EDISON

Entertainment One

Capital markets day

Unlocking the value of creativity

Media

Entertainment One's (eOne's) capital markets day (CMD) presentation highlighted its strong content and depth of management, with its independence allowing the luxury of platform agnosticism. With the major tech platforms building audience engagement to drive their broader business models, high-quality content remains a key differentiator that plays to eOne's strengths. The strategy for Family & Brands is to focus on a tight portfolio, maximising merchandising and licensing opportunities. Recent strong share price performance has narrowed the discount to peers, but further positive newsflow would allow additional upside. Our forecasts are unchanged.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/17	1,082.7	160.2	129.9	20.0	1.3	19.4	0.3
03/18	1,044.5	177.3	144.4	21.9	1.4	17.7	0.4
03/19e	1,208.6	193.4	154.9	23.6	1.5	16.5	0.4
03/20e	1,353.3	215.0	177.0	26.8	1.6	14.5	0.4

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Pure-play content

Management estimates FY18 global TV content spend at c US$95bn, excluding Google, Apple and Facebook (these last two have indicated spend of over €1bn - likely to be very conservative). eOne is shifting emphasis from lower-margin theatrical distribution to focus on pure-play content where it controls the global rights and can select the most advantageous buyers by territory. Mark Gordon (remaining 49% bought in January – see update) is ramping up content creation, with 60 shows either set up or in negotiation with networks, versus 15 a year earlier. The benefit of controlling global rights is clearly shown with a third series of *Designated Survivor* being commissioned by Netflix from 2019, after ABC chose not to continue. The developing music offering gives some synergistic benefits, with opportunities for managed artists to provide music for other group properties.

Ricky Zoom joining Family

The main challenge for Family & Brands with the proliferation of digital platforms is discoverability. By focusing on initially launching on linear TV to take advantage of its better marketing and concentrating on a small number of properties, eOne is able to manage the wider brand licensing and merchandising closely. *Peppa Pig* continues to defy growth expectations, with China already racking up over 100bn AVOD (Ad-supported Video on Demand) views and new experiential opportunities opening globally. *PJ Masks* is also now a global property and management quotes it as the number one pre-school brand in the US. *Ricky Zoom*, a vehicle-based animation, is the latest to join the slate and is set for broadcast in early 2019.

Valuation: Stronger investment case

Clarification of the investment case has boosted share price performance (+48% one year; +29% six months), narrowing the EV/EBITDA discount, hastened by DHX's poor performance. News on further commissions and network agreements would lift earnings forecasts and act as a catalyst for further share price appreciation in our view.

17 September 2018

Price	**388.4p**
Market cap	**£1,798m**

Net debt (£m) at end March 2018	314.5
Shares in issue	462.9m
Free float	98.1%
Code	ETO
Primary exchange	LSE (FTSE 250)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	13.1	10.0	49.1
Rel (local)	17.1	16.5	47.8
52-week high/low		395.6p	250.1p

Business description

Entertainment One is a global independent studio that specialises in the development, acquisition, production, financing, distribution and sales of entertainment content. Its rights library, valued at US$1.7bn (31 March 2017), is exploited across all media formats, and includes more than 80,000 hours of film and television content and approximately 40,000 music tracks.

Next events

Half year results	Late November 2018

Analysts

Fiona Orford-Williams +44 (0)20 3077 5739

Neil Shah +44 (0)20 3077 5715

media@edisongroup.com

Edison profile page

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Building content for a changing landscape

The CMD presentations were built around the newly reconfigured segments, with Music (which is reported as part of FTD) given its own slot. No new financial information was disclosed and there is no change to our forecasts, which are consistent with the company's guidance of the group doubling EBITDA over the course of FY15-20, on 10-15% organic revenue growth.

All three elements of the presentation emphasised the migration to a content-led strategy, with ownership of global rights giving the group the flexibility to sell or license to the most appropriate buyer territory by territory.

Film, Television & Digital (FTD): Moving to pure content

Steve Bertram, President, FTD, quoted the head of content licensing at an undisclosed tech platform (therefore one of Facebook, Apple, Amazon, Netflix or Google) as saying: "We definitely worry about a future, a future world that's vertically integrated, where access to content is limited, particularly with Disney and Fox off the table and Comcast expected to follow soon". The sheer scale of these platforms, which are both customers of traditional media and its competitors, is driving demand for content – particularly premium content, although each platform has a different approach. Apple's ethos is that content should appear in context on the large screens in an Apple store, aggregating content owned by others; Facebook is experimenting with different concepts that are relevant to the conversations it has with its users; Netflix is generating its own content as well as buying in, planning to release 700 original series, films and specials in 2018.

The engine behind the growth is the rapid share gains of SVOD (streaming video on demand), growing at a reported 20% CAGR. The competition between the platforms is driving the requirement for premium content and, despite the proliferation of non-linear distribution channels, there is still a tendency for the audiences to gravitate towards particular hits such as *Grey's Anatomy* or *Game of Thrones*. This is driving a trend to high production values, with some series budgets as high as £10-15m per episode. The real underlying competition is to grab and maintain audience attention.

eOne's business model means it is not tied to any one channel, network or platform and can sell to whichever partner provides the most advantageous opportunity. It cited recent high-profile commissions including:

- *Sharp Objects* (HBO);
- *Designated Survivor* (now with Netflix, which had the international distribution rights when previous series were originally with ABC; reconfigured for its new home in conjunction with Kiefer Sutherland);
- *Scary Stories* (CBS);
- *Nutcracker and the Four Realms* (developed in-house then taken and sold to Disney); and
- *Old City Blues* (Hulu).

The presence of such a highly regarded industry figure as Mark Gordon (President & Chief Content Officer, FTD) as a 'hands-on' chief content officer is clearly a draw for other talent, particularly for those who might feel constrained at more traditional studios and content providers.

Music: Eclectic and global

Music is the area of the business most likely to be overlooked, being reported within FTD, but which has nevertheless been growing strongly and represents US$66m of FY18 gross revenue (5% of group) and US$8.3m of EBITDA (4% group). Chris Taylor, Global President, Music, described how it derives its income from four strands: records (including streaming), publishing, artist management and live events, with a broad range of genres covered, from rap to heavy metal.

The key to driving continuing growth here (in line with guidance for the group at 10-15% CAGR) is signing up high-quality talent across those genres. eOne should gain from not imposing the artistic constraints often imposed by the major labels on one side and by having the in-house expertise and established routes to market globally that an indie may struggle with. Artists may also be attracted by cross-pollination opportunities across the group. Examples cited included *ICE* (Season 2), where 28 eOne songs were used, and *PJ Masks*, where the music for the live tour was produced and published in house. The group's extensive video capabilities are also an attraction, such as producing documentaries about artists to help drive audience engagement and hence other income streams.

Family & Brands: Growing the core brands

Olivier Dumont, President, Family & Brands, identified the key issues facing family entertainment and brand licensing companies currently as including:

- The squeeze on shelf space with retail retrenchment, particularly the failure of Toys R Us, which led to a 9% reduction in the US toy market in July.
- Discoverability in face of the proliferation of distribution channels.
- Sensitivity to the use of data in relation to children/GDPR.
- Counterfeiting in merchandise.

There are also key positive trends:

- The SVOD companies spending heavily on children's content.
- The opening up of the Chinese market, with 70 million pre-school children (16 million in the US).
- Video and brands driving engagement on social media.
- New consumer tech, such as home speakers.

eOne has chosen to focus its efforts on driving a small number of key brands, while keeping tight control over the number and quality of licences to avoid over-exposure. This gives a lower-risk option to nervous retailers. For the networks and SVODs, there are also advantages to sticking with known properties and this is part of the reason for the longevity of *Peppa Pig,* which now has a slate of 256 five-minute episodes and three 15-minute specials, with 117 more five-minute episodes in production. *PJ Masks* has also been racking up, with two series totalling 104 x 11-minute episodes with Series 3 (52 episodes, cost £8.2m) in production and Series 4 in development. Series 3 will be broadcast by Disney and Channel 5 in Q419.

Ricky Zoom has Series 1 in production (52 x 11 minutes, at a cost of £8.1m) plus Series 2 in development. Both *PJ Masks* and *Ricky Zoom* are being produced in France, where significant subsidies are available (35-40%) and will be broadcast in Q219. The location of production is directed towards those places where the most advantageous support is offered.

As well as the linear broadcast and the digital opportunities (VOD, games, apps), the brands are monetised through retail, live events and publishing. For *Peppa Pig*, the group has a global relationship with Merlin Entertainments for standalone attractions, standalone theme parks and for themed areas within other Merlin attractions. This is planned to extend to Shanghai and Beijing in 2019, taking advantage of the rapid build of awareness in China. On the merchandising front, eOne has an agreement with Alibaba on counterfeit goods, which has ensured that over 95% of branded product sold is genuine. *PJ Masks* will also start to be broadcast on terrestrial TV this month, with merchandising being launched later in the year.

Traditional broadcasters remain attractive partners for their ability to promote brands, but each territory is evaluated to determine the most appropriate partner. The same goes for the licensing partners/toy manufacturers.

Forecasts

Our numbers as per the new segmentation were set out in our May update, repeated here:

Exhibit 1: KPI history and forecast

KPI summary	2015	2016	2017	2018	2019e	2020e
FTD - investment in acquired content (£m)	165.9	119.9	180.5	150.7	145.0	130.0
FTD - investment in productions (£m)	113.0	92.8	222.3	290.0	384.0	446.0
Family - investment in content & production (£m)	1.9	5.8	5.3	9.6	13.5	15.0
Total content and production investment (£m)	280.8	218.5	408.1	450.3	542.5	591.0
% budget invested in in own productions	40%	42%	54%	64%	71%	71%
Half hours produced/ acquired (Television)	752	998	1023	939	> 1,000*	
No. theatrical releases (Film)	227	210	172	144	140*	
Box office ($m)	308	259	337	208		
Family licences	600	847	1083	1500	2000*	
Family retail sales ($bn)	1.0	1.1	1.5	2.4		
% TV pipeline green lit at start of financial year	N/A	N/A	61%	60%	40%	
Library valuation ($bn)	0.8	1.5	1.7			
Revenues (£m)						
FTD	729	741.2	996.8	911.9	1,060.0	1,190.0
Growth		2%	34%	-9%	16%	12%
Family	60.8	66.6	88.6	138.6	158.6	174.5
Growth		10%	33%	56%	14%	10%
Inter company	-4	-5	-3	-6	-10	-11
Group revenues	**785.8**	**802.7**	**1082.7**	**1044.5**	**1208.6**	**1353.3**
Revenue growth		2%	35%	-4%	16%	12%
EBITDA (£m)						
FTD EBITDA	90.9	92	115.5	107.1	115.5	133.9
FTD EBITDA margin	12.5%	12.4%	11.6%	11.7%	10.9%	11.3%
Family EBITDA	23.8	43.3	55.6	82.3	90.4	95.1
Family EBITDA margin	39.1%	65.0%	62.8%	59.4%	57.0%	54.5%
Intercompany eliminations	-7.4	-6.2	-10.9	-12.1	-12.5	-14.0
Group EBITDA	**107.3**	**129.1**	**160.2**	**177.3**	**193.4**	**215.0**
Group EBITDA margin	13.7%	16.1%	14.8%	17.0%	16.0%	15.9%

Source: eOne, Edison Investment Research. Note: *Company plan.

Valuation

We have separated out the FTD and Family valuations for our peer-based valuation. This shows a valuation of £4.30 based on FY19e, around 10% ahead of the current market price (£3.77 at the time or our last note in May). Further news on commissioning should act as a catalyst for upgrades, moving this target ahead.

Exhibit 2: Peer multiple valuation

£m	2018	2019e	2020e
FTD – EBITDA	107	116	134
Family – EBITDA	82	90	95
Group costs and depreciation	(16)	(17)	(19)
Multiples:			
Entertainment multiple (x)	18.2	12.6	11.2
Family multiple (x)	16.8	13.7	12.5
FTD EV	1950	1461	1496
Family EV	1380	1241	1189
Group costs	-275	-224	-225
Total EV	**3056**	**2478**	**2461**
Minorities	-214	-173	-172
corporate debt	315	315	274
Group equity	2527	1990	2015
shares in issue (m)	460.7	462.9	465.1
Implied value per share (£)	**5.49**	**4.30**	**4.33**
Implied value if PF is also treated as debt (£)	**5.24**	**4.05**	**4.08**

Source: Edison, Bloomberg. Note: Prices at 14 September 2018.

Exhibit 3: Financial summary

£m	2016	2017	2018	2019e	2020e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	802.7	1,082.7	1,044.5	1,208.6	1,353.3
Cost of Sales	(610.1)	(822.9)	(793.8)	(918.5)	(1,028.5)
Gross Profit	192.6	259.8	250.7	290.1	324.8
EBITDA	129.1	160.2	177.3	193.4	215.0
Operating Profit	124.7	155.3	173.7	188.9	210.0
Amortisation of intangibles	(27.4)	(41.9)	(39.6)	(37.0)	(37.0)
Exceptional items	(16.6)	(40.8)	(7.1)	(7.0)	0.0
Share based payment charge	(5.7)	(5.0)	(12.6)	(13.5)	(14.0)
JV tax, finance costs, dep'n	(1.6)	0.0	0.0	0.0	0.0
Operating Profit	73.4	67.6	114.4	131.4	159.0
Net Interest	(20.6)	(25.4)	(29.3)	(34.0)	(32.9)
Exceptional finance items	(6.5)	(6.3)	(7.5)	0.0	0.0
Profit Before Tax (norm)	104.1	129.9	144.4	154.9	177.0
Profit Before Tax (FRS 3)	47.9	35.9	77.6	97.4	126.0
Tax (reported)	(7.7)	(12.3)	0.6	(22.4)	(29.0)
Tax (adjustment for normalised earnings)	(16.8)	(14.8)	(28.5)	(8.6)	(6.4)
Profit After Tax (before non-controlling interests) (norm)	79.6	102.8	116.5	123.9	141.6
Profit After Tax (before non-controlling interests) (FRS3)	40.2	23.6	78.2	75.0	97.1
Non-controlling interests	(3.7)	(11.9)	(13.7)	(10.5)	(11.5)
Average Number of Shares Outstanding (m)	379.8	432.7	447.6	480.9	486.3
EPS - normalised (p)	19.4	20.0	21.9	23.6	26.8
EPS - FRS 3 (p)	9.8	2.7	14.8	13.9	18.2
Dividend per share (p)	1.2	1.3	1.4	1.5	1.6
Gross Margin (%)	24.0	24.0	24.0	24.0	24.0
EBITDA Margin (%)	16.1	14.8	17.0	16.0	15.9
Operating Margin (before GW and except) (%)	15.5	14.3	16.6	15.6	15.5
BALANCE SHEET					
Non-current Assets	890.7	972.7	936.9	977.0	964.3
Intangible Assets (incl Investment in programmes)	808.2	870.6	805.4	855.5	854.3
Tangible Assets	60.1	72.8	104.3	104.8	104.8
Deferred tax/Investments	22.4	29.3	27.2	16.7	5.2
Current Assets	752.0	928.3	899.1	924.1	942.6
Stocks	51.1	48.6	39.6	39.6	39.6
Investment in content rights	241.3	269.8	253.4	262.6	266.1
Debtors	351.3	476.5	486.9	546.9	586.9
Cash	108.3	133.4	119.2	75.0	50.0
Current Liabilities	(568.7)	(679.4)	(691.5)	(697.0)	(707.0)
Creditors	(470.7)	(574.6)	(514.7)	(520.2)	(530.2)
Short term borrowings	(98.0)	(104.8)	(176.8)	(176.8)	(176.8)
Long Term Liabilities	(413.6)	(464.6)	(438.7)	(434.5)	(346.5)
Long term borrowings	(309.1)	(368.3)	(375.6)	(371.4)	(283.4)
Other long term liabilities	(104.5)	(96.3)	(63.1)	(63.1)	(63.1)
Net Assets	660.4	757.0	705.8	769.5	853.4
CASH FLOW					
Operating Cash Flow	298.8	425.3	470.9	587.7	725.6
Net Interest	(10.3)	(24.3)	(26.2)	(34.0)	(32.9)
Tax	(17.7)	(18.4)	(32.5)	(26.9)	(29.0)
Capex	(8.6)	(3.5)	(3.2)	(5.0)	(5.0)
Acquisitions/disposals	(226.0)	(9.6)	(118.5)	(5.0)	0.0
Investment in content rights and TV programmes	(218.5)	(373.6)	(437.4)	(542.5)	(580.0)
Proceeds on issue of shares	194.5	(19.2)	52.0	0.0	0.0
Dividends	(4.0)	(8.3)	(13.0)	(14.3)	(15.7)
Net Cash Flow	8.2	(31.7)	(107.9)	(40.0)	63.0
Opening net debt/(cash)	314.2	299.7	339.7	433.2	473.2
Movements in exchangeable notes	0.0	0.0	14.5	0.0	0.0
Other including forex	6.3	(8.3)	(0.1)	0.0	0.0
Closing IFRS debt/(cash)	299.7	339.7	433.2	473.2	410.2
ANALYSIS OF NET DEBT					
Production finance	118.0	152.3	118.7	148.8	136.6
Net debt	181.7	187.4	314.5	324.5	273.6
Gearing	1.4	1.2	1.8	1.7	1.3

Source: Company accounts, Edison Investment Research

EDISON

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia