EDISON

Entertainment One

2019: Year of the (Peppa) Pig

Interim results

Media

Entertainment One's interims are in line with expectations. Our FY19 and FY20 revenue forecasts are trimmed but we have lifted expected margins, leaving EBITDA and EPS broadly unchanged. This reflects the further mix shift to Family & Brands, where good momentum continues behind *Peppa Pig* and *PJ Masks,* especially in China. Film & TV is part-way through its transition from distribution to content production, with divisional EBITDA also impacted by an H2-weighted release schedule. The net effect was a group EBITDA margin of 14.8% (H118: 13.3%). Changing consumption patterns provide a strong backdrop to high-quality content providers such as eOne. We regard the shares as attractively priced on earnings and with regard to the portfolio valuation of $2.0bn.

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	19.7	0.3
03/18	1,044.5	177.3	144.4	21.9	1.4	18.0	0.4
03/19e	1,135.0	195.0	159.5	24.5	1.5	16.0	0.4
03/20e	1,250.0	215.0	183.0	27.9	1.6	14.1	0.4

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

Family in the front seat

H119 Family & Brands revenue was up 29%, on maintained EBITDA margins. The outlook is good through H219 and FY20e, buoyed by new and renewed SVOD (streaming video on demand) deals for *Peppa Pig* in China, along with a growing licensing and merchandising programme, a movie slated for release in early 2019 and an experiential offering with Merlin Entertainments. *PJ Masks* is following in the slipstream in China, having established a strong position in a short time frame in the US and UK. *Ricky Zoom* should launch by summer 2019, with licensing and merchandising to follow. In Film & TV, the shift to content production from lower-margin distribution continues, with less investment in acquired content. There were fewer film theatrical releases in the period, with total FY19 output now guided to 120 from 140. Film & TV revenues were down 7% on prior year, with EBITDA down 25%, with management guiding to a heavier revenue and EBITDA weighting to H2.

Debt management

Total planned investment in Film & TV content for FY19e is now £460m, from £524m, split 30%:70% Film: TV. H119 working capital outflows were higher than prior year due to timing in SVOD deals and film and, coupled with the impact of the Mark Gordon transaction, net debt at the half year was £433m. Our modelling indicates a year-end figure of £346m. The group's senior secured notes, due 2022, may be refinanced, which would reduce the interest charges.

Valuation: Family boost

Higher market multiples and the shift in mix lifts our sum-of-the-parts valuation, since children's content stocks are (at the moment) more highly valued by the markets, with quality content in limited supply. Our implied valuation at 495p is 15% ahead of our previous indications and 26% of the current market price.

20 November 2018

Price	**393.2p**
Market cap	**£1,822m**

Net debt (£m) at 30 Sep 18	433
Shares in issue	463.4m
Free float	95.4%
Code	ETO
Primary exchange	LSE (FTSE 250)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(14.1)	7.9	32.6
Rel (local)	(13.4)	16.9	40.0
52-week high/low		447.6p	268.0p

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$2.0bn, 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

Y/E trading update	Apr 19
Full year results	May 19

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Family power

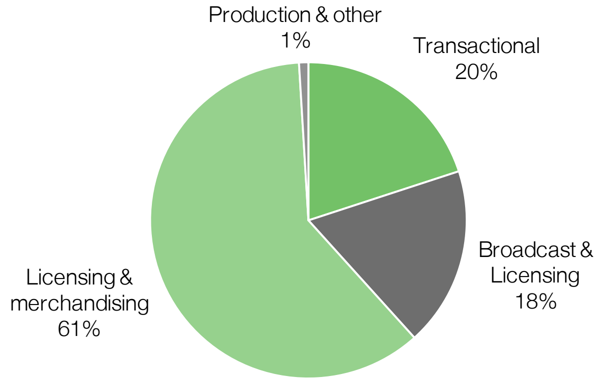
The flat H119 revenue, 10% uplift in underlying EBITDA (with consequent uplift in EBITDA margin) and broadly maintained forecasts are a reflection of the changing mix of the business as it shifts towards higher margin premium content. The Family & Brands division continued to perform particularly strongly with its strong character portfolio and associated licensing and merchandising offering. The change in the business is most pronounced in Film & TV as the focus on eOne developing its own exclusive content takes full hold.

Adjustments to forecasts – lower revenue, higher margins

While the statement indicates that the interim figures are in line with management expectations, we have revisited our forecasts in light of the change in mix and the guidance on spend on acquired and produced content. As a result, we have reduced our revenue expectations (FY19e: -6%; FY20e: -8%) but increased our EBITDA margin assumptions, from 16.0% up to 17.2% for FY19e and maintained the following year (was 15.9%). Minor changes to interest charges leave our EPS estimates unchanged. We have also edged up our expected year-end net debt number to £346m from £315m, which represents leverage of 1.8x EBITDA, as per management guidance.

Family & Brands: China power

Exhibit 1: H119 Family revenue split



Source: Company accounts

Key points from the interim statement are:

- Revenues up by 29%
- Increased volume of (high-margin) SVOD deals
- EBITDA margin maintained
- Retail revenues from Family brands increased from $1.2bn to $1.3bn

The new disclosures on revenue, described in more detail in May 2018 note, clearly demonstrate just how important the licensing and merchandising are for the division. Good distribution of the content is self-evidently key to driving retail demand and the TVOD and AVOD (ad-supported video on demand) channels remain crucial due to their heavier marketing spend to gain traction with their audiences.

The Chinese market is rapidly gaining in global importance, although still secondary to the US, and eOne continues to make impressive headway with terrestrial and SVOD deals, with the licensing and merchandising following in the wake. New and renewed SVOD deals are in place for *Peppa Pig* with Tencent, Youku, iQIYI and Mango TV and these four also all now carry *PJ Masks*.

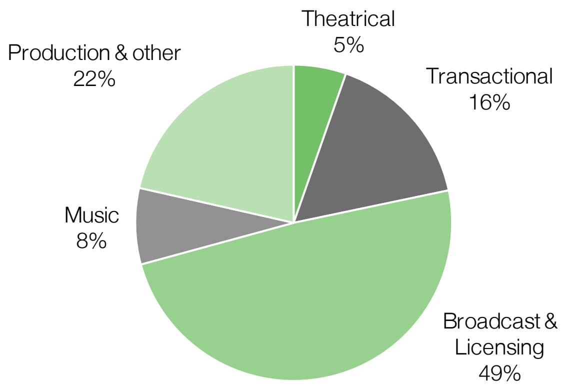
Peppa Pig is now a genuinely global and is certainly one of the highest-profile pre-school licensed brands. It accounted for 57% of divisional revenues, growing by 18% over H118 as China increases in the mix, although the brand is still strong in its more mature UK and US markets. New content is being delivered, with 117 further episodes set to air from Spring 2019 through to 2023, as well as a feature film co-produced with Alibaba which is also being released in Spring 2019. The Chinese New Year, starting 5th February 2019, is the Year of the Pig, which may give an additional boost.

PJ Masks is developing nicely and has built to 41% of divisional revenue as the licensing and merchandising rolls out. Again, the Chinese market is a major focus and two further seasons, one in production and one in development, should ensure that momentum is maintained. There were 1.4bn SVOD views of *PJ Masks* in China over its first five months.

Ricky Zoom (see September update note) airs for the first time next spring/summer, while a new series of *Cupcake & Dino* is scheduled for Netflix in H219. There are eight other projects currently in earlier development phases.

TV outshines Film for now

Exhibit 2: H119 Film & TV revenue split



Source: Company accounts

Both TV and Film are expected to have a much stronger H2 as projects air. In H119, broadcast & licensing revenues were ahead by 20%, while production revenues declined 26% as the timing of releases played out. For the full year, the group still expects to deliver over 1,000 half hours of acquired or produced content, accounting for 74% of the anticipated margin, and has 16 TV projects in development with networks or platforms. Acquired spend for the year is guided at an unchanged £45m, while TV production spend is guided at £275m is down from £309m, reflecting the higher element of non-scripted series' in the mix and the shorter 10-episode third series of *Designated Survivor* for Netflix. Non-scripted series will tend to sell at a lower value than scripted TV, but at an attractive margin.

Film production spend is also guided lower – from £70m to £50m as a result of the timing of releases, while the group's spend on acquired content is down 10% to £90m as the business model shifts in line with management's strategy.

The market remains good for high quality product - very much where eOne has set out its stall. The proliferation of distribution channels and competition between the major players (and new entrants) is driving them towards flagship series', which are then extended through commissioning of further episodes to maximise return from the brand franchise.

eOne has strong relationships with content creators and has the distinct advantage when competing for their output of being an independent player.

The costs savings from merging the TV and Film operations, for example by utilising a single global sales team, are set to deliver the expected £13-15m of annualised benefit, with around half that level in FY19. This is built into our forecasts.

Valuation

As previously, we have separated out the Film & TV and Family & Brands valuations for our peer-based valuation. This shows a valuation of £4.95 based on FY19e, 26% ahead of the current market price and an uplift of 15% from our £4.30 indication at the time or our last note in September. This reflects three factors:

- Increase in the share prices of comparators, expanding the current year multiple. When this exercise was carried out in September, Family stocks were on 13.7x current year EV/EBITDA (now 16.1x), while Film & TV multiples have expanded from 12.6x to 13.7x.
- a slight rebalancing of EBITDA toward the Family division;
- the market premium that family entertainment peers are accorded over more general (but relevant) film and TV entertainment stocks.

Exhibit 3: Peer multiple valuation

£m	2018	2019e	2020e
Film & TV - EBITDA	107	100	108
Family & Brands - EBITDA	82	107	121
Group costs and depreciation	-16	-17	-19
Multiples:			
Entertainment multiple (x)	13.1	13.7	12.1
Family multiple (x)	14.3	16.1	14.9
Film & TV EV	1403	1370	1305
Family & Brands EV	1174	1723	1805
Group costs	-215	-253	-257
Total EV	**2363**	**2840**	**2853**
Minorities	-165	-199	-200
corporate debt	315	346	278
Group equity	1883	2296	2375
shares in issue (m)	460.7	463.9	469.4
Implied value per share (£)	**4.09**	**4.95**	**5.06**
Implied value if PF is also treated as debt (£)	**3.84**	**4.70**	**4.82**

Source: Edison, I/B/E/S. Note: Prices at 19 November 2018

Exhibit 3: Financial summary

£m	2017	2018	2019e	2020e
Year end 31 March	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	1,082.7	1,044.5	1,135.0	1,250.0
Cost of Sales	(822.9)	(793.8)	(862.6)	(950.0)
Gross Profit	259.8	250.7	272.4	300.0
EBITDA	160.2	177.3	195.0	215.0
Operating Profit (before amort. and except.)	155.3	173.7	190.5	210.0
Amortisation of intangibles	(41.9)	(39.6)	(37.0)	(37.0)
Exceptional items	(40.8)	(7.1)	(7.0)	0.0
Share based payment charge	(5.0)	(12.6)	(13.5)	(14.0)
JV tax, finance costs, dep'n	0.0	0.0	0.0	0.0
Operating Profit	67.6	114.4	133.0	159.0
Net Interest	(25.4)	(29.3)	(31.0)	(27.0)
Exceptional finance items	(6.3)	(7.5)	0.0	0.0
Profit Before Tax (norm)	129.9	144.4	159.5	183.0
Profit Before Tax (FRS 3)	35.9	77.6	102.0	132.0
Tax (reported)	(12.3)	0.6	(23.5)	(30.4)
Tax (adjustment for normalised earnings)	(14.8)	(28.5)	(7.6)	(5.3)
Profit After Tax (before non-controlling interests) (norm)	102.8	116.5	128.4	147.3
Profit After Tax (before non-controlling interests) (FRS3)	23.6	78.2	78.5	101.6
Non-controlling interests	(11.9)	(13.7)	(10.5)	(11.5)
Average Number of Shares Outstanding (m)	432.7	447.6	480.9	486.3
EPS - normalised (p)	20.0	21.9	24.5	27.9
EPS - FRS 3 (p)	2.7	14.8	14.7	19.2
Dividend per share (p)	1.3	1.4	1.5	1.6
Gross Margin (%)	24.0	24.0	24.0	24.0
EBITDA Margin (%)	14.8	17.0	17.2	17.2
Operating Margin (before GW and except) (%)	14.3	16.6	16.8	16.8
BALANCE SHEET				
Non-current Assets	972.7	936.9	942.5	969.3
Intangible Assets (incl Investment in programmes)	870.6	805.4	821.0	859.3
Tangible Assets	72.8	104.3	104.8	104.8
Deferred tax/Investments	29.3	27.2	16.7	5.2
Current Assets	928.3	899.1	914.1	920.6
Stocks	48.6	39.6	39.6	39.6
Investment in content rights	269.8	253.4	252.6	244.1
Debtors	476.5	486.9	546.9	586.9
Cash	133.4	119.2	75.0	50.0
Current Liabilities	(679.4)	(691.5)	(696.8)	(706.8)
Creditors	(574.6)	(514.7)	(520.0)	(530.0)
Short term borrowings	(104.8)	(176.8)	(176.8)	(176.8)
Long Term Liabilities	(464.6)	(438.7)	(396.4)	(331.3)
Long term borrowings	(368.3)	(375.6)	(333.3)	(268.2)
Other long term liabilities	(96.3)	(63.1)	(63.1)	(63.1)
Net Assets	757.0	705.8	763.3	851.7
CASH FLOW				
Operating Cash Flow	425.3	470.9	574.8	698.2
Net Interest	(24.3)	(26.2)	(31.0)	(27.0)
Tax	(18.4)	(32.5)	(28.1)	(30.4)
Capex	(3.5)	(3.2)	(5.0)	(5.0)
Acquisitions/disposals	(9.6)	(118.5)	(5.0)	0.0
Investment in content rights and TV programmes	(373.6)	(437.4)	(483.5)	(580.0)
Proceeds on issue of shares	(19.2)	52.0	0.0	0.0
Dividends	(8.3)	(13.0)	(14.3)	(15.7)
Net Cash Flow	(31.7)	(107.9)	7.8	40.1
Opening net debt/(cash)	299.7	339.7	433.2	435.1
Movements in exchangeable notes	0.0	14.5	0.0	0.0
Other including forex	(8.3)	(0.1)	(9.7)	0.0
Closing IFRS debt/(cash)	339.7	433.2	435.1	395.1
ANALYSIS OF NET DEBT				
Production finance	152.3	118.7	89.6	116.9
Net debt	187.4	314.5	345.6	278.2

Source: Company accounts, Edison Investment Research

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