Entertainment One

Acquisition and fund-raise

Takes full ownership of MGC

Media

eOne has announced the proposed acquisition of the remaining 49% of the Mark Gordon Company (MGC) for $209m, financed with a mixture of new equity and debt. We estimate that the deal will be slightly earnings accretive in its first year before an anticipated $7-10m of cost synergies. In our view it is a logical extension of the group's strategy to build a diversified content business.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/16	802.7	129.1	104.1	19.4	1.2	16.1	0.4%
03/17	1,082.7	160.2	129.9	20.0	1.3	15.6	0.4%
03/18e	1,076.1	175.1	145.7	22.1	1.4	14.1	0.4%
03/19e	1,172.1	196.6	160.6	24.5	1.5	12.7	0.5%

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

Acquisition of the remaining 49% in MGC

Subject to shareholder approval, eOne has announced the proposed acquisition of the remaining 49% of MCG for $209m (£148m), taking full ownership of the venture. The transaction will be financed via the issue of $49m in equity to Mark Gordon (founder and CEO), an equity placing of $75m (4.1% of the current share capital) and $100m of new debt. The raise is $15m more than the $209m cost in order to cover associated transaction costs and other smaller acquisitions (not disclosed). This implies a multiple of approximately 8.8x FY19e EBITDA, a small discount to eOne's own multiple.

Forecasts: Earnings enhancing

MGC has performed well since eOne acquired its original 51% stake in January 2015. Notably, it has added *Designated Survivor* to its slate of recurring heritage shows and it has released its first film under joint ownership (*Molly's Game*). It also has a very active pipeline with c 50 new shows and films in development. Before cost savings, we estimate the acquisition to be 1.7% EPS-enhancing in FY19. This does not take account of a potential $7-10m in cost savings which management estimates could be delivered by 2020 now that it has full ownership. In parallel, management has reiterated that it is on track to deliver results in line with market consensus estimates for FY18e.

Valuation: Building a diversified content business

The acquisition fits with the group's strategy and tilts its activities further towards the faster-growing areas of Television and Family. In addition, Mark Gordon will take up a new position as chief content officer for the recently merged Film and Television business, which management believes will strengthen its ability to attract creative talent and partners. On a post deal FY19e EV/EBITDA of 9.3x, a discount to peers such as Lionsgate (13.9x) and DHX (10.1x), we believe the shares offer upside potential. Our revised sum-of-the-parts implies a valuation of 380p per share.

30 January 2018

Price	**312.0p**
Market cap	**£1,401m**
	US$/£:1.41
Net debt (£m) at 30 September 2017	313
Shares in issue	449.1m*
	includes share placing
Free float	90%
Code	ETO
Primary exchange	LSE (FTSE 250)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(4.1)	12.7	35.0
Rel (local)	(3.8)	10.3	24.9
52-week high/low		329.4p	216.0p

Business description

Entertainment One is an international entertainment company. Through its strategic partnerships and global distribution network, it produces, develops and acquires film, television, music and family content for distribution around the world. Its headquarters are in Canada and it has more than 1,300 employees. Approximately 55% of revenues are derived from North America, 30% from Europe and the balance from RoW.

Next events

FY18 trading update	March 2018

Analysts

Bridie Barrett +44 (0)20 3077 5700

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

media@edisongroup.com

Edison profile page

Entertainment One is a research client of Edison Investment Research Limited

Details of the acquisition

Deal terms

eOne will pay $209m (£148m) for the remaining 49% of MGC, taking full ownership of the group. Based on our estimates, this implies a total value of $426m (£303m) for 100%. Before potential cost savings, based on consensus estimates, this implies an EV/EBITDA multiple of 9.5x for FY18 or 8.8x for FY19e, a lower multiple than that paid for the original 51% in January 2015. The purchase price will be financed via:

- $49m (£35m) of new equity issued to Mark Gordon (12-month lock-in), who will join eOne as chief content officer for the TV and Film business at a group level in order to drive the recently merged business.
- $175m (£124m) of cash raised through a $75m equity placing (at 305p per share) which closed on the 30 Jan 2017 (4.1% of the pre-issue share capital) and the issuance of $100m of debt (£71m). $15m of the funding will be used for other smaller acquisitions and to cover transaction costs.
- The deal is classified as a related party transaction and will be voted on at a general meeting at the end of February.

Background to MGC

MGC was founded in 1987 by Mark Gordon and is based in Los Angeles. It has an excellent track record delivering highly rated films and television series including *Grey's Anatomy*, *Criminal Minds, Ray Donovan* and *Designated Survivor.* MGC's library also includes around 40 feature films including *Speed*, *Broken Arrow*, *Saving Private Ryan*, *The League of Extraordinary Gentlemen* and *Molly's Game*. eOne acquired the original 51% of MGC in January 2015 for $132.6m.

Historically, revenues have mainly been made up of 'participation payments' from broadcasters and film companies that bear the production costs but also retain a significant portion of the content rights. The acquisition by eOne has enabled MGC to increasingly move towards an independent studio model, investment has been increased and the development pipeline has expanded. Its flagship new production since eOne's acquisition has been *Designated Survivor*, distributed by ABC and Netflix exclusively outside North America.

Having increased sevenfold last year, MGC revenues increased by a further 82% in H118, although EBITDA expansion has been slower (+10% H118) as new shows are sold on an independent studio model basis. MGC has an active pipeline with approximately 50 shows in production and development along with a number of film projects. In H218, it has delivered season two of *Designated Survivor*, a new teen drama *Youth and Consequences* (for YouTube Red) and has released the venture's first film since joining eOne – *Molly's Game*. At the time of the interims, 91% of this year's expected profits were committed or greenlit and management has reiterated it is on track to deliver to expectations.

Strategic rationale: Streamlined film and television divisions

Mirroring industry trends, management took the decision two years ago to start to align its film and television divisions to create a streamlined approach to content production and distribution. The sales houses were merged in 2016, and last year it announced that it would also merge its film and television studios. Taking full control of MGC fits with this vision and a new management structure has been announced to support the organisational one; Mark Gordon has committed to remain with eOne for at least five years, taking up a new role at the group level as President and Chief Content

Officer. He will oversee the development of approximately 200 projects across the enlarged Film and Television divisions. Mark will work alongside Steve Bertram who will provide commercial leadership.

Management also believes that having a renowned creative on the board will in turn strengthen eOne's ability to attract creative talent and partners, necessary to foster a sustainable production and distribution pipeline. 100% ownership will also enable eOne to fully integrate the venture, with $7-10m of potential annual cost savings identified by 2020.

Forecasts: Earnings enhancing

As eOne already had control of MGC, the acquisition does not change the balance of the business at the EBITDA level however, in removing the minority, it helps to tilt the balance of the business further towards creation, which we believe has a more attractive risk:reward profile than pure distribution.

We have factored in today's placing. We also assume that the $49m of equity to be issued to Mark Gordon is at the same price and that the transaction and debt issue completes on the last day of February.

We have assumed that the debt issue for $100m will be a tap on an existing bond and so we assume similar terms; although the debt is currently trading at a 6% premium to nominal value and so the effective interest rate will be lower than the 6.9% coupon. We also note that the first call on the bond is in December 2018 when the group would hope to refinance the entire amount at a lower rate, which could add to the earnings upgrades further down the line. We have also assumed that 50% of the additional $15m raised will cover exceptional deal costs.

Overall, we increase our FY19e EPS by 1.7%. The effect of the bond issue is to increase our forecast gearing to 1.7x (from 1.3x), although we expect this to fall back to 1.4x in FY19.

Incremental cost savings would feature in 2020 forecasts, which we plan to initiate at the time of eOne's full year results.

Exhibit 1: Forecast changes

		2018e			2019e	
	previous	new	change	previous	new	change
Revenues (£m)	1,076.1	1,076.1	0%	1,172.1	1,172.1	0%
EBITDA (£m)	175.1	175.1	0%	196.6	196.6	0%
Investment in content	473.0	473.0	0%	530.0	530.0	0%
EPS (p)	22.1	22.1	0%	24.1	24.5	1.7%
Net debt	223.4	300.1	34%	189.8	269.7	42%
IPF	183.8	183.8	0%	204.3	204.3	0%

Source: Edison Investment Research

Exhibit 2: Financial summary

£m	2015	2016	2017	2018e	2019e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	785.8	802.7	1,082.7	1,076.1	1,172.1
Cost of Sales	(578.0)	(610.1)	(822.9)	(817.9)	(890.8)
Gross Profit	207.8	192.6	259.8	258.3	281.3
EBITDA	107.3	129.1	160.2	175.1	196.6
Operating Profit	103.6	124.7	155.3	169.6	190.1
Amortisation of intangibles	(22.2)	(27.4)	(41.9)	(40.0)	(40.0)
Exceptional items	(17.9)	(16.6)	(47.1)	(3.3)	(2.5)
Share based payment charge	(3.4)	(5.7)	(5.0)	(5.0)	(5.0)
JV tax, finance costs, dep'n	0.1	(1.6)	0.0	0.0	0.0
Operating Profit	60.2	73.4	61.3	121.3	142.6
Net Interest	(14.8)	(20.6)	(25.4)	(23.9)	(29.5)
Exceptional finance items	(1.4)	(6.5)	1.3	(11.8)	0.0
Profit Before Tax (norm)	88.8	104.1	129.9	145.7	160.6
Profit Before Tax (FRS 3)	44.0	47.9	37.2	85.6	113.1
Tax (reported)	(2.7)	(7.7)	(12.3)	(18.8)	(26.0)
Tax (adjustment for normalised earnings)	(16.8)	(16.8)	(16.1)	(13.2)	(10.9)
Profit After Tax (before non-controlling interests) (norm)	69.3	79.6	101.5	113.7	123.7
Profit After Tax (before non-controlling interests) (FRS3)	41.2	40.2	24.9	66.8	87.1
Non-controlling interests	0.0	(3.7)	(11.9)	(16.5)	(9.4)
Average Number of Shares, Diluted (m)	332.9	379.8	433.4	440.0	466.4
EPS - normalised (p)	20.8	19.4	20.0	22.1	24.5
EPS - FRS 3 (p)	12.7	9.8	3.0	11.6	16.8
Dividend per share (p)	1.1	1.2	1.3	1.4	1.5
Gross Margin (%)	26.4	24.0	24.0	24.0	24.0
EBITDA Margin (%)	13.7	16.1	14.8	16.3	16.8
Operating Margin (before GW and except) (%)	13.2	15.5	14.3	15.8	16.2
BALANCE SHEET				**10%**	**11%**
Non-current Assets	538.4	890.7	972.7	1,094.3	1,082.5
Intangible Assets (incl Investment in programmes)	473.9	808.2	870.6	993.7	978.4
Tangible Assets	6.1	60.1	72.8	78.3	81.8
Deferred tax/Investments	58.4	22.4	29.3	22.3	22.3
Current Assets	634.3	752.0	928.3	917.8	989.0
Stocks	52.0	51.1	48.6	48.6	48.6
Investment in content rights	221.1	241.3	269.8	297.8	302.4
Debtors	289.9	351.3	476.5	496.4	563.0
Cash	71.3	108.3	133.4	75.0	75.0
Current Liabilities	(488.3)	(568.7)	(679.4)	(637.8)	(636.2)
Creditors	(398.7)	(470.7)	(574.6)	(533.0)	(531.4)
Short term borrowings	(89.6)	(98.0)	(104.8)	(104.8)	(104.8)
Long Term Liabilities	(319.6)	(413.6)	(464.6)	(550.4)	(540.4)
Long term borrowings	(295.9)	(309.1)	(368.3)	(454.1)	(444.1)
Other long term liabilities	(23.7)	(104.5)	(96.3)	(96.3)	(96.3)
Net Assets	364.8	660.4	757.0	823.8	894.9
CASH FLOW					
Operating Cash Flow	271.9	320.1	438.4	477.2	621.8
Net Interest	(13.4)	(31.0)	(25.0)	(23.9)	(29.5)
Tax	(10.8)	(17.7)	(18.4)	(22.6)	(31.2)
Capex	(4.8)	(8.6)	(3.8)	(11.0)	(10.0)
Acquisitions/disposals	(104.3)	(226.0)	(7.5)	(134.0)	0.0
Investment in content rights and TV programmes	(280.8)	(218.5)	(408.1)	(473.0)	(530.0)
Proceeds on issue of shares	0.0	194.6	0.0	53.2	0.0
Dividends	(2.9)	(4.0)	(8.3)	(10.0)	(11.0)
Net Cash Flow	(145.1)	8.9	(32.7)	(144.1)	10.0
Opening net debt/(cash)	165.1	314.2	299.0	339.7	484.0
Movements in exchangeable notes	0.0	0.0	0.0	0.0	0.0
Other including forex	(4.0)	6.3	(8.0)	(0.1)	0.0
Closing IFRS debt/(cash)	314.2	299.0	339.7	484.0	473.9
ANALYSIS OF NET DEBT					
Production finance	89.3	118.0	152.3	183.8	204.3
Net debt	224.9	181.0	187.4	300.2	269.7
Gearing	2.1	1.4	1.2	1.7	1.4

Source: Company accounts, Edison Investment Research

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 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia