AMC Entertainment Holdings
A Free Cash Flow Story

Price: 15.35, Target: 28.00 William Tylko Published: July 31st, 2018, Revised: August 6th, 2018

Executive Summary

AMC is the world's largest movie exhibitor. Its operations span two major markets: the U.S., where it has approximately 8,000 screens and a 20% market share, and Europe, where it has approximately 2,700 screens and a 10% market share. Over the last 4 years, AMC has reinvested a considerable amount of cash in its business: a $3.4B acquisition spree doubled AMC's worldwide footprint; and an estimated $1.2B to date renovation project has enabled AMC to redefine the moviegoing experience. The impact of this increased use of capital in a market facing stiff competition from video on demand services is reflected in AMC's EV/EBITDA multiple of 8.3x vs. the market at 13.5x. The company has a $2B market cap, $4.6B net debt, and in 2017 had GAAP $127m of unlevered FCF and $640m in EBITDA. Since AMC's share price slid 60% in 2017, management has shifted its focus to restoring value to their shareholders and decreasing leverage. Significant free cash flow will be created when management begins to end their theater renovation program, and additional cash flow can be unlocked by selling non-core assets. Additionally, AMC also has a decent organic growth opportunity on its hands, AMC A-List, which is not being priced into the market. The combination of these factors will lead to excess returns.

Key Points

1. Industry Primer: The death of the movie theater industry has been greatly exaggerated
2. A-List: Unique growth opportunity could increase free cash flow by $130MM in 2022
3. Capital Expenditures to Slow: Lower Capex demands to benefit FCF $129MM in 2022
4. Deleveraging: Lower leverage could improve margin of error
5. AMC Management: Trained capital allocators

The Catalyst

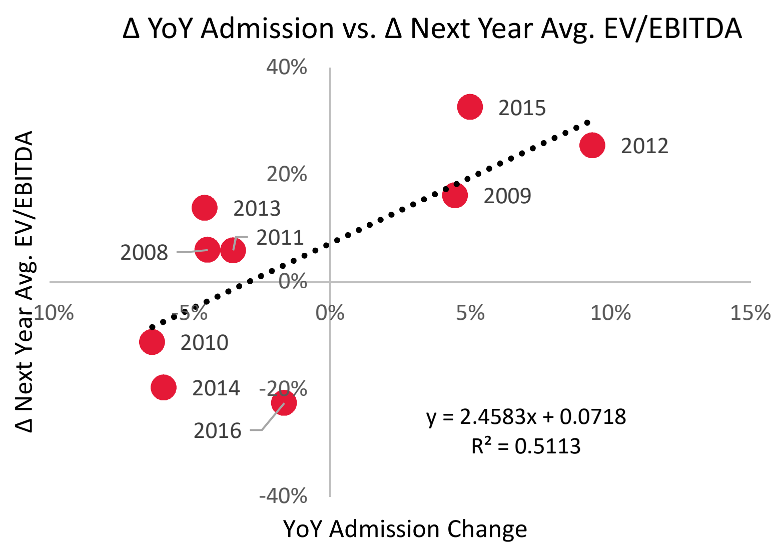
Higher than expected A-List enrollment and the realization of slowing capital needs could possibly squeeze the 25% short interest.

Industry Primer: The death of the movie theater industry has been greatly exaggerated

The theatrical exhibitor industry may be home to the most volatile unit economics in the market—and these trends impact both the bottom line and valuations. Attendance fluctuates based on the popularity of the currently in-exhibition movies, and the numbers of movies released. The number of movies released has a direct impact on the level of sales. For example, Disney has released between 8 and 13 movies for the last 6 years, and Disney's decision to release one additional movie will swing the U.S. Box Office $200MM.

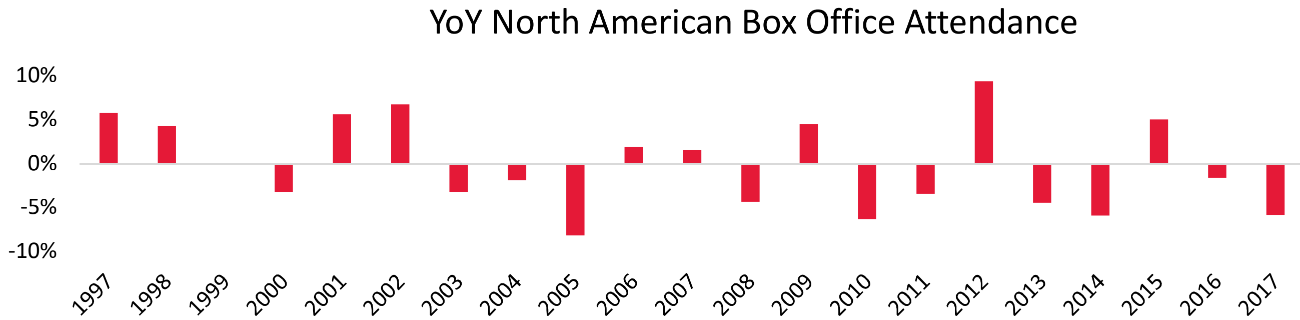
The bear argument for exhibitors is that they will be replaced by in home, premium video on demand (PVOD). The thesis for this bear argument was originally written at the time of the invention of the TV in 1927, but has since gained popularity during the rise of the internet. The difference between watching a movie at the theaters and your house is the experience. Consumers love to overpay for experiences; it's the basics of capitalism. For example, going to a baseball game, eating out at restaurants, and buying a $12 beer at an overcrowded bar when you know that you could purchase the same drink for $2 at the gas station around the corner. People enjoy experiences and will continue to pay for them.

But the volatile admissions economics often confuse investors that the PVOD secular demand threat is imminent. For example, when North American Box Office admissions slid -5.9% in 2017, the world claimed that this was evidence that movie theaters would be immediately replaced by online streaming. The reality is that the sales slump was the result of a nonexistent summer blockbuster hit in the U.S., and this trend is confirmed by admissions in Europe rising 2% YoY (Screen Daily), while having the same access to PVOD. The box office cyclicality has an impact on public valuations, with this year's attendance influencing next year's EV/EBITDA multiples.



The North American Box Office attendance has declined at an annualized rate of -150bps since its peak in 2004, and it's likely this trend will continue at its recent rate of -100bps as the market is adjusting to a new equilibrium. In the same period, ticket prices increased at a rate of +290bps per year, 80bps points above inflation. It can be reasonably be assumed that the box office will continue to grow at around 140bps per year.

The largest threat to the theatrical exhibitor industry is the current consolidation in the studio industry. Often, the after-consolidated studio produces less movies than the two separate studios did, which creates less demand for the box office. In addition, the more content a single studio produces, the likelihood that the studio may attempt to launch their own PVOD business increases. The largest threat here is Disney – a studio which has historically controlled nearly 40-50% of the U.S. Box Office after considering the likely acquisition of Fox. Disney plans to release their PVOD streaming business to consumers in 2019, and it is currently unclear how it will impact current theatrical releases. The reasonable capital allocator would try very hard to grow the new business and keep the old one in place, especially considering that the studio business has historically had larger operating income margins than other Disney segments.



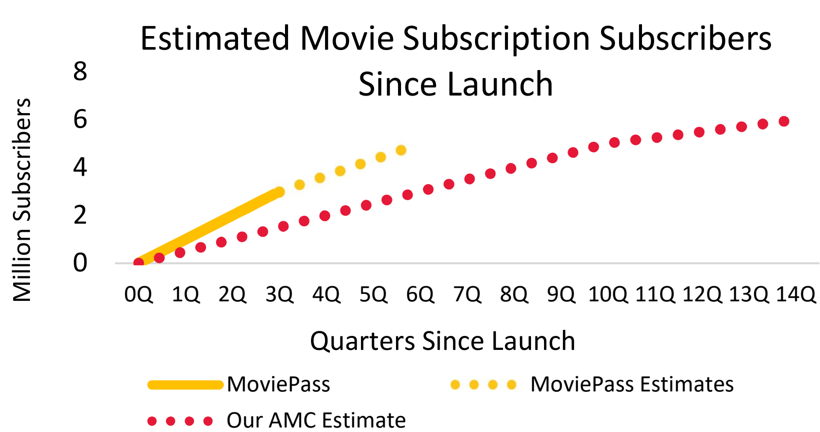
A-List: Unique growth opportunity could increase free cash flow by $130MM in 2022

In June of 2018, AMC responded to MoviePass by releasing its own subscription movie service model: AMC A-List. At $20 a month, the product is double the price of MoviePass, but offers key additional benefits that overtime will attract users. A-List lets users see any movie 3 times a week, book in advanced, and see high definition formats. Most importantly it is a dependable service, and at the end of the day it is accretive to AMC's EBITDA. AMC A-List's advantage over MoviePass is that AMC benefits from operating leverage: the additional cost to see another movie is likely 2-3x less for AMC than MoviePass, and AMC has negotiated contracts with premium formats (IMAX) to allow A-List subscribers to see premium formats at no additional cost. While MoviePass's model is not sustainable, MoviePass has proven the subscription movie theater is in high demand for the moviegoer. Without a marketing campaign, MoviePass has grown their service from 20K users in August 2017 to 3M users by June 2018, and MoviePass's management expects 5M users by year end.

The economics of a $20 A-List plan would be attractive to the 12% of the population in the U.S. who sees more than one movie a month, together purchasing 47% of tickets (MPAA). If AMC could demand their 21% U.S. Box Office market share of these users, AMC has a potential market size of 8M subscribers in the U.S. for this service. AMC's potential market share is could be larger, as 12% of the general population of the U.S. already pays $12 a year for AMC's household loyalty program, AMC Stubs, indicating a large amount of consumers prefer the brand. Additionally, in the likely scenario MoviePass suspends operations, their 3-4M members have only one real alternative: AMC. If given the opportunity, AMC should attempt to buy MoviePass's owner (HMNY), as their market capitalization of less than $1M is insignificant compared to the damage a competitor could do with the 5M subscribers.

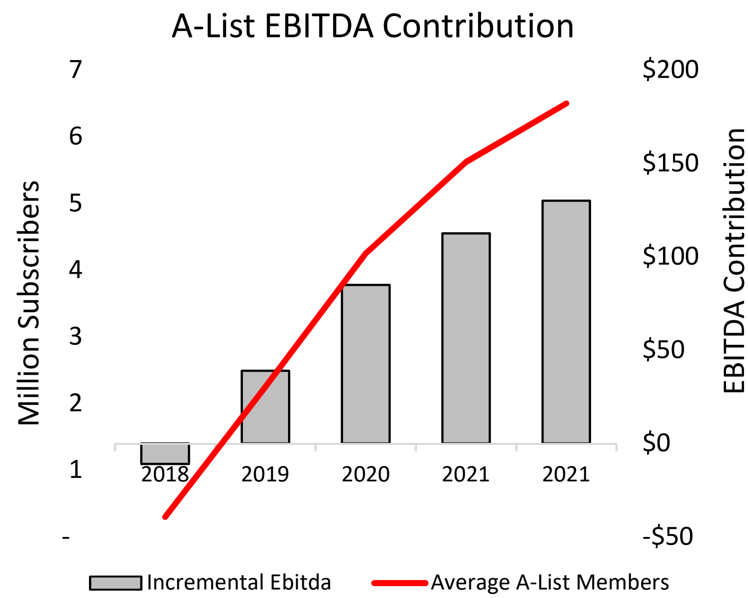
Given that AMC has direct relationships with 15 million households through AMC Stubs and 350 million visitors travel through AMC a year, it should not be difficult for AMC to market A-List. The service is already extremely popular - about two weeks after the roll-out of AMC A-List, our local AMC ticket collector suggested about 1 in 25 guests were already using the service.

For each million A-List subscribers, AMC estimates they will see an additional $15-25M in EBITDA per year, assuming customers attend 2.5



movies per month. AMC has suggested that onetime costs related to marketing A-List and an initial load of heavy users will cost the company $5-10MM in the second half of 2018. By 2019 AMC expects the service to have a neutral to positive impact on EBITDA, and a positive impact by 2020.

AMC has a chance here to shift their business model into a recurring revenue subscription model, which would demand a premium. Subscription services are naturally sticky, and consumers love them because the price seems more affordable. AMC also has additional opportunities that could increase revenue even further: family passes, or even raising ticket prices to the same price point of the monthly pass, that way consumers are enticed to sign up.



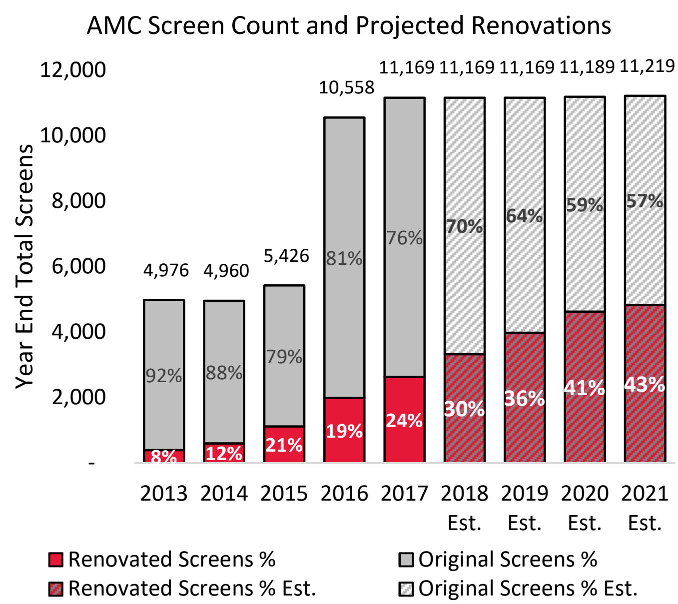
Given the potential market size, the strong probability of being the only subscription movie service for some time, and the already existing positive relationship between AMC and millions of consumers, we anticipate AMC could get to 1M subscribers by 2018, 3M by 2019 and 6M by 2020, and in an alternative worst-case scenario, half of that. Despite these advantages, our best-case estimate for A-List has a growth rate of approximately half the rate of growth for MoviePass.

Capital Expenditures to Slow: Lower Capex demands to benefit FCF $129MM in 2022

"At some point, we will be through this and the investment spending that we're making in our circuit can come considerably down. And I would expect that by 2020 or 2021, we'll be investing far less of our free cash flow back into the business."
Adam Aron, March Earnings Call

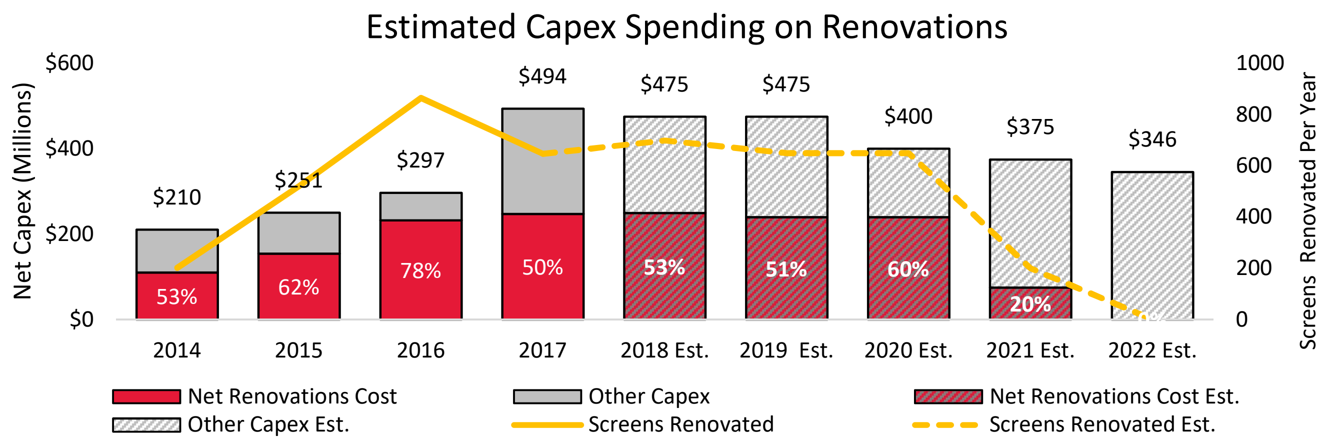
AMC has spent an estimated $1.2B gross over the past few years reinvesting and upgrading their theaters to provide grand experiences complete with luxurious recliners and upgraded concession amenities.

These $400k per screen upgrades are expensive, but renovations have proven to increase attendance by 40-60% in the first 12 months after the theater has opened, even with a 7% increase in price on average. AMC's target of renovating 4,830 (43%) of their screens could be reached by mid-2021 if renovations continue at the current pace. AMC is currently scheduled to be 70%



complete with this renovation target of 4,830 screens by year end 2018.

Normalized maintenance like capital expenditures have historically been around 4% of sales for AMC and we estimate AMC is likely to spend an additional 2% of sales on growth Capex. This estimate is slightly above comparable spend from historical public peers before the renovation trend. CapEx of 6% in 2022 would reduce gross capex by $280mm and net CapEx by $130mm.



Deleveraging: Lower leverage could improve margin of error

AMC will also unlock additional cash flows to investors as it delevers. AMC has sold off nearly $500mm of non-core assets within the last year, with $260MM of that within the last two months. Roughly half of the $500mm assets came from the sale of AMC's investment in National CineMedia, one-third came from sale lease backs, and the remainder from sales of minority equity investments.

Additionally, AMC is looking to IPO their European assets, a move which Bloomberg estimates could raise $1B for AMC, assuming 1/3rd of the new company is sold and AMC levers the company 9x EV/EBITDA. AMC management has confirmed that this may occur within the next year.

Reshaping AMC's leverage could increase room for possible margin of error, and provide opportunities to return cash to shareholders.

AMC Management: Trained capital allocators

AMC's management are keen capital allocators. In 2016 and early 2017, when their stock price was at near term highs they acquired undervalued competition using stock, and when their stock price hit lows, they switched to buying back stock.

AMC's capital allocation strategy has led it to invest abroad in markets that have potential. Their reasoning behind recent acquisitions is essentially if they renovate underinvested theaters in low competition markets, they will continue to see large scale returns as they did in the U.S.. In Europe, once again, AMC is the first major exhibitor to renovate its circuit. The company currently has one other expansion operation in Saudi Arabia, where they are building some of the first theaters in the country due to recent policy changes. The one Saudi Arabia theater that has recently opened out of the 50-100 planned is currently 20 times more profitable than the average AMC theater.

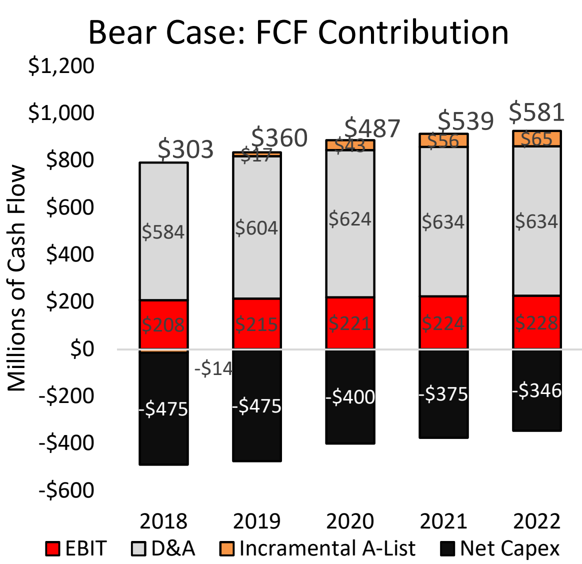
This capital allocation strategy is led by Adam Aron, an experienced industry veteran. Adam was the previous CEO at Starwood Hotels, Norwegian Cruise Line, and Vail Resorts. Additionally, Adam spent years at Apollo Management and United Airlines. At United Airlines, Adam unveiled one of the first frequent flyer programs. At Vail, Adam created the industry's first season pass. AMC could not have chosen a better CEO, as Adam is a seasoned veteran, with specific experience in capital allocation, experiences, and subscription loyalty programs.

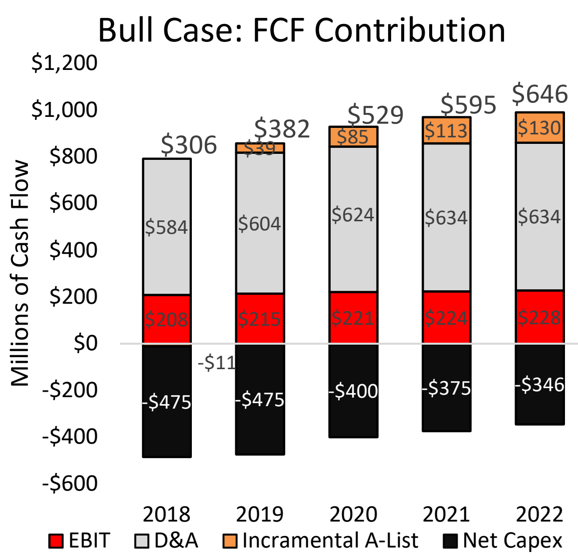
Valuation: Our models

We assume that in the near-term AMC's revenue will increase 2-2.5% to reflect an offset to 2017's US domestic box office miss, while long-term growth will continue at 1%. Between 2006 and 2014, a period with normal capital expenditures and a shrinking box office, AMC's four peers traded around an unlevered free cash flow multiple of 21x. A bear and bull case is used to arrive at a per share equity value of $28.00.

Bull case: This model assumes the incremental EBITDA from AMC A-List as mentioned above. Additionally, despite our strong belief that the movie theater is an experience people love akin to purchasing overpriced drinks at a bar, we use a multiple of 16x (compared to 21x historical) in our bull case to reflect a possible impairment to the attractiveness of the exhibitor industry. AMC's WACC is adjusted from 5.1% to 6% to reflect a normalized WACC.

Bear case: This model assumes incremental EBITDA revenue from AMC A-List with half of the consumers as in the bull case (.75m in year one, 3.25M in year 4), a free cash flow multiple of 11x to reflect a worsening outlook on movie exhibitors and a weighted cost of capital of 6%.





Bear Case	
Discount Rate	6.0%
FCF Mulitple	11.0
Present Value of FC	6,500
Net Debt	4,603
Equity Value	1,897
Target Price	$14.82
Last Close	$15.35
Upside	-3%

Bull Case	
Discount Rate	6.0%
FCF Mulitple	16.0
Present Value of FC	9,726
Net Debt	4,603
Equity Value	5,123
Target Price	$40.02
Last Close	$15.35
Upside	161%