

Initiation of coverage

**Buy**

22 September 2014

MARKET PRICE: **EUR2.58**

TARGET PRICE: **EUR3.48**

## Entertainment

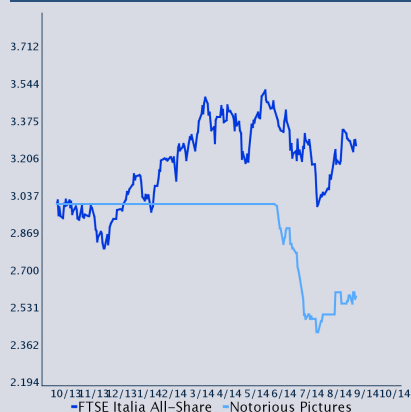
### Data

Shares Outstanding (m):	22.3
Market Cap. (EURm):	57.7
Enterprise Value (EURm):	50.7
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	4.7%	-	-
Rel. to FTSE IT	-3.3%	-	-

### Graph area Absolute/Relative 12 M



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## Attractive opportunities

We initiate coverage of Notorious Pictures with a Buy rating and a target price of EUR3.48 per share. We believe the company represents an attractive opportunity to invest in the entertainment market. Notorious Pictures, one of the leading Italian movie distributors, has been growing fast and was the largest independents by box office revenues in 1H14. A small team with extensive industry expertise, a lean cost structure and direct control of the entire value chain should allow Notorious Pictures to achieve very high EBITDA margins (we expect >60% this year vs. 31.2% in 2013) as demonstrated in 1H14 when margins were 61.4%. The IPO proceeds (EUR6.4 million net of direct listing costs) will allow Notorious the opportunity to enter the film production industry and increase the standing of forthcoming movie acquisitions, coupled with a net cash position (EUR8.8 million at June-14), complete our investment case, while the presentation of the business plan in November could enhance the appeal of the shares.

- > Notorious Pictures is a leading Italian movie distributor, with an excellent track record. Its strategy is to select the best movies for the Italian market with a cherry picking approach while the acquisition of full rights lasting 16-18 years coupled with arrangements with the main movie theatre chains and long term contracts with Sky and RAI Cinema (for Pay and free TV) should provide high visibility on future developments.
- > Based on the release of 16/18 films per annum, we expect the top line to rise to >EUR34 million in 2016 (from EUR9 million in 2013) with an EBITDA margin of more than 65%. The bottom line should rise to more than EUR11 million in 2016 while strong cash generation should lift net cash to EUR20 million at Dec-16.
- > Notorious Pictures distributed 8 new movies in 1H14 with >EUR7 million of theatrical sales. New distributions, together with revenues from movies released last year boosted total revenues to EUR15.2 million (+69% compared with full year 2013). The EBITDA margin increased significantly to 61.4% and net profit was EUR4.7 million after EUR2.2 million of D&A costs and a 33% tax rate. Net cash increased to EUR8.8 million.
- > The main risk is clearly the low visibility of future box office revenues. However, the quality of the management and its proven track record (all the movies distributed to date have been profitable in the first cycle of exploitation) and the recent acquisitions should mitigate this risk.

### Financials

	2013	2014E	2015E	2016E
Revenues (EURm)	9.0	25.4	29.8	34.5
EBITDA (EURm)	2.8	15.3	18.9	22.5
EBITDA margin (%)	31.2%	60.2%	63.6%	65.2%
EBIT (EURm)	2.0	12.2	15.2	17.8
EPS (EUR)	0.05	0.36	0.45	0.53
CFPS (EUR)	0.07	0.26	0.62	0.70
DPS (EUR)	0.0	0.0	0.0	0.0

Source: Company Data, UBI Banca Estimates

### Ratios

	2013	2014E	2015E	2016E
P/E(x)	-	7.2	5.7	4.9
P/CF(x)	-	5.2	4.1	3.5
P/BV(x)	-	3.5	2.2	1.5
Dividend Yield	-	0.0%	0.0%	0.0%
EV/EBITDA(x)	-	3.3	2.5	1.7
Debt/Equity (x)	-	-0.4	-0.4	-0.5
Debt/EBITDA (x)	-	-0.5	-0.6	-0.9

Source: Company Data, UBI Banca Estimates

**Key Financials**

(EURm)	2013	2014E	2015E	2016E
Revenues	9.0	25.4	29.8	34.5
EBITDA	2.8	15.3	18.9	22.5
EBIT	2.0	12.2	15.2	17.8
NOPAT	1.3	8.2	10.2	11.9
Free Cash Flow	-0.4	-0.3	4.2	8.4
Net Capital Employed	1.3	9.1	15.0	18.5
Shareholders' Equity	1.6	16.4	26.5	38.4
Net Financial Position	-0.3	-7.3	-11.5	-19.9

Source: Company data, UBI Banca estimates

**Key Profitability Drivers**

	2013	2014E	2015E	2016E
Net Debt/Ebitda (x)	-0.1	-0.5	-0.6	-0.9
Net Debt/Equity (x)	-0.2	-0.4	-0.4	-0.5
Interest Coverage (%)	58.5	304.2	378.9	444.2
Free Cash Flow Yield (%)	-	nm	7.3%	14.6%
ROE (%)	76.4%	48.8%	38.2%	30.9%
ROI (%)	170.9%	206.1%	117.8%	99.3%
ROCE (%)	114.5%	138.1%	78.9%	66.5%

Source: Company data, UBI Banca estimates

**Key Valuation Ratios**

	2013	2014E	2015E	2016E
P/E (x)	-	7.2	5.7	4.9
P/BV (x)	-	3.5	2.2	1.5
P/CF (x)	-	5.2	4.1	3.5
Dividend Yield (%)	-	0.0%	0.0%	0.0%
EV/Sales (x)	-	2.0	1.6	1.1
EV/EBITDA (x)	-	3.3	2.5	1.7
EV/EBIT (x)	-	4.2	3.1	2.1
EV/CE (x)	-	5.6	3.1	2.1

Source: Company data, UBI Banca estimates

**Key Value Drivers**

(%)	2013	2014E	2015E	2016E
Payout	0.0%	0.0%	0.0%	0.0%
Cost of Equity	9.4%	9.4%	9.4%	9.4%
WACC	9.4%	9.4%	9.4%	9.4%
NWC/Sales	3.6%	22.2%	19.2%	19.8%
Capex/Sales	21.8%	23.9%	32.2%	20.6%

Source: Company data, UBI Banca estimates

## INVESTMENT CASE

Notorious Pictures is a leading operator in Italian movie distribution. The company typically acquires full rights for movies, lasting 16-18 years, and distributes them through all available channels (cinema, Pay TV, Free TV, home video, new media), with an excellent track record and, we believe, a sustainable strategy.

We initiate coverage with a Buy rating and a target price of EUR3.48 per share (based on a DCF and a multiple comparison), which implies potential upside of almost 35%. We believe several key factors could drive share price performance in the coming months:

**Full control of the distribution value chain:** Notorious Pictures typically cherry picks from hundreds of screenplays those movies that it believes have the best prospects for success in the Italian market both in terms of box office and TV, which are the main sources of revenue. The movies are then directly distributed to cinemas and other distribution channels (distribution to home video is carried out indirectly). A significant proportion of revenues is secured by arrangements with the main movie theatre chains (which determine the success of the movie) and with long term contracts with Sky and RAI Cinema. The company directly manages editing and P&A costs (printing and advertising). In this way it controls the entire value chain, optimizing the economic cycle of each movie (first and second exploitation cycle).

**Management expertise:** the business model is clearly based on the box office results of the movies distributed and management expertise is therefore a critical factor. The Notorious Pictures team has long experience in the film industry (20 years on average) and has worked together for many years. Its ability to select successful titles is confirmed by the company's outstanding financial results in two years of existence and by the team's track record in previous roles.

**Attractive fundamentals:** profitability in the film distribution industry can be extremely attractive with EBITDA margins of more than 60%. Notorious Pictures already achieved margins of 31.2% last year and 61.4% in 1H14 and we estimate that they should grow further as investments are concentrated in the first phase of the cycle while revenues are spread over a much longer period. In addition the company had a net cash position of EUR8.8 million at June-14, partly stemming from IPO proceeds (EUR6.4 million net of direct listing costs). We expect revenues to rise to more than EUR34 million in 2016 with a 65.2% EBITDA margin and a bottom line of EUR11.9 million in 2016. We estimate that strong cash generation should allow the company to increase its net cash position to EUR19.9 million in 2016.

**New opportunities:** The company will announce a new business plan in November which is expected to focus on the investment of the IPO proceeds. Most of the financial resources will be invested in expanding the movie library (18/20 films per annum) and acquiring movies with a higher standing. In addition, Notorious Pictures should enter the film production and international co-production industries, which could generate higher profitability compared to pure distribution and, in the case of international co-productions, diversify the company from the Italian market. This activity is likely to be built up gradually and productions will start only once the full costs are covered through co-producers, product placements and tax and other public contributions. These opportunities could give Notorious Pictures a significant boost if the new strategy is a success, which, we believe, means that the best time to invest is right now to take full advantage of future expansion.

The company is exposed to few risks, mostly related to the low visibility of future box office revenues and its short history. However, we believe that risks are mitigated by the quality of the management and by its excellent track record both with Notorious Pictures (all the movies distributed to date have been profitable in the first cycle of exploitation) and given management's previous successes before the formation of Notorious.

Notorious Pictures is trading at a significant discount to the multiples of its direct peers (nearly 45% on average, excluding Dreamworks and Lions Gate, which have worldwide leading positions) and its multiples are broadly in line with Leone Film Group, its direct peer in Italy.

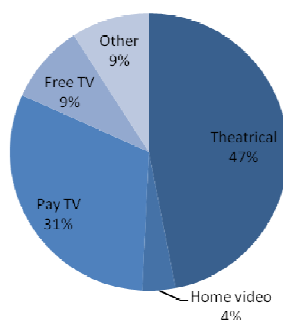
**Recent Developments**

- IH14 results, which were mostly in line with our estimates, revealed a sharp increase in revenues, which more than doubled due to new releases (8 movies) and rising revenues from other distribution channels (mainly Pay TV and Free TV). The EBITDA margin grew significantly to 61.4% and net profit exceeded EUR4.7 million. Net cash reached EUR8.8 million, of which EUR6.4 million is attributable to the proceeds of the IPO completed in June (net of direct listing costs).
- Notorious Pictures was the leading Italian independent distributor in the first half of the year with admissions of 3.1 million and EUR18 million of box office revenues.
- Theatrical revenues were lower in the second quarter but a much stronger contribution from other distribution channels contributed to sales of EUR5.7 million with an outstanding EBITDA margin of 69%. Net profit was EUR2.1 million.
- In the past two months the company announced the acquisitions of full rights on 4 new movies, including “Belle and Sebastien 2” (the first movie generated >EUR7.5 million of box office revenues) and “Rambo 5”. Further acquisitions should be announced shortly following the Toronto festival and the AFM in Los Angeles next month.

Notorious Pictures distributed 8 new movies in the first half, two of which delivered outstanding results (“Belle and Sebastian” with EUR4.4 million and “La belle et la bête” with EUR2.9 million). Theatrical sales more than doubled, reaching EUR7.3 million, which, together with revenues from movies released in 2012 and 2013 (nearly EUR3.5 million) boosted total revenues to EUR15.2 million (+68.6% compared with full year 2013). The EBITDA margin increased significantly to 61.4% and was particularly high in the second quarter (at 69%) due to the higher weighting of Pay TV and Free TV revenues. Net profit was EUR4.7 million after EUR2.2 million of D&A costs and a 33% tax rate.

Figure 1 – Revenues breakdown IH14A

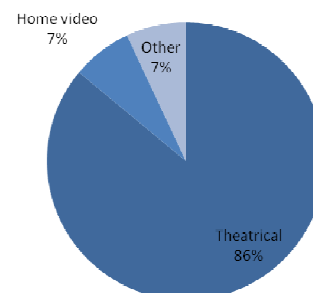
**In IH14 started to exploit the entire product cycle with a revenue contribution from Pay and Free TV channels...**



Source: Company data

Figure 2 - Revenues breakdown IH13A

**...while the first half of 2013, in its start-up phase, revenues mostly came from theatrical sales**



Source: Company data

It is important to stress that the company’s film library (EUR6.1 million gross value at June-14, already amortized for EUR2.8 million) 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 and its commercial exploitation. This means that a movie that exceeds its revenue plan would have a higher amortization, making this method very conservative.

Figure 3 – 2Q14A and 1H14A results

**1H14 strongly benefitted from two movies, which together represented nearly 50% of revenues: “Belle and Sebastien” and “La belle et la bête”. In 2Q14 the bulk of sales were represented by Pay TV revenues (46% of total).**

(EURm)	2Q13A	2Q14A	% Chg.	1H13A	1H14A	% Chg.
Sales Theatrical	1.62	1.04	-36.0%	3.07	7.13	132.1%
Sales Other	0.44	4.71	962.8%	0.50	8.07	1516.8%
<b>Sales total</b>	<b>2.06</b>	<b>5.75</b>	<b>178.4%</b>	<b>3.57</b>	<b>15.20</b>	<b>325.6%</b>
<b>EBITDA</b>	<b>0.52</b>	<b>3.97</b>	<b>nm</b>	<b>0.42</b>	<b>9.33</b>	<b>nm</b>
<b>% margin</b>	<b>25.3%</b>	<b>69.0%</b>		<b>11.8%</b>	<b>61.4%</b>	
EBIT	0.28	2.76	nm	0.10	7.11	nm
% margin	13.4%	47.9%		2.8%	46.8%	
Pre tax profit	0.27	2.74	nm	0.08	7.10	nm
<b>Net profit</b>	<b>0.16</b>	<b>1.80</b>	<b>nm</b>	<b>0.02</b>	<b>4.74</b>	<b>nm</b>
Net cash	0.32	8.76		0.32	8.76	

Source: Company data

Net cash increased to EUR8.8 million, of which EUR6.4 million is attributable to the IPO proceeds (net of direct listing costs), despite substantial growth in capex (EUR3.7 million vs. EUR1.1 million in 1H13) and in trade receivables (EUR10.6 million vs. EUR4.8 million at Dec-13) which are directly linked to the success of the movies released in the period (theatrical revenues are cashed in after an average of 120 days).

Figure 4 – Company’s revenues by movie in 1H14A

Movie title	Release	Genre	Revenues (EUR000)	% weight
Matching Jack	Oct-12	Drama	280	1.8%
Hello I Must Be Going	Nov-12	Drama	60	0.4%
Rec 3- Genesis	Jan-13	Horror	59	0.4%
Snowflake	Jan-13	Animation	159	1.0%
Upside Down	Feb-13	Fantasy	158	1.0%
Olympus Has Fallen	Apr-13	Action	272	1.8%
Lords of Salem	Apr-13	Horror	76	0.5%
Ghost Academy	Apr-13	Comedy	9	0.1%
Blood	Jun-13	Drama	15	0.1%
Dino Time	Jul-13	Animation	357	2.3%
Plan De Table	Jul-13	Comedy	540	3.6%
So Undercover	Aug-13	Comedy	287	1.9%
Riddik	Sep-13	Sci-Fi	912	6.0%
Kill Your Darlings	Oct-13	Thriller	34	0.2%
The last days	Oct-13	Sci-Fi	268	1.8%
The house of Magic	Jan-14	Animation	1060	7.0%
Belle et Sebastien	Jan-14	Family	4,387	28.9%
the number station	Feb-14	Thriller	181	1.2%
Beauty and the beast	Feb-14	Fantasy	2,874	18.9%
A long way down	Mar-14	Comedy	966	6.4%
Devil’s knot	May-14	Thriller	202	1.3%
The nut job	May-14	Animation	285	1.9%
Ghost movie 2	May-14	Comedy	639	4.2%
Other revenues			1,120	7.4%
<b>Total</b>			<b>15,200</b>	<b>100,0%</b>

Source: Company data

### Financial Projections

- We expect revenues to reach EUR25.4 million this year (implying sales of EUR10.1 million in the second half) with an EBITDA margin of about 60%. In 2015-16 sales are expected to rise further (by 16% on average excluding potential production revenues) while the EBITDA margin is expected to stabilize at about 65%. Net profit is expected to exceed EUR10 million already in 2015.
- There are now 8 movies in the pipeline for the second half of the year, including “A most wanted man” and “Night Crawler”, both of which are expected to generate high box office revenues. The 2015 pipeline currently includes 14 movies with further titles to be added in the next few months, and the company has 3 titles currently lined up for 2016.
- Although our current forecasts do not foresee a dividend payment, we do not rule out a distribution in future, given Notorious Pictures’ strong cash.

It is very difficult to assess reliable estimates for a distributor of motion picture content, as the top line is directly correlated to the box office results of future releases, which are clearly unpredictable. However, there is a clear pipeline of forthcoming movies for 2014 (8 movies scheduled in 2H), 2015 (14 movies) and 2016 (3 movies) and we expect further acquisitions in October and November, following the AFM in Los Angeles, which should complete the pipeline for 2015 and expand the number of titles due for release in 2016.

In order to assemble our forecasts we have divided the number of forthcoming movies over the next three years (17-18 per annum) into clusters based on expected box office revenues (on which all other sales are dependent). Theatrical sales are accounted at 40% of box office, Pay TV at an average of 26% of the box office (the contract with Sky includes a fee escalator clause on the basis of the admissions to the cinemas), Free TV at 8% (based on the contract with RAI Cinema), home video at 4%, and other revenues (Vod, PPV, Kiosk) at 2%, for a total of about 80% of the total box office spread along with the full rights duration (17 years on average). Clearly, the bulk of revenues is accounted in the first year of release (100% of theatrical revenues, 80% of Pay TV sales).

Figure 5 - Assumption of revenues per movie cluster

**Our assumptions are more conservative than previously achieved results. For example a 2014 A movie (“La belle et la bête”) with box office takings of EUR4.8 million, already generated >EUR2.8 million sales in 1H14.**

(EUR 000)	Admission (000)	Box office	Theatrical	Pay TV	Free TV	Home video	Other	Total
Movies A	800	4,800	1,920	1,000	250	200	75	3,445
Movies B	400	2,400	960	700	250	65	60	2,035
Movies C	200	1,200	480	500	150	45	40	1,215
Movies D	0	0	0	250	20	25	35	330

Source: UBI Banca estimates

Our cost projections assume that the MG (capitalized as an intangible asset) could range from EUR1.0 million for an A movie to EUR30K for a D movie, editing costs (also capitalized) are fixed at EUR35k per movie and P&A costs can range from EUR0.75 million for an A movie to EUR30K for a D movie. This translates to a potential gross margin per movie (after P&A costs) ranging from 44% for an A movie to 65% for a D movie.

Figure 6 - Assumption of cost per movie cluster

(EUR 000)	M.G.	Editing	P&A	Other costs	Total	Theoretical gain	% margin
Movies A	1,000	35	750	150	1,935	1,510	43.8%
Movies B	400	35	600	100	1,135	900	44.2%
Movies C	150	35	400	50	635	580	47.7%
Movies D	30	35	30	20	115	215	65.2%

Source: UBI Banca estimates

It should be noted that our estimates do not include the payment of bumps and/or royalties as estimated box office revenues are conservative and therefore always below the threshold above which royalties mature. If bumps or royalties come as a result, this is the consequence of performance far higher than expected and therefore generating higher gains for Notorious Pictures.

We also anticipate a weaker IH15 due to the lack of A movies, compared with IH14 which was characterized by the outstanding result of two movies which together represented nearly 50% of revenues.

Figure 7 – P&L estimates

**In the coming years the company should also benefit from revenues from the second exploitation of the rights.**

(EURm)	2013A	2014E	2015E	2016E
Movies A	1	2	2	3
Movies B	2	2	7	8
Movies C	4	10	6	5
Movies D	7	2	2	2
<b>Total movies</b>	<b>14</b>	<b>16</b>	<b>17</b>	<b>18</b>
Theatrical	4.19	11.08	13.44	15.84
Pay TV	3.55	8.65	10.20	11.30
Free TV	0.00	2.67	2.69	3.44
Home video	0.62	0.90	0.98	1.38
Vod, PPV, Kiosk	0.12	0.35	0.73	0.80
Other	0.54	1.70	1.73	1.77
<b>Total sales</b>	<b>9.01</b>	<b>25.35</b>	<b>29.77</b>	<b>34.53</b>
Direct costs (P&A and other)	(5.15)	(8.57)	(9.03)	(10.13)
<b>Gross margin</b>	<b>3.86</b>	<b>16.78</b>	<b>20.74</b>	<b>24.40</b>
<b>Gross margin (%)</b>	<b>42.8%</b>	<b>66.2%</b>	<b>69.7%</b>	<b>70.7%</b>
Labour and other structure costs	(1.05)	(1.52)	(1.80)	(1.89)
<b>EBITDA</b>	<b>2.82</b>	<b>15.26</b>	<b>18.95</b>	<b>22.51</b>
<b>% margin</b>	<b>31.2%</b>	<b>60.2%</b>	<b>63.6%</b>	<b>65.2%</b>
D&A on the library	(0.76)	(3.50)	(3.47)	(4.24)
Other D&A	(0.06)	0.41	(0.32)	(0.50)
<b>EBIT</b>	<b>1.99</b>	<b>12.17</b>	<b>15.16</b>	<b>17.77</b>
<b>% margin</b>	<b>22.1%</b>	<b>48.0%</b>	<b>50.9%</b>	<b>51.5%</b>

Source: Company data, UBI Banca estimates

Below the operating line, the company should have minimal financial charges (given its net cash position) and a tax rate of about 33%. This implies a net profit which is expected to rise to EUR8.0 million already this year and to EUR1.9 million in 2016.

We expect the balance sheet to reflect the increasing value of the library (classified as intangible fixed assets) following the acquisition of new rights. Net working capital is expected to remain broadly stable at about 20% of revenues. Net equity, assuming no dividend distribution is expected to rise to EUR38.4 million at end 2016 from EUR13.2 million at June-14 (deducting listing costs for EUR0.5 million).

We forecast that investments (mostly in the library) could be about EUR6 million this year, and about EUR8 million in the next two years. This trend would allow Notorious Pictures to generate substantial net cash flow leading to a rapid increase in net cash (EUR19.9 million expected at Dec-16 vs. EUR8.8 million at June-13).

### Valuation

- Our target price of EUR3.48 per share is based on the single average of a DCF (EUR3.86 fair value per share) and a relative valuation (EUR3.10 per share applying a 20% discount to take into account the limited free float of Notorious Pictures and its modest size).
- Given current upside potential of about 35% we initiate coverage with a Buy rating.
- At the target price, the company would trade at 4.6x 2014 EV/EBITDA, which is still below the average multiple for the industry (5.4x) and on 9.7x P/E (in line with peers).

Figure 8 – Valuation summary

(EUR)		Weight
DCF Valuation	3.86	50.0%
Relative Valuation (at 20% discount)	3.10	50.0%
<b>Target Price</b>	<b>3.48</b>	
Current price	2.58	
Potential upside	34.9%	

Source: UBI Banca estimates

Our cautious DCF model delivers a fair value of EUR3.86 per share, implying nearly 50% upside, which supports our Buy rating.

Our model incorporates the following assumptions:

- Risk-free rate of 3.5%;
- Market risk premium of 4.5%;
- A beta of 1.3, which reflects the cyclical nature of entertainment industry and well above the average of the industry (0.73);
- A terminal growth rate of 1% and an operating margin at 40% at terminal value, which is well below the 50.1% EBIT margin reported in 1H14.

Figure 9 – WACC and embedded DCF assumptions

Wacc assumptions		Embedded DCF assumptions	
Risk Free rate (10Y BTP bench.)	3.5%	Revenue CAGR 2014-2022 (%)	2.7%
Debt spread (%)	2.0%	EBIT CAGR 2014-2022 (%)	1.1%
Cost of debt [net] (%)	3.7%	EBIT margin 2014 (%)	48.0%
Market risk premium (%)	4.5%	Target EBIT margin 2022 (%)	40.0%
Beta (x)	1.30	Depr. on sales (avg 2014-2022) (%)	16.4%
Cost of equity (%)	9.4%	Capex on sales (avg 2014-2022) (%)	-22.3%
Weight of Debt	0%		
Weight of Equity	100%		
<b>WACC</b>	<b>9.4%</b>		

Source: UBI Banca estimates



We calculated a WACC of 9.35%, obtaining a theoretical value of EUR3.86 per share.

Figure 10 – DCF valuation

	(EUR m)	(% weight)
Sum of PV 2014-22 FCF	34.8	45%
Terminal value	42.7	55%
<b>Total Enterprise value</b>	<b>77.5</b>	<b>100%</b>
- minorities	0.0	
- Pension Provision	(0.1)	
- Net debt (+ cash)	8.8	
<b>Total Equity value</b>	<b>86.2</b>	
Fully diluted number of shares (m)	22.3	
<b>Fair value per share (EUR)</b>	<b>3.86</b>	

Source: UBI Banca estimates

Our valuation has limited sensitivity to the terminal growth rate and WACC although a lower beta and/or stronger growth would increase our DCF target price.

Figure 11 – Sensitivity analysis

WACC/g	0.00%	0.50%	1.00%	1.50%	2.00%
8.00%	4.03	4.17	4.34	4.52	4.74
8.50%	3.87	4.00	4.14	4.31	4.49
9.00%	3.73	3.84	3.97	4.11	4.28
9.35%	3.64	3.74	<b>3.86</b>	3.99	4.14
9.50%	3.60	3.70	3.82	3.94	4.09
10.00%	3.48	3.57	3.67	3.79	3.92
10.50%	3.37	3.45	3.55	3.65	3.76

Source: UBI Banca estimates

Notorious Pictures has several direct listed peers, although none of them is a pure distributor focused on a single geographical market. We have not taken into consideration in our relative valuation the two largest listed peers (DreamWorks Animation and Lions Gate) due to their large size and international focus.

Figure 12 – Peers characteristics

Company	Market Cap (EURm)	Country	Sales 2013A (EURm)	EBITDA 2013A (EURm)	% Margin	Film Library (unit)	Distribution	Movie production	TV production	Movie theatres	Music
Leone Film Group	43	Italy	20	13	61.9%	420	√	√			
DreamWorks	1,529	US	513	48	9.4%	74	√	√	√		
EuropaCorp	125	France	212	35	16.6%	500	√	√	√		
Splendid Medien	23	Germany	55	12	22.7%	na	√	√	√		√
Lions Gate Enter.	3,527	Canada	1,909	269	14.1%	8,000	√	√	√		
EntertainmentOne	1,211	UK	985	111	11.2%	35,000	√	√	√		√
Lucisano Media G.	44	Italy	35	15	41.6%	300	√	√	√	√	
<b>Notorious Pictures</b>	<b>58</b>	<b>Italy</b>	<b>9</b>	<b>3</b>	<b>31.2%</b>	<b>220</b>	√				

Source: Company data, Factset, UBI Banca estimates

Overall, Notorious Pictures is trading at a significant discount to its direct peers (45% on average), mainly due to its modest size compared to other competitors and its short history.

Based on a relative 2014-16 P/E, Notorious Pictures would be valued at EUR2.88 per share, on EV/EBITDA it would be EUR4.19 per share and on EV/EBIT it would be EUR4.56 per share. The average of these three valuations gives EUR3.87 per share. Applying a 20% discount to our relative valuation to factor in Notorious Pictures' modest size and low liquidity, generates a valuation of EUR3.10 per share. Taking DreamWorks Animation and Lions Gate into consideration produces a valuation of EUR6.43 per share (EUR5.14 after the 20% discount).

Figure 13 – 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.**

Company	Market Cap (EURm)	P/E			EV/EBITDA			EV/EBIT		
		2014	2015	2016	2014	2015	2016	2014	2015	2016
Leone Film Group	43	13.5 x	5.5 x		3.6 x	2.4 x		9.3 x	4.0 x	
EuropaCorp	128	4.2 x	3.2 x	5.2 x	4.3 x	3.8 x	5.4 x	6.2 x	5.1 x	5.4 x
Splendid Medien	22	6.2 x	4.8 x	4.4 x	2.1 x	2.0 x	2.0 x	5.8 x	4.9 x	4.5 x
Entertainment One	1,251	15.6 x	13.9 x	13.1 x	11.5 x	10.4 x	9.7 x	12.0 x	11.0 x	10.0 x
<b>Average</b>		<b>9.9 x</b>	<b>6.9 x</b>	<b>7.5 x</b>	<b>5.4 x</b>	<b>4.7 x</b>	<b>5.7 x</b>	<b>8.3 x</b>	<b>6.2 x</b>	<b>6.6 x</b>
<b>Median</b>		<b>9.8 x</b>	<b>5.2 x</b>	<b>5.2 x</b>	<b>4.0 x</b>	<b>3.1 x</b>	<b>5.4 x</b>	<b>7.8 x</b>	<b>5.0 x</b>	<b>5.4 x</b>
<b>Notorious Pictures valuation</b>										
Based on simple average		3.54	3.12	4.01	4.02	4.48	6.64	4.87	4.76	6.16
Based on median		3.53	2.35	2.75	3.05	3.14	6.36	4.56	3.91	5.21
<b>Current multiples</b>		<b>7.2 x</b>	<b>5.7 x</b>	<b>4.8 x</b>	<b>3.3 x</b>	<b>2.4 x</b>	<b>1.7 x</b>	<b>4.2 x</b>	<b>3.1 x</b>	<b>2.1 x</b>
Premium (discount to Average)		-27.1%	-17.4%	-35.7%	-38.7%	-47.6%	-70.4%	-50.1%	-51.1%	-67.7%
Premium (discount to Median)		-27.0%	9.7%	-6.0%	-17.0%	-21.0%	-68.9%	-46.5%	-38.8%	-60.6%

Source: Factset, UBI Banca estimates

**Appendix**

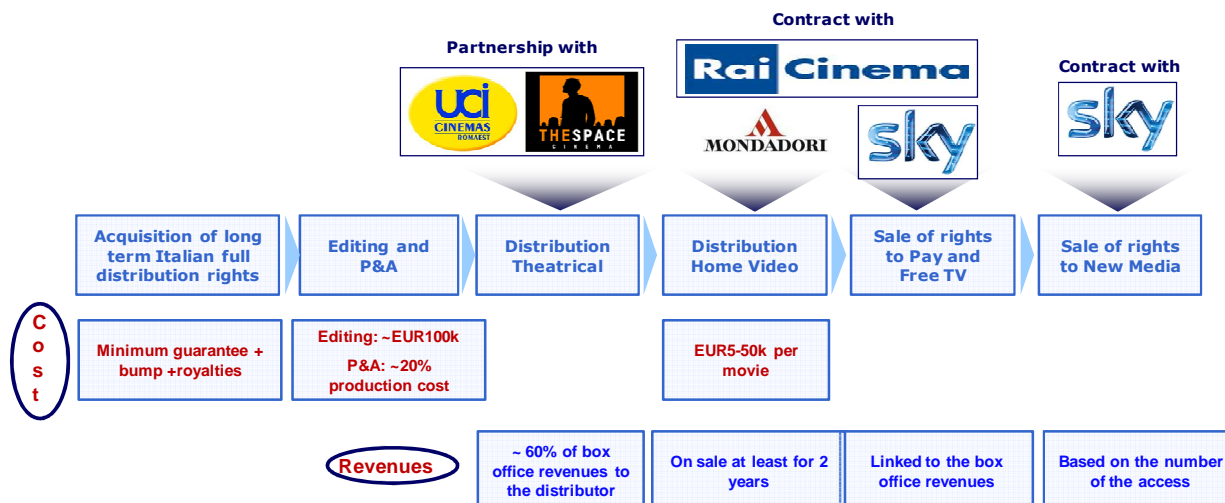
**COMPANY PROFILE AND BUSINESS MODEL**

Notorious Pictures was established in 2012 with the mission of becoming a leading Italian distributor based on to its founder’s knowledge and network of contacts (Mr. Marchetti, controlling 89.6% of the share) as well as those of his team. The company was listed in the AIM Italia market on June 23, 2014 at EUR3.0 per share raising EUR6.9 million of new financial resources.

The business model is relatively straightforward:

- The company usually acquires full rights for film titles for the Italian market lasting 16-18 years, from independent production companies in the US and in Europe and from international sales agencies, after scouting a large number of screenplays (about 450 p.a.) mainly at AFM (America Film Market) and at the most important film festivals (Toronto, Berlin, Cannes). Distributors such as Notorious Pictures usually have to pay a Minimum Guarantee (MG), which is a sort of upfront fee to the producers. This fee can range from EUR10k to over EUR1 million, depending on the standing of the movie. In addition, the producer is entitled to receive royalties based on box office revenues, known as “bumps”, if a given threshold of revenues is exceeded. The MG is capitalized by Notorious Pictures as an intangible asset and amortized over the exploitation period (based on the revenues reported each year compared with the original sales budget);
- Notorious Pictures incurs all the expenses for dubbing the film (about EUR30-60k per movie, also capitalized) and the so-called P&A costs (printing & advertising, which are not capitalized). Printing costs are now limited to EUR480 per movie theatre and could decline in future as Italian movie theatres are rapidly changing to digital, while advertising costs are generally much higher and exceed the amount of MG. Marketing is usually carried out through advertisements in newspapers and magazines, poster campaigns, promotional events and mass communication (TV, radio, Internet) utilizing materials provided by the producer;

Figure 14 - Notorius Pictures business model

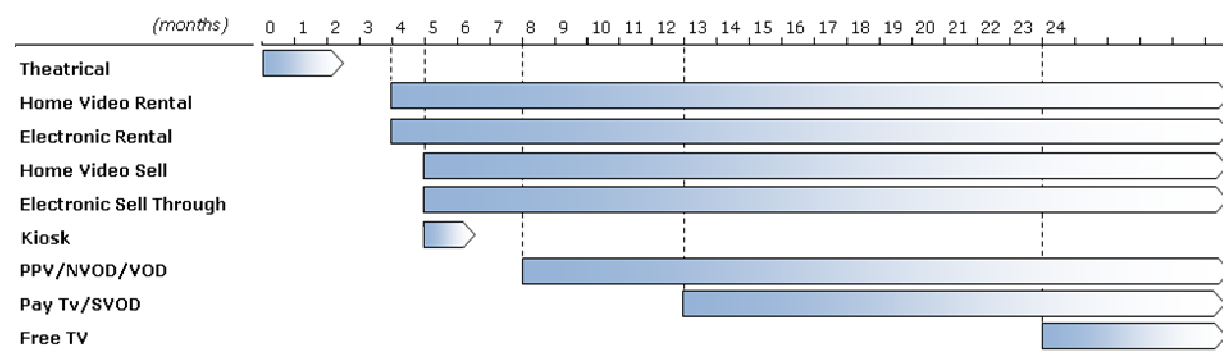


Source: Company data, UBI Banca

- Usually a movie is ready for distribution 12-18 months following acquisition of full rights. Theatrical distribution normally lasts two months, though it can be higher for successful movies, with box office revenues divided between the movie theatre (60%) and the distributor (40%). It is important to stress that Notorious Pictures entered into arrangements with the largest Italian movie theatre chains (UCI Cinemas and The Space, >800 screens, 40% market share in Italy) which are a key factor for the success of the movie. Movies are also distributed through independent agents covering all of the Italian regional markets. Ideally, theatrical revenues should allow Notorious Pictures to break even covering all MG, editing and P&A costs;
- Four months after distribution in theatres ceases, Notorious Pictures begins Home video distribution (sale of DVD and Blu Ray) through the traditional retail chains and at kiosks. Distributors are responsible for production costs though they retain a percentage of the sale price. Although it has agreements with RAI Cinema and Mondadori (for kiosk sales), home video distribution represents a minimal part of Notorious Pictures' revenues (<5% of IHI4turnover) and is expected to decline as the home video market is gradually shrinking to be replaced by new media (Vod, or video on demand);

Figure 15 - Full right product cycle

Interest Coverage (%)



Source: Company data

- After a period of several months, Notorious Pictures begins exploitation of full rights on Pay and Free TV channels (plus PPV or pay per view) which represent a significant proportion of expected revenues (>40% in the first half of 2014). The company has signed a 3 year agreement with Sky Italia (to be renewed by year-end) to license the exclusive rights on 37 movies (Sky will have the right of first refusal on additional movies) for 12/17 months (respectively for Pay TV and PPV), with a fee based on the admissions recorded for each film in cinemas. It also has a contract with RAI Cinema for 9 movies lasting 4/6 years. Generally, Pay TV revenues represent >25% of the box office revenues while Free TV less than 10%. It is important to underline that these channels can be exploited for several years (up to 20), therefore with a 100% margin after the end of the amortization period of the library (2-3 years);
- Finally, Notorious Pictures may exploit new media channels by distributing titles through several platforms (mobile devices such as tablets, smartphones, PCs). New Media rights are usually negotiated through licensing agreements that provide for the possibility of allowing end-users a single viewing or to download the film. New Media channels currently make a limited contribution to Notorious Pictures' revenues (less than 1% expected in 2014) but their importance is growing rapidly and we believe they will be an important source of revenues in the coming years.

Clearly the key factor that determines the profitability of a single movie is the box office which ought to cover all costs (including the D&A of the library) and is the driver for Pay and Free TV revenues. In this respect, Notorious Pictures has an outstanding track record as every film it has distributed was already profitable in the first phase of the exploitation cycle, meaning that all additional marginal revenue represents a 100% gain for the company.

### KEY PEOPLE

Notorious Pictures has 15 employees and a board of 5 directors of which one is independent. Clearly the company's team is its most valuable asset considering Notorious Pictures' conspicuous success in less than two years of existence and considering the team's past track record. The CEO, the General Director and the Purchasing Director are the key team members in selecting the titles that are expected to drive the company's revenues. All of them have long experience in the film industry and many of them have worked together for many years.

Figure 16 - Key people at Notorious Pictures

Name	Position	Previous working experience	Years in the business
G. Marchetti	Founders, CEO and owner	Walt Disney (sales manager), Mondo Home Entertainment (CEO), Moviemax (Chairman and CEO)	30
U. Girardi	Chairman	Mondo TV (CFO)	10
R. Proia	General Director	MTV Networks (Media director), Nexo (Strategy Director), Moviemax (General Director)	20
M. Brioschi	Purchasing Director	Mikado Film (acquisitions)	19
I. Tomio	Marketing Director	Toto 2000 (Media director), Moviemax (Promotion Manager)	10
L. Miorando	Editing Director	In charge for production (Divisual), Dubbing coordinator (MTV, Sedif, Sailing Channel)	17
G. Davalli	Commercial Director	Commercial ssistant (Athena, Mikado), Commercial Director (Moviemax)	17
B. Noviello	Administrative Director	Administratve and auditing manager (Frimm, Eustema, Feidos)	16

Source: Company data

Given the importance of its key personnel, one of the main risks that Notorious Pictures is exposed to is the risk of key personnel leaving the company. In order to retain its team, the company is currently studying incentive plans, possibly including stock options which should be announced along with its business plan in November. We believe that there is limited risk of any key people leaving the company in the short term, given that Notorious Pictures is still enjoying a period of rapid growth.

### STRATEGY

Notorious Pictures' strategy differs from the strategy of other companies in the market: first, the company does not have long term film distribution agreements with premier producers for the film acquisition, instead it adopts a cherry picking strategy to select its titles (management examined about 450 screenplays last year). Second, Notorious Pictures does not partner-up with other downstream distributors (see however the partnership with Leone Film Group for distributing two movies where Notorious Pictures manages theatrical distribution) but directly controls all its Italian theatrical distribution due to its partnership with UCI Cinemas and The Space and through its agent network. In this way, the company controls the entire value chain and this is one of the main strengths of the company in our view. Lastly, Notorious Pictures is not present in the product placement niche, focusing on pure distribution.

Following the EUR6.4 million cash inflow from the proceeds of the IPO (net of direct listing costs), Notorious Pictures is considering investing in two main directions, details of which should be made available in the business plan to be presented in November:

- Increasing the acquisition of rights on new movies from 14/15 p.a. to about 18/20, with a higher production budget. The targets will be thriller, animation, horror, family and

action movies. Based on our assumptions, the addition of 4 new films, coupled with a generally higher standing, could translate into additional sales of about EUR10 million, or nearly 40% of 2014E revenues, which should significantly increase the size of the company in the medium term ;

- Entry into film production industry probably from 2015 with 2 films, possibly through co-production. The clear advantage of production is that a large part of the production budget can be funded before investment costs for production are incurred, due to the sale of co-production shares and distribution rights (also outside Italy) and the attractive tax credit arrangements in Italy (up to 55% of the production costs plus any potential regional subsidies). Nevertheless, the production budget must be covered before the start of shooting by tax incentives (tax credit), government grants, product placement and pre-sales rights (HV, Pay TV PPV, VOD, free TV). As a result, production investments are generally limited to less than the half of the production costs while the distribution agreement can generate revenues for several years. In addition, with international co-productions generating revenues abroad and increasing geographical diversification, the risk of relying only on the Italian market will be reduced.

## SWOT ANALYSIS

Figure 17 – SWOT Analysis

Strengths	Weaknesses
Outstanding track record in film distribution	High volatility of box office revenues
Strong management expertise in the movie sector	The business is totally dependent on a small number of key personnel
Solid balance sheet with net cash of EUR8.8 million at June-14	Short history of the company. However, top management has been in the industry for more than 20 years and therefore has a strong network of relationships with the leading upstream producers
Distribution contracts and arrangements with the most important Italian clients (RAI Cinema, Sky, UCI and The Space)	Limited free float and liquidity
Opportunities	Threats
Upstream integration through the entrance in the production and co-production sector which generally generates higher margins	Piracy, which is rapidly increasing as a consequence of the digitalization process
Strong development of new channels and new media distribution channels	Home video market is rapidly declining (-14% CAGR in 2007-12)
Development of a factory for new and young movie directors	Technological breakthrough in the movie distribution market

Source: UBI Banca estimates

**Income Statement**

(EURm)	2013	2014E	2015E	2016E
Net Revenues	9.0	25.4	29.8	34.5
EBITDA	2.8	15.3	18.9	22.5
EBITDA margin	31.2%	60.2%	63.6%	65.2%
EBIT	2.0	12.2	15.2	17.8
EBIT margin	22.1%	48.0%	50.9%	51.5%
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	2.0	12.1	15.1	17.7
Taxes	-0.7	-4.1	-5.0	-5.9
Minorities & discontinuing ops	0.0	0.0	0.0	0.0
Net Income	1.3	8.0	10.1	11.9

Source: Company data, UBI Banca estimates

**Balance Sheet**

(EURm)	2013	2014E	2015E	2016E
Net working capital	0.3	5.6	5.7	6.8
Net Fixed assets	1.7	4.2	10.2	13.0
M/L term funds	-0.7	-0.7	-0.9	-1.4
Capital employed	1.3	9.1	15.0	18.5
Shareholders' equity	1.6	16.4	26.5	38.4
Minorities	0.0	0.0	0.0	0.0
Shareholders' funds	1.6	16.4	26.5	38.4
Net financial debt/(cash)	-0.3	-7.3	-11.5	-19.9

Source: Company data, UBI Banca estimates

**Cash Flow Statement**

(EURm)	2013	2014E	2015E	2016E
NFP Beginning of Period	-0.1	-0.3	-7.3	-11.5
Group Net Profit	1.3	8.0	10.1	11.9
Minorities	0.0	0.0	0.0	0.0
D&A	0.8	3.1	3.8	4.7
Change in Funds & TFR	0.0	0.0	0.0	0.0
Gross Cash Flow	2.1	11.1	13.9	16.6
Change In Working Capital	-0.6	-5.3	-0.1	-1.1
Other	0.0	0.0	0.0	0.0
Operating Cash Flow	1.5	5.8	13.8	15.5
Net Capex	-2.0	-6.1	-9.6	-7.1
Other Investments	0.0	0.0	0.0	0.0
Free Cash Flow	-0.4	-0.3	4.2	8.4
Dividends Paid	0.0	0.0	0.0	0.0
Other & Chg in Consolid. Area	0.7	0.0	0.0	0.0
Chg in Net Worth & Capital Incr.	0.0	7.2	0.0	0.0
Change in NFP	0.2	7.0	4.2	8.4
NFP End of Period	-0.3	-7.3	-11.5	-19.9

Source: Company data, UBI Banca estimates

**Financial Ratios**

(%)	2013	2014E	2015E	2016E
ROE	76.4%	48.8%	38.2%	30.9%
ROI	170.9%	206.1%	117.8%	99.3%
Net Fin. Debt/Equity (x)	-0.2	-0.4	-0.4	-0.5
Net Fin. Debt/EBITDA (x)	-0.1	-0.5	-0.6	-0.9
Interest Coverage (%)	58.5	304.2	378.9	444.2
NWC/Sales	3.6%	22.2%	19.2%	19.8%
Capex/Sales	21.8%	23.9%	32.2%	20.6%
Pay Out Ratio	0.0%	0.0%	0.0%	0.0%

Source: Company data, UBI Banca estimates

**Per Share Data**

(EUR)	2013	2014E	2015E	2016E
EPS	-	0.36	0.45	0.53
DPS	-	0.00	0.00	0.00
Op. CFPS	-	0.26	0.62	0.70
Free CFPS	-	-0.01	0.19	0.38
BVPS	-	0.74	1.19	1.72

Source: Company data, UBI Banca estimates

**Stock Market Ratios**

(x)	2013	2014E	2015E	2016E
P/E	-	7.2	5.7	4.9
P/OpCFPS	-	10.0	4.2	3.7
P/BV	-	3.5	2.2	1.5
Dividend Yield (%)	-	0.0%	0.0%	0.0%
Free Cash Flow Yield (%)	-	nm	7.3%	14.6%
EV (EURm)	-	50.7	46.5	38.1
EV/Sales	-	2.0	1.6	1.1
EV/EBITDA	-	3.3	2.5	1.7
EV/EBIT	-	4.2	3.1	2.1
EV/Capital Employed	-	5.6	3.1	2.1

Source: Company data, UBI Banca estimates

**Growth Rates**

(%)	2013	2014E	2015E	2016E
Growth Group Net Sales		181.2%	17.4%	16.0%
Growth EBITDA		442.1%	24.2%	18.8%
Growth EBIT		511.6%	24.5%	17.2%
Growth Net Profit		535.4%	26.5%	17.3%

Source: Company data, UBI Banca estimates



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