

Initiation of coverage

Buy

18 November 2016 – 5:30 PM

MARKET PRICE: EUR1.16

TARGET PRICE: EUR2.39

Entertainment

Data

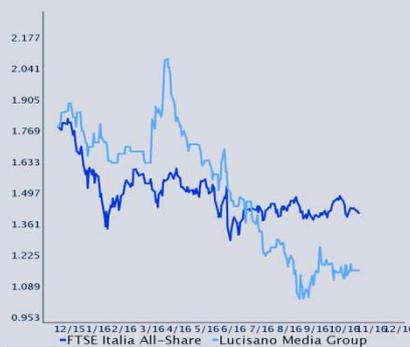
Shares Outstanding (m):	14.88
Market Cap. (EURm):	17.24
Enterprise Value (EURm):	39.98
Free Float (%):	12.5%
Av. Daily Trad. Vol. (m):	0.01
Main Shareholder:	Lucisano family 88.1%
Reuters/Bloomberg:	LCMG.MI LMG IM
52-Week Range (EUR)	1.0 2.1

Source: Factset, UbiBanca estimates

Performance

	1m	3m	12m
Absolute	-2.6%	-8.0%	-34.5%
Rel. to FTSE IT	-2.0%	-8.0%	-13.4%

Graph area Absolute/Relative 12 M



Source: Factset

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Unwarranted hard discount

We initiate coverage of Lucisano Media Group (LMG) with a Buy rating and target price of EUR2.39. The shares have sharply underperformed the market and the movie industry since the beginning of the year but we believe the share price trend is not related to the company performance. In fact, the deterioration in fundamentals in 2016 (we expect sales to fall 17% and the bottom line to decline by 20%) is due to postponement of an important TV production and is nonetheless compensated by an EBITDA margin increase. We expect a strong improvement next year sustained by a higher weight of TV and movie production (which generate higher margins) backed by an attractive pipeline. As a result, with the share price close to a historic low, we believe now is the perfect time to acquire a shareholding in the growing entertainment industry. The main risks for the company are the low visibility of future box office revenues and the presence of few key people managing the group.

- > With over EUR50 million sales, LMG is a leading movie company active in three businesses: production of movies and TV products (44% of revenues), distribution (10% of sales) and management of multiplex theatres (27% of revenues) while the residual 20% is represented by tax credits and other contributions. LMG, 88% controlled by the founder's family which still manages the company, was listed in 2014 at EUR3.50 per share raising EUR6 million.
- > We expect a slowdown in 2016, as important productions were delayed to 2017, with declining revenues (-17%) and bottom line (-20%). However, a strong recovery is expected for 2017: we anticipate top line growth of about 76% driven by new productions (8 movies and 4 TV fictions), with EBITDA approaching EUR30 million which could lead to a bottom line of >EUR8 million. Net debt is expected to grow significantly due to the new productions, reaching EUR38 million at Dec-17 (vs. EUR27 million at Dec-15).
- > We believe that the current market price reflects very negative expectations or stagnation at both top line and EBITDA, a scenario which is improbable in our view. In fact 2017 presents a high visibility, due to the advanced stage of 2017 production plans. Our target price, based on a DCF, a SOP and a multiple comparison offers >100% upside. Buy.

Financials	priced on 17 November 2016			
	2015	2016E	2017E	2018E
Revenues (EURm)	50.74	42.01	74.14	77.62
EBITDA (EURm)	20.17	18.06	29.32	32.92
EBITDA margin (%)	39.8%	43.0%	39.5%	42.4%
EBIT (EURm)	7.56	7.97	14.86	18.56
EPS (EUR)	0.34	0.27	0.58	0.78
CFPS (EUR)	0.76	0.95	0.85	2.24
DPS (EUR)	0.07	0.05	0.11	0.15

Source: Company Data, UBI Banca Estimates

Ratios	priced on 17 November 2016			
	2015	2016E	2017E	2018E
P/E(x)	7.9	4.3	2.0	1.5
P/CF(x)	2.2	1.2	0.7	0.7
P/BV(x)	1.5	0.6	0.5	0.4
Dividend Yield	2.6%	4.3%	9.5%	12.9%
EV/EBITDA(x)	3.4	2.2	1.9	1.5
Debt/Equity (x)	1.0	0.7	1.0	0.7
Debt/EBITDA (x)	1.3	1.2	1.3	0.9

Source: Company Data, UBI Banca Estimates

Key Financials

(EURm)	2015	2016E	2017E	2018E
Revenues	50.74	42.01	74.14	77.62
EBITDA	20.17	18.06	29.32	32.92
EBIT	7.56	7.97	14.86	18.56
NOPAT	5.07	5.34	9.96	12.43
Free Cash Flow	3.69	7.03	-15.72	8.73
Net Capital Employed	52.94	50.46	74.84	77.64
Shareholders' Equity	25.87	28.87	36.79	46.69
Net Financial Position	26.97	21.49	37.95	30.85

Source: Company data, UBI Banca estimates

Key Profitability Drivers

	2015	2016E	2017E	2018E
Net Debt/Ebitda (x)	1.3	1.2	1.3	0.9
Net Debt/Equity (x)	1.0	0.7	1.0	0.7
Interest Coverage (%)	4.5	8.0	13.5	23.2
Free Cash Flow Yield (%)	9.3%	40.7%	nm	50.6%
ROE (%)	19.4%	14.0%	23.6%	24.7%
ROI (%)	9.1%	9.6%	14.9%	15.4%
ROCE (%)	9.8%	10.3%	15.9%	16.3%

Source: Company data, UBI Banca estimates

Key Valuation Ratios

	2015	2016E	2017E	2018E
P/E (x)	7.9	4.3	2.0	1.5
P/BV (x)	1.5	0.6	0.5	0.4
P/CF (x)	2.2	1.2	0.7	0.7
Dividend Yield (%)	2.6%	4.3%	9.5%	12.9%
EV/Sales (x)	1.2	0.8	0.6	0.5
EV/EBITDA (x)	3.4	2.2	1.9	1.5
EV/EBIT (x)	9.0	5.0	3.8	2.7
EV/CE (x)	1.3	0.8	0.8	0.6

Source: Company data, UBI Banca estimates

Key Value Drivers

(%)	2015	2016E	2017E	2018E
Payout	20.7%	18.4%	18.9%	19.3%
Cost of Equity	9.4%	9.4%	9.4%	9.4%
NWC/Sales	25.8%	31.4%	28.0%	19.3%
Capex/Sales	13.0%	14.9%	31.1%	26.3%

Source: Company data, UBI Banca estimates

Investment Case

LMG is a leading operator in Italian movie industry. The company produces and distributes movies for both cinema and TV (fictions, series and mini-series), acquires full rights of foreign movies, lasting 16-18 years, distributing them through all available channels (cinema, Pay TV, Free TV, home video, new media), and controls 56 screens in the Centre and South of Italy. LMG, therefore, is a fully integrated independent player with an excellent box office track record.

LMG's share price has fallen 34% in the last twelve months (and -67% since the listing in July-14) and is now discounting worsening fundamentals for next year. Such a scenario is, in our view, improbable. Our optimism stems from:

- > The dynamism and the proactive attitude of the top management (namely Federica Lucisano and her sister Paola Lucisano) is dedicated to a continuous evolution of LMG's business model in order to take advantage of all possible sales channels to strengthen its competitive position, while simultaneously trying to lower the overall financial risk. Recent examples are a new JV between Italian independent producers and Sky to guarantee the distribution and the subsequent sale to Sky of several movies p.a., new high-budget TV productions with international standing and the acquisition of new international movies;
- > The developments for next year are strongly visible, due to the advanced stage of 2017 production plans, and should allow a rapid sales recovery in future, with the EBITDA margin remaining well above 30%;
- > Increased focus on the Production division should gradually enhance the product mix, with a significant boost to margins. The average EBITDA margin of the Production division is >50% compared to around 45% for Distribution and around 20% for the Multiplex division. In addition, the higher weighting of TV productions, which are sheltered by broadcasters, should reduce the overall financial risk;
- > Hidden value: we refer mostly to the existing film library (255 movies with a book value of almost EUR15 million, or EUR1.0 per share) which secure revenues for around EUR2.5 p.a. at no cost;
- > Solidity: the company has a solid financial structure (gearing of 1.0x, net debt/EBITDA of 1.3x) with the majority of its financial debt already renegotiated (EUR40 million up to 2024);
- > LMG's core markets have been substantially positive over the past few years with box office and admissions broadly flat, despite the economic downturn. We believe this trend will continue in future, sustained by favourable tax credits and subsidies increased by the recent cinema law: EUR400 million p.a. of fresh resources (+60%) should be available from 2017 for film industry.

Consequently, we believe this to be the ideal time to gain exposure to LMG: as soon as the company demonstrates a convincing improvement in the top line (rich pipeline ahead) and profitability, the subsequent share price appreciation could be very rapid and very substantial.

We initiate coverage with a Buy rating and a target price of EUR2.39 per share (based on a DCF, a SOP and a multiple comparison and applying 30% liquidity discount), which implies potential upside of >100%.

The company is exposed to few risks, mostly related to the low visibility of future box office revenues and the presence of few key people managing the group.

Company profile

Lucisano Media Group (LMG) is the only independent integrated player in movies and TV products in Italy. Founded in 1958 by Fulvio Lucisano, one of the most famous film producers in Italy, with focus on comedies and “spaghetti westerns”, the company has to date produced 150 movies and distributed >500 foreign movies in Italy with an excellent box office track record and has a library of 255 films. LMG movies have won many prizes, including two Oscars and 12 Oscar nominations.

Figure 1 – LMG main productions and box office results

Film production	Year	Box office (EUR000)
Notte prima degli esami	2005	12.469
Notte prima degli esami oggi	2006	12.117
Ex	2009	10.628
Maschi contro femmine	2010	13.612
Femmine contro maschi	2011	11.585
Ex - amici come prima	2011	5.000
Nessuno mi può giudicare	2011	8.606
Viva l'Italia	2012	5.297
Mai stati uniti	2013	5.720
Confusi e felici	2014	3.732
Scusate se esisto	2014	5.478
Noi e la Giulia	2015	4.036
Io che amo solo te	2015	3.381
Se mi lasci non vale	Jan-16	2.227

Source: Company data, Mymovies, Cinetel

In 1996 LMG entered the multiplex industry and in 2006 it acquired Stella Film, a large multiplex operator in the South of Italy, and is currently managing 56 screens with nearly 10,000 seats.

LMG has 73 employees, of which around 50 work in the multiplex division. In addition, the company employs temporary and free-lance workers.

Figure 2 – Short history of the company

1958	Founding Italian International Film
1960	Movie production and co-production
1970	Production of Italian comedies and Spaghetti Westerns
1980	Distributing Metro Goldwyn Mayer movies in Italy
1990	Distributing Polygram filmed Entertainment movies in Italy
1995	Founding IIF Homevideo
1996	Entering in the multiplex sector
2001	Entering in the TV production
2002	Distributing Columbia Tristar Motion Pictures movies in Italy
2003	Fedrica Lucisano appointed CEO of IIF and chairman of Lucisano
2006	Acquisition of Stella Film
2008	First co-production with Walt Disney, distributing NU Image movies in Italy
2014	Listing on the AIM market at EUR3.50 per share

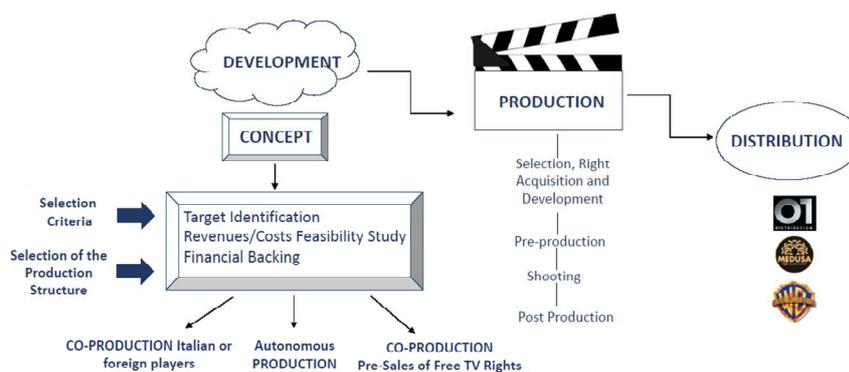
Source: Company data, UBI Banca estimates

The company is divided into 3 business units:

> **Production**, which accounted for 64.6% of 2015 revenues with an EBITDA margin of nearly 50%. This division is composed of both Movie and TV production.

Movie production. LMG manages the entire production cycle, from development of the “concept” through to distribution with major partners (with revenue-sharing agreements). Pre-production, lasting up to two years, is crucial as this phase includes the selection of the film director and the founding of the production. A large part of the production budget can be funded before investment costs for production are incurred, due to the sale of co-production shares and distribution rights (also outside Italy) and the attractive tax credit arrangements in Italy (up to 50% of the production costs plus any potential regional subsidies). As a result, production investments are generally limited to less than the half of the production costs 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 one year. Finally, LMG sustains the so-called P&A costs (mostly advertising, which is not capitalized) to launch the movie which can account for 20-25% of the total production budget. We should point out that LMG developed “The Factory” signing multi-year exclusive contracts with two of Italy’s most successful film directors: Massimiliano Bruno (“Nessuno mi può giudicare”, “Viva l’Italia”, “Confusi e felici”, “Beata ignoranza”) and Edoardo Leo (“Buongiorno papa”, “Noi e la Giulia”, “Che vuoi che sia”).

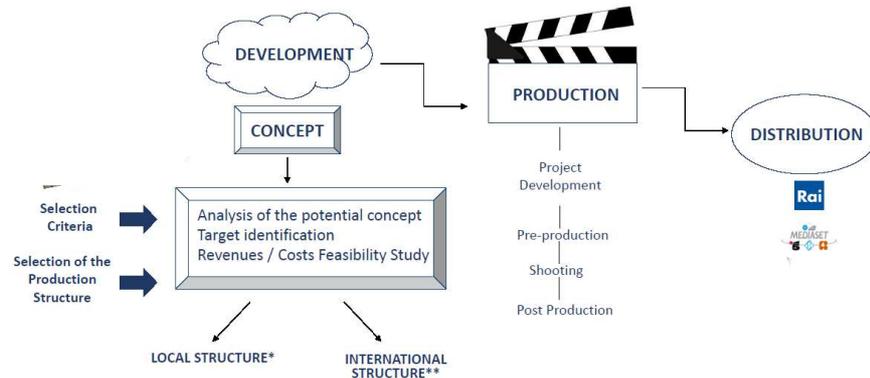
Figure 3 – Movie production: business model



Source: Company data

TV production. TV productions have a different business model, as the production is 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, the risk for the producer is minimal. In the case of international production, the producer owns part of the rights and covers part of the production costs.

Figure 4 – TV production: business model



Source: Company data

> **Distribution** (9.1% of 2015 sales with an EBITDA margin of almost 40% in 2015). LMG not only distributes its own productions, but also acquires full rights for film titles for the Italian market lasting 16-18 years, from independent production companies in the US and in Europe, 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 LMG 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 EUR10k to over EUR1 million, depending on the standing of the movie. In addition, the producer is entitled to receive royalties based on box office revenues, known as “bumps”, if a given threshold of revenues is exceeded. The MG is capitalized by LMG as an intangible asset and amortized over the exploitation period (based on the revenues reported each year compared with the original sales budget). After sustaining the expenses for dubbing the film (around EUR50k per movie, also capitalized) and P&A costs the movie is ready for theatrical distribution, which generally last 2 months. LMG does not distribute movies directly but signs revenue-sharing agreements with major distributors in Italy, such as 01 Distribution (Rai), Medusa and Warner Bros. As box office revenues are typically divided between the movie theatre (60%) and the distributor (40%), and revues sharing agreements are generally set at 50%, we can estimate cash inflow for LMG at about 20% of the box office. It is important to stress that LGM controls the third-largest movie theatre chain in Italy and this can be a useful help for the success of the movie. Four months following the termination of theatre distribution, LMG begins Home video distribution (though this now represents a minimal part of LMG’s revenues) and the exploitation of full rights on Pay and Free TV channels which represent a significant proportion of expected revenues (EUR7.9 million in 2015, representing 15.5% of consolidated sales). The company has agreements with Sky Italia to license the exclusive rights on several movies and with RAI Cinema, and it is looking for an agreement with Netflix (which pay around 5% of the box office result), 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 less than 10%.

- > **Multiplex**, representing 27% of revenues in 2015. This division, operating through Stella Film (100% controlled, but still managed by the founder, Mr. Stella) manages seven multiplex cinemas (of which two directly owned in Rome and Brindisi, with a book value of EUR19.2 million with EUR7.1 million of remaining mortgage payments at Dec-15) for a total of 56 screens and nearly 10.000 seats in the South of Italy (6 multiplex) and in Rome. Strategically, multiplex theatres allow LMG to reach the final customers, in support of directly produced movies, while simultaneously moderating the relative unpredictability of the results of the production and distribution activities. Over the past four years LMG has reported revenues of about EUR0.24 million per screen (including ancillary services such as merchandise sales, advertising, food & beverage, parking, alternative events) compared with an average of EUR0.19 million in Italy (3,353 screens in 2015 with 1,151 cinemas – *source: Anica*). In addition, LMG programs and broadcasts contents to 77 screens in the South of Italy. EBITDA margin for Multiplex division has been stable in the past, with an average of 19.6% (23.6% in 1H16) while revenues have grown at a CAGR of 1.87% in 2012-15. We also highlight that Multiplex is a deferred tax assets source as VAT on box office revenues stands at 10% compared with 22% VAT on purchasing as a whole.

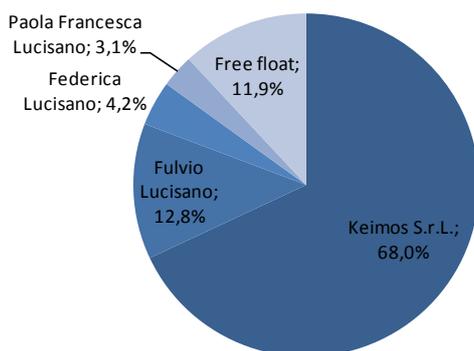
Altogether, LMG is able to generate profit along the whole value chain, diversifying the overall risk (production costs fully covered before shooting) and optimizing its investments with a target EBIT margin of 20-25% at the consolidated level (vs. 14.9% in 2015 and 18.3% in 1H16).

Shareholder structure

LMG was listed on the Milan Stock Exchange, in the AIM segment, in July 2014 at EUR3.50 per share, raising EUR6.4 million of fresh financial resources. The company is controlled by the founder's family (Lucisano, directly and through Keimos S.r.L., a company fully controlled by the family) with a 88.1% stake, so free float is therefore limited to 11.9%. The Lucisano family is directly involved in managing the company with the founder, Mr. Fulvio, serving as Chairman, while one daughter, Federica, is the group's CEO and another daughter, Paola Francesca is a Board member. The board of directors is composed of four members, one of whom is independent; the total remuneration of the board is EUR0.38 million p.a.

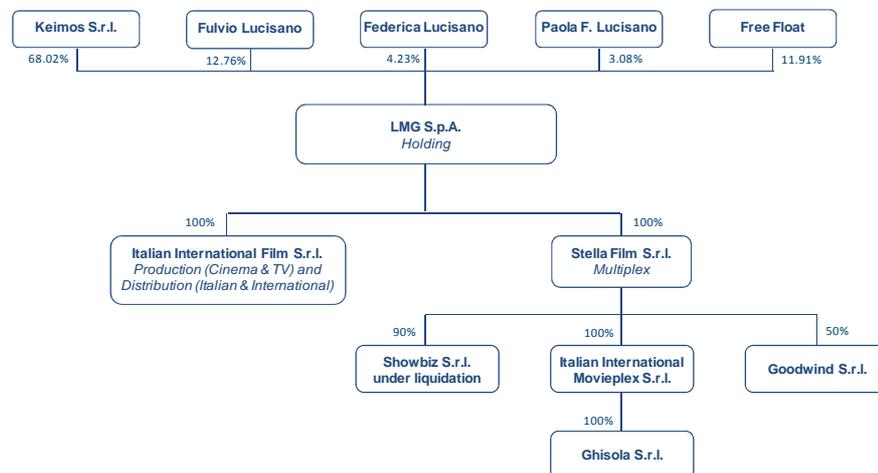
The shareholders' meeting in April-15 approved a 18-month buyback program of up to 2.02% of the share capital. Currently LMG has 22k treasury shares (representing 0.15% of the share capital).

Figure 5 – Shareholder structure



Source: Company data

Figure 6 – Company structure



Source: Company data

Key people

LGM has 73 employees, 2 of whom are managers, and a board of four directors which includes three members of the Lucisano family. Clearly, for an integrated movie player such as LMG, the company's team is its most valuable asset. The CEO, Federica Lucisano (head of foreign acquisitions since 1992, head of movie production since 2006, CEO since 2003), and executive director Paola Francesca Lucisano (head of TV productions since 2000) 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 new contracts for new TV productions.

Strategy

We are impressed by the dynamic approach of Federica Lucisano and his sister Paola Lucisano to the movie industry. The company is constantly evolving its business model in order to take advantage of all possible sale channels to strengthen its competitive position, while simultaneously trying to lower the overall financial risk. In this respect, we highlight the investments in the multiplex business (acquisition of Stella Film in 2006), which lowered the cyclicity of sales, the entry into TV productions (in 2001) and the subsequent upgrade to international TV productions currently underway, the creation of a factory for new talent, the development of international co-productions and the scouting of new libraries and new product placements. While this multi-approach strategy has proven to be successful (sales CAGR of >8% in 2012-15, EBIT CAGR close to 40%, net result moving from less than EUR1 million in 2012 to >EUR5 million last year and net debt down to EUR27 million at Dec-15 compared with EYR43 million at Dec-12) we are concerned that the group might have too many irons in the fire, with the risk of wasting human resources.

The company's strategy may be outlined as follows:

- > **Increasing the number and the reputation of TV productions.** Since 2000, when LMG entered the TV production industry, it has completed 16 productions. 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 12-15%, and, where specified, part of the distribution rights. The company is now moving further forward, starting TV productions for both Italy and the international market. The risk for the producer is higher (international TV productions are generally partially funded by the producer) but returns are generally higher. In addition, with international co-productions generating revenues abroad and increasing geographical diversification, the risk of relying only on the Italian market will be reduced while international co-production could increase LMG's attractiveness to international companies such as Sky and Netflix. A good example is "les Italiens", a new co-production with Space Rocket Nation with a high budget and an international cast directed by Nicolas Winding Refn ("Pusher", "Drive", "Only God forgives", "The Neon Demon").
- > **Acquisition of foreign movie rights with a higher production budget.** The targets will be comedy, family, thriller, drama and animation movies with an average of four foreign movies distributed each year. Based on our

assumptions, every high-standing movie could generate an average box office of about EUR3 million (compared with an average box office in Italy of EUR1.4 million in the past three years) thus translating into distribution sales of about EUR5 million to be shared with the downstream distribution partner (01 Distribution, M2 Pictures, Koch Media and others). LMG does not rule out the option of movie distribution without partnering-up with other downstream distributors in future. In this way, the company would control the entire value chain, although the average investment for each movie would be likely to increase;

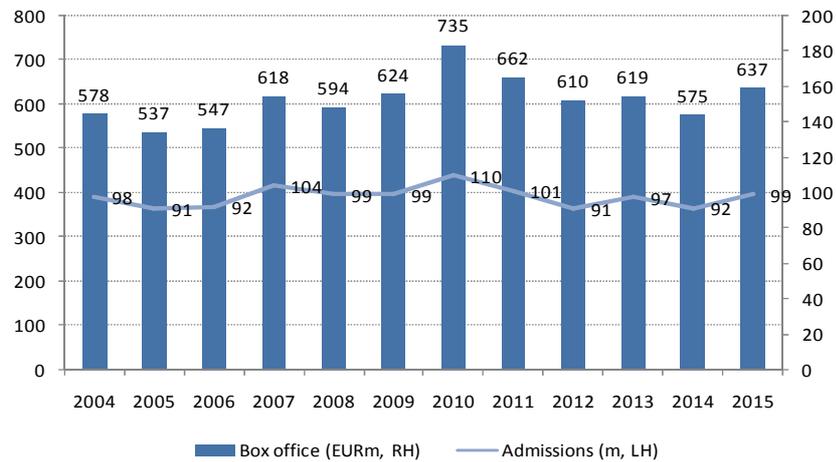
- > **Develop the recent JV with other Italian independent producers and Sky.** At the end of August, LMG signed an agreement with Sky Italia, Cattleya, Indiana, Palomar and Wildside (all independent Italian producers) to form a new distribution company (70-80% owned by Sky, with each independent producer including LMG holding 5%). The idea is to guarantee the distribution and the subsequent sale to Sky of several movies p.a. with the JV having the right of first run. Although the impact on LMG's P&L is likely to be negligible, we believe this is a positive step to create synergies amongst independent producers which should reduce P&A costs, while the partnership with Sky could increase the visibility of high quality Italian movies outside the domestic market;
- > **Acquisition of new libraries.** LMG currently owns a library of 255 movies, of which around 150 were directly produced (and therefore with rights in perpetuity). The company stated a target to acquire new libraries at the time of the IPO, but for the time being no deals have been made;
- > **Upgrading of the existing Multiplex.** LGM has invested heavily in the past few years in its multiplex (7 cinemas with 56 screens plus the management of a further 71 screens in the South of Italy) providing up-to-date technologies (IMAX projection system, Dolby Atmos, satellite projectors, 3D) to several screens. Continuing investment to upgrade these assets is likely in the future and the company does not rule out the possibility of new acquisitions in the Centre and South of Italy, although it has excluded new real estate acquisitions (LMG currently owns the property of two cinemas with a net book value of EUR19.2 million).
- > **Develop the "The Factory".** LMG has always invested in new talent and the company currently has exclusive contracts with two of the most successful Italian filmmakers (Massimiliano Bruno and Edoardo Leo) who have already directed several movies for LMG with positive box office results. We expect this trend to continue in future with the addition of partnerships with new young talent.

Reference market

With 473 movies released, of which 187 were Italian, admissions of nearly 100 million (1.5 admission per person per year) and box office revenues of EUR637 million in 2015 (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 of movies released offset by lower admission (about 210k per movie compared with 324k in 2010). The trend was also positive in 2016: admissions increased by 9% in the first ten months of the year and box office receipts rose by 7.6% (source: Ministry of cultural heritage).

Figure 7 – Box office and admissions in Italy (000, EURm)

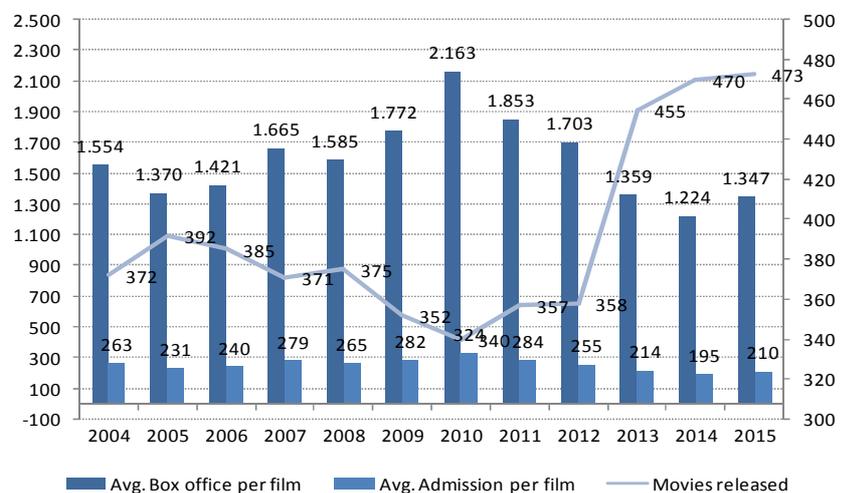
Admissions have historically been relatively stable, with an average ticket of EUR6.41 in 2015 compared with EUR5.90 ten years ago



Source: Cinetel

Figure 8 – Movies released, box office and admissions in Italy – average per movie (000)

Following 5 years of slowdown, both admission and box office sales per movie rose in 2015. 473 movies were released during the year (470 in 2014) with an increase of 10.8% at the box office.



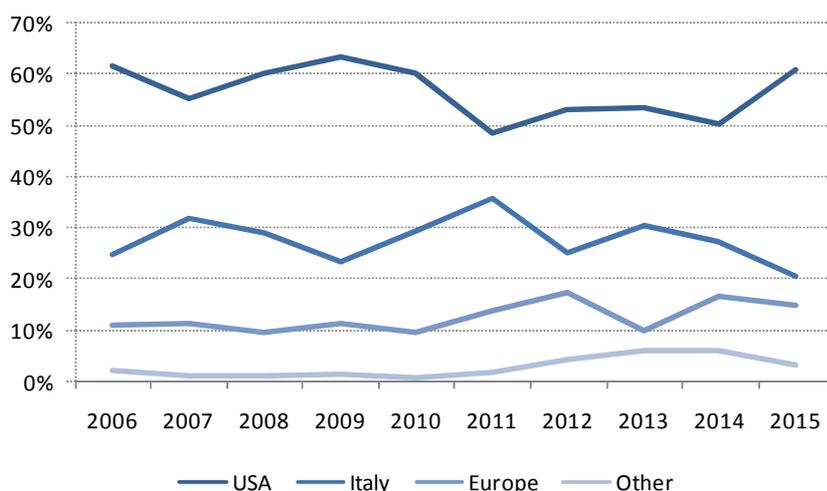
Source: Ubibanca on Cinetel data

It is important to highlight that seasonality is a significant feature of the movie industry: of 99.3 million admissions in 2015, 33% were in the first quarter, 19% in the second quarter, just 16% in the third quarter and the residual 32% in the last quarter of the year, with December and January (Christmas season) as the strongest months of the year, representing >25% of total admissions.

US movies represented more than 60% of total box office in 2015, with a rising trend while Italian film revenues accounted for 20.7% of the total last year, down from 2014 (27.2%) which was lifted by the blockbusters “Un boss in salotto” and “Il ricco, il povero e il maggiordomo”.

Figure 9 – Movie sales market share by country

US movies have always accounted for the lion’s share of Italian cinema attendance with an average of 57% in the past ten years. Italian movies represented 28% on average (2006-2015) but fell sharply last year to 20.7% (the worst year since 2006).



Source: Anica

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 potential global size.

Production

With 185 films in 2015, Italy ranks tenth position in the world for movies produced – a ranking 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 with EUR275 million coming from Italian initiatives (135 movies) and EUR64 million from foreign initiatives (50 movies, mostly French), with 6% increase compared to 2014. However, the average production cost per movie has declined in recent years.

Figure 10 – 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

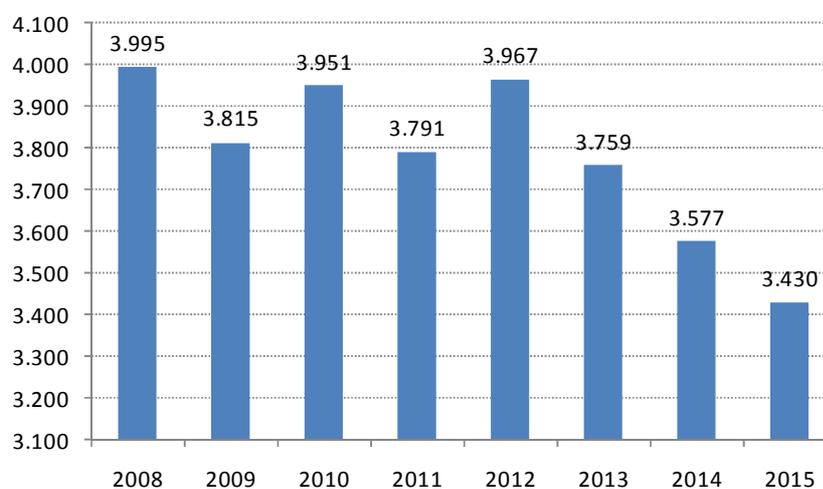
Source: Anica

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 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%.

As for TV productions and distribution, there was a sharp decline in movies broadcast by free generalist TV in 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. This represents a clear advantage for LMG, which distributes mostly Italian movies. Italian fictions (about 30% of total TV production investment) declined sharply over the past few years (we estimate investments halved from 2008) and are now totally focused on prime time.

Figure 11 – 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 fictions, mini-series and entertainment programs. Italian movies were 37% of total.

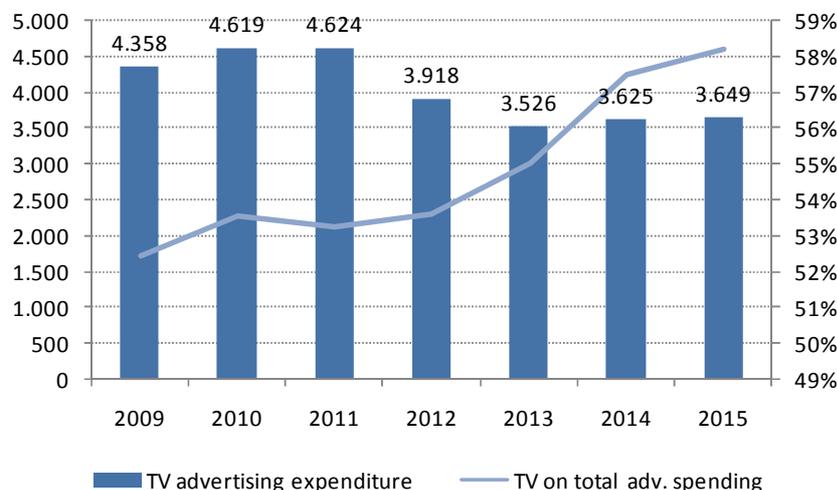


Source: Anica

However, according to Nielsen, TV advertising spending has declined significantly since 2012 (-13.5%) which has reduced the investment capacity of the broadcasters. The positive news is that TV advertising spending increased as a proportion of the total Italian advertising market and we believe that this should indicate that investment in TV productions should remain stable or grow in the future.

Figure 12 – TV advertising spending and penetration on total advertising 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 >58% of total advertising spending in Italy.



Source: Nielsen

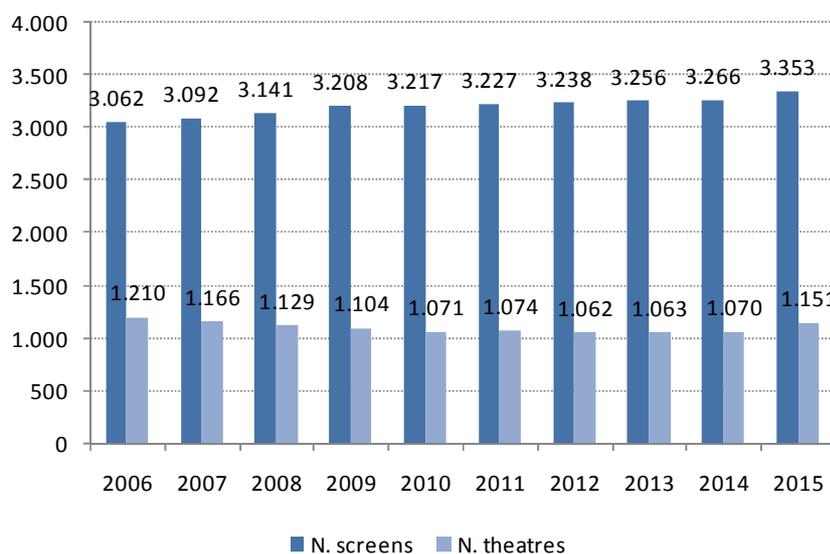
It should be clarified that pay TV has particular characteristics: In Italy, growing competition between the two existing operators (Sky Italia and Mediaset Premium) has led to an increase in the selection of films, with consistent growth in the number of screenings to around 50,000 in 2015, with a screening 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 last year, Cubovision (TIM) and Chili.

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.

Theatrical distribution

Theatrical distribution is the main distribution channel for films, with box office revenues of >EUR38 billion worldwide in 2015 with strong growth due largely to China, which grew an astounding 49%. Italy, the fourth biggest European market after France, the UK and Germany, generated theatrical revenue of about EUR637 million in 2015 (with an average ticket price of EUR6.4), including both box office and other services (source: Anica, Cinetel, SIAE), with 1,151 movie theatres accounting for a total of 3,353 movie screens (source: Cinetel). It is encouraging that new cinemas were opened in the past two years (+88 units or +8.3% vs. 2013) with a progressive increase in the penetration of multiplex and megaplex theatres, equipped with an ever-increasing number of screens and therefore able to provide spectators with a broader range of films to watch (while offering new amenities, such as food and drinks) which helps prolong the length of the exhibition period of films on general release. This trend has increased the number of screens by 97 units since 2013 (+3%) and by 291 since 2006 (+9.5%) with the global average per movie theatre now at 2.9 compared with 2.5 in 2006 (source: Cinetel). LMG controls 56 screens, or 1.7% of the existing screens in Italy.

Figure 13 – Movie theaters and screens in Italy



Source: Anica, Cinetel, SIAE

Competitive positioning

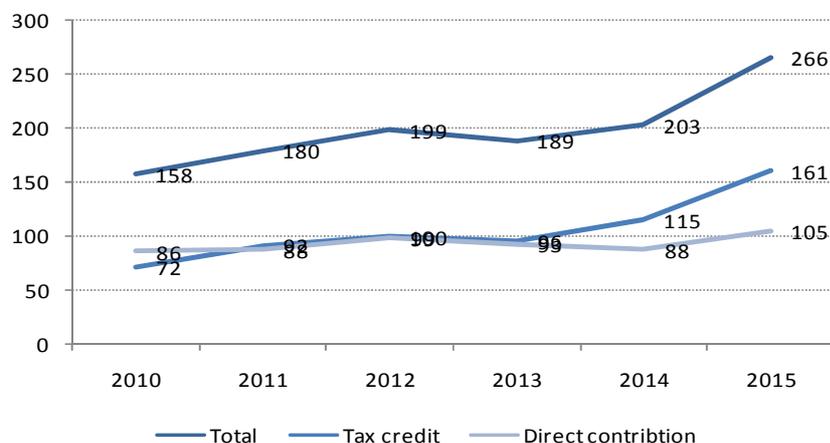
LMG has more than 50 years of history and has progressively gained market share in the Italian motion picture industry while entering new business sectors. We currently estimate the following market share for LMG:

- > **Film production:** the 4 movies released in 2015 by LMG generated box office revenues close to EUR12 million, about 1.9% of the total Italian box office last year. If we consider just Italian movies, LMG's market share amounted to 9.1% (compared with an average of 8% in the past five years), with all the movies ("Noi e la Giulia", "Io che amo solo te", "Gli ultimi saranno gli ultimi" and "Tutte lo vogliono") ranking within the top 100 (39th, 46th, 72th and 92th respectively). In the first half of 2016 LMG released one movie ("Se mi lasci non vale") with a box office of EUR2.3 million;
- > **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. In 2015 LMG reported sales from TV productions of EUR8.8 million (17.3% of consolidated sales), with a strong increase vs. 2014 (+45%) and more than the double those of 2013 (when sales were EUR3.8 million, or 10.8% of consolidated sales);
- > **Distribution:** LMG does not distribute directly but through revenue-sharing agreements with major distributors, in particular O1 Distribution (RAI) Medusa (Mediaset), Warner Bros and M2 Pictures. Aggregating the box office revenues of both directly produced films and those acquired abroad gives total revenues of about EUR17.4 million revenues in 2015, corresponding to a market share of around 2.7%, 8th place in the global ranking and second with independent distributions (with Lucky Red as the first one);
- > **Multiplex:** with 56 screens and 9,684 seats, LMG is the third largest operator in Italy for screens after UCI Cinemas and The Space. Based on box office revenues, we can estimate a national market share of around 2.1%.

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, of which 60% tax credits, with a growing trend in the past few years (Italian government expects EUR1701 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.

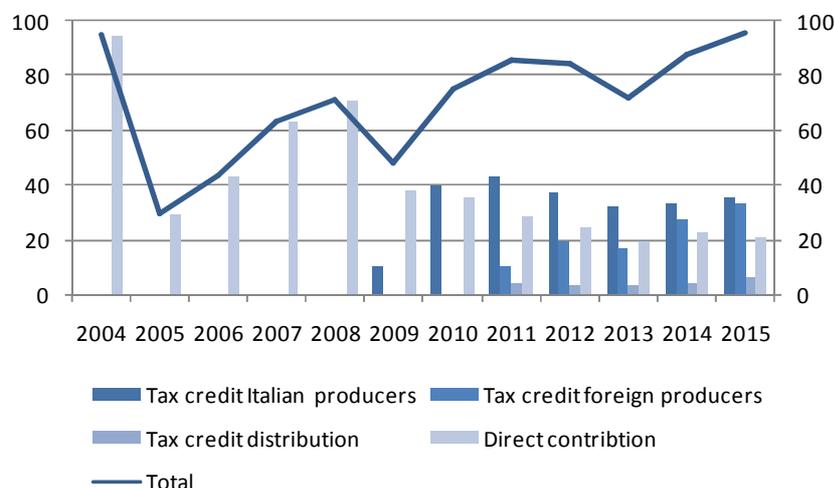
Figure 14 - Trend of public contribution for movie industry in Italy (EURm)



Source: Anica report 2015

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

Figure 15 - Total public Italian contribution for production and distribution



Source: Anica report 2015

The Italian Parliament recently approved a new law increasing support to the film industry: EUR400 million p.a. of fresh resources (+60%) should be available from 2017 for film production and distribution. The tax credits for independent producers who also distribute movies will increase to 40% (from 15% currently) while the ministerial committees for the allocation of funding will be abrogated. In addition EUR120 million (in 5 years) will be used to open new cinemas and to upgrade old theatres. These new rules could favour new investment in the film industry (till now penalized by legislative uncertainties).

Figure 16 - Tax credits

	Tax credits (% on cost)	Max	Requirements	Note
Production	15%	EUR3.5m p.a.	80% territoriality, cultural eligibility	Committee on cinema can increase tax credits on special situations
Co-production	15%	EUR3.5m p.a.	80% territoriality, cultural eligibility	Cost shared base
External investors	40% on max 49% of eligible cost	EUR1.0m p.a.	80% territoriality, cultural eligibility	20% if investor is also distributor
Distribution	15% of P&A cost	EUR1.5m p.a.	Italian movie of cultural interest, cultural eligibility	
Distribution	10% of P&A cost 25% on 60% of production costs	EUR2.0m p.a.	Italian movie, cultural eligibility	
Foreign production		EUR5.0m per movie	Cultural eligibility	
European independent producers	15%	EUR3.5m p.a.	Italian movie, cultural eligibility, 50% territoriality	In addition to the tax credit for production. For TV production must be reinvested in Italy within 24 months
Foreign producer and post-producer with no right	25%	EUR10.0m p.a. EUR50k per screen, max EUR200k per 3 years	Cultural eligibility, majority of Italian employees Multiplex must program Italian and European movies with cultural eligibility	
Theatrical distribution	30%			

Source: UBI Banca estimates

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 fictions (84), followed by documentaries and animation products, for a total amount of EUR54 million out of total production costs of around EUR360 million (source: *Anica, report 2015*) therefore covering 15% of total production costs.

It is important to highlight that LMG records tax credits and contributions as revenues. In 2015 LMG reported EUR7.1 million of tax credits and contributions (of which EUR1.4 million of support from regions) equal to 14% of sales, with an increase of 24% compared with 2014. In 1H16 there was a slowdown due to the lower number of movies produced.

SWOT Analysis

Figure 17- 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 to raise fund for new productions	The business is totally dependent on a small number of key personnel, involved in many different projects
Integrated player, with strong presence in multiplex and rising weight of TV productions. These two elements reduce the overall financial risk for the company	Limited free float (11.9%) and 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
Development of a factory for new and young movie directors	Unexpected decisions from downstream operators can significantly modify TV productions
Growing tax credits and subsidies reduce the average production cost	High competition

Source: UBI Banca estimates

2015 and 1H16 results

2015 was a positive year for LMG: sales increased by 15.1%, with strong improvements for the distribution division which benefitted from the good box office results of “Noi e la Giulia”, “Non sposate le mie figlie” and “Io che amo solo te”. Box office revenue was EUR17.3 million of which EUR11.8 million came from internally produced movies, implying a weight of 29% for LMG on box office result. Production division sales increased by nearly 8% sustained by TV right exploitation (up 11%) and by the sale of rights (+45%). Multiplex division was also up 6.9% due to higher admissions, with ancillary products (merchandise sales, advertising, food& beverage, parking, alternative events) representing 19% of the multiplex turnover. Other sales (equal to 20% of consolidated revenues vs. 18% in 2014) include tax credits, subsidies and other contributions.

Figure 18 – LMG 2015 consolidated results

(EURm)	2014A	2015A	% Chg.
Sales Multiplex	12.63	13.51	6.9%
Sales Distribution	2.89	5.00	73.1%
Sales Production	20.60	22.19	7.7%
Sales Other	7.97	10.04	26.0%
Sales total	44.08	50.74	15.1%
EBITDA	18.94	20.17	6.5%
% margin	43.0%	39.8%	
EBIT	4.21	7.56	79.6%
% margin	9.6%	14.9%	
Pre tax profit	2.50	5.88	134.8%
Net profit	2.20	5.03	128.7%
Net debt/(cash)	29.95	26.97	-9.9%

Source: Company data

The EBITDA margin declined slightly to 40% (from 43% in 2014 and 41.6% in 2013), but EBIT margin rose to 14.9% due to lower D&A costs (equal to 24.9% of sales, down from 33.4% in 2014).

After EUR1.7 million of financial charges and EUR0.7 million of taxes (14% tax rate), the net result was EUR5 million, more than double that of 2014.

Net debt decreased to EUR27 million (vs. EUR30 million at Dec-14) with gross debt of EUR39.6 million of which EUR35.5 million long term. NWC rose to 29.7% of sales (19.8% in 2014) mostly due to higher receivables from Mibac (the Ministry of Cultural Heritage) and other public entities (mostly regions) which reached EUR11.5 million. Capex of EUR7.6 million was slightly below the level of 2014. We also highlight that the company had >EUR12 million of cash and cash equivalent at Dec-15, in line with historical levels.

Reclassifying the receivables from Ministry of Cultural Heritage and other public entities into the net debt, we estimate that ROCE was 15.5% compared with 8.5% in 2014.

The first half of 2016 was much worse and well below consensus, with revenues declining by 18.3% despite positive box office momentum in Italy (in 1H16 admission increased by 15.6% and box office by 15.1%). This slowdown for LMG was caused by the distribution of just two movies (“Se mi lasci non vale” and “The Neon Demon”, which was a flop) vs. 5 movies in 1H15, the lack of blockbusters (present in 1H15 thanks to “Noi e la Giulia”) and the delay of the TV production of “Il sistema 2” while Multiplex divisions revenues were up 11.6% confirming the positive trend of the past few years.

Figure 19 – LMG 1H16 consolidated results

(EURm)	1H15A	1H16A	% Chg.
Sales Multiplex	6.48	7.24	11.6%
Sales Distribution	2.99	0.40	-86.7%
Sales Production	2.27	1.66	-26.9%
Sales Other	3.89	3.49	-10.4%
Sales total	15.64	12.78	-18.3%
EBITDA	5.84	4.05	-30.7%
% margin	37.4%	31.7%	
EBIT	2.60	2.34	-9.8%
% margin	16.6%	18.3%	
Pre tax profit	1.71	1.84	8.0%
Net profit	1.80	1.59	-11.7%
Net debt/(cash)	38.89	23.68	

Source: Company data

Consequently, EBITDA declined by 31% with a margin of 31.7% (vs. 37.4% in 1H15) but EBIT margin improved due to lower D&A costs. Higher taxes had a negative effect on the bottom line which fell 12% year-on-year to EUR1.6 million. After EUR4.3 million capex (new productions and movie acquisitions) net debt decreased to EUR23.7 million from EUR27 million at Dec-15, mostly due to lower NWC impacted by the reduction of trade receivables.

In 1H16 LMG renegotiated its long term financial debt, replacing the existing EUR23.6 million (maturing in Oct-19 with a 3.75% spread on 6 months Euribor) with new financing of EUR40 million, maturing in 2024 with a 2.75% spread on 6 months Euribor. The new financing should reduce financial charges by around EUR0.4 million p.a.

During the first half, four new movie production were launched (two of them to be released in November 2016) and LMG signed the agreements for two new TV productions (“Il sistema 2” and “Cohousing”) that should be released in 4Q17. LMG also acquired 4 movies at the Cannes festival (of which one, “Bad Moms”, already released with EUR1.3 million box office to date) including one thriller with Sylvester Stallone and several B movies, thereby enriching its library.

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 2H16 (2 movie productions and 2 movie distributions scheduled in 2H16) and 2017 (6-7 movie productions, 4 TV productions and the distribution of 4 movies, of which 3 movies already acquired). We expect further acquisitions in the coming months which should complete the pipeline for 2017 and expand the number of titles due for release in 2018. It is easier to assess forecasts for Multiplex, given a stable number of seats, a slight increase in ticket prices and an expected increase in admissions.

Movie and TV production

In order to assemble our forecasts we have divided the number of forthcoming movie productions over the next three years (6-7 movies per annum) into clusters based on expected box office revenues (on which all other sales are dependent). Theatrical sales are accounted at 20% of box office, Pay TV at an average of 20% of the box office, Free TV at 5%, and other revenues (home video, Vod, PPV, Kiosk) at 3%, for a total of about 50% of the total box office spread along the exploitation cycle. Clearly, the bulk of revenues is accounted in the first year of release (100% of theatrical revenues, 80% of Pay TV sales). We also added tax credits and subsidies with an incidence equal to 35% of the production costs.

Figure 20 - Assumption of revenues per movie cluster (EUR000)

Movie Production	Admission (000)	Box office	Theatrical	Pay TV	Free TV	Other	Tax credit and subsidies	Total
Blockbuster	625	4.000	800	800	200	120	1.750	3.670
Average	313	2.000	400	400	250	60	1.050	2.160
Weak	156	1.000	200	200	150	30	700	1.280

Source: 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. For 2016 LMG realized just one production ("Il sistema" for 6 episodes) with a good success having reached a share of 15.3%-19.5%. But 2017 will see strong growth of TV productions due to "Il sistema 2" (postponed from 2016), "Cohousing" and "Les Italianes" (high-budget international co-production with Space Rocket Nation, directed by Nicolas Winding Refn, already placed with Sky). We estimate an average fee of about 15% of the cost of production plus tax credit and subsidies for an average of 20% of the budget. This would translate into EUR2.6 million sales this year, EUR13 million in 2017 and EUR9.8 million in 2018.

Figure 21 – Production and co-production number (movie and TV)

	2016E	2017E	2018E
Blockbuster	2	4	5
Average	3	2	2
Weak	0	1	1
Total movies	5	7	8
TV productions	1	4	4

Source: UBI Banca estimates

Figure 22 – LMG Production revenues

(EUR000)	2016E	2017E	2018E
Blockbuster movie sales	7.13	14.26	17.83
Average movie sales	7.13	4.75	4.75
Weak movie sales	-	1.25	1.25
Total movie Production sales	14.26	20.26	23.82
Total TV production budget	9.50	37.00	28.00
Fee	1.43	5.55	4.20
Tax credit and subsidies	1.90	7.40	5.60
Total TV Production sales	3.33	12.95	9.80
Sale of rights	5.75	21.19	23.37
Total Production sales	23.33	54.40	56.99
EBITDA	13.59	24.48	27.93
EBITDA margin	58%	45%	49%

Source: UBI Banca estimates

The average EBITDA margin of the production division ranged from 50% to 60% in the past few years. We estimate an EBITDA margin of 58% for 2016 with some slowdown next year (to 45%) due to a higher weighting of TV productions which have lower profitability, and an improvement to 49% in 2018.

Distribution

The Distribution division includes revenues from rights on foreign movies and sales from the existing library. We assume that LMG could distribute 4-5 foreign movies p.a. (5 in 2016 with a box office of EUR3.9 million to date) with different box office results depending on the standing of the movie acquired. The existing library should generate sales of >EUR2 million p.a., with an increase in 2017-18 due to new additions. Altogether, Distribution division revenues could be EUR3.7 million this year, a sharp slowdown compared to 2015 due the lack of blockbusters (last year "Non sposate le mie figlie" reached EUR4 million box office) while 2017-18 should benefit from recent acquisitions.

Figure 23 – LMG Distribution revenues

(EURm)	2016E	2017E	2018E
Blockbusterster	0	2	2
Average	2	1	1
Weak	3	1	1
Total movies	5	4	4
Blockbuster movie sales	0.00	1.60	1.60
Average movie sales	1.00	0.50	0.50
Weak movie sales	0.60	0.20	0.20
Total new distributions	1.60	2.30	2.30
Distribution sales from existing library	2.20	2.20	2.70
Total distribution sales	3.80	4.50	5.00
EBITDA	1.63	1.80	2.00
EBITDA margin	43%	40%	40%

Source: UBI Banca estimates

Our cost projections assume that the MG (capitalized as an intangible asset) could range from EUR1.0 million for a blockbuster movie to EUR0.2 million for a weak movie and P&A costs can range from EUR1.5 million for a blockbuster movie to EUR0.2 million for a weak movie. This translates to a potential EBITDA margin of 40-45%.

Multiplex

Multiplex division revenues are easier to estimate. We assume a stable screen number in 2016-18 (56, which however could increase due to some screen additions in Benevento and Brindisi currently under examination) but an increase in admissions which could lift average sales per screen from EUR0.24 million in 2015 to EUR0.28 million in 2018. The EBITDA margin is expected to remain roughly stable at 19-20%, in line with the level of recent years.

Figure 24 – LMG Multiplex revenues

(EURm)	2012	2013	2014	2015	2016E	2017E	2018E
Sales	12.79	13.92	12.63	13.51	14.88	15.25	15.63
% growth		8.8%	-9.2%	6.9%	10.1%	2.5%	2.5%
Screens	55	55	55	56	56	56	56
Sales per screen	0.23	0.25	0.23	0.24	0.27	0.27	0.28
EBITDA	2.65	2.65	2.65	2.38	2.83	2.97	3.13
% margin	20.7%	19.0%	20.9%	17.6%	19.0%	19.5%	20.0%

Source: Company data, UBI Banca estimates

Consolidated forecasts

Summing up our estimates on the three divisions of LMG, we anticipate nearly 19% sales slowdown this year, as it was already evident in the first half (when sales were down 18.3%), but a strong recovery in 2017 mostly due to new productions (TV in particular). Accordingly, the EBITDA margin is expected to grow (better product mix) surpassing 42% in 2018.

Figure 25 – LMG consolidated expected results

(EURm)	2012A	2013A	2014A	2015A	2016E	2017E	2018E
Sales	39.9	35.2	44.1	50.7	42.0	74.1	77.6
% Change		-11.8%	25.1%	15.1%	-17.2%	76.5%	4.7%
EBITDA	17.5	14.7	18.9	20.2	18.1	29.3	32.9
% margin	43.8%	41.6%	43.0%	39.8%	43.0%	39.5%	42.4%
D&A	(14.7)	(13.1)	(14.7)	(12.6)	(10.1)	(14.5)	(14.4)
Operating profit	2.8	1.6	4.2	7.6	8.0	14.9	18.6
% margin	7.0%	4.5%	9.6%	14.9%	19.0%	20.0%	23.9%
Financials	(1.7)	(1.2)	(1.7)	(1.7)	(1.0)	(1.1)	(0.8)
Pretax Profit	1.1	0.4	2.5	5.9	7.0	13.8	17.8
Taxes	(0.2)	0.1	(0.3)	(0.8)	(2.9)	(5.1)	(6.2)
Tax rate (%)	30%	-26%	12%	14%	42%	37%	35%
Minorities	(0.2)	(0.2)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Net Profit	0.8	0.3	2.2	5.0	4.0	8.7	11.5
% Change		-54.9%	562.1%	124.8%	-19.7%	114.5%	33.2%

Source: Company data, UBI Banca estimates

D&A costs are expected to decline as a percentage of sales in the coming years (we should stress that movies are generally amortized for >60% in the first year after the release and that P&A costs are no longer capitalized and that rights are partially sold to free 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 surpass 20% in 2017, reaching the company's target of 20-25%.

Below the operating line, we expect financial charges of EUR1 million (recent renegotiation of long term debt) and a tax rate of about 35-40%. This implies a net profit which is expected to rise to EUR8.7 million in 2017 (after a slowdown this year) and to EUR11.5 million in 2018.

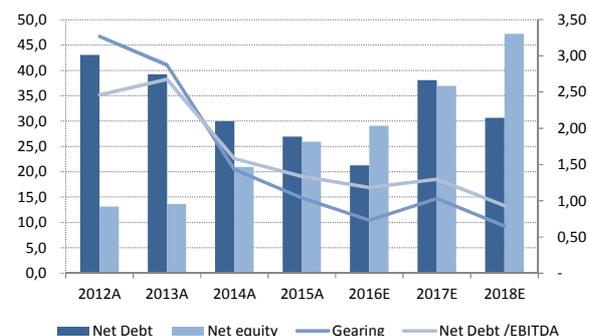
We expect the balance sheet to reflect the increasing value of the library (classified as intangible fixed assets) following the acquisition of new rights and new productions. Net working capital is expected to decline after the pick of 2016 (nearly 36% of sales) reaching 23% of revenues in 2018.

We forecast that investments (mostly in the library) could be about EUR7 million this year, and about EUR28 million in 2017 and EUR25 million in 2018 to sustain the new movie and TV productions. This trend would increase LMG's net debt which is expected to grow to EUR38 million expected at Dec-17 vs. EUR21.3 million at end-16. However, gearing should remain well below the historical level (around 1.0x vs. an average of 2.2x for 2012-15) with a net debt/EBITDA ratio rapidly declining below 1.0x vs. an average of 2.0x for 2012-15. Although net debt, at first glance, could be considered high, being above the current market capitalization, we believe the company's financial structure is not particularly stressed thanks to the substantial level of receivables from the Ministry of Cultural Heritage (EUR8.7 million at June-16) and from other public entities (EUR0.8 million) which should be converted to cash inflow in the coming months.

Assuming a payout ratio of around 20%, in line with last year, we estimate a DPS of EUR0.05 on 2016 results rising to EUR0.11 in 2017 and EUR0.15 in 2018, with an attractive dividend yield of >4% in 2016 rising to >9% in 2017 and >12% in 2018.

Figure 26 – Financial structure evolution (EURm)

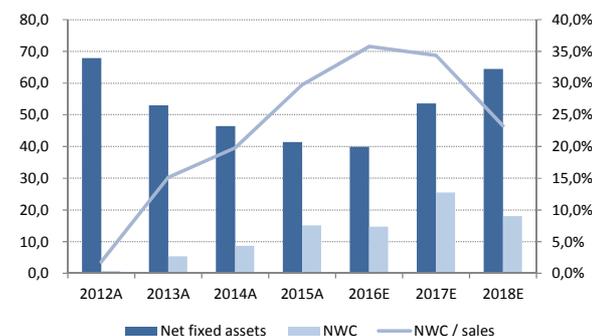
We expect an increase in net debt due to rising capex. However, gearing and leverage should remain well below the historical level.



Source: Company data, UBI Banca estimates

Figure 27 – Net fixed assets and operating NWC evolution (EURm)

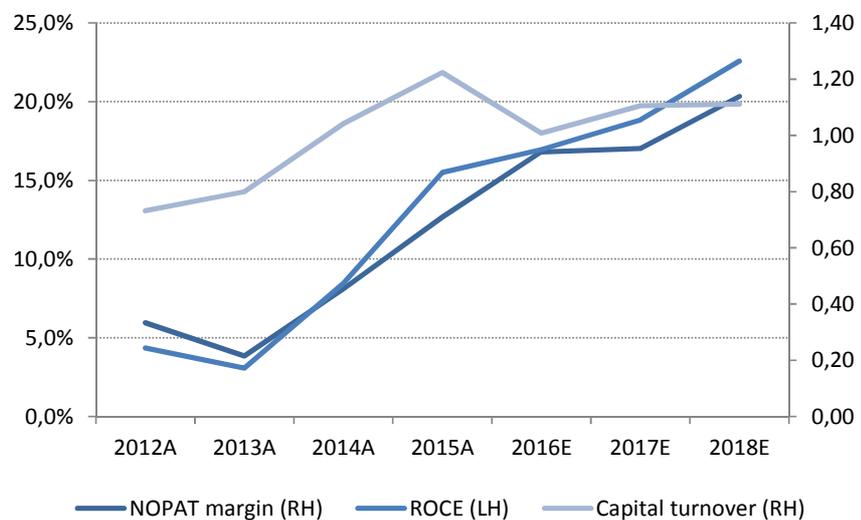
We cautiously assume a higher operating NWC to sales ratio in 2016-17 reflecting higher receivables. Net fixed assets are expected to increase



Source: Company data, UBI Banca estimates

We calculate an average capital turnover (sales / invested capital, reclassifying the receivables from the Ministry of Cultural Heritage and from other public entities) of 0.95x in the past four years, which improved in 2015 (to 1.22x), driving 2015 ROCE to 15.5% (from 8.5% in 2014). For 2016-18 we forecast a stabilization of capital turnover at about 1.1x, mostly due to higher fixed assets relating to higher investment in new productions. However, ROCE is expected to rise to 23% in 2018, due to a significant improvement of NOPAT margin in 2017-18.

Figure 28 – NOPAT margin, Capital Turnover and ROCE trend



Source: UBI Banca estimates

Valuation

LMG's current market capitalization (EUR17.2 million) is less than 32% of its net invested capital (and around 60% of its net equity) which implies continued material value destruction for the future. In other words, the current market price reflects very negative expectations of an absence of any top-line or EBITDA improvement, a scenario which we believe is improbable. The implication is that as soon as the company demonstrates a significant profitability improvement the share price could appreciate rapidly.

Our target price of EUR2.39 per share is based on the average of DCF, a relative valuation and a SOP, after having applied 30% liquidity discount to take into account the limited free float of LMG and its modest size. At the target price, LMG would trade at 2.6x 2017 EV/EBITDA, which is still well below the average multiple for our peer sample (4.2x).

Figure 29 – Valuation summary

We applied a 30% discount to our fair value to reflect the low liquidity of the shares and the modest size of the company

(EUR)	Fair Value	Weight	
DCF Valuation	2.59	33.0%	0.86
Relative Valuation	4.45	33.0%	1.47
SOP Valuation	3.29	33.0%	1.09
Fair value			3.41
Liquidity discount (30%)			(1.02)
Target price			2.39
Current price			1.16
Potential upside			106.0%

Source: Company data, UBI Banca estimates

DCF Valuation

Our cautious DCF model delivers a fair value of EUR2.59 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 1.46 (0.88 unleveraged), based on the average of the Entertainment industry in Europe (source: Damodaran Jan-16);
- > A debt spread of 3%, in line with the recent new long term financing (2.75% spread on 6 months Euribor);
- > A target debt/equity ratio of 50/50, which is in line with 2015 (49/51);
- > A terminal growth rate of 1% and an operating margin at 15% at terminal value, which is below the 18.3% EBIT margin reported in 1H16 and similar to 2015 (14.9%).

We calculated a WACC of 6.49%.

Figure 30 – WACC and embedded DCF assumptions

WACC assumptions		Embedded DCF assumptions	
Risk Free rate (10Y BTP bench.)	2.5%	Revenue CAGR 2016-2024 (%)	7.4%
Debt spread (%)	3.0%	EBIT CAGR 2016-2024 (%)	5.8%
Cost of debt [net] (%)	4.0%	EBIT margin 2016 (%)	19.0%
Market risk premium (%)	4.5%	Target EBIT margin 2024 (%)	15.0%
Beta (x)	1.46	Depr. on sales (avg 2016-2024) (%)	19.8%
Cost of equity (%)	9.1%	Capex on sales (avg 2016-2024) (%)	-27.1%
Weight of Debt	50%		
Weight of Equity	50%		
WACC	6.49%		

Source: UBI Banca estimates

Figure 31 – DCF valuation

Our DCF valuation implies an EV/EBITDA of 3.1x at terminal value		
	(EUR m)	(% weight)
Sum of PV 2016-26 FCF	14.5	22%
Terminal value	52.2	78%
Total Enterprise value	66.7	100%
- minorities	0.0	
- Pension Provision	(1.1)	
- Net debt (+ cash)	(27.0)	
Total Equity value	38.6	
Fully diluted number of shares (m)	14.9	
Fair value per share (EUR)	2.59	

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 (78% of enterprise value).

Figure 32 – Sensitivity analysis

Doubling the terminal growth rate would increase our DCF valuation by 32%					
WACC/g	0.00%	0.50%	1.00%	1.50%	2.00%
5.00%	2.99	3.43	3.99	4.71	5.66
5.50%	2.61	2.98	3.42	3.98	4.70
6.00%	2.29	2.60	2.96	3.41	3.97
6.49%	2.02	2.28	2.59	2.96	3.42
7.00%	1.78	2.00	2.26	2.57	2.94
7.50%	1.57	1.76	1.99	2.25	2.56
8.00%	1.38	1.56	1.75	1.98	2.24

Source: UBI Banca estimates

Relative valuation

LMG has several direct listed peers, although none of them is a fully integrated operator focused on a single geographical market. We have not taken into consideration in our relative valuation the global entertainment corporations (Walt Disney, Time-Warner, DreamWorks Animation and Lions Gate) due to their large size and international focus.

Overall, LMG is trading at a significant discount to its direct peers (55% on average), mainly due to its modest size compared to other competitors.

Based on a relative 2016-17 P/E, LMG would be valued at EUR4.20 per share, on EV/EBITDA it would be EUR5.52 per share and on EV/EBIT it would be EUR3.63 per share. The average of these three valuations gives EUR4.45 per share.

Figure 33 – Peer comparison and valuation based on multiples (priced on 17 November 2016)

Company	Market Cap (EURm)	P/E			EV/EBITDA			EV/EBIT		
		2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E
EuropaCorp SA	117		3.9 x		8.7 x	3.4 x		5.1 x		
Splendid Medien AG	19	15.8 x	7.1 x	5.5 x	2.1 x	1.7 x	1.5 x	13.0 x	6.8 x	5.3 x
Entertainment One Ltd.	1.207	12.3 x	10.5 x	9.3 x	8.8 x	7.7 x	5.8 x	9.2 x	8.0 x	6.0 x
Constantin Medien AG	164	16.2 x	10.5 x	8.0 x	2.6 x	2.3 x	2.0 x	7.1 x	5.6 x	4.6 x
Notorious Pictures S.p.A.	14	7.6 x	3.7 x		1.9 x	1.0 x		4.4 x	2.0 x	
Mondo TV S.p.A.	115	14.5 x	11.0 x	9.1 x	6.5 x	5.3 x	4.2 x	10.7 x	8.7 x	7.1 x
Highlight Communications AG	237	13.1 x	11.2 x	10.6 x	8.9 x	7.8 x	7.1 x	10.0 x	8.7 x	8.0 x
Average		13.2 x	8.3 x	8.5 x	5.6 x	4.2 x	4.1 x	9.0 x	6.4 x	6.2 x
Median		13.8 x	9.4 x	8.8 x	6.1 x	3.8 x	4.2 x	9.2 x	6.6 x	6.1 x
Current LMG market multiples	17	4.3 x	2.0 x	1.5 x	2.2 x	1.9 x	1.5 x	5.0 x	3.8 x	2.7 x
Discount to Average		-67.8%	-75.9%	-82.4%	-60.6%	-53.7%	-63.5%	-44.5%	-40.7%	-56.9%
Discount to Median		-69.1%	-78.7%	-83.0%	-63.5%	-49.1%	-64.1%	-45.2%	-42.5%	-56.2%

Source: Factset, UBI Banca estimates

SOP Valuation

We have also prepared a sum-of-the-part valuation:

- > **Multiplex division** has been valued with a DCF (WACC at 6.49%, terminal growth rate of 1% and an operating margin at 8% at terminal value) generating a fair value of EUR24.3 million for this division, or EUR1.63 per share;
- > **Library** was valued at book value (EUR14.9 million at June-16). As library is expected to generate an average of EUR2.3 million sales p.a. in 2016-18, with no additional costs, this valuation implies an EBITDA multiple of 6.4x;
- > **Net equity** for EUR26.2 million at June-16. We also deducted EUR1.05 million of goodwill at June-16, mostly related to the Multiplex division;

The sum of these three elements gives EUR65.7 million. We deducted net debt and pension provision at June-16 and added receivables from public entities (EUR9.5 million at June-16) coming to a total fair value of EUR50.2 million of 3.38 per share.

Figure 34 – Sum-of-the-part valuation

(EURm, EUR)	Fair value	Per share
Multiplex	24.32	1.63
Value of the library	14.91	1.00
Net equity	26.25	1.76
- Goodwill	(1.05)	(0.07)
Total assets	64.43	4.33
+ Receivables from public entities	9.54	0.64
- Pension Provision	(1.31)	(0.09)
- Net debt (+ cash)	(23.68)	(1.59)
Total SOP	48.98	3.29

Source: UBI Banca estimates

At our EUR2.39 per share target price, LMG Bag would trade at 9.6x 2016 P/E, which is still below the average multiple of our sample of peers (13.7x) and at 3.4x EV/EBITDA (vs. an average of 5.6x).

Figure 35 – Implicit multiples based on our EUR2.39 target price

(x)	2016	2017	2018
P/E	8.8 x	4.1 x	3.1 x
EV/EBITDA	3.2 x	2.6 x	2.1 x
EV/EBIT	7.3 x	5.0 x	3.7 x
EV/Sales	1.22 x	0.82 x	0.72 x
P/BV	1.2 x	1.0 x	0.8 x
EV/ Capital employed	1.2 x	1.0 x	0.9 x

Source: UBI Banca estimates

Income Statement

(EURm)	2015	2016E	2017E	2018E
Net Revenues	50.74	42.01	74.14	77.62
EBITDA	20.17	18.06	29.32	32.92
EBITDA margin	39.8%	43.0%	39.5%	42.4%
EBIT	7.56	7.97	14.86	18.56
EBIT margin	14.9%	19.0%	20.0%	23.9%
Net financial income /expense	-1.69	-1.00	-1.10	-0.80
Associates & Others	0.00	0.00	0.00	0.00
Profit before taxes	5.88	6.97	13.76	17.76
Taxes	-0.84	-2.93	-5.09	-6.22
Minorities & discontinuing ops	-0.00	-0.00	-0.00	-0.00
Net Income	5.03	4.04	8.67	11.54

Source: Company data, UBI Banca estimates

Balance Sheet

(EURm)	2015	2016E	2017E	2018E
Net working capital	15.07	15.03	25.49	18.06
Net Fixed assets	41.46	39.78	53.43	64.34
M/L term funds	-3.59	-4.35	-4.08	-4.76
Capital employed	52.94	50.46	74.84	77.64
Shareholders' equity	25.87	28.87	36.79	46.69
Minorities	0.10	0.10	0.10	0.10
Shareholders' funds	25.97	28.97	36.89	46.79
Net financial debt/(cash)	26.97	21.49	37.95	30.85

Source: Company data, UBI Banca estimates

Cash Flow Statement

(EURm)	2015	2016E	2017E	2018E
NFP Beginning of Period	29.95	26.97	21.49	37.95
Group Net Profit	5.03	4.04	8.67	11.54
Minorities	0.00	0.00	0.00	0.00
D&A	12.61	10.08	14.46	14.36
Change in Funds & TFR	0.00	0.00	0.00	0.00
Gross Cash Flow	17.64	14.13	23.13	25.90
Change In Working Capital	-6.33	0.05	-10.46	7.43
Other	0.00	0.00	0.00	0.00
Operating Cash Flow	11.31	14.17	12.66	33.33
Net Capex	-7.62	-7.15	-28.38	-24.60
Other Investments	0.00	0.00	0.00	0.00
Free Cash Flow	3.69	7.03	-15.72	8.73
Dividends Paid	0.00	-1.04	-0.74	-1.64
Other & Chg in Consolid. Area	-0.71	-0.50	0.00	0.00
Chg in Net Worth & Capital Incr.	0.00	0.00	0.00	0.00
Change in NFP	2.98	5.48	-16.46	7.10
NFP End of Period	26.97	21.49	37.95	30.85

Source: Company data, UBI Banca estimates

Financial Ratios

(%)	2015	2016E	2017E	2018E
ROE	19.4%	14.0%	23.6%	24.7%
ROI	9.1%	9.6%	14.9%	%
Net Fin. Debt/Equity (x)	1.0	0.7	1.0	0.7
Net Fin. Debt/EBITDA (x)	1.3	1.2	1.3	0.9
Interest Coverage	4.5	8.0	13.5	23.2
NWC/Sales	29.7%	35.8%	34.4%	23.3%
Capex/Sales	13.0%	14.9%	31.1%	26.3%
Pay Out Ratio	20.7%	18.4%	18.9%	19.3%

Source: Company data, UBI Banca estimates

Per Share Data

(EUR)	2015	2016E	2017E	2018E
EPS	0.34	0.27	0.58	0.78
DPS	0.07	0.05	0.11	0.15
Op. CFPS	0.76	0.95	0.85	2.24
Free CFPS	0.25	0.47	-1.06	0.59
BVPS	1.74	1.94	2.47	3.14

Source: Company data, UBI Banca estimates

Stock Market Ratios

(x)	2015	2016E	2017E	2018E
P/E	7.9	4.3	2.0	1.5
P/OpCFPS	3.5	1.2	1.4	0.5
P/BV	1.5	0.6	0.5	0.4
Dividend Yield (%)	2.6%	4.3%	9.5%	12.9%
Free Cash Flow Yield (%)	9.3%	40.7%	nm	50.6%
EV (EURm)	67.96	39.98	56.49	49.45
EV/Sales	1.2	0.8	0.6	0.5
EV/EBITDA	3.4	2.2	1.9	1.5
EV/EBIT	9.0	5.0	3.8	2.7
EV/Capital Employed	1.3	0.8	0.8	0.6

Source: Company data, UBI Banca estimates

Growth Rates

(%)	2015	2016E	2017E	2018E
Growth Group Net Sales	11.4%	-18.1%	90.4%	2.7%
Growth EBITDA	6.5%	-10.5%	62.4%	12.3%
Growth EBIT	79.6%	5.4%	86.4%	24.9%
Growth Net Profit	124.8%	-19.7%	114.5%	33.2%

Source: Company data, UBI Banca estimates

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