UK – Smaller Companies

Sector: Media, AIM

Apace Media

Initiation of coverage

15.5p

31 January 2007

Company Note: APA.L

12 Month	Market Cap
Buy	**£13.8m**

12m Range (p)	15.25 – 23.5
Price target	20p
Confidence in estimates	Low
Expected movement in ests	⇔
Company code	APA.L
Avg. daily volume	164,461
Shares in issue	89.0m
Net cash (E)	£1.9m
Next news	April - Finals

Activities

Apace operates a group of television channels in Bulgaria and Macedonia, and has an intellectual property company, focused on television production, in the UK.

Analyst

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Emerging picture coming into focus

Apace is a young entrepreneurial company exploiting opportunities in two interesting areas. Its television production company, which it is building organically, has had a good run of early successes having attracted a high calibre of key staff. The Eastern European broadcasting interests are enjoying rapid progress through high growth in local advertising markets as well as internal improvements in sales and management. Both sides of the business have scope for significant development, but the multiple of 10.0x to December 2007 as yet fails to recognise that potential. We are initiating coverage with a Buy recommendation and a target price of 20p, giving upside of 29% on the current price.

Year to December	2005PF	2006E	2007E	2008E
Sales (£000's)	5,656	10,747	18,908	22,041
EBITDA (£000's)	548	450	2,479	3,356
PBT (£000's)	262	28	2,035	2,912
EPS (p)	-	(0.23)	1.55	1.79
DPS (p)	-	-	-	-
PER (x)	-	-	10.0	8.7
EV/EBITDA (x)	28.7	34.9	6.3	4.7
Yield (%)	-	-	-	-

- **Content creation – organic growth to build valuable business.** Apace has attracted an excellent team to build a strong new independent television producer. Recognising the costs and uncertainties of building such a business through acquisition, it has set out to do this organically, and has scored early successes with commissions from the BBC and National Geographic. This business is expected to continue its rapid growth over the coming years on the basis of existing capacity and will add new talent to the team as opportunities arise. As well as the main television production business, Apace also owns growing businesses in music and sports television production.
- **European Broadcasting – opportunities in emerging markets.** Apace has established a presence in two Eastern European markets, Bulgaria and Macedonia. It is well placed to grow in these countries through high market growth and better management. Apace is also looking for further acquisition opportunities in its existing countries of operation and in other parts of the region. Apace has a stated intention of acquiring a station in Albania, and we believe that the recent fund-raising was in part to enable such a transaction. The individual operations are enhanced through being part of a group, with better content, better access to advertisers and better management.
- **Multiples do not match high growth potential.** The shares currently trade on a multiple of 10.0x against earnings to December 2007 falling to 8.7x to December 2008. We believe that these multiples fail to recognise the growth potential within Apace's businesses. Nor do they match up to the comparators on a sum of the parts basis. Our sum of the parts valuation, with discounts applied to the more established competitors, suggests a price range of 17p to 23p. Given the rapid growth of the company and the early stage of its development, there is some uncertainty as to estimates, but that uncertainty is for upgrades as well as downgrades. Should Apace hit our 2007 numbers, we believe that it will merit a significant re-rating. Evidence of this should come from news flow throughout the year regarding new television commissions and progress updates regarding Eastern Europe at the time of the results in April. We are initiating coverage with a Buy recommendation and a 20p price target.

Investment case

Growth from two key sources

The growth story at Apace has two distinct elements, content creation (mainly television production and music) and Eastern European broadcasting. We believe that both strands have significant growth potential, which is not fully reflected in current forecasts.

TV production, to be built organically

- **Content Creation – clear organic growth strategy.** The strategy within television production is to build a sizeable operation through organic means. This relies on the ability to attract talent and win commissions. Apace bought Steadfast as a start-up in late 2005 to achieve this, and progress to date in the pace of growth and commissions won has been impressive.

Early successes as a result of recruitment of good people…

…and excellent industry relationships

  - ***Good creative talent recruited –*** Steadfast has been able to attract good people by offering them the chance to be an important part of a growing operation, with the further attraction of equity participation through options.
  - ***Excellent industry relationships –*** It has also won commissions through excellent relationships within the industry. Over time, these commissions will provide Apace with a catalogue of content over which it has full control and which can be exploited internationally.
  - **Deterred from acquisitions by high prices –** Although this strategy carries some significant unknowns, Apace is deterred from acquisitions because of the high multiples payable. Given that television production also relies heavily on its key people, acquisition is not necessarily a route to long-term success.

It is certainly easy to see how Steadfast can add value to Apace. The unknown elements are the speed and extent of this growth potential.

The Music operations are also enjoying high growth, having been bought out of administration several years ago and turned around. A recent deal with Sony BMG has given Apace access to better content and this should continue to drive growth over the coming year.

Eastern European broadcasting offers opportunities for growth through growth in the ad market…

- **Eastern European Broadcasting – increases in advertising and carriage fees along with expansion through acquisition.** Within broadcasting, there are a number of facets to the growth strategy.
  - ***Advertising market growing very strongly –*** the developing economies in which Apace is operating have huge potential for growth in their advertising markets. This is driven in part by economic growth, and helped by EU accession. As these markets develop, major advertisers are entering or increasing their presence.

…increased market share…

  - ***Opportunity to increase advertising market share –*** Apace is able to bring some expertise to the sales of advertising. As its footprint builds, it is also better able to build relationships with advertisers and media buyers, with the possibility of pan-regional advertising. Furthermore, with improved content and programming, it should be able to increase its audience share, with consequent benefit to its advertising sales.

…higher carriage fees…

  - ***Increase in carriage fees –*** Apace's Bulgarian stations have invested in must-have content and, as a result, have been able to raise carriage fees aggressively. It believes that its carriage fees are still low in relation to the competition, and, with compelling content, it should be able to raise its fees further.

…and further acquisitions and launches

  - ***Acquisitions and launches –*** Apace believes that it will be able to make further well-priced acquisitions that it can then improve in terms of audience and advertising income. Alternatively, there are opportunities to revamp existing channels or to launch new ones. There is also the opportunity to share content across channels and territories with the effect of either reducing overall cost and/or improving the quality of the content. For example, when Apace recently acquired rights to the Spanish football league games in Bulgaria, it also took the Macedonian rights. We expect that in future it will do more such deals on a regional basis, which is attractive to a rights holder and so likely to represent a better deal for Apace.
  - ***Strong local team –*** Apace has invested heavily in setting up a management team in Eastern Europe to grow this business, both organically and through acquisition.

- **Attractive valuation –** Apace is seeing good growth in its sports production business, Proactive Sports, but it is Steadfast, Music and Eastern European broadcasting that will drive the share price.

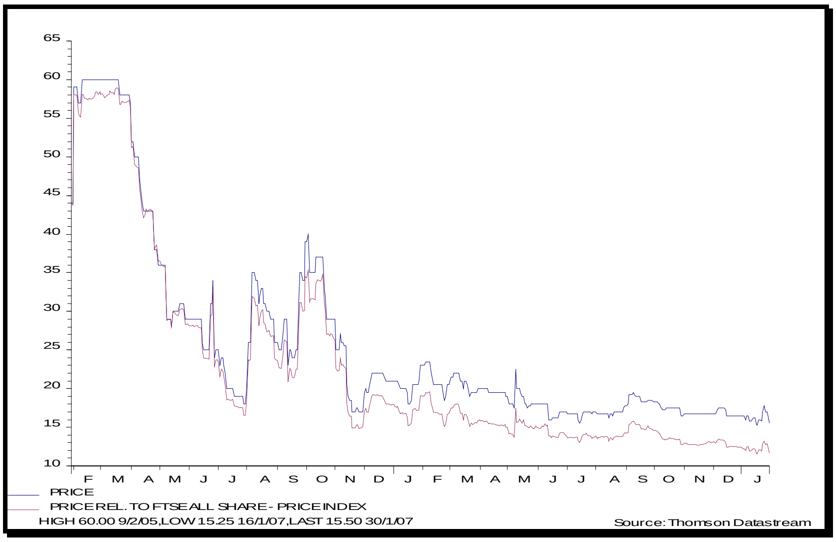
- **Significant growth forecast –** Our estimates foresee significant growth in these key areas. This necessarily involves some uncertainties as to the quantum and timing of growth, but in the round we do not believe that they are unrealistic. We also see good scope for continued growth thereafter, so we do not see the FY07 multiples as aggressive.

Investor concerns

- **Overseas operations –** a significant part of Apace's operations are in Eastern Europe. While this developing market offers significant opportunities, it is not without risk – political and economic. Furthermore, it is hard for investors to monitor progress or recognise threats in a timely manner other than through the company. We note above that, while in the medium to long term we see significant growth opportunities, there is significant uncertainty as to the speed/timing of such growth. That said, Apace has invested heavily to recruit a strong local management team to expand the business through acquisition and build it organically.
- **Competitive threat/sports rights –** Diema is viewed as having "must-have" content, ensuring that it is an important part of a cable package. In turn, this has allowed it to push its carriage fees in recent periods. The most important element of that "must have" content is sports rights which come up periodically for tender. The English Premier League rights are probably the most important element in the portfolio, with these rights recently secured through to 2010. We expect that its strategy of acquiring assets in other parts of the region will enable it to bid for such rights on a regional basis, which should be more attractive to the rights owner.
- **Speed of development within television production –** Steadfast has been very successful in its short life to date in winning commissions, but it is still hard to extrapolate this success very far. Revenue streams within television production are lumpy, especially in the early days without a substantial back catalogue or on-going formats. While we expect Steadfast to continue to develop successfully, the rate of such development is unpredictable.
- **Mix of business –** The union of a UK-based content business with an Eastern European broadcaster is not immediately obvious, and it is therefore questionable whether these businesses should be under the same corporate roof. But in reality there are some synergies: firstly, there is an increasing requirement for production know-how within the broadcasting business; and the Eastern European market provides a cheap testing ground for certain television formats which can then be enhanced and adapted for the more expensive (and more lucrative) UK and US markets.
- **Loss of key employees –** Apace has a number of key employees, but we consider them generally to be highly committed through economic interest. Didier Stoessel is the entrepreneurial force behind the business, especially the Eastern European expansion. His 25.8% shareholding means that he is unlikely to move. Charles Thompson is similarly tied in through his interests in Apace and his minority interests in Steadfast.
- **Corporate governance –** Didier Stoessel holds the role of Chairman and Chief Executive.

Share price performance

The shares have experienced significant volatility since the time of the reverse in February 2005, reaching 42p in September 2005 and falling as low as 15.25p earlier this year. This is the result of uncertainties as to the speed of development with the market getting ahead of itself at times. We anticipate that this volatility will reduce as trading becomes more predictable.



History

Set up in 2002 – entrepreneurial and fast-growing

Apace was set up in 2002 by Didier Stoessel. He established and acquired operations in content ownership and creation, distribution and rights exploitation. As a young private company, Apace was highly entrepreneurial and grew quickly.

Listed through reverse into cash shell

In **April 2005**, Apace obtained a quote through a reverse into FTV, a cash shell. FTV had been established several years before to provide advertising on garage forecourts, but its business had failed to gain critical mass. At the time of the reverse, Apace was valued at £4.1m. A placing at the time of the reverse raised a further £2m at 30p per share.

Acquired first Bulgarian TV assets, MMTV

In **September 2005**, Apace made its first acquisition in the Eastern European television sector, paying €660k for a 66% stake in MM Televizia. MM's main assets were two Bulgarian music television channels, MMTV and M2, distributed on cable and satellite.

Acquired Steadfast, a start-up TV production company

Also in **September 2005**, Apace appointed Chris Rowlands and Charles Thompson to the board. These appointments heralded the acquisition of 75% of Steadfast Television from these directors in **November 2005** and marked Apace's expansion into entertainment and documentary television formats.

Acquired further Bulgarian assets, Diema TV

In **December 2005**, Apace raised £7m in an institutional placing at 15p per share. It also announced the acquisition of a 50% stake in Diema, a multi-channel Bulgarian broadcaster, with an agreement to acquire a further 16% over the next two years. The acquisition of the 50% stake was completed in **January 2006**, and the 16% interest was subsequently acquired in April 2006. The total consideration for that 66% stake was £3m.

Through 2006, Apace has announced several key hires in its Steadfast Television subsidiary. It now has all its key personnel in place.

Acquired TV Era in Macedonia

In **November 2006**, Apace announced the acquisition of TV Era, a Macedonian terrestrial television channel. This is a small channel, but represents the first steps outside the original Bulgarian territory, and we expect further acquisitions in Macedonia and elsewhere in Eastern Europe.

In **December 2006**, Apace announced that it had raised a further £3m (gross), placing 20m shares at 15p. These funds are to be used for acquisitions and further investment in existing activities, especially Eastern European broadcasting and television production.

Operational overview

Apace operates in two distinct markets – Content Creation and Eastern European Broadcasting. Content Creation operates in television production and music. Broadcasting currently consists of several channels in Bulgaria and a newly acquired station in Macedonia. Apace is also examining opportunities in other Eastern European territories.

Content Creation

Content creation made up of TV production, sports TV production and music

Apace has a number of content creation, distribution and exploitation businesses, all based in the UK. The lead business going forward is ***Steadfast Television***, set up last year by Chris Rowlands and Charles Thompson to produce factual and entertainment programming. Within television, the other main business is ***Pro-Active Television*** (sports programming). ***Apace Branded Content*** (advertiser funded programming) has been folded into these operations and now operates as ***Steadfast International***, acting as Steadfast's distributor. ***Apace Music's*** main activity is the sale of compilation CDs and the exploitation of Apace's own library of music rights.

Steadfast established in 2005 create significant TV production business through organic means

Steadfast Television. Steadfast was established in 2005 with a plan to grow a substantial production business through organic means, with the company wary of high multiples being paid for such businesses. Steadfast has already grown significantly in terms of headcount and commissions, with 50 hours either produced or in development in its first twelve months.

Early successes from recruitment of well-respected industry professionals

These early successes can largely be put down to recruiting high-quality, experienced people from the industry. Several of these have come from former Television Corporation companies, Mentorn and Sunset + Vine. Steadfast has been able to attract a high quality of staff as it offers an opportunity to join a well-financed, potentially high-growth operation, led by people with a proven track record, at an early stage. Steadfast has now assembled all the key personnel for its team in terms of creative, production and sales, although it will continue to recruit on an opportunistic basis.

That high quality track record, for both creativity and timely delivery, has enabled Steadfast to win more than its fair share of commissions, even at this early stage.

- *Fans United* was produced by Apace Branded Content for Unilever and was aired in the UK on ITV, running for nine weeks over summer 2006. This focused on football fans across a number of countries (Britain, Germany, Russia, Holland, Spain, Portugal, Brazil and Argentina) and their passion for the game. An international version, over 12 parts, has also been sold in 35 overseas territories.
- *Sky Cops* was shown at prime time (8pm to 9pm) on Wednesday evenings on BBC1 in Autumn 2006. It follows teams of police air support units in London and South Yorkshire. This is a five part series with significant potential for export, with the first overseas sales now completed. In the UK, it scored a 21% share of viewing, which is among the highest all year in that time slot. A second series of this programme is now in the final stages of being commissioned.
- The BBC has made two further commissions, *They Stole My Life* and *Closed Circuit Television*. *They Stole my Life* is an hour long special documentary about identity theft. *Closed Circuit Television* is two one-hour specials looking at the use and impact of CCTV in the UK.
- National Geographic has commissioned four hour-long programmes, *Earth Shocks*, and is believed to be close to completing the commissioning of a further of eight hour-long programmes (*Salvage Code Red*) in partnership with Discovery Canada.
- Discovery Canada is also expected soon to commission four hour-long programmes titled *The Art of Manipulation*.
- ITV has commissioned a factual entertainment pilot programme, *My Cousin…*, which has enormous potential if the pilot proves successful.

Steadfast currently specialises in popular factual television, but it intends to expand into other genres through the recruitment of creative talent with the appropriate specialisms when opportunities arise.

Sector is highly fragmented, including a handful of small cap quoted competitors

Competition in this area comes from the vast number of independent production companies. The quoted sector includes such entities as RDF Media, Shed, DCD Media, Ten Alps and Tinopolis.

Independent TV production market estimated at c £1bn

The UK production market is estimated to be worth approximately £2.5bn, with the BBC's own production activities being the biggest part of that at c 30%. The independent market is estimated at just over £1bn, with some 800 independent production companies.

Sector in good health with higher demand for independent production and benefits of international rights exploitation

The independent sector, although competitive, is generally in good health. This comes as a result of channel proliferation increasing the demand for content, a move for higher levels of independent production at the BBC, and the ability since the introduction of the Communications Act to retain rights for exploitation either internationally or at the end of the licence period.

Pro-Active produces 200 hours of sports content annually

Pro-Active Television. Pro-Active is Apace's sports television producer. It was bought out of receivership in 2002, having previously formed part of Sportsworld Media Group. Pro-Active produces over 200 hours of sports coverage annually for broadcasters around the world. As well as direct coverage of sports events, Pro-Active also repackages content into high-quality magazine-style programmes which it sells internationally.

Channel proliferation means that there is high demand for such content

The proliferation of sports channels internationally seeking to provide 24 hour output means that there is healthy demand for a wide variety of such packaged sports content. Pro-Active supplies over 100 hours of content annually to each of Sky Sports, FOX Sports and ESPN Star.

Recent successes in rugby coverage

Pro-Active specialises in rugby (which makes up some 50% of total production), waterskiing, sailing, squash and rallying. It has recently been particularly successful in its rugby coverage, where it has a partnership with the International Rugby Board. Under this partnership, it now produces and distributes coverage of all the IRB events outside the main international arena. This includes the Under 19s World Championships in Dubai, the Under 21s World Championships, the International Rugby Sevens series, the Sevens World Cup in Hong Kong and the Women's World Cup.

Pro-Active has succeeded in registering a vast increase in rugby broadcast coverage. In the Sevens World Series, in which Pro-Active was first involved in 2004, overall coverage has more than tripled and live coverage is six times higher. Pro-Active's rugby is now available in over 250 million homes across 80 countries.

Pro-Active's packaged programmes include *Destination Adventure* (adventure travel), *Hot Water* (watersports), *Sports Mania* (extreme sports), *Race World* (motor racing), *Spectacular Squash, Spectacular Places* (squash) and *IRB Sevens* (rugby).

Steadfast International Limited. Steadfast International Limited acts as Apace's television distributor. It originally operated as Apace Branded Content (ABC), providing advertiser-funded programming and, while its focus is now on distribution, it will continue to look for opportunities in this field. This shift in emphasis makes use of ABC's skill in distribution and has the advantage of retaining the distribution margin within the operation.

ABC has produced two series to date, one for Unilever and one for Nissan, with a renewed commission from Nissan under production. For Unilever, it produced *Fans United* (see above) to reach a young male demographic with its Sure brand both here and in other territories. For Nissan, it produced *Nissan Sports Adventure*, 26x30 minute programmes of exhilarating sports action from exotic locations around the world. *Fans United* was distributed free to broadcasters in territories where Unilever sells the Sure or Rexona brands. Outside these territories, Apace owns and sells the rights to the programme. *Nissan Sports Adventure* is provided free of charge to broadcasters around the world.

Advertiser-funded programming – an alternative to the 30 second slot

Advertiser-funded programming is intended to provide an alternative means of exposure to the traditional 30 second advertising slot. For the cost of producing a series, an advertiser can have regular and repeated exposure to audiences internationally, with content either supporting its brand and/or targeting its core market.

Apace has particular expertise in this area derived from the history of many of its people at Television Corporation, which produced Gillette World of Sport for many years.

Limited acceptance of advertiser-funded programming for the time being

While there appears to be clear logic to the advertiser-funded programming concept, in reality the market has been slow to develop. In the UK, the BBC is unable to take such programming. Among the commercial broadcasters, ITV is generally reluctant to take advertiser-funded programming for reasons of quality and control, and the other commercial broadcasters do not have the potential, in terms of commercial impacts, to justify the expense. From the advertiser's perspective, there are also relatively few truly global brands to commission such programming. For these reasons, ABC has now been integrated into Steadfast, to be able to offer this service in time but recognising that current demand cannot justify the overhead expense of a separate operation.

Compilation CDs for the mid-price and budget market

Apace Music. Apace's music business produces CD compilations made up of tracks from its library of owned and licensed music. These are sold in the mid-price and budget markets in the UK and internationally. These CDs have a good gross margin (c 40%) and, as compilations, generally carry low levels of risk compared to new music.

Now selling over 1 million units annually

In 2005, Apace Music sold over half a million units, releasing 80 different albums on a range of labels, the main ones being Bar de Lune ("chill-out" albums), Mastercuts (classic artists across funk, soul and reggae) and Pure (mood music). In 2006, we believe that Apace sold over a million units.

Recent deal gives Apace access to Sony BMG catalogue

Apace has recently agreed a deal with Sony BMG, giving Apace access to Sony BMG's catalogue. This will allow Apace to produce a higher quality of compilation, so achieving higher sales volumes, with those volumes also being at a higher price. While this may imply a lower percentage margin, it should equate to a higher absolute margin per unit with more units sold. Apace has also extended its distribution into the US, opening up a large new market.

Impulse purchase, so should not be effected by rise of on-line music

Although the market for hard-copy music formats is under considerable pressure from online offerings, we do not believe that this has a significant effect (either opportunity or threat) on Apace's business. Its products sell mostly as impulse purchases from general retailers and so are unlikely to be the victim of substitution.

In H1, Apace Music had a 30% increase in sales to c £1.3m. We expect it to have accelerated further during H2, producing total sales of approximately £3m, over 60% up on the prior year.

Eastern European Broadcasting

Diema and MMTV in Bulgaria

Apace's broadcasting activities are founded on two acquisitions in Bulgaria. In September 2005, Apace acquired a 66% stake in ***MM Televizia*** for €660k. This was followed up by the acquisition of ***Diema*** in January 2006 (50%) and April 2006 (16%) for a total of £3m.

TV Era in Macedonia

That has recently been backed up by a small acquisition in Macedonia – ***TV Era*** *(66%)*, an Albanian language terrestrial station. The consideration for this acquisition was not disclosed, but we do not expect it to have been high given the size of the station.

BULGARIA

Diema has a suite of four channels with a particular strength in sport.

- ***Diema +*** was the original channel, launched in 1999. Its core focus is sports and movies
- ***Diema 2*** followed in 2003, offering movies, news, entertainment and domestic sports
- ***Diema Extra***, launched in 2005, is a subscription channel with premium content in international sports and movies.
- ***Diema Family*** is the most recent addition, coming on air in July 2006. As the name suggests, this is aimed at children and families. The launch has been successful, with ratings increasing.

Key sports rights mean that Diema is in high demand

Diema has a number of key sports rights that make it an important part of a cable offering. These rights include English Premier League football and the French and Spanish equivalents. Diema has also recently won the rights to the UEFA European 2008 Championships, breaking the state monopoly on such rights. Apace has secured key sporting rights for English, French and Spanish football which it believes make it the dominant sports channel through to 2010. It also has the leading tennis rights, with Wimbledon and the ATP Masters.

Among the leading non-national channels

Excluding the three national terrestrial channels, Diema + and Diema 2 are normally ranked within the top three stations in Bulgaria as measured by reach. Diema Family, which was launched recently, is currently lagging, but Apace believes that it can exceed the ratings of its predecessor, Alexandra TV, which it replaced in July. Alexandra, also Diema owned, ranked sixth in reach in January, excluding the national stations.

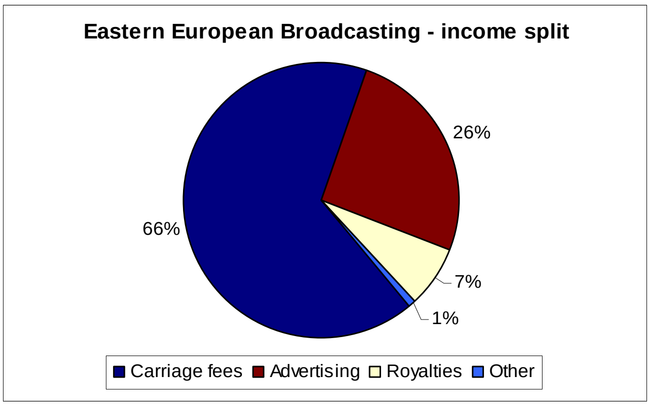
Diema also acquires local Bulgarian rights to major cinema releases, selling these rights into cinemas and using them for its own television channels and DVD releases.

Bulgaria's answer to MTV

MMTV, launched in 1996, was Bulgaria's first music channel, and was supplemented by MM2, specialising in local music, in 2003. These are equivalents to MTV for the Bulgarian market. MM Televizia also owns a local record label and a television production business.

Income mainly from carriage fees and advertising

Apace's income from its broadcasting comes mainly from a mix of carriage fees and advertising. It is enjoying significant increases on both fronts. It also receives smaller amounts from royalties and pay-per-view income.



Source: Charles Stanley estimates

Recent rises in carriage fees, but scope for more to come

Quality content makes it a must-have channel for cable operators

Carriage fees – Apace charges carriage fees to cable operators to include the Diema and MM channels in its offerings. Management believes that its current carriage fees are low despite double digit increases in the last two years. This is based on a "cost per subscriber" calculation, which shows Diema below the industry average. Furthermore, given its high quality content, management further believes that it merits a premium to that average. Diema was recently taken off one of the leading cable operators during renewal negotiations, but was reinstated at a 20% fee increase after a spike in customer churn during the period when Diema was unavailable. That 20% increase was imposed across the board from 1 January 2006, so we expect significant revenue increases from this source over 2006. We expect further significant increases over 2007, in part reflecting the increased cost of sports rights.

Significant scope for advertising growth

Advertising – In 2005, Apace's pro forma advertising revenues from Bulgarian television were some £500k. There appears to be significant scope for growth in this revenue stream on a couple of counts.

Share of advertising lags its share of viewing – better management to address this imbalance

- First, Apace's share of advertising income significantly lags its share of viewing (share of advertising 1%, share of viewing 5%). Apace has reorganised its advertising sales department, and is already making inroads in growing its advertising revenues. In H1, advertising revenue grew by 100%. This is largely a function of advertising volumes, with the number of adverts screened on Diema channels soaring from 2,339 during October 2005 to 9,014 in October 2006.

Whole advertising market growing rapidly

- Secondly, the Bulgarian advertising market is far from mature. With rapid economic development and recent entry into the European Union, it is set to continue its high growth. In 2005 it grew by over 30%, with television advertising increasing 27%. Television advertising expenditure per head in Bulgaria stood at £18.30 for 2005 against £79.53 in the UK. Adjusting for the different GDP per capita (UK GDP per capita is some 3.1x that of Bulgaria), Bulgaria still lags significantly.

Apace believes that it has the infrastructure in place to manage a much larger operation in the region, having recruited a heavyweight local management team with both transaction capabilities and on-going management skills. The operational gearing benefits of this should be evident over the coming periods.

Background information on Bulgaria

Bulgaria has a population of approximately eight million. It joined the European Union on 1 January 2007, and this is expected to provide significant economic benefits. These come in the form of grants and additional inward foreign investment, which stood at €2.3 billion in 2005. Growth in GDP has been healthy, with annual real growth recorded between 4.1% and 5.7% for each of the last five years, with similar levels of growth anticipated for the next three years (source: Economist Intelligence Unit).

Bulgarian television market

Bulgaria has three national terrestrial services..

There are currently three national terrestrial television services. Bulgarian National Television (BNT) is the state-owned channel, with Balkan News Corporation (bTV) and Nova TV as commercial operators, owned by News International and Greece's Antenna Group respectively. As well as the national terrestrial services, there are also a small number of local terrestrial services.

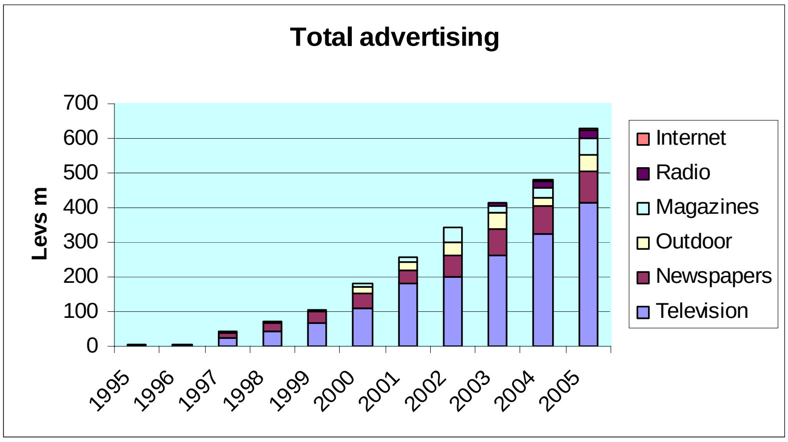
…and numerous cable and satellite channels

There are numerous cable and satellite channels, with Apace's Diema and MM families being among the leaders in this field. A large proportion of the population receives such services, with c 69% of citizens having access to cable television. According to Zenith Optimedia, a typical basic cable subscription costs 15 levs per month, roughly equivalent to £5.00-£5.50.

Provision of cable television is highly fragmented

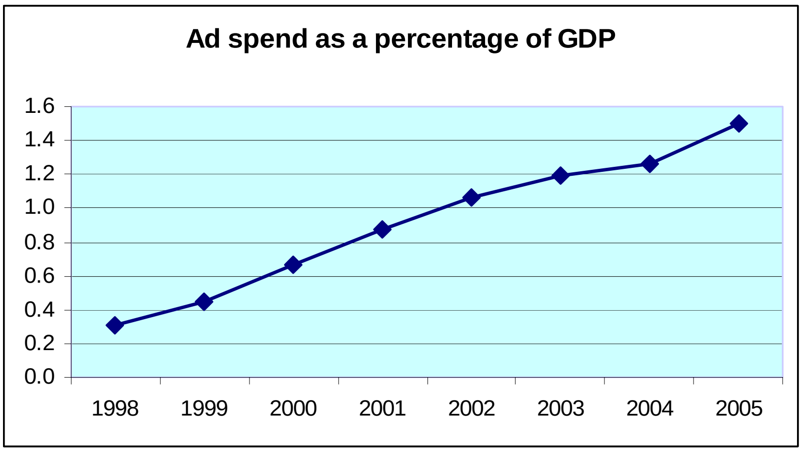
The provision of cable television is very highly fragmented (some 2,500 operators), with some operators covering just small towns or even villages. There are, however, several large cable suppliers (e.g. CabelTEL, Evrotur Sat TV, Eurocom Cable) operating in the major cities, and these operators are slowly leading a consolidation in the market.

Ad market has developed rapidly from low levels



Source: ZenithOptimedia

The advertising market has had explosive growth from its former low levels. The total ad market was worth 630 million levs in 2005, some £218m. Growth in television advertising has been high throughout this period, coming in at 31%, 25% and 27% in 2003, 2004 and 2005 respectively.



Source: ZenithOptimedia

Ad spend as a percentage of GDP still lags some of the stronger economies in the region

Ad spend as a percentage of GDP has also risen sharply. For 2005 this stood at 1.50%. While this is now higher than many in the region, it still lags some of the stronger economies such as Hungary (2.29%), Serbia (2.18%) and Slovakia (2.05%). By way of comparison, the US has been between 2.22% (2005) and 2.52% (2000) for the last decade.

MACEDONIA

TV Era is Skopje's most established Albanian language station

***TV Era**,* set up in 1994, broadcasts mainly in and around the capital, Skopje, and is the most established Albanian language station in this area. It currently has a high degree of focus on news and current affairs, and produces a significant proportion (c. 50%) of its output in-house. Its schedule also includes sports, entertainment and children's programming.

Opportunities include…

This acquisition presents several opportunities for Apace:

…ad market growth…

- Advertising market – the Macedonian advertising market has significant scope for growth as the economy develops;

…better management of ad sales…

- Advertising sales – Apace believes that it can bring greater know-how in the selling of advertising on Era, so increase sales that way as well as benefiting from the market growth referred to above;

…improved viewing from better programming and access to content, and…

- Programming and content – Apace also believes that it can run the station better, using its expertise from its Bulgarian channels. In terms of content, it can share some of its content across geographical markets and will in future be able to buy rights on a regional basis rather than a country by country basis;

… further acquisitions, either to serve the Albanian community outside Skopje or to address the Macedonian community

- Further acquisitions – we expect that Era is a first foothold in Macedonia. As it focuses on the Albanian community in Skopje, there is significant opportunity to expand geographically or to focus on the Macedonian community. If Apace is to acquire national rights to content, it will want to maximise this through wider audience accessibility. Also, this acquisition adds impetus to the intention to acquire in Albania, as a large amount of content can be then shared.

Background information on Macedonia

Macedonia has a population of approximately two million. Its population is made up mainly of Macedonians (64%) and Albanians (25%). It is an EU Candidate country and is expected to become a member in 2010. GDP growth has picked up in recent years, reaching 4.1% and 3.7% in 2004 and 2005 respectively after periods of instability several years ago. The EU has recently forecast faster rates of growth through to 2008 (3.8% for 2006, 4.5% for 2007 and 5.5% for 2008).

Macedonian television market

Macedonia has six national terrestrial television channels, three of which are private and three of which are state-owned. There are a further five channels achieving national coverage through cable or satellite distribution. There is also a large number of local stations (more than 50). Given this level of fragmentation in a country with a small population – and this population falling into two main language groups – there is significant scope for consolidation, with potential for audience growth through quality content.

There are some 60-70 cable operators offering 20+ channels, made up of national, local and international stations.

Management

The management team at Apace provides a good combination of financial acumen, entrepreneurship, transaction capability, and creativity.

Didier Stoessel, Chairman and Chief Executive, founded Apace in 2002. Stoessel has spent most of his career in investment banking with Merrill Lynch and HSBC, eventually becoming Chief Executive of Corporate Finance at HSBC, a position he left in 2001.

At Apace, Stoessel has day-to-day responsibility for the European television operations. As a former corporate financier, he is also well qualified in identifying and assessing possible acquisition targets.

Charles Thompson, Chief Executive of Steadfast Television, is a highly experienced television executive. Starting his career at the BBC and Thames Television, he has since spent over twenty years in the independent sector. In 1992, he founded Folio Productions, which was sold to Mentorn in 1997, which in turn became part of Television Corporation in 1998. At Television Corporation, Thompson became managing director of Mentorn, and was a main board director. Thompson set up Steadfast Productions with Chris Rowlands in 2005 and is the managing director of this business at Apace. He retains a minority holding in Steadfast.

Martin Johnston, Finance Director, joined FTV in August 2000, ahead of its flotation, and has continued with the group following its reverse take-over of Apace. Prior to joining FTV, Martin held a number of senior financial roles with industrial companies, most recently as Finance Director of Servomex from 1994 until its sale in 1999.

Chris Rowlands resigned unexpectedly as Chief Operating Officer earlier this year having joined Apace in September 2005. While we regard this as a loss to the group, we do not believe that his departure is any cause for concern. Rowlands has a reputation as a recovery expert (HTV and Television Corporation) and we understand that, once Steadfast was up and running, he did not feel that there was enough of a challenge for him at Apace. We take some comfort that this implies that Steadfast is running smoothly, especially as Rowlands remains a significant shareholder in the group.

Financial overview

Fast-growing, but limited history makes short-term patterns harder to discern

Apace is a fast-growing, young business with a limited financial history. It is the product of several acquisitions and start-ups. As a result, the near-term trading patterns are perhaps harder to discern than normal. We therefore caveat these estimates as being a best estimate, but speed of growth, timing of commissions and the need for further investment may lead to changes, both positive and negative.

Year to December, £'000	2005PF	2006E	2007E	2008E
Content Creation	3,082	7,361	14,295	16,874
Eastern European Broadcasting	2,574	3,386	4,613	5,167
Sales	**5,656**	**10,747**	**18,908**	**22,041**
Cost of sales	(2,977)	(6,552)	(12,332)	(14,506)
Gross profit	2,679	4,195	6,576	7,535
Margin (%)	*47.4%*	*39.0%*	*34.8%*	*34.2%*
Other Op. Expenses	(2,443)	(3,745)	(4,097)	(4,179)
Content Creation	231	632	2,004	2,582
Margin (%)	*7.5%*	*8.6%*	*14.0%*	*15.3%*
Eastern European Broadcasting	683	693	1,425	1,774
Margin (%)	*26.5%*	*20.5%*	*30.9%*	*34.3%*
Central costs	(366)	(875)	(950)	(1,000)
EBITDA	**548**	**450**	**2,479**	**3,356**
Margin (%)	*9.7%*	*4.2%*	*13.1%*	*15.2%*
Depreciation	(312)	(472)	(544)	(544)
EBITA	**236**	**(22)**	**1,935**	**2,812**
Margin (%)	*4.2%*	*-0.2%*	*10.2%*	*12.8%*

Source: Company, Charles Stanley Securities

Changes in margin a function of start-ups and changing mix

The pattern in margins seen in the table above is a product of the changes happening within the business. Margins for 2006, and to a lesser degree in 2005, are depressed by the start-up costs at Steadfast, which is now running at a full fixed overhead but still developing in turnover terms. We expect this to move from a small loss in 2006 to a profit of c £800k in 2007, giving a margin of 10.4%.

37% turnover growth in H1

European Broadcasting – the Bulgarian channels enjoyed turnover growth of 37% in H1, with advertising income more than doubling and carriage fees rising by 20% after a price increase.

Double digit growth in advertising in the medium term

We believe that advertising has significant growth potential, with the market growing by an estimated 15% and Diema especially catching up in terms of its share. We believe, therefore, that double digit advertising growth should be achievable in the medium term, although the level of H1 growth is clearly not sustainable.

Further rises in carriage fees to come

In terms of carriage fees, we believe that there is limited scope for "volume" increases, as Apace's channels are already widely available, but expect to see further growth through price increases. We understand such increases for 2007 to be at a similar level to, or possibly even higher than, the 20% increases seen at the start of 2006.

Costs also increasing as Diema secures must-have content, especially sports rights

While most of the costs involved are largely fixed, one important element, content, is not. Diema has built up a significant presence on the back of must-have content. This includes bidding for rights, such as the English Premier League rights. We believe the cost of such rights to be increasing, countering some of the benefits from the higher income. However, we anticipate that Apace should see margins increase substantially as a result of the feed through of the increases in advertising and carriage fees.

TV Era still small, so good scope for growth

The Broadcasting division now includes TV Era from Macedonia. The revenue from this, as a terrestrial channel, is based on advertising, which we believe to be very small currently. The opportunity to build on this comes from improved programming, with the possibility of buying rights on a regional basis and repurposing content from Bulgaria.

Steadfast still in development phase – full overhead but turnover to increase rapidly from here

Content Creation – in the medium term, a large part of this division is based on ***Steadfast***, which is still very much in development mode. While the company is up to its full headcount and therefore its full fixed cost base, it is still building turnover, which is a lengthy process. Initially, this is in winning commissions, but in the longer term this has the benefits of back-catalogue sales. We base our forecasts for Steadfast on achieving sales of £2.8m for this year (implying an H2 turnover of £1.9m) growing to £8m next year. We anticipate that it will then be able to make a margin of c. 10%-12%.

Music growing rapidly and now to benefit from Sony agreement

The ***Music*** activities have been growing healthily. This activity is expected to receive a boost from the new deal with Sony BMG, giving Apace access to its back catalogue. We expect this to lead to higher sales volumes, and these at a higher price. On the other hand, the cost to Apace is higher than its normal output, so the operating margin, in percentage terms, is expected to fall, although this should lead to higher absolute profitability. We estimate operating profit of £0.5m from turnover of £3.0m in 2006, rising to £0.6m from £3.7m of sales in 2007.

Pro-Active making good progress recently but scope for high growth is limited

Pro-Active has had impressive increases in its output recently. While this may continue, we generally regard this business as having the lowest scope for absolute growth of Apace's operations in the medium to long term, given its focus on minority sports. While it has greatly expanded its rugby coverage, this is restricted to second rung competitions. That said, it is managing respectable levels of growth on a relative basis, with a respectable margin level.

As is to be expected in a fast-growing company, central costs are also increasing. From a pro forma £0.4m in 2005, we expect to see £875k in 2006 rising to £950k in 2007.

Apace currently has tax losses in the UK which should mean that it pays little or no tax on its UK activities until 2008. It is subject to tax in Eastern Europe at a rate of approximately 20%. For 2008, the growth in the business at the EPS line is underplayed, as the increase in tax rate limits the EPS growth to 15.5%, while the PBT growth is 42.2%.

Cash balances provide scope for acquisitions and investment

Apace finished H1 06 with cash balances of £1.8m. We expect H2 to have seen net cash edge up to £1.9m after increases in working capital and a small cash payment for Era, offset by £1.5m of placing proceeds. Thereafter, with profitable trading the company should be cash-generative. The recent share placing, raising £3m before expenses (of which £1.5m came in January 2007), provides fire-power for acquisitions in Eastern Europe and scope for investment to accelerate organic growth.

There are several minority holdings in Apace's portfolio. Apace owns 75% of Steadfast, with directors and staff holding the remaining 25%. There is also a 10% minority holder in Pro-Active. In Eastern Europe, Apace owns 66% of MMTV, Diema and ERA.

Investment case and valuation

Expectation of rapid growth

There are many reasons to expect Apace to grow rapidly both in terms of turnover and profitability.

Eastern Europe to grow through cost and operational synergies and through better management

In Eastern Europe, Apace is using its commercial know-how to increase revenues and profitability. The acquisition strategy offers the benefits of shared content, those benefits being in both cost and quality. It also offers the opportunity to provide attractive packages to advertisers.

Pieces in place for growth at Steadfast

In television production, Apace is building a valuable business organically. While this may take time to gain momentum, the evidence so far is that Apace has the people on board who can win commissions and then successfully deliver programmes.

We value these two elements separately, on the basis of our expectations for 2007. We believe that this is conservative given the growth that we expect thereafter and we demonstrate this by performing the same exercise for 2008.

Content valued against RDF and Shed

We value the content business against television production businesses, of which there are several on the UK market. The two leading companies in the UK small cap. arena are RDF Media and Shed Productions.

		PER adj to 31/12/07	EV/EBITDA adj to 31/12/2007
RDF Media	RDF.L	13.8	7.6
Shed Productions	SHD.L	11.8	6.7
Average		12.8	7.1

It is worth noting within the above table that the range of estimates for Shed is very wide as a result of some trading uncertainties. This follows the news that neither Footballers Wives nor Bad Girls is to be recommissioned, although Shed believes that it will win new commissions that will replace these earnings. The PBT estimates for the current financial year range from £5.8m to £8.4m and for the following year from £8.2m to £13.5m.

Below these, there are a number of companies in different stages of development such as Ten Alps, Tinopolis and DCD Media. For this second group of companies, there is insufficient data for meaningful comparison to Apace.

- Tinopolis is currently in loss, and expected to move into profit in the current year (to September 2007). Adjusted for a calendar year end, this gives a 16.0x earnings multiple for 2007 falling to 10.3x in 2008. Given the acquisition by Tinopolis of the Television Corporation, a larger entity than itself, in February 2006 there is still a significant degree of risk within these numbers.
- For DCD Media, there are no market estimates available beyond the current financial year (to 30 June 2007). The shares currently stand on a multiple of 20.5x to that date having been in loss for the previous two years. As with Tinopolis, recent acquisitions, three in the case of DCD, add to the risk profile of this company.

From the table above, we derive an earnings multiple for content creation of 12.8x for calendar 2007 (11.9x for 2008). With expected operating profits of £1.8m for this year, we believe that this business should be worth between £14.3m (based on EBITDA multiples) and £15.9m.

Comparators for the broadcasting business are CME and Modern Times

The best comparator for the broadcasting business is Central European Media Enterprises (CME), which operates in six countries in Central and Eastern Europe (Czech Republic, Croatia, Romania, Slovak Republic, Slovenia and Ukraine). Compared to Apace, CME is clearly more established, with operations addressing a wider total population, but it has clear similarities. CME is quoted on NASDAQ, has a market capitalisation of c $3bn, and trades on 28.5x to December 2007, falling to 18.0x for 2008.

An alternative comparator, albeit originally founded on more developed markets, is Modern Times Group, which offers pay TV channels in 21 countries and free TV channels in ten countries. MTG has its origins in Sweden but its operations stretch from Scandinavia into Central and Eastern Europe and through the former Soviet states. For 2007, the shares trade on an earnings multiple of 18.6x, falling to 15.9x for 2008.

Using that Modern Times 2008 multiple, recognising that CME has scale and an established track record, on our taxed operating profit (taxed at 20% local rates), we arrive at a valuation of £16.7m.

From these divisional valuations, we must also take account of central costs, cash balances and minorities. The minorities include a 25% stake in Steadfast, 34% stakes in Diema and MMTV and a 10% stake in Pro-Active.

	Basis	Value	10% disc.	20% disc.
Content Creation	12.8x FY07 (fully taxed op prof)	15.9	14.3	12.7
Broadcasting	18.6x FY07 (fully taxed op prof)	16.7	15.1	13.4
Central costs	10.0x FY07	-6.7	-6.7	-6.7
		26.0	22.8	19.5
Cash	CS year end estimate	1.9	1.9	1.9
Minorities	Multiples as above	-7.8	-7.0	-6.2
Equity value		**20.2**	**17.7**	**15.2**
Number of shares		88,959,742		
Value per share		23p	20p	17p

Valuation range produces upside of up to 39%

Our valuation table produces a value per share of 23p. We also display valuations taking a 10% and 20% discount to our multiples for content creation and broadcasting. These produce values per share of 20p and 17p respectively. This range gives a minimum 9.7% upside on the current price and a potential upside of up to 48%.

Looking at the same valuation table for 2008, the upside potential is considerably higher, although we recognise that the uncertainty to that point is greater.

	Basis	Value	10% disc.	20% disc.
Content Creation	11.9x FY08 (fully taxed op prof)	19.6	17.6	15.7
Broadcasting	15.9x FY08 (fully taxed op prof)	18.7	16.9	15.0
Central costs	10.0x FY08	-7.0	-7.0	-7.0
		31.3	27.5	23.7
Cash	CS year end 2006 estimate	1.9	1.9	1.9
Minorities	Multiples as above	-9.1	-8.2	-7.3
Equity value		**24.2**	**21.3**	**18.3**
Number of shares		88,959,742		
Value per share		27p	24p	21p

Value to be realised as business soon seen as more mature and with positive news flow on acquisitions

We see this disparity from the current price as the result of the early-stage nature of this company, but we expect a degree of maturity during the coming twelve months. Should the company achieve our estimates, which we do not believe to be aggressive, the resultant multiple (10.0x, albeit on low tax rate) should appear very cheap given the ongoing growth opportunities. Furthermore, with cash available for acquisitions and to fuel the organic growth (for which there are several clear opportunities) the news flow over the coming period should also attract positive attention.

Buy with 21p target

We initiate coverage with a buy recommendation with an initial 20p target. We see scope for significant upgrades to that target with confirmation of progress through the year and beyond.

Charles Stanley SECURITIES

Summary Profit and Loss Account

Year to December, £'000	2005PF	2006E	2007E	2008E
Content Creation	3,082	7,361	14,295	16,874
Eastern European Broadcasting	2,574	3,386	4,613	5,167
Sales	**5,656**	**10,747**	**18,908**	**22,041**
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Other Op. Expenses	(2,443)	(3,745)	(4,097)	(4,179)
Content Creation	231	632	2,004	2,582
Eastern European Broadcasting	683	693	1,425	1,774
Central costs	(366)	(875)	(950)	(1,000)
EBITDA	**548**	**450**	**2,479**	**3,356**
Depreciation	(312)	(472)	(544)	(544)
EBITA	**236**	**(22)**	**1,935**	**2,812**
Net interest	26	50	100	100
PBT - Normalised	**262**	**28**	**2,035**	**2,912**
Exceptional items		(150)	-	-
PBT - Reported		(122)	2,035	2,912
Tax charge		(89)	(225)	(724)
Minorities		(100)	(430)	(578)
Net Profit - Normalised		**(161)**	**1,380**	**1,609**
Net Profit - Reported		(311)	1,380	1,609
Wgt Avg shares - Diluted (m)		70.4	89.0	89.0
EPS (Dil.) - Normalised (p)		**(0.23)**	**1.55**	**1.79**
Wgt Avg shares - Basic (m)		69.8	89.0	89.0
EPS (Basic) - Reported (p)		**(0.45)**	**1.55**	**1.79**
DPS (Paid) - Normalised (p)		**0.00**	**0.00**	**0.00**

Source: Company, Charles Stanley Securities

Summary Balance sheet

Year to June, £'000	2005A	2006E	2007E	2008E
Intangible fixed assets	4,164	9,050	9,250	9,450
Tangible fixed assets	964	1,964	1,920	1,876
Net working capital	3,730	2,659	759	859
Net (debt)/cash	3,683	1,934	5,388	7,200
Assets employed	**12,541**	**15,607**	**17,317**	**19,385**
Other assets/(liabilities)	-	-	-	-
Provisions (incl. Pension)	(45)	(45)	(45)	(45)
Net Assets	**12,496**	**15,562**	**17,272**	**19,340**

Source: Company, Charles Stanley Securities

Valuation & Performance ratios

Year to June	2005PF	2006E	2007E	2008E
Valuation ratios				
PER - Normalised		n/a	10.6	9.2
EV/ Sales	2.9	1.5	0.9	0.8
EV/EBITDA	30.3	36.9	6.7	5.0
EV/EBITA	70.4	n/a	8.6	5.9
FCF yield %		3.6%	14.0%	13.0%
Dividend Yield %		0.0%	0.0%	0.0%
Performance ratios				
Sales growth %		90%	76%	17%
EBITDA growth %		n/a	451%	35%
EPS dil (normalised growth) %		n/a	n/a	15%
EBITDA margin %	9.7%	4.2%	13.1%	15.2%
EBITA margin %	4.2%	n/a	10.2%	12.8%
Interest cover x	n/a	n/a	n/a	n/a
Dividend cover (norm) x	n/a	n/a	n/a	n/a
Net Cash/ (Debt) £m	3.7	1.9	5.4	7.2
Net (Debt)/ Equity %	n/a	n/a	n/a	n/a
ROE %		n/a	8.0%	8.3%
Net Assets per share (p)	18.1	17.5	19.4	21.7

Source: Company, Charles Stanley Securities

Summary Cash flow statement

Year to June, £'000	2005A	2006E	2007E	2008E
EBITA	**(540)**	**(172)**	**1,935**	**2,812**
Depreciation	51	472	544	544
Change in working capital	(3,612)	1,423	400	(100)
Other non-cash movements	(39)	-	-	-
Cash generated from ops.	**(4,140)**	**1,723**	**2,879**	**3,256**
Net Interest	43	53	100	80
Tax	-	(58)	(225)	(724)
Cash from operating act.	**(4,097)**	**1,718**	**2,754**	**2,612**
Net capex	(469)	(1,303)	(700)	(700)
Free cash flow	**(4,566)**	**415**	**2,054**	**1,912**
(Purchase)/disposal of subsid.	(440)	(3,554)	-	-
Loans drawn/ (repaid)	-	-	-	-
Dividends	-	-	-	-
Shares issued/(repurchased)	8,393	1,400	1,500	-
Other	(85)	(10)	(100)	(100)
Movement in net cash/(debt)	**3,302**	**(1,749)**	**3,454**	**1,812**
Net (debt)/cash	**3,683**	**1,934**	**5,388**	**7,200**

Source: Company, Charles Stanley Securities

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