

March 12, 2018

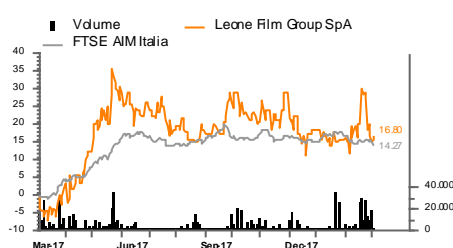


Fair Value: €6.54
(Prev. €5.48)

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LFG 1Y Relative Performance Chart



Market Data:

Current Price (€)	4.50
Fair Value (€)	6.54
Upside (%)	45.33
Market Cap (€/mn)	63.42
52 Wk High/Low (€)	3.50-5.67
Free Float (%)	31.3
Avg. Daily Trading 90d	4,647
Share Out (mn)	14.09
Price Change YTD (%)	-2.17
Price Change 1Y (%)	21.62
Dividend Yield (%)	2.0

LFG: 2017 - What a WONDERful year!

In 2017, LFG became the first Italian independent distributor with a market share of 7.6% of total box office (b.o.) revenues. LFG distributed 22 films during 2017, including George Clooney's *Suburbicon*, *Saw: Legacy* and Luc Besson's *Valerian*. Best performers in terms of 2017 b.o. revenues include *La La Land* and *Wonder* with contributions of €8.3mn and €5.2mn respectively, with *Wonder* continuing to perform in 2018 for a total cash in to date of €12.1mn. The year 2017 was also strong in terms of critical recognition: *La La Land* and *Hacksaw Ridge* together won 8 golden statuettes at the 89th Academy Awards (2017 Oscars).

Lotus Production matured... 2017 was a strong year for Lotus Production: the company signed an exclusivity agreement with Mr. Paolo Genovese, who also became a shareholder of LFG. *The Place*, Mr. Genovese's latest movie, was one of the best Italian movies in 2017 with €4.3mn b.o. revenues. Moreover, the TV series *Immaturi* was also a strong performer in terms of audience, especially among millennials.

Preliminary Results Summary. LFG released strong guidance on its preliminary results. In particular, the top-line experienced a growth of +80.3% YoY reaching €98.6mn, 62.7% higher than our estimates. However, FY17 revenues were affected by the new accounting policy relating to the international executive productions, which in 2017 were reported on a revenue and cost basis as opposed to 2016 when they were reported on a net contribution basis. EBITDA is expected to be €26.7mn, in line with our expectations, while Net Debt is expected to be €40.8mn, 13% below. In 2017, LFG postponed 12 films, 10 in distribution and 2 in production. This negatively affected the EBITDA, which came in €2.4mn lower, and positively affected the Net Debt, which is €13.4mn lower than the company guidance contained in the 2017-2019 Business Plan (BP) published in April 2017.

Fine-Tuning of LFG's 2017-2019 pre-money Business Plan. We increased our 2017 EBIT estimate by 10.5% to €6.3mn on the back of the stronger contribution of international executive productions, which should have a big impact on EBIT. We lowered our expected 2017 Net Income by 2.2% due to the negative effect of the currency hedge. On the back of the change in accounting policy and also of the growing contribution of the executive production business, we increased 2018 revenues by 72.1% (from €66.42mn to €114.29mn) and 2019 revenues by 88.1% (from €66.7mn to €125.5mn). We also increased 2018 and 2019 EBITDA by around 8.0% and 2018 and 2019 EBIT by around 11%.

2018 strong releases and capital increases. 2018 starts with the releases of Steven Spielberg's *The Post* (€6.2mn b.o. revenues) and Muccino's *A Casa Tutti Bene* (€8.1mn b.o. revenues). On February 21, up to €30mn capital increase was announced in order to consolidate LFG leadership and increase the stock liquidity.

Fair Value increased. 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 €6.54ps, which implies +45.33% on the current stock price.

€ thousand	Revenues	EBITDA	EBITDA Margin	EBIT	Earnings	EPS
2015A	38,833	19,181	49%	4,350	3,567	0.25
2016A	54,707	23,518	43%	2,964	1,818	0.13
2017E	98,585	26,653	27%	6,300	2,994	0.21
2018E	114,289	32,442	28%	9,231	5,006	0.36
2019E	125,508	36,133	31%	11,432	6,613	0.47

Source: Company data, KT&Partners' estimates

FY17 Preliminary Results

LFG has released strong guidance on its preliminary results; in particular the top-line experienced a growth of +80.3% YoY reaching €98.6mn, thanks to the strong contribution of the **international executive productions**. LFG started this business at the end of 2016 and now is one of the main players in the Italian market. FY17 revenues were also affected by the new accounting policy relating to the international executive productions that are now reported on a revenues and cost basis, while previously only the margin was reported.

EBITDA is expected to be €26.7mn, in line with our expectations, while Net Debt is expected to be €40.8mn, 13% below. It is important to take into account that in 2017 LFG postponed 12 films, 10 in distribution and 2 in production. This negatively affected the EBITDA, which came in €2.4mn lower, and positively affected the Net Debt, which was €13.4mn lower than the company guidance contained in the 2017-2019 BP published in April 2017.

Table 1: Summary Preliminary FY17 Results vs KT&P's Expectations and Company BP

€ thousand	2017E	2017P	A/E	2017BP
Revenues	60.6	98.6	62.7%	60.9
EBITDA	26.9	26.7	-0.7%	29.1
Net Debt	47.0	40.8	-13.2%	54.2

Source: Company data

Market Trend: 2017 Italian Box Office Revenues

According to Cinetel, the Italian box office closed 2017 down by -11.62%, with box office revenues at €584.5mn (vs €661.3mn in 2016). Looking at the audience, the number of tickets sold was 92.3mn vs 105.3mn in 2016, with €6.33 the average ticket price (+0.80% YoY). The four majors (i.e. Warner Bros, Universal, Walt Disney and 20th Century Fox) experienced an increase in their box office revenues, with €363.1mn cashed in 2017 vs €360.3mn in 2016. On the other hand, the Italian distributors' box office declined to €221.4mn from €301mn during 2017. **This trend confirms the volatility of the market and the fact that a big hit - such as *Quo Vado* with €65.3mn box office - is able to condition a large part of the Italian market value.** We note that the top three films distributed in 2016 totaled €115.7mn vs €50.2mn in 2017.

Table 2: Key Numbers of the Italian Market

FY 2017				
Majors	Box Office Revenues (€)	Audience (#)	Box Office Revenues (%)	Audience (%)
WARNER BROS ITALIA S.P.A.	115,634,442	17,862,188	19.8%	19.4%
UNIVERSAL S.R.L. (*)	108,226,007	16,666,453	18.5%	17.9%
WALT DISNEY S.M.P. ITALIA	81,927,408	12,287,344	14.0%	13.5%
20TH CENTURY FOX ITALIA S.P.A.	57,312,489	8,968,435	9.8%	9.7%
Total	363,100,345	55,784,420	62.1%	60.5%

(*) Including Filmauro's Box Office results

Italian Companies	Box Office Revenues (€)	Audience (#)	Box Office Revenues (%)	Audience (%)
01 DISTRIBUTION	56,603,551	9,410,932	9.7%	10.2%
MEDUSA FILM S.P.A.	33,740,922	5,623,661	5.8%	6.1%
LUCKY RED DISTRIB.	25,893,431	4,364,509	4.4%	4.7%
EAGLE PICTURES S.P.A.	24,752,924	4,086,456	4.2%	4.4%
VIDEA-CDE S.P.A.	11,090,555	1,908,152	1.9%	2.1%
NOTORIOUS PICT. S.P.A.	11,060,158	1,831,197	1.9%	2.0%
NEXO DIGITAL S.P.A.	6,841,100	684,949	1.2%	0.7%
OTHERS	51,409,222	8,560,905	8.8%	9.3%
Total	221,391,861	36,470,761	37.9%	39.5%

Grand total	584,492,206	92,255,181	100.0%	100.0%
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FY 2016				
Majors	Box Office Revenues (€)	Audience (#)	Box Office Revenues (%)	Audience (%)
WARNER BROS ITALIA S.P.A.	123,383,153	19,246,961	18.7%	18.3%
WALT DISNEY S.M.P. ITALIA	90,751,089	13,875,309	13.7%	13.2%
UNIVERSAL S.R.L. (*)	77,330,842	12,582,632	11.7%	11.9%
20TH CENTURY FOX ITALIA S.P.A.	68,810,168	10,814,091	10.4%	10.3%
Total	360,275,252	56,518,993	54.5%	53.7%

Italian Companies	Box Office Revenues (€)	Audience (#)	Box Office Revenues (%)	Audience (%)
MEDUSA FILM S.P.A.	104,629,354	15,696,346	15.8%	14.9%
01 DISTRIBUTION	52,541,108	8,871,679	7.9%	8.4%
LUCKY RED DISTRIB.	36,227,176	5,933,957	5.5%	5.6%
EAGLE PICTURES S.P.A.	25,596,770	4,161,037	3.9%	4.0%
BIM DISTRIB. S.R.L.	11,524,222	2,009,031	1.7%	1.9%
NOTORIOUS PICT. S.P.A.	10,384,403	1,868,615	1.6%	1.8%
M2 PICTURES S.R.L.	9,526,992	1,613,621	1.4%	1.5%
OTHERS	50,607,860	8,624,666	7.7%	8.2%
Total	301,037,885	48,778,952	45.5%	46.3%

Grand total	661,313,137	105,297,945	100.0%	100.0%
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Source: Cinetel and Company data

LFG distributes its films through the main Italian operators (i.e. Medusa Film and 01 Distribution), therefore, in order to fully capture Leone's market share we need to focus just on Italian players (ex. Majors) and extract from their results the movies that they distribute for LFG: the result of this exercise shows that the company represents the **first Italian player in the market, with a market share of 7.6% in terms of box office revenues and 7.8% in terms of audience.**

Table 3: LFG Market Share

FY 17				
Italian Players	Box Office Revenues (€)	Audience (#)	Box Office Revenues (%)	Audience (%)
LEONE FILM GROUP S.P.A.	44,212,895	7,167,660	7.6%	7.8%
01 DISTRIBUTION	35,782,034	6,057,700	6.1%	6.6%
LUCKY RED DISTRIB.	25,619,901	4,311,193	4.4%	4.7%
MEDUSA FILM S.P.A.	24,220,737	4,074,640	4.1%	4.4%
EAGLE PICTURES S.P.A.	11,155,260	1,874,365	1.9%	2.0%
VIDEA-CDE S.P.A.	11,090,555	1,908,152	1.9%	2.1%
NOTORIOUS PICT. S.P.A.	11,060,158	1,831,197	1.9%	2.0%
NEXO DIGITAL S.P.A.	6,841,100	684,949	1.2%	0.7%
OTHERS	51,409,222	8,560,905	8.8%	9.3%
Total	221,391,861	36,470,761	37.9%	39.5%

Source: Cinetel and Company data

Note that Cinetel underestimates box office revenues as it collects data related to about 90% of the total market.

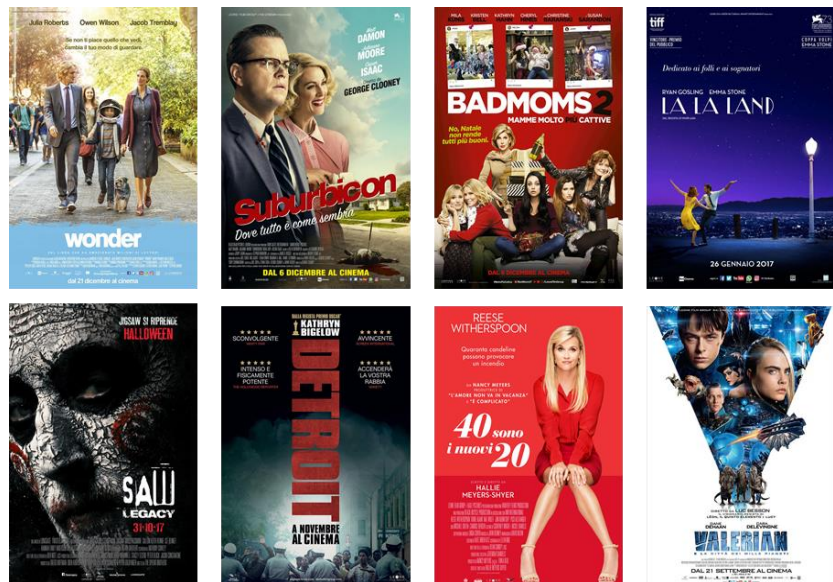
FY 16				
Italian Players	Box Office Revenues (€)	Audience (#)	Box Office Revenues (%)	Audience (%)
MEDUSA FILM S.P.A.	81,478,968	12,025,271	12.3%	11.4%
LEONE FILM GROUP S.P.A.	50,800,073	8,086,231	7.7%	7.7%
01 DISTRIBUTION	29,860,339	5,257,705	4.5%	5.0%
LUCKY RED DISTRIB.	35,393,152	5,766,221	5.4%	5.5%
EAGLE PICTURES S.P.A.	21,461,876	3,527,591	3.2%	3.4%
BIM DISTRIB. S.R.L.	11,524,222	2,009,031	1.7%	1.9%
NOTORIOUS PICT. S.P.A.	10,384,403	1,868,615	1.6%	1.8%
M2 PICTURES S.R.L.	9,526,992	1,613,621	1.4%	1.5%
Altri	50,607,860	8,624,666	7.7%	8.2%
Total	301,037,885	48,778,952	45.5%	46.3%

2017: Rich Releases Despite Some Delays

Distribution. On the distribution front, LFG distributed 22 films during 2017, including George Clooney’s *Suburbicon*, *Saw: Legacy* and Luc Besson’s *Valerian*. We note that 10 films (*Tulip Fever*, *The Shack*, *Billionaire Boys Club*, *Rebel in the Rye*, *Marrowbone*, *No Exit*, *Based on a True Story*, *Soldado*, *Les Nouvelles Aventures d’Aladin* and *Stronger*) that were expected to be distributed in the second part of 2017 have been postponed to 2018 due to both commercial reasons and delays in foreign film productions. On the other hand, the film *Wonder* - which sees Julia Roberts as leading actress - was released in advance at the end of 2017 for a total cash in of €12.1mn up to March 4, 2018.

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

Chart 1: Some Films Distributed during 2017



Note that *Valerian* has already hit the theaters.

Source: Company data

Production. As for the upstream, the executive production of the TV series *Immaturi* was completed during 2017, and *Innamorati di Me* was released on SKY in September. *The Place*, directed by Paolo Genovese, was filmed in July, and September saw the beginning of the production of Gabriele Muccino’s *A Casa Tutti Bene*, which has been released in February 2018 for a total cash in of €8mn up to March 4, 2018. We highlight that the pipeline also includes international TV series (not included in the 2017-2019 Business Plan) such as Stefano Sollima’s *Colt* (based on an original idea of Sergio Leone) and Giuseppe Tornatore’s *I Beati Paoli*. We note also that production has been affected by some delays, as the movies *Hotel Gagarin* and *Notti Magiche*, which were scheduled to be released in the second half of 2017, have been postponed to 2018.

Still concerning the upstream, we note that in February the Company signed exclusive rights with Mr. Paolo Genovese relating to the famous Italian director’s artistic performance during the period 2019-2023. The agreement will enter into force on the expiry date of Mr. Genovese’s current contract with Lotus Production. The artistic director will receive compensation in the form of

both cash and treasury shares. In detail, Mr. Paolo Genovese will obtain a stake in LFG over the next 2 years. Shares will be subject to: i) 5 years' lock-up and ii) pre-emptive and drag-along rights in favor of Mr. Andrea Leone and Ms. Raffaella Leone. For the time being, Mr. Genovese has received 140,935 shares, equal to a 1.0% stake.

Estimates Review: Fine-Tuning of LFG'S BP

On January 31, 2018, LFG disclosed its FY17 preliminary results. We fine-tuned our expectations on pre-money basis, substantially increasing the company's top-line on the back of the growing international executive production business and the strong pipeline. We increased 2018 Revenues by 72.1% (from €66.42mn to €114.29mn) and 2019 Revenues by 88.1% (from €66.7mn to €125.5mn) mostly due to the executive production contribution.

The executive production for international clients is expected to keep on growing in the coming years. Indeed, 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. It is worth mentioning that this business is characterized by a lower level of margins, penalizing LFG EBITDA margin, but at the same time the absence of financial risk and D&A has a positive effect on EBIT. For this reason, we increased our expected 2017 EBIT by 10.5% from €5.70mn to €6.30mn. On the other hand, we lowered 2017 Net Income in order to take into account the negative impact of the mark-to-market of the currency hedge. We increased 2018 and 2019 EBITDA by around 8.0% and increased 2018 and 2019 EBIT by around 11.0%. Net Income for 2018 and 2019 have been increased by less than EBIT, since we still expect some negative contribution from the currency hedges.

Table 4: LFG's FY17-19BP vs KT&P's Estimates

€ thousand	2016A	2017E Old	2017E New	Change	2018E Old	2018E New	Change	2019 Old	2019 New	Change
Revenues	54.70	60.59	98.59	62.7%	66.42	114.29	72.1%	66.7	125.5	88.1%
YoY Change (%)			80.2%		9.6%	15.9%		0.5%	9.8%	
EBITDA	23.50	26.88	26.65	-0.9%	30.01	32.44	8.1%	33.4	36.1	8.0%
YoY Change (%)			13.4%		11.6%	21.7%		11.5%	11.4%	
EBIT	3.00	5.70	6.30	10.5%	8.28	9.23	11.5%	10.3	11.4	11.2%
YoY Change (%)			110.0%		45.2%	46.5%		24.2%	23.8%	
Net Income	1.80	3.06	2.97	-2.8%	4.85	5.01	3.2%	6.3	6.6	4.8%
YoY Change (%)			65.2%		58.5%	68.4%		30.2%	32.1%	
Net Debt	32.30	47.00	40.80	-13.2%	51.00	45.00	-11.8%	51.0	45.0	-11.8%
YoY Change (%)			26.3%		8.5%	10.3%		n.a.	0.0%	

Source: Company data and KT&Partners' estimates

Valuation

Given the level of seasonality that characterizes this business (which includes b.o. 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 represent the real 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 5: 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	4,962	2.22	15.54	27.65	n.m.
Entertainment One Ltd.	London	1,515	1.55	9.68	9.88	13.03
EuropaCorp SA	Euronext Paris	92	2.18	5.00	n.m.	n.m.
Eros International PLC Class A	NYSE	685	3.35	10.66	12.91	23.20
Avg. International Peer Group		1,814	2.33	10.22	16.81	18.12
Leone Film Group SpA	Milan	64	0.91	3.22	11.32	12.72
Lucisano Media Group S.p.A.	Milan	33	0.68	1.84	3.28	2.97
Notorious Pictures S.p.A.	Milan	25	0.91	2.34	5.99	10.70
Avg. Italian Peer Group		29	0.80	2.09	4.63	6.84
Leone Film Group SpA	Milan	64	0.91	3.22	11.32	12.72

Source: KT&Partners' elaboration on Factset data

Table 6: 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	4,962	2.07	13.63	21.94	31.36
Entertainment One Ltd.	London	1,515	1.44	8.74	8.81	11.77
EuropaCorp SA	Euronext Paris	92	2.20	4.85	n.a.	n.m.
Eros International PLC Class A	NYSE	685	2.67	8.31	9.33	16.29
Avg. International Peer Group		1,814	2.09	8.88	13.36	19.81
Leone Film Group SpA	Milan	64	0.83	2.89	9.14	9.63
Lucisano Media Group S.p.A.	Milan	33	n.a.	n.a.	n.a.	n.a.
Notorious Pictures S.p.A.	Milan	25	0.86	2.21	4.90	8.71
Avg. Italian Peer Group		29	0.86	2.21	4.90	8.71
Leone Film Group SpA	Milan	64	0.83	2.89	9.14	9.63

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 €6.39ps and €6.68ps, respectively. We took the average and **we set €6.54ps as a fair value.**

Table 7: Multiples Valuation

Multiple Valuation (€mn)	2018E	2019E	Average
EV/EBIT multiple comparison			
Peer Group EV/EBIT netted from 15% liquidity discount	14.29	11.36	
LFG EBIT	9.23	11.43	
Enterprise value	131.91	129.81	
LFG Net Debt FY17	40.80	40.80	
Equity Value	91.11	89.01	
Number of shares (mn)	14.09	14.09	
Value per share	6.46	6.32	6.39
P/E multiple comparison			
Peer Group P/E netted from 15% liquidity discount	15.40	16.83	
LFG earnings	5.01	6.61	
Market Cap	77.09	111.34	
Number of shares (mn)	14.09	14.09	
Value per share	5.47	7.90	6.68
Fair Value (Avg.) - € ps			6.54

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