EDISON

Entertainment One

PJ Masks catching Peppa

Interim results

Media

eOne's H118 results delivered a 36% increase in EBITDA driven by an outstanding performance in Family with *Peppa Pig* making its mark in China and the rapid global roll out of *PJ Masks* establishing it as a global brand. Management has reiterated that the company is on track to deliver full year expectations; we have updated our forecasts for mix effects but leave our overall EBITDA forecast unchanged.

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	14.9	0.4
03/17	1,082.7	160.2	129.9	20.0	1.3	14.5	0.4
03/18e	1,076.1	175.1	146.1	22.1	1.4	13.2	0.5
03/18e	1,172.1	196.6	164.1	24.1	1.5	12.0	0.5

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

Strong growth in profitability

eOne's strategy to build a more balanced content and brand business paid dividends in the first half with an outstanding performance from Family (revenues +64%) and Television (+17%), offsetting the impact of a weak release slate in the Film division (-29%). Overall revenues, broadly flat, saw the mix swing significantly in favour of these higher-margin divisions, enabling a 36% increase in adjusted EBITDA to £51m and a 53% increase in adjusted PBT to £36m. Differences in the timing of major releases in Film compared to last year meant that cash conversion remained weak resulting in an increase in net debt to £312.8m.

PJ Masks joins Peppa as a global Family brand

The successful global roll out of *PJ Masks* saw its revenues increase 600% to contribute a third of Family revenues, rapidly catching *Peppa,* which also performed well (+18%) due to its early success in China. A solid performance at eOne Television and an excellent result at MGC, buoyed by the success of *Designated Survivor*, drove the strong growth in Television. Against a strong period last year, Film's relatively weak first half slate took its toll on the top line, with revenues down 29%. However, initiatives to realign the cost base enabled profitability to be maintained at last year's level with the group on track to deliver the £10m targeted savings this year. With 82% of the current year's budgeted profits already committed or greenlit, the outlook in Television remains robust. *PJ Masks*' roll-out and *Peppa*'s expansion in China should drive further growth in Family, and with a better slate and a further £8m of cost savings identified as part of the merger of the film and television studios, Film's margins should also recover in H218.

Valuation: Sum-of-the-parts of up to 362p

Despite the c 25% increase in the share price since the FY17 results in May, eOne is trading on an EV/EBIT discount of c 30% to its closest Film and Family peers. Evidence of continued expansion in the Television and Family divisions, along with a stabilisation of cash flows within Film could see the shares moving closer to our 362p sum-of-the-parts (SOTP) valuation.

21 November 2017

Price	**290p**
Market cap	**£1,249m**

Net debt (£m) at 30 September 2017	313
Shares in issue	429.6m
Free float	68%
Code	ETO
Primary exchange	LSE (FTSE 250)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.5	20.4	20.1
Rel (local)	2.3	20.4	9.7
52-week high/low		297.1p	214.5p

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

Trading update	March 2018

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H118 results highlights

Mix shift underpins strong EBITDA growth

H117 revenues decreased by 1% to £396m with very strong growth in Family (+64%) and Television (+17%) offsetting declines in Film (-29%). On a constant currency basis, revenues decreased 5%. While revenues were broadly stable, the mix effects of the shift in group revenues towards higher-margin divisions meant that adjusted EBITDA increased by 36% to £51m, and despite a higher adjusted finance charge flowing from last year's re-financing of £13.1m (H117: £11.5m), adjusted PBT increased by 53% to £36m and adjusted EPS by 85% to 4.8p. Reported PBT of £0.8m (H117: £2.5m loss) includes £3.3m of one-off charges, mainly relating to the set up costs of its new Film venture MAKEREADY, contingent consideration related to the Renegade 83 acquisition and the re-shaping of the Film and Television divisions. It also includes a one-off finance charge of £6.5m relating to losses on currency hedges. The group's policies have subsequently been tightened as £5.2m of these losses related to contracts that were not in compliance with the group's policy.

Net debt was £312.8m and production finance £141.8m, up from £187m and £118m, respectively, as at end March 2017.

Exhibit 1: Summary H118 results

Summary results (£m)	H117	H217	FY17	H118	y-o-y change	FY18e
Total revenues	401.0	674.4	1,082.7	395.7	(1%)	1,076.1
Total adjusted EBITDA	37.7	122.5	160.2	51.4	36%	175.1
EBITDA margin (%)	9.4%	18.2%	14.8%	13.0%		16.3%
PBT – adjusted	23.8	106.1	129.9	36.4	53%	146.1
EPS – adjusted (p)	2.6	17.4	20.0	4.8	85%	22.1
EPS – reported (p)	(0.5)		3.0	(1.4)		12.6
Investment in content and productions	198.4	209.7	408.1	229.8	16%	473.0
Net debt	263.3		187.4	312.8		223.4
IPF			152.3	141.8		183.8

Source: eOne (historics), Edison Investment Research (forecasts)

Divisional highlights and outlook

Exhibit 2: H1 results – divisional

Revenues (£m)	H117	H217	FY17	H118	y-o-y % growth
Television	144.5	350.4	502.2	168.5	17%
Family	37.9	50.7	88.6	62.1	64%
Film division revenues	242.0	352.2	594.2	171.8	(29%)
Eliminations	(23.4)	(78.9)	(102.30	(6.7)	(71%)
Total revenues	**401.0**	**681.7**	**1,082.7**	**395.7**	**(1%)**
Television EBITDA	18.5	44.3	62.8	20.6	11%
Family EBITDA	24.7	30.9	55.6	38.1	54%
Film EBITDA	(2.3)	55.0	52.7	(2.6)	13%
Group costs	(3.2)	(7.7)	(10.90	(4.7)	47%
Total adjusted EBITDA	**37.7**	**122.5**	**160.2**	**51.4**	**36%**
EBITDA margin (%)	9.4%	18.0%	14.8%	13.0%	
EBITDA margin – Television (%)	12.8%	12.6%	12.5%	12.2%	
EBITDA margin – Family (%)	65.2%	60.9%	62.8%	61.4%	
EBITDA margin – Film (%)	(1.0%)	15.6%	8.9%	(1.5%0	
Film Investment	94.0	48.6	142.6	93.4	(1%)
Television Investment	102.1	158.1	260.2	131.5	29%
Family Investment	2.3	3.0	5.3	5.0	126%
Total investment	**198.4**	**209.7**	**408.1**	**229.8**	**16%**

Source: eOne

Television (43% H1 revenues, 40% EBITDA)

Television revenues increased by 17%, supported by a 29% increase in investment. EBITDA increased by 11% with margins down slightly to 12.2% (H117: 12.8%) due to a lower margin at eOne Television, as well as mix effects with a greater proportion of MGC revenues now derived under an independent studio model. Across the three sub-divisions:

- eOne Television revenues increased by 22%. International sales benefited from the distribution of third-party content as well as the newer MGC productions. Although the number of half hours of content produced decreased (301 vs 360 in H117), overall investment increased as the emphasis has shifted to the production of higher profile titles. However, EBITDA margins decreased from 7.2% to 6.6% due to a weaker performance for the Canadian unscripted business. While this means eOne now expects to deliver fewer half hours of content than last year (900), the outlook for the remainder of the year appears well underpinned; 82% of the full year expected profits have been committed or greenlit, and the group still expects to invest over £40m in acquired content and £160m in production spend.
- Having increased sevenfold last year, MGC revenues increased by a further 82% in H118, driven by the delivery of season 1 and initial episodes for season 2 of *Designated Survivor*. These shows are sold on an independent studio model basis (rather than receiving a participation payment from its network partner, ABC). Consequently they are higher grossing but lower-margin sales. The EBITDA margin at 19% (H117: 32%) was consequently lower. MGC has a good pipeline of shows in production and development along with a number of film projects. In H218 it expects to deliver season two of *Designated Survivor*, a new teen drama *Youth and Consequences* (for YouTube Red) and the venture's first film since joining eOne – *Molly's Game* (which will also be distributed by eOne in its territories outside the US). 91% of this year's expected profits are committed or greenlit.
- Music revenues decreased by 9% against a strong comparison last year, which included the number one album *Cleopatra* from the Lumineers. Despite this, EBITDA increased by 16% as the division continued to benefit from last year's outsourcing of physical sales activities. By continuing to focus on digital distribution and artist management, while at the same time leveraging its content across the group, eOne believes it can continue to improve the profitability of this division.

Family (16% H1 revenues, 74% EBITDA)

Revenues increased by 64% driven by an exceptional performance from *Peppa* and *PJ Masks*. *Peppa* generated £37.4m of revenues (+18% y-o-y) with growth driven by the brand's performance in China where licensing and merchandising increased by over 700%. Asia remains a key growth opportunity; the number of licensing arrangements in China is expected to grow from 20 (end FY17) to 60 by the end of FY18. A further 117 episodes are in production for delivery over the three years to December 2021 and its addition to Merlin Entertainments' theme parks (first ones to be opened in 2018), as well as the success of last year's film support the fact that the *Peppa* brand remains on a firm footing in its more mature markets, and signal that it has achieved evergreen status.

PJ Masks has had a stellar performance and is fast approaching *Peppa*'s scale, but in a much shorter period of time. Revenues increased over 600% to £22.3m in H118 and *PJ Masks* now accounts for more than a third of divisional revenues. This growth was largely driven by the global roll-out by master toy partner Just Play and new licensing deals. Building on this early momentum, deals are being signed across Europe, Australia and Asia with a full launch in China planned for next year. It is broadcasting in all key territories on Disney Junior and France TV. A second season (52 episodes) is in production and a third has been greenlit.

Film (44% H1 revenues, -5% EBITDA)

The Film division's revenues were affected by a weaker cinema slate (theatrical revenues -45%), which featured fewer high-profile films (H117 included Spielberg's *The BFG*) as well as the generally challenging marketplace across all other distribution channels (home entertainment revenues -39%, broadcast and digital -28%). Growth was also affected by the group's retrenchment from physical distribution of music in the US. The pipeline for the second half of the year is stronger, including Spielberg's *The Post, A Bad Moms Christmas* and *Molly's Game*. Nevertheless, the £150m spend targeted for investment in acquired content at the start of the year has been reduced to £130m, while investment in productions is still expected to increase year-on-year.

The re-shaping of the Film division started in 2016 and has seen the division move away from physical distribution towards digital, and has now delivered the targeted £10m run rate of savings, which meant that the EBITDA performance was broadly maintained despite the weaker top line. Management has also identified a further £8m of savings, to be delivered by 2020 as a result of the integration of the Film and Television studios, announced at the end of last year.

Cash conversion and balance sheet

Net debt of £312.8m was reported (year to March 2017: £187m) and production finance of £141.8m (£118m).

The level of production finance is broadly in line with our expectations. The group invested £229.8m in content and productions, a 16% increase on H117 with the vast majority of the increase seen in the Television division. Almost two-thirds of this now relates to produced rather than acquired content (H117: 45%), in line with the group's strategy to create a more balanced content business and to move closer to the creative process. This is reflected in the greater use of production financing, which we view as a positive signal that the group is delivering to its strategy.

The increase in net debt (corporate debt) was higher than we expected. Cash conversion was affected by the £41m exceptional costs announced in 2017 related to the restructuring of the Film division. In addition, variance in the timing of major film releases in the Film division compared to FY17 resulted in a £36m investment in content gap as well as a working capital outflow of £25m. This should reverse in part in the second half of the year although management now expects year end gearing to be approximately 1.3x EBITDA (up from its previous guidance of 1.2x).

Exhibit 3: H118 cash flow

(£m)	Non IPF funded business					IPF funded business				
	TV	Family	Film	plc	Total	TV	Family	Film	plc	Total
EBITDA	18.5	38.4	(2.7)	(4.7)	49.5	2.1	(0.3)	0.1		1.9
Production IIC gap	3.1	(0.8)	(36.1)		(33.8)	(60.7)	(1.9)	(16.9)		(79.5)
Content IIC gap	(12.3)	(0.8)	1.0		(12.1)		(0.1)			
Working capital	0.0	(10.4)	(25.4)	0.3	(35.5)	58.7	(0.1)	28.9		87.5
JV movements					0.0					0.0
Adjusted cash flow	9.3	26.4	(63.2)	(4.4)	(31.9)	0.1	(2.3)	12.1		9.9
Cash conversion	50%	69%	N/A	94%	N/A	5%	N/A	N/M		500%
Capital expenditure					(1.5)					0.0
Tax paid					(21.7)					(1.0)
Net interest paid					(11.5)					(0.7)
Free cash flow					(66.6)					8.2
One-off items					(41.2)					(1.8)
Acquisitions					(3.2)					0.0
Other					0.0					0.0
Dividends paid					(10.0)					
Foreign exchange/ other					(4.4)					4.1
Movement					(125.4)					10.5
Net financing/debt at the start of the period					(187.4)					(152.3)
Net financing/debt at the end of the period					(312.8)					(141.8)

Source: eOne

Forecasts updated for mix effects

With 82% of Television budgeted margins committed or greenlit for the year, strong momentum being generated by *PJ Masks* and *Peppa* around the world, and a better slate in the second half in Film, management has confirmed that the company remains on track to deliver its full year expectations.

We have updated our forecasts to reflect the lower anticipated investment in content in Film and Television, as well as for revenue mix effects (raising our estimates for Family, offset by lower Film). This results in a reduction in our revenue forecasts, but at the EBITDA level overall we leave our forecast broadly unchanged. We raise our year-end net debt forecast to £223m (from £204m).

Exhibit 4: Summary forecast changes

(£m)	2018e			2019e		
	Previous	New	Change	Previous	New	Change
Revenues	1,180.2	1,076.1	(9%)	1,280.1	1,172.1	(8%)
EBITDA	175.0	175.1	0%	199.9	196.6	(2%)
Investment in content	483.0	473.0	(2%)	550.0	530.0	(4%)
PBT – normalised	146.0	146.1	0%	167.4	164.1	(2%)
EPS (p)	22.0	22.1	0%	24.7	24.1	(2%)
Net debt	204.4	223.5	9%	160.6	189.8	18%
IPF	185.6	183.8	(1%)	210.0	204.3	(3%)

Source: Edison Investment Research

Valuation: SOTP indicates upside to 362p

A straight EBITDA peer comparison in this sector is complicated by the fact that while eOne and some of its larger Film peers include amortisation of programming costs in their definition of EBITDA, the smaller film companies, television and brand licensing groups do not. We believe an EBIT comparison is a more consistent metric. On this basis, eOne trades on a 10.8x EV/EBIT multiple in FY18e and 9.5x in FY19e (this is based on a more conservative definition of EV that includes the value of IPF debt. Excluding this financing, the EV/EBIT multiple is 10.0x and 8.9x in FY18e and FY19e, respectively).

While the shares have increased by c 25% since the FY17 results in May, eOne's valuation rating remains at a considerable discount to its peer group average of 14.6x FY18 EV/EBIT and 12.5x FY19e.

Given the diversity of content it now produces and distributes, as well as the differing margins and performance of each division, a sum-of-the-parts valuation is appropriate. There are considerable synergies now being generated across the group and we do not believe that a discount to this value is deserved. On this basis, we believe the share could be worth up to 362p.

Exhibit 5: Sum-of-the-parts

(£m)	FY18e	FY19e	Comment
EBIT multiples (x)			
Film	10	8	25% discount to US peers (reflecting smaller scale and European media sector ratings discount)
eOne Television	12	11	In line with TV groups and majors
MGC	13	12	In line with other TV groups and majors
Music	9	9	Average sector multiple
Family	15	14	Growth multiple attached to strong brands. Align to DHX peer
Plc costs	9	9	Relatively fixed costs – align to low growth divisions
Implied enterprise values (£m)			
Film	500	408	
eOne Television	399	444	
MGC (51%)	175	182	
Music	50	53	
Family	1,072	1,136	
Plc costs	(153)	(162)	
Other minority adjustments	(25)	(20)	
Total EV, £m	2,018	2,041	
Corporate debt, £m	321	321	
IPF, £m	142	142	
Implied equity value, £m	1,558	1,581	
NOSH (m)	429	429	
Implied value per share (p)	362	368	

Source: Edison Investment Research

Exhibit 6: 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)	0.0
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	145.1
Net Interest	(14.8)	(20.6)	(25.4)	(23.5)	(26.0)
Exceptional finance items	(1.4)	(6.5)	1.3	(6.5)	0.0
Profit Before Tax (norm)	88.8	104.1	129.9	146.1	164.1
Profit Before Tax (FRS 3)	44.0	47.9	37.2	91.3	119.1
Tax (reported)	(2.7)	(7.7)	(12.3)	(20.1)	(27.4)
Tax (adjustment for normalised earnings)	(16.8)	(16.8)	(16.1)	(12.1)	(10.4)
Profit After Tax (before non-controlling interests) (norm)	69.3	79.6	101.5	114.0	126.4
Profit After Tax (before non-controlling interests) (FRS3)	41.2	40.2	24.9	71.2	91.7
Non-controlling interests	0.0	(3.7)	(11.9)	(17.5)	(19.9)
Average Number of Shares, Diluted (m)	332.9	379.8	433.4	437.5	442.0
EPS – normalised (p)	20.8	19.4	20.0	22.1	24.1
EPS – FRS 3 (p)	12.7	9.8	3.0	12.6	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					
Non-current Assets	538.4	890.7	972.7	969.3	947.5
Intangible Assets (incl Investment in programmes)	473.9	808.2	870.6	869.7	854.4
Tangible Assets	6.1	60.1	72.8	78.3	81.8
Deferred tax/Investments	58.4	22.4	29.3	21.3	11.3
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)	(637.6)	(634.5)
Creditors	(398.7)	(470.7)	(574.6)	(532.8)	(529.7)
Short term borrowings	(89.6)	(98.0)	(104.8)	(104.8)	(104.8)
Long Term Liabilities	(319.6)	(413.6)	(464.6)	(473.7)	(460.5)
Long term borrowings	(295.9)	(309.1)	(368.3)	(377.4)	(364.2)
Other long term liabilities	(23.7)	(104.5)	(96.3)	(96.3)	(96.3)
Net Assets	364.8	660.4	757.0	775.7	841.5
CASH FLOW					
Operating Cash Flow	271.9	320.1	438.4	484.2	623.1
Net Interest	(13.4)	(31.0)	(25.0)	(23.5)	(26.0)
Tax	(10.8)	(17.7)	(18.4)	(24.1)	(32.9)
Capex	(4.8)	(8.6)	(3.8)	(11.0)	(10.0)
Acquisitions/disposals	(104.3)	(226.0)	(7.5)	(10.0)	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	0.0	0.0
Dividends	(2.9)	(4.0)	(8.3)	(10.0)	(11.0)
Net Cash Flow	(145.1)	8.9	(32.7)	(67.4)	13.3
Opening net debt/(cash)	165.1	314.2	299.0	339.7	407.3
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	407.3	394.0
ANALYSIS OF NET DEBT					
Production finance	89.3	118.0	152.3	183.8	204.3
Net debt	224.9	181.0	187.4	223.5	189.8

Source: eOne (historics), Edison Investment Research (forecasts)

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