

This Time IS Different at Lionsgate (LGF.A/LGF.B)

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- ▶ Disclosure: Cove Street Capital owns LGF.B shares (recent addition)



Presentation Overview

- ▶ Brief biography and firm overview
- ▶ Overview of Lionsgate (LGF for short)
- ▶ Contrarian investment premises
- ▶ What we think has changed
- ▶ What is Lionsgate worth?
- ▶ Where we could be wrong?
- ▶ Contact information
 - ▶ Shameless podcast plug



Ben Claremon Biography

- ▶ Ben Claremon joined Cove Street in 2011 as a research analyst. He also serves as a Co-Portfolio Manager for our Classic Value | Small Cap Plus strategy.
- ▶ Previously he worked as an equity analyst on both the long and the short side for hedge funds Blue Ram Capital and Right Wall Capital in New York. Prior to that, he spent four years with a family commercial real estate finance and management business.
- ▶ Mr. Claremon was also the proprietor of the value investing blog, The Inoculated Investor. He is now the host of the Compounders podcast.
- ▶ His background includes an MBA from the UCLA Anderson School of Management and a BS in Economics from the University of Pennsylvania's Wharton School.



COMPOUNDERS:

The Anatomy of a Multibagger

HOSTED BY BEN CLAREMON
Cove Street Capital Portfolio Manager



Cove Street Capital at a glance

5

- Cove Street Capital (“CSC”) is an LA-based, SEC-registered investment adviser founded in 2011
 - 100% employee owned
 - ~\$700 million under management
- Concentrated, Small/SMID/Micro Cap value focus
 - 3 investment pillars: Business, Value, People
- <http://covestreetcapital.com/>



LGF Profile

- ▶ Market Cap: \$3.085 billion
- ▶ Total Debt: \$2.552 billion
- ▶ Total Cash: \$261 million
- ▶ Minority Interest: \$233.6 million
- ▶ Enterprise Value: \$5.609 billion
- ▶ TTM Revenue: \$3.35 billion
- ▶ Dividend Yield: N/A
- ▶ Net debt to TTM OIBDA: 4.7x
 - ▶ 3.6x if you exclude the investments in Starz Int'l



LGF Segment Overview



7

▶ Motion Picture

- ▶ Movie studio that generates revenue through theatrical releases, home entertainment, as well as television and international licensing
- ▶ Film library includes John Wick, Twilight, Hunger Games, Saw and even Dirty Dancing
- ▶ Combined film and TV library includes ~17,000 titles
 - ▶ \$740M in TTM revenue at what management claims are 50% cash flow margins



▶ Television Production

- ▶ TV production studio that creates content for Starz, linear TV, AVOD and SVOD
- ▶ Created hits such as Weeds and Mad Men
- ▶ Now delivering 34 series to various partners with new demand emerging from AVOD players
- ▶ Generated \$1.5 billion in revenue FY 2021 (includes library revenue quoted above)

▶ Media Networks

- ▶ Consists primarily of Starz and Starz International
- ▶ Has about 29 million subs around the world
 - ▶ 16.7M global streaming subs; 7M Starz Int'l subs
 - ▶ Targeting 50M to 60M global subs over the next 3 years
- ▶ Cost of building int'l D-to-C at Starz has crushed profitability
- ▶ Bought Starz from Liberty Media in 2016 for \$4.4B



MAD MEN



STARZ!



Contrarian Investment Premises

- Degree of stock price underperformance leads to alternatives being on the table that may not have been 5 years ago
 - Not the same company that turned down a \$40 bid from Hasbro in 2017
- Mark Rachesky of MHR Fund Management is not a “never sell bro” and is interested in maximizing the value of his substantial investment
 - This is a Vancouver-based company so A and B shareholders **both** have 1 vote per share regarding any takeover offer
- Insatiable demand for content makes movie/TV production studios more—not less—valuable and being the last sizeable, independent studio provides scarcity value to LGF
 - Proof points: Amazon buying MGM and Blackstone buying Hello Sunshine
 - There is room for Lionsgate to be an arms dealer to other content players
 - Every content producer except Disney, Netflix, and Warner-Discovery needs more scale
- Starz is a little bit of an odd asset but...
 - It generates a lot of cash: \$400M in EBITDA in the US
 - Management won't indefinitely lose \$140M/year building Starz Int'l
- Sum-of-the-parts value for Lionsgate is materially higher than the stock price





LGF.B Stock Chart

9



Source: Morningstar

Shareholder Base

- ▶ 2 share classes
 - ▶ A shares= voting shares; B shares= non-voting shares
- ▶ Key players:
 - ▶ MHR: owns 34.36M shares
 - ▶ Bought the shares [from Carl Icahn for \\$7](#) per share...in 2011
 - ▶ [Sold 20% of his stake in 2015](#) at ~ \$33/share
 - ▶ Controls 23.2% of voting class shares (LGF.A)
 - ▶ 2 Board Members
 - ▶ Mark Rachesky
 - ▶ Emily Fine
 - ▶ Liberty Global: 2.9% stake
 - ▶ 1 Board Member
 - ▶ CEO Mike Fries
 - ▶ Discovery: 2.2% stake

<u>Holder</u> ▼	<u>Common Stock Equivalent Held</u> ▼	<u>% Of CSO</u> ▼	<u>Market Value (USD in mm)</u> ▼
MHR Fund Management LLC ▼	34,361,802	15.292	498.9
Shapiro Capital Management LLC ▼	21,471,825	9.556	311.8
The Vanguard Group, Inc. ▼	16,122,938	7.175	234.1
BlackRock, Inc. (NYSE:BLK) ▼	13,425,332	5.975	194.9
Dimensional Fund Advisors L.P. ▼	9,309,208	4.143	135.2
Liberty Global plc (NasdaqGS:LBTY.A) ▼	6,549,972	2.915	95.1
FMR LLC ▼	6,481,962	2.885	94.1
Discovery, Inc. (NasdaqGS:DISC.A) ▼	5,000,000	2.225	72.6

Source: CapitalIQ

What is Different Now?



11

- Current Stock Price (10/12/21)
 - LGF.A: \$14.64; LGF.B: \$13.20
- Big gap between today's price and what Hasbro allegedly offered—and where MHR sold stock in 2015
- Starz subs now more OTT than linear
- Library content and content production capacity have become more valuable
- CEO and Vice Chairman are 4 years older
- MHR's performance can't be great
- Consolidation happening at a rapid pace
 - CBS-Viacom, Warner-Discovery, Amazon-MGM
 - MGM received a very healthy multiple
- D-to-C streaming companies receiving very high valuations



Michael Burns
Michael Newberg | CNBC

Shares of [Lionsgate](#) popped 4 percent in Tuesday midday trading after a [Variety report](#) revealed that toy builder [Hasbro](#) was close to acquiring the entertainment company in 2017.

Hasbro looked to buy the company for at least \$40 per share but Lionsgate's board chairman Mark Rachesky thought the bid was too low and ended the deal, the report said, citing sources familiar with the situation.



Now the Tricky Part: Valuation

- Stock looks expensive on traditional metrics
 - LGF trades at about 12x FY 2022E EBITDA for a business whose cash flows are hard to predict
 - Not a lot of pure-play, public comps left for the movie studio
 - Comcast paid \$4.1B for Dreamworks in 2016 (4.1x TTM sales)
 - Multiple implies a \$15B+ EV for LGF by the way
 - Starz was bought for \$4.4B but EBITDA is DOWN since then (due to int'l spending)
 - AMCX (a decent comp?) trades at under 7x forward EBITDA
 - The EV/sub multiples from sell-side analysts are problematic (see table)
 - Harkens back to the tech bubble days: price to eyeballs
- \$178M in TTM interest expense leads to net income losses
- Accounting for films and TV programs is....complicated
 - Hard to predict cash flows
 - Big amortization charges as well as distribution & marketing costs
 - Hit driven business, especially when it comes to theatrical
 - Good luck trying to create a logical DCF for Lionsgate

Valuing AMC's Streaming Business

	2020	2021	2022
Subscribers (000)			
Year-End Subscribers	6,000	9,000	12,000
Average OTT Subs	4,500	7,500	10,500
Revenue Per Sub	\$4.10	\$4.40	\$4.50
SVOD/OTT Revenue (\$M)	\$221	\$396	\$567
Valuation			
Revenue Multiple (3.5x)	\$775	\$1,386	\$1,985
Per-Subscriber (\$362 From Crunchyroll)			\$3,801

Source: Bloomberg Intelligence, Company Filings



An Interesting Tidbit

- LGF Board Member Gordy Crawford (a former PM at Capital Group) did a call with a J.P. Morgan sell-side analyst
 - Never seen a Board Member do a sell-side call before
 - Gordy has been aggressively buying shares since August of 2020 (see chart)
 - Has bought LGF.B shares as high as \$15.70
 - Walked the audience through how he would value LGF
 - Publicly put out a \$33/share SOTP number
 - He is clearly biased but that is a BIG margin of safety versus the current stock price
 - The fact that management would allow such a call to happen is suggestive that, just maybe, the company is considering monetizing assets

Holder Name	Trade Date Range	Security Type	Transacted Shares	Transaction Value Range (USD)	Transaction Type	Price Range (USD)
Crawford, Gordon Independent Director	Aug-10-2021	Class B Non-Voting Shares	9,490	116,158	Open Market Acquisition	12.24
Crawford, Gordon Independent Director	May-10-2021	Class B Non-Voting Shares	50,153	687,568	Open Market Acquisition	13.71
Crawford, Gordon Independent Director	May-05-2021 - May-07-2021	Class B Non-Voting Shares	82,090	1,085,400	Open Market Acquisition	12.95 - 13.60
Crawford, Gordon Independent Director	Mar-11-2021 - Mar-12-2021	Class B Non-Voting Shares	100,000	1,559,296	Open Market Acquisition	15.40 - 15.70
Crawford, Gordon Independent Director	Nov-10-2020 - Nov-12-2020	Class B Non-Voting Shares	200,000	1,661,801	Open Market Acquisition	8.15 - 8.50
Crawford, Gordon Independent Director	Aug-24-2020 - Aug-25-2020	Class B Non-Voting Shares	50,000	423,560	Open Market Acquisition	8.43 - 8.51
Crawford, Gordon Independent Director	Aug-18-2020	Class B Non-Voting Shares	42,740	341,578	Open Market Acquisition	7.99
Crawford, Gordon Independent Director	Aug-14-2020 - Aug-17-2020	Class B Non-Voting Shares	57,260	433,139	Open Market Acquisition	7.56 - 7.57

Source: CapitalIQ

Is MGM a Good Comp for LGF?



14

- No content company is the same, but it is worth comparing MGM (worth \$8.45B to Amazon) versus LGF
 - Both libraries have about 17K titles
 - LGF has a larger library of newer movies, as highlighted by the results of the last decade:
 - Wide release movies: LGF with 121 versus 44 from MGM
 - Box office: LGF at \$6.5B versus \$3.1B for MGM
 - Total movies: LGF at 704 versus 159 for MGM
 - Starz > EPIX
 - LGF's TV business > MGM's
 - But, MGM's library may have more monetization upside
 - Gordy Crawford: If MGM is worth \$8.45B, there is no way LGF is not worth more than that
 - \$8.45B EV for LGF implies \$26/share





A Few Points to Consider

- SOME CAVEATS
 - This is a very difficult company to value
 - MGM multiple may not be applicable due to an under-monetized library
 - Adjusting for Starz's international losses may over-value that business
 - These businesses may not be able to be split up neatly
 - Beware of double counting the library revenue
- This **is** a special situation
 - Our research suggests this time is different
 - There is a clear desire at Lionsgate to close the gap between the share price and the company's estimate of intrinsic value
- However, there are ways to make money from here absent a sale
 - Continued growth of the TV Production segment
 - Either Starz Int'l becomes profitable on its own or the losses stop coming
 - Rebound in theatrical as COVID's impact on theaters abates
- SOTP value provides a margin of safety that protects the downside



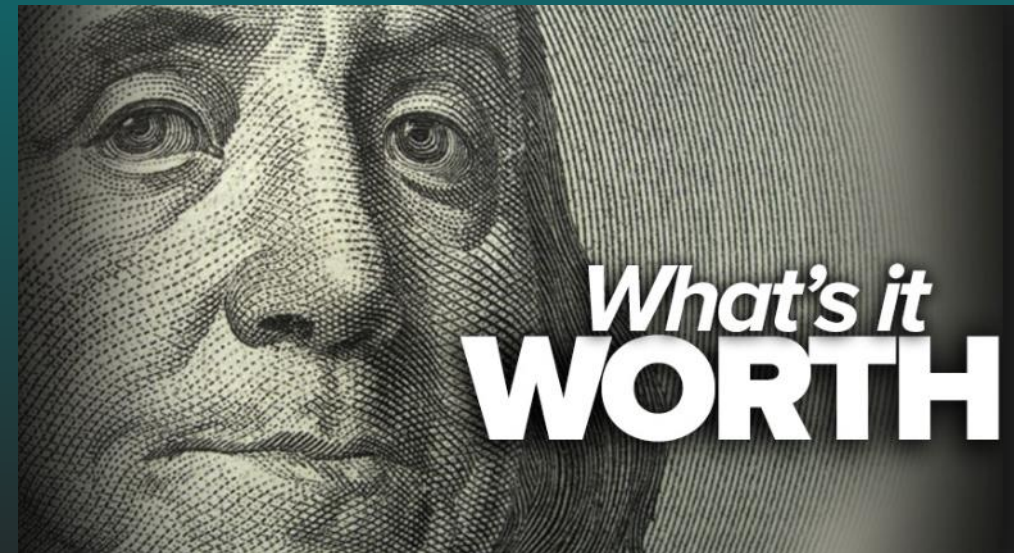


Cove Street's SOTP Value

16

▶ Valuation Methodology

- ▶ Assumes A shares and B shares treated the same in a deal (not guaranteed of course)
- ▶ First, value the library, which includes TV and Motion Picture content
 - ▶ Assumes the value of the TV and movie studios are nothing but the past library--\$0 value for future growth
 - ▶ Very conservative assumption given the growth of the TV Production business
 - ▶ Gordy Crawford put a \$1.5B value on the TV business
 - ▶ MGM multiple: press reported 20x library cash flow
 - ▶ Base case: 12x
 - ▶ Upside case: 15x
- ▶ Second, value Starz
 - ▶ Base case: adds back \$70M in losses (roughly half)
 - ▶ Applied multiple: 8x
 - ▶ Upside case: excludes \$140M of losses
 - ▶ Applied multiple: 8.5x
 - ▶ Modest premium to AMCX's multiple
- ▶ Put a multiple on the corporate SG&A (~\$113M in FY 2021)
 - ▶ Base case: 7x
 - ▶ Upside case: 5x





Cove Street's SOTP Value

- ▶ **Base Case:** \$18.00
 - ▶ Remember this values the future revenue from studios at \$0
 - ▶ Capitalizes \$70M in Starz losses in perpetuity
- ▶ **Upside Case:** \$27.50
 - ▶ Embeds a discount to the reported MGM multiple of 20x
 - ▶ Also values the future revenue from the studios at \$0

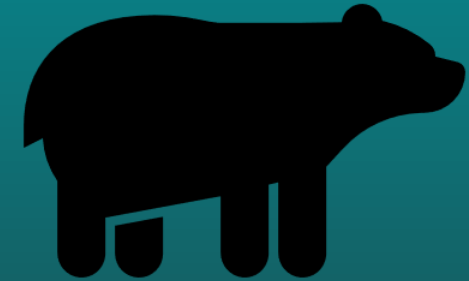
Base Case	(millions of \$)		Upside Case	(millions of \$)
Library Cash Flow	\$370.0		Library Cash Flow	\$370.0
Cash Flow Multiple	12.0x		Cash Flow Multiple	15.0x
Library Value	\$4,440.0		Library Value	\$5,550.0
Starz EBITDA	\$360.0		Starz EBITDA	\$430.0
EBITDA Multiple	8.0x		EBITDA Multiple	8.5x
Starz Value	\$2,880.0		Starz Value	\$3,655.0
Corporate Unallocated	(\$113.0)		Corporate Unallocated	(\$113.0)
Applied Multiple	7.0x		Applied Multiple	5.0x
Corporate	-\$791.0		Corporate	-\$565.0
Total EV	\$6,529.0		Total EV	\$8,640.0
Net Debt	2,291.0		Net Debt	2,291.0
Minority Interest	233.6		Minority Interest	233.6
Equity Value	\$4,004.4		Equity Value	\$6,115.4
Shares Outstanding (mm)	221.8		Shares Outstanding (mm)	221.8
Per Share	\$18.05		Per Share	\$27.57



Short Points

18

- ▶ The leverage is way too high and will eventually be a problem
- ▶ What Amazon is paying for MGM is not a relevant benchmark
 - ▶ And the deal may not even get through an FTC review
- ▶ Starz is a subscale business that gets less valuable each day
 - ▶ Management will continue to throw money at it regardless
- ▶ No single buyer wants both Starz and legacy Lionsgate
- ▶ MHR essentially controls this company and will not allow a sale at a price that most shareholders would be really happy with
- ▶ Lionsgate is running out of potential acquirers, especially with the Biden administration's crackdown on consolidation
 - ▶ Does Amazon-MGM even get approved?
- ▶ CEO Feltheimer and Vice Chairman Burns will never let anyone else control their baby
 - ▶ Having 2 classes of shares is often problematic
- ▶ Lionsgate has periodically been "cheap" on an SOTP basis many times...so what?





Q&A and Contact Information

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▶ <https://twitter.com/BenClaremon>

▶ Compounders Podcast:

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