

July 25, 2018



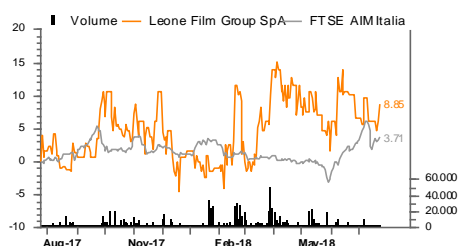
Fair Value: €6.31
(Prev. €6.54)

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LFG 1Y Relative Performance Chart



Market Data:

Current Price (€)	4.92
Fair Value (€)	6.31
Upside (%)	28.25
Market Cap (€/mn)	69.340
52 Wk High/Low (€)	4.20-5.45
Free Float (%)	24.6
Avg. Daily Trading 90d	4,023
Share Out (mn)	14.09
Price Change YTD (%)	6.96
Price Change 1Y (%)	4.55
Dividend Yield (%)	0.0

LFG 2018-20: fewer movies...higher budget

In July 2018, LFG disclosed its FY18-20 Business Plan, updating its guidance for the next 3 years. The new plan is based on the release of 59 movies (45 distribution movies and 14 productions), which should allow LFG to grow its top line to €136.8mn by the end of 2020 (+ 8.9% CAGR2017-20). Over the next 3 years, the Group aims to: i) retain a higher share of movies' rights; ii) distribute a lower number of movies but with a higher budget; and iii) increase the international executive productions. Over the period 2018-20, investments are forecasted to amount to €75.7mn and should allow a decrease in NFP of ca. €10.0mn.

1H18 main releases. Since the beginning of the year, LFG has distributed 5 movies (*The Post*, *Quello che non so di lei*, *Wind River*, *Stronger* and *12 Soldiers*), of which 2 were released in July (*Stronger* and *12 Soldiers*). In addition, 1H18 saw the release of Simone Spada's *Hotel Gagarin* movie, the TV series *Immaturi* and Gabriele Muccino's *A Casa Tutti Bene* movie, which is, to date, among the best performers in 2018.

1H18 market overview. According to Cinetel, the Italian box office kept recording a negative trend, closing 1H18 down by 7.10%, with box office revenues at €294.3mn (vs €316.8mn in 1H17). The 4 majors (i.e. Universal, Walt Disney, 01 Distribution and Warner Bros) experienced a decrease in their box office revenues, with €177.2mn cashed in 1H18 vs €190.5mn in 1H17. The movie *A Casa Tutti Bene* ranked among the top 5 movies of the first half of 2018, with box office revenues exceeding €9.1mn.

LFG's capital increase. On May 24, 2018 LFG announced the suspension of the accelerated book building process, aimed to raise up to €30mn, due to difficult market conditions and political instability. The right issue was aimed at consolidating LFG's leadership and increasing the stock liquidity. Instead, the €1mn right issue reserved to Paolo Genovese was successfully completed and the artistic director now has a 2.8% stake in LFG.

Estimates review. Following the release of the new business plan, we revised our estimates, substantially decreasing the FY18 top line by 4.7%, mostly due to the postponement of some releases. On the other hand, FY19 revenues were revised upward by 2.1% and are projected to reach €136.0mn in FY20, thanks to: i) the growing international executive productions; and ii) the distribution of bigger movies. EBITDA and EBIT are expected to be lower than our previous estimates, mainly as a result of the lower profitability of the international executive productions. EBITDA is projected to reach €39.3mn in FY20 (+10.1% CAGR2017-20). As for the bottom line, Net Income is expected to amount to €10.1mn (+37.4% CAGR2017-20) as a consequence of the increasing tax credits related to the production business.

Fair value fine-tuning. We believe the best way to provide a fair valuation of LFG is to focus on multiple comparisons: focusing on 2018 and 2019 EV/EBIT and P/E multiples - and applying a 15% discount to international peers to reflect both the size difference and the lower liquidity of the stock - we derive a fair value of €6.31ps, which implies an upside of 28.25% on the current stock price.

€ thousand	Revenues	EBITDA	EBITDA Margin	EBIT	Earnings	EPS
2016A	54,707	23,518	43.0%	2,964	1,818	0.13
2017A	105,790	29,423	27.8%	5,423	3,904	0.28
2018E	108,970	30,220	27.7%	6,870	5,429	0.39
2019E	128,100	32,460	25.3%	9,675	7,691	0.55
2020E	136,045	39,310	28.9%	13,045	10,135	0.72

Source: Company data, KT&Partners' estimates

Market Trend: 1H18 Italian Box Office Revenues

According to Cinetel, the Italian box office kept recording a negative trend, closing the 1H18 down by 7.10%, with box office revenues at €294.3mn (vs €316.8mn in 1H17). Looking at the audience, the number of tickets sold was 45.7mn vs 51.8mn in 1H17, with €6.43 the average ticket price (+5.2% YoY). The 4 majors (i.e. Universal, Walt Disney, O1 Distribution and Warner Bros) experienced a decrease in their box office revenues, with €177.2mn cashed in 1H18 vs €190.5mn in 1H17. Within the market, Italian movies reported a good performance, increasing their market share from 18.1% in 1H17 to 28.9% in the first half of 2018. Among the 10 top movies of 2018, there were 3 Italian productions: *A Casa Tutti Bene* was the fifth in terms of box office (over €9.1mn).

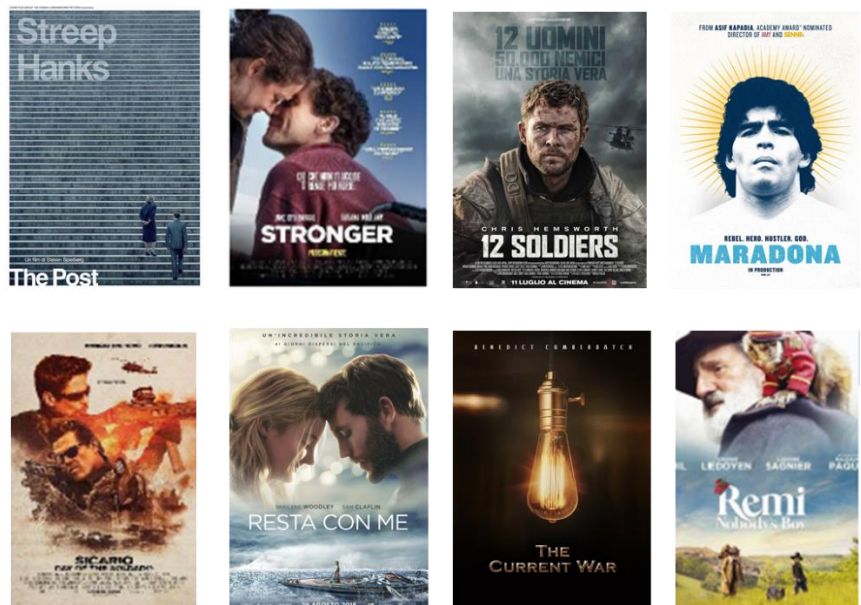
2018-20 Pipeline

In July 2018, LFG disclosed its FY18-20 Business Plan, updating its guidance for the next 3 years. The new business plan confirms the growth of the 2 businesses thanks to the release of 59 movies by the end of the period.

Distribution. On the distribution front, LFG forecasts to distribute 45 movies: 22 films in 2018, 12 films in 2019 and 11 films in 2020. Up to now, 5 movies have already been released and are still performing on the screen (*The Post*, *Quello che non so di lei*, *Wind River*, *Stronger* and *12 Soldiers*). We note that the 2018 pipeline includes 4 movies (*Stronger*, *Billionaire Boys Club*, *Soldier* and *Tulip Fever*) that were scheduled to be released in 2017 and postponed to 2018 due to commercial reasons and/or delays in foreign film productions.

It is worth mentioning that changes in release dates are typical in this industry.

Chart 1: Some 2018-20 Distribution Releases



Source: Company data

Production. As for the upstream, 11 productions and 3 executive productions are expected to be completed by the end of 2020. *A Casa Tutti Bene*, directed by Gabriele Muccino, was released in February 2018 and realized box office revenues exceeding €9.1mn as of May 2018. The first half of 2018 also saw the release in theaters of Simone Spada's *Hotel Gagarin* movie and the broadcasting on Mediaset's channels of the TV series *Immaturo*. We highlight that the pipeline also includes international TV series (not included in the 2018-20 Business Plan) such as Stefano Sollima's *Colt* (based on an original idea of Sergio Leone), Giuseppe Tornatore's *I Beati Paoli*, and *Vatican*, based on the book by Gianluigi Nuzzi.

Estimates Review: Fine-Tuning of LFG'S BP

Following the release of the new FY18-20 Business Plan, we fine-tuned our estimates, decreasing the FY18 top line by 4.7%, mostly due to the postponement of some releases, along with the change in the product mix in the distribution. Indeed, in the coming years, LFG aims to retain higher percentages of movies' rights by reducing the pre-sale of equity participations: this implies lower revenues in the short term but at the same time it allows consolidation of the Group's library, thus increasing returns in the long run. On the other hand, for 2019 and 2020, we expect LFG's revenues to grow at a higher pace on the back of: i) the growing international executive production business¹; and ii) the distribution of fewer movies but with a bigger budget. In particular, FY19 revenues were revised upward by 2.1% and are projected to reach €136.0mn in FY20.

Although there is a positive contribution in the top line coming from the international executive production, this business is characterized by a lower level of profitability, which penalizes LFG's main margin. Taking this into consideration and the higher P&A expenses expected, we revised downward FY18 EBITDA by 6.9% and FY19 EBITDA by 10.2%, reaching €39.3mn in FY20. EBIT has been decreased to €6.9mn in FY18 (-25.6%) and to €9.7mn in FY19 (-15.4%) and it is expected to amount to €13.0mn in 2020.

In terms of the bottom line, we projected FY18 and FY19 net income to be higher than our previous estimates (+8.4% and +16.3%, respectively), thanks to the increasing tax credits related to the production business. At the end of the business plan's period, we expect the bottom line to stand at €10.1mn.

On the capital structure side, we left unchanged our estimates for FY18 net debt, which is projected to reach €35.0mn by the end of 2020, thus decreasing by €10.0mn over the period 2018-20.

¹ Thanks to the "tax credit", foreign producers intending to locate part of their foreign film-making on Italian soil can take advantage of a production partnership with domestic producers. In simple terms, even if the Italian executive producer is the only one who can claim the benefit, the foreign producer will transfer to the Italian company a sum equal to the total Italian cost less the fiscal benefit accrued plus a fee.

Table 1: LFG's FY17-19BP vs KT&P's Estimates

€ thousand	2017A	2018E Old KT&P	2018E New KT&P	Change	2019 Old KT&P	2019 New KT&P	Change	2020 New KT&P
Revenues	105.8	114.3	109.0	-4.7%	125.5	128.1	2.1%	136.0
YoY Change (%)		8.0%	3.0%		9.8%	17.6%		6.2%
EBITDA	29.4	32.4	30.2	-6.9%	36.1	32.5	-10.2%	39.3
YoY Change (%)		10.2%	2.7%		11.4%	7.4%		21.1%
EBIT	5.4	9.2	6.9	-25.6%	11.4	9.7	-15.4%	13.0
YoY Change (%)		70.2%	26.7%		23.8%	40.8%		34.8%
Net Income	3.9	5.0	5.4	8.4%	6.6	7.7	16.3%	10.1
YoY Change (%)		28.2%	39.1%		32.1%	41.7%		31.8%
Net Debt	40.50	45	45	0.0%	45.0	40.0	-11.1%	35.0
YoY Change (%)		11.1%	11.1%		n.a.	-11.1%		-12.5%

Source: Company data and KT&Partners' estimates

Valuation

Given the level of seasonality that characterizes this business (which includes box office volatility and the risk of the postponement of some films, with its consequent relevant effect on cash flows), **we believe the best way to provide a fair valuation of LFG is to focus on multiple comparisons.** Even if we recognize that different amortization policies could affect results, we believe the use of EBIT and earnings multiples makes sense, as D&A also represent a part of the cost of films produced or distributed that otherwise could not be properly reflected.

Peers have been chosen to take into account the business activity and the services provided. However, it is worth noting that the selected companies are quite different in terms of the size of revenues and international presence.

Table 2: Peer Group Valuation Table - 2018 Multiples

Company Name	Stock Exchange	Market Cap (€mn)	EV/SALES 2018	EV/EBITDA 2018	EV/EBIT 2018	P/E 2018
Lions Gate Entertainment Corp Class A	NYSE	4,436	2.21	15.07	26.23	n.m.
Entertainment One Ltd.	London	1,932	1.90	11.46	11.62	15.00
EuropaCorp SA	Euronext Paris	73	1.92	2.96	n.m	n.m
Eros International PLC Class A	NYSE	701	3.60	11.42	13.23	24.55
Avg. International Peer Group		1,786	2.41	10.23	17.03	19.77
Leone Film Group SpA	Milan	67	0.98	3.55	15.62	12.31
Lucisano Media Group S.p.A.	Milan	33	n.a.	n.a.	n.a.	n.a.
Notorious Pictures S.p.A.	Milan	46	1.29	3.92	8.16	11.76
Avg. Italian Peer Group		39	1.29	3.92	8.16	11.76
Leone Film Group SpA	Milan	67	0.98	3.55	15.62	12.31

Source: KT&Partners' elaboration on Factset data

Table 3: Peer Group Valuation Table - 2019 Multiples

Company Name	Stock Exchange	Market Cap (€mn)	EV/SALES 2019	EV/EBITDA 2019	EV/EBIT 2019	P/E 2019
Lions Gate Entertainment Corp Class A	NYSE	4,436	2.05	13.34	20.94	30.53
Entertainment One Ltd.	London	1,932	1.74	10.36	10.38	12.90
EuropaCorp SA	Euronext Paris	73	1.72	2.41	n.m	n.m
Eros International PLC Class A	NYSE	701	3.02	9.09	10.43	17.01
Avg. International Peer Group		1,786	2.13	8.80	13.92	20.15
Leone Film Group SpA	Milan	67	0.84	3.31	11.09	8.69
Lucisano Media Group S.p.A.	Milan	33	n.a.	n.a.	n.a.	n.a.
Notorious Pictures S.p.A.	Milan	46	1.21	3.47	6.32	9.00
Avg. Italian Peer Group		39	1.21	3.47	6.32	9.00
Leone Film Group SpA	Milan	67	0.84	3.31	11.09	8.69

Source: KT&Partners' elaboration on Factset data

We decided to exclude Italian comparables as their valuations (highlighted in the tables above) are completely decoupled by fundamentals and do not represent the real multiples of the movie/entertainment industry.

On the other hand, we have applied a 15% discount to international peers to reflect the lower stock liquidity of LFG. **Focusing on 2018 and 2019 EV/EBIT and P/E multiples**, we derive a valuation of €4.71ps and €7.91ps, respectively. We took the average and **we set €6.31ps as a fair value.**

Table 4: Multiples Valuation

Multiple Valuation (€mn)	2018E	2019E	Average
EV/EBIT multiple comparison			
Peer Group EV/EBIT netted from 15% liquidity discount	14.47	11.83	
LFG EBIT	6.87	9.68	
Enterprise value	99.43	114.44	
LFG Net Debt FY17	40.50	40.50	
Equity Value	58.93	73.94	
Number of shares (mn)	14.09	14.09	
Value per share	4.18	5.25	4.71
P/E multiple comparison			
Peer Group P/E netted from 15% liquidity discount	16.81	17.12	
LFG earnings	5.43	7.69	
Market Cap	91.24	131.71	
Number of shares (mn)	14.09	14.09	
Value per share	6.47	9.35	7.91
Fair Value (Avg.) - € ps			6.31

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