Dollar's fall means earnings drop at the Seven Network

At its AGM in October 1997, the Seven Network was set for a positive year ahead. That was before the Australian currency collapsed against the US dollar and the increased cost of debts began to have an impact

Having touted the possibility of 10 per cent revenue growth for the 1997-98 financial year, the Seven Network's management team took a step back earlier this year and re-forecasted its expected earnings before interest and tax to between $175-180 million rather than the $185 million some media analysts had earlier predicted.

That step has proved to be a wise one as the network's first-half profit results, released to the market on March 9, showed a lower than expected profit and a slump in share price. A rise of almost 10 per cent in programming costs, particularly in sport, was held responsible.

Seven's net profit rose 4.1 percent to $65.6 million in the December half and the network's share price fell from $5.35c to $5.11c as investors reacted to the news. Earnings before interest and tax rose 14.4 per cent to $116.12 million, outstripping rival networks Nine and Ten which both recorded earnings growth of less than 13 per cent.

Chairman Kerry Stokes said that investment in programming was necessary for the network's long-term health."In broadcast television we have a strong business with prospects for continuing growth," said Mr Stokes. "But we are going to have to compete vigorously in what is becoming an increasingly competitive environment."

In the past five months, Seven has had to endure 1998 earnings forecast downgrades from several media analysts, due largely to the cost of the network's A$585 million involvement in loss-making U.S.-based movie studio Metro-Goldwyn Mayer (MGM), plus the side-effects of the lower Australian dollar.

The latter, in particular, has taken a toll on Seven's profit and loss statement. The lower dollar meant that the cost of the Winter Olympics programming rights was more expensive. Negotiated at an exchange rate of US$0.80c, the February 1998 rate of roughly US$0.67c meant that Seven's costs for the Games were significantly higher than was initially envisaged. How much impact this will have on the bottomline revenue generated by increased advertising during the Winter Olympics fortnight remains to be seen.

At best, analysts are expecting Seven to only break even or perhaps make a small loss on the event instead of a profit. Variable audience ratings, especially during the first week of the Winter Olympics when broadcasts were interrupted by heavy blizzards, also led to a fluctuating share price and to some analysts bagging the network.

Quoted in the *Australian Financial Review*, February 14-15, one said: "The general consensus is that the Olympics have not been a huge success and I have some real concerns about how much Seven is spending on commentators."

The fall of the Australian dollar also increased Seven's costs for servicing the debt – denominated in US dollars – with which it bought 24.7 per cent of MGM in July 1996. MGM booked a net loss of $191.4 million for the December year.

The net result, according to the International Brokers Estimate System, is that four of the 13 analysts who follow Seven have down-graded their earnings estimates since February 1998. The consensus now is that Seven will report earnings per share of 30c, an increase of 2.4 per cent on last year but below the 33c a share forecast by analysts in September 1997.

The slip in 1997-98 prospects follows what was a positive year as reported in the Seven Network's 1996-97 annual report.

According to the network's managing director Gary Rice, Seven was the only terrestrial broadcaster during 1996-97 to increase audience share in prime time and build market share across all key demographics. Overall ratings for the year saw Seven achieve 35.8 per cent compared to the Nine Network's 38.8 percent (AC Nielsen figures). It stuck with its ratings successes, program stalwarts including the ever popular *Blue Heelers* police drama, daily soap/drama *Home And Away* and infotainment productions such as *Better Homes & Gardens, The Great Outdoors, Who Dares Wins* and *Where Are They Now?*

"Our future will be determined by what appears on the television screen: the delivery of the right programming to the right audiences. This objective will drive Seven not only this year but also in the years to come," said Mr Stokes.

In fact, the performance of Seven's broadcast television business underpinned the company's progress in 1996-97. Record operating profit before income tax of $142.1 million was the result of stringent financial management and cost management programs, plus strong sales performance in an uneven overall advertising market.

During the 1996-97 financial year, the network initiated developments in local programming, such as hospital drama *All Saints* which began screening after the Winter Olympics, secured long-term international programming agreements and identified business and strategic investments which it was hoped would determine the future direction of the company.

Key to this was the purchasing of a stake in Hollywood movie studio MGM. Seven's initial investment of US$250 million increased during July 1997 with the acquisition of a further US$100 million in preferred stock. Seven now owns half the common stock in MGM and 30 per cent of the preferred stock. It also holds equal representation on the MGM board to Tracinda Corporation (the other joint venture partner in the MGM buyout) and owns 50 per cent of the voting rights in MGM.

While the MGM acquisition was seen by the network as a platform for the development of its future as a broadcast television-based entertainment company, analysts were less than kind about its prospects, pointing out the studio's indecision about when to list and highlighting its lack of a recent blockbuster movie as a long-term problem. The box office success of the studio's latest James Bond film *Tomorrow Never Dies*, however, may go some way toward repairing its prospects in time for a listing this year.

During 1996-97, Seven also strengthened its involvement in the Australian Football League as a partner in the winning consortium constructing the Docklands stadium in Melbourne, and also through securing the first and last refusal rights to broadcast television coverage of the competition from the 2002 season. Seven's commitment to the Docklands development is worth $99.5 million.

Seven also has an equity holding in Optus Communications, rights to 50 million shares at $1.25 per share and an entitlement to acquire an additional 50 million shares in Optus Communications at the time of the company's planned 1998 listing on the Australian Stock Exchange at the float price. The network retains a major role in subscription television through substantial holdings in Optus Vision's programming and channel supply ventures MovieVision and Sports Vision on Optus Vision, and Sky News Australia, the news channel on Optus Vision and Foxtel.

While actively developing an involvement in programming for new technologies and the delivery platforms for this programming (not forgetting that Seven purchased the ABC's loss-making international television service ATV in September 1997 to give it a foothold in the Asian broadcasting market and continue the network's international expansion), Seven's stated primary objective is the ongoing development of its broadcast television business. With strategic investments in MGM, Optus Communications and subscription television, the acquisition of ATV in Asia and the ongoing development of the network, Seven should play a key role in determining the future of communications in Australia.

It was well-placed to achieve this in 1997-97 but what 1998 holds for the network remains to be seen.

The Seven Network, Year–on–Year Financial Highlights

	1996–97	1995–96	1994–95	1993–94	1992–93
Sales revenue	$756.9m	$671.2m	$582.8m	$555.0m	$564.4m
Earnings before interest and tax	$155.3m	$132.3m	$96.1m	$97.3m	$57.1m
Interest	($13.2m)	($12.3m)	($7.6m)	($7.2m)	($10.6m)
Operating profit before income tax	$142.1m	$120.0m	$88.5m	$90.1m	$46.5m
Abnormal items	($1.6m)	($1.4m)	($47.2m)	–	$1.0m
Income tax	($51.6m)	($3.3m)	–	–	–
Operating profit after income tax	$88.9m	$115.3m	$41.3m	$90.1m	$47.5m
Minority interests	–	($0.2m)	–	$0.1m	$0.1m
Net profit	$88.9m	$115.1m	$41.3m	$90.2m	$47.5m
Earnings per share (diluted–cents)	28.8c	15.5c	20.0c	37.3c	13.0c
Final dividend (cents per share)	17.5c	13.6c	12.0c	16.5c	29.3c
Total dividend (cents per share)	12.0c	16.0c	15.5c	NA	NA

Note:
The 1995–96 financial year comprised 53 weeks. The 1992–93, 1994–95 and 1996–97 financial years comprised 52 weeks. The additional week in the 1995–96 financial year contributed $2.7 million to net profit. 1992–93 and 1993–94 data has been normalised, as if the company's recapitalisation had occurred before the beginning of the financial year.