Entertainment & Leisure
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COMPANY UPDATE / ESTIMATE CHANGE

Regal Entertainment Group

RGC — NYSE — Neutral-3

Strong 4Q Results; Slight Raise to 2017 Estimates; Neutral Rating Based On Valuation

Key Metrics

RGC - NYSE	(as of 2/9/17)		$21.84
Price Target			N/A
52-Week Range			$16.84 - $24.79
Shares Outstanding, basic (mil)			156.0
Market Cap. ($mm)			$3,407
3-Mo. Average Daily Volume			1,880,305
Institutional Ownership			99%
Total Debt (12/16) (mil)			$2,340
ROE (TTM Ended 12/16)			N/A
Shareholders' Deficit (12/16) (mil)			($839)
Price/Book Value			N/A
Annual Dividend & Yield		$0.88	4.0%
EBITDA Margin (TTM Ended 12/16)			20%

EPS FY 12/31 (excluding nonrecurring items)

	2015	2016	Prior 2017E	Curr. 2017E
1Q	$0.15	$0.27		
2Q	$0.38	$0.23		
3Q	$0.18	$0.29		
4Q	$0.36	$0.33		
Year	$1.08	$1.11	$1.15	$1.25
P/E	20.2x	19.7x		17.5x

Note: Quarterly EPS figures may not add to annual figure due to rounding.

Revenue ($mm)

	2015	2016	Prior 2017E	Curr. 2017E
1Q	$691	$787		
2Q	$863	$786		
3Q	$725	$812		
4Q	$848	$813		
Year	$3,127	$3,197	$3,300	$3,320

Company Description: *Regal Entertainment Group is the largest movie theatre operator in the world. Philip Anschutz and related entities recently held just under half of the common shares but had over 75% of the voting power. Regal recently operated 7,267 screens at 561 theatres in 42 states, the District of Columbia, and some U.S. territories. Regal holds an approximate 20% stake in National CineMedia (NCMI), which produces & distributes in-theatre pre-feature programming, and offers advertising opportunities, special event programming, and meeting services.*

Investment Highlights

- **Mindful of a tough comparison, we were impressed by Regal's 4Q results.** Business was above our expectations, likely a testament to recent investments in the theatre base, such as luxury recliner seating and expanded food & beverage offerings. Also, we considered the film slate decent. Total 4Q revenues declined 4% from the year ago quarter, which benefited from a favorable release slate, including *Star Wars: The Force Awakens* in December 2015. Adjusted EBITDA—a closely watched metric—dropped only 2% and with a surprising 50 basis point margin improvement. Adjusted EPS were $0.33 compared to $0.36 in the year ago quarter. Street consensus for EPS was $0.26 and our estimate was $0.23.

- **Amenities are likely moving the needle.** A re-seating initiative (replacing traditional slightly-rocking seats with over-sized luxury recliners equipped with electronic footrests) and adding higher quality food and beverages (including alcohol, where allowed) have been impactful. Less than 25% of Regal's auditoriums currently feature recliners. We believe this favorable business trend can continue for the next few years.

- **We have updated our 2017 estimates.** We feel good about the industry's prospects and Regal's operations for the current year. Changes to our 2017 outlook include a $20 million increase to revenues and a $0.10 increase to diluted EPS.

- **We maintain our Neutral rating.** We view valuation as average and consider the current 1Q to be the most difficult quarter of the year in terms of film slate and comparisons to year ago results. We will monitor the stock for potentially better risk/reward conditions later in the year. We still consider RGC a suitable holding for income investors, as we consider the dividend well covered by cash flow.

Note Important Disclosures on Pages 5-6.
Note Analyst Certification on Page 5.

Further comments on 4Q. We were impressed with Regal's 4Q results. The box office environment was decent, including success from *Rogue One: A Star Wars Story* that exceeded our expectation. In addition, the benefits of theatre upgrades such as recliner seating and expanded food/beverage/alcohol offerings (in select markets) continued to have positive effects.

For Regal's 4Q, total revenues, adjusted EBITDA (earnings before interest, taxes, depreciation and amortization), and diluted EPS all exceeded our expectations. Adjusted EBITDA of $172.6 million declined 2% from a year ago, but the decline reflected the tough comparison to robust results in 4Q 2015 (i.e. *Star Wars: The Force Awakens*). The dollar figure exceeded our estimate by $20 million and EBITDA margin improved a surprising 50 basis points. All things considered, we viewed the quarter quite favorably.

Dividends. The dividend outlook is solid, in our view. In the coming days, we expect Regal to declare a regular quarterly dividend of $0.22 per share, payable in mid-March. This would represent the 13th consecutive quarterly dividend at that rate. In 2016, free cash flow (after above-average capital spending) was $197 million. This compares to an estimated $135-$140 million spent on dividends. We believe a slightly larger cushion may exist in 2017. Also, the current cash balance of $246 million may add some support to the dividend policy.

Outlook. We consider the industry outlook for 2017 to generally be favorable. The film release slate looks solid to us, culminating with the next *Star Wars* film in 4Q. We have refined our financial estimates after giving consideration to recent results and future margin assumptions. Our updated forecast for Regal includes a near 4% increase in revenues in 2017 to $3.320 billion, an increase of $20 million from our previous estimate. Our adjusted EBITDA estimate is $660 million, up from our previous figure of $640 million. We have also raised our adjusted EBITDA margin assumption. Our new diluted EPS estimate is $1.25, up $0.10 from our previous figure of $1.15.

Valuation. On a price/earnings basis, RGC is trading at 17.5x our updated 2017 EPS estimate. Over the past ten years, RGC's median forward P/E multiple is about 18x, with a range of 10x-29x. Given the company's capital structure and cash flow generation, we believe a cash flow valuation measure is more meaningful. Enterprise Value divided by EBITDA (EV/EBITDA) focuses on the implied total value of a company (market capitalization plus net debt) relative to its cash flow generating ability and is commonly used in analysis of media and entertainment companies, as well as many companies with significant depreciation or interest expense. On this measure, and based on our estimated year-end net debt assumption, RGC is currently trading at 8.3x our 2017 adjusted EBITDA estimate. We believe the historical valuation range for RGC over the past ten years is roughly 6x-10x twelve-month forward adjusted EBITDA.

Exhibit 1
Valuation Analysis (figures in millions except ratios and per share data)

		2017E	2016	2015	2014	2013
Share Price (2/9/17)	$21.84					
Recent Diluted Share Count	157.0					
Market Capitalization	$3,429					
Net Debt, year end ~		$2,044	$2,094	$2,123	$2,213	$2,030
Enterprise Value (EV)		$5,473	$5,522	$5,552	$5,642	$5,459
Adj. EBITDA		$660	$630	$608	$576	$598
EV / Adj. EBITDA		**8.3x**	**8.8x**			
Adjusted Diluted EPS		$1.25	$1.11	$1.08	$0.95	$1.04
P/E Multiple		**17.5x**	**19.7x**			

Note: Valuation multiples are based on current market capitalization figures and projected year-end net debt levels.

Source: Regal Entertainment Group and Hilliard Lyons estimates

Opinion. We believe industry fundamentals are generally favorable at this time, yet we are mindful of tough box office comparisons in 1Q of the current year. Trends toward theatres offering more amenities such as recliner seating and expanded food & beverage offerings (including alcohol in allowed markets) are producing encouraging results, and we believe these trends are in relatively early stages, with continued implementation planned over the next several years.

We rate RGC Neutral. Although we believe the current stock valuation is reasonable, we do not have a sense of urgency to buy RGC at this time. We believe investor concern could build regarding a lack of unit growth and reliance on higher "same-store sales" based on price increases and more customers coming to enjoy the current amenities. In sum, we prefer to wait for a more attractive buying opportunity, perhaps with a more favorable near-term box office outlook or with a lower stock valuation.

We note the stock's 4% dividend yield, which may appeal to income investors, particularly those seeking representation from the Consumer Discretionary sector (recent sector yield of 1.4%). As such, we believe RGC is an appropriate holding in a portfolio context. We consider dividends adequately covered by cash flow in a soft box office environment and widely covered in a strong environment. We believe a slight dividend raise or a special dividend could occur later in 2017, yet we are not assuming either will happen.

Suitability. Our Suitability rating on RGC is 3 on a 1-to-4 scale (1=most conservative, 4=most aggressive). This view is based on the company's dependence on the industry's box office environment, past earnings volatility (such as in times of weak box office sales), and a considerably leveraged balance sheet. We also consider positive factors such as historical levels of free cash flow and its status as an industry leader.

Considerations and risks. We believe investors should consider several factors before investing in RGC. These include the company's leveraged balance sheet with currently negative shareholders' equity, the company's dividend policy, the state of credit markets, the impact of technology on out-of-home entertainment, dependence on quality motion pictures from the major studios, the typical release window for motion pictures (before becoming available in ancillary markets), controlling interest from one stockholder/entity, and general economic conditions.

Competitive factors include the threat of alternative methods of film delivery. This includes direct delivery of motion pictures through online means (more of a threat to DVD sales, in our view) and simultaneous release of some movies in theatres and on DVD or via in-home distribution (to date done only to a limited degree and with negligible results). We believe the theatrical run is and will continue to be the most important aspect of a film's product life cycle and expect overall industry attendance in the 1.2-1.4 billion range every year.

During 2015, a lawsuit was filed by a small Texas operator against several national exhibitors, including Regal, on the basis of alleged anti-trust issues as it relates to the film allocation process among studios and exhibitors. The U.S. Department of Justice began an investigation during the year. We cannot predict the duration nor the outcome of the lawsuit. At this point, we do not believe it would be prudent to assume any major change in industry dynamics as it relates to our financial model.

Exhibit 2
Consolidated Statements of Income (figures in millions except percentages and per share data)

	2017E	% chg.	2016	% chg.	2015	% chg.	2014~	% chg.
Admissions	$2,135.0	3.6%	$2,061.7	1.2%	$2,038.2	2.0%	$1,998.9	(2.9%)
Concessions	975.0	4.5%	932.6	3.4%	901.7	8.7%	829.6	1.6%
Other Revenues	210.0	3.6%	202.8	8.2%	187.4	16.0%	161.6	0.0%
Total Revenues	3,320.0	3.8%	3,197.1	2.2%	3,127.3	4.6%	2,990.1	(1.6%)
Film Rental & Advert. Costs	1,145.0	3.4%	1,107.3	1.3%	1,093.1	4.4%	1,047.1	(2.9%)
Cost of Concessions	125.0	4.6%	119.5	4.5%	114.4	3.0%	111.1	(0.4%)
Cost of Goods Sold	1,270.0	3.5%	1,226.8	1.6%	1,207.5	4.3%	1,158.2	(2.6%)
Gross Profit	2,050.0	4.0%	1,970.3	2.6%	1,919.8	4.8%	1,831.9	(0.9%)
Rent Expense	439.0	2.7%	427.6	1.4%	421.5	(0.4%)	423.4	2.4%
Other Operating Expenses	910.0	3.0%	883.2	2.3%	863.7	6.2%	813.2	0.0%
General & Admin. Exp.	88.0	4.0%	84.6	7.4%	78.8	5.9%	74.4	0.9%
Deprec. & Amort.	238.0	3.2%	230.7	6.4%	216.8	4.6%	207.2	3.5%
Loss (Gain) on Disp. & Impair. of Operating Assets	6.0		4.8		19.7		7.3	
Total Operating Expenses	1,681.0	3.1%	1,630.9	1.9%	1,600.5	4.9%	1,525.5	1.1%
Income From Operations	369.0	8.7%	339.4	6.3%	319.3	4.2%	306.4	(9.8%)
Interest Expense, Net	124.0	(3.2%)	128.1	(1.2%)	129.6	2.5%	126.5	(10.5%)
Earnings Recognized from NCM	(33.0)	12.2%	(29.4)	(5.2%)	(31.0)	(3.4%)	(32.1)	(14.4%)
Other, net	(38.0)	(13.4%)	(43.9)	14.6%	(38.3)	32.1%	(29.0)	2.1%
Loss on Debt Extinguishment	2.0		2.9		5.7		62.4	
Income Before Taxes	314.0	11.5%	281.7	11.2%	253.3	41.8%	178.6	(32.5%)
Provision for Income Taxes	122.5	10.1%	111.2	11.1%	100.1	36.4%	73.4	(31.4%)
Total Net Income	191.5	12.3%	170.5	11.3%	153.2	45.6%	105.2	(33.2%)
Less: Noncontrolling Int., net	(0.1)		0.1		(0.2)		(0.4)	
N.I. Attrib. to Control. Interest	191.6	12.5%	170.4	11.1%	153.4	45.3%	105.6	(33.0%)
Adjusted Net Income*	$196.5	12.7%	$174.4	3.3%	$168.9	14.1%	$148.0	(8.7%)
Diluted EPS, Adjusted	**$1.25**	12.5%	**$1.11**	3.1%	**$1.08**	13.6%	**$0.95**	(8.8%)
Diluted Shares Outstanding	157.0	0.1%	156.8	0.2%	156.5	0.1%	156.3	0.4%
Adjusted EBITDA	**$660.0**	4.7%	**$630.4**	3.7%	**$607.7**	5.6%	**$575.7**	(3.7%)
As a % of Revenues:		bp chg.		bp chg.		bp chg.		bp chg.
Film Rental & Advert. Costs~	53.63%	(8)	53.71%	8	53.63%	125	52.38%	4
Cost of Concessions~	12.82%	1	12.81%	13	12.69%	(70)	13.39%	(27)
Gross Profit	61.75%	12	61.63%	24	61.39%	12	61.27%	42
Rent Expense	13.22%	(15)	13.37%	(10)	13.48%	(68)	14.16%	55
Other Operating Expenses	27.41%	(22)	27.63%	1	27.62%	42	27.20%	44
Deprec. & Amort.	7.17%	(5)	7.22%	28	6.93%	0	6.93%	34
Total Operating Expenses	50.63%	(38)	51.01%	(17)	51.18%	16	51.02%	136
Income From Operations	11.11%	50	10.62%	41	10.21%	(4)	10.25%	(94)
Adjusted EBITDA	19.88%	16	19.72%	29	19.43%	18	19.25%	(42)
Adjusted Net Income	5.92%	46	5.45%	5	5.40%	45	4.95%	(39)

* Excludes nonrecurring items such as gains on sale, impairment charges, and other items

Note: Film Rental & Advert. Costs and Cost of Concessions are expressed as percentages of Admissions and Concessions Revenue, respectively. ~ Denotes a 53-week fiscal year period

Source: Regal Entertainment Group and Hilliard Lyons estimates

Additional information is available upon request.

Prices of other stocks mentioned: National CineMedia Inc. - NCMI - $13.25

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

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Investment Ratings

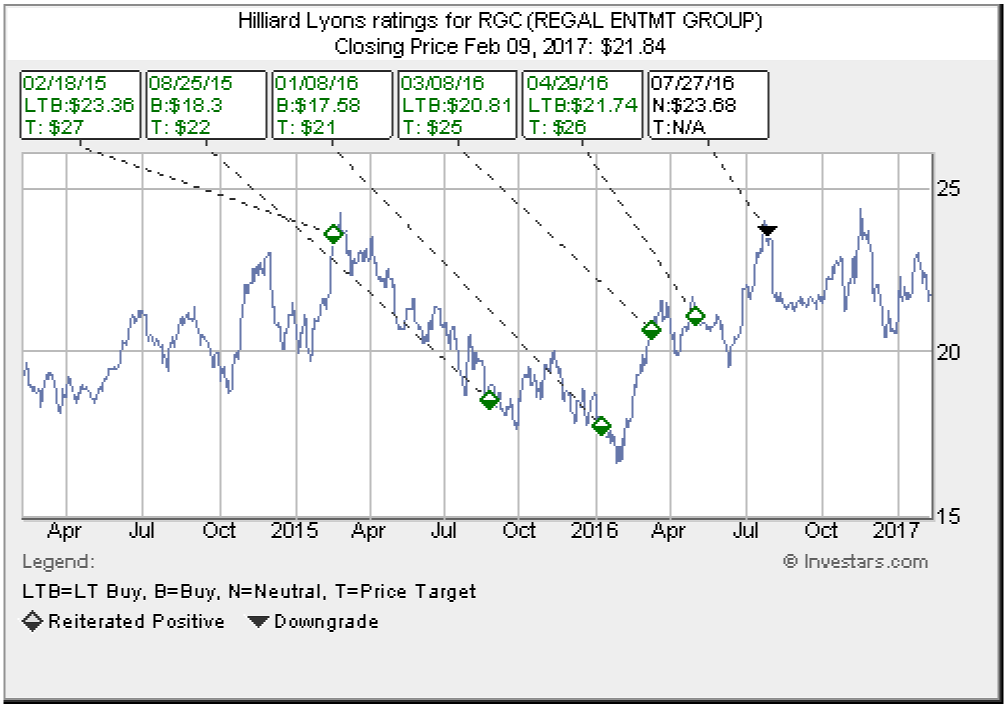
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2–3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 2017



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

<u>Other Disclosures</u>

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