

FAB UNIVERSAL CORPORATION

\$150M Hidden Value

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FAB UNIVERSAL CORPORATION (NYSE MKT – FU - \$4.04)

Price Target: \$9.00

Rating: Strong Buy (2)

COMPANY SNAPSHOT

FAB Universal Corp. is a global leader in digital media entertainment sales and distribution. FAB delivers media through Intelligent Kiosks, Retail Stores, Retail Licensees and online through three business units: Digital Media Services, Retail Media Sales and Wholesale Media Distribution. Billions of movie, music, podcast, TV show and other digital files are distributed to consumers in 240 countries. Sales of digital media are generated through kiosks networks, subscription sales for mobile devices, smartphone Apps and Netflix-like subscription models. In 2012, billions of downloads of copyrighted music, games, ringtones, ebooks, movies and podcasts were distributed to 50M+ people worldwide.

KEY STATISTICS

Price as of 4/24/13	\$4.04
52 Wk High – Low	\$5.70 – 1.90
Est. Shares Outstanding	20.7M
Market Capitalization	\$83.7M
3 Mo Avg Vol	59,000
Exchange	NYSE: MKT

COMPANY INFORMATION

FAB Universal Corporation
 5001 Baum Boulevard, Suite 770
 Pittsburgh PA 15213
 412.621.0902
www.fabuniversal.com
 IR: Arthur Douglas & Associates
 Art Batson: 407.478.1120

INVESTMENT HIGHLIGHTS

Following a review of FAB's Libsyn subscriber numbers and Netflix's (NASDAQ – NFLX) subscriber growth and valuation methodology we believe that a case can be made that FAB's Libsyn division could be worth \$150M or more.

U.S.-based FAB Universal announced unique monthly audiences has experienced accelerated growth from 20 million people in the first quarter of 2012 to 28 million people in the first quarter of this year. The 40% increase is a result of the addition of 8 million podcast audience members enjoying podcasts from 240 countries around the world on the Libsyn Network each and every month. Plus, we believe that roughly half of the subscribers streamed their podcasts versus downloading.

We project FAB will earn around \$4M for 1Q13 and on the heels of the \$5.3M net income recorded in 4Q12, the shares are likely to move sharply higher. In our view, one of the hurdles the stock needs to overcome in order to get to the next level is to demonstrate big net income for consecutive quarters. Once that occurs, FAB could be off to the races. 1Q13 results are slated to be released on or about May 15, 2013.

FAB is an incredibly undervalued stock that has been overlooked by the Street, presenting a unique opportunity for investors. Despite its EPS outlook and \$5M per quarter in cash generation, FAB trades only 4.3x our FY13E EPS estimate. Even with a discount for its foreign operations, the stock should be afforded at least a 10x multiple on FY13E EPS by year-end, and that does not even include the hidden Libsyn value. Therefore, we rate these shares Strong Buy with a year-end price target of \$9.00.

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Ridiculously Overlooked and Undervalued Subscriber Base

In our initiation of coverage report, released on March 25, 2013, we focused on the underlying value of FAB's shares based upon projected net income derived primarily through its China-based operations. However, following events of the past week, we believe that we may have overlooked or grossly undervalued the potential value of its Digital Media Services Business (podcasting), known as Libsyn.

For example, the trend in digital content distribution is shifting from an advertiser-supported model to a mix of "freemium" (mix of free and paid) model to a fully paid subscription model. Those firms with a paid subscription model typically carry much higher valuations than those that utilize an advertiser-supported model.

For example, Netflix (NASDAQ – NFLX) just announced its most recent quarterly results to great fanfare. The Company now boasts 29M subscribers to its \$7.99/month streaming video service. At current levels, the stock trades at a market cap exceeding \$12 billion. If one were to value the stock based on the number of subscribers, the value of each subscriber is well over \$400 per subscriber, or over 4x annual revenue generated per subscriber.

In the case of Sirius XM (NASDAQ – SIRI), the stock trades with a market cap of over \$20B, and the Company has over 23M paying subscribers, which translates into a value of \$900 per subscriber, or over 4x average subscriber revenue.

We believe that based on trends in the space, Libsyn could choose to introduce a paid subscription option especially as more and more users stream rather than download podcasts. A quick back of the envelope forecast could look like this in the not so distant future:

$$\begin{aligned} \text{Libsyn: } 30M \text{ subscribers: } 10\% \text{ opt in} &= 3M \text{ paid subscribers} \\ 3M \times \$25/\text{annual unlimited fee} &= \$75M \text{ in revenue} \\ \mathbf{2x \$75M} &= \mathbf{\$150M \text{ value}} = \mathbf{\$7.00+/\text{share}} \end{aligned}$$

A few important points must be noted here. First, we are not saying that FAB's Libsyn business is the same as Netflix or Sirius. We recognize that to a degree we are comparing apples and oranges. However, considering that in all 3 cases, we are talking about the distribution of digital content via paid subscription, all 3 are still fruits. Netflix deserves a very high valuation due to its leadership status, hyper-growth, profitability, and (now) its original programming. Sirius is a de facto standard in its space as well. We should also note that while paid digital content subscription rates for most companies seem to top out in the mid-\$30M range, Libsyn could exceed that figure due to its wide reach abroad. Finally, as noted above, our assumption uses a 50% haircut to the current revenue per subscriber multiples of NFLX and SIRI and assumes only 10% opt in for a paid subscription service at a very low (merely suggested) annual rate.



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Conclusion

With all of this in mind, we believe that there is real, hidden value in the FAB/Libsyn podcast subscription unit which, when monetized, could be afforded a substantial valuation. In the interim, the credibility that the projected 1Q13 net income generation will provide FAB's shares cannot be discounted, as in our opinion, many investors seem to have taken a wait-and-see or I'm from Missouri attitude.

As a result, despite the EPS outlook and \$5M per quarter in recent and projected cash generation, FAB trades only 4.3x our FY13E EPS estimate. We believe that even with a discount that is typically associated with stocks whose primary businesses are abroad, the stock is too cheap. With 20% projected net margins and an increasingly dominant share of the market, an argument could be made that FAB should trade 15x our FY13E EPS.

However, given the "fresh" nature of the recent acquisition in China, we have elected to take a more conservative stance and project that a 33% discount for its foreign operations could be assessed this year. If FAB is afforded at least a 10x multiple on FY13E EPS by year-end, the stock would reach our \$9.00 price objective. Given the huge profitability and leading market status, we rate these shares Strong Buy.

Goldman Small Cap Research Ratings and Risk Profile Definitions:

Strong Buy (1) The expectation that the stock will exceed stock market performance, with below average equity market risk.

Strong Buy (2) The expectation that the stock will exceed stock market performance, with average equity market risk.

Strong Buy (3) The expectation that the stock will substantially exceed equity stock market performance, with above average to speculative risk.

Speculative Buy: The expectation that the stock will substantially exceed stock market performance, with speculative market risk.

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Recent Trading History For FU

(Source: BarChart.com)



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Table I. Projected Income Statement

FAB Universal Corporation

(in thousands, \$)

	<u>1Q12</u>	<u>2Q12</u>	<u>3Q12</u>	<u>4Q12</u>	<u>FY12E</u>	<u>1Q13E</u>	<u>2Q13E</u>	<u>3Q13E</u>	<u>4Q13E</u>	<u>FY13E</u>	<u>FY14P*</u>
Revenue											
Wholesale					\$16,400	\$14,400	\$14,500	\$14,500	\$14,500	\$57,900	\$59,000
Retail					\$2,000	\$1,500	\$1,500	\$1,600	\$1,700	\$6,300	\$7,000
Kiosk					\$7,800	\$7,000	\$7,500	\$8,000	\$8,500	\$31,000	\$38,000
Podcast (and legacy)					\$3,800	\$800	\$800	\$800	\$900	\$3,300	\$4,000
Total Revenue	\$1,856	\$2,037	\$1,745	\$24,000	\$27,459	\$23,700	\$24,300	\$24,900	\$25,600	\$98,500	\$108,000
Cost of Sales	\$968	\$1,122	\$784	\$10,900	\$16,440	\$12,324	\$12,393	\$12,450	\$12,800	\$49,967	\$51,840
Gross Profit (Loss)	\$888	\$915	\$961	\$13,100	\$11,019	\$11,376	\$11,907	\$12,450	\$12,800	\$48,533	\$56,160
Operating Exp											
R&D	\$66	\$70	\$73	\$100	\$270	\$100	\$100	\$100	\$100	\$400	\$700
SG&A	\$1,819	\$1,182	\$5,672	\$7,680	\$13,502	\$5,925	\$6,075	\$6,225	\$6,400	\$24,625	\$24,840
Operating Inc (Loss)	(\$997)	(\$337)	(\$4,784)	\$5,320	(\$2,753)	\$5,351	\$5,732	\$6,125	\$6,300	\$23,508	\$30,620
Other Expense	\$354	\$0	\$1,036	\$0	\$79	\$200	\$200	\$200	\$200	\$800	\$1,000
Other Income	\$160	\$6	\$132	\$0	\$0	\$100	\$200	\$300	\$400	\$1,000	\$1,500
Taxes	\$0	\$0	\$52	\$0	\$1,351	\$945	\$1,032	\$1,121	\$1,170	\$4,267	\$5,602
Net Income (Loss)	(\$997)	(\$331)	(\$4,951)	\$5,320	(\$4,183)	\$4,306	\$4,700	\$5,105	\$5,330	\$19,441	\$25,518
Inc Discnt Ops					\$178						
Comp Inc/For Curr			\$338		\$1,562						
Total Inc/Loss			(\$4,614)		(\$4,005)						
Net Inc. (Loss) per Share	(\$0.12)	(\$0.04)	(\$0.51)	\$0.11	(\$0.34)	\$0.21	\$0.22	\$0.24	\$0.25	\$0.92	\$1.09
Est. Shares Outstanding	8,192	8,659	9,724	20,000	11,779	20,750	21,000	21,200	21,500	21,113	23,500

* denotes preliminary estimate

Note 1: FY12 quarterly results include revenue and expenses from discontinued businesses from 1Q12-3Q12 and China operations beginning late 3Q13. Not all expense items were

Note 2: Management provided 1Q13 revenue and net income guidance as well as FY13 revenue and net income guidance. Quarterly estimates are projected solely by GSCR.



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Analyst: Robert Goldman

Rob Goldman has over 20 years of investment and company research experience as a senior research analyst and as a portfolio and mutual fund manager. During his tenure as a sell side analyst, Rob was a senior member of Piper Jaffray's Technology and Communications teams. Prior to joining Piper, Rob led Josephthal & Co.'s Washington-based Emerging Growth Research Group. In addition to his sell-side experience Rob served as Chief Investment Officer of a boutique investment management firm and Blue and White Investment Management, where he managed Small Cap Growth portfolios and *The Blue and White Fund*.

Analyst Certification

I, Robert Goldman, hereby certify that the view expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report.

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