Technicolor

Q1 results

Growing animation in performance

Media

Technicolor's Q121 figures show (constant currency) revenue up 3.6% on prior year, buoyed by continued strong demand in Connected Home. The outlook for Production Services is considerably improved as filming gets underway and projects are greenlit. Full year and FY22 earnings guidance is maintained, with margins set to improve after earlier streamlining and ongoing cost control. Following FY20's financial restructure, the equity proportion of Technicolor's enterprise value is no longer greatly overshadowed by the debt. With improving cash flow, a revaluation of the equity seems underway, with the share price up 72% year-to-date.

Year end	Revenue (€m)	EBITDA (€m)	EBITA (€m)	PBT* (€m)	EPS* (€)	EV/EBITDA (x)
12/19	3,800	325	42	(73)	(4.92)	5.6
12/20	3,006	167	(56)	(43)	(0.38)	10.8
12/21e	2,933	270	60	(3)	(0.03)	6.7
12/22e	3,255	385	180	117	0.46	4.7

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

Encouraging signs across the portfolio

Demand for high-quality broadband gateways continues to be strong in North America and is improving in Eurasia as people's digital domestic consumption continues to rise. The limiting factor is the availability of memory and processing componentry. Here, the group's leading market position gives some protection on supply and some leverage on passing through additional costs. Production Services is also benefiting from a good recovery in demand, with MPC Episodic particularly busy with projects for streamers. DVD Services revenues were down less than expected, with EBITDA margins starting to lift as pricing improvements from contract renegotiations kick in.

Profits and cash weighted to H2

Our forecasts continue to be aligned with management guidance, which was adjusted for the disposal of Post Production in April. Guidance also has sufficient leeway to cater for the impact of the component situation in Connected Home. Profits and cash flow are likely to be skewed to the second half, with cash flow benefiting from a more normalised working capital position in Connected Home and a resumption of down payments in Production Services. Our model points to a year-end net debt position of €837m, which would be 3.1x adjusted EBITDA, well within management's target of less than 4.0x.

Valuation: Revaluation underway

Since the completion of the financial restructuring in September 2020, the shares have risen from €1.16. The valuation is now starting to reflect improving underlying trading, albeit that the equity remains dominated by the value of the debt (although no longer dwarfed). As confidence grows that guidance on profitability and cash generation can be achieved, we would expect the rating to improve further.

14 May 2021

Price	**€3.11**
Market cap	**€733m**
	US$1.21/€
Net debt (IFRS, including leases) at end March 2021 (€m)	1,074
Shares in issue	235.8m
Free float	100%
Code	TCH
Primary exchange	Euronext
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(1.8)	54.9	(50.8)
Rel (local)	(4.7)	38.1	(64.2)
52-week high/low		€5.71	€1.16

Business description

Technicolor is a worldwide technology leader operating in the media and entertainment industry. Its activities fall into three business segments: Production Services, DVD Services and Connected Home.

Next events

Half year	End July

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Q121 shows a turnaround is underway

We show the Q1 figures below at constant currency but note that adverse forex movements mean that at current rates, revenues would be down 3.7% on the prior year.

During this quarter, Production Service's activities were still overshadowed by the impact of the pandemic, with Connected Home generating 60% of group revenues and 65% of adjusted EBITDA. On a group basis, adjusted EBITA almost reached break even.

Group free cash flow (before financials and tax) improved from an outflow of €314m in Q120 to an outflow of €196m, which reflects a significant improvement in the working capital position. For the full year, management continues to expect that this figure will be around break even.

Segmental performances and prospects are discussed separately below.

Exhibit 1: Summary Q120 results

€m	Production Services	Change y-o-y	DVD Services	Change y-o-y	Connected Home	Change y-o-y	Corporate & Other	Change y-o-y	Group	Change y-o-y
Revenue	140	-16.6%	139	-7.7%	428	+18.3%	5	-40.3%	**711**	**+3.6%**
Adjusted EBITDA	14	+29.5%	4	N/A	28	+90.5%	(3)	N/A	**43**	**+71.7%**
Margin	9.7%		3.1%		6.4%		(48.7%)		**6.0%**	
Adjusted EBITA	(2)	N/A	(6)	N/A	10	N/A	(4)	-81.3%	**(1)**	**+97.8%**
Margin	(1.5%)		(4.2%)		2.4%		(65.6%)		**(0.1%)**	

Source: Company accounts. Note: Changes at constant currency.

Connected Home (60% of Q121 revenue): Trading and outlook

As might be expected, the revenue growth within Connected Home stemmed from strong demand for domestic broadband, particularly in North America, which represented 62% of segmental revenues and where revenues were ahead by 34.4% at constant currency. Cable customers are still looking to upgrade their broadband to cope with stepped up demand from home working, home education and entertainment.

There was also good growth in Europe, the Middle East and Africa (+24.5%) and in Asia-Pacific (+37.7%). Latin America continues to be a very challenging market, with the twin impacts of weak currency and continuing severe community COVID-19 cases.

EBITDA margins of 6.4% compare to Q120 at 4.1%, boosted by the cost reductions from the transformation plan as discussed in previous reports.

The key issue for Connected Home is the availability and pricing of componentry, a well-documented problem across many industries stemming from supply and distribution issues exacerbated by the pandemic. This is expected to persist at least through Q2 and Q3 before plateauing in Q421. Supply squeezes are a recurring issue, and this iteration is broader than simply memory. However, Connected Home is an important supplier to the cable companies, who themselves are anxious not to disappoint their own customers, putting the group in a stronger position than some smaller players, particularly in terms of passing through a proportion of cost increases.

Management is confident that the demand side of the equation will continue to be strong, with continued upgrades in Wi-Fi technologies and higher speeds.

DVD Services (20% of Q121 revenue): Trading and outlook

Disc volumes continued their decline, down 10.7% in volumes on Q120. However, the segmental revenue decline was lower at -7.7% at constant currency. This mostly reflects the pricing renegotiations achieved last year, along with some benefit from handling of logistics for non-disc products.

With a severely depleted programme of studio releases, this represents a relatively strong performance, driven by good demand for library titles.

The revised pricing agreements also helped improve the achieved adjusted EBITDA margin, which was 3.1% from 0.6% in Q120. We would expect further progress here over the rest of the year, reflecting the realignment of the physical estate as well as the benefit of higher volumes as release schedules replenish.

Production Services (20% of Q121 revenues): Trading and outlook

With the disposal of Post Production, this segment is to be rebadged as Technicolor Creative Services, leveraging the brand’s fame.

Like-for-like revenues were unsurprisingly soft in the quarter, down 16.6% at constant currency, as the comparative period was prior to the drastic impact of lockdowns on live filming for the film and TV industry. Within this, however, it is notable that MPC Episodic, which works primarily with the major streaming companies, doubled its revenues. Adjusted EBITDA margins climbed from 6.2% in Q120 to 9.7% Q121, as efficiencies within the transformation plan are starting to take effect.

Prospects for the rest of the year are on an improving trajectory as the industry reopens and with underlying thirst for content a constant. Much work continues to be done in rebuilding as a more efficient concern, with much more co-operation behind the brand frontages in areas such as R&D and technology. The group held onto its key talent through the pandemic, but the industry runs with a meaningful contingent of freelance labour and it is likely that there may be some pressure on wage inflation here. However, it is worth noting that the group recruits globally, with India a key location, so there is potential for some substitution from the highest labour cost territories.

Production schedules are looking strong through the remainder of the year and well into FY22 as content companies look to refill their hoppers. 90% of the segment’s FY21 budget for film and episodic is already in place.

The appointment of Andrea Miloro as head of Mikros Animation is potentially important and is a clear commitment from management to build share in the animation segment. Andrea Miloro is a well-known industry figure, having been co-president of Fox Animation and previously holding various senior production roles at Fox/BlueSky Studios and Sony Pictures Animation.

Exhibit 2: Financial summary

€m		2019	2020	2021e	2022e
Year-end 31 December		IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue		3,800	3,006	2,933	3,255
Cost of Sales		(3,375)	(2,725)	(2,575)	(2,830)
Gross Profit		425	281	358	425
EBITDA		325	167	270	385
EBITA		42	(56)	60	180
Amortisation of acquired intangibles		(54)	(41)	(41)	(41)
Exceptionals		(79)	(151)	(10)	(10)
Reported operating profit		(121)	(264)	27	147
Net Interest		(84)	77	(81)	(81)
Joint ventures & associates (post tax)		(1)	0	0	0
Exceptionals		0	155	0	0
Profit Before Tax (norm)		(73)	(43)	(3)	117
Profit Before Tax (reported)		(206)	(188)	(54)	66
Reported tax		(3)	(5)	(5)	(5)
Profit After Tax (norm)		(75)	(48)	(8)	112
Profit After Tax (reported)		(208)	(193)	(59)	61
Minority interests		0	0	0	0
Discontinued operations		(22)	(15)	0	0
Net income (normalised)		(75)	(48)	(8)	113
Net income (reported)		(230)	(207)	(59)	61
Average Number of Shares Outstanding (m)		15	126	241	247
EPS - normalised (c)		(492.18)	(38.38)	(3.18)	45.73
EPS - normalised fully diluted (c)		(492.18)	(33.64)	(2.97)	42.67
Dividend per share (c)		0.00	0.00	0.00	0.00
Revenue growth (%)		(5)	(21)	(2)	11
Gross Margin (%)		11.2	9.4	12.2	13.1
EBITDA Margin (%)		8.6	5.6	9.2	11.8
EBITA Margin (%)		1.1	(1.9)	2.1	5.5
BALANCE SHEET					
Fixed Assets		2,082	1,674	1,606	1,538
Intangible Assets		1,483	1,251	1,185	1,119
Tangible Assets		476	288	286	284
Investments & other		40	62	62	62
Deferred tax and other		84	72	72	72
Current Assets		1,127	1,344	1,319	1,549
Stocks		243	195	190	211
Debtors		507	425	415	460
Cash & cash equivalents		64	330	321	484
Other		312	394	394	394
Current Liabilities		(1,542)	(1,379)	(1,326)	(1,406)
Creditors		(825)	(710)	(657)	(737)
Tax and social security		(41)	(21)	(21)	(21)
Short term borrowings		(95)	(72)	(72)	(72)
Other		(581)	(576)	(576)	(576)
Long Term Liabilities		(1,631)	(1,466)	(1,482)	(1,498)
Long term borrowings		(1,203)	(1,070)	(1,086)	(1,102)
Deferred tax		(27)	(15)	(15)	(15)
Other long term liabilities		(401)	(381)	(381)	(381)
Net Assets		37	172	118	183
Minority interests		0	0	0	0
Shareholders' equity		37	172	118	183
CASH FLOW					
Net profit		(208)	(193)	(59)	61
Depreciation and amortisation		322	263	213	213
Working capital		(69)	(101)	(38)	15
Tax and interest		(76)	(41)	(66)	(66)
Exceptional & other		101	(9)	56	86
Operating cash flow		70	(81)	106	309
Capex		(169)	(138)	(145)	(145)
Acquisitions/disposals		(2)	0	30	0
Equity financing		1	60	0	0
Dividends		0	0	0	0
Other		3	5	0	0
Net Cash Flow		(97)	(154)	(9)	164
Opening net debt/(cash)		733	1,234	812	837
FX			(16)	0	0
Discontinued		(35)	(23)	0	0
Other non-cash movements		(369)	615	(16)	(16)
Closing net debt/(cash)		1,234	812	837	690

Source: Company accounts, Edison Investment Research

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