

NOVEMBER 4, 2015

## EQUITY RESEARCH

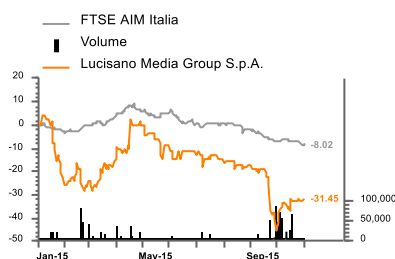


**Target Price: €3.6**

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**LMG Relative Price Chart**



Lucisano Media Group (LMG) announced its 1H2015 results, which were in line with expectations. YoY, the company's turnover remained nearly unchanged at €15.6mn, down just 1% from 1H2014. The most important developments in the first half were the following: a) the 9% YoY increase in revenues generated from the exhibition segment, through Stella Film, a welcome development that is in line with the overall growth of the Italian motion picture industry during the same period; and b) the increase in the number and success of foreign films distributed by LMG and their rising contribution to the company's top line. *Non Sposate Le Mie Figlie*, the French comedy for which LMG acquired 100% of the Italian rights, by itself generated €4mn in box-office revenues in 1H2015. And the film continues to generate additional revenues via channels including pay TV, free TV and DVD sales. Aiming for further growth in the distribution segment, throughout this year LMG improved its 2016 and 2017 distribution pipeline by acquiring 6 foreign films, 3 of which are animated. We anticipate the contribution of this segment to 2016E revenues to improve by a percentage point YoY.

On the production front, which is LMG's core business, *Noi e La Giulia* -- a Warner Bros. co-production -- was the only motion picture to hit theaters in 1H2015, generating €4mn in box-office revenues. 2H2015 will be relatively richer in terms of the production pipeline: The last quarter of a year, embracing the holiday period, is of utmost importance for movie producers, as it is the high season for movie-watching in theaters. Therefore, producers need to time the exhibition of their films very well. In 2015, the Italian motion picture industry is even more energized than usual, as overall box-office revenues around the country are recovering after a tough 2014. In 1H2015, the industry registered an 11% YoY growth, 6.7% of which is attributable to the increase in the size of audience, with the remaining 4.3% due to the increase in average ticket prices. Considering that in 2014 both audience size and revenue generation of Italian cinemas hit the lowest level since 2006, this was a recovery that was much hoped for. We project the industry to reach €635mn in box-office revenues in 2015, the highest in the last 4 years. The share of Italian productions (and co-productions) is not expected to reach the 31% attained in 2013, which was mainly due to *Sole a Catinelle's* €52mn performance. However, we believe it will approach 28% by year-end, again outperforming 2014. In this macro environment, LMG is introducing one film in October -- *Io Che Amo Solo Te*, the romantic summer-comedy featuring Riccardo Scamarcio and Laura Chiatti -- and one in November -- *Gli Ultimi Saranno Ultimi*, the Massimiliano Bruno film featuring Paola Cortellesi and Alessandro Gasman --. Adding these two films to *Tutte Lo Vogliono*, which LMG exhibited in September, which has generated € 2mn in box-office income, we anticipate overall production revenues in 2H2015 to contribute the most to our overall FY2015 production revenue estimate of €22mn.

In 1H2015, we observed a 6 percentage point YoY contraction in the company's EBITDA margin, down to 37%, due to the fact that some production costs for the 3 movies of 2H2015 were incurred during the first half, suppressing operating margins. By YE2015, we expect a correction in the EBITDA margin back to 43%. On the other hand, we see a margin improvement in 1H2015 at the bottom line of 2 percentage points YoY, due mainly to the fact that LMG did not incur tax expenses in the period. This will change in 2H2015.

LMG trades at respectively 54% and 46% discounts to its European peers' 2015E P/EBIT and EV/EBITDA multiples. In addition, current MCap of €25.1mn reflects neither the real estate carried on the B/S at a net book value of €28mn, nor that of the film library of €24mn. We value LMG on a P/EBIT basis, which is the most appropriate multiple for the industry, and this translates into a target price of €3.6 per share.

Market Data (€)	
Close Price (€)	1.69
52 Wk. High/Low (€)	2.94 / 1.34
Average Daily Trading Volume (90 day)	7,902
Price Change: 1 w	0.3%
Price Change: 1 m	10.3%
Price Change: YTD	-30.8%
Market Capitalization	25.1
Dividend Yield	0.0%

€ thousand	Revenues	EBITDA	EBITDA Margin	EBIT	Earnings	Net Margin
2013	35,235	14,650	41.6%	1,594	337	1.0%
2014	44,082	18,943	43.0%	4,212	2,238	5.1%
2015E	50,803	22,065	43.4%	8,597	5,134	10.1%
2016E	56,044	24,118	43.0%	10,471	6,652	11.9%

Source: Company data, KT&P estimates

## 1H2015 Results

LMG's first-half top line, almost unchanged YoY at €15.6mn, is in line with expectations. The breakdown of revenues was: €7.1mn (46%) from Stella Film (exhibition), €6.4mn (41%) from production and €2.2mn (14%) from distribution. The improvement in exhibition revenues, an increase of 9% YoY, from €6.5mn in 1H2014 to €7.1mn in 1H2015, is very much welcomed and in line with the overall growth of the Italian motion picture industry over the same period. Stella Film's introduction of new technologies, including opening of the IMAX Theater in Naples and the state-of-art ATMOS screen at Andromeda Theater in Rome, are surely supporting this performance. On the production front, LMG had only one new production in the first half, *Noi e La Giulia*, which generated €4mn in big-screen revenues. On the distribution side, the Company distributed 4 foreign productions, *Spivet*, *Samba*, *I 7 Nani* (animated) and the French hit *Non Sposate le Mie Figlie*, which in total generated nearly €6mn in box-office revenues. The contribution of these films to LMG's top line, €2.2mn, represents a doubling of the YoY increase in distribution revenues vs. €1.1mn in 1H2014. With this gain, LMG has demonstrated skill in choosing the right European films that Italians enjoy.

**Table 1: Summary Income Statement**

€ thousand	1H2013	1H2014	1H2015	YoY %
Sales	12,099	12,704	11,748	
Other Sales	2,176	3,020	3,892	
<b>Total Sales</b>	<b>14,275</b>	<b>15,724</b>	<b>15,640</b>	-1%
Service Costs	-7,845	-14,172	-18,523	
Personnel Costs	-1,352	-1,380	-1,333	
Other Operating Costs	-605	-599	-757	
Capitalized Prod. Costs	758	7,212	10,817	
<b>EBITDA</b>	<b>5,231</b>	<b>6,785</b>	<b>5,844</b>	-14%
<i>EBITDA Margin</i>	<i>37%</i>	<i>43%</i>	<i>37%</i>	
Depreciation and Amortization	-3,881	-4,395	-3,244	
<b>EBIT</b>	<b>1,350</b>	<b>2,390</b>	<b>2,600</b>	9%
Net Financial Income	-740	-739	-892	
<b>PBT</b>	<b>610</b>	<b>1,651</b>	<b>1,708</b>	
Taxes	76	-316	93	
<b>Net Income</b>	<b>686</b>	<b>1,335</b>	<b>1,801</b>	
Minority Interests and other	145	-4	12	
<b>Net Income after MI and other</b>	<b>541</b>	<b>1,339</b>	<b>1,789</b>	34%

Source: Company Data

We observe a 6 percentage point YoY contraction in LMG's EBITDA margin, from 43% in 1H2014 to 37% in 1H2015, mainly due to the fact that some production costs for 2H2015 films were incurred during the first half, suppressing operating margins. During 2H2015, with the generation of related revenues at the top line, LMG should be able to recover the lost margin.

LMG's net profit in 1H2015 was €1.8mn, with a 34% YoY increase. This notable increase, in spite of contracting operating margins, was because the Company did not incur any tax expenses in 1H2015. In 2H2015, this will change. Still, we expect the Company to maintain its 11% net margin thanks to improving operating profitability.

**Table 2: Summary Balance Sheet**

€ thousand	YE2014	June30th, 2014	June30th, 2015
Cash and Cash Equivalents	15,050	6,933	10,455
Trade Receivables	18,738	9,711	20,974
Other Current Assets	14,505	15,330	16,351
<b>Current Assets</b>	<b>48,293</b>	<b>31,974</b>	<b>47,780</b>
Tangible Assets	29,059	29,767	27,985
Intangible Assets	15,281	22,922	24,119
Other Non-Current Assets	2,799	2,453	2,917
<b>Non-Current Assets</b>	<b>47,139</b>	<b>55,142</b>	<b>55,021</b>
<b>TOTAL ASSETS</b>	<b>95,432</b>	<b>87,116</b>	<b>102,801</b>
Trade Payables	11,552	9,991	12,456
Financial Debt	3,995	3,781	3,953
Other Short-term Liabilities	13,123	12,734	13,892
<b>Short-Term Liabilities</b>	<b>28,670</b>	<b>26,506</b>	<b>30,301</b>
Financial Debt	41,509	41,193	45,898
Deferred Taxes	839	858	796
Other Long-Term Liabilities	3,417	4,434	3,021
<b>Long-Term Liabilities</b>	<b>45,765</b>	<b>46,485</b>	<b>49,715</b>
Minority Interests and other	139	81	101
<b>Shareholders' Equity</b>	<b>20,858</b>	<b>14,044</b>	<b>22,684</b>
<b>TOTAL LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>	<b>95,432</b>	<b>87,116</b>	<b>102,801</b>

Source: Company Data

LMG's net debt at the end of 1H2015 was €38.9mn. We usually adjust this number with government-related receivables (listed under Other Current Assets) that LMG carries on its balance sheet and collects in a range of 6 months to 4 years. These receivables include: a) Tax Credits that the Italian government provides to movie producers; b) Funds that Italian regions offer; and c) Subsidies that the government awards, depending on the box-office performance of the films. At the end of 1H2015, related receivables amounted to €10.6mn on LMG's balance sheet. Accordingly, LMG's adjusted net debt at the end of 1H2015 was €28.3mn.

During 1H2015, LMG capitalized a total of €10.8mn as production and acquisition costs for movies both already released and that will be released in 2H2015. As a result, its net book value (for the LMG library) reached €24.1mn (intangible assets). The tangible assets of €28mn, on the other hand, are the book value of the two real estate properties that Stella Film owns in Rome and Brindisi, together with the remaining mortgage payments for the related assets.

## FY2015 - FY2016 Outlook

In addition to the 3 movie productions -- *Tutte Lo Vogliono*, *Io Che Amo Solo Te* (which obtained the first place at the box office in its first week of release), and *Gli Ultimi Saranno Ultimi* -- which will hit theaters in 2H2015, LMG also has one TV production, *Il Sistema* that will air in 2H2015. A production for RAI, *Il Sistema*, is expected to replicate the success of *Anna e Yusuf*, LMG's previous TV production that RAI aired in September, reaching c.20% views in prime time.

**Table 3: LMG's 2H2015 and 2016 Pipeline**

Title	Type	Release Date
Tutte Lo Vogliono	Production	September 2015
Io Che Amo Solo Te	Production	October 2015
Gli Ultimi Saranno Ultimi	Production	November 2015
Il Sistema	TV production	December 2015
Se Mi Lasci Non Vale	Co-Production	February 2016
La Cena di Natale	Production	2H2016
Sotto Gli Occhi di Tutti	Production	2H2016
Professione Lolita	Production	2H2016
Undefined	Production	2H2016
The Trap	Distribution	2H2016
The Worst Marriage in Georgetown	Distribution	2H2016
Heidi	Distribution	2H2016
Cohousing	TV Production	2016
Les Italien	TV Production	2016

Source: LMG

With the richer production pipeline in 2H2015, we expect the Company's FY2015 turnover to reach €50.8mn, with a 15% YoY increase, and we expect the EBITDA margin to recover to 43% by year-end, with EBITDA reaching €22mn. Expected net profit for FY2015 is €5.1mn, with an expected net margin improvement of 5 percentage points YoY.

Both LMG and Warner Bros. want to replicate the success of 2015's *Noi e La Giulia* in their new co-production *Se Mi Lasci Non Vale*, whose production has already started and is expected to be completed in December 2015. The Company plans to realize a total of 5 productions for the big screen and 2 for TV during 2016, and together with support from the distribution of 3 foreign films in Italy and Stella's exhibition business, the Company's top line is projected to grow further to an expected €56mn by YE2016 (Table 4 below).

Table 4: Summary Estimates

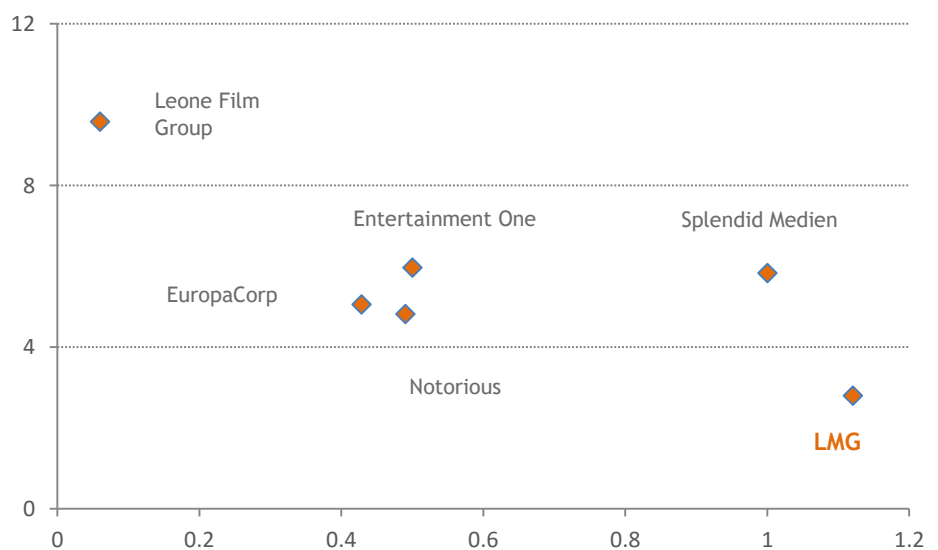
€ thousand	2013	2014	2015E	2016E
<b>Net Sales</b>	<b>35,235</b>	<b>44,082</b>	<b>50,803</b>	<b>56,044</b>
<b>EBITDA</b>	<b>14,650</b>	<b>18,943</b>	<b>22,065</b>	<b>24,118</b>
Amortization	-13,056	-14,731	-13,468	-13,647
EBIT	1,594	4,212	8,597	10,471
Net Financial Income	-1,196	-1,709	-1,599	-1,682
PBT	398	2,503	6,998	8,789
Taxes	105	-299	-1,864	-2,138
Net Income	503	2,204	5,134	6,652
<b>Net Income after MI</b>	<b>337</b>	<b>2,238</b>	<b>5,134</b>	<b>6,652</b>

Source: Company data, KT&P estimates

## Valuation

To value LMG, we identified a series of comparables (see Appendix). We have chosen our peers taking into consideration their business activity, even though we should note that some of the selected companies are different in terms of the size of revenues and their international presence. On a 2015E P/EBIT basis, LMG trades at a deep 54% discount to its European peers, as seen below in Graph 1. We value LMG on a P/EBIT basis, which is the most appropriate multiple for the industry, and this translates into €53.8mn equity value or €3.6 per share. On 2015E EV/EBITDA basis, Company shares are again at a 46% discount to European comparables.

Graph 1: 2015E P/EBIT versus EBIT Growth (2014E-15E)



Source: Factset, KT&P Estimates

Apart from the discount that the comparative peer valuation points to, LMG's current market valuation of €25.1mn reflects neither the real estate (located in Rome and Brindisi) carried on the balance sheet with a net book value of €28mn, nor the film library with a net book value of €24mn.

## Trend of Overall Italian Box-Office Revenues

Following 2014, a year when overall Italian box-office revenues contracted 7% YoY to €575mn (Table 5 below), we are witnessing a 2015 on the rise. During 1H2015, Italian theaters generated €330mn of revenues, which was 11% higher vs. 1H2014. 6.7% of this YoY increase is attributable to the increase in audience size, whereas 4.3% is due to the increase in the average ticket price. 2H2015 is expected to be strong as well, due to (1) good-performing American animated films like *Minions* and *Inside Out*, both of which rose to be 2015's highest income generators to date (with respective box-office revenues of €23.1mn and €22.5mn), and (2) to expected newcomers, both American and Italian, which will hit the theaters in the last quarter of the year.

Looking at Italy's best box-office performers YtD, we see only one Italian production, *Si Accettono Miracoli* in the top 10, with box-office revenues of €15.5mn. This outlook may change in 4Q2015, as a series of new Italian films are on the way, including Lucisano's *Io Che Amo Solo Te* and *Gli Ultimi Saranno Ultimi*.

**Table 5: Italian Box-Office Revenues and Breakdown since 2010**

	2010	2011	2012	2013	2014	2015E
<b>Overall box-office revenues (€ mn)</b>	735	662	610	618	575	635
<b>YoY Change</b>	18%	-10%	-8%	1%	-7%	10%
<b>Made-in-USA films (€ mn)</b>	414	304	314	332	289	318
<b>Made-in-Italy films* (€ mn)</b>	204	220	147	189	156	172
<b>Others (€ mn)</b>	117	138	149	97	130	146
<b># of films exhibited</b>	345	363	364	453	470	526
<b># of audience (mn)</b>	110	101	91	97	92	

Source: Cinetel data, KT&P expectations

\*Including co-productions with other countries

Since 2010, Italians have spent increasingly less on watching movies in theaters. Overall box-office revenues in 2014, €575mn, are 22% lower than the €735mn revenues in 2010, even though the number of films exhibited in theaters is significantly (36%) higher (470 films exhibited in 2014 compared to 345 films exhibited in 2010).

Table 6: Italian Box-Office Revenues Growth vs. GDP Growth Historically

In Italy/YoY Growth:	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
<b>GDP</b>	1.1%	2.3%	1.5%	-1.2%	-5.5%	1.7%	0.6%	-2.4%	-1.8%	-0.4%
<b>Box-office Revenues</b>	-6.9%	1.9%	12.8%	-3.7%	4.9%	18.0%	-9.9%	-7.9%	1.8%	-7.0%

Source: FactSet, Cinetel data

Historically, motion pictures have proven to be a non-correlated asset (Table 6 above). Therefore, it would be hard to fully attribute the contraction in the market to Italy's economic downturn in recent years. If we analyze the audience numbers in the last decade, we see that 90 million is the audience number that Italy reaches even in down years like 2005, 2006, 2012 and 2014. The years in which audience numbers rise significantly, e.g., to 110 million in 2010, are related largely to the number of Italian blockbusters rather than the number of Italian productions. In 2010, for example, a year when the industry grew 18% YoY, there were 5 Italian blockbusters that exceeded the €10mn box-office threshold, one of them being LMG's *Maschi Contro Femine* that generated €14mn in big-screen revenues in that year. On the other hand, in 2014, an absolute down year for the industry, the most-watched Italian film in theaters -- *Un Boss in Salotto* -- reached hardly €12mn in big screen revenues.

The increasing cinema-going in 1H2015 is a proof that Italian cinema-goers are once again ready for new Italian blockbusters. Their attraction to the big screen will of course depend on the productions on the way. The Italian government is supporting the growth of the industry as well: The Renzi government's new Stability Law proposal (Legge di Stabilità) introduces the much-awaited increase in Tax Credits to motion picture producers from the current €115mn to €140mn per year.

## Appendix A: Comparative Valuation

Company Name (mn/€)	Exchange	Market Cap	EV/SALES 2015	EV/EBITDA 2015	EV/EBIT 2015	P/EBIT 2015	P/E 2015
Lions Gate Entertainment	NYSE	5,274	2.82	18.07	25.85	21.17	25.03
DreamWorks Animation	NASDAQ	1,647	2.82	n.m.	n.m.	n.m.	n.m.
Entertainment One	London	954	1.12	8.03	8.61	5.97	9.85
Bona Film Group	NASDAQ	716	2.38	40.44	n.m.	n.m.	n.m.
EuropaCorp	Euronext Paris	141	0.99	4.04	8.10	5.06	7.87
Splendid Medien	Xetra	23	0.50	2.25	7.84	5.83	8.04
Leone Film Group	Milan	38	1.81	4.93	13.62	9.58	19.10
Notorious Pictures	Milan	56	1.80	3.04	4.29	4.82	7.27
<b>Average peer group</b>		<b>1,106</b>	<b>1.78</b>	<b>11.54</b>	<b>11.38</b>	<b>8.74</b>	<b>12.86</b>
<b>Average European peer group</b>		<b>242</b>	<b>1.24</b>	<b>4.46</b>	<b>8.49</b>	<b>6.25</b>	<b>10.43</b>
<b>LMG</b>	<b>Milan</b>	<b>25</b>	<b>1.05</b>	<b>2.42</b>	<b>6.21</b>	<b>2.91</b>	<b>4.87</b>

Source: Factset and KT&Partners estimates

Company Name (mn/€)	EV/SALES 2016	EV/EBITDA 2016	EV/EBIT 2016	P/EBIT 2016	P/E 2016
Lions Gate Entertainment	2.60	14.85	20.20	16.54	19.63
DreamWorks Animation	2.32	17.86	22.05	17.19	32.62
Entertainment One	1.01	6.81	7.09	4.92	7.78
Bona Film Group	1.64	14.00	16.52	16.66	20.84
EuropaCorp	0.96	3.53	6.29	3.93	6.05
Splendid Medien	0.45	2.01	6.57	4.89	6.64
Leone Film Group	0.94	1.87	10.21	7.18	9.55
Notorious Pictures	1.45	2.33	3.33	3.74	5.58
<b>Average peer group</b>	<b>1.42</b>	<b>7.91</b>	<b>11.53</b>	<b>9.38</b>	<b>13.59</b>
<b>Average European peer group</b>	<b>0.96</b>	<b>3.31</b>	<b>6.70</b>	<b>4.93</b>	<b>7.12</b>
<b>LMG</b>	<b>0.95</b>	<b>2.21</b>	<b>5.10</b>	<b>2.39</b>	<b>3.76</b>

Source: Factset and KT&Partners estimates



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