AMC ENTERTAINMENT HOLDINGS **WILLIAM TYLKO 8/5/19**

SITUATION OVERVIEW

Concerns surrounding the box office, free cash flow conversion and high leverage have pushed AMC's stock to new lows. We find these concerns misplaced, and think they are obscuring a lucrative opportunity. We see AMC's equity as currently trading at 4x 2022's free cash flow.

BUSINESS DESCRIPTION

1. AMC is the world's largest movie exhibitor. AMC's domestic circuit of 8,000 screens represents 3/4ths of AMC's revenue and 20% of the domestic box office. The international segment contains 2,600 screens and represents 10% of the European box office.
2. AMC sold 348mn tickets worldwide (1% Y/Y growth) and generated revenues of $5.28B in 2018. 60% of AMC's revenue comes from admissions, 31% from Food and Beverage (86% gm) and 9% from advertising, fees and other.

Fundamentals (post ASC 842)	2017	2018	2019	2020	2021	2022	2023
Revenue	5081	5461	5592	5624	5861	5977	6127
Gross Profit	3223	3480	3561	3586	3743	3827	3921
EBITDA	748	836	831	797	894	917	946
EBITDAR	1643	1727	1782	1755	1858	1887	1926
Net Capex	493	449	450	385	330	275	275
Free Cash Flow	-68	-53	52	65	240	303	314
EBITDA Margin		15.3%	14.9%	14.2%	15.2%	15.3%	15.4%
FCF Margin		-1.0%	0.9%	1.2%	4.1%	5.1%	5.1%
Attendance		3.4%	1.1%	-1.5%	2.1%	0.5%	0.5%
Ticket Price		1.3%	-1.0%	2.0%	1.8%	0.7%	2.0%

Valuation			
Shares Outsanding		Debt	
Class A	52	Net Debt	4,857
Class B	52	Operating Lease	5,358
RSUs	2	Enterprise Value	6,032
Total Diluted Shares	106	EV+OL	11,390
Current Price	11.10		
Equity Valuation	1174		

INVESTMENT THESIS

1) **Consumers still enjoy going to movies.**
   a) **Movies are the most affordable outside of the household experience for consumers,** and are substantially cheaper than sporting events, concerts and theme parks. On the run movies also represent cultural phenomenons that form the bedrock of many social conversations.
   b) A loyal subset of customers still heavily support the box office. In 2018, 1.3bn tickets were sold in North America, with 3/4ths of the population going to see at least one movie. Twelve percent of the population is defined as moviegoers - who see at least one movie a month, and purchase about half of all tickets sold.
   c) **Streaming is not inversely correlated to attendance**: North American Box Office attendance has been relatively flat since 2011, even as the number of U.S. Netflix accounts has tripled to about half of all households. Adjusting for the relative strength in the 2018 box office lineup, attendance could be estimated at falling -0.5% a year.
   d) The industry has consistently been able to offset limited attendance growth with annual price increases of 1-3%.

2) **AMC is strategically positioned as the largest and most advanced exhibitor in the world.**
   a) Through several acquisitions, AMC has positioned itself as the largest exhibitor in the world with a focus on the developed market; specifically within the U.S., Europe and Saudi Arabia. AMC's largest competitors are Cineworld (Europe/U.S.) and Cinemark (U.S./EM). As all three markets predominantly exhibit the same U.S. films, AMC should benefit from the scale of its combined operations.
      i. Benefits from being the largest exhibitor in the world are evident within AMC's U.S. operations. AMC's take rate on films (film revenues less film rental cost) is approximately 150bps higher than Cinemark.
   b) Significantly higher capital expenditures on a per screen basis has made AMC the most refurbished and technologically advanced U.S. exhibitor circuit. We estimate that AMC has a similar number of U.S. premium format screens (IMAX/Prime) as its two largest U.S. competitors combined, in addition to having the most recliner seats in the industry. AMC has invested $360k/screen in the U.S. since 2013, approximately 24% and 150% more than peers Cinemark and Regal (source).
   c) AMC is positioning itself competitively with loyalty programs to capture more moviegoers. The results from this are becoming clear, as AMC's last two quarters beat industry admissions by several hundred basis points.

3) **A-List represents an opportunity to push loyalty among moviegoers, reduce volatility of the box office and create significant growth opportunities, ultimately resulting in EBITDA margin expansion.**
   a) Subscription programs give theaters the ability to lock users into their brand and push increased spending on food and beverage. As movies are often a group activity, subscription members will enlist friends to come with them to their theater.

b) The total addressable market for theater subscriptions within the U.S. is about $5bn, or 20mn subscribers. This is based on the assumption that 50% of moviegoers see more than one movie a month. AMC's marketshare equivalent TAM would be $1bn, or 4mn users. AMC could have a higher take rate as it is the largest network, and because its subscription program is seemingly underpriced vs. its peers. AMC's free loyalty reward program has 19mn accounts.

c) Subscription models vary among exhibitors. A-List (860k members) and Regal Unlimited (just launched on 7/29/19) have similar models where unlimited movies cost $20/month. A-List has slight advantages including access to premium formats, no reservations fees and a 3mo contract vs. Regal's 12mo. Cinemark's Movieclub is $9.99 a month and is oriented towards less frequent moviegoers. Moviepass hit 3mn members at its peak.
   i. Given Regal's recent subscription launch, we expected A-List churn to increase, possibly losing around 100k members. We see this as slightly helping AMC A-List frequency, as Regal's 12 month commitment will likely convert only the heaviest use members from AMC. As Regal's subscription service seems to be relatively more expensive, we think AMC has room to raise prices.

d) Management believes A-List will add $36 of incremental EBITDA per subscriber per year. As AMC pays studios around 51% of admission revenue, direct cash outflows related to A-List are around $4.6-5 per visit, making the cash breakeven on the service above 4x views per month. In the first 4.25 months of 2019, AMC saw average frequency of 2.6x. The $32 of incremental EBITDA is the benefit from members visiting theaters roughly 3.5x more often, purchasing 2.5x more concessions as prior, any additional revenue from bringing along guests, less any negative impacts such as less transaction fees.

e) AMC recently launched AMC Artisan Films, which is being used to highlight non-blockbuster films. **We believe AMC's intent here is to push A-Listers to attend lesser known indies, which are substantially higher margin films.** Any success of pushing A-List users to lower cost films could substantially improve profitability.

f) Adam Aron is uniquely qualified to create a subscription product. His multiple decade career involved several introductions of reward programs and subscriptions. Adam helped pioneer Pan-Am's first frequent flyer program, invented the skiing annual pass at Vail resorts, and led several other loyalty initiatives at Hyatt and other lodging/ entertainment companies.

g) Management believes these initiatives, in addition to the continued expansion in high margin markets such as Saudi Arabia will drive 200bps of EBITDA expansion in the next 3-5 years.

4) Elevated CapEx cycle sunset to substantially increase free cash flows by ~$200mn over the next 3-5 years.

a) AMC has spent net $1.3bn on growth CapEx initiatives in the last 5 years. These initiatives include installing premium seating in 2,681 screens, upgrading 285 screens to premium formats (IMAX/Prime) and installing dine in options at 172 screens. These formats are considerably favored by consumers. AMC cites ROI for theater renovations averaging 25% in the U.S. and >50% in Europe. Recliners and premium formats should continue to be a tailwind for AMC as moviegoers look for a differentiated experience from home entertainment.

b) As domestic renovations finish within the next 1-2 years, AMC plans to ramp up recliners within the European circuit, where recliners are underinvested at 15% of the market vs. 75% in the U.S. After the European circuit is completed in 3-5 years, AMC expects to decrease net growth CapEx to $125mn, which would increase free cash flow by $207mn vs. 2018.

c) **The manufacturer of the recliners (VIP Cinema Seating) confirmed to us that these chairs will last for 8-12 years, which would setup the next CapEx cycle to start around 2025-2026, 4-6 years after CapEx decreases substantially**. VIP Cinema also believes annualized repair costs to be 3% of the purchase price, which confirms AMC's expected capital expenditure plan.
   i. As AMC depreciates these chairs over a 7 year period, while the chairs are expected to last for an average of 10 years, **earnings are actually understated.**
   ii. VIP Cinema Seatings 1st lien term loan due 2024 is now trading at 91cents. This move is directly related to AMC reducing the number of seating purchases, confirming they are reducing CapEx.

d) AMC expects to spend 4-5% on CapEx going forward in perpetuity, vs. 2-4% historically for the theater business.

5) AMC's high leverage is not a concern.

a) A wave of exhibitor bankruptcies took place in early 2000, however, conditions were different
   i. Peter Davis at MIT Solan attributed the cause for the bankruptcy of four out of the six largest exhibitors to be the cannibalization created from new high quality theaters. Domestically, AMC has spent a considerable amount retooling its theaters, while competitors like Regal lag sufficiently behind.
   ii. At bankruptcy, Regal, Carmike, and United Artists had leverage of 8.8x, 5.7x and 11.7x respectively - all considerably higher than AMC today. Both Regal and Carmike's defaults were triggered by a loan covenant - of which AMC has none. Exhibitors were also less concentrated and a considerably smaller portion of the market.

b) As AMC is cash constrained because of their high capital expenditures, they will have the ability to manage around these expenditures, and will certainly not trigger a liquidity event prior to cutting CapEx.
c) European IPO can help AMC delever business quickly if needed: AMC management last disclosed that it was interested in IPOing 1/3rd of its European circuit in 2H'19/ 1H'20. If this circuit received 9x EBITDA (Cineworld comp), it would generate 600mn in cash.

6) Recent box office drag is challenging, but meaning is exaggerated by the market:

a) The 1H'19 result of -8.6% ($-580mn) can be easily explained by several headwinds, and are completely reasonable given historical box office volatility. The poor YTD is effectively explained by lack of any blockbusters when compared to Q1'18 which had Black Panther. Moviepass' collapse is likely causing a 1-2% headwind – their 2-3mn average members were spending at a rate of $45 per quarter – effectively representing 3.75% of the box office. 2019 is also the first year in a while where ticket prices are not rising – this is due to exhibitor subscription programs recording a lower than market ticket price, a similar subscription related effect on premium formats and theaters pushing the total ticket price up through service fees.
b) The box office will likely grow for the next three quarters as Q3'19 - Q1'20 is widely estimated to outperform the previous year by 9%/9%/5%. The back half of 2019 looks heathy with large blockbusters such as The Joker and Star Wars 9.
c) The 2020 slate lacks major tentpole blockbusters such as Star Wars, Avengers, or Avatar. While record years are made by blockbusters, the box office survives without them: 2011 and 2014 are two recent years where no single film crossed $400mn (compared to a recent average of 3 $400mn films per year) and the box office performed -3% and -5.5% respectively. Consensus sell side estimates for the box office to decline by 0.5% to 1% in 2020 are likely understating the possible weakness. Key releases are Birds of Prey, James Bond 25, Fast and Furious 9, Wonder Woman 1984, Minions 2, and Black Widow.
d) The 2021 box office looks remarkably healthier with major tentpoles of Avatar 2, The Batman, Thor, and Indian Jones 5, likely creating another record box office year.

VALUATION

1) Despite being best positioned, AMCs trades at a discount to its peers due to its high leverage and low free cash flow conversion.

a) AMC trades at 7.6x/6.5x estimated 2019 EBITDA/EBITDAr. Over the last 10 years, Regal and Cinemark have traded on average at 8.1x/7.3x EBITDA/EBITDAr est. The non-financial SPX index trades at 13.7x EBITDA.
b) Regal and Carmike were purchased at 9.7x and 8.0x trailing EBITDA.
c) Given AMC's leverage is 6x/5.8x EBITDA/EBITDAr, a rerate to its peers multiples on an EV basis would have a significant impact on equity.

2) EBITDA multiples are primarily driven by growth, risk, and FCF conversion. All of these three factors are likely to see remarkable improvement over the next 3-5 years.

a) **Growth**: Given AMC's superior circuit and subscription options, AMC should be positioned to outperform the industry. Management estimates that they can increase revenue by 3-5% per year for the next several years.
b) **Risk**: The 2021 Box Office lineup is likely to be a record year, limiting concerns surrounding long term risk to the model.
c) **Free cash flow** is likely to increase substantially in the next 3-5 years. Management believes they can increase EBITDA margins to 16-18% in the period, grow revenues by 3-5% and decrease CapEx by $174mn.

3) AMC is dirt cheap at 4x 2022 FCF

1) The combination of 200bps of margin expansion, decreased CapEx of $174mn, and annualized revenue growth of 2% puts AMC close to $300mn in LFCF by 2023 from close to nothing in 2019. Assuming a 12x FCF multiple (vs SPX at 23x), this would value the equity at $3.5-4B, about 130% higher than today.

5 Year Out Valuation	2023	Mutiple	EV/MC
Revenue	6127	1.21	7,444
EBITDA	946	7.87	7,444
EBITDAR	1926	6.89	13,267
FCF	314	12.00	3,770

Valuation			
Shares Outsanding		**Debt**	
Class A	83	Net Debt	3,675
Class B	52	Operating Lease	5,823
RSUs	4	Enterprise Value	7,444
Total Diluted Shares	139	EV+OL	13,267
Equity Valuation	3770		
Share Price	27.2		
IRR (including div)	27%		

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CATALYSTS:

1) Sentiment pertaining to the box office will materially improve in 2H 2019 as it is expected to post gains of 9% Y/Y, bringing the 2019 box office growth to flat.
2) Management will likely give an update on the European IPO soon, as they previously indicated an update was coming in 2H'19 or 1H'20. A European IPO would cause a deleveraging, which would cause the multiple to rerate.
    a) Vue International (3rd/4th largest European exhibitor) is set to IPO in September.
3) As the 2021 box office becomes more clear, and analysts understand how the free cash flow is going to be impacted in the near term, the stock should rerate.

RISKS AND MITIGANTS

1) **The box office faces several headwinds and thus accordingly trades at a considerably lower valuation than the rest of the market.**
    a) **Movie Studio Consolidation:** A threat for exhibitors is a studio consolidation event where the existing studios spend little to create innovative franchises and new tech entrants purchase all of the good movie talent preventing decent movies being shipped to the box office. This is somewhat happening - but the result will not be realized for a long time. The Disney/Fox acquisition will allow Disney to own 1/3rd of the box office, making it difficult for medium sized studios to compete. An additional negative of studio consolidation for exhibitors is that box office consolidation has historically correlated with higher film rents.
    b) **Direct to consumer:** A DTC threat is often overhyped, but it is unlikely to materialize for several reasons. Without scale - it will be difficult for studios to reach a large enough audience to outperform box office profitability. Netflix with 150mn subscribers is vastly unprofitable, burning 2-3bn in fcf for the last several years. Thus it is extremely lucrative for studios to abide the theatrical box office window, maximize cash flows and then potentially stream the movie on a platform.
        i. Disney for example made $3bn in operating income on $10bn in revenue in its studios segment. It would be tough to imagine Bog Iger (son of Capital Cities) to preference running this segment at a loss in order to deliver videos direct to consumers, while if the studio waited for the 100 DTC window it could maintain its profitability and achieve streaming goals.
        ii. Disney has previewed how it intends to use Disney+ to enhance the moviegoer experience with Marvel series complementing Marvel films in the box office. Disney has also already committed to a handful of movies and has a full box office line up through 2023, and plans to alternate releases of Star Wars and Avatar between 2021 and 2027. No original Disney+ films have been announced. **Contrary to speculation - there is no evidence that supports Disney abandoning the Box Office**.
    c) **Ticket price competition**: many analysts note that the average ticket price falling from $9.16 in Q1'18 to $9.01 in Q1'19 is a worrisome sign for exhibitors. The effect of this is mostly attributable to AMC - which has seen its ticket price fall from $9.62 to $9.16 in the same period, due to its A-List and Discount Tuesday initiatives. As AMC has a 20% market share, they are contributing roughly 10/16 cents to the overall drop. AMC is using reservation fees to offset the cost of the tickets.

2) **Control of AMC by Wanda Group impairs cooperate governance, questions if shareholders are being treated equally, and brings additional risk.**
    a) The split share class structure of AMC enables Wanda to effectively control AMC with 60-70% of the vote while only owning about 50% of economic interests. Wanda is a target of the PRC's deleveraging plan, has only achieved half of their mandated leverage reduction so far.
    b) Wanda has proven that they will place their interest above shareholders with the 2018 dividend recap with Silverlake. Wanda essentially forced AMC to take on debt, repurchase shares and pay a considerable dividend, in order to send a large sum of cash to Wanda Group. The decision for AMC to take on more debt was a surprise for investors who had previously heard AMC management's promise to deleverage.
    c) Wanda conflict decreases the possibility of activist involvement or a buyout. Non-Wanda shareholders must also consider the probability of upcoming Wanda liquidity requirements.
    d) As Wanda is cash poor, we think it is unlikely that AMC will cut its dividend. **AMC IR told us they are committed to the current capital allocation plan, and have spent last 6-9 months making this clear.**
    e) Silverlake convertible note info: $600mn note due September 2024, conversion at $18.95. The convertible will reset in September 2020 if the current trading price times 1.2x is below the conversion price. Wanda will forfeit the first 5.6mn shares if there is a conversion, and the conversion has a lower limit at 30% of fully-diluted shares outstanding (45.5mn shares). The reset will occur if the stock is below $15.8 in September 2020, with common shareholders being affected below $13.4, and with max reset occurring at $11.

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SECOND QUARTER EARNINGS - 8/8/2019

1) Street consensus of $1.46bn in revenue and $226mn in EBITDA have already priced in AMC's likely strong fundamentals vs. peers. A-List and Discount Tuesday will continue to be a drag on average ticket prices.
    1) NCMI (industry proxy) and Cinemark have already reported in Q2 that attendance fell by -4.5% and -1%. In Q1, NCMI, Cinemark, and AMC reported declines of -14.9%, -13%, and -11%. Assuming a similar Q/Q peer attendance beat, AMC attendance would be close to flat.
    2) If attendance is flat and ticket prices fall -3%, revenue and EBITDA would be $1.44bn/$220mn, slightly below consensus.
2) We expect the stock to move based management commentary surrounding ticket prices, operating expenses, and any update on the IPO of the international segment. If the number of A-List subscribers as of 8/7/19 is not disclosed, we expect A-List churn has picked up materially due to Regal Unlimited's launch.

FURTHER DILIGENCE

1) Impact of Justice Department's revisitation of the Paramount Decrees.
    a) Consult experts on the likelihood of specific clauses being redone.
2) Develop a Python script to scrape box office sell through data from AMC's website.
3) Determine proximity between AMC, Regal and Cinemark's domestic circuits, in order to determine impact of subscriptions on each other.
4) Diligence into customer satisfaction

OPEN QUESTIONS FOR MANAGEMENT

1) CapEx going forward in the international segment is likely higher than operating cash flows. Given the international business has 2x leverage, would it make more sense to borrow in Euros especially given where rates are?
2) AMC has the ability to fund $44.3mn in share repurchases through August 2nd, 2019. Given the rather quick and dramatic repricing in the stock that occurred, is management going to utilize the remainder of these buybacks before they expire? Buybacks would likely be accretive to the common for the following reasons:
    a) The expected annualized return on equity is likely larger than the 25% hurdle for CapEx projects.
    b) The dividend yield on the equity is greater than the yield on the debt, meaning effectively borrowing to repurchase shares decreases net financing costs, which achieves other AMC capital allocation goals.
    c) Reducing the share count will limit the dilutive effects that the Silverlake convertible can create upon possible reset in September, 2020.
3) Given the weak slate of movies coming into 2020, and the fact that Regal Unlimited is a 1Yr commitment, would it make sense to push A-Listers for a 1Yr commitment prior to the eventual Q4'19?

SUMMARY OF RESOURCES CONSULTED

Public filings from:

AMC
Carmike
Cinemark
Cineworld
NCMI
Regal
United Artists

Industry Data:

Box Office Pro
Box Office Mojo
Sensor Tower
Google Trends

Industry Professionals:

Brad Bailey - EVP of Sales and Marketing, VIP Cinema Seating
John Merriwether - VP of Investor Relations, AMC Entertainment Holdings

Academic Studies:

Peter Davis, MIT Sloan: *Entry, Cannibalization and Bankruptcy in the U.S. Motion Picture Exhibition Market*

Important Disclosures/Information:

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