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Media

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A step change with 24-7 deal

7digital's acquisition of 24-7 consolidates its position as the largest provider of B2B music services in Europe and adds £18m of secured revenues to its pipeline. Accelerated platform integration means EBITDA profitability will be pushed out to FY18, when management expects the deal to be significantly earnings enhancing and the group to be both profitable and cash flow positive.

24-7 acquisition adds a significant new client

7digital has completed the acquisition of Copenhagen's 24-7 from MediaMarktSaturn (MMS), Europe's leading consumer electronic retailer. The final deal values 24-7 at £2.2m through the issue of 23.1m new shares and £0.9m acquired cash which is refundable post completion. After issue, MMS will become a 12.7% shareholder and significant customer of the enlarged group, which will continue to service its Europe-wide Juke! service for a contract value of £11m over three years, as well as additional development work worth £6m (over two years). The acquisition also brings contracts with other customers, including Danish telco TDC with an annualised value of £2.7m.

Step change in scale; earnings enhancing by FY18

Management estimates that the acquisition will increase its revenues by £5m in FY17 and by over £8m in FY18, more than doubling licence revenues from those reported in FY16. Although the accelerated integration of the platform is likely to mean that 7digital remains loss making at the EBITDA level in FY17 (versus its previous expectation of becoming profitable at the EBITDA level across the year in FY17), it expects the deal to be significantly earnings enhancing in FY18, with the overall group becoming profitable. MMS will also front load its contract with set-up fees of £5.7m in FY17 supporting near-term cashflow.

Considerable strategic progress; undemanding rating

7digital has made considerable strategic progress over the last year, culminating in the acquisition of its largest European competitor. With at least £18m of additional revenues secured over the next three years, a stronger balance sheet following its recent £3m equity raise and the support of all three major music labels as customers and partners, we believe 7digital is well positioned to benefit from the rapid evolution of the market for music streaming services. The emphasis now will be on integrating the platforms, securing new clients and delivering profitability in FY18. Given the group was already on track to reach EBITDA profitability pre the 24-7 deal, this appears highly achievable and the FY18 P/E of 4.0x undemanding.

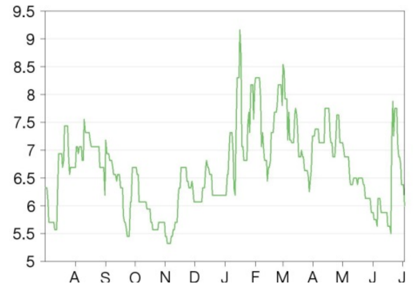
Consensus estimates

Year end	Revenue (£m)	EBITDA (£m)	PBT (£m)	EPS (p)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)
12/16	11.9	(3.5)	(4.7)	(4.5)	0.7	N/A	N/A
12/17e*	19.5	(1.6)	(2.6)	(1.6)	0.5	N/A	N/A
12/18e*	25.0	3.3	2.7	1.5	0.4	2.9	4.0

Source: 7digital accounts, Bloomberg.

Price	6.0p
Market cap	£11m

Share price graph



Share details

Code	7DIG
Listing	AIM
Shares in issue	183m

Business description

7digital is a leading provider of end-to-end digital music platform solutions & 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, EBITDA profitability expected across FY18.
- 24-7 deal provides synergy potential and cements its leading 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