EDISON

Scale research report - Update

Edel

Media

11 February 2020

Further shift in mix to digital

Edel's FY19 figures showed flat revenues against FY18, with a dip in profitability. This mostly reflects lower demand and pricing pressure at optimal media, the segment handling physical production and distribution. Increased depreciation following earlier capital investment exacerbated the effect on EBIT, down 25%. The shift in revenue to digital benefits working capital and the reversion of capex to maintenance levels should also help reduce group debt, refinanced post year-end on more favourable terms. The shares trade at a discount to global entertainment content and publishing stocks on historical EV/EBITDA and EV/sales, partly due to limited liquidity.

Focus on digital, rights ownership

The customer base for physical product continues to consolidate. Having invested over FY17–18, optimal media now has very efficient production and distribution facilities, allowing it to build market share, albeit that price competition and cost pressure have affected profitability. Higher depreciation limited the decrease in group EBITDA to 7% for FY19, while EBIT fell by 25%. There are opportunities to extend the group's physical business, particularly in book publishing and through developing non-traditional routes to market. The greater FY20 growth potential is in the digital segment within Kontor New Media and in the acquisition of upstream rights. Kontor acts as an aggregator between rights owners and platform providers and is well positioned as downloads and streaming continue their strong progress.

Subdued outlook

Management guidance is for FY20 sales to be at a slightly lower level than FY19, with consolidated net income at around prior year level (€2.2m). Given that the expectation is for growth at Kontor New Media, the implication is that conditions in the physical market for music, books and entertainment will remain testing. Raw material and energy costs are expected to have a negative impact, though this may accelerate the withdrawal of further competitors from the market. The guidance also refers to potential tax liabilities that may arise from the application of trade taxes on additional licences and from the treatment of revenues derived from pursuing those that have illegally abused rights.

Valuation: Discount to content, publishing

We have maintained the same valuation approach as previously, comparing Edel's rating with the global media subsectors of entertainment content and publishing. The shares trade at a significant discount on EV/sales, most likely reflecting the manufacturing element. Uncertainty regarding the potential tax liabilities may also be acting as a drag on the share price. While the lower EPS has lifted the P/E multiple to a premium, the discount on historical EV/EBITDA is now 46%.

Key financials

Year end	Revenue (€m)	PBT (€m)	Adjusted EPS (€)	DPS (€)	P/E (x)	Yield (%)
09/18	209.2	6.6	0.16	0.10	13.8	4.5
09/19	209.5	4.4	0.08	0.10	27.5	4.5

Source: Edel accounts

Price	**€2.20**
Market cap	**€50m**

Share price graph

Share details

Code	EDL
Listing	Deutsche Börse Scale
Shares in issue	22.73m
Last reported net debt at 30 Sept 2019	€51.9m

Business description

Edel is one of Europe's leading independent media groups. It is both a publisher and a producer. Edel offers the music, film and book industry a unique full-service model, covering marketing and production as well as the distribution of audio content, video content and books.

Bull

- Diversity of revenue streams.
- Full-service, third-party offering.
- Resurgence of vinyl.

Bear

- Difficult CD, DVD and Blu-Ray markets.
- Small free float.
- Spotify's dominance in streaming.

Analysts

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Edison profile page

Financials

The group published its full year report to end September 2019 in February.

Exhibit 1: Half year and full year progression to 30 September 2019

€000s	H119	% change	H219		FY19	% change
Year end 30 September						
Revenue	108,074	+2	101,424	-2	209,498	0
EBITDA as reported	10,469	+1	5,568	-19	16,036	-7
EBITDA margin (%)	9.7		5.5		7.7	
Profit before tax (as reported)	4,904	-13	(497)	N/A	4,407	-33
Net income (as reported), before minority	3,211	-12	(966)	N/A	2,245	-44

Source: Edel accounts Note: Figures reported under HGB/German GAAP

Earlier management guidance was for FY19 revenues of €207.5m, a 4% y-o-y reduction in sales. The outturn of flat revenues year-on-year is therefore a better result. Net income of €4.4m, however, came in slightly below the level previously guided of €4.7m. EBITDA margin (always weaker in H2) dipped to 5.5% in the second half of the year, from 6.7% in H218 and 9.7% achieved in H119.

Manufacturing and logistics (optimal media) accounted for 52% of FY19 revenues, down from 54% in FY18, which represents a fall of 3.1% in absolute revenues. Marketing and sales (book and audiovisual content) grew revenues by 3.9% over the prior year.

There were also some substantial swings in the geographical composition of the revenue, partly reflecting the change in business mix. In FY18, revenues from the DACH region were €111.1m, 53% of group. For FY19, DACH revenues were 13% lower giving group share of 46%. Great Britain, Edel's second largest market, increased its share of group revenues from 15% to 22%, an absolute gain of 44%. Sales in the Netherlands, the group's third largest market, were flat on prior year, US sales were also ahead by 44%, whereas sales in France were 49% lower than prior year.

Net debt was €51.9m at end FY19 compared to €54.8m at the half-year stage and €56.3m at the end of FY18. With the shift in business mix favouring digital product and services, working capital requirements should continue to reduce. Coupled with capex reverting to near-maintenance levels, we would expect group net debt to continue to fall.

FY20 guidance is for sales to be 'slightly lower' than in 2019, with net income at around the FY19 level of €2.2m. This could imply a small improvement in operating margin, assuming tax stays at similar levels and a modest reduction in interest payments (given the refinancing, lower balance sheet borrowings and reducing working capital requirement).

Valuation

Our valuation framework for Edel is unchanged from our previous note. Analysis is complicated by the range of the company's activities, from pressing CDs for third parties through children's animated TV, to being the market-leading publisher of cookery books and handling logistics and services for the world's largest music publishers. Any peer group comparison is therefore inevitably limited. Given these constraints, rather than selecting a set of inadequate peers, we have looked globally across the main subsectors in which Edel operates, particularly entertainment content and publishing, to examine key valuation metrics based on consensus forecasts. We have stripped out unprofitable companies from our EV/EBITDA and P/E calculations, as well as any obvious distortive outliers.

Exhibit 2: Sectoral valuations for related activities

	P/E (x)			EV/sales (x)			EV/EBITDA (x)		
	Last	FY1	FY2	Last	FY1	FY2	Last	FY1	FY2
Publishing	21.4	19.6	18.9	1.9	1.5	1.4	10.8	8.6	7.9
Broadcast & Entertainment	21.0	21.4	15.9	2.6	2.3	2.0	11.6	10.6	8.6
Edel	27.5	N/A	N/A	0.5	N/A	N/A	6.1	N/A	N/A

Source: Refinitiv, Edison Investment Research. Note: Prices as at 10 February 2020.

We would expect that the multiple to sales for Edel would be lower than the comparator groups due to the large volumes of third-party revenues that it handles, which will also distort margin comparisons. The change in the group's legal identity to a partnership limited by shares in March 2019 (deemed more appropriate for the family-based group structure), reduces the potential influence of minority shareholders and so also has valuation implications. The founding family retains a 64% stake.

The reduction in group profitability, particularly in H219, where the group swung into a loss, reduced earnings per share and consequently lifted the historical P/E ratio. Nevertheless, Edel's share price appears to be well below the global market on both EV/sales and EV/EBITDA multiples, in part due to its comparatively modest size and limited liquidity, given the family's 64% shareholding. At present values, Edel's historical EV/EBITDA multiple is at a 46% discount to peers.

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