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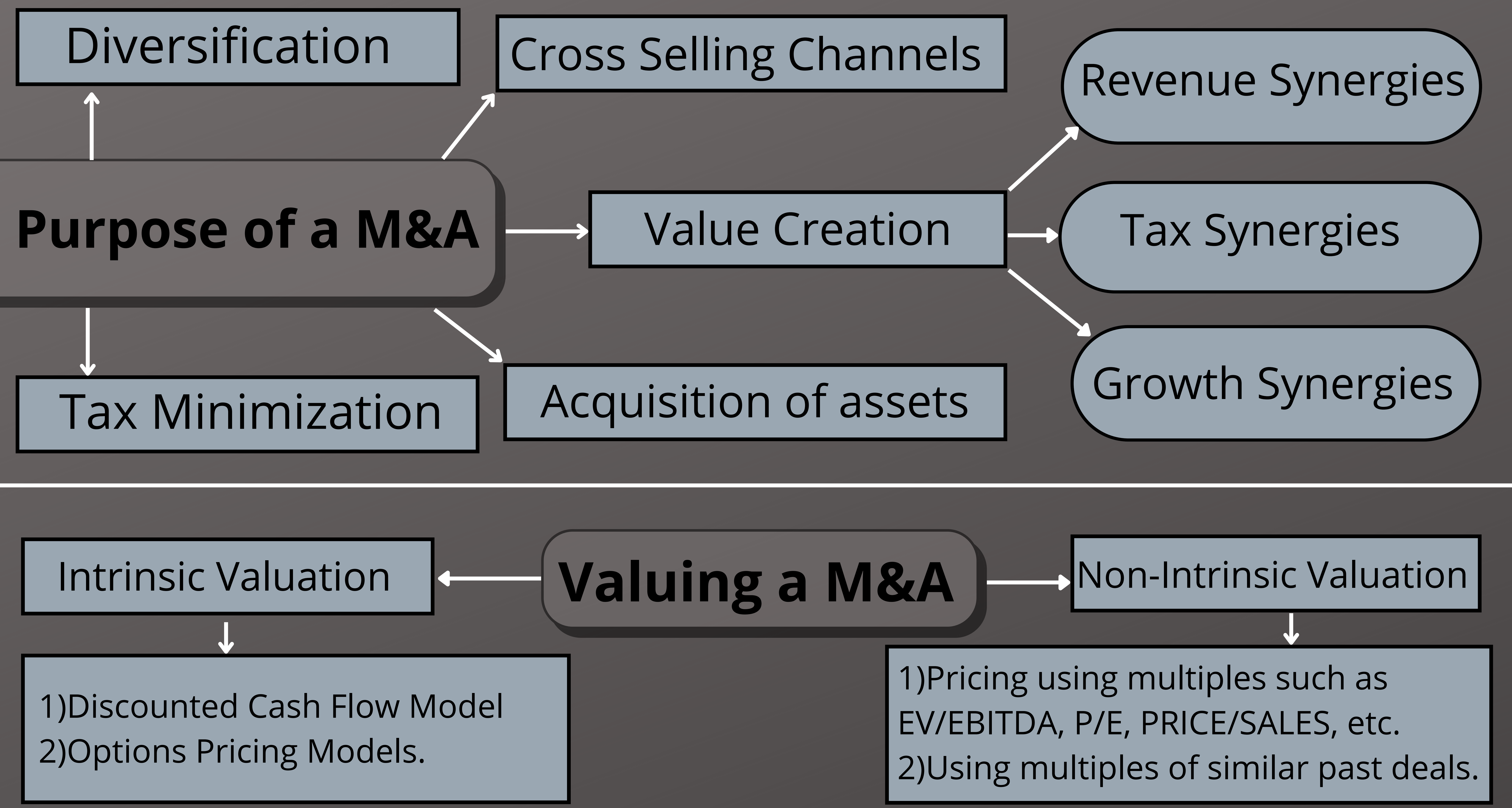
Acquisition Analysis of Starz by Lionsgate Entertainment

LIONSGATE

STARZ


Purpose of a M&A
Diversification
Cross Selling Channels
Value Creation
Revenue Synergies
Tax Synergies
Growth Synergies
Tax Minimization
Acquisition of assets
Valuing a M&A
Intrinsic Valuation
1)Discounted Cash Flow Model
2)Options Pricing Models.
Non-Intrinsic Valuation
1)Pricing using multiples such as
EV/EBITDA, P/E, PRICE/SALES, etc.
2)Using multiples of similar past deals.

Industry Trends

Consolidation due to industry wide disruptions by Amazon Prime and Netflix.

↓

Higher reinvestments with an average reinvestment rate of 91% in the entertainment sector during the year 2016.

↓

Growth and expansion in different geographies and formation of Joint-Ventures and partnerships.

Position of Lionsgate before the acquisition.

1)Faced with **heavy competition** from other industry players.

2)Cyclical and Hit Driven Revenues.

3)**Lower operating margins** than the industry average.

4)Company has grown historicaly through M&As.

5)Has a **higher** than industry standard reinvestment rate, hence has viable growth opportunities.

Position of Starz before the acquisition.

1)Legacy television content distribution player.

2)**Slow** revenue growth due to a significant revenue chunk from the television distribution business.

3)**Comparable** and **slightly better** operating margins than industry standards.

4)**No reinvestment** and **limited plans** for expansions, was looking for a target for the past two years.

Why this acquisition makes sense for Lionsgate?

1)**More points of contact with distributors, buyers and creators**, which will strengthen the combined company's operations and **achieve economies of scale.**

2)Financial stability of Starz will help in more **predictable and less hit driven cash flows.**

3)Help Lionsgate expand its fortress in the **premium content** offering segment.

Synergies:

Tax synergies of $150 million per year till FY'21.

Operating cost synergies of $50 million per year till FY'21.

Why this acquisition makes sense for Starz?

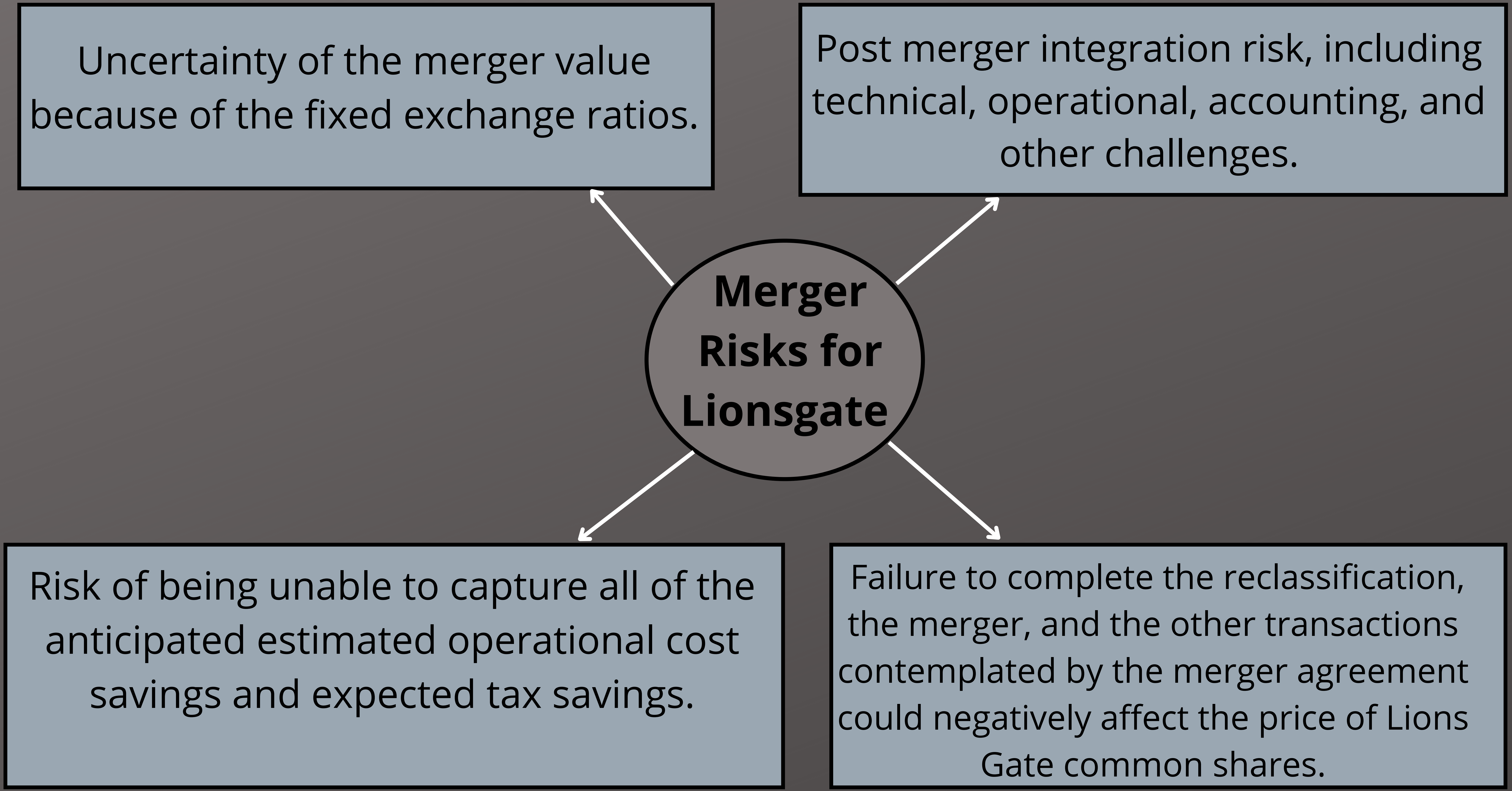
1)Unlock shareholder value.

2)**Hedging the risks and uncertainties** of remaining an independent public company in a market with increasing consolidation and competition from more prominent players.

3)**Increase the number of distributors** to and the ability to capitalize more on the existing content

Charcteristics of acquistion

			Favourable Characteristics
1)	Sole bidder ✓	Bidding War	Sole Bidder
2)	Public Target ✓	Private Target	Private Target
3)	Pay with Cash ✓	Pay with stock ✓	Cash
4)	Large Target	Small Target ✓	Small Target
5)	Cost Synergies ✓	Growth Synergies	Cost Synergies


Merger Risks for Lionsgate
Uncertainty of the merger value because of the fixed exchange ratios.
Post merger integration risk, including technical, operational, accounting, and other challenges.
Risk of being unable to capture all of the anticipated estimated operational cost savings and expected tax savings.
Failure to complete the reclassification, the merger, and the other transactions contemplated by the merger agreement could negatively affect the price of Lions Gate common shares.

The Orignal Deal

Deal Value: $4.4 Billion

After Deal Effect: Lionsgate stock to be reclassified into two voting and non-voting shares

Starz Series B stockholders get:$7.26 in cash and 0.6321 of Lionsgate’s new non-voting and voting stock each.

Starz Series A stockholders get: $18.00 in cash and 0.6784 of Lionsgate’s new non-voting stock

Deal Type: Cash and Stock

Share exchange ratio: Fixed

DCF Valuation Of Lionsgate

1)In this valuation methodology, the Unlevered Free Cash Flows for **10 years** were discounted at the **Cost of Capital of 8.80%.**

2)The terminal value was found using the Gordon Growth Model with a **perpetuity growth rate of 2.75%.**

3)The reinvestment was calculated using the **sales to capital ratio of 1.63,** which was the industry average.

4)The present value of the firm obtained was **$5.7 Billion.**

DCF Valuation of Starz

1)In this valuation methodology, the Unlevered Free Cash Flows for **5 years** were discounted at the **Cost of Capital of 12%.**

2)The terminal value was found using the Gordon Growth Model with the **perpetuity growth rate of 2.75%.**

3)The reinvestment was calculated using the historical reinvestment rate close to **0%.**

4)The present value of the firm obtained was **$3.12 Billion.**

Valuing Synergy

1)To find the combined value post merger, the Unlevered Free Cash Flows built using the **synergic effects** were valued at a **Cost of Capital of 8.05%.**

2)The terminal value was found using the Gordon Growth Model with a **perpetuity growth rate of 2.75%.**

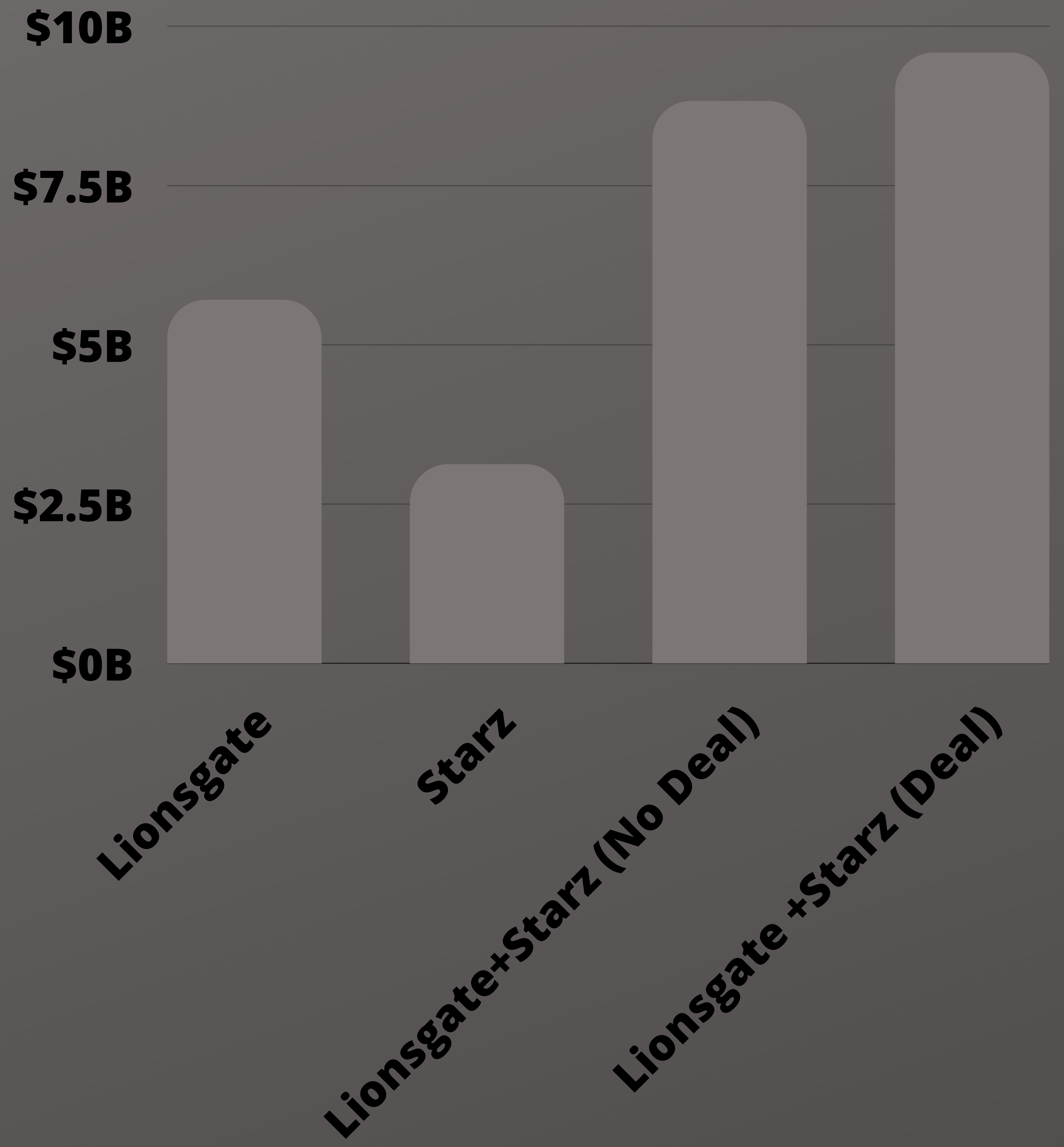
3)Reinvestment rate was kept equal to Lionsgate reinvestment rate.

4)**Improved operating margins** were reflected in the DCF valuation.

5)**Revenue Growth** in year one was found using the **weighted average revenue growth** of both the firms.

6)**The synergic value** of the deal was found to be **$0.757 Billion.**

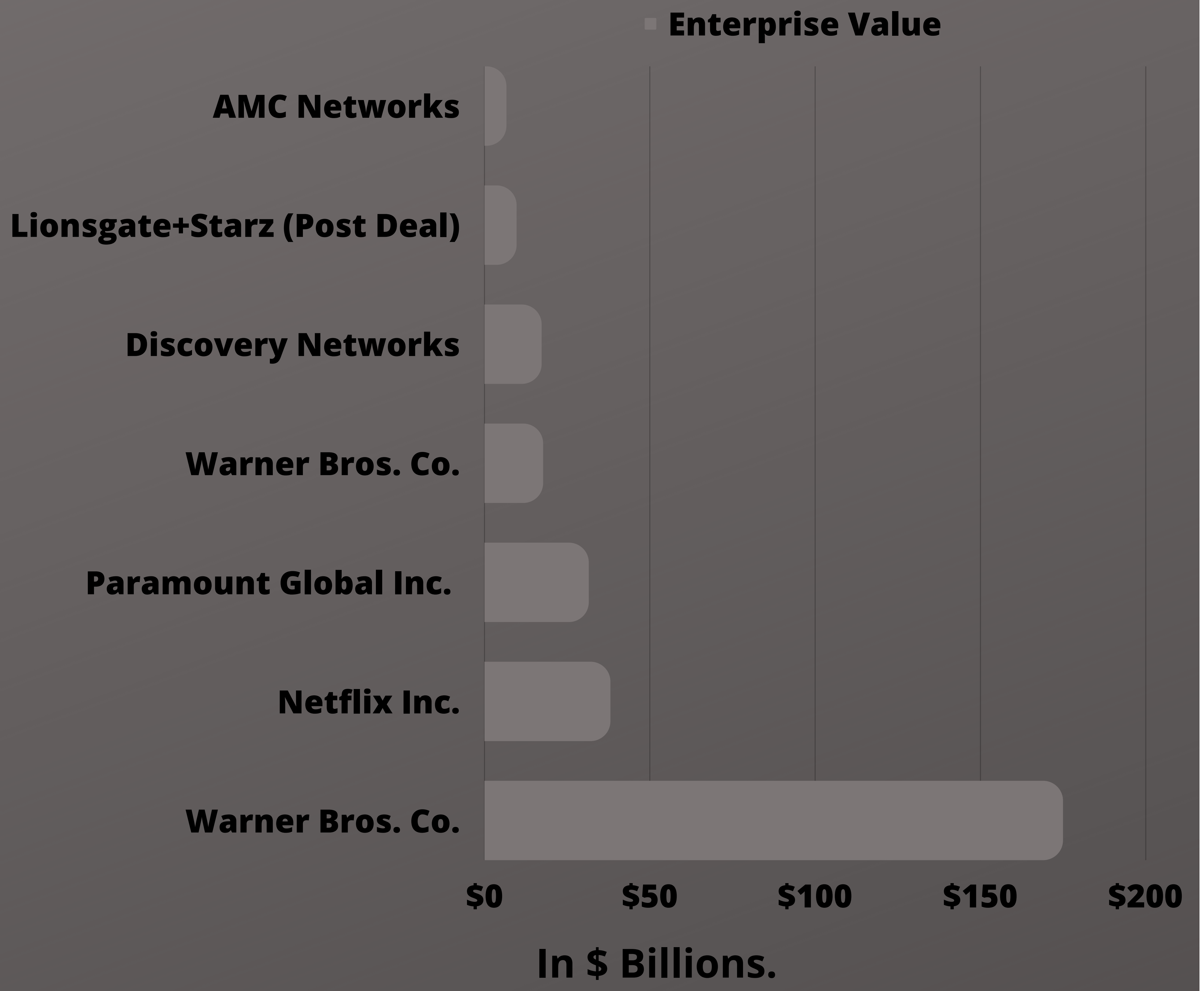
Valuing Synergy



No Deal			Deal
Lionsgate	Starz	Lionsgate+ Starz	Lionsgate+ Starz
$5.70	$3.12	$8.82	$9.58

Enterprise Values in $Billions

Synergic Value=$0.76B



Post Merger Positioning of Lionsgate in the Media and Entertainment Industry.

Present Situation of Lionsgate.

1)5 Years ahead presently, Lionsgate is looking forward to spinoff the Starz Divison.
2) The management is engaged in conversations with several potential strategic partners.
3)The main reason is that Starz is unable to add any substantial value as it continues to be in the niche business.