EDISON

Technicolor

Q1 figures

Division on schedule

Media

Technicolor's Q122 results show broadly flat group revenues (at constant exchange rates) with a good step up in EBITDA as the mix shifts towards higher-margin activities and the benefits of earlier cost control exercises come through more noticeably. Management FY22 guidance is confirmed, with our forecast adjusted for a small change in accounting treatment as previously flagged. The process of spinning off the majority of Technicolor Creative Studios to a separately quoted vehicle is on schedule for implementation in Q322, with a London capital markets day set for 14 June to showcase the two intended corporate entities. Debt refinancing is also progressing to plan.

Year end	Revenue (€m)	EBITDA (€m)	EBITA (€m)	PBT* (€m)	EPS* (€)	EV/EBITDA (x)
12/20	3,006	163	(59)	(46)	(0.36)	11.8
12/21	2,898	268	95	(6)	(0.11)	7.2
12/22e	2,975	375	175	89	0.32	5.2
12/23e	3,135	415	224	138	0.48	4.6

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

Demand outstrips ability to supply

Q122 group EBITDA margins of 7.2% were up 161bps at constant currency, stepping up from 9.7% in Q121 to 13.0% for Technicolor Creative Studios (TCS) and from 6.3% to 7.7% at Connected Home. The underlying demand in both these operations remains very strong. For TCS, demand for high-quality content is robust across film, episodic and animation, with 80% of the current year pipeline booked. As described in our February update, the industry is beset by shortages of talent from which TCS is not immune, which is a constraint on faster growth. At Connected Home, demand for domestic broadband continues to be very good, with higher revenue growth again constrained by industry-wide component shortages.

Clearer picture emerging of new entities

At the intended capital markets day on 14 June, management will present the two future businesses, and the vote to approve the spin-off is set for 30 June. A full management line up for each is now in place, along with an outline of the segmented debt post refinancing (an EGM has now approved the issuance of the €300m of mandatory convertible loan notes). Technicolor ex-TCS would carry €300–375m of private debt with an asset-based loan facility, with the balance of the debt being carried by TCS in the form of a term loan.

Valuation: Complexity discount

The valuation reflects the current complexity of the group and the cost and constraints imposed by the debt. The proposed restructure tackles both issues. Our sum-of-the-parts, based on compiling segmental FY23e earnings-based valuations, variously discounted, derives a value equivalent to €4.07/share, down from €4.95 in our last report, reflecting peer price movements and higher seasonal net debt. A group-based DCF, using a WACC of 9.0% and 1% terminal growth, gives a value of €3.85/share. Both valuations are well above the current price.

12 May 2022

Price	**€2.97**
Market cap	**€700m**
	US$1.15/ €
Net debt (IFRS, including leases) at end March 2022 (€m)	1,230
Shares in issue	235.8m
Free float	90.6%
Code	TCH
Primary exchange	Euronext
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(11.7)	5.5	3.6
Rel (local)	(7.8)	17.5	4.9
52-week high/low		€3.60	€2.55

Business description

Technicolor is a worldwide technology leader operating in the media and entertainment industry. Its activities fall into three business segments: Technicolor Creative Studios, DVD Services and Connected Home.

Next events

Capital markets day for TCS and for Technicolor ex-TCS	14 June 2022

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Q122 shows benefit of strong demand

We show the Q1 figures below at current currency rates but note that these have benefited from favourable exchange rate movements. At constant rates, group revenues were down 0.3%, but at current rates, this moves to an improvement of 6.6% over the prior year.

During this quarter, TCS continued to benefit from the rebound in industry activity post the impact of the pandemic, climbing to 26% of group revenue for the period, compared with 20% in Q121. The improvement in profitability lifted its proportion of group adjusted EBITDA (before Central and Other) from 36% to 42%. Connected Home contributed 54% of group revenues and half of adjusted EBITDA. On a group basis, adjusted EBITA moved from just below break-even to a positive €14m.

Group free cash flow (before financials and tax) improved from an outflow of €200m in Q121 to an outflow of €126m (€314m in Q120), which reflects the better operating performance, a lower working capital position (mostly at Connected Home) and reduced costs of restructuring. Q1 – and H1 – is generally a period of free cash outflow, with inflows in the seasonally stronger H2. For the current year, management expects that this figure will be around €230m (€217m excluding Trademark Licensing, for which it expects to conclude the sale by end July, bringing in another €100m).

IFRS net debt at the quarter end was €1,230m, up from €1,039m at the year-end, ahead of the current market capitalisation of €700m.

Our forecasts replicate management guidance, which was confirmed with the Q122 statement. This is for

- revenue to grow from continuing operations;
- adjusted EBITDA from continuing operations of €375m (€365m excluding Trademark Licensing);
- adjusted EBITA from continuing operations of €175m (€161m excluding Trademark Licensing); and
- free cash flow from continuing operations, before financial results and tax, of €230m (€217m excluding Trademark Licensing) post inflows in the seasonally stronger H2.

Management guidance for adjusted EBITDA and adjusted EBITA is unchanged, with our forecast for the former now reduced by €10m, and for adjusted EBITA by €5m, as was flagged in the February year-end statement, to reflect changes in the accounting treatment (IFRIC adjustments) of software-as-a-service (SaaS) revenues.

Segmental performances and outlooks

Exhibit 1: Summary Q122 results

€m	TCS	Change y-o-y	DVD Services	Change y-o-y	Connected Home	Change y-o-y	Corporate & Other	Change y-o-y	Group	Change y-o-y
Revenue	198	+41.6%	150	+8.2%	408	-4.6%	1	-82.5%	**756**	**+6.6%**
Adjusted EBITDA	26	+13.0%	5	+15.0%	31	+15.9%	(7)	-31.9%	**55**	**+28.6%**
Margin	13.0%		3.1%		7.7%				**7.2%**	
Adjusted EBITA	11	N/A	(3)	N/A	14	+36.6%	(8)	30.2%	**14**	**N/A**
Margin	5.6%		(1.1%)		3.4%		(65.6%)		**1.9%**	

Source: Technicolor accounts. Note: Changes at current currency rates.

Connected Home (54% of Q122 revenue)

Demand for broadband boxes has remained strong into FY22 and looks set to continue as consumers look for faster and more reliable connectivity. This underlying high level of demand is greater than can be fulfilled, given the ongoing global shortages of key components and supply chain bottlenecks. Broadband accounted for 79% of the quarterly revenue, up from 67% in Q121. Overall segmental revenues were down 5% (-11% at constant currency). Video revenues were down 39% (-43% at constant currency), while broadband revenues were ahead by 12% (4% at constant currency). Connected Home is a global leader in broadband gateways and won some notable new business in the period, including with Telstra in Australia. For Bouygues in France, it is developing a premium 4K UHD set-top box integrated with 'best-in-class' Wi-Fi.

There is no direct impact on the business from the war in Ukraine on the customer or supplier front, but there is further disruption to transport as some supplies are diverted to longer sea routes.

EBITDA margins climbed to 7.7% in Q122 from 6.3% (Q120: 4.1%), boosted by the cost reductions from the transformation plan as discussed in previous reports and operating efficiencies from the platform-based approach. Had the ability to meet demand not been constrained, the implication is that margins would have climbed further.

The key issue for Connected Home remains the availability and pricing of componentry, a well-documented problem across many industries, stemming from supply and distribution issues exacerbated by the pandemic. The group is a key supplier to the cable companies, who themselves are anxious not to disappoint their own customers, putting the group in a stronger position than some smaller players, particularly in terms of passing through a proportion of cost increases.

TCS (26% of Q122 revenues)

Strong demand across all aspects of TCS, from film and episodic through advertising and animation, propelled segmental revenues ahead by 42% (33% at constant currency) to €198m.

MPC (now the core brand for work in the film and episodic space) was involved in 20 theatrical films in the period, delivering four in Q122, including *Sonic the Hedgehog 2* and *Elvis*. In episodic, MPC worked on more than 30 projects for clients including Disney+, Peacock, Netflix, Paramount+, Apple TV, Amazon and HBO. The Mill worked on more than 1,000 advertising projects during the quarter, including 34 Super Bowl projects. Mikros Animation was in production on six feature film projects, including *PAW Patrol: The Mighty Movie* (Spin Master Entertainment/ Paramount) and *Thelma the Unicorn* (Netflix) and numerous series for names such as DreamWorks, Disney and Nickelodeon.

Mikros Animation will also be working on the new animated version of *Charlie and the Chocolate Factory* with Netflix under the directorship of Taika Waititi.

Technicolor Games also has a very strong client roster. Its Q122 releases included 2K Sports' *WWE 2K22*.

The adjusted EBITDA margin firmed from 9.7% up to 13.0%, with efficiency gains from the business restructuring and from the operational gearing from higher volumes. However, the ability to recoup all the benefit is constrained by the particularly tight labour market in specialists in this field, leading to shortages, employee churn and higher costs of employment.

The number of staff employed had risen from 10,700 at the previous year-end to 11,800 at end March. Management is confident that the 80% of FY22 pipeline that is already committed can be delivered on the basis of the capacity now in place.

DVD Services (20% of Q122 revenue)

Disc volumes continued their decline, down 16.5% in volumes on Q121. However, segmental revenues increased by 8.2% (+2.2% at constant currency) as newer sources of revenue were built up outside the traditional disc production and logistics. There are two main elements of this growth:

- Vinyl: the group had signed a contract with a top three global music company in Q122 and expects to add the other two in Q222. Two large US independents are also in negotiations.
- Supply chain/fulfilment: a 'major anchor' client contract has been signed to add to significant volumes of products already being handled.

EBITDA margin for the segment was flat at 3.1%, reflecting the positive contribution from earlier cost cutting and the newer activities, offset by the impact of lower disc volumes. These factors are expected to continue through the year, with a shift in the disc business towards new releases and away from catalogue material, as theatrical releases pick up as movies delayed by the pandemic hit the screens.

Exhibit 2: Financial summary

€m	2019	2020	2021	2022e	2023e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	3,800	3,006	2,898	2,975	3,135
Cost of Sales	(3,375)	(2,729)	(2,493)	(2,527)	(2,680)
Gross Profit	425	277	404	448	455
EBITDA	325	163	268	375	415
EBITA	42	(59)	95	175	224
Amortisation of acquired intangibles	(54)	(41)	(38)	(38)	(38)
Exceptionals	(79)	(151)	(53)	(11)	(10)
Reported operating profit	(121)	(267)	30	150	200
Net Interest	(84)	77	(127)	(110)	(110)
Joint ventures & associates (post tax)	(1)	0	0	0	0
Exceptionals	0	155	0	0	0
Profit Before Tax (norm)	(73)	(46)	(6)	89	138
Profit Before Tax (reported)	(206)	(191)	(97)	40	90
Reported tax	(3)	(5)	(24)	(5)	(10)
Profit After Tax (norm)	(75)	(51)	(30)	84	128
Profit After Tax (reported)	(208)	(196)	(121)	35	80
Discontinued operations	(22)	(15)	(19)	0	0
Net income (normalised)	(75)	(51)	(30)	84	128
Net income (reported)	(230)	(210)	(140)	35	80
Average Number of Shares Outstanding (m)	15	126	241	247	247
EPS - normalised (c)	(492.18)	(40.77)	(12.26)	33.83	51.88
EPS - normalised fully diluted (c)	(492.18)	(35.73)	(11.42)	31.57	48.42
Dividend per share (c)	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	(5)	(21)	(4)	3	5
Gross Margin (%)	11.2	9.2	14.0	15.0	14.5
EBITDA Margin (%)	8.6	5.4	9.3	12.6	13.2
EBITA Margin (%)	1.1	(2.0)	3.3	5.9	7.2
BALANCE SHEET					
Fixed Assets	2,082	1,665	1,730	1,657	1,592
Intangible Assets	1,483	1,242	1,283	1,248	1,198
Tangible Assets	476	288	305	265	250
Investments & other	40	62	59	59	59
Deferred tax and other	84	72	83	85	85
Current Assets	1,127	1,344	1,268	1,291	1,372
Stocks	243	195	335	309	316
Debtors	507	425	359	332	322
Cash & cash equivalents	64	330	196	271	355
Other	312	394	378	379	379
Current Liabilities	(1,542)	(1,379)	(1,359)	(1,376)	(1,392)
Creditors	(825)	(710)	(671)	(689)	(744)
Tax and social security	(41)	(21)	(29)	(29)	(29)
Short term borrowings	(95)	(72)	(65)	(65)	(65)
Other	(581)	(576)	(594)	(593)	(554)
Long Term Liabilities	(1,631)	(1,466)	(1,505)	(1,521)	(1,537)
Long term borrowings	(1,203)	(1,070)	(1,170)	(1,186)	(1,202)
Deferred tax	(27)	(15)	(20)	(20)	(20)
Other long term liabilities	(401)	(381)	(315)	(315)	(315)
Net Assets	37	163	134	51	35
Minority interests	0	0	0	0	0
Shareholders' equity	37	163	134	51	35
CASH FLOW					
Net profit	(208)	(196)	(121)	35	80
Depreciation and amortisation	322	261	222	215	205
Working capital	(69)	(101)	(81)	71	58
Tax and interest	(76)	(41)	(50)	(95)	(100)
Exceptional & other	101	(9)	43	(10)	(20)
Operating cash flow	70	(86)	14	215	224
Capex	(169)	(104)	(95)	(140)	(140)
Acquisitions/disposals	(2)	(3)	27	0	0
Equity financing	1	60	0	0	0
Dividends	0	0	0	0	0
Other	3	(21)	(3)	0	0
Net Cash Flow	(97)	(154)	(57)	75	84
Opening net debt/(cash)	733	1,234	812	1,039	980
FX		(16)	16	0	0
Discontinued	(35)	(23)	(29)	0	0
Other non-cash movements	(369)	615	(156)	(16)	(16)
Closing net debt/(cash)	1,234	812	1,039	980	912

Source: company accounts, Edison Investment Research

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