EDISON

Entertainment One

FY17 results

Strong performance across the group

Media

An excellent performance in Television and Family and the recovery in Box Office in Film underpinned strong revenue and EBITDA growth in FY17 and the outlook for FY18 remains positive. The efforts that the group has made to move closer to the creative process in Film, and to diversify beyond Film, has greatly improved the financial and risk profile. We expect the ratings gap to peers to narrow.

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	12.4	0.5
03/17	1,082.7	160.2	129.9	20.0	1.3	11.9	0.5
03/18e	1,180.2	175.0	146.0	22.0	1.4	10.9	0.6
03/19e	1,280.1	199.9	167.4	24.7	1.5	9.8	0.6

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

Television and Family power growth, Film stable

Revenues increased 35%, 8pp ahead of our estimates with an exceptional performance from Television (+85%) and Family (+33%) and the Sierra acquisition supporting the Film division's overall growth (+7%). Currency and acquisitions contributed 15% and 6%, respectively. EBITDA growth of 24% lagged revenue growth due to mix effects, but was broadly in line with our forecast as was adjusted EPS at 20.0p. Net debt increased slightly to £187.5m (1.2x EBITDA) and a dividend of 1.3p has been proposed.

On the front foot

The pipeline for FY18 is strong in Television, which has over two-thirds of its budget committed or green-lit. In Family, *Peppa Pig* has firmly established itself in the US and continues to build a following in China. With another 117 episodes commissioned, the brand should remain fresh for some time. Encouragingly, *P J Masks* appears to be following suit. At a cost of £47m, the reshaping of the Film division is being accelerated to support eOne's strategy to move closer to the creative process, as it has with MGC, Spielberg's Amblin and (announced last week) Brad Weston. Additional efficiencies are expected by combining Film and Television into one studio. We are changing the mix of forecasts between revenues and margins which reduced our FY18e EBITDA by 2% and a slightly higher tax rate leads us to reduce EPS by 7%. We introduce a FY19e EPS estimate of 24.7p.

Valuation: Improved financial and risk profile

69% of EBITDA is now derived from the higher growth, lower risk Television and Family divisions. While Film is more mature, last year's Box Office recovery puts this division on a more stable footing and the group's strategy to bring itself closer to the production process should also help it to better manage the profile and risk of films being distributed. This strategy, which leans more towards created rather than acquired content is also less capital intensive. The 20% FY18e EV/EBITDA discount to peers (Lionsgate, DHX) is unjustified in our view.

23 May 2017

Price	**241.4p**
Market cap	**£1,029m**
Net debt (£m) as at 31 March 2017	187.5
Production finance (£m) as at 31 March 2017	152.3
Shares in issue	426.6m
Free float	68%
Code	ETO
Primary exchange	LSE (FTSE 250)
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.4)	(1.7)	38.9
Rel (local)	(6.6)	(4.5)	13.3
52-week high/low		255.0p	156.5p

Business description

Entertainment One is a leading international entertainment company that sources, selects and sells films and television content. Its library contains over 40,000 film and TV titles, 4,500 half-hours of TV programming and 45,000 music tracks.

Next event

FY18 interims	November 2017

Analysts

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Edison profile page

Entertainment One is a research client of Edison Investment Research Limited

FY17 results: TV & Family power growth, Film recovers

Revenues increased 35% y-o-y to £1,082.7m, 8% ahead of our forecast. Television grew by 85% y-o-y (19% higher than forecast), Family by 33% (13% ahead of our forecast) and Film 7% (in line with our estimates). Acquisitions (65% of Renegade 83 acquired in March 2016, as well as the full year impact of Sierra Pictures acquired in December 2015 and some smaller deals) contributed £50.2m (6%) to revenue growth and currency 15%. Underlying EBITDA of £160.2m increased 24% y-o-y (or 15% at constant currency), 2% ahead of our forecast (Exhibit 1). The EBITDA margin at 14.8% decreased by 1.3pp y-o-y reflecting mix effects, in particular the impact of first revenues from productions contracted under the independent studio model by MGC, the impact of the lower margin Sierra acquisition and a 74% increase in central costs related to the growth of the business. Acquisitions contributed 0.5% to EBITDA.

Adjusted PBT of £129.9m is broadly in line with our estimate and includes £25.4m of net finance charges. This was higher than those incurred in FY16 (£20.6m), despite the lower average corporate net debt level, reflecting the full year impact of higher interest rates following the December 2015 refinancing. Reported PBT of £37.2m was affected by significant one-off charges relating principally to the re-shaping of the Film division (see our note: Exceptional charge to restructure Film). Adjusted EPS of 20.0p (in line with our forecast) increased at a slower rate than PBT, as a result of the dilutive impact of the October 2015 rights issue.

In line with our forecasts, eOne invested £408m in content and productions, a significant increase on the £218.5m invested in FY16 with the vast majority of the increase seen in the Television division, alongside a better cinema slate in Film.

More than half of this content was financed through production financing (which increased to £152.3m at the year-end), with £215.7m of the total financed by eOne. The up-front payments required with a strong film slate and the ongoing working capital impact of the transition to a digital distribution model, affected adjusted cash conversion which decreased to 52% (FY16:62%). Year-end net debt increased slightly to £187.5m, 15% ahead of our forecast; on a consolidated basis net debt was broadly in line (£339.7m). The board is proposing a full year dividend of 1.3p per share (FY16: 1.2p).

Management is guiding to another strong year of revenue and profit growth in Television and Family and expects a more stable performance in Film in the current year.

Exhibit 1: Summary results

Year end March (£m)	FY16a	FY17a	change y-o-y	FY17e	Difference to forecast %
Revenues	802.7	1,082.7	34.9%	1,003.1	7.9%
EBITDA	129.1	160.3	24.2%	157.0	2.1%
EBITDA margin	16.1%	14.8%		15.7%	(1.3%)
Operating income	124.7	155.3	24.5%	151.7	2.4%
Amortisation of acq. intangibles	(27.4)	(41.9)		(33.0)	27.0%
Share based payments	(4.1)	(5.0)		(4.0)	25.0%
JV tax, finance costs and depreciation	(1.6)	0.0		0.0	
Exceptional items	(16.6)	(47.1)		(7.5)	528.0%
Reported operating profit	75.0	61.3	(18.3%)	107.2	(42.8%)
PBT adjusted	104.1	129.9	24.8%	126.7	2.5%
PBT - reported	47.9	37.2	(22.3%)	82.2	(54.7%)
EPS - adjusted, diluted (p)	19.4	20.3	3.1%	20.0	1.5%
EPS - reported, diluted (p)	9.7	3.0	(69.1%)	12.6	(23.0%)
Other KPIs					
Net debt - corporate	180.8	187.5	3.7%	169.3	10.8%
Net debt – Production Finance	118.0	152.3	29.1%	189.8	(19.8%)

Source: eOne (actuals), Edison - forecasts

Divisional performance and outlook

Exhibit 2: Summary divisional performance and forecasts

Year end March (£m)	FY16a	FY17 a	% change y-o-y	FY18e	FY19e
Investment in content & production:					
Television	102.5	260.0	154%	294.0	340.0
Family	5.8	5.3	(9%)	9.0	10.0
Film	110.2	142.6	29%	200.0	200.0
Total investment in content &production	**218.5**	**407.9**	87%	**503.0**	**550.0**
Of which - acquired	*121.5*	*181.2*		*198.0*	*203.4*
Of which - produced	*97.0*	*226.7*		*305.0*	*346.6*
Revenues:					
Television	244.7	452.7	85%	528.0	611.7
Family	66.6	88.6	33%	115.2	132.5
Film	553.4	594.2	7%	597.0	601.0
Inter segment	(62.0)	(52.8)	(15%)	(60.0)	(65.1)
Total revenues	**802.7**	**1,082.7**	35%	**1180.2**	**1280.1**
EBITDA:					
Television	39.2	62.8	60%	68.9	80.4
Family	43.3	55.6	28%	63.3	72.9
Film	52.8	52.7	(0%)	53.5	57.5
Inter segment	(6.2)	(10.8)	74%	-10.8	-10.8
Total EBITDA	**129.1**	**160.3**	24%	**175.0**	**199.9**
EBITDA margin (%)	16.1%	14.8%		14.8%	15.6%

Source: eOne – reported, Edison - forecast

Television: Now eOne's largest division by EBITDA

eOne increase its investment in Television by 154% to £260.2m in FY17 and the impact was clearly evident in the division's performance. Revenues increased by 85% to £452.7m and EBITDA by 60%. EBITDA margins decreased by 2.1pp to 13.9% due to mix effects, with MGC's new productions (which are sold under an independent studio model) growing disproportionately strongly. Growth was strong across the three sub-divisions (Exhibit 2).

- eOne Television delivered 1,023 half hours of content (FY16: 998), revenues increased by 75% to £328.2m and EBITDA by 36% to £30.9m. The US Scripted business performed well, delivering a good mix of both returning series (*Rogue, Saving Hope*) and newer shows (*Private Eyes, Ice and Cardinal, You Me Her*). Non-scripted benefited from the acquisition of Renegade 83; however, the US reality business was weaker. The non-scripted business was reorganised during the year with Paperny Entertainment and Force Four Entertainment combined (£1.1m of cost savings are expected as a result). International sales were also helped by the distribution of *Designated Survivor* (MGC) which included a worldwide streaming rights deal (ex US) with Netflix.
- MGC revenues increased more than sevenfold to £119.9m and EBITDA by 82% to £26.2m (or 140% on a like-for-like basis) as a result of the success of newer shows; *Designated Survivor* (one of ABC's most watched dramas) and *Conviction* added to the participation revenues received from MGC's staple of existing shows. These new productions are sold on an independent studio model (rather than receiving a producer fee) and consequently are higher grossing but lower margin sales.
- Music revenues increased by 28% to £54.1m, boosted by the full year impact of last year's Dualtone Music and Last Gang Entertainment acquisitions, as well as a strong release schedule; 79 albums were released (FY16: 64) including the US Billboard hit album *Cleopatra* from The Lumineers. Efficiency measures which included the outsourcing of physical sales activities and a higher share of digital meant that EBITDA increased by 185% to £5.7m.

The strong performance looks set to continue in the current year and management is budgeting a 13% increase in investment. There is a good pipeline of returning shows and a number of new series waiting to be green-lit; eOne Television is targeting around 1,000 half hours of programming in the current year and has 60% of its budget already committed; MGC's return series continue to perform well (*Criminal Minds, Greys Anatomy, Ray Donovan* and *Quantico*) and *Designated Survivor* has been renewed for a second season. It also has a number of film projects underway for which it is receiving producer fees; 84% of FY18 budget has been committed. In addition, the TV sales force for eOne Television and Film has been combined to better leverage the group's scale (on content windows outside of cinema) and is expected to result in improved revenues and profitability from the current year.

Family: PJ Masks joins Peppa as a significant asset for the group

FY17 was another stellar year for Family, which increased revenues by 33% and EBITDA by 28%. Growth continues to be driven by its largest asset *Peppa Pig,* which generated retail sales of over $1.2bn in FY17 (FY16: $1.1bn), buoyed by the widening of the licensing and merchandising programme in the US (+170%), now eOne's largest licensing market. While the UK, Australia, Italy and Spain are arguably now fairly mature markets for *Peppa*, the brand has been refreshed this year with an additional 52 episodes and its first film release (*Peppa Pig: My First Cinema Experience*) and last week's announcement that a further 117 episodes will be delivered between 2019 and 2023, which should keep the brand fresh for some time to come. Growth opportunities remain in Asia, notably China, and a number of other European markets which should continue to power growth internationally.

It is particularly encouraging to see that one of eOne's newer brands, *PJ Masks,* is now having a considerable impact; revenues increased by 500% y-o-y to £13.3m (15% of total revenues). The show is now being rolled out in 85 territories across the Disney Junior Network and France TV and the licensing programme, which started in the US in September last year will be widened this year.

Management expects Family revenue and EBITDA to grow significantly in FY18, although increased investment in the sales platform in a number of markets and higher royalty payments for *PJ Masks* will lead to a decline in the EBITDA margin.

Film: re-shaping the division

Revenues increased by 7% to £594.2m, although higher up-front costs associated with a film's release to cinema, as well as the full year impact of the acquisition of the lower margin Sierra Pictures meant EBITDA was flat y-o-y at £52.7m.

The volume of films distributed decreased to 172 (FY16:210); however, several high profile releases including the *BFG, The Girl on the Train* and multiple Oscar winning *La La Land* enabled theatrical revenues to increase by 50%, offsetting the headwinds in home entertainment (down 22%) and broadcast and digital (flat) from the previous year's weaker slate. Production and international sales increased by 79% to £108.0m following the acquisition of Sierra Pictures in FY16 and the buyout of Sierra Affinity in the current year.

eOne believes that it can drive a more consistent and improved performance by taking greater control over the content it distributes; this means fewer large output deals where visibility beyond the early years tends to be low, becoming involved in a film earlier in the production process, and by focusing on fewer, but higher quality films. This strategy is already evident with the relationships that eOne has developed with Spielberg's Amblin, MGC and (announced last week) the new Brad Weston venture, MAKEREADY and yesterday's (22 May) announcement of a new distribution partnership with Annapurna Pictures.

It is also accelerating the restructuring programme initiated last year (targeting £10m cost savings) which will involve the continued streamlining of operations, the creation of a merged sales team for TV and Film, and the consolidation of other functions. eOne has provided £47m to cover the re-shaping of the Film division, including a one off £20m charge related to the renegotiation of one of its larger distribution agreements.

For the year ahead, management is budgeting a 40% increase in investment. The cinematic slate looks solid, including titles from Luc Besson *(Valerian and the City of a Thousand Planets)*, Spielberg *(The Post),* Aaron Sorkin (*Molly's Game*) and George Clooney (*Suburbicon*). Home entertainment should benefit from the tailwinds of the stronger Box Office performance in FY17.

Cash flow: Greater use of production finance

Cash conversion (excluding production financing) was 52% of which Television was 96%, Family 91% but Film -16%. The low cash conversion in Film is partly to be expected in a year of a strong cinema release slate due to the timing of up-front minimum guarantee payments (and should unwind during the course of the current year). However, cash conversion also continues to be affected by significant working capital outflows related to the growing proportion of sales derived from digital distribution (where revenues are recognised up front, but cash is received monthly). After interest expenses (£24.2m), exceptional costs related to the restructuring of the film division (£17.6m), payments for acquisitions (£9.6m), dividends (£8.3m) and foreign exchange (£7.6m), year-end net debt increased slightly to £187.5m (FY16: £180.8m), equivalent to 1.2x EBITDA.

The use of production finance increased during the year to £152.3m (FY16: £118.0m), consistent with the group's strategy to become closer to the production process in Film and to scale its Television activities.

Forecast changes

FY18 looks set to be another good year for eOne in both Television and Family, and Film appears to be on a more stable footing. We have updated our forecasts to reflect the significant revenue beats in Television and Family. However, a lower EBITDA margin profile and a slightly higher tax rate (22%) translate to a 7% reduction in our EPS estimate to 22.0p. We also introduce forecasts for FY19, which assume ongoing strong growth in Television and Family, with a more stable performance in Film. Our changes to forecasts are summarised in Exhibit 3 and full forecasts are presented at the back of this report.

Exhibit 3: Summary forecast changes

		2018e		2019e
	Previous	New	% change	Introduced
Revenues (£m)	1,093.9	1,180.2	8%	1,280.1
EBITDA (£m)	178.0	175.0	-2%	199.9
Investment in content	500.0	503.0	1%	550.0
Amortisation				
PBT - normalised	149.4	146.0	-2%	169.9
EPS (p)	23.7	22.0	-7%	24.7
Net debt	125.1	204.4	63%	160.6
IPF	215.2	185.6	-14%	210.0
Consolidated IFRS net debt	340.3	389.9	15%	370.6

Source, Edison forecast

Valuation: Significantly improved risk profile

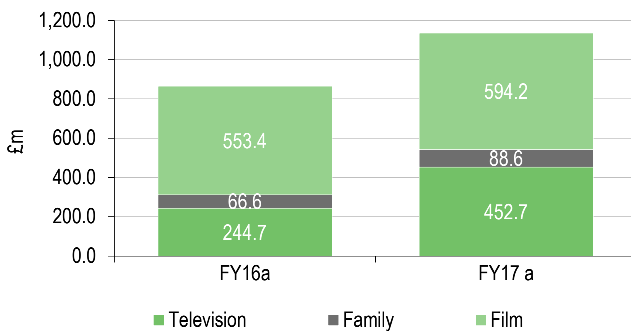
Based on the more conservative calculation of EV (including production finance), eOne trades on a FY18e EV/EBITDA multiple of 8.4x and a P/E of 10.9x. According to Bloomberg (21 May 2017), eOne's closest US peer, Lionsgate (TV/ Film content) trades on 12.7x FY18e EV/EBITDA and 16.1x P/E and Canadian listed DHX Media (children's content) is on 9.0x EV/EBITDA and 18x P/E.

The operational, financial and risk profile of eOne has improved considerably over the last two years and we consider this discount unjustified.

- The higher growth divisions of Television and Family now account for 69% of EBITDA. With Film on a more stable footing, this underpins our forecast EPS growth of 12% in FY18e and 16% in FY19e.
- The financial risk profile of investment into Television content is considerably lower than for Film as it does not involve large up-front minimum guarantees, and the majority of production costs are covered by up-front commitments or subsidies before a show is green lit.
- Over 50% of eOne's content sales are now financed by production finance. The group's gearing is a comfortable 1.2x EBITDA and we expect this to decrease further in the current year.

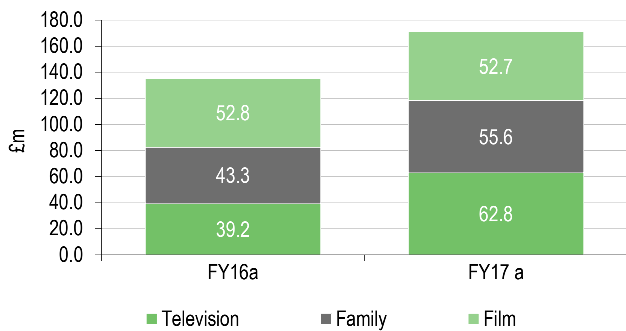
Taking an average of the Lionsgate and DHX EBITDA multiples implies a value for eOne of 343p.

Exhibit 4: Revenue contribution



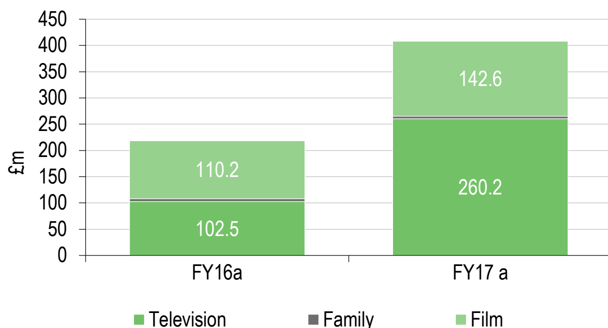
Source: eOne, Edison Investment Research

Exhibit 5: EBITDA contribution



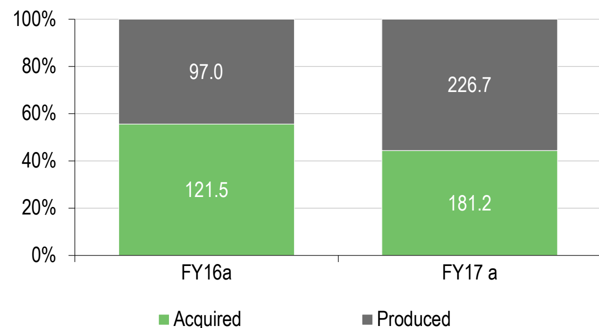
Source: eOne, Edison Investment Research

Exhibit 6: Divisional investment in content and production



Source: eOne

Exhibit 7: Produced vs acquired content



Source: eOne

Exhibit 8: Financial summary

£m	2014	2015	2016	2017	2018e	2019e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	823.0	785.8	802.7	1,082.7	1,180.2	1,280.1
Cost of Sales	(642.3)	(578.0)	(610.1)	(822.9)	(896.9)	(972.9)
Gross Profit	180.7	207.8	192.6	259.8	283.2	307.2
EBITDA	92.8	107.3	129.1	160.2	175.0	199.9
Operating Profit	90.2	103.6	124.7	155.3	169.5	193.4
Amortisation of intangibles	(36.0)	(22.2)	(27.4)	(41.9)	(40.0)	(40.0)
Exceptional items	(22.1)	(17.9)	(16.6)	(47.1)	0.0	0.0
Share based payment charge	(2.7)	(3.4)	(5.7)	(5.0)	(5.0)	(5.0)
JV tax, finance costs, dep'n	0.0	0.1	(1.6)	0.0	0.0	0.0
Operating Profit	29.4	60.2	73.4	61.3	124.5	148.4
Net Interest	(11.8)	(14.8)	(20.6)	(25.4)	(23.5)	(26.0)
Exceptional finance items	3.9	(1.4)	(6.5)	1.3	0.0	0.0
Profit Before Tax (norm)	78.4	88.8	104.1	129.9	146.0	167.4
Profit Before Tax (FRS 3)	21.5	44.0	47.9	37.2	101.0	122.4
Tax (reported)	(1.5)	(2.7)	(7.7)	(12.3)	(22.2)	(28.2)
Tax (adjustment for normalised earnings)	(18.4)	(16.8)	(16.8)	(16.1)	(9.9)	(10.4)
Profit After Tax (before non-controlling interests) (norm)	58.5	69.3	79.6	101.5	113.8	128.9
Profit After Tax (before non-controlling interests) (FRS3)	20.0	41.2	40.2	24.9	78.7	94.3
Non-controlling interests	0.0	0.0	(3.7)	(11.9)	(17.5)	(19.9)
Average Number of Shares, Diluted (m)	318.7	332.9	379.8	433.4	437.5	442.0
EPS - normalised (p)	18.4	20.8	19.4	20.0	22.0	24.7
EPS - FRS 3 (p)	5.5	12.7	9.8	3.0	14.4	17.4
Dividend per share (p)	1.0	1.1	1.2	1.3	1.4	1.5
Gross Margin (%)	22.0	26.4	24.0	24.0	24.0	24.0
EBITDA Margin (%)	11.3	13.7	16.1	14.8	14.8	15.6
Operating Margin (before GW and except) (%)	11.0	13.2	15.5	14.3	14.4	15.1
BALANCE SHEET						
Non-current Assets	366.0	538.4	890.7	972.7	956.9	927.8
Intangible Assets (incl Investment in programmes)	343.1	473.9	808.2	870.6	857.3	834.7
Tangible Assets	5.5	6.1	60.1	72.8	78.3	81.8
Deferred tax/Investments	17.4	58.4	22.4	29.3	21.3	11.3
Current Assets	559.9	634.3	752.0	928.3	942.8	1,015.6
Stocks	47.2	52.0	51.1	48.6	48.6	48.6
Investment in content rights	230.1	221.1	241.3	269.8	287.8	291.0
Debtors	243.7	289.9	351.3	476.5	531.4	600.9
Cash	38.9	71.3	108.3	133.4	75.0	75.0
Current Liabilities	(449.2)	(488.3)	(568.7)	(679.4)	(673.9)	(682.1)
Creditors	(401.1)	(398.7)	(470.7)	(574.6)	(569.1)	(577.3)
Short term borrowings	(48.1)	(89.6)	(98.0)	(104.8)	(104.8)	(104.8)
Long Term Liabilities	(168.6)	(319.6)	(413.6)	(464.6)	(456.4)	(437.1)
Long term borrowings	(155.9)	(295.9)	(309.1)	(368.3)	(360.1)	(340.8)
Other long term liabilities	(12.7)	(23.7)	(104.5)	(96.3)	(96.3)	(96.3)
Net Assets	308.1	364.8	660.4	757.0	769.3	824.2
CASH FLOW						
Operating Cash Flow	264.2	271.9	320.1	438.4	534.0	660.1
Net Interest	(10.7)	(13.4)	(31.0)	(25.0)	(23.5)	(26.0)
Tax	(5.9)	(10.8)	(17.7)	(18.4)	(26.7)	(33.8)
Capex	(4.2)	(4.8)	(8.6)	(3.8)	(11.0)	(10.0)
Acquisitions/disposals	(6.1)	(104.3)	(226.0)	(7.5)	(10.0)	(10.0)
Investment in content rights and TV programmes	(281.4)	(280.8)	(218.5)	(407.9)	(503.0)	(550.0)
Proceeds on issue of shares	0.0	0.0	194.6	0.0	0.0	0.0
Dividends	0.0	(2.9)	(4.0)	(8.3)	(10.0)	(11.0)
Net Cash Flow	(44.1)	(145.1)	8.9	(32.7)	(50.1)	19.4
Opening net debt/(cash)	144.5	165.1	314.2	299.0	339.7	390.0
Movements in exchangeable notes	0.0	0.0	0.0	0.0	0.0	0.0
Other including forex	23.5	(4.0)	6.3	(8.0)	(0.1)	(0.0)
Closing IFRS debt/(cash)	165.1	314.2	299.0	339.7	390.0	370.6
ANALYSIS OF NET DEBT						
Production finance	54.0	89.3	118.0	152.3	185.6	210.0
Net debt	111.1	224.9	181.0	187.4	204.4	160.6

Source: eOne (historics), Edison (forecasts)

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