LEONE FILM GROUP

Initiation of coverage **Buy**

10 May 2017 – 5:30 PM | *MARKET PRICE:* ***EUR4.64*** | *TARGET PRICE:* ***EUR5.16***

Entertainment

Data

Shares Outstanding (m):	14.09
Market Cap. (EURm):	65.4
Enterprise Value (EURm):	120.4
Free Float (%):	25.8%
Av. Daily Trad. Vol. (m):	0.01
Main Shareholder:	Leone family 57.5%
Reuters/Bloomberg:	LFG.MI LFG IM
52-Week Range (EUR)	2.0 4.7

Source: Factset, UbiBanca estimates

Performance

	1m	3m	12m
Absolute	17.5%	54.7%	54.8%
Rel. to FTSE IT	11.6%	40.2%	32.3%

Graph area Absolute 12 M

Source: Factset

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High quality and vision

We initiate coverage of Leone Film Group (LFG), a leading company in the Italian entertainment industry, with a Buy rating and target price of EUR5.16 per share. We believe that the company has several strengths: 1) proactive management with an innovative vision of the movie industry, which has prompted the company to enter new businesses, widening its product range and enabling LFG to cover all the key aspects of the value chain of the industry, reaching a leading position in Italy, 2) a wide set of long-term contracts with content providers (i.e. Lionsgate/Summit), broadcasters (RAI, Mediaset, Sky, Netflix and others) and highly respected Italian directors, 3) an attractive line-up of 74 planned releases in 2017-19 (56 movie distributions, 11 productions and 7 executive productions) that provide very high visibility for the future, 4) a film library of almost 500 movies which secure revenues of about EUR3-4 million p.a. at no cost, 5) an attractive dividend policy offering a dividend yield of about 3% 6) the possible forthcoming transfer of the shares to the MTA and later to the STAR segment which should increase the liquidity of the shares with a consequent reduction in the discount applied by investors to stocks listed on the AIM market. The main risks for the company are the low visibility of future box office revenues and a relatively small senior management group.

> With nearly EUR55 million sales in 2016, LFG is a leading movie company active in two businesses: production of movies and TV products (35% of 2016 revenues) and distribution (54% of 2016 revenues) while the residual 11% is represented by tax credits and other contributions. LFG, 57.5% controlled by the Leone brothers, was listed in 2013 at EUR4.80 per share rising >EUR16 million.

> We forecast a sales CAGR of 8% in the next three years, an EBITDA margin that could rise to 53% in 2019 (from 43% in 2016) and a bottom line of >EUR6 million. Net debt is expected to grow significantly due to the investments in both production and distribution projects, reaching EUR55 million at Dec-17 (vs. EUR32 million at Dec-16).

> Our target price of EUR5.16 per share is based on the average of a DCF analysis and a relative valuation, applying a 10% discount, and offers >10% upside.

Financials priced on 9 May 2017

	2016	2017E	2018E	2019E
Revenues (EURm)	54.71	61.31	68.48	68.43
EBITDA (EURm)	23.52	29.55	34.99	36.25
EBITDA margin (%)	39.3%	39.8%	42.6%	44.5%
EBIT (EURm)	2.96	5.83	8.37	10.59
EPS (EUR)	0.13	0.21	0.33	0.45
CFPS (EUR)	1.90	1.35	2.34	2.34
DPS (EUR)	0.09	0.11	0.15	0.20

Source: Company Data, UBI Banca Estimates

Ratios priced on 9 May 2017

	2016 *	2017E	2018E	2019E
P/E(x)	20.2	21.7	13.9	10.4
P/CF(x)	1.6	2.5	2.1	2.1
P/BV(x)	1.1	1.9	1.7	1.6
Dividend Yield	3.4%	2.4%	3.2%	4.3%
EV/EBITDA(x)	3.0	4.1	3.4	3.0
Debt/Equity (x)	1.0	1.6	1.4	1.0
Debt/EBITDA (x)	1.4	1.8	1.5	1.2

Source: UBI Banca Estimates ** Based on 2016 average price*

Key Financials

(EURm)	2016	2017E	2018E	2019E
Revenues	54.71	61.31	68.48	68.43
EBITDA	23.52	29.55	34.99	36.25
EBIT	2.96	5.83	8.37	10.59
NOPAT	2.01	3.96	5.69	7.20
Free Cash Flow	-4.73	-21.05	2.67	12.82
Net Capital Employed	65.31	89.37	91.40	84.89
Shareholders' Equity	33.02	34.77	37.92	42.11
Net Financial Position	32.29	54.60	53.49	42.77

Source: Company data, UBI Banca estimates

Key Profitability Drivers

	2016	2017E	2018E	2019E
Net Debt/Ebitda (x)	1.4	1.8	1.5	1.2
Net Debt/Equity (x)	1.0	1.6	1.4	1.0
Interest Coverage (%)	2.3	4.2	5.7	8.1
Free Cash Flow Yield (%)	-12.9%	0.0%	0.0%	0.0%
ROE (%)	5.5%	8.7%	12.4%	15.0%
ROI pre-tax (%)	4.7%	7.4%	9.1%	11.6%
ROCE (%)	4.5%	6.1%	8.5%	11.7%

Source: Company data, UBI Banca estimates

Key Valuation Ratios

	2016	2017E	2018E	2019E
P/E (x)	20.2	21.7	13.9	10.4
P/BV (x)	1.1	1.9	1.7	1.6
P/CF (x)	1.6	2.5	2.1	2.1
Dividend Yield (%)	3.4%	2.4%	3.2%	4.3%
EV/Sales (x)	1.61	1.44	1.33	1.61
EV/EBITDA (x)	3.0	4.1	3.4	3.0
EV/EBIT (x)	23.4	20.6	14.3	10.3
EV/CE (x)	1.1	1.3	1.3	1.2

Source: Company data, UBI Banca estimates

Key Value Drivers

(%)	2016	2017E	2018E	2019E
Payout	69.8%	51.3%	45.0%	44.7%
Cost of Equity	8.0%	8.0%	8.0%	8.0%
NWC/Sales	4.4%	13.9%	10.5%	9.5%
Capex/Sales	52.7%	54.1%	36.9%	24.7%

Source: Company data, UBI Banca estimates

Investment Case

Leone Film Group (LFG) is a leading company in the Italian movie industry. Founded by the sons of the famous director, Sergio Leone, it produces and distributes movies for both cinema and TV (series, international co-productions), acquires full rights of foreign movies, lasting 15-25 years, co-distributing them through all available channels (cinema, Pay TV, Free TV, home video, digital and new media), performs executive productions and has a library of almost 500 movies with an excellent box office track record.

Despite the rally in the share price since the start of the year (+74% YTD and +55% in the past three months) we believe LFG represents an attractive buying opportunity for the following reasons:

> The vision and the proactive attitude of Andrea Leone and his sister Raffaella Leone that made LFG a successful company with a business model that evolved to exploit new sales channels, while simultaneously lowering the overall financial risk through high-budget TV productions with international standing, executive productions and movie co-productions;

> The forthcoming possible graduation to the MTA should improve the liquidity of the shares while enhance the attractiveness of the stock. In this respect last month Andrea and Reffaella Leone, together with Antonio Belardi, sold 6%of LFG (at EUR4.3 per share) increasing the free float to 25.8%, thus complying with the MTA requirements. A listing on the STAR segment could be a subsequent step;

> LFG's wide set of long-term contracts with content providers (i.e. Lionsgate), broadcasters (RAI, Mediaset, Sky, Netflix and others) and highly respected Italian directors. This framework, in our view. should provide LFG with high-quality content procurement and successful distribution allowing the company to maintain an EBITDA margin for the Distribution division well above 50%;

> Increased focus on the Production division should gradually enhance the product mix, with a significant boost to margins while the higher weighting of TV productions, which are sheltered by broadcasters, and new executive productions (no capital absorption) should reduce the overall financial risk;

> 2017-19 business plan which anticipates 74 releases in 2017-19 (56 movie distributions, 11 productions and 7 executive productions) which should help lift consolidated revenues to EUR67 million in 2019 with a 7.2% CAGR in the period and a consolidated EBITDA margin of more than 64% in 2019. Our estimates are broadly in line with the plan in 2017-18 but more conservative in 2019;

> Hidden value: we refer mostly to the existing film library (almost 500 movies with a book value of EUR45 million, or EUR3.2 per share) which secures revenues of about EUR3-4 million p.a. at no cost;

> LFG's core markets have been substantially positive over the past few years despite the economic downturn. We believe this trend will continue in future, sustained by favourable tax credits and subsidies which were recently increased to EUR400 million p.a. (+60%) and which should be available to the film industry from 2017.

We initiate coverage with a Buy rating and a target price of EUR5.16 per share (based on a DCF, and a comparison of multiples and applying 10% liquidity discount), which implies potential upside of about 11%.

The company is exposed to few risks, mostly related to the low visibility of future box office revenues and a relatively small senior management group.

Company profile

Leone Film Group (LFG) is a leading independent integrated company in movie distribution and productions (film and TV) in Italy. Founded in 1989 by the son and the daughter of Sergio Leone, one of the most famous film directors in Italy, with a focus on "spaghetti westerns", the company has, to date, produced several films and distributed >200 foreign movies in Italy with an outstanding box office track record and has a library of nearly 500 films, including several evergreens and all of the films directed by Sergio Leone (including "Once Upon a Time in America"). LFG movies have won many prizes, including several Oscars (for examples "La La Land" and "La Pazza Gioia", released this year, won respectively six Oscars and a "David di Donatello").

Figure 1 – LFG main movie productions and distribution in the past few years

Film production	**Year**	**Box office (EURm)**
Perfetti Sconosciuti	2016	17.4
Immaturi	2011	15.2
Immaturi (il viaggio)	2012	11.8
Tutta colpa di Freud	2014	7.9
La Pazza Gioia	2016	6.2
Il Professor Cenerentolo	2015	6.1
Italiano Medio	2015	4.1
Film distribution	**Year**	**Box office (EURm)**
The Wolf of Wall Street	2013	12.0
The Hateful Eight	2016	8.5
La La Land	2017	8.0
Rush	2013	6.5
Hacksaw Ridge	2016	5.8
The Girl of the Train	2016	4.9
Big Friendly Giant	2016	4.7
Fury	2015	4.3

Source: Company data, Mymovies, Cinetel

LFG has always distributed foreign movies leveraging on long term agreements with the major US content providers (Lionsgate, DreamWorks, Weinstein and others) but in 2009 it entered the film production industry and has completed three movies to date. Production activity increased sharply in 2014 following the acquisition of Lotus Production which is active in movie and TV co-productions (with long term agreements with top directors) and is one of the main Italian companies in executive productions. The founder (Mr. Belardi) is now part of the Board of LFG with a 4.5% stake.

Figure 2 – Snapshot on the existing library

Source: Company data

Figure 3 – Short history of the company

1989	Founding Andrea Leone Film: free and pay TV distribution, home video
2001	Entrance in the theatrical distribution (Columbia, Warner, Medusa and 01 Distribution)
2002	First TV format (Lotus Production)
2009	First movie production ("Generazione mille euro") and first executive production (Lotus)
2010	Entrance in the product placement sector through Pacmedia
2011	Acquisition of the rights for Italy of "Once Upon A Time In America"
2012	Long term agreement with DreamWorks (15 years)
2012	First international co-production
2013	Listing on the AIM market at EUR4.80 per share
2014	Acquisition of Lotus Production for EUR2.4 million plus 5.2% of LFG
2014	Agreement with Lionsgate up to 2019 for 8-10 movies p.a. (renewed in 2015)
2014	Agreement with Weinstein Company
2014	Agreement with Giuseppe Tornatore (1 movie, 1 TV series)
2015	First International executive production (John Wick 2)
2015	Entrance in the documentary co-production
2015	Long term agreement with Netflix
2015	Agreement with Eagle Pictures for 3 years
2016	Agreement with Cinecittà for executive productions
2016	Long term agreement with Sky Italia up to 2019 for 39 movies
2016	Long term agreement with RAI up to 2020 for at least 10 movies p.a.
2016	Maite Bulgari enters in LFG with 10.6% stake at EUR4.0 per share
2017	Agreement with Paolo Genovese who became shareholder of LFG (1% stake)
2017	Presentation of the new 2017-19 business plan

Source: Company data

With 21 employees plus several temporary and free-lance workers, the company is divided into two business units:

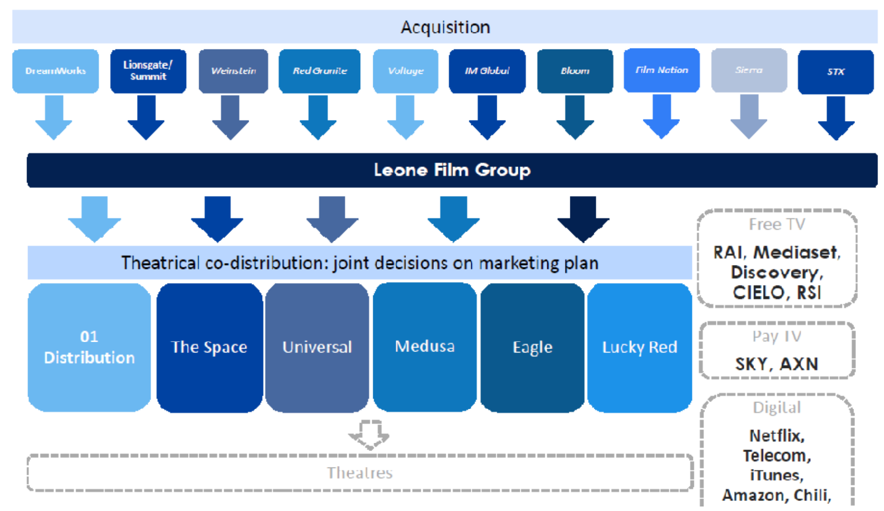
> **Distribution:** 58% of 2016 sales with an EBITDA margin of 61.1% and an EBIT margin of 4.1%.

> **Production**, which accounted for 42% of 2016 revenues with an EBITDA margin of 18.6 % and an EBIT margin of 5.6%. This division, mostly managed by Lotus Production, is composed of both Movie and TV production and is also active in executive production and executive production services for international producers.

Distribution.

LFG acquires full rights for film titles for the Italian market lasting 15-25 years, from independent production companies in the US. To stabilize the purchasing process, LFG has established long term agreements and partnerships with four main content providers: Lionsgate and Summit Entertainment (8-10 movies p.a. up to 2019), DreamWorks (now Amblin entertainment) which also includes co-production on one movie ("The Kidnapping of Edgardo Mortara" directed by Steven Spielberg, to be released in 2019), The Weinstein Company and Red Granite. In addition, LFG selects other movies after scouting a large number of screenplays mainly at AFM (America Film Market) and at the most important film festivals (Toronto, Berlin, Cannes). As a distributor LFG usually has to pay a Minimum Guarantee (MG), a form of advance fee, to the producers (the movie is generally released after 12-18 months). This fee can range from few thousand EUR to few million EUR, depending on the movie budget and it's economic potential. The MG is capitalized by LFG as an intangible asset and amortized over the exploitation period (following the "revenues forecasting method" which is based on the revenues reported each year compared with the yearly updated sales budget). After expenses for dubbing the film soundtrack (around EUR50k per movie, also capitalized) and P&A costs (printing & advertising, which are not capitalized) the movie is ready for theatrical distribution, which generally lasts about 2 months. LFG does not distribute movies directly but signs distribution agreements with major distributors in Italy, such as 01 Distribution (RAI, with a contract for 10 international movies p.a. up to 2020 which also includes the exploitation of free TV rights and potential co-production of movies produced by LFG), Eagle Pictures, Medusa and Lucky Red. Box office revenues are typically divided between the movie theatre (60%) and the distributor (40%), and distribution agreements are generally set at 15/25%. Four months following the end of theatre distribution, LFG begins Home video distribution (though this now represents a minimal part of LFG's revenues or 2.2% of 2016 consolidated turnover), and after one year the exploitation of full rights on PPV or pay per view and Pay TV channel followed by Free TV channel (after 24 months). TV distribution represents a significant proportion of expected revenues (EUR8 million in 2016, representing 14.7% of consolidated sales). The company has agreements with Sky Italia to license the exclusive rights on 39 movies up to mid-2019, with RAI Cinema, Netflix (which pays around 5% of the box office result), and other digital distributors (Telecom Italia, iTunes, Amazon, Chili. Wuaki TV, Infinity) with a fee based on the admissions recorded for each film in cinemas. Generally, Pay TV revenues represent >25% of the box office revenues while Free TV is less than 10%.

Figure 4 – Distribution: business model



Source: Company data

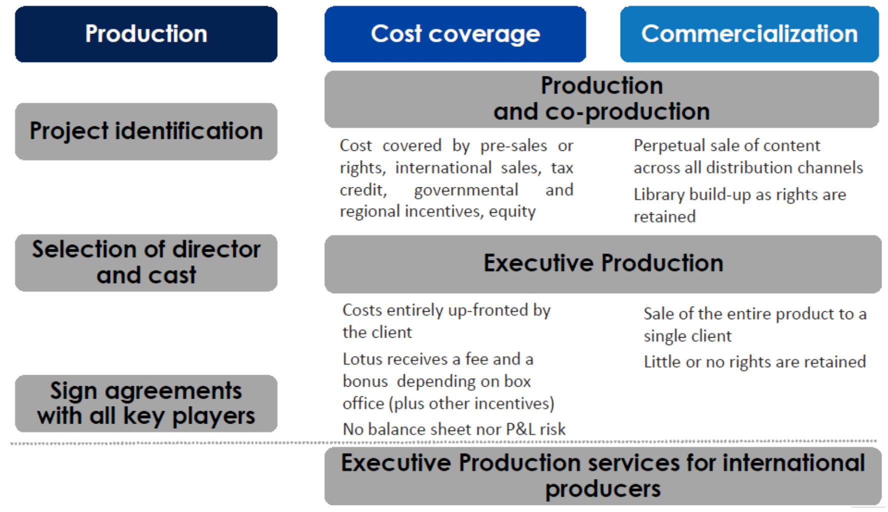
When the initial revenue cycle has come to an end (2/3 years on average) the movie rights become part of LFG's library. It is important to emphasise that distribution channels can be exploited for several years (up to 25), which implies a growing margin along with the amortization period of the library.

Clearly a key determining factor for the profitability of a single movie is the box office which ought to cover all costs (including the P&A) and is the driver for Pay TV revenues.

Movie production and co-production

LFG manages the entire production cycle, from development of the "concept" through to distribution with major partners (with or without revenue-sharing agreements). Pre-production is crucial as this phase includes the selection of the film director and the funding of the production. A large part of the production budget can be funded before the largest part of investment costs for production are incurred, due to the sale of co-production shares and distribution rights (also outside Italy), the attractive tax credit arrangements in Italy and various regional subsidies. As a result, production investments are generally limited (LFG is highly disciplined and does not proceed with production until costs are fully covered) while the distribution agreement can generate revenues for several years. The shooting phase is generally shorter, lasting 4-8 weeks while post production, which includes editing and the recording of the soundtrack can take up to another few months. Finally, LFG sustains the so-called P&A costs (mostly advertising, which is not capitalized) to launch the movie.

Figure 5 – Movie production: business model



Source: Company data

LFG is also active in the national and international executive production business This activity enables the making of the movie for third parties which may either buy an already scripted (by LFG) movie or ask for support in shooting their own original story. Production costs are entirely covered by the producers and LFG receives a fee that is directly related to the movie budget plus, in some cases, a bonus depending on box office. Little or no rights are retained and consequently executive production does not entail investment by LFG and presents no risk, although profitability is limited. In other words, this activity represents a way to generate additional revenues while lowering the overall risk for the company.

As an additional feature, LFG signed an agreement with Cinecittà to provide executive production services exploiting Cinecittà's facilities.

We should point out that LFG has signed multi-year exclusive contracts with several of Italy's most successful film directors: Paolo Genovese, Paolo Virzì, Giuseppe Tornatore, Gabriele Muccino, Maccio Capotonda and Rolando Ravello, plus a contract with Herbert Ballerina as actor.

Figure 6 – Italian directors under contract

Source: Company data

TV production

TV production has a different business model, as productions are generally entirely financed by the broadcaster ("full commission" model with a predetermined producer fee set at 12-15% of the production budget), which also has the rights on the product and is also involved in developing the concept and in the casting, controlling in this way the entire value chain. Therefore, there is no risk for the producer. In the case of international production, the producer owns part of the rights and covers part of the production costs.

In summary we believe LFG is capable of generating profit along the whole value chain, diversifying the overall risk (production costs fully covered before shooting) and optimizing its investments with a target EBITDA margin of >60% at the consolidated level (vs. 43.1% in 2016).

Shareholder structure and key people

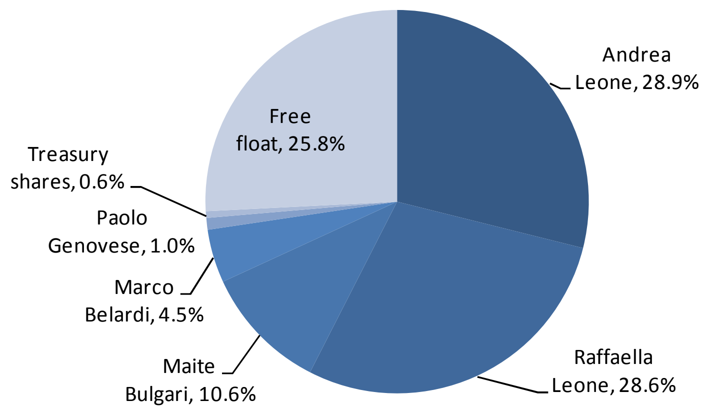
LFG was listed in the AIM segment of the Milan Stock Exchange in December 2013 at EUR4.80 per share, raising EUR16.1 million of fresh financial resources. The company is controlled by Andrea and Raffaella Leone with a combined shareholding of 57.5% stake; other important shareholders are Maite Bulgari, who bought a 10.6% shareholding in the company in September 2016 at EUR4.0 per share, at a premium of almost 100% on the share price of the day prior to the announcement. This shareholding is subject to a lock up of three years and drag-along and tag-along rights for Andrea and Raffaella Leone. Another major shareholder is Marco Belardi, the former owner of Lotus Production whose 4.5% stake is subject to a lock up of five years.

On 19 April 2017 Andrea and Reffaella Leone, together with Antonio Belardi, sold 6% of LFG at EUR4.30 per share in order to increase the free float ahead of the company's impending graduation to MTA. The free float following this transaction is 25.8%.

The Leone family is directly involved in managing the company with Andrea serving as Chairman and CEO while Raffaella is the group's CEO. Mr. Belardi is the CEO of Lotus Production and Maite Bulgari is Deputy Chairman and has a seat on the board. The board of directors is composed of six members, one of whom is independent; the total remuneration of the board is EUR0.76 million p.a.

The shareholders' meeting in April-15 approved a 18-month buyback program of up to 2.13% of the share capital. Currently LFG has 81k treasury shares (representing 0.57% of the share capital).

Figure 7 – Shareholder structure



Source: Company data

LFG has 21 employees, and a board of six directors. A film production company's most valuable asset is the strength of its team, and this applies to LFG as much as to any other film producer. Both of the CEOs, Andrea and Raffaella Leone are the key team members in selecting the titles that are expected to drive the company's revenues. Each has long experience in the film industry, an extensive network and strong credibility, all key factors in fund-raising for new productions, to acquire new successful movies in the international market and to acquire contracts for new TV productions. Mr. Belardi set up Lotus Production in 1996 and has long and successful experience in movie and TV production and in executive productions.

Strategy

The Leone family has demonstrated a singularly dynamic approach to the movie industry. The company is continually adapting its business model to take advantage of all possible sale channels to strengthen its competitive position, while simultaneously seeking to minimise overall financial risk. As an example, we highlight the Company's entry into the International co-production business in 2012, its acquisition of Lotus Production in 2014, which created a real "film factory" and expanded LFG's activity to executive productions (movie and TV), which reduced the financial risk as the production budget is entirely funded by the producer, the entry into International executive production services (2015, with a subsequent agreement with Cinecittà), the expansion into TV series production (2016), the agreements with several well-respected Italian film directors (Tornatore, Genovese, Virzì, Muccino, Capotonda and others), long-lasting agreements with top content providers (Lionsgate, DreamWorks, Weinstein) and with leading Italian distributors (Medusa, 01 Distribution, Eagle Pictures, Lucky Red) and Netflix (2015), and the scouting of new libraries and new product placements. This multi-approach strategy has proven to be successful generating a sales CAGR of >40% in 2012-16 and EBITDA CAGR of 37%.

The company's strategy to make LFG the most successful independent movie production and distribution group in Italy, may be outlined as follows:

> **Increasing the number and the reputation of movie productions.** LFG is planning 11 new movie productions in 2017-19 of which 5 this year, exploiting its long term agreements (often exclusive) with leading Italian directors (Tornatore, Muccino, Virzì, Sollima, Genovese, who was awarded for 1% shareholding in LFG which will be increased to 3% by 2018). The development of the movie production segment presents attractive returns (EBITDA margin well over 20%). In addition, international co-productions could increase awareness of the company in the market e.g. LFG will co-produce Steven Spielberg's next film "The Kidnapping of Edgardo Mortara" and hold the rights for the Italian market;

> **Exploit the TV production market.** The clear advantage of TV production compared with film production is that production costs are generally totally funded by the broadcaster ("full commission") leaving the producer with a "producer's fee" of about 15%, and, where specified, a share of distribution rights. The company is now starting TV productions and co-productions for Italy and the international market leveraging on Oscar winning director Giuseppe Tornatore ("Beati Paoli"), Stefano Sollima ("Colt") and Paolo Genovese (two series: "The Booth at the End" and "Tutta colpa di Freud") while LFG's first TV production ("Immaturi") will be broadcast in September. The risk for international TV productions is higher (international TV productions are generally partially funded by the producer) but returns are also generally higher. In addition, with international co-productions generating revenues abroad and increasing geographical diversification, the risk of sole exposure to the Italian market will be reduced while involvement in international productions could increase LFG's attractiveness to international companies such as Sky and Netflix. We believe that TV productions could be a key long term growth driver and that the interest of Maite Bulgari who also controls a TV production company, could be an additional benefit and could lead to synergies with LFG;

> **Develop executive productions and production services for International producers:** These activities present no risk, do not absorb capital and are exposed to a low degree of competition but also generally have a modest

EBITDA margin (we estimate 4-5%). LFG has a solid track record in these activities that are becoming more attractive given the increase in tax credits. Therefore, we believe these activities could provide additional revenues in the coming years while reducing specific risk for LFG;

> **Acquisition of foreign movie rights with a higher production budget.** Target productions will be comedy, family, thriller and dramatic movies (no animation, no superhero movies) with 56 movies expected to be distributed in 2017-19 of which 29 in the current year. Based on our assumptions, every top-rated movie could generate average box office takings of about EUR2.3 million (compared with average box office receipts in Italy of EUR1.25 million over the past three years) which would translate into distribution sales of >EUR50 million p.a. which may be shared with the downstream distribution partner (01 Distribution, Medusa, Eagle Pictures and others). Although LFG does not rule out the option of movie distribution without partnering-up with other downstream distributors in future, we believe the agreement with RAI (valid till 2020 with 10 international movies to be distributed each year and the subsequent acquisition by RAI of the free-to-air TV rights) could prevent LFG from moving in this direction;

> **Acquisition of new libraries.** LFG currently owns a library of nearly 500 movies including several evergreens with rights in perpetuity, which generate about EUR3-4 million revenues p.a. at no cost. The company is always scouting new libraries;

> **Develop long term agreements with the most talented directors.** LFG has long term relationships with international directors such as Quentin Tarantino, Steven Spielberg, Martin Scorsese, Mel Gibson, Ron Howard and others which is fundamental to the ability to secure Italian distribution rights for blockbuster titles. In Italy LFG signed seven contracts with the most talented directors (generally reporting high box office takings), some of which are exclusive, in order to fulfil forthcoming movie and TV productions. We expect this trend to continue in future with the addition of partnerships with new talents.

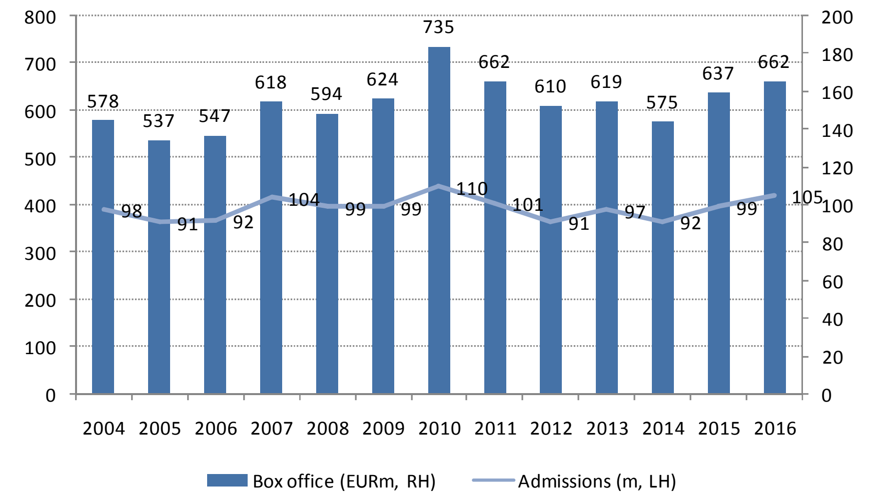
> **Potential acquisitions.** LFG could potentially acquire competitors in order to expand outside Italy; possible targets for expansion might include France, Spain, Germany and UK, although we do not expect any further diversification, for example into the acquisition of movie theatres. However, given gearing of 0.98x at end-16 which could rise this year due to higher capex, we estimate that financial resources for potential M&A activity is limited. The possibility exists for transactions based on a share swap (or a mix of cash and shares), which would significantly increase the size of potential acquisitions, with limited dilution for the Leone family.

Reference market

With 554 movies released, of which 208 were Italian (including co-productions), admissions of 105 million (1.5 admission per person per year) and box office revenues of EUR662 million in 2016 (*source: Cinetel, which covers about 90% of the market*) Italy is one of the largest movie markets in Europe after the UK, France and Germany. The industry trend has been relatively stable over the past few years, with an increase in new releases offset by lower admissions (about 190k per movie compared with 324k in 2010).

Figure 8 – Box office and admissions in Italy (000, EURm)

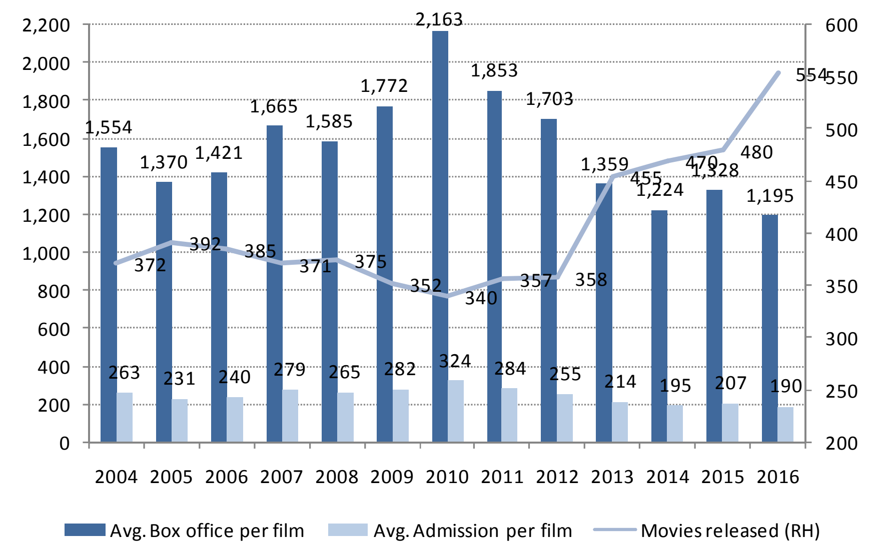
Admissions have historically been relatively stable, with an average ticket of EUR6.28 in 2016 compared with EUR5.95 ten years ago



Source: Cinetel

Figure 9 – Movies released, box office and admissions in Italy – average per movie (000)

Both admission and box office sales per movie declined in 2015. 554 movies were released during the year (480 in 2016) with a slowdown of 10% at the box office.



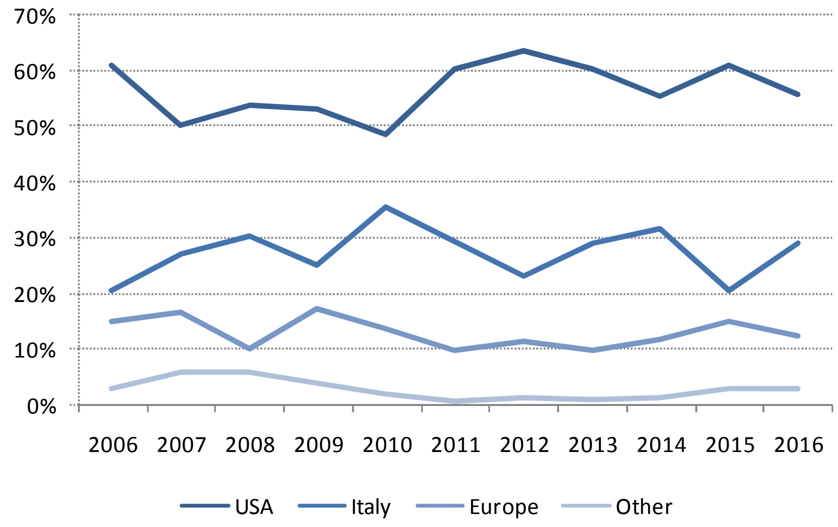
Source: Ubibanca on Cinetel data

It is important to highlight that seasonality is a significant feature of the movie industry: of 105 million admissions in 2016, 38% were in the first quarter, 18% in the second quarter, just 14.7% in the third quarter and the residual 29% in the last quarter of the year, with December and January (Christmas season) as the strongest months of the year, representing nearly 30% of total admissions.

US movies represented 55.7% of total box office in 2016 while Italian film revenues accounted for 29.5% of the total last year, strongly up from 2015 (20.7%) thanks to two blockbusters ("Quo Vado?" and "Perfetti sconosciuti" for which LFG was executive producer) which together reported EUR83 million box office revenues or 43% of the total for all Italian movies released in 2016.

Figure 10 – Movie sales market share by country

US movies have always accounted for the lion's share of Italian cinema attendance with an average of 56% in the past ten years. Italian movies represented 28% on average (2007-2016).



Source: Anica, Cinetel

The sector is composed of a discrete number of firms (6,139 firms in 2014) although the sector exhibits a certain degree of fragmentation. An analysis of the average number of employees per firm - only 95 companies have more than 50 employees and 3,803 have no employees as they make use of collaboration agreements - highlights the problem of the small average size of the typical Italian film company which has negative repercussions on their competitive capacity in a business of potentially global scale.

Production

Italy ranks tenth in the world for film production with 199 films in 2016 – the ranking is led by India with nearly 2,000 films – and is the top European country for the number of fully domestically produced movies. Total investment was EUR339 million in 2015 (latest data available) with EUR275 million coming from Italian initiatives (135 movies) and EUR64 million from foreign initiatives (50 movies, mostly French), an increase of 6% compared to 2014. However, the average production cost per movie has declined in recent years.

Figure 11 – Italian movie production market

	2011	2012	2013	2014	2015
Number of Italian Production	**155**	**166**	**167**	**201**	**185**
o/w Number of Italian production and co-production*	146	150	156	194	179
o/w Number of minority co-production	9	16	11	7	6
Total cost of Italian Production (EURm)	**423.3**	**493.1**	**357.6**	**319.5**	**338.8**
Average cost of Italian production(EURm)	2.73	2.97	2.14	1.59	1.83

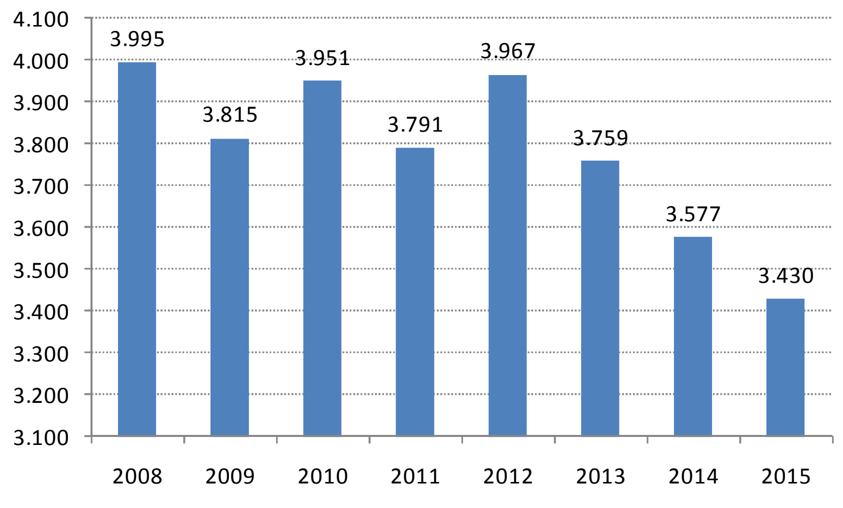
Source:Anica

The industry was also sustained by the introduction of the film production tax credit (which could cover a significant proportion of production costs) and a series of government subsidies (see paragraph below), in particular external tax credits for investors external to the movie industry. In 2015 >31% of productions costs were covered by tax credits and subsidies compared with 29% in 2015 and 26% in 2014 *(based on Anica data*). In addition, local subsidies contributed about 4% of production costs and supranational funds about 1%.

There has been a sharp decline in movies broadcast by free-to-air TV networks over the past four years, offset by a higher number of TV productions such as entertainment programs, mini-series, film TV etc. However, we should point out that Italian movies broadcast on TV represent over 35% of the total number of movies broadcast, a much higher proportion than at the cinema, where Italian productions account for about 25% of the total. Italian fiction (about 30% of total TV production investment) has declined sharply over the past few years (we estimate investments halved from 2008) and are now totally focused on prime time.

Figure 12 – Movies broadcasted by generalist TV in 2015 (excluding double passages)

Over the past few years there has been a sharp reduction in movies broadcast in favour of fiction programmes, mini-series and entertainment programmes. Italian movies were 37% of total.

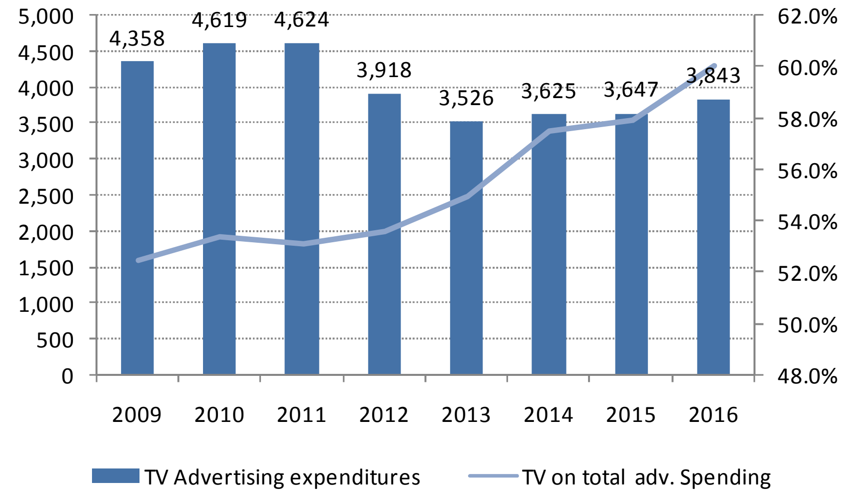


Source: Anica

However, according to Nielsen, TV advertising spending has declined significantly since 2011 (-16.8%) which has reduced the investment capacity of the broadcasters. The positive news is that TV advertising spending has recovered since 2013 (and was up 5.4% last year, with only internet advertising growing more) and increased as a proportion of the total Italian advertising market. We believe that this suggests that investment in TV productions could remain stable or grow in the future.

Figure 13 – TV advertising spending in Italy (EURm) and penetration on total adv. market

TV advertising expenditure has declined in recent years, although it has stabilized since 2013. However, the penetration of TV advertising has increased and is now around 60% of total advertising spending in Italy.



Source: Nielsen

It should be clarified that pay TV has particular characteristics: In Italy, growing competition between the two existing operators (Sky Italia and Mediaset Premium) has led to an increase in the selection of films, with steady growth in the number of screenings to around 50,000 in 2015, with a screening to film ratio of 24x. In 2015, 475 Italian movies were broadcast (23% of total) - an increase of 9% vs. 2014. However, we think that there may be gradual erosion of their market share mostly due to the development of VoD operators such as Netflix, which arrived on the market in 2015, Telecom Italia, iTunes, Infinity, Chili and the upcoming Amazon (all served by LFG).

Another phenomenon has been the proliferation of themed channels on Digital Terrestrial Television (DTT) and on Satellite TV, which have practically tripled the film content of national Free TV. In particular, 5,099 films were programmed in 2015 with a total of 15,409 screenings and an average programming per film of 3, significantly higher than for the generalist TV stations. On the basis of this trend, it is evident that the main TV operators have a constant need to enrich their film library, not only in terms of enlarging their catalogue of films but also to support the various thematic channels and the demand for PPV.

Competitive positioning

LFG has progressively gained market share in the Italian motion picture industry while entering new business sectors. We currently estimate the following market share for LFG:

- **Distribution:** LFG does not distribute directly but through distribution agreements with major distributors, in particular 01 Distribution (RAI) Medusa (Mediaset), Eagle Pictures and Lucky Red. Aggregating the box office revenues of directly produced films and movies acquired abroad gives total revenues of about EUR29 million revenues in 2016, corresponding to a market share of around 4.4%, 8th place in the global ranking and second with independent distributions (with Lucky Red as the first one). It should also be noted that LFG reported an average box office per movie released of EUR2.1 million in 2016, well above the Italian average (EUR1.2 million).

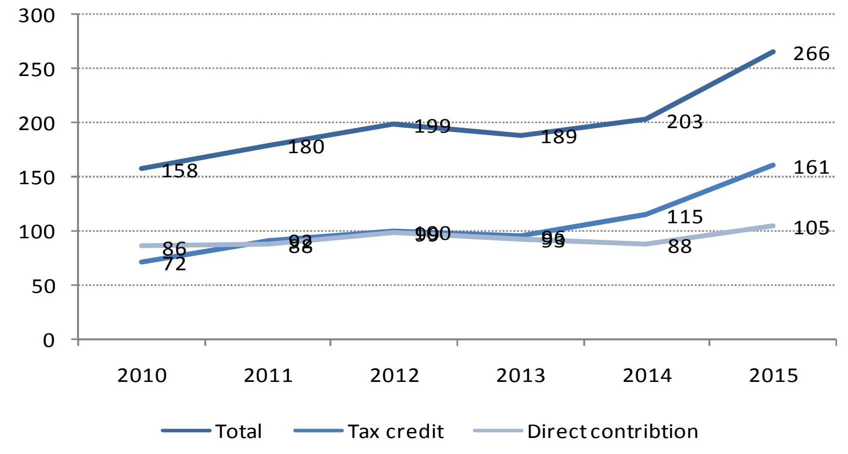
- **Film production:** the 2 movies released in 2016 by LFG ("La Pazza Gioia" and "Miami Beach") generated box office revenues of almost EUR7 million, about 1% of the total Italian box office last year. If we consider just Italian movies, LFG's market share amounted to 3.6%, with "La Pazza Gioia" ranking within the top 100 (25th). Executive productions generated a box office of EUR18.6 million (2.8% of the total Italian box office in 2016 and 9.7% of the box office of the Italian movies) with "Perfetti Sconosciuti" ranking second in the full year (after "Quo Vado?");

- **TV production:** it is difficult to estimate the market share of a TV producer; not only can the spending of Italian broadcasters vary significantly each year, but the cost of each individual production can also be somewhat erratic. Although LFG released no TV product in 2016 it will release "Immaturi" in September on Canale 5 (8 episodes x 80 minutes). A further four series are expected to be released in 2018-19 of which two ("Beati Paoli" and "Colt") are of international standing.

Tax credits and subsidies

The Italian movie industry has always benefitted from considerable support from central government and from local public authorities (mainly regional authorities). In particular, the total contribution (direct and tax credits) was EUR266 million in 2015 (last data available, *source: Anica*), of which 60% tax credits, with a growing trend in the past few years (the Italian government expects EUR170 million tax credits for 2016). In addition, foreign movies received a contribution of EUR64 million. 135 Italian movies were supported out of a total of 185 movies produced in 2015 while foreign movies were 24.

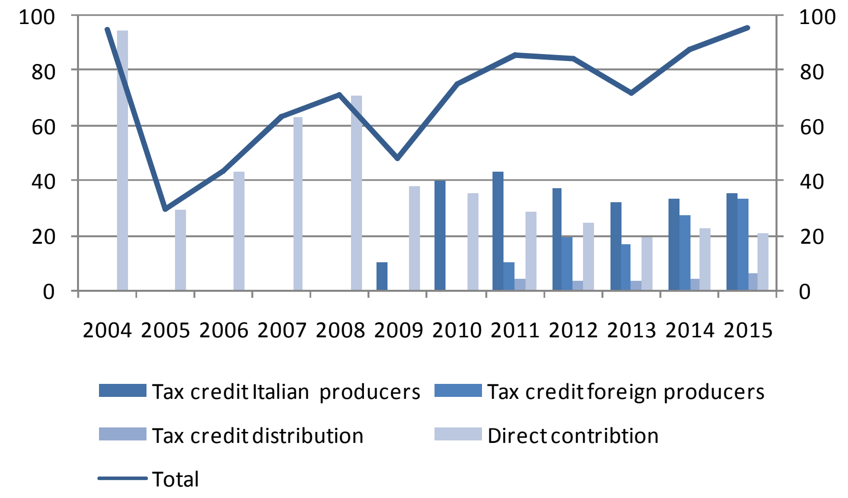
Figure 14 - Trend of public contribution for movie industry in Italy (EURm)



Source: Anica report 2015

Direct investment from public administration in production and distribution was close to EUR100 million in 2015 (+9%), with tax credits representing nearly 80% of the total. Tax credits, introduced in 2009, rapidly increased and were later extended to distribution and foreign producers.

Figure 15 - Total public Italian contribution for production and distribution



Source: Anica report 2015

The Italian Parliament approved a new law increasing support for the film industry: EUR400 million p.a. of fresh resources (+60%) should be available from 2017 for film production and distribution. However, the implementing decrees of the new law are still pending and therefore the detailed amount of upcoming the tax credits is unpredictable. In our view, these new rules could favour new investment in the film industry (till now penalized by legislative uncertainties).

In addition to ministerial contributions, some regions offer direct support for movies produced in the region (mostly Apulia, Lazio and Piedmont), based on different criteria.

Finally, 95 TV productions were supported in 2015, mostly fiction (84), followed by documentaries and animation products, for a total amount of EUR54 million out of total production costs of about EUR360 million (source: *Anica, report 2015*) therefore covering 15% of total production costs.

It is important to highlight that LFG records tax credits and contributions as revenues. In 2016 LFG reported EUR3.9 million of tax credits and contributions equal to 7% of sales and 20% of production revenues, more than tripling the EUR1 million reported in 2015. Clearly, the planned increase of the production activity in the coming years should lead to an increase in tax credits and contributions in future.

SWOT Analysis

Figure 16 - SWOT Analysis

Strengths	Weaknesses
Outstanding track record in film production and distribution	High volatility of box office revenues
Strong management expertise in the movie sector, with long history and extensive network. This is a key factor in fund-raising for new productions and in acquiring blockbusters for distribution	The business is totally dependent on a small number of key personnel, involved in many different projects
Established relationships with international directors and top Italian movie directors	Declining ROCE due to high investments and NOPAT slowdown
Long lasting agreements with top international content providers and with the main Italian distributors	Limited liquidity

Opportunities	Threats
Strong development of new channels and new media distribution channels	Piracy, which is rapidly increasing as a consequence of the digitalization process
Entry to International TV productions with potential sales and co-production agreements and potential synergies with the Maite Bulgari production company	Rising capex in 2017-18 will increase net debt and net invested capital (ratcheting up gearing and lowering capital turnover)
Listing on MTA in the short term and on the STAR segment as a second step	Unexpected decisions from downstream operators can significantly alter TV productions
Recovery of the product placement activity, currently minimal	Delays in film and TV production schedules could postpone releases
Growing tax credits and subsidies reduce average production cost	High competition and fragmentation of the players in the industry

Source: UBI Banca estimates

2016 results

LFG reported an increase in revenues of >40% in 2016, with a strong improvement in the distribution division which benefitted from the good box office results of “The Hateful Eight”, “The Girl on the Train” and “The divergent: Allegiant”. Box office revenue was EUR29.4 million leading to EUR4.7 million of theatrical sales while pay TV reached EUR7 million (+34%) and free TV EUR8 million (+28%). However, distribution revenues were less than projected in the original business plan (EUR38 million sales expected) due to the postponed release of nine movies to the following year and one release on December 30 (“Big Friendly Giant”) which contributed almost nothing to 2016 revenues. Production division sales increased by 28% sustained by 2 productions and 2 executive productions (plus 4 executive production services), with outstanding box office results for “Perfetti Sconosciuti” (EUR17.4 million), and “La Pazza Gioia” (EUR6.2 million). Other sales (equal to 11% of consolidated revenues vs. 5% in 2015) include tax credits, subsidies and other contributions.

Figure 17 – LFG 2016 consolidated results

(EURm)	2015A	2016A	% Chg.
Sales Distribution	21.8	29.5	35.6%
Sales Production	15.0	19.2	28.1%
Sales Other	2.1	6.0	189.2%
Sales total	**38.8**	**54.7**	**40.9%**
EBITDA	**19.2**	**23.5**	**22.7%**
% margin	**49.4%**	**43.0%**	
EBIT	**4.4**	**3.0**	**-31.9%**
% margin	**11.2%**	**5.4%**	
Pre tax profit	4.5	1.7	-62.5%
Net profit	**3.6**	**1.8**	**-49.4%**
Net debt/(cash)	24.0	32.3	34.4%

Source: Company data

The EBITDA margin declined slightly to 43% (from 49.4% in 2014) due to higher personnel costs and to the reduction of production costs capitalized, and EBIT margin halved to 5.4% due to higher D&A costs (equal to 37.6% of sales).

After EUR1.3 million of financial charges and nearly no taxes, the net result was EUR1.8 million, half of the level of 2015.

Net debt increased to EUR32 million (vs. EUR24 million at Dec-15) with gross debt of EUR40.8 million of which EUR23.6 million long term. NWC fell to 4.8% of sales (18.1% in 2015) mostly due to lower trade receivables (171 days vs. 244 days in 2015). Capex of EUR31.5 million was slightly above the level of 2015.

Fixed assets totaled EUR63.8 million, of which EUR61 million were intangible assets: these included EUR45.1 million in rights (LFG’s library) corresponding to 71% of the current market cap) and EUR5.7 million of goodwill (on Lotus Production).

Total net invested capital was EUR66.4 million, +14% compared to the figure of EUR58.3 million reported at Dec-15, giving a ROI of 4.5%.

2017-2019 Business plan

In April LFG presented a new three-year business plan which scaled back original 2016-18E targets mostly due to the postponement of some releases (nine in 2016).

The new business plan, based on IFRS, forecasts 74 releases in 2017-19 of which 56 movie distributions, 11 productions and 7 executive productions which could lift revenues to EUR67 million in 2019 with a 7.2% CAGR over the period. EBITDA could grow at 22.5% CAGR with margins rising to 64.5% in 2019 compared with 43.1% in 2016. The Production division could be the main driver which might result in rapid profitability improvements due to new TV and movie productions. The plan is based on agreements already signed with distributors and on planned production budgets and implies rising investments which could drive up net financial debt (to EUR54.2 million or more at Dec-17). Net profit is expected to be EUR2.7 million this year and EUR7.0 million in 2019 while dividends will be based on a 50% pay-out ratio (implying a dividend yield of about 3% based on the current market price).

Figure 18 – LFG 2016-2019 business plan

(EURm)	2016A	2017E	2018E	2019E	CAGR 16-19E
Movie released	14	29	12	15	
Productions	2	5	4	2	
Exec. Productions	2	3	3	1	
Sales Distribution	31.6	36.0	37.6	39.5	7.7%
Sales Production	23.1	24.9	29.0	27.9	6.5%
Consolidated sales	**54.7**	**60.9**	**66.6**	**67.3**	**7.2%**
EBITDA Distribution	19.3	20.1	24.7	25.4	9.6%
% margin	61.1%	55.8%	65.7%	64.3%	
EBITDA Production	4.3	9.0	10.7	18.0	61.2%
% margin	18.6%	36.1%	36.9%	64.5%	
EBITDA Consolidated	**23.6**	**29.1**	**35.4**	**43.4**	**22.5%**
% margin	**43.1%**	**47.8%**	**53.2%**	**64.5%**	
D&A	(20.6)	(23.7)	(27.0)	(31.8)	
EBIT	**3.0**	**5.4**	**8.4**	**11.6**	**57.0%**
% margin	**5.5%**	**8.9%**	**12.6%**	**17.2%**	
Net profit	**1.8**	**2.7**	**4.7**	**7.0**	**57.3%**
Net debt	32.3	54.2	52.9	40.9 *	
Capex	31.6	40.1	30.3	20.1 *	
	57.8%	65.8%	45.5%	29.9%	

Source: Company data ** advances for 2020 pipeline not included*

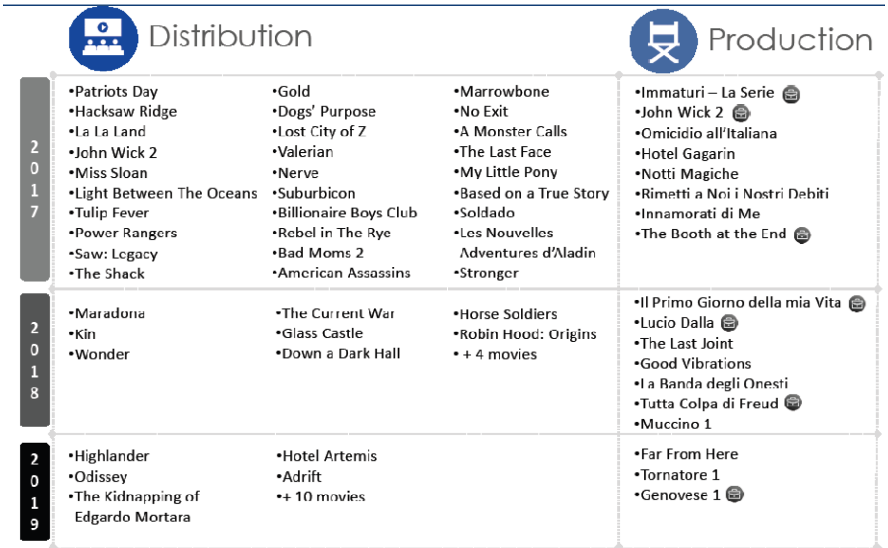
Based on the current line-up, we believe the business plan targets are achievable in 2017-18, although we acknowledge the risk to targets of the postponement of some releases as already happened in 2016.

LFG expects a sharp increase in the profitability of the Production division in 2019 ahead of a slight decline in sales (-3.7%). This is due to the pre-sale of pay TV rights (which could rise to 30% of the production budget) which brings forward the EBITDA of future releases. Our estimates incorporate a normalized margin in 2019 which is lower than those anticipated by the business plan.

Financial projections

It is very difficult to assess reliable estimates for a producer and distributor of motion picture content, as the top line is directly correlated to the box office results of future releases, which are clearly unpredictable. However, there is a clear pipeline of forthcoming movies for 2017 (29 movie distributions, 5 productions of which one TV production and 3 executive productions) and 2018 (4 movie productions, 3 executive productions and the distribution of 12 movies, all already acquired). We expect further acquisitions in the coming months which should complete the pipeline for 2019 and build up the pipeline due for release in 2020.

Figure 19 – 2017-19 expected releases



Source: Company data

Distribution

The Distribution division includes revenues from rights on foreign movies and sales from the existing library. We assume that LFG's line-up (29 movies to be released this year, 12 in 2018 and 15 in 2019) will be released as planned. Clearly, there is the risk that some movies could be postponed or delayed, as already happened last year shifting revenues to the subsequent year. Box office is forecast to be EUR2.2 million per movie (compared with EUR2.1 million in 2016 and >EUR4 million on average in the four movies released to date) with a 5% increase in 2018 and 2019. Box office takings could translate to almost EUR12 million theatrical revenues this year, EUR9.4 million in 2018 and EUR12 million in 2019. Additional sales could come from Pay and free-to-air TV, from the sale of rights and from other channels. The existing library could generate sales of >EUR3 million p.a., with an increase in 2017-18 due to new additions. In summary, Distribution division revenues could be EUR35.7 million this year, a 20% increase compared to 2016.

We cautiously assume that the EBITDA margin could remain stable at 55-60%, below the average of 2014-16 (63.1%) with EBIT undermined by D&A of about 50% of sales (the "revenues forecasting method" implies that >80% of the movie is amortized in the first two years).

Figure 20 – LFG Distribution revenues and margins

(EURm)	2016A	2017E	2018E	2019E
Total movies	14	29	12	15
Box office (EURm)	29.4	63.9	27.8	36.5
Per movie (EURm)	2.1	2.2	2.3	2.4
Theatrical sales	4.7	11.5	5.0	6.6
Pay TV sales	7.0	7.7	9.4	12.0
Free TV sales	8.0	9.1	10.1	10.7
Sales of right	7.0	4.2	5.5	3.1
Other sales	2.8	3.3	3.7	4.3
Total Distribution sales	**29.5**	**35.7**	**33.7**	**36.6**
EBITDA	**18.2**	**18.9**	**19.6**	**22.0**
% margin	**61.6%**	**53.0%**	**58.0%**	**60.0%**
D&A	**(17.9)**	**(17.9)**	**(18.6)**	**(18.3)**
EBIT	**0.3**	**1.1**	**1.0**	**3.7**
% margin	**0.9%**	**3.0%**	**3.0%**	**10.0%**

Source: UBI Banca estimates

Movie and TV production

In order to assemble our forecasts we have considered the number of forthcoming productions and co-production over the next three years (3-4 movies and 1-2 TV production per annum) and 3 executive productions yearly (except in 2019 which has lower visibility). Most of the revenues should come from executive productions, theatrical sales are accounted at 20% of box office revenues (on which all other sales are dependent). Pay TV at an average of 15% of the box office and other revenues (home video, Vod, PPV, Kiosk) at 2%, for a total of about 40% of the total box office spread along the exploitation cycle. LFG has already released one executive production in 2017 (“John Wick 2” which took EUR1.8 million at box office), and one direct production (“Omicidio all’Italiana” with EUR1 million box office).

Figure 21 – LFG Production revenues and margins

(EURm)	2016A	2017E	2018E	2019E
Direct productions	2	5	4	2
Executive productions	2	3	3	1
Executive productions sales	14.8	15.0	21.9	18.0
Theatrical sales	2.2	2.2	2.4	3.1
Pay TV sales	1.5	1.5	1.7	2.2
Sales of right sales	0.4	0.4	0.5	0.7
Other sales	0.3	0.3	0.3	0.3
Total Production sales	**19.2**	**19.4**	**26.8**	**24.4**
EBITDA	**5.4**	**5.6**	**7.2**	**7.3**
% margin	**28.0%**	**28.7%**	**26.9%**	**30.0%**

Source: Company data, UBI Banca estimates

TV production can vary significantly from year to year depending by the number of productions realized and by the budget of each production. LFG is expected to release two executive productions in 2017 (“Immaturi” for 8 episodes to be released in September on Mediaset and “The booth at the end” 5 episodes, both directed by Paolo Genovese). TV productions are expected to rise sharply in 2019.

It should be noted that our estimates do not take into account “Colt” (directed by Stefano Sollima) and “Beati Paoli” (directed by Giuseppe Tornatore), both high-budget international productions.

The average EBITDA margin of the production division ranged from 25% to 43% in 2014-16. We estimate an EBITDA margin of 28.7% for 2016 with some slowdown next year (to 27%) due to a higher weighting of TV productions which have lower profitability, and an improvement to 30% in 2019.

Consolidated forecasts

Summing up our estimates on the two divisions of LFG and adding tax credits and subsidies representing about 22% of production revenues and other revenues (mostly chargebacks of P&A costs) for around EUR2 million p.a., we expect a 12% increase in sales this year and a further 12% sales growth in 2018, while we are more conservative on 2019, given the low visibility on the line-up. Accordingly, we expect modest growth in the EBITDA margin (better product mix) to 53% in 2019. Potential upside could come from unexpected blockbusters which could lift revenues from other channels and could generate bonuses, and from co-production agreements and/or right sales on the TV series “Beati Paoli” and “Colt”.

Figure 22 – LFG consolidated expected results

(EURm)	2014A	2015A	2016A	2017E	2018E	2019E
Distribution sales	20.3	21.8	29.5	35.7	33.7	36.6
Production sales	2.5	15.0	19.2	19.4	26.8	24.4
Other sales	1.6	2.1	6.0	6.2	8.0	7.4
Consolidated sales	**24.3**	**38.8**	**54.7**	**61.3**	**68.5**	**68.4**
% Change		59.9%	40.9%	12.1%	11.7%	-0.1%
EBITDA	**14.7**	**19.2**	**23.5**	**29.6**	**35.0**	**36.3**
% margin	**60.7%**	**49.4%**	**43.0%**	**48.2%**	**51.1%**	**53.0%**
D&A	(11.0)	(14.8)	(20.6)	(23.7)	(26.6)	(25.7)
EBIT	**3.8**	**4.4**	**3.0**	**5.8**	**8.4**	**10.6**
% margin	**15.5%**	**11.2%**	**5.4%**	**9.5%**	**12.2%**	**15.5%**
Financials	0.4	0.2	(1.3)	(1.4)	(1.5)	(1.3)
Pretax Profit	4.1	4.5	1.7	4.4	6.9	9.3
Taxes	(1.6)	(1.0)	0.1	(1.4)	(2.2)	(3.0)
Tax rate (%)	38%	21%	-7%	32%	32%	32%
Net Profit	**2.6**	**3.6**	**1.8**	**3.0**	**4.7**	**6.3**
% Change		**38.3%**	**-49.4%**	**66.2%**	**55.6%**	**34.3%**

Source: Company data, UBI Banca estimates

D&A costs are expected to remain stable at about 38% of sales in the coming years (we should stress that movies are generally amortized for >60% in the first few years after initial release and that rights are partially sold to free-to-air TV) and therefore the EBIT improvement should be stronger than for EBITDA. This should translate to a significant improvement in the operating margin, expected to reach 9.5% in 2017 (from 5.4% in 2016), and 15.5% in 2019.

Below the operating line, we expect financial charges of about EUR1.5 million and a tax rate of about 32%. This implies a net profit which is expected to rise to EUR3.0 million in 2017 (after a slowdown in 2016) and to EUR6.3 million in 2019.

We expect the balance sheet to reflect the increasing value of the library (classified as intangible fixed assets) following the acquisition of new rights and new productions. Net working capital is expected to increase after the sharp decline of

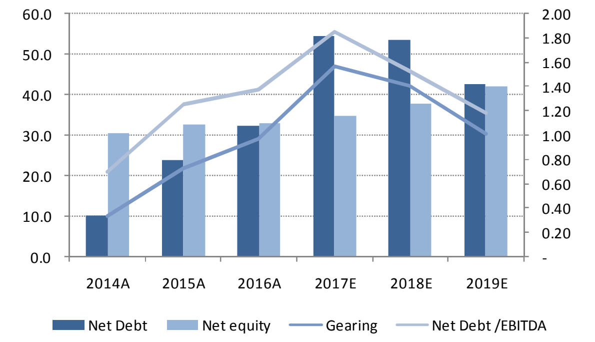
2016 (nearly 5% of sales) reaching 17% of revenues this year and 11.3% in 2019.

We forecast that investments (mostly in the library) could be about EUR40 million this year, and about EUR30 million in 2018 and EUR20 million in 2019 (excluding advances for the 2020 pipeline) to sustain the production and distribution of new movies. This trend would increase LFG's net debt which is expected to grow to EUR54.6 million at Dec-17 (vs. EUR32.3 million at end-16) with a gearing at around 1.6x vs. an average of 0.7x for 2014-16 and a net debt/EBITDA ratio topping 1.8x this year but rapidly declining at 1.0x in 2019.

Assuming a payout ratio of around 50%, in line with the company's guidance, we estimate a DPS of EUR0.11 on 2017 results rising to EUR0.15 in 2018 and EUR0.20 in 2019, implying a dividend yield 2.4% up to 4.3% on current market price.

Figure 23 – Financial structure evolution (EURm)

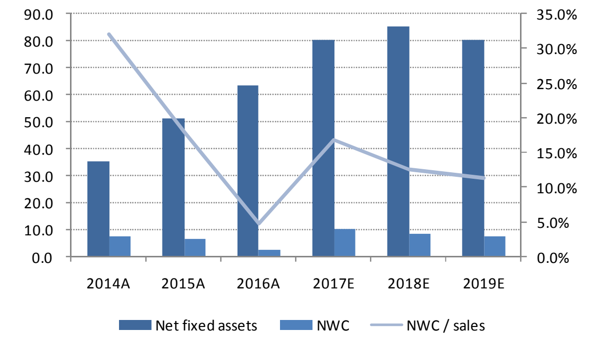
We expect an increase in net debt due to rising capex. However, gearing and leverage should fall in 2018-19.



Source: Company data, UBI Banca estimates

Figure 24 – Net fixed assets and operating NWC evolution (EURm)

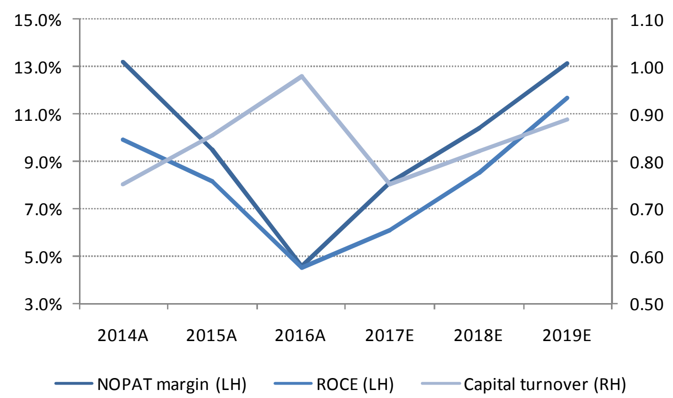
We cautiously assume a higher operating NWC to sales ratio in 2017-19 reflecting higher receivables. Net fixed assets are expected to increase



Source: Company data, UBI Banca estimates

We calculate an average capital turnover (sales / invested capital) of 0.86x over the past three years, which improved in 2016 (to 0.98x). For 2017-19 we forecast a stabilization of capital turnover at about 0.82x, mostly due to higher fixed assets relating to higher investment in new productions. However, ROCE is expected to rise to >11% in 2019, due to a significant improvement in the NOPAT margin.

Figure 25 – NOPAT margin, Capital Turnover and ROCE trend



Source: UBI Banca estimates

Valuation

Despite a rally in the share price of 74% since the beginning of the year, primarily driven by the possible transfer to the MTA, by the new 2017-19 business plan and by the strong box office results of some movie releases, LFG's current market capitalization (EUR65 million) is broadly in line with its net invested capital which implies that LFG may not be able to create value in future. We believe this scenario is highly unlikely given the wide line up of the company and the margin improvements expected for 2017-19.

Our target price of EUR5.16 per share is based on the average of DCF and a relative valuation, after having applied a 10% liquidity discount to take into account the limited liquidity of LFG and its modest size. The discount could disappear as soon as the company would be listed on the MTS.

At the target price, LFG would trade at 4.3x 2017 EV/EBITDA, which is below the average multiple for our peer sample (5.6x).

Figure 26 – Valuation summary

We have applied a 10% discount to our fair value to reflect the low liquidity of the shares and the modest size of the company. This discount could narrow following the transfer to the MTA market segment.

(EUR)	Fair Value	Weight	
DCF Valuation	6..60	50.0%	3.30
Relative Valuation	4.87	50.0%	2.44
Fair value			**5.74**
Liquidity dicount (10%)			(0.57)
Target price			**5.16**
Current price			4.64
Potential upside			11.2%

Source: Company data, UBI Banca estimates

DCF Valuation

Our cautious DCF model delivers a fair value of EUR6.60 per share.

Our model incorporates the following assumptions:

> a risk-free rate of 2.5%, which is our long-term assumption for the interest rate on Italian bonds (2% inflation target of ECB plus 0.5% of real interest, in line with the long term historical average);

> a market risk premium of 4.5%;

> a leveraged beta of 1.26 (0.72 unleveraged), based on the average of the Entertainment (0.58) and broadcasting (0.86) industries in Europe (*source: Damodaran Jan-17*);

> A debt spread of 3%;

> A target debt/equity ratio of 53/47, which is in line with our 2019 forecasts and similar to 2016 (49/51);

> A terminal growth rate of 1.50% and an operating margin at 12% at terminal value, which is below the EBIT margins we expect for 2018 and 2019.

We calculate a WACC of 5.89%.

Figure 27 – WACC and embedded DCF assumptions

WACC assumptions		**Embedded DCF assumptions**	
Risk Free rate (10Y BTP bench.)	2.5%	Revenue CAGR 2017-2025 (%)	2.5%
Debt spread (%)	3.0%	EBIT CAGR 2017-2025 (%)	5.3%
Cost of debt [net] (%)	4.0%	EBIT margin 2017 (%)	9.5%
Market risk premium (%)	4.5%	Target EBIT margin 2025 (%)	12.0%
Beta (x)	1.23	Depr. on sales (avg 2017-2025) (%)	38.0%
Cost of equity (%)	8.0%	Capex on sales (avg 2017-2025) (%)	-37.7%
Weight of Debt	53%		
Weight of Equity	47%		
WACC	**5.89%**		

Source: UBI Banca estimates

Figure 28 – DCF valuation

Our DCF valuation implies an EV/EBITDA of 4.0x at terminal value

	(EUR m)	**(% weight)**
Sum of PV 2017-25 FCF	37.5	30%
Terminal value	88.1	70%
Total Enterprise value	**125.6**	**100%**
- minorities	0.0	
- Pension Provision	(0.3)	
- Net debt (+ cash)	(32.3)	
Total Equity value	**93.0**	
Fully diluted number of shares (m)	14.1	
Fair value per share (EUR)	**6.60**	

Source: UBI Banca estimates

Our valuation has significant sensitivity to the terminal growth rate and WACC as the fair value in our DCF model is largely based on terminal value (70% of enterprise value).

Figure 29 – Sensitivity analysis

Doubling the terminal growth rate would increase our DCF valuation by 51%

WACC/g	**0.50%**	**1.00%**	**1.50%**	**2.00%**	**2.50%**
4.50%	7.37	8.37	9.71	11.58	14.36
5.00%	6.52	7.30	8.31	9.65	11.51
5.50%	5.82	6.45	7.24	8.25	9.58
5.89%	5.39	5.93	**6.60**	7.45	8.47
6.00%	5.23	5.75	6.38	7.18	8.18
6.50%	4.73	5.17	5.69	6.32	7.11
7.00%	4.30	4.67	5.11	5.63	6.26

Source: UBI Banca estimates

Relative valuation

LFG has several direct listed peers. We have not taken into consideration in our relative valuation the global entertainment corporations (Walt Disney, Time-Warner) due to their large size and international focus.

LFG is trading at a discount of about 30% on EV/BITDA but at a premium on EV/EBIT and P/E to its direct peers, being penalized by its conservative amortization policy. However, it should be acknowledged that LFG presents the one of highest growth rates within our sample.

Based on a relative 2017-18 P/E, LFG would be valued at EUR3.14 per share, on EV/EBITDA it would be EUR8.12 per share and on EV/EBIT it would be EUR1.60 per share. The average of these three valuations gives EUR4.83 per share.

Figure 30 – Peer comparison and valuation based on multiples (priced on 9 May 2017)

Company	Market Cap	P/E		EV/EBITDA		EV/EBIT		Share performance	
	(EURm)	2017E	2018E	2017E	2018E	2017E	2018E	One Month	Three months
EuropaCorp SA	150	16.6 x	22.3 x	3.4 x	4.1 x	14.6 x	17.2 x	-2.14%	0.27%
Splendid Medien AG	17	14.7 x	10.2 x	2.4 x	2.1 x	13.9 x	10.2 x	-2.09%	-5.95%
Lions Gate	4,759	23.8 x	18.7 x	13.3 x	11.3 x	18.9 x	15.6 x	-2.20%	-12.62%
Entertainment One Ltd.	1,248	10.6 x	9.6 x	7.4 x	6.9 x	7.9 x	7.6 x	2.71%	4.01%
Highlight Communications AG	257	11.8 x	11.0 x	8.8 x	8.0 x	9.7 x	8.9 x	4.42%	-1.40%
Lucisano Media Group	32	3.5 x	2.6 x	2.3 x	1.9 x	4.5 x	3.4 x	6.65%	59.26%
Mondo TV	125	11.3 x	9.7 x	5.6 x	4.7 x	9.0 x	8.4 x	2.13%	4.05%
Notorious Pictures	23	5.7 x	4.6 x	1.3 x	1.0 x	2.9 x	1.9 x	2.54%	21.35%
Average		**12.3 x**	**11.1 x**	**5.6 x**	**5.0 x**	**10.2 x**	**9.1 x**	**2.81%**	**7.59%**
Current LFG market multiples	65	21.7 x	13.9 x	4.1 x	3.4 x	20.6 x	14.2 x	17.52%	54.73%
Discount to Average		**76.7%**	**25.6%**	**-26.8%**	**-31.8%**	**102.7%**	**55.9%**		

Source: Factset, UBI Banca estimates

At our EUR5.16 per share target price, LFG would trade at 3.6x 2018 EV/EBITDA, which is below the average multiple of our sample of peers (5.0x)

Figure 31 – Implicit multiples based on our EUR5.16 target price

(x)	2017E	2018E	2019E
P/E	24.1 x	15.5 x	11.5 x
EV/EBITDA	4.3 x	3.6 x	3.2 x
EV/EBIT	21.9 x	15.1 x	10.9 x
EV/Sales	1.72 x	1.54 x	1.42 x
P/BV	2.1 x	1.9 x	1.7 x
EV/ Capital employed	1.4 x	1.4 x	1.4 x

Source: UBI Banca estimates

Appendix

Figure 32 – Distribution line up

Source: Leone Film Group

Figure 33 – Movie production line up

Hotel Gagarin
Script: Simone Spada, Lorenzo Rossi Espagnet
Director: Simone Spada
Cast: Luca Argentero, Claudio Amendola, Giuseppe Battiston

Rimetti a Noi i Nostri Debiti
Script: Antonio Morabito and Amedeo Pagani
Director: Antonio Morabito
Cast: Claudio Santamaria, Marco Giallini

Notti Magiche
Script: Paolo Virzì, Francesca Archibugi, Francesco Piccolo
Director: Paolo Virzì
Cast: t.b.c.

Il Primo Giorno Della Mia Vita
Script: Paolo Genovese
Director: Paolo Genovese
Cast: t.b.c.

The Last Joint
Script: Gianluca Ansanelli, Tito Buffulini
Director: Maccio Capatonda
Cast: t.b.c.

Far From Here
Script: Paolo Virzì
Director: Paolo Virzì
Cast: t.b.c.

Source: Leone Film Group

Figure 34 – TV production line up

Colt
Original Idea: Sergio Leone
Script: Stefano Sollima, Luca Infascelli, Massimo Gaudioso
Director: Stefano Sollima
Cast: t.b.c.

Immaturi – La Serie
Script: Paolo Genovese, Paola Mammini, Giovanna Guidoni
Director: Rolando Ravello
Cast: Ricky Memphis, Luca Bizarri, Paolo Kessisoglu, Maurizio Mattioli, Sabrina Impacciatore, Nicole Grimaudo, Ilaria Spada

Beati Paoli
Original Idea: Luigi Natoli
Script: Giuseppe Tornatore, Massimo De Rita, Salvatore Marcarelli
Director: Giuseppe Tornatore
Cast: t.b.c.

Tutta Colpa di Freud
Script: Paolo Genovese
Director: Paolo Genovese
Cast: t.b.c.

The Booth at the End
Script: Christopher Kubasik
Director: Paolo Genovese
Cast: Valerio Mastandrea

Source: Leone Film Group

Figure 35 – Movies of Sergio Leone in the library

Source: Leone Film Group

Income Statement

(EURm)	2016	2017E	2018E	2019E
Net Revenues	54.71	61.31	68.48	68.43
EBITDA	23.52	29.55	34.99	36.25
EBITDA margin	39.3%	39.8%	42.6%	44.5%
EBIT	2.96	5.83	8.37	10.59
EBIT margin	5.0%	7.9%	10.2%	13.0%
Net financial income /expense	-1.26	-1.39	-1.46	-1.31
Associates & Others	0.00	0.00	0.00	0.00
Profit before taxes	1.70	4.44	6.91	9.28
Taxes	0.12	-1.42	-2.21	-2.97
Minorities & discontinuing ops	0.00	0.00	0.00	0.00
Net Income	1.82	3.02	4.70	6.31

Source: Company data, UBI Banca estimates

Balance Sheet

(EURm)	2016	2017E	2018E	2019E
Net working capital	2.62	10.31	8.66	7.71
Net Fixed assets	63.79	80.33	85.25	80.56
M/L term funds	-1.11	-1.26	-2.51	-3.38
Capital employed	65.31	89.37	91.40	84.89
Shareholders' equity	33.02	34.77	37.92	42.11
Minorities	0.00	0.00	0.00	0.00
Shareholders' funds	33.02	34.77	37.92	42.11
Net financial debt/(cash)	32.29	54.60	53.49	42.77

Source: Company data, UBI Banca estimates

Cash Flow Statement

(EURm)	2016	2017E	2018E	2019E
NFP Beginning of Period	24.03	32.29	54.60	53.49
Group Net Profit	1.82	3.02	4.70	6.31
Minorities	0.00	0.00	0.00	0.00
D&A	20.55	23.72	26.62	25.66
Change in Funds & TFR	0.00	0.00	0.00	0.00
Gross Cash Flow	22.37	26.74	31.32	31.97
Change In Working Capital	4.40	-7.69	1.65	0.96
Other	0.00	0.00	0.00	0.00
Operating Cash Flow	26.77	19.05	32.97	32.92
Net Capex	-31.50	-40.10	-30.30	-20.10
Other Investments	0.00	0.00	0.00	0.00
Free Cash Flow	-4.73	-21.05	2.67	12.82
Dividends Paid	-1.21	-1.27	-1.55	-2.11
Other & Chg in Consolid. Area	-2.32	0.00	0.00	0.00
Chg in Net Worth & Capital Incr.	0.00	0.00	0.00	0.00
Change in NFP	-8.26	-22.31	1.12	10.71
NFP End of Period	32.29	54.60	53.49	42.77

Source: Company data, UBI Banca estimates

Financial Ratios

(%)	2016	2017E	2018E	2019E
ROE	5.5%	8.7%	12.4%	15.0%
ROI	4.7%	7.4%	9.1%	11.6%
Net Fin. Debt/Equity (x)	1.0	1.6	1.4	1.0
Net Fin. Debt/EBITDA (x)	1.4	1.8	1.5	1.2
Interest Coverage	2.3	4.2	5.7	8.1
NWC/Sales	4.4%	13.9%	10.5%	9.5%
Capex/Sales	52.7%	54.1%	36.9%	24.7%
Pay Out Ratio	69.8%	51.3%	45.0%	44.7%

Source: Company data, UBI Banca estimates

Per Share Data

(EUR)	2016	2017E	2018E	2019E
EPS	0.13	0.21	0.33	0.45
DPS	0.09	0.11	0.15	0.20
Op. CFPS	1.90	1.35	2.34	2.34
Free CFPS	-0.34	-1.49	0.19	0.91
BVPS	2.34	2.47	2.69	2.99

Source: Company data, UBI Banca estimates

Stock Market Ratios

(x)	2016	2017E	2018E	2019E
P/E	20.2	21.7	13.9	10.4
P/OpCFPS	1.4	3.4	2.0	2.0
P/BV	1.1	1.9	1.7	1.6
Dividend Yield (%)	3.4%	2.4%	3.2%	4.3%
Free Cash Flow Yield (%)	-12.9%	-32.5%	4.1%	19.6%
EV (EURm)	69.4	120.4	119.3	108.6
EV/Sales	1.2	1.6	1.4	1.3
EV/EBITDA	3.0	4.1	3.4	3.0
EV/EBIT	23.4	20.6	14.3	10.3
EV/Capital Employed	1.1	1.3	1.3	1.3

Source: Company data, UBI Banca estimates

Growth Rates

(%)	2016	2017E	2018E	2019E
Growth Group Net Sales	14.2%	24.1%	10.7%	-0.9%
Growth EBITDA	22.7%	25.7%	18.4%	3.6%
Growth EBIT	-31.9%	96.8%	43.5%	26.5%
Growth Net Profit	-49.4%	66.2%	55.6%	34.3%

Source: Company data, UBI Banca estimates

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