and using our Morison KSi association to assist them locally. As part of our international focus, we are also commercial partners of the Creative Industries Council **www.thecreativeindustries.co.uk**, which works with the UK government to put creative businesses at the heart of the UK's productivity and growth agenda.

For more information on Kingston Smith's services to the media sector, visit **www.kingstonsmith.co.uk**

Kingston Smith's 2018 M&A Highlights

Our corporate finance team is proud to have advised on the following media transactions in 2018:

Marketing Services	Marketing Services	Theatre	Media & Marketing Services	Marketing Services
Sale of Healthcircle to Fishawack Group	Acquisitions of Red Hare and Grey Whippet	Sale of London's Theatre Royal Haymarket to Access Entertainment	Sale of Zebra Worldwide Group to CreativeDrive Inc.	Sale of Taylor James to Williams Lea Group
HEALTHCIRCLE ALLROUND BRAND HEALTH	M&CSAATCHI	THEATRE ROYAL HAYMARKET	ZEBRA WORLDWIDE	
Lead Adviser	Due Diligence	Lead Adviser	Lead Adviser	Lead Adviser

Contact us

If you would like to discuss any of the matters arising in this edition or how we can help you, please contact one of the Kingston Smith partners by email or on 020 7304 4646.

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More information about Kingston Smith and our services to the media sector can be found at: www.kingstonsmith.co.uk/media

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