ZOO DIGITAL

SOFTWARE & COMPUTER SERVICES

28 September 2023

ZOO.L

52p

Market Cap: £50.8m

SHARE PRICE (p)

12m high/low	208p/52p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	$16.0m *(at 30/09/23)*
Enterprise value	£40.8m
Index/market	AIM
Next news	Interims, November
Shares in issue (m)	97.8
Chair	Gillian Wilmot
Chief Executive	Stuart Green
CFO	Phillip Blundell

COMPANY DESCRIPTION

ZOO Digital provides subtitling and dubbing technology and services to producers of TV series and feature films.

www.zoodigital.com

ZOO DIGITAL IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

Gareth Evans

+44 (0) 20 7781 5301

gevans@progressive-research.com

Tessa Starmer

+44 (0) 20 7781 5303

tstarmer@progressive-research.com

AGM flags continued workflow disruption

This morning's AGM statement by ZOO confirms that trading is still being impacted by the two market issues detailed at the recent prelims. First, the industry-wide strikes that have halted new productions have not been fully resolved. A deal has been reached with the writers (WGA) but talks are still ongoing with the actors' union, given the complexities surrounding AI. Second, workflow is still disrupted as the major streaming providers realign business models to increase profitability. However, we believe this presents a unique opportunity for ZOO to seize market share with its unique end-to-end offering and growing local presence. We have adjusted our estimates for FY24 to reflect the near-term headwinds and feel it is prudent to remove FY25 forecasts until visibility improves.

- **Strike nearing an end.** The double strike by both actors and writers has halted new productions. Both sides have similar demands, including better wages, compensation from streaming services and job protection against the use of AI. Over the past week, the writers' side has reached a deal. However, until the union representing actors also reaches an agreement (with media speculating that this will be in November), new productions will be unable to resume.

- **Customer reorganisation.** Content owners and the major streaming providers are realigning business models to generate more profit and cash, moving away from market share capture. We believe that on a medium-term view, ZOO, with its end-to-end (E2E) offering, could benefit from these strategic reviews and any resulting supplier rationalisation.

- **Estimate changes and withdrawing FY25.** Management has guided that H1 revenue will be approximately $21m, with a significant EBITDA loss for the period. Our estimates for FY24 had assumed that orders would resume in October 2023. Given the ongoing issues, we have therefore downgraded our estimates for FY24, with revenue falling to $45m from $85m and EBITDA moving to a loss of $8.0m.

- **What to look for on the upside.** Although client cost-saving programmes and industrial action have created a temporary short-term hiatus, we believe that ZOO is strategically positioned to benefit as one of the few end-to-end vendors, with the streaming industry undergoing a 'content explosion' and aggressive geographical expansion. We see potential that subtitling and dubbing could be in demand for back-catalogue work (similar to that experienced during Covid when production was halted).

FYE MAR ($M)	2020	2021	2022	2023	2024E
Revenue	29.8	39.5	70.4	90.3	45.0
Adj EBITDA	2.1	4.5	7.1	15.5	-8.0
Fully Adj PBT	-1.0	0.9	0.3	9.5	-13.8
Fully Adj EPS (c)	-1.2	1.0	-0.2	10.0	-12.7
EV/Sales (x)	1.7x	1.3x	0.7x	0.6x	1.1x
EV/EBITDA (x)	24.0x	11.3x	7.2x	3.3x	-6.8x
PER (x)	N/A	64.0x	N/A	6.6x	N/A

Source: Company Information and Progressive Equity Research estimates.

Estimate changes

With the ongoing pause in client workflows, we adjust our estimates for FY24. We had previously anticipated an uptick in profitability in the current year, given the operational gearing impact. However, the subdued workflows have led to significant EBITDA loss in H1 on revenue of $21m.

We have cut or FY24 revenue estimate by 47% to $45m from $85m. ZOO had anticipated a quicker recovery of project volumes, so the cost base has not reduced fast enough to offset the lower revenue; we therefore downgrade FY24E adjusted EBITDA to an $8m loss from a $9m profit. We forecast year-end net cash to be $8.0m.

Previously we had built into our estimates a bounce-back in workflow demand from October 2023. Given the limited visibility, we have been cautious and assumed H2 23 will be similar to H1 23. This assumes that even with an end to the actors' strike in November, it will take at least a month to get studios up and running again. This could prove to be too cautious if production picks up more rapidly, and if the major players emerge quickly from their reorganisation phase with ready-to-go budget allocations.

ZOO Digital – Estimate changes

	FY24E		
$m unless stated	**Old**	**New**	**Change (%)**
Revenue	85.0	45.0	-47%
Adj EBITDA	9.0	(8.0)	-189%
Fully adj PBT	2.6	(13.8)	-630%
Fully adj EPS (c)	2.5	(12.7)	-609%

Source: Progressive Equity Research estimates

ZOO's cost base has been adjusted to reduce the impact of the temporary slowdown. A significant proportion of cost savings have actually come from utilising production facilities in lower-cost geographies, taking advantage of recent acquisitions, such as Vista India. Therefore, even once workflow resumes, we do not expect the full base to be reinstated. Having significantly scaled up operations, we believe that ZOO is in a good position to deliver material profitable growth when workflow does resume. ZOO remains financially strong, with net cash expected to be 'no less than $16m' at 30 September.

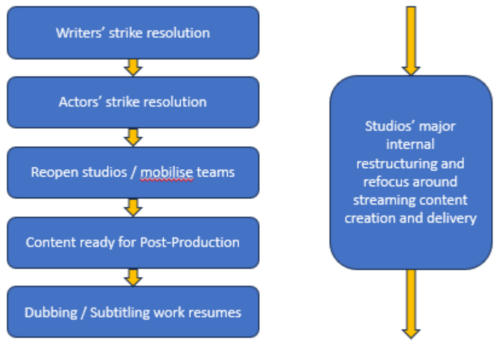
We still expect project workflow to resume later in FY24, with ZOO well placed, particularly given the contribution from recent and additional planned acquisitions. We also see near-term potential for an uptick in back-catalogue work, similar to that experienced during Covid when production was halted.

Market and outlook

Content owners and the major streaming providers are realigning business models to generate more profit and cash, moving away from market share capture. We believe that on a medium-term view, ZOO, given its end to end (E2E) offering, could stand to benefit from these strategic reviews and the likely resulting supplier rationalisation.

We highlight the progression of workflow resuming. The end to the writers' strike is already imminent with media speculation that the actors strike could also be resolved by November, at which point new production would resume.

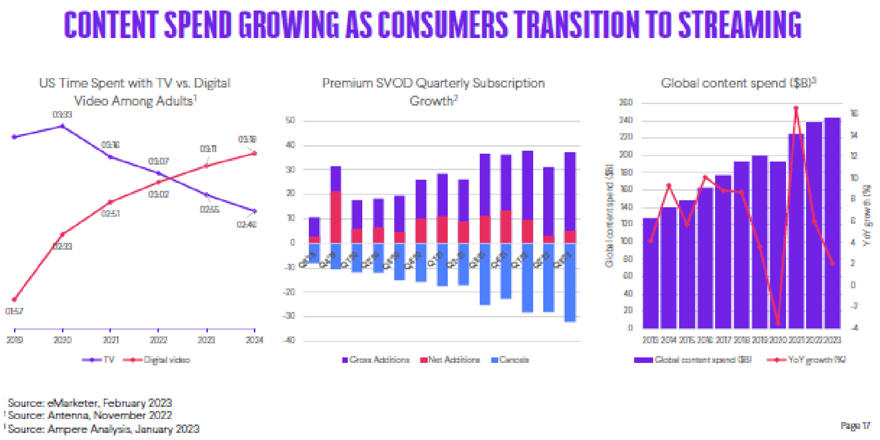
Twin headwinds



Source: Progressive Equity Research

Despite short-term disruptions, the opportunity for ZOO remains clear. The market is vast, with streaming service providers continuing their focus on content as a key differentiator. Industry content spend is growing year on year, albeit with a greater focus on profitability.

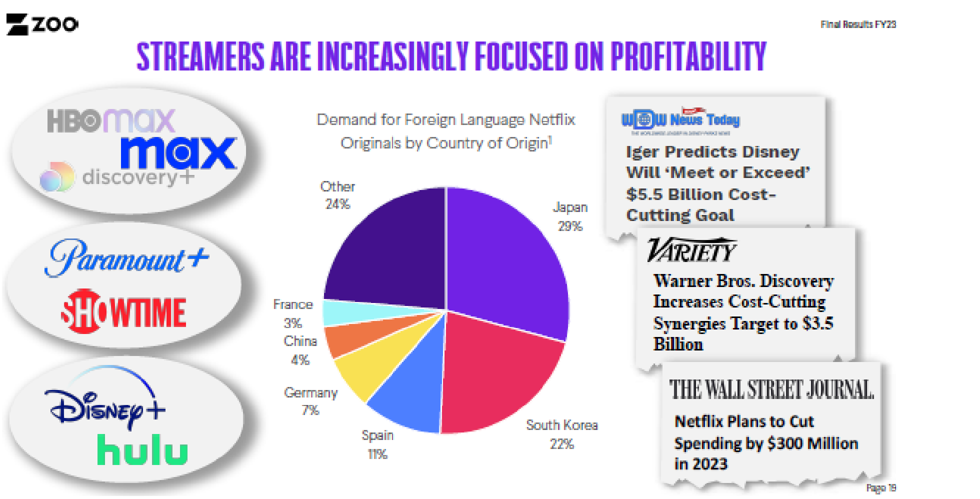
Investment in original content by OTT providers



Source: ZOO Digital

Globalisation by the major streaming providers continues to drive growth for ZOO's true end-to-end services. Media localisation is a good way to unlock ROI as the major players look to drive profitability. We anticipate that the total industry spend on media localisation will continue to grow over the mid to long term.

Demand for foreign language



Source: ZOO Digital

Conclusion

In our view, ZOO remains well placed to take advantage of the opportunities in what remains a large, growing and evolving market. Although client cost-saving programmes and industrial action have created a temporary short-term hiatus in workflow, which has resulted in softening of H1 FY24 revenues, we believe that ZOO's large customers are now rationalising their supplier bases and that ZOO is strategically positioned to benefit as one of the few end-to-end vendors. We also expect ZOO to generate a more diversified revenue base given the recent onboarding of significant new clients.

ZOO's key growth drivers remain intact, content budgets remain large and the focus by the key streaming players on monetisation models represents a material opportunity, in our view, underpinned by the roll-out of ZOO's strategic geographic hubs.

Financial Summary: Zoo Digital

Year end: March (US$m unless shown)

PROFIT & LOSS	**2020**	**2021**	**2022**	**2023**	**2024E**
Revenue	29.8	39.5	70.4	90.3	45.0
Adj EBITDA	2.1	4.5	7.1	15.5	(8.0)
Adj EBIT	(0.3)	1.6	3.7	8.1	(14.0)
Reported PBT	0.0	(3.6)	1.1	7.9	(14.3)
Fully Adj PBT	(1.0)	0.9	0.3	9.5	(13.8)
NOPAT	(0.3)	1.4	3.1	6.5	(11.3)
Reported EPS (c)	0.4	(4.2)	1.5	9.3	(14.4)
Fully Adj EPS (c)	(1.2)	1.0	(0.2)	10.0	(12.7)
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0

CASH FLOW & BALANCE SHEET	**2020**	**2021**	**2022**	**2023**	**2024E**
Operating cash flow	1.0	6.3	5.2	15.5	(14.5)
Free Cash flow	0.3	4.1	0.8	6.1	(19.4)
FCF per share (c)	0.4	5.4	0.9	6.1	(19.6)
Acquisitions	0.0	0.0	(3.0)	(1.3)	(1.4)
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	10.1	0.0	15.6
Net cash flow	(0.9)	1.8	3.0	5.9	(3.9)
Overdrafts / borrowings	(8.0)	(11.2)	(9.1)	(8.4)	(8.4)
Cash & equivalents	1.2	2.9	6.0	11.8	8.0
Net (Debt)/Cash	(6.8)	(8.3)	(3.2)	11.8	8.0

NAV AND RETURNS	**2020**	**2021**	**2022**	**2023**	**2024E**
Net asset value	5.3	7.6	27.7	35.1	37.3
NAV/share (c)	7.1	10.2	32.6	39.5	41.5
Net Tangible Asset Value	3.6	4.4	13.3	14.7	13.4
NTAV/share (c)	4.9	5.8	15.7	16.6	14.9
Average equity	5.3	7.6	27.7	30.1	36.2
Post-tax ROE (%)	6.0%	(41.7%)	4.8%	27.4%	(38.5%)

METRICS	**2020**	**2021**	**2022**	**2023**	**2024E**
Revenue growth	3.4%	32.7%	78.1%	28.2%	(50.1%)
Adj EBITDA growth	427.9%	112.1%	56.6%	117.8%	(151.6%)
Adj EBIT growth	(71.6%)	(638.8%)	127.1%	120.9%	(273.2%)
Adj PBT growth	N/A	N/A	(66.7%)	3070.7%	(244.8%)
Adj EPS growth	N/A	N/A	(116.2%)	(6100.1%)	(228.0%)
Dividend growth	N/A	N/A	N/A	N/A	N/A
Adj EBIT margins	(1.0%)	4.1%	5.2%	9.0%	(31.1%)

VALUATION	**2020**	**2021**	**2022**	**2023**	**2024E**
EV/Sales (x)	1.7	1.3	0.7	0.6	1.1
EV/EBITDA (x)	24.0	11.3	7.2	3.3	-6.8
EV/NOPAT (x)	-172.0	37.5	16.4	7.9	-4.8
PER (x)	N/A	64.0	N/A	6.6	N/A
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	0.6%	8.3%	1.4%	9.4%	(28.5%)

Source: Company information and Progressive Equity Research estimates

28 September 2023

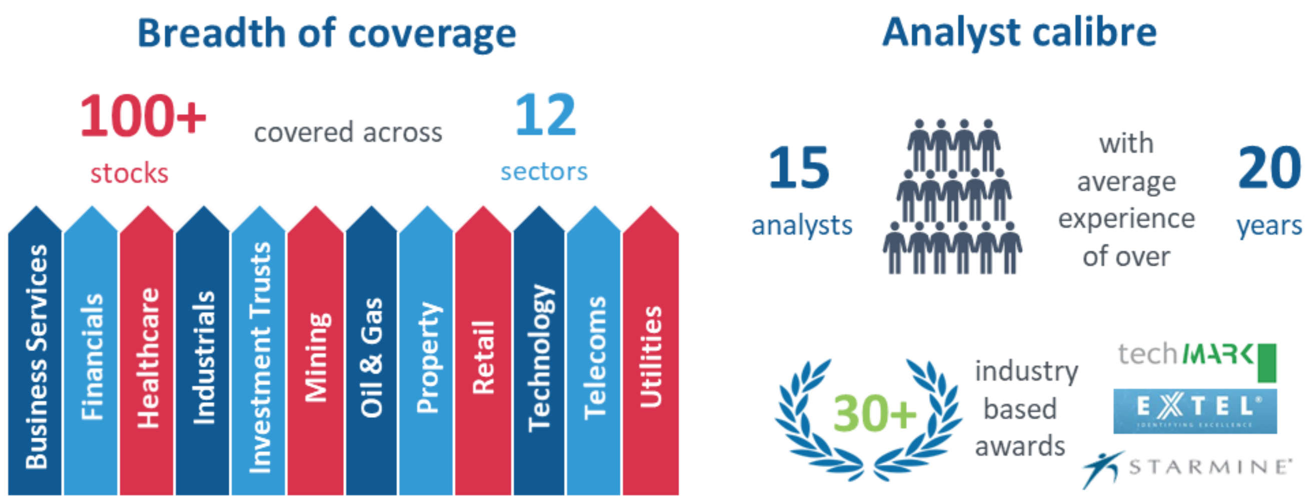
Disclaimers and Disclosures

This document is provided for information purposes only, and is not a solicitation or inducement to buy, sell, subscribe, or underwrite securities or units. Investors should seek advice from an Independent Financial Adviser or regulated stockbroker before making any investment decisions. PERL does not make investment recommendations. Any valuation given in a research note is the theoretical result of a study of a range of possible outcomes, and not a forecast of a likely share price. PERL does not undertake to provide updates to any opinions or views expressed in this document.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom. It has not been prepared in accordance with the legal requirements designed to promote the independence of investment research. It is not subject to any prohibition on dealing ahead of the dissemination of investment research.

PERL does not hold any positions in the securities mentioned in this report. However, PERL’s directors, officers, employees and contractors may have a position in any or related securities mentioned in this report. PERL or its affiliates may perform services or solicit business from any of the companies mentioned in this report.

The value of securities mentioned in this report can fall as well as rise and may be subject to large and sudden swings. In addition, the level of marketability of the shares mentioned in this report may result in significant trading spreads and sometimes may lead to difficulties in opening and/or closing positions. It may be difficult to obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance.



To arrange a meeting with the management team, or for further information about Progressive, please contact us at:
+44 (0) 20 7781 5300
info@progressive-research.com