7digital

Media

22 July 2016

On track to break-even during H216

With a 10% y-o-y increase in the annualised MRR rate in June and £5m of new contracts announced year to date, 7digital seems on track to turn EBITDA positive in the second half of this year. This should provide a more visible forward valuation for the shares, which look attractive on less than half of peers' FY17e P/E and EV/EBITDA multiples.

Trading update: New contract wins

Management expects H1 revenues to be broadly flat y-o-y, affected by the transition to a B2B licensing model and the fact last year's comparison includes termination payments from the legacy Blackberry contract. More relevant is the development of monthly recurring revenue (MRR), which is up 4% y-o-y and annualised MRR was up 10% in June, with high-margin licensing revenues up 17% y-o-y. Compared to the 72% increase in MRR reported last December, this does mark a slowdown in the pace of growth. However, as flagged at the AGM in April, new contract wins in Q1 were strong (contracts with a lifetime value of £3.9m); this has continued in Q2 with £1.1m of new business won and the sales pipeline is 'healthy', with three new contract wins announced in conjunction with the trading update.

H216 EBITDA break-even on track

The new business wins are expected to have a positive impact in the second half of this year, and with 50% of revenues dollar denominated, 7digital's path towards break-even appears to be on track. News that Guvera, one of 7digital's larger clients, has placed two of its Australian subsidiaries into administration should not affect the repayment of an £818k outstanding receivable. This debt was at the group level, is being repaid in instalments over the next eight months and, provided Guvera remains a solvent, ongoing business (which was not with the Australian subsidiaries), should not be affected.

Attractive valuation: Not priced for growth

7digital has made considerable progress transitioning from a B2C download model to one of licensing high-margin B2B streaming solutions, which now accounts for the majority of its revenues. The results of this transition should become increasingly evident at the EBITDA level. In addition to seeing ongoing growth momentum in MRR, we consider achieving EBITDA break-even a key catalyst to a more visible valuation for the shares. On an FY17e consensus EV/EBITDA of c 4.0x, 7digital trades at less than half the valuation of small-cap SaaS and video streaming peers, representing attractive value for an operationally geared growth company.

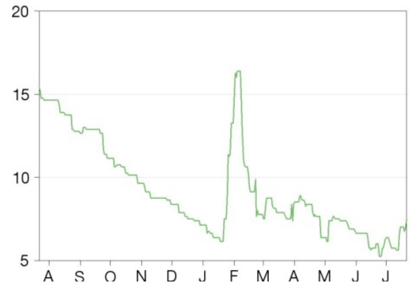
Consensus estimates

Year end	Revenue (£m)	EBITDA (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	EV/EBITDA (x)
12/14	10.2	(3.1)	(3.8)	(4.3)	0.0	N/A	N/A
12/15	10.4	(2.1)	(2.9)	(2.8)	0.0	N/A	N/A
12/16e	13.9	(0.7)	(1.5)	(1.3)	0.0	NA	NA
12/17e	16.3	1.9	1.0	0.9	0.0	8.3	4.0*

Source: Company accounts, Bloomberg. Note: *Net cash of £1m includes NPV of acquired debt.

Price	**7.5p**
Market cap	**£9m**

Share price graph



Share details

Code	7DIG
Listing	AIM
Shares in issue	115.75m

Business description

7digital is a B2B digital music and radio services company. Its platform and access to global music rights enables businesses in the radio, electronics and telecoms industries around the world to offer and commercialise music streaming and radio services. Customers include Onkyo, Panasonic, Guvera, Astro, Mariposa, Electric Jukebox, eMusic and i.am +.

Bull

- Well positioned in the global music industry's transition to streaming services. Customers in 33 markets.
- Strong pipeline of prospects, streaming MRR growing and EBITDA profitability expected towards the end of this year.
- Debt free.

Bear

- Disruptive business model; large B2C competitors could retaliate.
- The download business, while much lower margin than licensing revenues, is a drag on growth.
- Limited share liquidity.

Analysts

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