

Leverage and larger cost base hurt

Maintain Buy; likely at an earnings trough now

Maintain Buy; cut SOTP-based TP to SGD0.37, implying 23% upside

We maintain our Buy rating, but lower SOTP-based TP to SGD0.37 as we cut our FY19/20F revenue/PATMI by c.3%/40%. The earnings cut is mainly to reflect: 1) slightly slower-than-expected revenue run-rate; 2) higher-than-expected interest expense; and 3) higher-than-expected tax rates. At the same time, we make changes to our SOTP-based valuation, where we now value the 'unlisted' businesses of MM2 on an EV/EBITDA basis (vs. P/E earlier as we expect the cinema business to be loss-making at the NPAT level). The stock is trading at 7.4x FY19F EV/EBITDA. While 3Q19 results were disappointing, we believe the results likely signal an earnings trough as:

- Interest cost is unusually high in FY19 due to various one-off accounting charges and purchase price allocations after the acquisition of Cathay Cineplexes. We expect interest cost to decline to SGD14.3mn in FY20F vs. SGD17.6mn in FY19F, led by the debt retirement related to the acquisition.
- While the EBITDA of MM2's cinema operations is currently positive, PBT is largely loss-making, based on our estimates, due to the higher fixed asset base and interest expenses. However, we see opportunities for margin improvement on the back of higher utilisation rate with more B2B deals and lower interest liabilities.
- The revenue profile of MM2 remains robust with most segments recording healthy growth along with improving cash flow visibility, which should help for reinvestment into the higher returns core business.

Cinema as a double-edged sword – divestment could be healthy

The acquisition of Cathay Cineplexes a year ago was perceived by the market as a launchpad for MM2 to become a key regional entertainment player. However, we believe the acquisition is currently perceived to be a double-edged sword. While we continue to like the strong cash-generating ability of the cinema, where MM2 is likely to fund re-investment for future growth, the high leverage on the back of this acquisition would likely continue to weigh on earnings. Any partial divestment of the cinema assets or debt retirement would likely become a growth catalyst for the stock.

Year-end 31 Mar	FY18		FY19F		FY20F		FY21F	
Currency (SGD)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	192	285	277	319	310	345	338	
Reported net profit (mn)	26	43	19	38	23	43	26	
Normalised net profit (mn)	26	33	20	38	23	43	26	
FD normalised EPS	2.28c	2.86c	1.71c	3.31c	1.96c	3.68c	2.25c	
FD norm. EPS growth (%)	31.7	26.0	-24.8	15.5	14.8	11.3	14.5	
FD normalised P/E (x)	13.2	N/A	17.5	N/A	15.3	N/A	13.3	
EV/EBITDA (x)	5.6	N/A	7.4	N/A	6.5	N/A	5.9	
Price/book (x)	1.9	N/A	1.7	N/A	1.6	N/A	1.4	
Dividend yield (%)	na	N/A	na	N/A	na	N/A	na	
ROE (%)	19.8	21.1	9.8	15.8	10.7	15.1	11.0	
Net debt/equity (%)	net cash	99.6	87.8	78.5	65.9	62.0	44.9	

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

14 February 2019

Rating Remains	Buy
Target Price Reduced from 0.64	SGD 0.37
Closing price 13 February 2019	SGD 0.30
Potential upside	+23.3%

Anchor themes

Content is king, especially in the current digital age where consumption patterns are shifting drastically. We believe that MM2 is well positioned to capture these shifts, by leveraging on its strong content development capabilities and multi-platform business.

Nomura vs consensus

We see value and are relatively bullish on the growth prospects of MM2's asset-light core business vs. the Street.

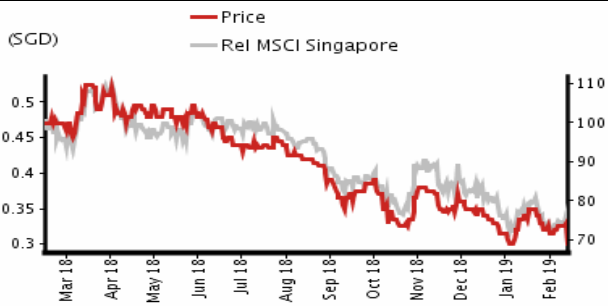
Research analysts

Singapore Consumer Related

Guo Hao Yong - NSL
guohao.yong@nomura.com
+65 6433 6967

Key data on MM2 Asia

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (SGD)	-10.4	-18.9	-37.5	M cap (USDm)	257.3
Absolute (USD)	-10.6	-17.3	-39.0	Free float (%)	43.9
Rel to MSCI Singapore	-10.4	-23.4	-29.8	3-mth ADT (USDm)	0.2

Income statement (SGDmn)

Year-end 31 Mar	FY17	FY18	FY19F	FY20F	FY21F
Revenue	96	192	277	310	338
Cost of goods sold	-50	-104	-149	-172	-191
Gross profit	45	88	128	139	148
SG&A	-20	-47	-72	-76	-80
Employee share expense					
Operating profit	25	41	56	62	67
EBITDA	40	62	76	84	90
Depreciation	-2	-6	-10	-12	-14
Amortisation	-14	-15	-10	-9	-9
EBIT	25	41	56	62	67
Net interest expense	-1	-1	-17	-14	-12
Associates & JCEs	0	0	0	0	0
Other income	0	1	2	2	2
Earnings before tax	24	41	40	50	57
Income tax	-4	-7	-12	-15	-17
Net profit after tax	20	34	28	35	40
Minority interests	-3	-7	-9	-12	-14
Other items			1		
Preferred dividends					
Normalised NPAT	18	26	20	23	26
Extraordinary items			-1		
Reported NPAT	18	26	19	23	26
Dividends					
Transfer to reserves	18	26	19	23	26

Valuations and ratios

Reported P/E (x)	17.4	13.2	18.6	15.3	13.3
Normalised P/E (x)	17.4	13.2	17.5	15.3	13.3
FD normalised P/E (x)	17.4	13.2	17.5	15.3	13.3
Dividend yield (%)	na	na	na	na	na
Price/cashflow (x)	32.3	523.0	na	6.2	5.7
Price/book (x)	3.6	1.9	1.7	1.6	1.4
EV/EBITDA (x)	8.6	5.6	7.4	6.5	5.9
EV/EBIT (x)	13.8	8.5	10.1	8.8	7.8
Gross margin (%)	47.3	46.0	46.2	44.7	43.7
EBITDA margin (%)	42.2	32.4	27.6	27.0	26.6
EBIT margin (%)	26.1	21.4	20.1	20.1	19.9
Net margin (%)	18.3	13.8	6.8	7.4	7.7
Effective tax rate (%)	15.3	17.8	30.0	30.0	30.0
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	28.6	19.8	9.8	10.7	11.0
ROA (pretax %)	24.9	13.0	10.9	11.7	12.2

Growth (%)

Revenue	149.7	100.6	44.2	12.1	9.0
EBITDA	117.0	54.0	22.9	9.8	7.3
Normalised EPS	90.3	31.7	-24.8	14.8	14.5
Normalised FDEPS	90.3	31.7	-24.8	14.8	14.5

Source: Company data, Nomura estimates

Cashflow statement (SGDmn)

Year-end 31 Mar	FY17	FY18	FY19F	FY20F	FY21F
EBITDA	40	62	76	84	90
Change in working capital	1	153	-229	-7	-6
Other operating cashflow	-32	-215	-21	-20	-23
Cashflow from operations	9	1	-173	56	61
Capital expenditure	-10	-10	-10	-10	-10
Free cashflow	-1	-10	-184	46	51
Reduction in investments					
Net acquisitions					
Dec in other LT assets					
Inc in other LT liabilities					
Adjustments	-16	-63	-3	-3	-3
CF after investing acts	-17	-73	-187	43	47
Cash dividends	0	0	0	0	0
Equity issue	18	82	0	0	0
Debt issue	10	12	148	-25	-25
Convertible debt issue	11	115	7	0	0
Others	-1	-69	-17	-14	-12
CF from financial acts	38	140	138	-39	-37
Net cashflow	21	67	-49	4	10
Beginning cash	5	26	93	45	49
Ending cash	26	93	45	49	59
Ending net debt	-14	-27	177	148	113

Balance sheet (SGDmn)

As at 31 Mar	FY17	FY18	FY19F	FY20F	FY21F
Cash & equivalents	26	93	45	49	59
Marketable securities					
Accounts receivable	46	115	146	163	178
Inventories	1	7	6	7	8
Other current assets	23	21	21	21	21
Total current assets	96	236	217	239	265
LT investments					
Fixed assets	11	41	41	39	36
Goodwill	47	292	295	298	302
Other intangible assets	9	9	9	7	5
Other LT assets	2	8	8	8	8
Total assets	166	586	571	592	617
Short-term debt	6	5	100	75	50
Accounts payable	47	275	76	87	97
Other current liabilities	9	12	12	12	12
Total current liabilities	62	292	188	174	159
Long-term debt	5	61	121	121	121
Convertible debt					
Other LT liabilities	2	21	21	21	21
Total liabilities	69	374	330	316	301
Minority interest	11	30	39	52	65
Preferred stock					
Common stock	88	153	153	153	153
Retained earnings	34	61	79	102	128
Proposed dividends					
Other equity and reserves	-37	-31	-31	-31	-31
Total shareholders' equity	85	183	201	224	250
Total equity & liabilities	166	586	571	592	617

Liquidity (x)

Current ratio	1.55	0.81	1.15	1.37	1.67
Interest cover	18.1	37.3	3.3	4.5	5.5

Leverage

Net debt/EBITDA (x)	net cash	net cash	2.32	1.76	1.25
Net debt/equity (%)	net cash	net cash	87.8	65.9	44.9

Per share

Reported EPS (SGD)	1.73c	2.28c	1.62c	1.96c	2.25c
Norm EPS (SGD)	1.73c	2.28c	1.71c	1.96c	2.25c
FD norm EPS (SGD)	1.73c	2.28c	1.71c	1.96c	2.25c
BVPS (SGD)	0.08	0.16	0.17	0.19	0.22
DPS (SGD)	0.00	0.00	0.00	0.00	0.00

Activity (days)

Days receivable	134.8	153.5	172.0	182.2	184.1
Days inventory	3.3	12.6	15.5	14.1	14.3
Days payable	254.7	565.3	428.7	173.3	175.9
Cash cycle	-116.7	-399.2	-241.3	22.9	22.5

Source: Company data, Nomura estimates

Fig. 1: MM2 Asia Ltd – SOTP valuations

MM2 Asia Ltd							
Year ended 31 March (SGD mn)							
Sum-of-the-parts Valuation							
	Stake	FY3/19 EBITDA	Multiple	Valuation	MM2's portion	Remarks	
Unlisted Entities							
Core Production & Distribution	100%	42.9	8.0x	343.2	343.2	In-line with peers	(1)
Cinema Operations	100%	12.4	10.0x	124.0	124.0	In-line with peers	(2)
Net Debt					176.9	Expected net debt as of end-FY19F	(3)
Equity Value					290.3		(1)+(2)-(3) = (4)
Listed Stub Entities							
Concert Promotions (UnUsUaI)	39%	4.2	na	303.6	118.9	Market valuation as of 13 Feb 2019	(5)
Post-Production (VividThree)	42%	18.5	na	61.1	25.4	Market valuation as of 13 Feb 2019	(6)
Total Stub Valuation					144.3		(5)+(6)=(7)
Total Equity Value		434.6					(4)+(7)
Shares outstanding (mn)		1162.8					
Implied Fair Value per share		SGD 0.37					

Source: Bloomberg, company data, Nomura estimates

3Q19 results review:

3Q19 results were disappointing but were hardly operationally-related, with the exception of cinema (elaborated below), in our view. Most of the “misses” are largely related to the finalisation in the accounting treatment, one-off charges and interest costs. We think that optimising the group’s capital structure should be of utmost priority in the near-term and an earnings trough is largely in sight. We also detail some of the key updates of the various business verticals below:

Core business

- The production pipeline for the core business is generally robust with various opportunities available. Blockbuster movie “More Than Blue”, which grossed c.SGD2mn based on our estimates, would also be booked in 4Q19.
- Debt related to the acquisition of Cathay Cineplexes, particularly the medium term note (MTN) and term loan, is booked under the MM2 Group which is then accounted for as “Investment Borrowings” under the accounting rules. Consequently, interest expenses resulting from these borrowings are not tax-deductible. Unless MM2 decides to refinance these debt tranches at the MM Connect level, which houses Cathay Cineplexes, tax rates are likely to remain elevated in the near-term. We continue to assume c.30% tax rate for MM2 in our estimates.

UnUsUaL (UNU SP, Not Rated)

- While revenue remains robust, gross margins came in relatively below our expectations. This is largely attributed to projects located in cities such as Jakarta and parts of North Asia, where UnUsUaL recently made its entry. Other than higher administrative costs associated with these projects, profit-sharing is also usually required with local organising partners, resulting in a decline in margins.
- As UnUsUaL further expands into family entertainment, we think that a downside to gross margins would likely be the new norm going forward due to potentially lower ASPs. However, this is likely to be mitigated by the higher show counts and better sustainability associated with these projects, in our view.
- While the pipeline remains robust and strong for UnUsUaL, we see the potential for UnUsUaL to take on debt to finance some of its expansion plans in FY20F.

Cinema

- Based on our estimates, we believe EBITDA is likely to trend below our expectations and this is largely related to the higher fixed costs after the opening of Cathay Cineplexes at Parkway Parade. That said, we see opportunities for margin improvement on the back of higher utilisation rate with more B2B deals and lower interest liabilities. These factors reinforce our view that earnings are likely at the trough.
- 3Q18 results were also restated due to the deferred payment arrangement relating to the acquisition of Cathay Cineplexes. In the “Purchase Price Allocation” exercise, part

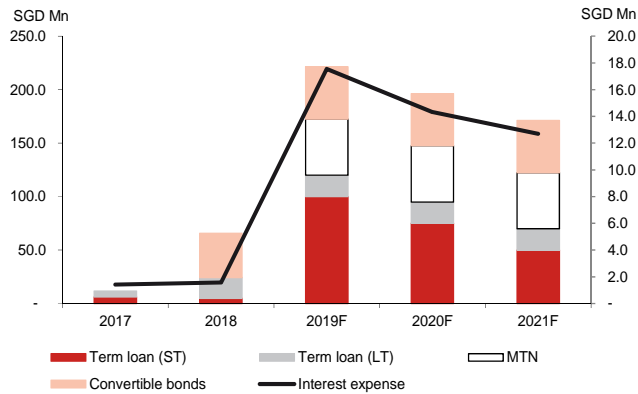
of the allocated goodwill was “overstated” due to the presence of an “interest” component, which was subsequently expensed off.

- Management acknowledges that the partial spin-off of Cathay Cineplexes remains an option to pare down debt over the next 12-24 months.

VividThree (VTH SP, Not Rated)

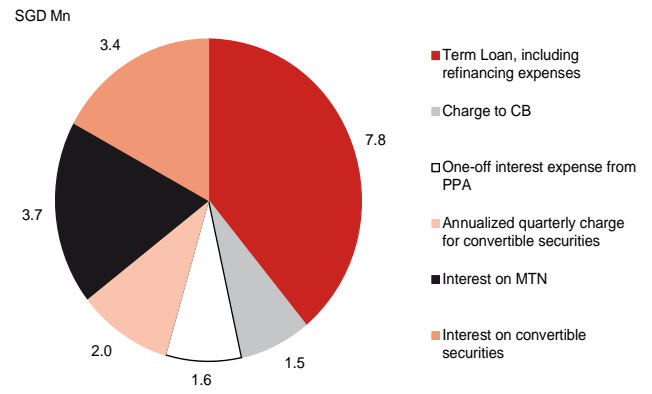
- Revenue growth was largely on track as the first Train to Busan Virtual Reality Tour set was successfully delivered in Beijing. Execution and reviews were also largely positive.
- Management further expects another one-to-three sets of differing sizes for various cities and this should support the revenue in the near-term.
- Management has also highlighted the potential of acquiring various intellectual properties for the content production of virtual reality sets in FY19F.

Fig. 2: MM2’s debt profile – expecting debt to decline



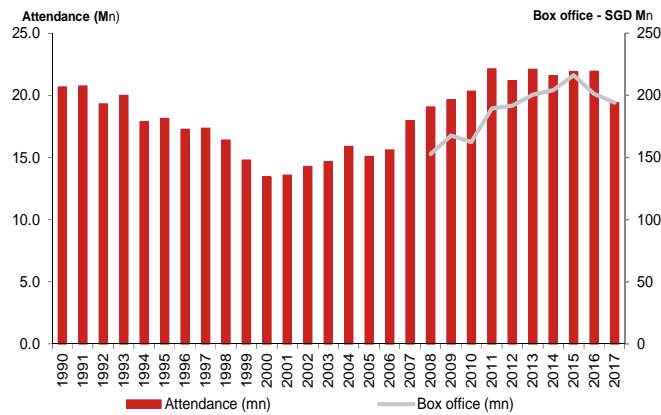
Source: Company data, Nomura estimates

Fig. 3: MM2’s interest expense split



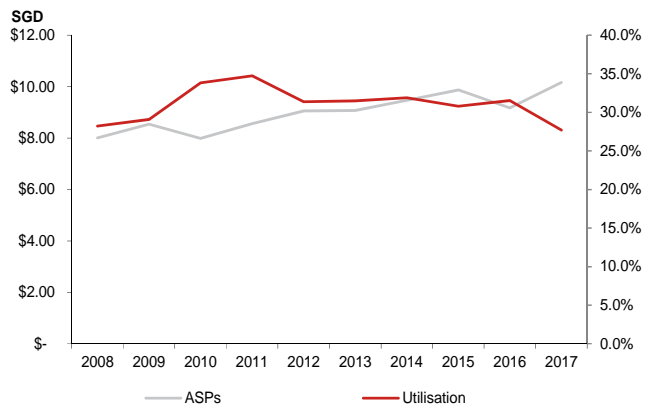
Source: Company data, Nomura estimates

Fig. 4: Singapore’s box office was relatively soft in FY16/17



Source: IMDA, Nomura estimates

Fig. 5: Utilisation on a decline, ASPs on the rise, in our view



Source: IMDA, Nomura estimates; utilisation calculated based on 5 shows a day over 365 days

Fig. 6: ASEAN media peers valuation summary

	Bloomberg ticker	Cncy	Rating	Local price	Mkt Cap (US\$ mn)	PE (x)		EV/EBITDA (x)		Div Yield (%)		FCF Yield (%)	
						FY1	FY2	FY1	FY2	FY1	FY2	FY1	FY2
MM2 Asia	MM2 SP	SGD	Buy	0.3	257	17.5	15.3	7.4	6.5	na	na	nm	10.0
FTA TV													
SCMA	SCMA UJ	IDR	Neutral	1,755	1,820	16.8	15.4	11.5	10.6	3.7	4.1	5.6	5.9
MNC	MNCN UJ	IDR	Neutral	825	835	8.2	7.1	5.3	5.0	4.9	6.1	12.7	10.3
BEC	BEC TB	THB	Rating Suspended	6.3	399	na	44.6	3.8	3.4	0.4	1.7	6.2	7.4
Media Prima	MPR MK	MYR	NR	0.41	112	na	na	7.0	6.5	na	na	32.0	(8.5)
ABS-CBN	ABS PM	PHP	NR	22.7	374	9.2	6.2	3.3	2.8	na	na	na	na
Zee Entertainment	Z IN	INR	Buy	408	5,533	23.9	20.8	14.5	12.9	0.9	1.1	2.1	3.0
Sun TV Network	SUNTU IN	INR	Buy	554	3,079	14.9	13.8	7.8	7.2	2.9	3.5	5.2	6.3
Average						14.6	18.0	7.6	6.9	2.6	3.3	10.6	4.1
Median						14.9	14.6	7.0	6.5	2.9	3.5	5.9	6.1
Pay TV													
Astro Malaysia	ASTRO MK	MYR	Neutral	1.58	2,025	14.2	12.4	6.6	6.3	6.6	7.0	16.7	16.8
MSKY	MSKY UJ	IDR	NR	1,180	759	na	na	na	na	na	na	na	na
Dish TV	DITV IN	INR	Neutral	33	847	31.2	19.4	4.0	3.7	0.8	1.2	15.4	19.3
StarHub	STH SP	SGD	Neutral	1.89	2,408	15.1	16.3	7.2	7.3	8.4	6.5	6.9	5.1
PCCW	8 HK	HKD	NR	4.84	4,760	33.8	26.2	6.3	6.1	6.3	6.4	19.6	21.9
Average						23.6	18.6	6.0	5.9	5.5	5.2	14.7	15.8
Median						23.2	17.9	6.5	6.2	6.5	6.4	16.1	18.1
Film Exhibitors													
Major	Major TB	THB	Neutral	23.9	682	20.0	19.1	11.2	10.2	4.9	4.7	6.6	6.9
Wanda	002739 CH	CNY	NR	20	5,089	22.3	19.9	12.3	10.4	0.8	0.9	3.0	5.5
CJ CGV	079160 KS	KRW	NR	40,800	768	20.0	13.0	na	na	0.8	0.8	7.5	9.1
PVR	PVRL IN	INR	NR	1,476	974	39.7	30.4	13.8	11.1	0.2	0.2	(3.7)	0.5
IMAX China	1970 HK	HKD	Buy	20	928	19.3	18.1	10.3	9.6	1.6	1.7	0.4	0.6
Cineworld	Cine LN	GBp	NR	262	4,625	12.6	10.3	8.8	7.2	4.3	5.3	11.2	12.5
Cinemark	CNK US	USD	NR	37	4,300	17.4	15.8	7.9	7.6	3.5	3.7	3.0	4.4
Average						21.6	18.1	10.7	9.3	2.3	2.5	4.0	5.6
Median						20.0	18.1	10.7	9.9	1.6	1.7	3.0	5.5
Regional Entertainment													
MM2 Asia	MM2 SP	SGD	Buy	0.30	257	17.5	15.3	7.4	6.5	na	na	nm	10.0
Spackman Entertainment	SEG SP	SGD	NR	0.03	20	4.0	2.5	na	na	na	na	na	na
Village Roadshow	VRL AU	AUD	NR	3.24	447	29.2	18.3	8.0	6.9	1.0	3.2	11.0	7.9
Alibaba Pictures Group	1060 HK	HKD	NR	1.52	4,936	na	na	na	na	na	na	na	na
IMAX China	1970 HK	HKD	Buy	20.45	928	19.3	18.1	10.3	9.6	1.6	1.7	0.4	0.6
Media Asia Group Holdings	8075 HK	HKD	NR	0.11	30	na	na	na	na	na	na	na	na
HMV Digital China Group	8078 HK	HKD	NR	0.01	17	na	na	na	na	na	na	na	na
Interactive Entertainment	8081 HK	HKD	NR	0.03	22	na	na	na	na	na	na	na	na
YG Entertainment Inc	122870 KS	KRW	NR	44,600	721	99.0	41.1	39.8	24.6	0.3	0.4	(0.6)	1.2
Showbox Corp	086980 KS	KRW	NR	3,120	174	13.5	11.1	na	na	1.6	1.6	35.2	37.8
Average						30.4	17.7	16.4	11.9	1.1	1.7	11.5	11.5
Median						18.4	16.7	9.1	8.2	1.3	1.6	5.7	7.9

Source: Bloomberg, Nomura estimates. Pricing are as of 13 February 2019 close. Consensus forecast are used for non-rated stocks.

Valuations

Our new TP of SGD0.37 is derived from SOTP valuation methodology, ascribing EV/EBITDA multiples of 8x/10x to the FY19F EBITDA of its core business/cinema operations. A net debt of SGD177mn is also expected as of end-FY19F. Valuations of UnUsUaL and VividThree are as per current market cap as of 13 February 2019.

Risks

Key downside risks include: 1) lack of financing arrangement for productions; 2) cost uncertainties from delays or overruns resulting in a budget shortfall; 3) growing piracy issues and lack of IP protection limiting MM2's growth prospects; and 4) unexpected capital expenditure required for MM2's cinema business.

Appendix A-1

Analyst Certification

I, Guo Hao Yong, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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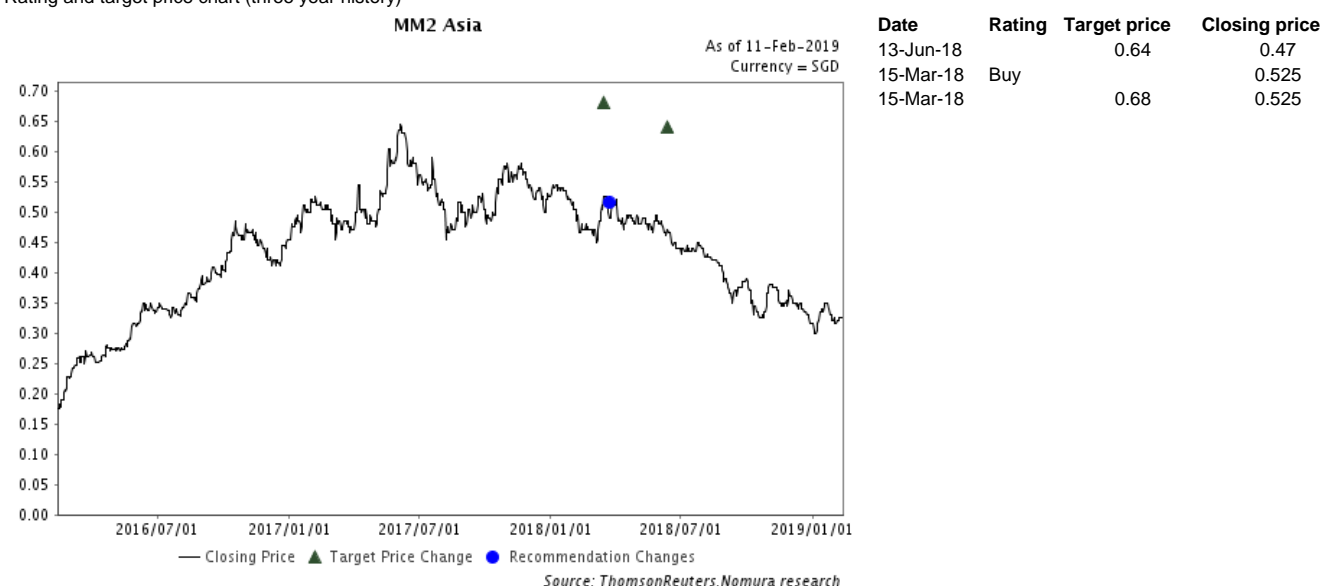
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
MM2 Asia	MM2 SP	SGD 0.30	13-Feb-2019	Buy	N/A	

MM2 Asia (MM2 SP)

SGD 0.30 (13-Feb-2019) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of SGD0.37 is derived from SOTP valuation methodology, ascribing EV/EBITDA multiples of 8x/10x to the FY19F EBITDA of its core business/Cinema operations. A net debt of SGD177mn is also expected as of end-FY19F. Valuations of UnUsUaL and VividThree are as per current market cap as of 13 February 2019. The benchmark index for this stock is MSCI Singapore.

Risks that may impede the achievement of the target price Key downside risks include: 1) lack of financing arrangement for productions; 2) cost uncertainties from the delays or overruns, resulting in a budget shortfall; 3) growing piracy issues and lack of IP protection limiting MM2's growth prospects; and 4) unexpected capital expenditure required for MM2's Cinema business.

Important Disclosures

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As at 31 December 2018.

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