

Company Update

Buy (maintained)

03 March 2015

MARKET PRICE: **EUR2.60**

TARGET PRICE: **EUR3.73 (from EUR3.33)**

Entertainment

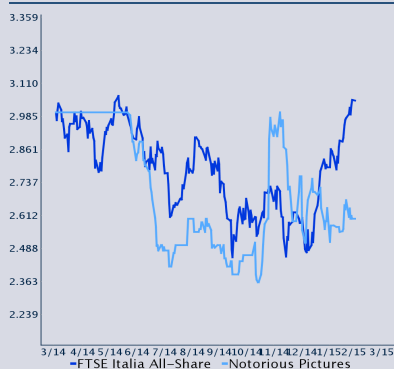
Data

Shares Outstanding (m):	22.3	
Market Cap. (EURm):	58.0	
Enterprise Value (EURm):	49.6	
Free Float (%):	9.9%	
Av. Daily Trad. Vol. (m):	0.0	
Main Shareholder:	Mr. Marchetti 89.6%	
Reuters/Bloomberg:	NPI.MI	NPI IM
52-Week Range (EUR)	2.4	3.0

Performance

	1m	3m	12m
Absolute	1.6%	-12.8%	-
Rel. to FTSE IT	-6.4%	-22.1%	-

Graph area Absolute/Relative 12 M



Next event

19 March 2015: Shareholders meeting

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Sound results in 2014

Notorious Pictures reported positive results for the second half of 2014 more than doubling sales and EBITDA despite a lack of movies with outstanding box office success. This was made possible due to revenues from pay and free TV which beat our expectations. The net result, however, was slightly below our estimates due to higher D&A costs and taxes. We have fine tuned our forecasts with a negligible negative impact at EPS level. We remain positive about Notorious Pictures which has attractive upside (>40%) and has already secured a significant proportion of its 2015-16 pipeline (16 movies out of 18 in 2015 and 15 movies for 2016-17) following recent acquisitions, had a positive start to 2015 driven by the success of "Selma" and "Mune" (>EUR1.5 million each at box office) In December it also secured agreements with Mediaset and RAI which could generate about Euro 9 million revenues. The shares are still trading at a significant discount to the multiples of its direct peers (49% on average). We reiterate our Buy recommendation with a new target price of EUR3.73 per share (from EUR3.33).

- > Notorious Pictures distributed 17 new movies in 2014 with nearly EUR10 million of theatrical sales. New distributions, together with revenues from titles released last year boosted total revenues to EUR26.8 million (nearly triple that of 2013). The EBITDA margin increased significantly to 53.6% (vs. 31.2% in 2013) and net profit was EUR6.5 million after EUR4.3 million of D&A costs and a 35% tax rate.
- > After investment of EUR7.6 million in 2014 the company's film library reached EUR9.8 million gross value at Dec-14, already amortized for EUR4.9 million. Net cash increased to EUR7.5 million at Dec-14 and Notorious Pictures unexpectedly announced a DPS of EUR0.081 giving a 3.1% yield at the current market price.
- > The company confirmed its 2014-17 business plan and is expected to distribute 18 new movies this year (of which 16 already acquired) anticipating revenues close to EUR29 million and an EBITDA margin of >61%. Our estimates, which have been fine tuned, incorporate sales CAGR of 12.6% to 2017 with EBITDA margin which should grow from 60% this year to 65.6% in 2017. We have slightly increased sales and EBITDA forecasts but reduced EBIT due to higher D&A costs, resulting in an EPS reduction of 7% this year and 1% in 2016.
- > We have increased our target price to EUR3.73 per share (from EUR3.33) on the back of the rerating of the multiples of our peer sample.

Financials

	2014	2015E	2016E	2017E
Revenues (EURm)	26.8	29.0	34.4	38.2
EBITDA (EURm)	14.3	17.4	21.9	25.1
EBITDA margin (%)	53.6%	60.0%	63.8%	65.6%
EBIT (EURm)	10.0	12.4	15.5	19.1
EPS (EUR)	0,29	0,37	0,46	0,58
CFPS (EUR)	0,28	0,46	0,67	0,78
DPS (EUR)	0.08	0.09	0.12	0.14

Source: Company Data, UBI Banca Estimates

Ratios

	2014	2015E	2016E	2017E
P/E(x)	9.0	7.1	5.6	4.5
P/CF(x)	5.4	4.4	3.5	3.1
P/BV(x)	4.0	2.8	2.0	1.5
Dividend Yield	3.1%	3.5%	4.5%	5.6%
EV/EBITDA(x)	3.5	2.9	2.1	1.6
Debt/Equity (x)	-0.5	-0.4	-0.4	-0.4
Debt/EBITDA (x)	-0.5	-0.5	-0.5	-0.7

Source: Company Data, UBI Banca Estimates

Key Financials

(EURm)	2014	2015E	2016E	2017E
Revenues	26.8	29.0	34.4	38.2
EBITDA	14.3	17.4	21.9	25.1
EBIT	10.0	12.4	15.5	19.1
NOPAT	6.7	8.3	10.4	12.8
Free Cash Flow	-1.3	2.8	5.9	8.9
Net Capital Employed	7.1	12.5	18.0	22.0
Shareholders' Equity	14.6	21.0	29.3	39.7
Net Financial Position	-7.5	-8.5	-11.3	-17.7

Source: Company data, UBI Banca estimates

Key Profitability Drivers

	2014	2015E	2016E	2017E
Net Debt/Ebitda (x)	-0.5	-0.5	-0.5	-0.7
Net Debt/Equity (x)	-0.5	-0.4	-0.4	-0.4
Interest Coverage (%)	333.4	311.0	387.8	477.4
Free Cash Flow Yield (%)	-2.3%	4.8%	10.1%	15.4%
ROE (%)	44.2%	38.9%	35.3%	32.6%
ROI (%)	167.2%	98.1%	87.5%	86.5%
ROCE (%)	112.1%	65.7%	58.6%	57.9%

Source: Company data, UBI Banca estimates

Key Valuation Ratios

	2014	2015E	2016E	2017E
P/E (x)	9.0	7.1	5.6	4.5
P/BV (x)	4.0	2.8	2.0	1.5
P/CF (x)	5.4	4.4	3.5	3.1
Dividend Yield (%)	3.1%	3.5%	4.5%	5.6%
EV/Sales (x)	1.9	1.7	1.4	1.1
EV/EBITDA (x)	3.5	2.9	2.1	1.6
EV/EBIT (x)	5.1	4.0	3.0	2.1
EV/CE (x)	7.1	4.0	2.6	1.8

Source: Company data, UBI Banca estimates

Key Value Drivers

(%)	2014	2015E	2016E	2017E
Payout	27.8%	25.0%	25.0%	25.0%
Cost of Equity	9.4%	9.4%	9.4%	9.4%
WACC	9.4%	9.4%	9.4%	9.4%
NWC/Sales	18.3%	26.8%	28.2%	29.6%
Capex/Sales	28.2%	25.7%	26.2%	22.0%

Source: Company data, UBI Banca estimates

Recent Developments

- 2014 results were broadly in line with our estimates. Revenues nearly tripled and were 6% above our expectations thanks to higher free TV sales (EUR4.5 million vs. our EUR4.1 million) and a sharp increase of barter contracts (for example with radios). EBITDA was directly in line with our forecast although the EBITDA margin was slightly below our estimates due to barter contracts that have no impact on EBITDA (sales being equal to the cost of production). D&A was higher than expected due to more rapid amortization of the library, resulting in EBIT 9% below our expectations. The net result, taking a higher than expected tax rate into account, was 11% lower than our estimates. Net cash rose to EUR7.5 million (partly due to proceeds of EUR6.5 million from the IPO) which was in line with forecasts, despite capex of >EUR7.5 million, which increased the film library to >200 titles.
- In the second half of the year Notorious Pictures distributed 9 movies more than doubling theatrical sales compared with 2H13. Theatrical sales per movie were lower than in 1H14 (EUR0.3 million per movie vs. EUR0.9 million) which benefitted from the success of “Belle and Sebastien” and “Beauty and the Beast”. Contribution from other distribution channels reached EUR8.9 million (+106%). The EBITDA margin remained stable at around 43% and net profit exceeded EUR1.7 million.
- The company’s film library reached EUR9.8 million gross value at Dec-14, already amortized for EUR4.9 million. The library is amortized using the so-called “individual-film-forecast-computation method” which is based on the ratio determined for each movie between the revenues earned at the reporting date and the sales projections prepared by the Board with an overall period of ten years from the release of the movie. This means that a movie that exceeds its revenue plan has a higher amortization, explaining the higher than expected D&A reported in 2H14.
- Contrary to our expectations, Notorious Pictures also announced a DPS of EUR0.0806, implying a pay-out of 28% (in line with the 25% dividend policy stated in the business plan) representing a dividend yield of 3.1% at current market price.
- Last December the company signed an agreement with RAI Cinema and RTI Mediaset for the distribution of 120 movies on free TV channels for a total amount of EUR9 million. In addition, it signed a new contract with Sky for the distribution of 6 movies (EUR0.7 million value). These contracts increase the visibility of revenue flow from pay and free TV over the next few years.
- In February the company acquired the full rights to 12 new movies at the Berlin Festival, including “Predestination” and “Albert” both to be released in 2015.

Figure 1 – 2H14 and 2014 results

While sales exceed our expectations, EBITDA was in line. Net result was lower than expected due to higher D&A costs and taxes.

(EURm)	2013A	2014A	% Chg.	2H13A	2H14A	% Chg.	2014E	Delta UBI
Sales Theatrical	4,19	9,77	133,1%	1,12	2,64	135,8%	9,64	1,4%
Sales Other	4,82	16,99	252,3%	4,32	8,92	106,3%	15,66	8,5%
Sales total	9,01	26,76	196,9%	5,44	11,56	112,4%	25,30	5,8%
EBITDA	2,82	14,34	409,6%	2,39	5,02	109,6%	14,27	0,5%
% margin	31,2%	53,6%		44,0%	43,4%		56,4%	
EBIT	1,99	10,00	402,7%	1,89	2,89	52,9%	10,95	-8,7%
% margin	22,1%	37,4%		34,7%	25,0%		43,3%	
Net profit	1,26	6,47	413,7%	1,24	1,73	39,7%	7,31	-11,5%
Net cash	0,32	7,52		0,32	7,52		7,49	0,5%

Source: Company data, UBI Banca estimates

Financial Projections

- Following the 2014 results, we have fine tuned our 2015-16 estimates and introduced 2017 forecasts. We maintain our projections for 2015-16 theatrical sales but we have slightly increased free TV sales estimates to give a total increase of 0.5% for our consolidated revenues prospects. We substantially confirm our EBITDA margin estimates, but we have increased our D&A expenses estimates (due to the reduction of the amortization period of the library) which slightly erodes expected operating profit (by 4% in 2015). Taking into account a slightly higher tax rate, we have cut our net profit estimate by about 4% in 2015-16.
- For 2017, we expect the release of 18 movies with sales exceeding EUR38 million. We expect the EBITDA margin to exceed 65% and net profit is forecast to rise to EUR13 million. Our estimates are slightly below the targets stated in the company's business plan (sales of EUR39.7 million, EBITDA of EUR26.6 million).
- We expect self financing to exceed EUR13 million this year, reaching EUR19 million in 2017. However, NWC absorption is expected to grow significantly (NWC could rise to 27% of turnover this year compared with 18% in 2014) mostly due to the increase of trade receivables related to higher TV revenues (Pay TV operators pay on average after >250 days and free TV >500 days) and we anticipate EUR25 million cumulative capex in 2015-17. Altogether, we estimate net cash to reach EUR17.7 million at Dec-17 from EUR7.5 million at Dec-14 including dividends with a pay-out ratio of 25%.
- There are now 16 movies in the pipeline for 2015 (two of which recently acquired) which cover >85% of the budget based on our calculations (two more titles should be added in the next few months) with "Selma" and "Mune" already performing well (>EUR1.5 million of box office in the first three weeks) while the "Belle and Sebastien" sequel (to be released in Dec-15) is expected to be a strong success. The company has 16 titles currently lined up for 2016 and 2017.
- Our estimates do not incorporate external growth, which, however, has not been ruled out by Notorious Pictures which is scouting some film production companies.

Figure 2 - Old vs. new estimates

The reduction of 2015 net result is tied to higher D&A costs and taxes.						
(EURm)	2014A	2015E		2016E		2017E
		Old	New	Old	New	New
Total Sales	26,8	28,8	29,0	34,2	34,4	38,2
% change			0,5%		0,4%	
EBITDA	14,3	17,3	17,4	21,5	21,9	25,1
% change			0,3%		1,9%	
EBIT	10,0	13,0	12,4	15,4	15,5	19,1
% change			-4,0%		0,4%	
Net Profit	6,5	8,8	8,2	10,5	10,4	13,0
% change			-6,9%		-1,0%	
EPS	0,29	0,39	0,37	0,47	0,46	0,58
% change			-6,9%		-1,0%	
Net Debt/(Cash)	(7,5)	(9,3)	(8,5)	(12,2)	(11,3)	(17,7)

Source: Company data, UBI Banca estimates

Figure 3 - Detailed P&L estimates

In preparing our forecasts we have divided the number of forthcoming movies over the next three years (18 per annum) into clusters based on expected box office revenues (on which all other sales are dependent). Our cost projections assume that the MG could range from EUR1.0 million for an A movie to EUR16K for a D movie and P&A costs can range from EUR0.73 million for an A movie to EUR150K for a D movie.

	2013A	2014A	2015E	2016E	2017E
Movies A	1	2	3	3	3
Movies B	2	2	8	6	9
Movies C	4	10	5	7	4
Movies D	7	3	2	2	2
Total movies	14	17	18	18	18
Theatrical	4,19	9,77	13,36	12,76	13,66
Pay TV	3,55	8,66	9,20	10,35	11,35
Free TV	0,00	4,48	4,64	4,71	4,77
Home video	0,62	1,09	0,83	1,00	0,69
Vod, PPV, Kiosk	0,12	0,49	0,21	1,14	1,28
Production	0,00	0,00	0,00	3,16	4,74
Other	0,54	2,28	1,00	1,52	1,72
Total sales	9,01	26,76	29,24	34,63	38,21
Direct costs (P&A and other)	(5,15)	(9,63)	(9,91)	(10,58)	(11,15)
Gross margin	3,86	17,13	19,33	24,06	27,06
Gross margin (%)	42,8%	64,0%	66,1%	69,5%	70,8%
Labour and other structure costs	(1,05)	(1,50)	(1,69)	(1,87)	(1,98)
EBITDA	2,82	15,63	17,64	22,18	25,08
% margin	31,2%	58,4%	60,3%	64,1%	65,6%
D&A on the library	(0,75)	(4,19)	(4,79)	(6,26)	(5,81)
Other D&A	(0,07)	(0,15)	(0,16)	(0,16)	(0,17)
EBIT	1,99	11,29	12,69	15,76	19,10
% margin	22,1%	42,2%	43,4%	45,5%	50,0%

Source: Company data, UBI Banca estimates

Figure 4 - 2015 movies pipeline (Box office at March 02)

	Movie title	Release	Genre	Country	Cluster	Box office (000)
1	Italo	Jan-15	Family	Italy	C	723
2	Mune	Feb-15	Animation	France	B	1.526
3	Selma	Feb-15	Drama	USA	A	1.548
4	Wolf Totem	Mar-15	Family	France	A-B	
5	Black Sea	Apr-15	Thriller	UK	B	
6	Ci devo Pensare	Apr-15	Comedy	Italy	C	
7	Albert	May-15	Animation	Germany	D	
8	Predestination	Jul-15	Thriller/Action	Australia	B	
9	Garm wars	Jul-15	Animation/Sci-Fi	Japan	D	
10	Left behind	Aug-15	Thriller/Action	USA	B	
11	The Reach	Aug-15	Thriller	USA	C	
12	We are your friends	Sep-15	Comedy	USA	C	
13	My bakery in Brooklyn	Sep-15	Comedy	USA	C	
14	Cell	Oct-15	Thriller/Horror	USA	C	
15	Bleed for this	Nov-15	Biopic	USA	C	
16	Belle et Sebastien 2	Dec-15	Family	France	A	

Source: Company data, UBI Banca estimates,

Valuation

- Having fine tuned our estimates, our DCF valuation has fallen to EUR3.88 per share (from EUR3.94). However, our relative valuation has increased to EUR3.57 per share (applying a 30% discount to take into account the limited free float of Notorious Pictures and its modest size) from EUR2.67 per share. This is due to the recent increase of the multiples of our peer sample (2015 P/E average is now at 10.7x vs. 7.4x in our latest report, and EV/EBITDA grew to 6.3x from 4.4x) which seems more tied to a general reduction of the consensus rather than strong share price performance (our peer sample has significantly underperformed the market index over the past three months). As a result, we have decided to increase the discount applied to the average multiple of our peer sample to 30% (from 20% previously). The simple average of our DCF and a relative valuation gives EUR3.73 which is our new target price (from EUR3.33 previously).
- The weak performance of the shares (-11% since our report of December 5, 2014) coupled with a higher target price, increases upside potential to 43% prompting us to confirm our Buy rating.
- At the target price, the company would trade at 3.9x 2015 EV/EBITDA, which is still below the average multiple for the industry (6.3x) and on 10.2x P/E (10.7x for peers).

Figure 5 – Valuation summary

(EUR)		Weight
DCF Valuation	3,88	50,0%
Relative Valuation (at 30% discount)	3,57	50,0%
Target Price	3,73	
Current price	2,60	
Potential upside	43,3%	

Source: UBI Banca estimates

Figure 6 – DCF Valuation

Our model incorporates a terminal growth rate of 1% and an operating margin of 38% at terminal value, which is below the 42.9% EBIT margin expected for 2015.

	(EUR m)	(% weight)
Sum of PV 2015-23 FCF	37,5	47%
Terminal value	41,8	53%
Total Enterprise value	79,3	100%
- minorities	0,0	
- Pension Provision	(0,1)	
- Net debt (+ cash)	7,5	
Total Equity value	86,7	
Fully diluted number of shares (m)	22,3	
Fair value per share (EUR)	3,88	

Source: UBI Banca estimates

Figure 7 - Peers comparison and valuation based on multiples

Our sample does not include DreamWorks Animation and Lions Gate whose multiples are well above other companies due to their leading worldwide position and their large size. Neither did we include Lucisano Media Group due to the lack of a reliable consensus. Despite the positive results of the second half of the year, Notorious Pictures is trading at a significant discount to its direct peers (49% on average), mainly due to its modest size compared to other competitors and its short history and this gap strongly increased since our latest report (5 December 2014) when it was 32%.

Company	Market Cap (EURm)	P/E		EV/EBITDA		EV/EBIT	
		2015	2016	2015	2016	2015	2016
Leone Film Group	40	19,1 x	10,1 x	4,9 x	0,5 x	13,6 x	2,0 x
EuropaCorp	135	5,3 x	10,7 x	2,7 x	0,0 x	4,3 x	11,9 x
Splendid Medien	20	6,7 x	5,4 x	7,3 x	5,1 x	8,0 x	5,8 x
Entertainment One	1.224	12,0 x	11,2 x	10,3 x	9,7 x	10,8 x	10,1 x
Average		10,7 x	9,4 x	6,3 x	3,8 x	9,1 x	7,5 x
Median		9,3 x	10,4 x	6,1 x	2,8 x	9,4 x	8,0 x
Notorious Pictures valuation							
Based on simple average		3,94	4,35	5,29	5,50	5,48	5,70
Based on median		3,42	4,84	5,13	5,52	5,62	6,04
Current market multiples		7,1 x	5,6 x	2,9 x	2,1 x	4,0 x	3,0 x
Discount to Average		-34,1%	-40,2%	-54,6%	-44,0%	-56,4%	-59,5%
Discount to Median		-24,0%	-46,3%	-53,2%	-23,6%	-57,5%	-62,1%

Source: Factset, UBI Banca estimates

Income Statement

(EURm)	2014	2015E	2016E	2017E
Net Revenues	26.8	29.0	34.4	38.2
EBITDA	14.3	17.4	21.9	25.1
EBITDA margin	53.6%	60.0%	63.8%	65.6%
EBIT	10.0	12.4	15.5	19.1
EBIT margin	37.4%	42.9%	45.1%	50.0%
Net financial income /expense	0.0	0.0	0.0	0.0
Associates & Others	0.0	0.0	0.0	0.0
Profit before taxes	10.0	12.4	15.5	19.1
Taxes	-3.5	-4.2	-5.1	-6.1
Minorities & discontinuing ops	0.0	0.0	0.0	0.0
Net Income	6.5	8.2	10.4	13.0

Source: Company data, UBI Banca estimates

Balance Sheet

(EURm)	2014	2015E	2016E	2017E
Net working capital	4.9	7.8	9.7	11.3
Net Fixed assets	5.0	7.6	10.3	12.8
M/L term funds	-2.8	-2.9	-2.0	-2.1
Capital employed	7.1	12.5	18.0	22.0
Shareholders' equity	14.6	21.0	29.3	39.7
Minorities	0.0	0.0	0.0	0.0
Shareholders' funds	14.6	21.0	29.3	39.7
Net financial debt/(cash)	-7.5	-8.5	-11.3	-17.7

Source: Company data, UBI Banca estimates

Cash Flow Statement

(EURm)	2014	2015E	2016E	2017E
NFP Beginning of Period	-0.3	-7.5	-8.5	-11.3
Group Net Profit	6.5	8.2	10.4	13.0
Minorities	0.0	0.0	0.0	0.0
D&A	4.3	5.0	6.4	6.0
Change in Funds & TFR	0.0	0.0	0.0	0.0
Gross Cash Flow	10.8	13.1	16.8	18.9
Change In Working Capital	-4.6	-2.9	-1.9	-1.6
Other	0.0	0.0	0.0	0.0
Operating Cash Flow	6.2	10.3	14.9	17.3
Net Capex	-7.6	-7.5	-9.0	-8.4
Other Investments	0.0	0.0	0.0	0.0
Free Cash Flow	-1.3	2.8	5.9	8.9
Dividends Paid	0.0	-1.8	-2.0	-2.6
Other & Chg in Consolid. Area	2.0	0.0	-1.0	0.0
Chg in Net Worth & Capital Incr.	6.5	0.0	0.0	0.0
Change in NFP	7.2	1.0	2.8	6.3
NFP End of Period	-7.5	-8.5	-11.3	-17.7

Source: Company data, UBI Banca estimates

Financial Ratios

(%)	2014	2015E	2016E	2017E
ROE	44.2%	38.9%	35.3%	32.6%
ROI	167.2%	98.1%	87.5%	86.5%
Net Fin. Debt/Equity (x)	-0.5	-0.4	-0.4	-0.4
Net Fin. Debt/EBITDA (x)	-0.5	-0.5	-0.5	-0.7
Interest Coverage	333.4	311.0	387.8	477.4
NWC/Sales	18.3%	26.8%	28.2%	29.6%
Capex/Sales	28.2%	25.7%	26.2%	22.0%
Pay Out Ratio	27.8%	25.0%	25.0%	25.0%

Source: Company data, UBI Banca estimates

Per Share Data

(EUR)	2014	2015E	2016E	2017E
EPS	0,29	0,37	0,46	0,58
DPS	0,08	0,09	0,12	0,15
Op. CFPS	0,28	0,46	0,67	0,78
Free CFPS	-0,06	0,13	0,26	0,40
BVPS	0,66	0,94	1,32	1,78

Source: Company data, UBI Banca estimates

Stock Market Ratios

(x)	2014	2015E	2016E	2017E
P/E	9.0	7.1	5.6	4.5
P/OpCFPS	9.3	5.7	3.9	3.3
P/BV	4.0	2.8	2.0	1.5
Dividend Yield (%)	3.1%	3.5%	4.5%	5.6%
Free Cash Flow Yield (%)	-2.3%	4.8%	10.1%	15.4%
EV (EURm)	50.6	49.6	46.8	40.5
EV/Sales	1.9	1.7	1.4	1.1
EV/EBITDA	3.5	2.9	2.1	1.6
EV/EBIT	5.1	4.0	3.0	2.1
EV/Capital Employed	7.1	4.0	2.6	1.8

Source: Company data, UBI Banca estimates

Growth Rates

(%)	2014	2015E	2016E	2017E
Growth Group Net Sales	196.9%	8.3%	18.6%	11.1%
Growth EBITDA	409.6%	21.3%	26.1%	14.3%
Growth EBIT	402.7%	24.4%	24.7%	23.1%
Growth Net Profit	413.7%	26.5%	26.7%	25.0%

Source: Company data, UBI Banca estimates

Disclaimer

Analyst Declaration

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Historical ratings and target prices

Date	Rating	Target Price (EUR)	Market Price (EUR)
22 September 2014	BUY	3.48	2.58
5 December 2014	BUY	3.33	2.92