

Company Update

Buy (maintained)

05 December 2014

MARKET PRICE: **EUR2.92**

TARGET PRICE: **EUR3.33 (from EUR3.48)**

Entertainment

Data

Shares Outstanding (m):	22.3	
Market Cap. (EURm):	65.2	
Enterprise Value (EURm):	60.2	
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	18.7%	14.6%	-
Rel. to FTSE IT	15.6%	26.3%	-

Graph area Absolute/Relative 12 M



2015-17 business plan

Although the 2014-17 business plan recently presented by the company was slightly below our estimates, our investment case for Notorious Pictures remains intact: 1) we expect the company to deliver significant sales growth in the next two years (we estimate +14% in 2015, +19% in 2016) due to the increased number and standing of forthcoming movie acquisitions and the entry into film production (from 2016 with 2 co-productions) made possible by the IPO proceeds (EUR6.4 million net of direct listing costs), 2) its full control of the distribution value chain, recently enlarged with new agreements with RAI and Mediaset, gives Notorious Pictures high operational leverage, which should translate into higher EBITDA margin in the coming years (>60%), 3) despite the outstanding share performance (+13% since we initiated coverage on September 22 while the Italian stock market fell 7%) the company is still trading at a significant discount to the multiples of its direct peers (32% on average, excluding Dreamworks and Lions Gate, which have worldwide leading positions), and 4) Notorious Pictures announced a dividend distribution from 2016 (based on a 25% pay-out ratio). Potential acquisitions and the listing at MTA should add further appeal. We reiterate our Buy recommendation with a new target price of EUR3.33 per share.

- > The 2015-17 business plan confirmed the company's strategy of expanding the movie library (to 18 film p.a.) while increasing the overall standing of new acquisitions, and entry into film production and international co-production, which could generate higher profitability than pure distribution. The business plan forecasts revenues of almost EUR40 million in 2017 with an EBITDA margin of 67% and net cash of >EUR18 million despite high cumulative capex of EUR29 million between 2014-17 and investment in NWC which is likely to rise to 44% of sales in 2017 from 34% this year.
- > However, business plan projections were slightly below our expectations mostly for three reasons: weaker than expected box office results for the movies presented in 2H14, which are therefore likely to generate lower revenues in future, higher D&A costs, related to the shortening of the amortization period of the library, and a different sales mix (lower theatrical sales).
- > We have therefore reduced our EBITDA estimates by 6.5% on average and our Net Profit forecasts by 11.2%. Consequently, we have reduced our target price to EUR3.33 per share (from EUR3.48) which still implies >10% upside.

Financials

	2013	2014E	2015E	2016E
Revenues (EURm)	9.0	25.3	28.8	34.2
EBITDA (EURm)	2.8	14.3	17.3	21.5
EBITDA margin (%)	31.2%	56.4%	60.1%	62.9%
EBIT (EURm)	2.0	11.0	13.0	15.4
EPS (EUR)	0.06	0.33	0.39	0.47
CFPS (EUR)	0.07	0.11	0.39	0.59
DPS (EUR)	0.00	0.00	0.10	0.12

Source: Company Data, UBI Banca Estimates

Ratios

	2013	2014E	2015E	2016E
P/E(x)	-	8.9	7.4	6.2
P/CF(x)	-	6.1	5.0	3.9
P/BV(x)	-	4.2	2.7	2.0
Dividend Yield	-	0.0%	3.4%	4.0%
EV/EBITDA(x)	-	4.2	3.4	2.6
Debt/Equity (x)	-	-0.5	-0.4	-0.4
Debt/EBITDA (x)	-	-0.5	-0.5	-0.6

Source: Company Data, UBI Banca Estimates

Key Financials

(EURm)	2013	2014E	2015E	2016E
Revenues	9.0	25.3	28.8	34.2
EBITDA	2.8	14.3	17.3	21.5
EBIT	2.0	11.0	13.0	15.4
NOPAT	1.3	7.3	8.7	10.3
Free Cash Flow	-0.4	-2.3	1.8	6.1
Net Capital Employed	1.3	8.2	15.2	20.6
Shareholders' Equity	1.6	15.7	24.5	32.8
Net Financial Position	-0.3	-7.5	-9.3	-12.2

Source: Company data, UBI Banca estimates

Key Profitability Drivers

	2013	2014E	2015E	2016E
Net Debt/Ebitda (x)	-0.1	-0.5	-0.5	-0.6
Net Debt/Equity (x)	-0.2	-0.5	-0.4	-0.4
Interest Coverage (%)	58.5	273.8	324.1	386.1
Free Cash Flow Yield (%)	-0.7%	nm	2.8%	9.3%
ROE (%)	76.4%	46.5%	35.9%	32.0%
ROI (%)	170.9%	156.1%	82.5%	70.6%
ROCE (%)	114.5%	104.6%	55.3%	47.3%

Source: Company data, UBI Banca estimates

Key Valuation Ratios

	2013	2014E	2015E	2016E
P/E (x)	-	8.9	7.4	6.2
P/BV (x)	-	4.2	2.7	2.0
P/CF (x)	-	6.1	5.0	3.9
Dividend Yield (%)	-	0.0%	3.4%	4.0%
EV/Sales (x)	-	2.4	2.0	1.6
EV/EBITDA (x)	-	4.2	3.4	2.6
EV/EBIT (x)	-	5.5	4.5	3.6
EV/CE (x)	-	7.3	3.9	2.7

Source: Company data, UBI Banca estimates

Key Value Drivers

(%)	2013	2014E	2015E	2016E
Payout	0.0%	0.0%	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	3.6%	33.3%	44.9%	47.7%
Capex/Sales	21.8%	19.0%	23.6%	20.8%

Source: Company data, UBI Banca estimates

Recent Developments

- Notorious Pictures presented its 2015-17 business plan and its 2014 forecasts on November 27: the company's strategy is to increase both the quality and the quantity of its business library targeting distribution of 18 movies per annum with a higher standing compared with 2014, and entry into film production, with 2 movies in 2016 and 3 movies in 2017.
- Financial targets indicate CAGR in revenues of 18% in 2014-17 with an EBITDA margin growing from 57% in 2014 to 67% in 2017. Net profit is expected to rise to EUR13 million in 2017 from EUR7.4 million this year. Net cash is expected to be more than EUR18 million at the end of the business plan despite higher investments associated with the commencement of movie production.
- Overall, financial targets are slightly below our expectations (on average by 4.2% at the EBITDA level in the period 2014-16 and by 9.1% at net profit level). This is due to a decline in theatrical sales and margin per movie and due to the weaker than expected performance of some films in 2H14 ("Posh", "A Most Wanted Man" and "Universal Soldier" performed below expectations) and higher D&A expenses as the company is reducing the amortization period of the library.
- Notorious Pictures also announced a dividend distribution from 2015 with a pay-out of 25% and an incentive loyalty plan (which does not include stock options) for all employees for a total amount of EUR0.5 million (plus associated costs) in 2015-17.
- The company acquired the full rights to 3 new movies at the AFM in Los Angeles, including "We are your friends", "Unlocked" (both to be released in 2015) and "Robinson Crusoe" (animation, to be released in 2016). The company is also talking with Sky to renew the contract for pay TV (expiring in June 2015) and with RAI for a similar free TV deal.

Figure 1 – Notorious Pictures 2014-17 business plan vs. our estimates of Sept-14

While expected revenues are broadly in line with our old estimates, margins are below forecast due to a different product mix and higher D&A expenses.

(EUR 000)	Business Plan				Our old estimates			% change		
	2014E	2015E	2016E	2017E	2014E	2015E	2016E	2014E	2015E	2016E
Theatrical	9.794	13.504	12.512	15.152	11.080	13.440	15.840	-11,6%	0,5%	-21,0%
Pay TV	8.560	9.050	10.600	11.350	8.650	10.200	11.300	-1,0%	-11,3%	-6,2%
Free TV	4.120	4.150	4.700	4.000	2.670	2.690	3.440	54,3%	54,3%	36,6%
Home video	1.001	830	1.200	760	900	980	1.380	11,2%	-15,3%	-13,0%
Vod, PPV, Kiosk	320	200	1.135	1.135	350	726	800	-8,6%	-72,5%	41,9%
Production	0	0	3.160	4.740	0	0	0			
Second time on air	0	0	528	1.476	0	0	0			
Other	1.656	1.000	1.000	1.000	1.700	1.734	1.769	-2,6%	-42,3%	-43,5%
Total revenues	25.451	28.734	34.835	39.748	25.350	29.770	34.529	0,4%	-3,5%	0,9%
% growth	-	12,9%	21,2%	14,1%	-	17,4%	16,0%			
EBITDA	14.520	17.612	22.371	26.617	15.261	18.949	22.509	-4,9%	-7,1%	-0,6%
% margin	57,1%	61,3%	64,2%	67,0%	60,2%	63,6%	65,2%			
D&A	3.440	4.492	6.309	7.420	3.091	3.792	4.740	11,3%	18,5%	33,1%
EBIT	11.080	13.120	16.062	19.197	12.170	15.157	17.769	-9,0%	-13,4%	-9,6%
% margin	43,5%	45,7%	46,1%	48,3%	48,0%	50,9%	51,5%			
Pre tax	11.062	13.127	16.071	19.197	12.130	15.117	17.729	-8,8%	-13,2%	-9,4%
Net Result	7.402	8.931	10.942	13.083	8.006	10.128	11.878	-7,5%	-11,8%	-7,9%

Source: Company data, UBI Banca estimates

Financial Projections

- Following weaker than expected box office results for some recent films (primarily “A Most Wanted Man”, “Posh” and “Universal Soldier”, partially offset by good results for “The Giver”), we have reduced our 2014 theatrical sales estimates to EUR9.6 million (from EUR11.1 million) but increased free TV sales, leaving total revenues for this year largely unchanged (implying sales of EUR10.1 million in the second half of the year). EBITDA margin has been reduced to 56% (from 60%) to reflect the different sales mix. Adding higher D&A expenses (due to the reduction of the amortization period of the library), we have slashed our net profit estimate by about 9%.
- Following publication of the new business plan, we have also revised our 2015-16 estimates: we have increased our film distribution estimate to p.a. to 18 (of which 2 directly produced in 2016), but have cautiously reduced estimates of average sales per movie to EUR1.6 million in 2015 from EUR1.75 million, EBITDA has been lowered by about 7% to reflect the different sales mix and the growth of direct costs (including the new incentive plan for EUR0.5 million). EBIT declines by about 14% compared to our previous estimates also due to higher D&A costs and net profit forecasts are reduced by about 12% although the tax rate has been lowered to 32%.
- We expect self financing to exceed EUR10 million this year, reaching EUR16 million in 2016. However, NWC absorption should grow significantly (NWC should reach 33% of turnover this year and 48% in 2016 compared with 4% in 2013) mostly due to the increase of trade receivables related to higher TV revenues (Pay TVs pay on average after >250 days and free TV >500 days) and we anticipate EUR19 million cumulated capex in 2014-16. Adding the first dividend payment in 2016 (for EUR2.2 million) we estimate net cash to reach EUR12.2 million at Dec-16 from EUR7.5 million at Dec-14.
- There are now 13 movies in the pipeline for 2015, which cover about 70% of the budget based on our calculations (further titles should be added in the next few months), with “Selma” and “Belle and Sebastien” sequel expected to be a strong success at the box office, while the company has 4 titles currently lined up for 2016 and 2 titles for 2017.
- Our estimates do not include any external growth, which however, has not been ruled out by Notorious Pictures which is scouting some film production companies. In addition, the company could ask to move to the Italian main stock market (MTA) in 2016.

Figure 2 – Old vs. new estimates

(EURm)	2013A	2014E		2015E		2016E	
		Old	New	Old	New	Old	New
Total Sales	9,0	25,4	25,3	29,8	28,8	34,5	34,2
% change			-0,2%		-3,1%		-0,9%
EBITDA	2,8	15,3	14,3	18,9	17,3	22,5	21,5
% change			-6,5%		-8,5%		-4,4%
EBIT	2,0	12,2	11,0	15,2	13,0	17,8	15,4
% change			-10,0%		-14,5%		-13,1%
Net Profit	1,3	8,0	7,3	10,1	8,8	11,9	10,5
% change			-8,7%		-13,2%		-11,8%
EPS		0,36	0,33	0,45	0,39	0,53	0,47
% change			-8,7%		-13,2%		-11,8%
Net Debt/(Cash)	(0,3)	(7,3)	(7,5)	(11,5)	(9,3)	(19,9)	(12,2)

Source: Company data, UBI Banca estimates

Figure 3 – Detailed P&L estimates

In order to assemble 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 (capitalized as an intangible asset) 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. This translates to a potential gross margin per movie (after P&A costs) ranging from 22% for an A movie to 65% for a D movie.

(EURm, unit, %)	2013A	2014E	2015E	2016E
Movies A	1	2	3	3
Movies B	2	2	8	6
Movies C	4	10	5	7
Movies D	7	3	2	2
Total movies	14	17	18	18
Theatrical	4,19	9,64	13,36	12,76
Pay TV	3,55	8,55	9,20	10,35
Free TV	0,00	4,13	4,24	4,31
Home video	0,62	1,00	0,83	1,00
Vod, PPV, Kiosk	0,12	0,32	0,21	1,14
Other (including production contributions)	0,54	1,66	1,00	4,68
Total sales	9,01	25,30	28,84	34,23
Direct costs (P&A and other)	(5,15)	(9,53)	(9,62)	(10,58)
Gross margin	3,86	15,77	19,22	23,66
Gross margin (%)	42,8%	62,3%	66,6%	69,1%
Labour and other structure costs	(1,05)	(1,50)	(1,88)	(2,14)
EBITDA	2,82	14,27	17,34	21,52
% margin	31,2%	56,4%	60,1%	62,9%
D&A on the library	(0,76)	(2,81)	(3,85)	(5,52)
Other D&A	(0,06)	(0,50)	(0,53)	(0,55)
EBIT	1,99	10,95	12,96	15,44
% margin	22,1%	43,3%	45,0%	45,1%

Source: Company data, UBI Banca estimates

Figure 4 – 2015 movies pipeline

A movies are expected to report box office revenues >EUR4.5 million, B movies EUR1.7 million, C movies EUR1 million, D movies EUR0.2 million.

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

Source: Company data, UBI Banca estimates

Valuation

- Following our estimates downgrade, we lower our target price to EUR3.33 (from EUR3.48) per share based on the single average of a DCF (EUR3.94 fair value per share, which benefitted from the reduction of the risk-free rate from 3.5% to 3%) and a relative valuation (EUR2.67 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 13% we confirm our Buy rating.
- At the target price, the company would trade at 3.3x 2015 EV/EBITDA, which is still below the average multiple for the industry (4.4x) and on 8.4x P/E (7.4x for peers).

Figure 5 – Valuation summary

(EUR)		Weight
DCF Valuation	3,94	50,0%
Relative Valuation (at 20% discount)	2,67	50,0%
Target Price	3,33	
Current price	2,92	
Potential upside	13,0%	

Source: UBI Banca estimates

Figure 6 – DCF Valuation

Our DCF valuation benefits from the reduction of the risk-free rate that lowered the WACC to 8.85% (from 9.35%). Our models incorporates a terminal growth rate of 1% and an operating margin at 38% at terminal value (from 40% used before), which is below the 43.3% EBIT margin expected for 2014.

	(EUR m)	(% weight)
Sum of PV 2014-22 FCF	33,7	43%
Terminal value	45,5	57%
Total Enterprise value	79,3	100%
- minorities	0,0	
- Pension Provision	(0,1)	
- Net debt (+ cash)	8,8	
Total Equity value	87,9	
Fully diluted number of shares (m)	22,3	
Fair value per share (EUR)	3,94	

Source: Company data, 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. Overall, Notorious Pictures is trading at a significant discount to its direct peers (32% on average), mainly due to its modest size compared to other competitors and its short history even though this gap was reduced since our latest report (22 September) when it was 45%.

Company	Market Cap (EURm)	P/E			EV/EBITDA			EV/EBIT		
		2014	2015	2016	2014	2015	2016	2014	2015	2016
Leone Film Group	39	13,5 x	5,5 x		3,6 x	2,4 x		9,3 x	4,0 x	
EuropaCorp	135	5,5 x	5,3 x	5,2 x	3,4 x	2,6 x	2,6 x	5,7 x	4,2 x	4,1 x
Splendid Medien	20	44,5 x	5,5 x	4,4 x	3,1 x	2,2 x	1,9 x	21,1 x	5,9 x	4,7 x
Entertainment One	1.194	14,8 x	13,3 x	12,5 x	11,3 x	10,3 x	9,5 x	11,9 x	10,8 x	10,0 x
Average		19,6 x	7,4 x	7,4 x	5,4 x	4,4 x	4,7 x	12,0 x	6,2 x	6,3 x
Median		14,2 x	5,5 x	5,2 x	3,5 x	2,5 x	2,6 x	10,6 x	5,1 x	4,7 x
Notorious Pictures valuation										
Based on simple average		6,42	2,91	3,45	3,77	3,83	5,07	6,21	4,04	4,89
Based on median		4,64	2,17	2,45	2,59	2,39	3,05	5,53	3,36	3,81
Current multiples		8,9 x	7,4 x	6,2 x	4,2 x	3,4 x	2,6 x	5,5 x	4,5 x	3,6 x
Discount to Average		-54,5%	0,4%	-15,3%	-21,5%	-22,6%	-45,5%	-54,1%	-27,3%	-43,3%
Discount to Median		-37,0%	34,6%	19,3%	19,7%	33,9%	-1,6%	-48,1%	-10,3%	-24,6%

Source: Factset, UBI Banca estimates

Income Statement

(EURm)	2013	2014E	2015E	2016E
Net Revenues	9.0	25.3	28.8	34.2
EBITDA	2.8	14.3	17.3	21.5
EBITDA margin	31.2%	56.4%	60.1%	62.9%
EBIT	2.0	11.0	13.0	15.4
EBIT margin	22.1%	43.3%	45.0%	45.1%
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	10.9	12.9	15.4
Taxes	-0.7	-3.6	-4.1	-4.9
Minorities & discontinuing ops	0.0	0.0	0.0	0.0
Net Income	1.3	7.3	8.8	10.5

Source: Company data, UBI Banca estimates

Balance Sheet

(EURm)	2013	2014E	2015E	2016E
Net working capital	0.3	8.4	12.9	16.3
Net Fixed assets	1.7	3.6	6.5	8.0
M/L term funds	-0.7	-3.8	-4.2	-3.7
Capital employed	1.3	8.2	15.2	20.6
Shareholders' equity	1.6	15.7	24.5	32.8
Minorities	0.0	0.0	0.0	0.0
Shareholders' funds	1.6	15.7	24.5	32.8
Net financial debt/(cash)	-0.3	-7.5	-9.3	-12.2

Source: Company data, UBI Banca estimates

Cash Flow Statement

(EURm)	2013	2014E	2015E	2016E
NFP Beginning of Period	-0.1	-0.3	-7.5	-9.3
Group Net Profit	1.3	7.3	8.8	10.5
Minorities	0.0	0.0	0.0	0.0
D&A	0.8	3.3	4.4	6.1
Change in Funds & TFR	0.0	0.0	0.0	0.0
Gross Cash Flow	2.1	10.6	13.2	16.5
Change In Working Capital	-0.6	-8.1	-4.5	-3.4
Other	0.0	0.0	0.0	0.0
Operating Cash Flow	1.5	2.5	8.7	13.2
Net Capex	-2.0	-4.8	-6.8	-7.1
Other Investments	0.0	0.0	0.0	0.0
Free Cash Flow	-0.4	-2.3	1.8	6.1
Dividends Paid	0.0	0.0	0.0	-2.2
Other & Chg in Consolid. Area	0.7	2.2	0.0	-1.0
Chg in Net Worth & Capital Incr.	0.0	7.2	0.0	0.0
Change in NFP	0.2	7.2	1.8	2.9
NFP End of Period	-0.3	-7.5	-9.3	-12.2

Source: Company data, UBI Banca estimates

Financial Ratios

(%)	2013	2014E	2015E	2016E
ROE	76.4%	46.5%	35.9%	32.0%
ROI	170.9%	156.1%	82.5%	70.6%
Net Fin. Debt/Equity (x)	-0.2	-0.5	-0.4	-0.4
Net Fin. Debt/EBITDA (x)	-0.1	-0.5	-0.5	-0.6
Interest Coverage	58.5	273.8	324.1	386.1
NWC/Sales	3.6%	33.3%	44.9%	47.7%
Capex/Sales	21.8%	19.0%	23.6%	20.8%
Pay Out Ratio	0.0%	0.0%	25.0%	25.0%

Source: Company data, UBI Banca estimates

Per Share Data

(EUR)	2013	2014E	2015E	2016E
EPS	0.06	0.33	0.39	0.47
DPS	0.00	0.00	0.10	0.12
Op. CFPS	0.07	0.11	0.39	0.59
Free CFPS	-0.02	-0.10	0.08	0.26
BVPS	0.07	0.70	1.10	1.47

Source: Company data, UBI Banca estimates

Stock Market Ratios

(x)	2013	2014E	2015E	2016E
P/E	-	8.9	7.4	6.2
P/OpCFPS	-	25.9	7.5	4.9
P/BV	-	4.2	2.7	2.0
Dividend Yield (%)	-	0.0%	3.4%	4.0%
Free Cash Flow Yield (%)	-	nm	2.8%	9.3%
EV (EURm)	-	60.2	58.9	55.0
EV/Sales	-	2.4	2.0	1.6
EV/EBITDA	-	4.2	3.4	2.6
EV/EBIT	-	5.5	4.5	3.6
EV/Capital Employed	-	7.3	3.9	2.7

Source: Company data, UBI Banca estimates

Growth Rates

(%)	2013	2014E	2015E	2016E
Growth Group Net Sales		180.6%	14.0%	18.7%
Growth EBITDA		406.8%	21.5%	24.1%
Growth EBIT		450.4%	18.4%	19.1%
Growth Net Profit		480.3%	20.2%	19.2%

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