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7digital

Media

13 March 2017

Price	7.2p
Market cap	£11m

Share price graph

Share details

Code	7DIG
Listing	AIM
Shares in issue (post placing) Indicative shares assuming full issue 162m	150.5m

Business description

7digital is a leading provider of end-to-end digital music platform solutions and services. 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 musical.ly, Onkyo, Panasonic, Astro, Cdiscount, Electric Jukebox, eMusic and i.am +.

Bull

- Global footprint. Leading provider of B2B platform services to the music industry. Well-positioned in the global music industry's transition to streaming services.
- Pipeline of prospects, high-margin recurring licence revenues growing strongly, EBITDA profitability expected across FY17.
- Potential deal to acquire 24-7 would consolidate its largest competitor, provides synergy potential and cements its position.

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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7digital is a research client of Edison Investment Research Limited

Potential acquisition of 24-7 and share placing

FY16 results were in line and with £8m of contract wins during the year, 7digital looks on track to deliver its targeted FY17 EBITDA profitability. The proposed acquisition of its most significant European competitor, 24-7, would add scale, synergy potential and cements its position as the leading provider of platform services to the rapidly evolving digital music industry.

Proposed acquisition and £3m fund raise

7digital is in the final stages of negotiating the acquisition of Copenhagen's 24-7, its largest European competitor. The all-share transaction values 24-7 at approximately £1.6m with 24-7's parent company, MediaMarktSaturn (Europe's leading consumer electronic retailer), becoming a shareholder and significant customer of the enlarged group, which will continue to service its Europe-wide Juke! service. The acquisition would add approximately £1m of EBITDA in FY18. In parallel, 7digital has announced a £2.26m share placing (at 6.5p) and open offer of up to £0.75m to raise £3m in total. We estimate the proposed transaction, net with the dilution effect of the share issue would reduce consensus EPS in FY18 by 10% to 15%.

EBITDA profitability targeted in FY17

FY16 revenues increased 15% to £11.9m and the EBITDA loss of £3.5m is in line with consensus. Licensing (+5%) was affected by the administration of Guvera. Excluding this, underlying growth was 15% (with momentum building in H216 +21%). Content grew strongly (+28%) and Creative was more stable (+5%). Snowite has been fully integrated and the targeted £1m of overhead savings have been delivered, moving the group to an EBITDA break-even position in Q416. New contract wins with a value of c £8m were announced during FY16 (double FY15's level) and this should underpin revenue momentum moving into FY17. 62% of revenues are now from high-margin licence deals and operational gearing effects should ensure a large proportion of future revenue growth is converted to profits, putting the group on track for its targeted EBITDA profitability in FY17.

Step change in scale, consolidating largest peer

The consolidation of 24-7 would add scale, synergy potential and with the strengthening of the balance sheet, would make 7digital the 'go-to' platform for companies looking to launch music streaming services. With the support of all three major music labels as customers and partners and a new strategic shareholder on the register, 7digital is well positioned to benefit from the rapid evolution of the market for music streaming services. This is not being reflected in its 0.6x EV/sales rating (post placing, pre-acquisition).

Consensus estimates (pre deal)

Year end	Revenue (£m)	EBITDA (£m)	PBT (£m)	EPS (p)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)
12/15	10.4	(2.1)	(2.9)	(2.8)	0.8	N/A	N/A
12/16	11.9	(3.5)	(4.7)	(4.5)	0.7	N/A	N/A
12/17e	14.0	0.8	0.1	0.1	0.6	10.2	72.0

Source: 7digital accounts, Bloomberg. (post-placing)

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