Singapore Company Guide

mm2 Asia

Version 7 | Bloomberg: MM2 SP | Reuters: MM2A.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Nov 2016

BUY

Last Traded Price (8 Nov 2016): S$0.47 (STI : 2,820.24)
Price Target 12-mth: S$0.56 (20% upside) (Prev S$0.475)

Potential Catalyst: Earnings-accretive acquisitions

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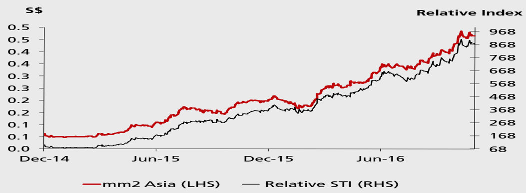
What's New

- **To be 4th largest cinema operator in Malaysia with new acquisition**
- **Option to purchase two more cinemas and projects under development**
- **Favourable purchase price; scaling up for better synergies and cost savings**
- **Maintain BUY with higher TP of S$0.56**

Price Relative



Forecasts and Valuation

FY Mar (S$ m)	2015A	2016A	2017F	2018F
Revenue	24.3	38.3	154	207
EBITDA	9.92	19.4	31.5	41.7
Pre-tax Profit	6.58	9.99	22.1	29.9
Net Profit	5.08	8.90	18.4	24.8
Net Pft (Pre Ex.)	5.13	8.90	18.4	24.8
Net Pft Gth (Pre-ex) (%)	68.1	73.4	106.3	35.3
EPS (S cts)	0.61	0.98	1.75	2.37
EPS Pre Ex. (S cts)	0.62	0.98	1.75	2.37
EPS Gth Pre Ex (%)	68	59	78	35
Diluted EPS (S cts)	0.61	0.98	1.75	2.37
Net DPS (S cts)	0.0	0.0	0.0	0.0
BV Per Share (S cts)	2.32	4.00	6.94	9.31
PE (X)	75.6	47.2	26.5	19.6
PE Pre Ex. (X)	75.0	47.2	26.5	19.6
P/Cash Flow (X)	nm	nm	34.8	20.5
EV/EBITDA (X)	38.2	21.7	15.0	11.8
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	20.0	11.6	6.7	5.0
Net Debt/Equity (X)	CASH	CASH	CASH	0.1
ROAE (%)	44.5	32.1	33.7	29.2
Earnings Rev (%):			-	5
Consensus EPS (S cts):			1.80	2.20
Other Broker Recs:		B: 2	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P

Building recurring income

4th largest cinema operator in Malaysia. The acquisition of 13 screens in Malaysia would propel mm2 Asia to the top four players in Malaysia. Besides building recurring income, this acquisition would enable the group to scale up for better synergies and cost savings. In terms of its core production business, we expect North Asia, including China, Hong Kong and Taiwan, to contribute >70% of core revenue from FY17F, up from 23% in FY16. Upside to earnings could come from more projects, especially in China where budgets are much higher.

We project mm2 to grow at an EPS CAGR of 70% from FY15-FY18, underpinned by growth in productions, expansion into the China market, and contributions from cinema operations and entertainment company, UnUsUal Group.

UnUsUal listing. The successful listing of UnUsUal, which mm2 acquired at 10.2x PE back in February 2016, would enable mm2 to crystallise gains and unlock value, and allow UnUsUal to tap on public funds for expansion.

Valuation:

Maintain BUY with higher TP of S$0.56. We have adjusted our FY18F earnings up by 5% to incorporate contribution from the new cinemas. Maintain BUY; target price raised to S$0.56, from S$0.475 (adjusted for 1-for-1 stock split), and pegged to FY18F earnings and peers' average of 24x.

Key Risks to Our View:

No long-term financing arrangements for productions. The commencement of each production is dependent on mm2's ability to secure funding.

Availability of good scripts. Lack of good scripts for production may lead to less support from stakeholders.

At A Glance

Issued Capital (m shrs)	1,029
Mkt. Cap (Sm/USm)	478 / 345
Major Shareholders (%)	
Wee Chye Ang	45.9
Yeo Khee Seng	9.2
StarHub	8..6
Free Float (%)	36.3
3m Avg. Daily Val (US$m)	1.2
ICB Industry : Consumer Services / Media	

WHAT'S NEW

Acquiring 13 cinemas in Malaysia

4th largest cinema operator in Malaysia with new acquisition. mm2 Asia has entered into a binding term sheet with Lotus Fivestar Cinemas (M) Sdn Bhd for the acquisition of 13 cinema for RM118m (assuming target EBITDA of between RM10m to RM12.5m per year is met). The purchase consideration will be funded entirely via bank borrowings and cash. The cinemas were established between 2009 and 2016, and currently comprise a total of 90 screens with 15,818 seats. Upon completion of the proposed acquisition, the group will own a total of 133 cinema screens in Malaysia, elevating it to the 4th largest cinema operator in the Malaysian market, with a market share of about 14% in terms of number of screens, up from about 4% previously.

Option to purchase two more cinemas and projects under development. The proposed acquisition comes with an option to purchase another two cinemas located in Terengganu and Sandakan. The price payable for the additional cinemas shall be 8x the EBITDA achieved by the additional cinemas for the first year.

Other than these, mm2 is also entitled to acquire from Lotus Fivestar Cinemas other projects under development at cost.

Favourable purchase price compared to previous Mega and Cathay acquisitions. The purchase consideration of RM118m translates to a valuation of about RM1.31m per screen. This compares favourably with the group's earlier cost of acquisition of cinemas from Cathay Cineplexes Sdn Bhd and Mega Cinemas Management Sdn Bhd, which were RM1.33m and RM1.69m per screen respectively. On an EBITDA basis, the latest acquisition of 8x-9x EBITDA is comparable to the two previous acquisitions. However, this deal is much more favourable if we include the option to acquire the two additional cinemas and projects under development.

Building recurring income. The proposed acquisition is in line with mm2's intention to diversify into the downstream value chain of film production. mm2 believes this will complement its current and future businesses, strengthening its competitive advantage through the ownership of cinemas, as well as providing a source of recurring income to the group.

Scaling up for better synergies and cost savings. With a total of 133 cinema screens in Malaysia (excluding the option for the two additional cinemas and those under development), mm2 will have better bargaining power in negotiating for film screening. Besides, it will also be able to enjoy economies of scale for its F&B business within the cinemas, which generates good margins.

FY18F earnings raised by 5%. Completion for this acquisition is expected to be around February next year. We have adjusted our FY18F earnings up by 5% to incorporate contribution from the new cinemas. For this acquisition, costs tend to be higher at the initial stage, mainly due to depreciation charges as the cinemas acquired are relatively new, and also interest cost. Thus, minimal impact to earnings in the initial years but we should see a quantum leap from around the fourth or fifth year onwards. Maintain BUY; target price raised to S$0.56, from S$0.475 (adjusted for 1-for-1 stock split), and pegged to FY18F earnings and peers' average of 24x.

Location of the cinemas to be acquired

Location	No. of cinemas
Selangor	2
Perak	3
Johor	2
Penang	2
Negeri Sembilan	1
Sarawak	2
Malacca	1

Source: DBS Bank; National Film Development Corporation Malaysia (FINAS)

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

Acquisitions to strengthen competitive edge and build income base

mm2 has made several acquisitions to maintain its competitive advantage. The latest is the acquisition of 13 cinemas in Malaysia. Upon completion likely in February next year, mm2 will own a total of 18 cinemas with a market share of about 14% in terms of number of screens. The ownership of cinemas will provide a source of recurring income to the group and cost savings in the longer term, as mm2 usually has to pay about 50% of its gross intake for rental of cinemas. Cinema operation is a profitable business, and could be profitable even with less than 50% of the seats occupied.

Other than cinemas, mm2 has recently entered into a MOU to acquire up to 30% stake in RINGS.TV, a leading interactive live streaming broadcast platform for S$4.5m in a bid to beef up its OTT (over-the-top) platform. In February 2016, mm2 acquired a 51% stake in UnUsUal Group, one of Asia's largest promoters and organisers of shows and entertainment acts, for S$26m.

Consolidating its position in local market; tapping on StarHub's strong brand name

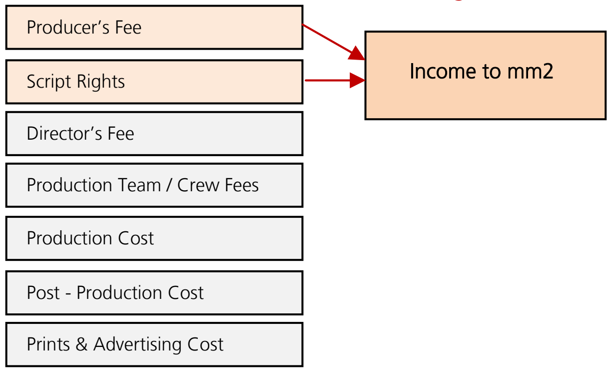
As the industry leader, mm2 is poised for more opportunities ahead. With the entry of StarHub with a 9.05% stake, mm2 can tap on the former's strong brand name and this could raise its profile and pave the way for bigger opportunities ahead. mm2 could also leverage on StarHub to attract more sponsorship for its productions. StarHub can choose to tap on mm2's cineplex business to showcase its content, as well as gain access to top-rated concerts and artistes through UnUsUal, in which mm2 owns a 51% stake.

Going for niche markets in North Asia; adaptation of successful movies. In terms of strategy in China, instead of competing directly with the local big boys, mm2's strategy is to go for small, niche markets and replicate its proven business model that it has in Singapore. For example, remaking successful titles like "The Journey" or Jack Neo's "I not Stupid" movie in a specific province like Sichuan, which has a population of about 80m, which is >10x bigger than Singapore. mm2 can adapt the movie to the local setting, which would be more appealing to the locals there.

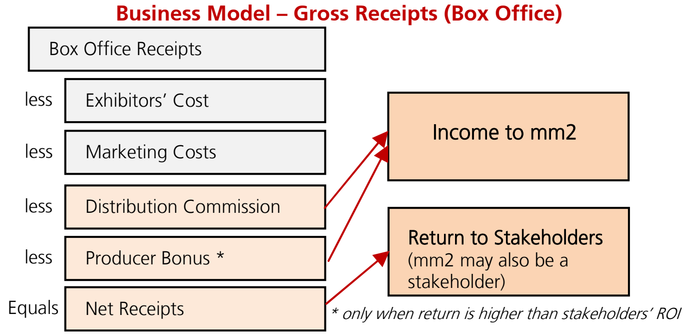
Besides production of movies, mm2 can also produce variety shows, either on its own or tie-ups with one of its shareholders, Hesheng Media, which is one of the largest integrated media companies in China.

Distribution of movies, another core competency of mm2 other than production and advertising, is also another channel that can broaden mm2's income in China.

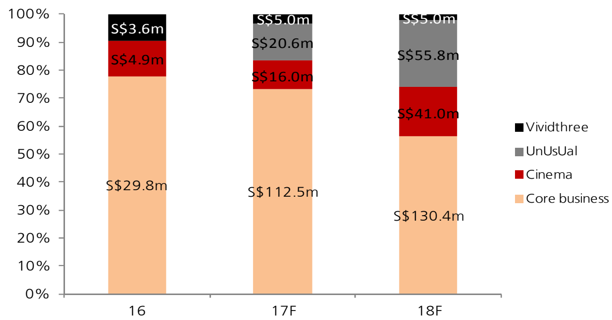
Business Model – The Film Budget



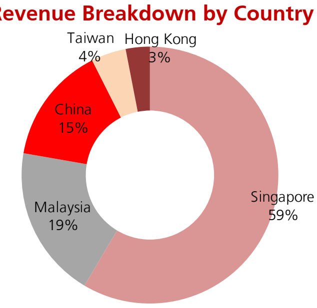
Business Model – Gross Receipts (Box Office)



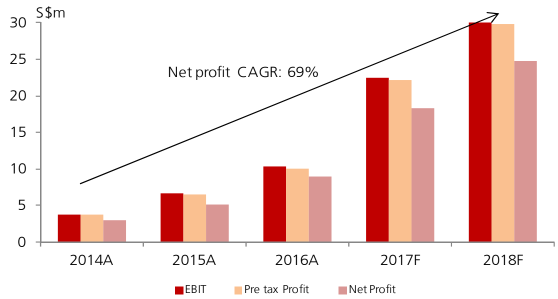
Revenue Breakdown by Segment



FY16 Revenue Breakdown by Country



Profitability Trend



Source: Company, DBS Bank

Balance Sheet:

Net cash position. mm2 was in a net cash position as at March 2016. Though we do not rule out the possibility of the group taking on more debt, as it is constantly on the lookout for acquisitions that can complement its existing business and also to build its recurring income base, the full impact from its recent acquisitions should lead to stronger earnings and equity base.

Asset-light business model. More than half of its assets are current assets, comprising mainly cash and receivables, even with the acquisition of cinemas and UnUsUal.

Share Price Drivers:

UnUsUal listing. The successful listing of UnUsUal, which mm2 acquired at 10.2x PE back in February 2016, would enable mm2 to crystallise gains and unlock value, and allow UnUsUal to tap on public funds for expansion.

Growing production and distribution income.
Its core business, which includes production, distribution and sponsorship, is expected to account for at least 70% of total revenue going forward. In terms of production project pipeline, we expect more than half of the production to come from North Asia. In China, we are expecting the group to also produce dramas, which will have a much bigger production budget than movies. Even for movies in China, their production budgets and margins are also better than local productions.

mm2 has also entered into an agreement to acquire the exclusive licensed rights to produce and broadcast *The Voice* for the Singapore/Malaysia version. *The Voice* is a popular format show currently being watched by more than 500 million viewers. mm2, together with Clover Films, has also clinched the distribution rights for 19 movies in Singapore and Malaysia. Though distribution margins are much lower than production, at about 3% vs ~40%, it is very scalable.

Key Risks:

No long-term financing arrangements for productions. The commencement of each production is dependent on mm2's ability to secure funding.

Availability of good scripts. Lack of good scripts for production may lead to less support from stakeholders.

Unable to predict the commercial success of movies produced. The commercial success of its productions is primarily determined by inherently unpredictable audience reactions.

Company Background

mm2 Asia is a leading producer of films and TV/online content in Asia. As a producer, mm2 provides services over the entire film-making process – from financing and production to marketing and distribution, and thus has diversified revenue streams.

Number of Titles (Production & Distribution)

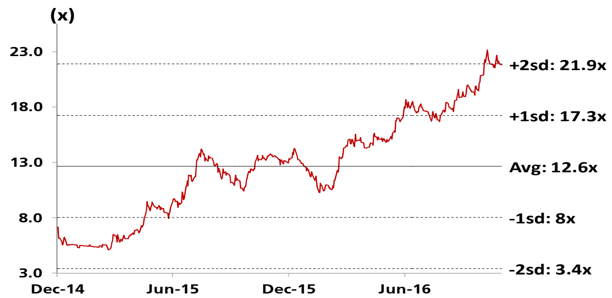
Year	Number of Titles (Production)	Number of Titles (Distribution)
FY Mar 2012	3	2
FY Mar 2013	6	8
FY Mar 2014	6	18
FY Mar 2015	9	26
FY Mar 2016	14	24
Apr 16 to Sep 17*	37	

* *projection*

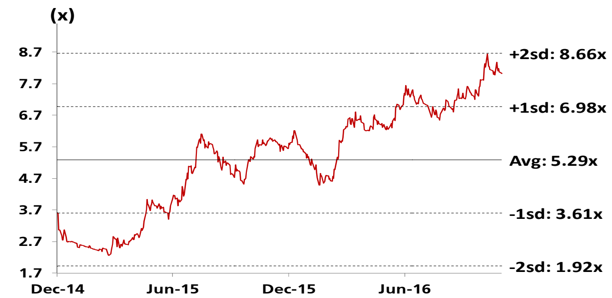
Details of cinemas acquired

Cinema	Place	Capacity
Cathay Cineplex City Square	Johor Bahru	14 screens, 2,826 seats
Cathay Cineplex Damansara	Damansara	16 screens, 2,472 seats
Mega Cineplex Prai	Penang	6 screens, 1,420 seats
Mega Cineplex Langkawi	Langkawi	3 screens 536 seats
Mega Cineplex Bertam	Bertam	4 screens 756 seats
LFS 1 Plaza, Kuala Selangor	Selangor	5 screens, 733 seats
LFS Seri Iskandar	Perak	7 screens, 1,349 seats
LFS 1 Segamat	Johor	8 screens, 1,703 seats
LFS Prangin Mall	Penang	8 screens, 1,490 seats
LFS Bahau	Negeri Sembilan	6 screens, 1,036 seats
LFS Shaw Centre, Point Klang	Selangor	4 screens, 875 seats
LFS Riverside, Kuching	Sarawak	4 screens, 585 seats
LFS IOI Kulai	Johor	6 screens, 920 seats
LFS Kerian Sentral Mall	Perak	8 screens, 1,183 seats
LFS Summer Mall	Sarawak	12 screens, 2,038 seats
LFS Mahkota Parade	Malacca	4 screens, 645 seats
LFS Bukit Jambul	Penang	6 screens, 1,167 seats
LFS Kampar	Perak	6 screens, 846 seats

Forward PE Band (x)



PB Band (x)



Source: Company, DBS Bank

Segmental Breakdown

FY Mar	2014A	2015A	2016A	2017F	2018F
Revenues (S$m)					
Core Business	16.1	24.3	29.8	112.5	130.4
Production				51.9	59.9
Distribution				47.6	56.5
Sponsorship				3.0	4.0
TV Content				10.0	10.0
Cinema			4.9	16.0	36.0
UnUsUal				20.6	35.8
Vividthree			3.6	5.0	5.0
Total	16.1	24.3	38.3	154	207
Gross profit (S$m)					
Core Business	5.1	9.6	13.1	24.1	27.7
Production				20.8	23.9
Distribution				1.4	1.7
Sponsorship				0.5	0.6
TV Content				1.5	1.5
Cinema			2.8	8.8	19.8
UnUsUal				7.6	13.2
Vividthree			2.5	3.5	3.5
Total	5.09	9.58	18.4	44.1	64.3
Gross profit Margins (%)					
Core Business	32	39	44	21	21
Production				40	40
Distribution				3	3
Sponsorship				15	15
TV Content				15	15
Cinema			57	55	55
UnUsUal				37	37
Vividthree			69	70	70
Total	31.6	39.5	48.0	28.6	31.0

Full-year contributions from the five cinemas and newly acquired 13 cinemas for FY18F

Partial contributions from UnUsUal

Much lower margin of about 3% for distribution business; vs about 40% for production

Income Statement (S$m)

FY Mar	2014A	2015A	2016A	2017F	2018F
Revenue	16.1	24.3	38.3	154	207
Cost of Goods Sold	(11.0)	(14.7)	(20.0)	(110)	(143)
Gross Profit	5.09	9.58	18.4	44.1	64.3
Other Opng (Exp)/Inc	(1.4)	(3.0)	(8.0)	(21.6)	(31.6)
Operating Profit	3.72	6.62	10.4	22.5	32.7
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.0	0.0	(0.4)	(0.4)	(2.8)
Exceptional Gain/(Loss)	0.0	(0.1)	0.0	0.0	0.0
Pre-tax Profit	3.70	6.58	9.99	22.1	29.9
Tax	(0.7)	(1.5)	(1.1)	(3.8)	(5.1)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	3.04	5.08	8.90	18.4	24.8
Net Profit before Except.	3.05	5.13	8.90	18.4	24.8
EBITDA	7.16	9.92	19.4	31.5	41.7
Growth					
Revenue Gth (%)	N/A	50.7	57.9	302.0	34.4
EBITDA Gth (%)	nm	38.5	95.2	62.6	32.4
Opg Profit Gth (%)	nm	78.3	56.7	116.7	45.3
Net Profit Gth (Pre-ex) (%)	nm	68.1	73.4	106.3	35.3
Margins & Ratio					
Gross Margins (%)	31.6	39.5	48.0	28.6	31.0
Opg Profit Margin (%)	23.0	27.3	27.1	14.6	15.8
Net Profit Margin (%)	18.8	20.9	23.2	11.9	12.0
ROAE (%)	166.5	44.5	32.1	33.7	29.2
ROA (%)	34.8	18.5	16.7	14.3	10.7
ROCE (%)	104.8	37.7	27.3	30.4	21.0
Div Payout Ratio (%)	0.0	0.0	0.0	0.0	0.0
Net Interest Cover (x)	NM	NM	26.8	58.1	11.7

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Mar	1H15	2H15	1H16	2H16
Revenue	9.7	14.6	12.7	25.6
Cost of Goods Sold	(4.0)	(10.7)	(4.3)	(15.6)
Gross Profit	5.7	3.9	8.4	10.0
Other Oper. (Exp)/Inc	(1.2)	(1.8)	(3.0)	(5.4)
Operating Profit	4.5	2.1	5.4	4.6
Other Non Opg (Exp)/Inc	0.0	(0.0)	0.0	(0.0)
Associates & JV Inc	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	0.0	0.0	0.0	0.0
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0
Pre-tax Profit	4.5	2.0	5.4	4.6
Tax	(0.9)	(0.6)	(0.9)	(0.2)
Minority Interest	0.0	0.0	0.0	0.0
Net Profit	3.6	1.5	4.5	4.4
Net profit bef Except.	3.6	1.5	4.5	4.4
EBITDA	5.3	4.6	6.7	4.6
Growth				
Revenue Gth (%)		51	(13)	102
EBITDA Gth (%)		(13)	45	(31)
Opg Profit Gth (%)		(54)	161	(15)
Net Profit Gth (Pre-ex) (%)		(60)	208	(2)
Margins				
Gross Margins (%)	58.7	26.7	66.1	39.0
Opg Profit Margins (%)	46.7	14.1	42.4	17.9
Net Profit Margins (%)	37.4	10.0	35.5	17.1

Volatile margins mainly due to different stages of revenue recognition

Balance Sheet (S$m)

FY Mar	2014A	2015A	2016A	2017F	2018F
Net Fixed Assets	0.10	0.10	3.65	20.4	66.4
Invts in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	3.90	6.36	26.1	17.6	9.18
Cash & ST Invts	0.60	5.76	4.74	19.5	26.6
Inventory	1.49	4.77	9.83	40.3	52.3
Debtors	11.4	20.6	24.4	90.5	122
Other Current Assets	0.0	0.0	0.26	0.26	0.26
Total Assets	17.5	37.6	69.0	188	276
ST Debt	0.10	0.22	0.20	0.20	0.20
Creditor	11.4	14.7	23.8	106	138
Other Current Liab	0.24	1.46	4.21	4.92	6.24
LT Debt	1.02	0.09	2.85	2.85	32.9
Other LT Liabilities	0.94	1.92	0.75	0.75	0.75
Shareholder's Equity	3.65	19.2	36.2	72.6	97.4
Minority Interests	0.13	0.0	0.98	0.98	0.98
Total Cap. & Liab.	17.5	37.6	69.0	188	276
Non-Cash Wkg. Capital	1.23	9.19	6.49	19.9	30.0
Net Cash/(Debt)	(0.5)	5.45	1.69	16.4	(6.5)
Debtors Turn (avg days)	128.6	240.0	214.2	136.0	186.8
Creditors Turn (avg days)	273.9	417.3	640.7	234.8	332.7
Inventory Turn (avg days)	35.9	100.2	243.0	90.5	126.2
Asset Turnover (x)	1.8	0.9	0.7	1.2	0.9
Current Ratio (x)	1.1	1.9	1.4	1.4	1.4
Quick Ratio (x)	1.0	1.6	1.0	1.0	1.0
Net Debt/Equity (X)	0.1	CASH	CASH	CASH	0.1
Net Debt/Equity ex MI (X)	0.1	CASH	CASH	CASH	0.1
Capex to Debt (%)	46.0	645.4	279.3	565.8	141.0
Z-Score (X)	16.9	13.1	8.6	4.0	3.8

Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Mar	2014A	2015A	2016A	2017F	2018F
Pre-Tax Profit	3.70	6.58	9.99	22.1	29.9
Dep. & Amort.	3.45	3.29	8.98	8.98	8.98
Tax Paid	(0.7)	(1.5)	(1.1)	(3.1)	(3.8)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(7.0)	(12.0)	(22.6)	(14.1)	(11.5)
Other Operating CF	1.00	1.00	0.0	0.0	0.0
Net Operating CF	**0.53**	**(2.6)**	**(4.7)**	**14.0**	**23.7**
Capital Exp.(net)	(0.5)	(2.0)	(8.5)	(17.3)	(46.6)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	0.0	0.0	0.0	0.0
Net Investing CF	**(0.5)**	**(2.0)**	**(8.5)**	**(17.3)**	**(46.6)**
Div Paid	0.0	0.0	0.0	0.0	0.0
Chg in Gross Debt	0.0	2.94	2.35	0.0	30.0
Capital Issues	0.0	7.75	9.10	18.0	0.0
Other Financing CF	0.46	(1.7)	(0.7)	0.0	0.0
Net Financing CF	**0.46**	**9.05**	**10.7**	**18.0**	**30.0**
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	0.47	4.44	(2.5)	14.8	7.08
Opg CFPS (S cts)	0.90	1.13	1.98	2.68	3.36
Free CFPS (S cts)	0.00	(0.6)	(1.5)	(0.3)	(2.2)

FY17 and FY18 - Acquisition of cinemas and RINGS.TV

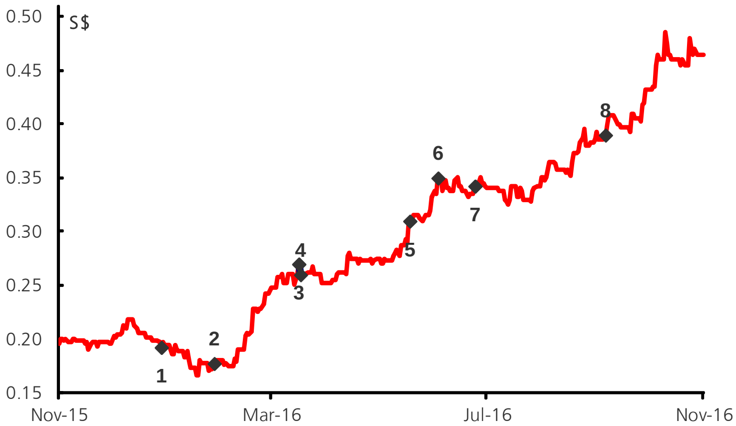
Issue of shares to finance recent acquisitions

Assume partial debt financing for the acquisition of cinemas

Proceeds from IPO

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	05 Jan 16	0.19	0.26	BUY
2:	04 Feb 16	0.18	0.26	BUY
3:	23 Mar 16	0.27	0.26	BUY
4:	24 Mar 16	0.26	0.31	BUY
5:	25 May 16	0.31	0.37	BUY
6:	10 Jun 16	0.35	0.37	BUY
7:	01 Jul 16	0.34	0.41	BUY
8:	13 Sep 16	0.39	0.47	BUY

***Note**: Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank
Analyst: Lee Keng LING

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 9 Nov 2016 16:27:53
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