FAB UNIVERSAL CORPORATION
A Cash Generation Machine

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FAB UNIVERSAL CORPORATION (NYSE MKT – FU - $4.17	
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 5/17/13	$4.17
52 Wk High – Low	$5.70 – 1.90
Est. Shares Outstanding	20.7M
Market Capitalization	$86M
3 Mo Avg Vol	77,000
Exchange	NYSE: MKT

COMPANY INFORMATION

FAB Universal Corporation
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412.621.0902
www.fabuniversal.com
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INVESTMENT HIGHLIGHTS

FAB Universal recently reported solid 1Q13 results. While some of the figures were a bit light relative to our expectations, some of the most important metrics bode very well for the balance of the year.

FAB followed up a 4Q12 performance where the Company generated $5M in cash with an even more stellar performance in 1Q13. For the quarter FAB generated $10.1M in cash on $22.6M in recorded revenue. FAB ended the period with just under $30M in cash.

2Q13 is expected to be similar to 1Q13 and our full-year projections remain unchanged while we adjust the quarterly composition of our forecasts. Management guidance for roughly $100M in revenue and net income of $20M has not changed. Once we have another quarter of results for a reference point, we will modify our estimates by quarter for 2H13.

Whether valued on an asset basis by division or a multiple of earnings this stock is remarkably cheap. Moreover, the way management leverages its operations is enviable as FAB could increase its gross cash by $1.00 per share between now and the end of the year.

Now that FAB has demonstrated major net income and cash generation performance in consecutive quarters, we believe that the Street is going to take notice. Despite its EPS outlook FAB trades only 4.3x our FY13E EPS estimate of $0.92. 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.

Key Takeaways

Rather than merely repeating what is found in the Company's quarterly release and latest 10-Q, we have elected to focus in on what we believe are the key takeaways in which investors should focus attention.

Top-line and bottom-line trends: 1Q13 marks the second consective quarter of revenue north of $22M and $3.0M in net income ($3.5M in comprehensive income.) In fact, FAB has recorded $0.26 in EPS in just the last 2 quarters alone. Even with break-even results for the next 2 quarters would result in trailing 12-month EPS of $0.26, and at current prices that would represent only a 16x earnings multiple.

Metrics are a moving target: Until we have at least another quarter to use as a reference point it is difficult to forecast financials on a quarterly basis. For example, 4Q and 1Q are likely the best and worst for the Company on a seasonal basis, respectively. The line items of the repotted results varied from our forecast more than we expected so we will not revise our quarterly model until we have greater clarity next quarter. Still, management guided for roughly $23M in revenue and $3M in net income for 2Q13 and $100M in revenue and $20M in net for the year. Our annual projections remain in line with this guidance.

Cash generation is more important than EPS: FAB followed up its 4Q12 performance where the Company generated $5M in cash with an even more stellar performance in 1Q13. For the quarter FAB generated $10.1M in cash on $22.6M in recorded revenue. FAB ended the period with just under $30M in cash. At this rate, FAB could increase its gross cash by $1.00 per share between now and the end of the year.

Why the Stock is Cheap

In our view, any way you slice it, the stock is cheap. From an asset perspective, we outlined how/why the Company's Libsyn division of its digital media business could be worth $150M in an update in late April.

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) boasts 29M subscribers to its $7.99/month streaming video service. At current levels, the stock trades at a market cap exceeding $13 billion. If one were to value the stock based on the number of subscribers, the value of each subscriber is $450 per subscriber, or over 4x annual revenue generated per subscriber.

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:

Libsyn: 30M subscribers: 10% opt in = 3M paid subscribers
3M x $25/annual unlimited fee = $75M in revenue
2x $75M = $150M value = $7.00+/share

A few important points must be noted here. First, we are not saying that FAB's Libsyn business is the same as Netflix and we recognize that to a degree we are comparing apples and oranges. Still, considering that we are talking about the distribution of digital content via paid subscription, it is all the same category. Finally, as noted above, our assumption uses a 50% haircut to the current revenue per subscriber multiples of NFLX and assumes only 10% opt in for a paid subscription service at a very low (merely suggested) annual rate.

In the meantime, considering that FAB is generating millions per quarter in cash from its China-based operations, <u>we believe that a multiple on that annual cash generation could be equivalent to the Libsyn figures above.</u> With a meaningful amount of goodwill and intangible assets, few could argue with valuing the business based on its cash flow alone, rather than book value.

<u>The recent and current EPS multiples illustrate just how incredibly cheap the stock is on an absolute basis.</u>

For example, the Company has earned $0.26 in EPS for the past two quarters. If the Company were to only break-even for the next 2 quarters, that would give the stock a 16x multiple on EPS for the trailing twelve-month period.

If we are wrong and FAB only earns $0.50 for 2013, the stock is trading at a paltry 8x EPS versus the current 4.5x.

We are <u>not</u> suggesting that the upcoming quarterly results will be poor. This exercise is just another example of how undervalued the stock is and the huge opportunity that the stock offers. After all, it will generate tens of millions in cash per year and millions in net income per quarter. Now that FAB has demonstrated major net income and cash generation performance in consecutive quarters, we believe that the Street is going to take notice.

Despite its EPS outlook FAB trades only 4.5x our FY13E EPS estimate of $0.92. 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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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.

Recent Trading History For FU

(Source: BarChart.com)

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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