Kingston Smith

Outlook 2017

SURVey

Introduction

Once again, we have concluded our yearly survey to ascertain the expectations of finance and managing directors of marketing services, and media and consulting businesses on the future 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.

2016 was a year of significant change in the political environment with Brexit and the unexpected results from the American presidential elections; it has left many business owners in the industry uncertain about what 2017 will bring. It is unsurprising therefore that the survey shows that, whilst the industry remains optimistic, this is moderated by caution around the general economic and political climate.

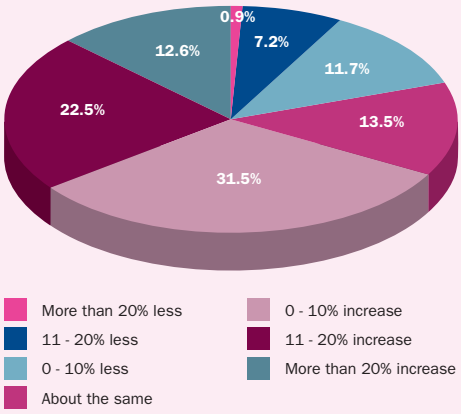
JUST OVER TWO-THIRDS OF OUR RESPONDENTS ARE PREDICTING SOME SORT OF GROWTH IN REVENUE THIS YEAR, COMPARED TO 80% LAST YEAR.

Growth agenda

Over the last few years growth within the industry has been difficult - agencies continue to deal with the pace of change in the marketing landscape and the ability to retain good people, whilst being under continued fee pressure from their clients.

We see that optimism continues this year but with an air of caution. Just over two-thirds of our respondents are predicting some sort of growth in revenue this year, compared to 80% last year. A third of our respondents predicted growth will be between 0-10%, and 22% predicted growth between 11-20%. There remains a small group of 13% who are very optimistic in predicting that their growth will be over 20%. Nearly 50% of respondents who have this view were from digital agencies. However, as we already know, it is increasingly difficult to categorise creative companies into single disciplines, with many businesses now integrating digital services into their offerings.

How much better or worse do you think revenue levels will be in the calendar year 2017 compared to 2016?



This year, a disappointing 20% of respondents thought that there would be some sort of decline in income over the next year - around three times as many as last year!

The wide ranging results we have received in conducting this survey are indicative of the uncertainty currently typifying the industry.

Profit focus

So, how is the expected change to the top line in 2017 predicted to impact on profit levels?

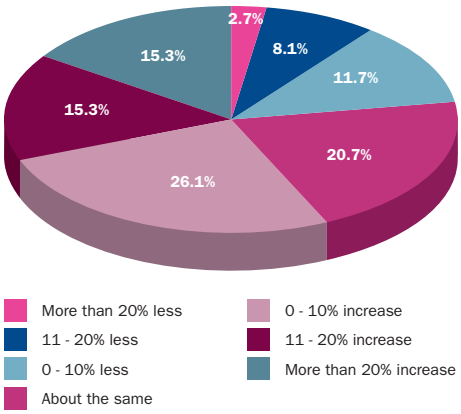
Unsurprisingly, the results of the survey suggest that growth in profit will be less than growth in revenue.

Just over two-thirds of our respondents predicted revenue growth in 2017 – with only 56% of our respondents predicting an increase in their profit. The predicted growth for 2017 is generally more conservative this year. 15.3% of the respondents believe profit margins will increase by 11-20% compared to 24% this time last year. Only 26% predict that profit margins will increase by 0-10%, compared to 38% last year.

Worryingly, the number predicting a decline in profits almost doubled from last year to 22%. However, when it comes to those who are very optimistic in anticipating profits to improve by over 20%, this number has increased from 10% last year to 15%. This is consistent with our view that the market is polarising.

It is interesting to see that 20% of the respondents who predicted revenue growth in 2017, predicted that profit margins will stay the same or decrease in 2017. This highlights the difficulties and pressures that agencies are facing when they try to make a positive impact on the bottom line through increasing revenues.

How much better or worse do you think your profit levels will be in the calendar year 2017 compared to 2016?



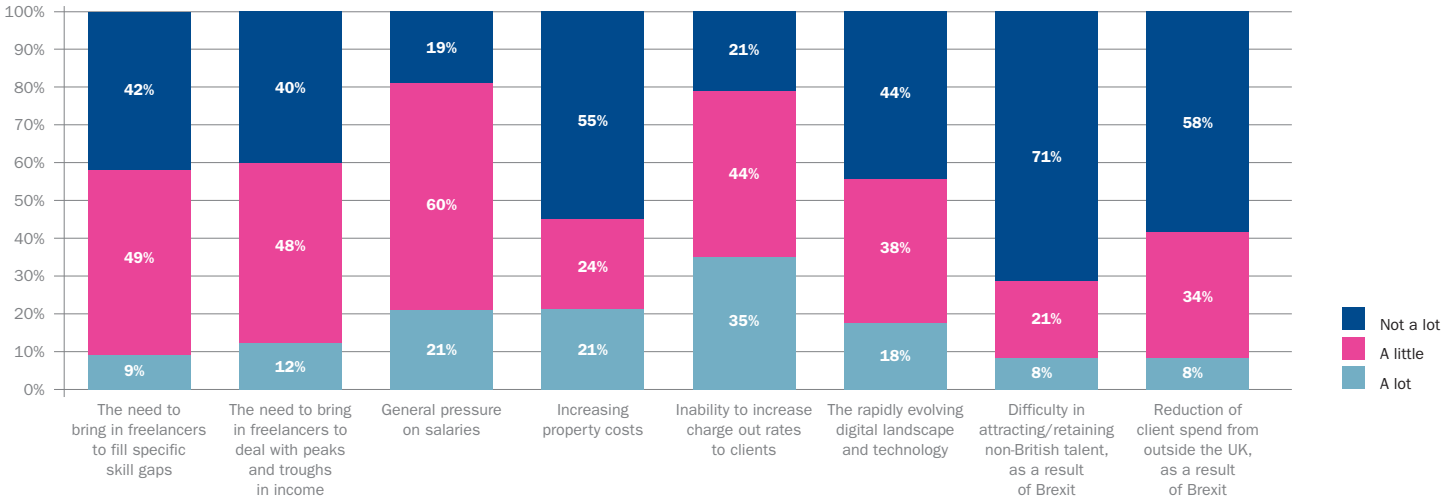
The key reason identified for such pressures was fee pressure from clients; with staff costs and property costs also causing some concern. It therefore remains important to set charge out rates to clients at a level that ensures recoverability of time and costs, with a decent profit margin on top! We are increasingly being asked by our clients to review their charge out rates and ensure there is an appropriate profit element.

THE KEY REASON IDENTIFIED FOR THE PRESSURE ON MARGINS WAS FEE PRESSURE FROM CLIENTS.

Surprisingly, the ability to attract and retain non-British talent was not a key concern for many of those surveyed - just under 10%. It remains to be seen whether this becomes a major post-Brexit issue or not.

Interestingly, the rapidly evolving digital landscape was of much less concern this year – with 56% citing it as a concern compared to the 83% last year. Perhaps this is indicative of the industry feeling it has better got to grips with it following years of investment.

Which of the following do you think are likely to put pressure on profit margins during 2017?



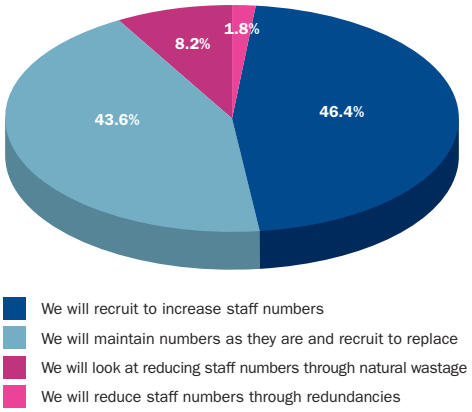
Managing the assets

The most important asset in the creative sector is the people. In the current industry-wide skills shortage, the need for companies to be proactive in attracting, retaining and motivating their workforce has never been so important.

In line with the flavour of this year's outlook survey, a more conservative result can be seen in that only 46% of respondents predict that they will be looking to increase staff numbers. This was compared to 63% in the previous year. Some 44% of the respondents have said they intend to maintain numbers and recruit to replace leavers; this is compared to 34%. Again, this result is indicative of the uncertainty in the industry. It remains positive, however, that only 1.8% of the respondents will be looking to decrease staff numbers through redundancies – this remains consistent with the 2016 results of 1.1%.

Clearly, given the competitiveness in the market, there is an opportunity for companies to review the ways in which they attract new staff and incentivise their current workforce.

How do you think your staffing requirements will change in 2017 compared to 2016?



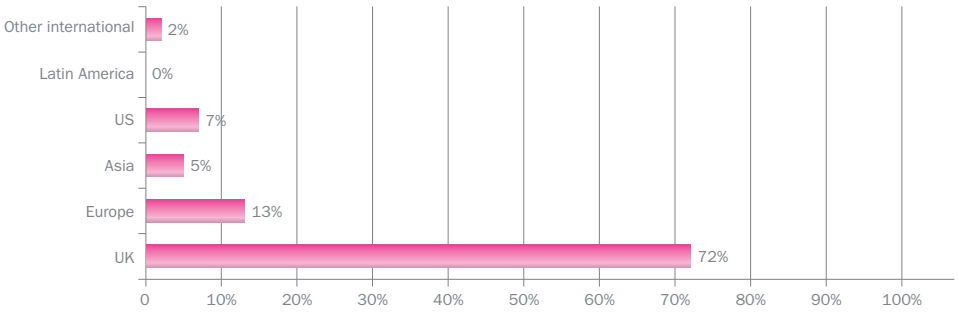
International markets

We couldn't undertake an outlook survey for 2017 without mentioning Brexit. It is therefore promising that when our respondents were asked about whether they thought Brexit would be their greatest challenge in 2017, 62% answered no. This is further supported by respondents' answers to pressure on profit margins – with 99% of our respondents predicting that a reduction of client spend from outside the UK as a result of Brexit was of no or little concern to them.

The results of the survey showed consistency with previous surveys. The majority of business comes from the UK as we would expect; however, this has marginally fallen again this year to 72%. This percentage has been slowly decreasing since 2013 as agencies target keys areas such as US and Europe. It will be interesting to see how Brexit and the election of Donald Trump will affect these percentages in the future.

79% OF RESPONDENTS PREDICTED THAT A REDUCTION OF CLIENT SPEND FROM OUTSIDE THE UK WAS OF NO OR LITTLE CONCERN TO THEM.

How much of your business comes from (%):



Conclusion

Whilst the 2017 outlook survey showed positive responses for revenue growth, optimistic predictions for the future have remained relatively conservative, suggesting that agencies are continuing to feel the squeeze.

The view on both growth in revenue and profit for the year are less optimistic than last year, and we continue to see signs of polarisation in the success of agencies.

Many agencies have invested heavily in technology and digital capabilities over the last few years and this has been reflected in declining margins. However, the concern around the impact of the evolving digital landscape reduced quite a lot in this year's survey – perhaps indicating that agencies feel they are now better equipped to deal with it.

Fee pressure from clients now appears to be the industry's biggest perceived challenge. Whilst that is nothing new, the uncertain economic climate that exists will inevitably mean clients think harder before committing to large chunks of budget spend.

Interestingly, the caution characterising the industry seems largely unrelated to the possible direct implications of Brexit, such as talent shortage and reduction of client spend outside the UK. In fact, most felt that Brexit will be 'much ado about nothing' for them. Perhaps it is too early to tell…

MANY AGENCIES HAVE INVESTED HEAVILY IN TECHNOLOGY AND DIGITAL CAPABILITIES OVER THE LAST FEW YEARS AND THIS HAS BEEN REFLECTED IN DECLINING MARGINS.

About Kingston Smith

Kingston Smith LLP is one of the UK's top 20 audit and accounting firms, and a founding member of Morison KSi, a worldwide association of independent accountancy firms.

Kingston Smith's West End office, with its team of six partners and 60 staff, specialises in advising media businesses. We are able to provide a full range of audit, accountancy, tax and corporate finance services, as well as specialist ad-hoc advisory services on all financial issues. 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.

Our clients are spread across the media sector, covering all the key disciplines within marketing services, TV and commercial production, media technology, publishing, consulting, live entertainment 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 businesses' 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 network to assist you locally. As part of our international focus, we are also commercial partners of www.thecreativeindustries.co.uk. Developed by industry and government, this portal aims to celebrate UK successes globally and increase international trade and inward investment in the creative sector.

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

Kingston Smith's 2016 M&A Highlights

Our corporate finance team is proud to have advised on the following media transactions in 2016:

Digital
Sale of majority stake in Code Computer Love to Mediacom, part of WPP
Lead Adviser

PR
Sale of House PR to W Communications
Lead Adviser

Media
Management Buy Out (MBO)
Corporate Finance Advisers

Digital
Sale of Flipside to Weber Shandwick, part of the Interpublic Group
Corporate Finance Adviser

Media
Growth Capital Fundraising
Lead Adviser

Marketing Services
Acquisition of The Brooklyn Brothers by Golin
Transaction Tax

PR
Sale of 3 Monkeys Communications to Zeno Group
Transaction Support

Marketing
Sale of 4Ps Marketing to NetBooster Group
Transaction Tax

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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