

# Laguna Research Partners

FUNDAMENTAL RESEARCH & ANALYSIS

## Lions Gate Entertainment Corp.

(LGF, AMEX / TSE)

### BASIC REPORT

January 5, 1999

Recent Price, AMEX	\$3 3/16
Price Range*	\$3 3/4 – 2 5/8
Average Daily Volume*	71,000
Fiscal Year	March
Inside Ownership	29%
Market Capitalization	US\$77.6 MM

\* Since trading began on the AMEX on November 17, 1998.

Fiscal Year	Rev. (MM) <sup>1</sup>	EBITDA		EPS <sup>1</sup>	P/E <sup>2</sup>
		per share <sup>1</sup>	P/EBITDA <sup>2</sup>		
1998A	\$ 64	\$0.33	13.7x	\$(0.04)	n.m.
1999E	\$116	\$0.20	24.7x	\$(0.12)	n.m.
2000E	\$208	\$0.58	8.4x	\$ 0.20	24.2x

<sup>1</sup> Revenue, EBITDA and EPS stated in Canadian dollars.

<sup>2</sup> \$US / \$C exchange rates used for price ratio calculations: \$0.71 for FY 1998 and \$0.65 for FY 1999 and FY 2000.

### Compound Annual Gth.: 1998-2000E

Revenue	80%
EBITDA	93%

### Capitalization (Sept. 30, 1998): MM<sup>2</sup>

Shares Outstanding <sup>3</sup>	24.348
Cash & Equivalents	\$ 11.828
Long-term Debt	\$ 42.243
Shareholders' Equity	\$154.628

<sup>2</sup> Canadian dollars.

<sup>3</sup> Adjusted for 1-for-2 consolidation effective November 17, 1998.

**Company Description:** Lions Gate Entertainment Corp., formed in mid-1997, produces and distributes live action and animated feature films and television programs, distributes pre-recorded videos, and operates a major motion picture / television studio facility.

*Lions Gate Entertainment, we estimate, is positioned to achieve compound annual growth of 80% in revenue and 93% in EBITDA during FY 1998 through FY 2000. We look for the Company to generate EPS of C\$0.20 in FY2000, following projected EPS of C\$(0.12) in FY1999.* The key points supporting these projections are as follows.

- *Lions Gate's revenue and operating profit from motion picture production and distribution activities will, we estimate, jump from the C\$51.4 million and C\$10.4 million, respectively, reported in FY 1998 to an estimated C\$91.0 million and C\$17.4 million, respectively, in FY 2000.* Importantly, these projections do not reflect the substantial benefit that we feel could accrue to Lions Gate as a result of its investment in Mandalay Pictures.
- *We estimate that Lions Gate's television-related businesses—not including a sharply expanding animation business—will generate FY 2000 revenue of C\$79.5 million and operating profit of C\$9.8 million.* The Company's early successes in the reality-based and one-hour drama markets indicate to us that these impressive forecasts could be surpassed.
- *Lions Gate's Ciné-Groupe motion picture and television animation business should achieve a leap in revenue from the C\$9.1 million reported in FY 1998 to an estimated C\$31.6 million in FY 2000. Operating profit should surge from the FY 1998 level of C\$2.1 million to a projected C\$7.5 million.* Synergies with Lions Gate's television division and a 20% investment from Fox should position Ciné-Groupe to penetrate important new growth markets, particularly the US television market.
- *Revenue and operating profit generated by Lions Gate Studios, the Company's studio rental business, should reach a projected C\$6.0 million and C\$3.7 million, respectively, in FY 2000 versus the C\$3.7 million and C\$2.3 million reported in FY 1998.*

Analyst: Kevin B. Skislock

**COMPANY PROFILE: Aggressively Building a Portfolio of Revenue and Profit Growth Drivers**

*Lions Gate Entertainment Corp., formed in early 1997 and headquartered in Vancouver, British Columbia, produces and distributes live action and animated feature films and television programs, distributes pre-recorded videos, and operates a major motion picture / television studio facility.* The Company's key operating units include Lions Gate Films (based in Montreal and Toronto), Mandalay Pictures (Los Angeles), Lions Gate Media (Los Angeles), Mandalay Television (Los Angeles), Ciné-Groupe (Montreal) and Lions Gate Studios (Vancouver).

*In the short time since the formation of Lions Gate—please see a synopsis of corporate developments in Chart I on the facing page—entrepreneur Frank Giustra, chairman and CEO of the Company, has completed Phase I of his master growth plan. In fact, Phase II is already underway.* Here are the details.

- *Phase I of the Lions Gate growth plan is nearly completed...* During the first phase of Lions Gate's development, Giustra has focused on building the Company's content production and acquisition capabilities. Most importantly, in our view, he has not only created the foundation for a production / acquisition powerhouse—we estimate that the Company's 12-month revenue run rate already exceeds C\$115million—but, via savvy deal making, he has accomplished this with a minimum commitment of Lions Gate capital.
- *...and Phase II of the growth plan has already begun.*

*The Company's focus during Phase II is to aggressively leverage its burgeoning content base by further enhancing its content delivery capabilities. Importantly, as Lions Gate expands its system of dedicated "pipelines" connecting its content creators with the most appropriate target audiences, the Company should be able to lay off an increased portion of the risk inherent in creating its motion picture and television libraries.* Lions Gate has already begun to build its delivery capabilities in the theatrical release market. It has also started to deliver filmed entertainment product directly to the in-home entertainment market via two newly acquired home video distribution businesses and one joint venture relationship. Further, a 20% investment by Fox Family Worldwide in Lions Gate's Ciné-Groupe animation division provides Lions Gate with a direct pipeline into the North American children's television market.

*We expect that Lions Gate will focus most of its distribution building efforts on the television market.* Specifically, we expect Lions Gate to be aggressive in forging new relationships with specialty cable channels and broadcasters, in deals similar to the Fox / Ciné-Groupe transaction.

*In general, we are extremely impressed with the potential revenue and profit generating power of this business model. Even more importantly, we are highly confident that Giustra, given his long record of accomplishment as an enterprise builder and wealth creator, will effectively execute this model.* Simply put, once a filmed entertainment library—for either the motion picture or television markets—reaches critical mass, the value of that library can be enhanced exponentially via savvy deal making on the distribution side of the business. In even simpler terms, the cost of producing a great C\$6 million dollar independent film remains fixed, regardless of how many people eventually pay to see that film. The more people who see that film in a theatre, on cable, on broadcast television, or on home video, the greater will be a studio's return on its initial C\$6 million investment. In fact, an effectively negotiated distribution deal might not only expand the potential audience for a film, but could also reduce Lions Gate's financial exposure on the initial C\$6 million investment. *Giustra, and the management team that he has formed at Lions Gate over the past 18 months, are clearly aware of the revenue and profit generating potential of this business model and appear determined to exploit that potential.*

Chart I

Lions Gate Entertainment Corp.

**Key Corporate Developments - Building a Portfolio of Revenue and Profit Growth Drivers**

Formation-to-date

Date	Event	Comments
June 18, 1997	Lions Gate Entertainment acquires a 47.6% interest in <b>Cinepix Film Properties, Inc.</b> , a long established producer and distributor of feature-length motion pictures. Cinepix is renamed Lions Gate Films. This deal included Cinepix's 56% ownership in <b>Ciné-Groupe</b> .	Total consideration of C\$ 17.0 million in cash.
July 31, 1997	Lions Gate Entertainment acquires a 100% interest in <b>North Shore Studios</b> . North Shores' 210,000 square foot production facility in North Vancouver is comprised of sound stages, and office and support space. North Shore has been renamed Lions Gate Studios.	Consideration in this deal totaled C\$26.0 million consisting of C\$9.4 million in cash plus C\$ 16.6 million in 8.5% promissory notes. (Effective April 15, 1998 the interest rate on these notes was reduced to 6.0%.)
November 12, 1997	Lions Gate Entertainment acquires the remaining 52.4% of <b>Lions Gate Films that it did not already own</b> .	Total consideration of approximately C\$216 million consisting of 7.2 million common shares at C\$3 per share.
November 12, 1997	Lions Gate Entertainment acquires a 100% interest in <b>Mandalay Television, LLC</b> . Mandalay supplies movies-of-the-week, mini-series and television series to the television market.	Total consideration in this deal came to C\$5.8 million consisting of C\$ 19 million in cash plus roughly 13 million common shares at C\$3 per share.
November 13, 1997	Lions Gate Entertainment Corp. goes public by acquiring, in a reverse takeover, the cash assets of Beringer Gold Corp.	About 2.6 million common shares at C\$2.66 per share.
March 1, 1998	Lions Gate Entertainment 1) acquires a 45% equity interest in <b>Mandalay Pictures LLC</b> , 2) enters a long-term, multi-picture financing and distribution agreement with <b>Paramount Pictures</b> , and 3) commences negotiations with motion picture distributors in seven foreign markets. Mandalay plans to develop and produce 20 Class A motion pictures during the March 1998 through March 2003 period.	Lions Gate has contributed US\$50 million to Mandalay Pictures and is required to contribute an additional US\$25 million by December 31, 1998.
April 15, 1998	Lions Gate Entertainment forms <b>Lions Gate Media, Inc.</b> as the Company's core television operation.	LGM will expand via the development and/or acquisition of distribution, program-ming services and content creation.
May 14, 1998	Lions Gate Entertainment secures <b>C\$3.1 million in proceeds</b> from exercise of C\$4.50 warrants.	In this transaction, an investor acquired 691667 shares by exercising its Class D warrants.
May 21, 1998	Mandalay Television receives <b>orders from four major US networks</b> for four of its new series.	"Cupid" (ABC), "Mercy Point" (UPN), "Oh, Baby" (LifeTime), and "Rude Awakening" (ShowTime) are to be produced in association with Columbia TriStar Productions.
June 24, 1998	<b>Fox Family Worldwide</b> buys a 20% stake in Lions Gate's Ciné-Groupe.	Fox paid C\$3 million for this 20% stake implying a total value of C\$ 15 million for Ciné-Groupe. Also, Fox investment provides validation, we believe, of Ciné-Groupe's family entertainment strategy.
June 30, 1998	Lions Gate Entertainment acquires 100% of <b>International Movie Group, Inc.</b> , an independent distributor of English-language films to markets outside of North America.	Total consideration of 14 million common shares. Movie Group's primary asset, at the time of the acquisition, was a library of 32 films and distribution rights to an additional five films.
July 30, 1998	Lions Gate Films opens acquisitions, productions and distribution office in <b>London</b> .	This office's immediate goal is to aggressively build a high quality and critically acclaimed library of films through in-house development and acquisitions.
August 28, 1998	Lions Gate Media announces its acquisition of <b>Termite Art Productions</b> , a leading non-fiction television content provider.	Consideration consisted of three convertible non-interest-bearing promissory notes having a total outstanding principal amount of US\$2.8 million.
September 14, 1998	Lions Gate Films and Rentrak Corporation form <b>Locatrak, Inc.</b> , a video revenue sharing distribution company.	The new company's pay-per-transaction system will distribute videos from Lions Gate Films as well as videos from 80-plus suppliers including Disney, Fox and Universal.
September 18, 1998	Lions Gate Entertainment Corp. announces a <b>share repurchase program</b> of up to 3.7 million common shares.	This figure represents approximately 10% of the public float at the time of the announcement.
November 17, 1998	Lions Gate Entertainment Corp. <b>shares are consolidated one-for-two</b> and commence trading on the American Stock Exchange.	These efforts were undertaken to increase awareness and exposure of the Company among US institutional and retail investors.

Source: Company publications.

Compilation and comments: Laguna Research Partners LLC.

Table I  
Lions Gate Entertainment Corp.  
**Incremental Revenue and Operating Profit Analysis**  
FY 1998 through FY 2000 E (March Fiscal Year)  
(C\$ millions)

REVENUE	FY 1998	FY 2000 E	FY 1998 - FY 2000 E		
			Compound Annual Growth	\$ Increment	% of \$ Increment
Films	\$ 51.4	\$ 91.0	33.5%	\$ 39.5	27.5%
Television	-	79.5	n.m.	79.5	55.2%
Animation	9.1	31.6	82.5%	22.5	15.7%
Studios	3.7	6.0	28.3%	2.4	1.6%
Total	\$ 64.1	\$ 208.0	80.1%	\$ 143.9	100.0%

OPERATING PROFIT	FY 1998	FY 2000 E	FY 1998 - FY 2000 E		
			Compound Annual Growth	\$ Increment	% of \$ Increment
Films	\$ 10.4	\$ 17.4	29.3%	\$ 7.0	29.9%
Television	-	9.8	n.m.	9.8	41.8%
Animation	2.1	7.5	80.6%	5.3	22.8%
Studios	2.3	3.7	26.8%	1.4	6.0%
Total	\$ 15.0	\$ 38.4	60.0%	\$ 23.4	100.0%

Note: Figures might not add due to rounding.

Source: Company publications.

Estimates: Laguna Research Partners LLC.

***During the FY 1998 through FY 2000 timeframe—please see Table I above—we estimate that Lions Gate will achieve compound annual growth of 80% in revenue and 60% in operating profit.***

- ***Lions Gate's television business is likely, we feel, to account for more than half of the Company's revenue growth during this period.*** Specifically, we look for television to generate 55.2% of the Company's FY 1998 through FY 2000 revenue growth. Additionally, Lions Gate's animation activities—these are almost all television related—will account for an estimated 15.7% of revenue growth over this same period.
- ***We estimate that the Company's operating profit growth will also be driven primarily by television-related business.*** Live action television programming will likely generate 41.8% of Lions Gate's projected operating profit growth. Animation—as mentioned above, this is almost solely related to television—should account for an estimated 22.8% of Lions Gate's operating profit growth over the FY 1998 through FY 2000 timeframe.

**MOTION PICTURES: Lions Gate Films & Mandalay Pictures**

Through various business units, Lions Gate is involved in *the production and distribution of independent feature films, the worldwide distribution of feature films for theatrical, television and home video audiences*, and, by means of a 45% equity investment in Mandalay Pictures, *the production of major or "Class A" feature motion pictures*.

***The Market***

*The worldwide distribution of motion picture product—via, primarily, the theatrical release, television and home video markets—generated an estimated US\$24.9 billion in revenue in 1998, up 5.7% versus the 1997 figure of US\$23.5 billion.* As shown in Table II on the following page—the data in this Table was developed by Carmel, California-based Paul Kagan Associates, Inc.—the *television* market for motion picture product is likely to have fueled this growth with an 11.0% climb to the US\$7.3 billion level. *Theatrical release* also provided an important boost to total revenue growth.

- *According to AC Nielsen / EDI, North American box office revenue climbed 9% to US\$6.8 billion-plus in 1998.* Theatre ticket sales, industry sources estimate, were up 5% to 1.38 billion while the average price of a ticket advanced roughly 4%. The Walt Disney Company, in a close race with the Paramount division of Viacom, Inc., appears to have led the North American market with total box office revenue of US\$1.1 billion.
- *Worldwide, Fox Entertainment Group, Inc. led the competition with a 1998 box office revenue tally of nearly US\$2.7 billion.* Class A product—*Titanic*—and independent-style films—*There's Something About Mary* and *The Full Monty*—both played an important role in Fox's 1998 performance.

*In our view, growth in North American box office revenue is being driven by successful film product as well as by a sharp upgrade in the motion picture theatre asset base.* Aggressive construction of megaplex theatres—*theatres with 14 or more screens—by leading exhibitors such as AMC Entertainment, Inc., Loews Cineplex Entertainment Corp. and Regal Cinemas, Inc., has sharply boosted average screen count per theatre and the perceived convenience and quality of the movie-going experience. Exhibitor incentives appear strong to continue megaplex construction in that these larger, ultra-modern theatres generate an estimated 10% higher patron count per screen, 40% higher revenue per screen and 130% higher theatre-level cash flow per screen versus older, smaller multiplexes.*

*This process of asset redevelopment is still in its early stages in overseas markets.* There are approximately 30,000 motion picture screens in the US compared with just 100,000 throughout the rest of the world. Industry experts believe that the international population could support another 25,000 to 35,000 screens. In Japan, for instance, there are just 1.4 movie screens for every 100,000 people compared to about 10 screens per 100,000 people in the US. The populous Chinese market is estimated to have only 3,000 motion picture screens, nearly all of them at single screen theatre sites.

*In sum, we believe that 1) the eventual resumption of economic growth in Asia, 2) a sharply enhanced theatre asset base in the US, and 3) a continuation of the international multiplex build-out, should provide major and independent filmmakers with an excellent foundation for strong long-term box office revenue growth.*

Table II  
 Lions Gate Entertainment Corp.  
**Worldwide Motion Picture Distribution: Revenue Stream Overview**  
 1990, 1998 E and 2003 E  
 (US\$ millions)

Revenue Source	1990	1998 E	2003 E
Home video			
US	\$ 2,539	\$ 6,690	\$ 10,012
International	2,338	4,185	4,610
Total	4,877	10,875	14,622
Theatrical rentals			
US	2,117	3,099	4,050
International	2,227	3,585	5,415
Total	4,344	6,684	9,465
Television			
US broadcast netw orks	176	743	1,031
US pay television	872	1,554	2,231
US basic cable	263	1,174	2,225
US television syndication	749	123	77
International television	1,226	2,173	2,894
International pay television	276	1,146	1,846
Cable / DBS / MMDS / PPV	32	357	1,100
Total	3,594	7,270	11,404
Hotel / Airline / Other	32	58	78
TOTAL	\$ 12,847	\$ 24,887	\$ 35,569
As a % of total:			
Home video	38.0%	43.7%	41.1%
Theatrical rentals	33.8%	26.9%	26.6%
Television	28.0%	29.2%	32.1%
Hotel / Airline / Other	0.2%	0.2%	0.2%
TOTAL	100.0%	100.0%	100.0%
Annual growth:			
Home video		1.5%	6.7%
Theatrical rentals		7.4%	6.9%
Television		11.0%	8.6%
Hotel / Airline / Other		7.4%	5.4%
AVERAGE		5.7%	7.4%

Source: Paul Kagan Associates, Inc.

### ***Lions Gate's Motion Picture Strategy***

***Lions Gate's strategy for the production and distribution of motion pictures is based on disciplines that permeate all of the Company's businesses: lay off a substantial portion of production costs, maintain content ownership, and maximize distribution opportunities.*** Here are the details.

- ***Lions Gate Films is a producer and distributor of feature films and television movies.*** The Company typically produces 10 to 12 films annually with per film budgets of US\$15 million or less, minimizing its financial risk through pre-sale and co-production agreements. These films are typically cast-driven and independently styled. In 1996, Lions Gate Films produced 10 films, including two Home Box Office world premieres, two Showtime world premieres, and three films for the Miramax "Dimension" label. In 1997, this unit produced ten films, including three Home Box Office world premieres and one film for Miramax "Dimension".

***The business model for this segment of Lions Gate's motion picture business is, in our view, extremely attractive.*** If Lions Gate were to finance and produce a film on its own, such a film would likely have a "smaller" budget of roughly C\$3 million. Roughly 70%—or C\$2.1 million—of that could be offset by the "pre-sale" of foreign theatrical, television and home video distribution rights. Additionally, the pre-sale of North American pay television rights might generate anywhere from C\$150,000 to C\$1.2 million, with the upper end of this range representing pay television channel world premiere content. Finally, home video sales could be expected to approximate C\$1.5 million, less marketing costs of an estimated C\$500,000. Over this film's 36-month conception-through-delivery cycle, then, total costs would be C\$3 million for production, plus C\$500,000 for home video marketing. Revenue streams would total C\$2.1 million for foreign pre-sales, plus C\$750,000 for North American pay television pre-sales, plus C\$1.5 million in revenue generated by the initial sale of home videos to video rental retailers. ***The net of these hypothetical cost and revenue figures—this spread is called the "gross contribution"—would be C\$850,000. This is a very attractive return, in our opinion, given that foreign pre-sales of C\$2.1 million plus North American pay television pre-sales of C\$750,000 had nearly covered the film's C\$3 million production cost before shooting even began. Additionally, this gross contribution figure does not reflect the long-term financial benefits of retaining the film's library rights.***

- ***Lions Gate Films also acquires films for distribution throughout the US, Canada and overseas markets.***

In the ***United States***, Lions Gate has handled / is handling theatrical distribution of *Buffalo '66*, *Love and Death on Long Island* and *Gods and Monsters*. *Gods and Monsters* has been awarded the prestigious National Board of Review award for "Best Picture" of 1998 and has generated Golden Globe nominations for "Best Picture" "Best Actor" and "Best Supporting Actress." We expect that this recognition will significantly boost the revenue-generating power of Lions Gate's *Gods and Monsters* distribution rights.

In ***Canada***, Lions Gate has handled the theatrical release of such notable films as *Antonia's Line*, *Enchanted April*, *Indochine*, *Like Water for Chocolate*, *Strictly Ballroom*, *The Crow*, *The Crying Game*, and *The Piano*. Lions Gate is distributing *Gods and Monsters*, referred to above, in Canada as well as in the United States.

On June 30, Lions Gate acquired International Movie Group, an independent distributor of English-language films to all media in ***all markets outside of North America***. IMG currently owns distribution rights to 32 feature titles, 12 of which were co-financed and co-produced with Canal Plus.

On July 30, Lions Gate Films further heightened its presence in ***Europe*** by opening an office in London, England. This office, we expect, is likely to generate a flow of UK / European film financing opportunities

and film investment opportunities to which the Company might not have previously had exposure. This office will immediately set out to build a commercially and artistically formidable library with global audience appeal through in-house development and acquisition.

***The business model applied by Lions Gate to the acquisition of product for distribution is, in our opinion, very attractive.*** Lions Gate might acquire US distribution rights to a promising independently produced film for C\$200,000. In addition, the Company, might spend C\$1.0 million in marketing the film to the theatrical, television and home video markets. Such a film might generate C\$2.2 million at the box office, of which approximately C\$1.0 million would accrue to Lions Gate. Sales to video rental retailers might total C\$750,000. Finally, a pay television channel might pay about one-third of video sales—C\$250,000—for rights to distribute on television. Total costs of C\$1.2 million, then, would include distribution rights for C\$200,000, plus C\$1.0 million in marketing expenditures. Total revenue of C\$2.0 million would include Lions Gate's box office split of C\$1.0 million, plus C\$750,000 from home video sales, plus C\$250,000 for pay television rights. ***The net of these figures is C\$800,000, an attractive return on an investment of C\$1.2 million. The length of this product cycle is approximately 24 months.***

- ***Lions Gate Films has been active in expanding its distribution of motion picture product to the home video market.***

In the ***United States***, Lions Gate distributes home video product through Avalanche Home Entertainment, a wholly owned Lions Gate subsidiary, and Sterling Home Entertainment, a 50/50 joint venture with Scanbox Asia Pacific Limited. Sterling appears to have further solidified its position as a leader in the video distribution marketplace by acquiring all North American video rights to the direct-to-video motion picture *Legionnaire* starring Jean-Claude Van Damme. *Legionnaire*, boasting a US\$35 million budget, is set to release on both home video and DVD-ROM on February 16.

Additionally, theatrical productions generated by Lions Gate Films are released to the ***United States*** home video market by Universal Home Video.

In ***Canada***, Lions Gate has teamed with Rentrak Corporation in a joint venture dubbed Locatrak, to bring a home video "pay per transaction" system to video retailers in the province of Quebec. Locatrak will distribute Lions Gate Films productions as well as titles from more than 80 suppliers including Disney, Fox, and Universal.

Lions Gate also releases its own films to the home video market in ***Canada*** via a distribution agreement with Columbia TriStar.

***The business model relating to Lions Gate's video distribution business appears to be particularly compelling.*** The North American distribution rights for a direct-to-video motion picture with major stars attached might cost Sterling Entertainment an estimated US\$2.0 million to US\$2.5 million. Sterling's North American marketing and overhead costs could total an additional US\$1.4 million. North American video sales for such content might total US\$6 million to US\$8 million. ***The net of US\$3.4 million to US\$3.9 million in total costs against US\$6 million to US\$8 million in revenue, is US\$2.5 million to US\$4.1 million.***

***Finally, Lions Gate further leverages its library of more than 800 feature films in the Canadian cable, free and pay television markets.*** Lions Gate films produced roughly 80 of these titles itself, of which approximately 50 are currently in active distribution. The remaining 720 titles are films for which Lions Gate has acquired distribution rights.

***In March 1998, Lions Gate gained significant exposure to the potential profits from a slate of 20 Class A motion pictures to be produced by Mandalay Pictures over the next five years. And it has gained this exposure, in our view, by minimizing its capital at risk. The terms of the deal are as follows.***

- Mandalay Pictures is a co-venture between LG Pictures (a wholly-owned indirect subsidiary of Lions Gate) and Tigerstripes (a company controlled by motion picture executive Peter Guber).
- Lions Gate has contributed US\$50 million to Mandalay Pictures in exchange for preferred membership units in Mandalay Pictures which entitle Lions Gate to a preferred return of the capital it has contributed.
- Lions Gate has also been obligated to contribute an additional US\$25 million before December 31, 1998. The Company announced on December 30 that it had satisfied this obligation by securing an "off-balance-sheet" production loan facility for Mandalay Pictures. Chase Manhattan Bank is providing this facility.
- Lions Gate has four of seven members on the Mandalay Pictures executive committee (the board of directors of Mandalay).
- Mandalay Pictures is committed to producing 20 Class A motion pictures during a five-year period.
- At the end of that five-year period, following the preferred return of contributions made by Lions Gate, Lions Gate will receive 45% of the distributions of Mandalay Pictures and Tigerstripes will receive 55%. Given that Lions Gate is putting up all of the equity in Mandalay Pictures, any losses that are realized by Mandalay during the five-year term of the agreement will be fully borne by Lions Gate. These losses would be fully recouped at the end of the five-year agreement, before the distribution of Mandalay profits to Lions Gate and Tigerstripes. During the five-year term of this agreement, Lions Gate will account for its Income Statement exposure to Mandalay on an equity method basis.
- Lions Gate can choose to pay Tigerstripes' backend distribution from Mandalay in the common shares of Lions Gate Entertainment Corp. Conversely, Tigerstripes can choose to take its distribution in Lions Gate shares.

***The creative force behind Mandalay Pictures is Peter Guber, founder of Casablanca Record and Film Works, co-founder and former chairman of Polygram Pictures, co-founder of Guber-Peters Entertainment Company, and former chairman and CEO of Sony Pictures Entertainment.*** Films directly produced and executive produced by Guber, individually or jointly, have received numerous Academy Award nominations, including four nominations for "Best Picture". His financial and critical successes include *Rain Man*, *Batman*, *Gorillas in the Mist* and Steven Spielberg's *The Color Purple*. Just prior to the formation of Mandalay Pictures, Peter Guber was the founder and CEO Mandalay Entertainment, a joint venture with Sony Pictures Entertainment. Mandalay Entertainment's releases during 1997 included *Donnie Brasco*, *I Know What You Did Last Summer*, and *Seven Years in Tibet*. More recent releases have included *I Still Know What You Did Last Summer*, *Les Misérables*, and *Wild Things*. ***In general, Peter Guber has produced films averaging more than US\$53 million—inflation adjusted—in US box office revenue. This is 39% higher than the inflation-adjusted average of US\$38 million for films produced by all major studios combined.*** Guber's average negative cost is estimated to be in the US\$38 million range, inflation adjusted.

***The profit potential of the Lions Gate / Tigerstripes deal has been greatly enhanced, in our opinion, by a long-term, multi-picture financing, production and distribution agreement between Mandalay Pictures and Paramount Pictures, a subsidiary of Viacom, Inc.***

- **Paramount will market and distribute Mandalay Pictures' feature films worldwide**, except in the UK, Italy, Germany, France, Japan, Spain, Australia and Greece, where distribution will be handled, for the most part, by companies having previous relationships with Mandalay Pictures executives.
- **In general terms, Paramount and the foreign distribution partners referred to above, are expected to provide roughly 90% of each film's financing.** Mandalay Pictures will provide the remaining 10%.

**We expect that the annual pace of production at Mandalay will call for one, four, five, five, and five motion pictures to be produced in years one through five, respectively.** Mandalay recently announced its first picture under the Lions Gate / Tigerstripes agreement will be *The Legend of Sleepy Hollow*. This will be a live action, special effects film with a major budget. *Legend* will be directed by Tim Burton (*Batman*) and will star Johnny Depp (*Edward Scissorhands* and *Donnie Brasco*). A release date for this film has yet to be set.

**Finally, the Lions Gate motion picture growth strategy is being executed by executives who, like Peter Guber, have a long record of success in the film business.**

- **John Dunning, chairman of Lions Gate Films and Andrè Link, CEO of Lions Gate Films, were the co-founders of Cinepix, Inc.—the predecessor company to Lions Gate Films—in 1962.** Both remain actively involved in the management of Lions Gate Films.
- **Jeff Sackman, president of Lions Gate Films, has been with Lions Gate Films and its predecessor Cinepix since 1991.** He has been involved in the acquisition and release of leading independent films including *My Left Foot*, *Sex Lies and Videotape*, *The Crow*, *The Crying Game*, and *The Piano*.

**In the independent production and distribution arena, Lions Gate competes with both studio and non-studio entities.** Key competitors include **Fine Line Features** (*The Sweet Hereafter*, *Deconstructing Harry*), a wholly-owned subsidiary of New Line Cinema, owned by Time Warner, Inc.; **Fox Searchlight Pictures** (*The Brothers McMullen*, *The Full Monty*, *Waking Ned Devine*), a unit of Fox Entertainment Group; **Goldwyn Films** (*Hanging Garden*, *Velvet Goldmine*), the independent film arm of MGM; **Gramercy Pictures** (*Four Weddings and a Funeral*, *Dead Man Walking*, *Fargo*), a co-venture of Universal Pictures and Polygram Filmed Entertainment; **Miramax Films** (*Good Will Hunting*, *The English Patient*, *Pulp Fiction*), a division of Disney; **October Films** (*A Soldier's Daughter Never Cries*, *Breaking the Waves*), partially owned by Universal; **Samuel Goldwyn Films, LLC** (*Stranger Than Paradise*, *I Shot Andy Warhol*); and, **Sony Pictures Classics** (*The Opposite of Sex*, *In the Company of Men*), a division of Sony Corporation.

**In the Class A film production marketplace, Lions Gate will compete with established producers and distributors of major motion pictures.** These competitors include **Metro-Goldwyn-Mayer, Inc.**; **Paramount Pictures Corporation**, a division of Viacom, Inc.; **Sony Pictures Entertainment**, a division of Sony Corporation; **Twentieth Century Fox Film Corp.**, a division of The News Corporation's Fox Entertainment Group; **Universal Studios, Inc.**, a division of The Seagram Company Ltd.; **Walt Disney Company**; and, **Warner Bros.**, a division of Time Warner, Inc.

#### **Lions Gate's Motion Picture Outlook**

**As indicated in Table I on page four of this report, Lions Gate's motion picture business is expected to achieve compound annual growth of 33.5% in revenue and 29.3% in operating profit over the FY 1998 through FY 2000 period.**

- ***During the remainder of FY 1999, Lions Gate Films is releasing three films which, in our view, appear to hold substantial box office potential.***

*Gods and Monsters*, released on November 20, has beaten Steven Spielberg's *Saving Private Ryan* for the National Board of Review's 1998 Best Picture award. Ian McKellen has won the NBR's 1998 Best Actor award for his performance in the same film. NBR's annual film awards typically set the tone for Hollywood's annual awards season, so the potential positive box office impact of the recognition given *Gods and Monsters* is, in our opinion, substantial. *Gods and Monsters* has also generated Golden Globe nominations for Best Motion Picture, Best Actor and Best Supporting Actress.

*Les Boys II*, sequel to *Les Boys*, the highest grossing film in Quebec history, was released on December 8. While sequels typically generate less box office than original films, box office results during its first several weeks of release indicate that *LBII* could solidly outdraw its predecessor.

*Affliction*, directed by Paul Schrader and starring Nick Nolte, Sissy Spacek, James Coburn and Willem Dafoe, was released on December 30. New York Film Critics has bestowed its 1998 Best Actor award on Nick Nolte for his role in this film. The film has also earned Nolte a Golden Globe "Best Actor" nomination.

Looking to later releases, Lions Gate holds US distribution rights for *Red Violin*, which has opened well in Canada. Christian Bale will star in place of Leonardo DiCaprio in *American Psycho*, a Lions Gate Films production, which goes in front of cameras in March. The film is budgeted at US\$10 to US\$15 million.

- ***Lions Gate's relatively new US video division under the Avalanche and Sterling labels should, we expect, be an important growth driver for Lions Gate over the remainder of FY 1999 and throughout FY 2000.*** The February release of *Legionnaire* should be an important factor in boosting revenues from virtually zero for the past 12 months to C\$25 million to C\$30 million over the coming 12 months. Profitability, as indicated in our discussion of Lions Gate's various video-related business models, should be strong.
- ***Ciné-Groupe is currently in production on an animated feature to be released theatrically by Columbia TriStar in 1999.*** This new film, *Heavy Metal F.A.K.K.2*, is the follow-up to the financially successful *Heavy Metal*.

## **TELEVISION: Lions Gate Media & Mandalay Television**

Lions Gate is involved in the production of *reality-based, family, one-hour dramatic and comedic series, movie-of-the-week*, and *mini-series* television programming.

### ***The Market***

***According to figures compiled by Paul Kagan Associates, revenue generated by the worldwide distribution of television programming has grown at a 6.9% compound annual rate during the 1988 through 1997 period. More recently, during the 1994 through 1997 timeframe, growth in worldwide television programming revenue has decelerated slightly to the 6.3% level.*** Please see Table III on the following page for details.

- Compound annual growth in total ***US television programming revenue*** of 6.1% and 5.4% during 1988 through 1997 and 1994 through 1997, respectively, has been driven primarily by powerful compound annual growth—19.5% and 9.0%, respectively—in sales of television programming to basic cable networks in the US.

Table III

Lions Gate Entertainment Corp.

**Worldwide Television Programming Revenues: Licensing of US-Produced Programming**

1988, 1994 and 1997

(US\$ millions)

Revenue Source	1988	1994	1997	1988 - 1997 Increment		1994 - 1997 Increment	
				\$	%	\$	%
Broadcast network programming spending	\$ 5,584	\$ 7,864	\$ 9,104	\$ 3,520	38.7%	\$ 1,240	36.6%
Broadcast syndication	1,680	2,030	2,385	705	7.8%	355	10.5%
Barter syndication	916	1,479	1,854	938	10.3%	375	11.1%
Basic cable networks	345	1,324	1,715	1,370	15.1%	391	11.5%
US pay TV / mini-pay	989	1,182	1,195	206	2.3%	13	0.4%
<b>Total: US</b>	<b>9,514</b>	<b>13,879</b>	<b>16,253</b>	<b>6,739</b>	<b>74.2%</b>	<b>2,374</b>	<b>70.0%</b>
International television (feature films)	752	1,063	1,414	662	7.3%	351	10.3%
International television (series and MOW's)	623	1,131	1,524	901	9.9%	393	11.6%
International pay TV	167	677	951	784	8.6%	274	8.1%
<b>Total: international</b>	<b>1,542</b>	<b>2,871</b>	<b>3,889</b>	<b>2,347</b>	<b>25.8%</b>	<b>1,018</b>	<b>30.0%</b>
<b>Total: worldwide</b>	<b>\$ 11,056</b>	<b>\$ 16,750</b>	<b>\$ 20,142</b>	<b>\$ 9,086</b>	<b>100.0%</b>	<b>\$ 3,392</b>	<b>100.0%</b>

Annual Growth:	1988 - 1997 Compound Annual Gth.		1994 - 1997 Compound Annual Gth.	
Broadcast network programming spending	5.0%	5.0%	5.6%	5.0%
Broadcast syndication	7.4%	5.5%	4.0%	5.5%
Barter syndication	8.0%	7.5%	8.1%	7.8%
Basic cable networks	10.0%	8.5%	19.5%	9.0%
US pay TV / mini-pay	0.7%	0.6%	2.1%	0.4%
<b>Average: US</b>	<b>5.7%</b>	<b>5.4%</b>	<b>6.1%</b>	<b>5.4%</b>
International television (feature films)	8.0%	10.0%	7.3%	10.0%
International television (series and MOW's)	10.2%	8.6%	10.5%	10.5%
International pay TV	12.1%	12.0%	21.3%	12.0%
<b>Average: international</b>	<b>9.8%</b>	<b>9.9%</b>	<b>10.8%</b>	<b>10.6%</b>
<b>Average: worldwide</b>	<b>6.4%</b>	<b>6.2%</b>	<b>6.9%</b>	<b>6.3%</b>

Source: Paul Kagan Associates, Inc.

Increment and CAG Calculations: Laguna Research Partners LLC.

- Compound annual growth in *international television programming revenue* has exceeded 10% annually over the past nine years. Sales of feature films, series and movies-of-the-week have all been important drivers in international markets.

### *Lions Gate's Television Strategy*

*Lions Gate's strategy for maximizing profit growth in the worldwide television market is to become a significant content provider in high growth niches that are "under the radar screens" of the studios.* Product niches that fit this description include non-fiction content—non-scripted, reality-based programs such as *Cops* and *911* are increasingly dominating the primetime network schedule—and one hour series programming for cable and syndication. While this product doesn't have the "breakout" potential characteristic of the primetime network television business, it provides healthy rates of return, fast turnaround of capital, and backend profit exposure.

- *On August 28, Lions Gate acquired Termite Art Productions, a leading supplier of non-fiction television content to the Discovery Channel, the Learning Channel and Fox Prime Time. In the short time since its acquisition by Lions Gate, Termite's performance in the reality-based market has been impressive.*

On November 19, Termite's *Busted on the Job 3* achieved the highest audience rating in Fox history for a non-baseball Thursday special. This latest installment of *Busted* was also the US's number two show that evening, second only to *Frasier*.

Additionally, Lions Gate has sold its first primetime series, *RedHanded*, to UPN. This is the first "reality" series to which UPN has committed. Lions Gate expects to produce the six episodes purchased by UPN at a solid profit. Britain's ITV has already purchased six episodes and has been airing the program on its London Weekend Television. Lions Gate will control international distribution rights for this show.

*In a broad sense, the business model characteristics of the reality-based television market are, we feel, attractive. First, production costs are low.* Given the low overhead and variable cost characteristics of high-growth niche content, this product is often profitable during its first cycle of distribution. *Second, reality-based product is proving to have broad international audience appeal.* *Cops*, for example, a pioneer product in the reality-based marketplace, is currently distributed in 46 overseas markets in both its original US form and in locally adapted versions. *And, third, this market provides Lions Gate with low cost / low risk ancillary market opportunities.* Home video spin-offs such as *Cops: Too Hot for TV!* and *Jerry Springer: Uncensored!* are examples of ancillary market content compiled from existing "out takes" through which popular reality-based franchises can be aggressively leveraged.

*In the cable market for reality-based content, the specifics of Lions Gate's business model are as follows.* The production cost of one hour of cable market reality-based programming generally ranges from US\$125,000 to US\$150,000. Cable channels will generally pay a license fee equal to two-thirds of production cost for each one-hour episode. In addition, international rights can typically be sold for US\$50,000 to US\$75,000 per one-hour episode. *The gross contribution on reality-based product usually approximates 10% of production costs and the conception-to-delivery cycle runs an average of nine months. While returns on capital in this market are not earthshaking, the production of reality-based cable content provides Lions Gate with a relatively predictable source of revenue and profit.*

*In the network market for reality-based content, Lions Gate is able to achieve economics that are solidly superior to those it achieves in the cable market.* An hour of network market reality-based programming costs US\$400,000 to US\$450,000 to produce. Networks will generally pay a US\$500,000 per episode license

fee for such product and international distribution rights will typically generate an additional US\$100,000 to US\$200,000 per hour of content. ***The net of US\$400,000 to US\$450,000 in total expenses against total revenue of US\$600,000 to US\$700,000 indicates a gross contribution of US\$200,000 to US\$250,000 per episode. The conception-to-delivery cycle for network market reality-based content is about six months.***

- ***Lions Gate has also achieved early success in the primetime series market.***

***In May, Lions Gate announced that it had received orders from four major US networks for four of its new series concepts: Cupid, a one-hour romantic comedy was picked-up by ABC; Mercy Point, a one-hour science fiction medical drama was picked-up by UPN; Oh Baby, a half-hour comedy was picked-up by LifeTime and; Rude Awakening, a one-hour comedy was picked-up by Showtime.***

***Since the original airing of these shows, an impressive three of the four have received orders for additional episodes. Cupid has received orders for nine episodes in addition to the 13 already delivered. Oh Baby has already delivered 22 episodes and is in negotiation for the delivery of a second season. Rude Awakening, which had already delivered 13 episodes, has received an order for an additional 22 episodes.***

***Lions Gate is committed to pursuing a conservative business model in the primetime series business. First, the Company is unlikely to take an ownership position in productions over the near term.*** Episodic content produced by Mandalay Television is 100% underwritten by Columbia TriStar. Lions Gate takes a producers fee and a meaningful percentage of profits from the adjusted gross for *Cupid, Oh Baby* and *Rude Awakening*. Columbia TriStar assumes 100% of the risk.

***For the purpose of perspective, it is useful to note that the business model relating to the financing of primetime series is characterized by high-risk and high upside potential.*** The typical one-hour series costs US\$900,000 to produce. The first cycle US run can generate anywhere from zero to US\$300,000 in revenue per episode. The Canadian and international markets can generate an additional US\$150,000 to US\$200,000 and US\$500,000 in revenue, respectively. Hour-long content is often unprofitable in its first year of production, breakeven in its second year and profitable in year three and beyond.

- ***Lions Gate is also taking a conservative approach to the movie-of-the-week and mini-series markets, because network demand for independently-produced "long-form" content is contracting.*** Over the past two years, the networks have increasingly shifted the production of long-form television content in-house, while the international market has remained strong.

***Lions Gate is addressing this market shift in two important ways.*** First, the Company is focusing on product that is likely to have strong appeal with overseas audiences. Second, Lions Gate is negotiating aggressive distribution deals to maximize its upside.

***On December 15, Lions Gate announced that it will produce Shutter Speed, a made-for-television movie, for TNT. Also, TBS has ordered First Daughter for 1999 delivery.*** Following a quiet 1998, Lions Gate now has 55 hours of long form product in development with the various networks. The company plans to produce between four or five movies and mini-series during calendar 1999. Mandalay Television expects to do somewhere between US\$25 million and US\$35 million in long-form production for calendar 1999.

***While Lions Gate currently is pursuing a medium risk strategy in the movie-of-the-week market, a quick review of production economics for this type of content provides some perspective on why the Company is taking this approach.*** Movie-of-the-week production costs average US\$3.6 million to US\$3.8 million per movie. The pre-sale of network broadcast rights typically covers just 70% of this budget. Producers, then,

depend on the sale of international broadcast rights—these can amount to US\$1.0 million to US\$1.3 million—to be profitable. Further, financing for a movie-of-the-week project is committed for the duration of an 18-month conception-to-delivery cycle.

***Economics currently prevailing in the mini-series market are better, but still carry risk.*** Mini-series production costs typically total between US\$12 million and US\$16 million. As is the case for movies-of-the-week, producers of mini-series must depend on the sale of international broadcast rights—these can total US\$4 million to US\$5 million—to generate a profit on mini-series content. Our estimates indicate an average gross contribution of US\$750,000 to US\$1.25 million from mini-series product.

- ***In our view, Lions Gate's production of animated television product provides the Company with substantial potential for upside surprises in operating results.*** As in its motion picture and live-action television divisions, Lions Gate management is developing strategies for simultaneously leveraging the creative output of its Ciné-Groupe animation division through a broader array of distribution pipelines and boosting the size of the Lions Gate library while cutting its financial exposure at the front end.

***In June, 1998, Lions Gate announced that Fox Family Worldwide had made an investment of C\$3 million in the Company's Ciné-Groupe animation subsidiary. In return, Fox received a 20% equity stake in Ciné-Groupe.*** We view this deal as a significant positive for Lions Gate for several reasons. ***First***, Fox's C\$3 million 20% stake in Ciné-Groupe implies a total equity valuation for Ciné-Groupe of C\$15 million. As indicated earlier in this report, Lions Gate management is giving serious consideration to the possibility of taking Ciné-Groupe public as a strategy towards gaining fuller recognition of this value in the public equity markets. ***Second***, the Fox investment is particularly critical because it provides Ciné-Groupe with significant exposure in the US marketplace. Historically, most of Ciné-Groupe's product has been distributed in Canada and Europe. While Fox does not have right of first refusal on Ciné-Groupe's animated output, this equity investment gives Fox access to product they like.

***The profitability of Lions Gate's animated television content production is a function of 1) its ability to defray costs through tax credits, subsidies and co-production deals, and 2) the success of merchandising activity related to a concept's animated characters.*** Depending on animation detail and quality, the production of a half-hour animated episode can cost anywhere from US\$275,000 to US\$500,000. About 20%, 30% and 50% of this budget can be covered by US, Canadian and international pre-sales, respectively. Merchandising, then, is the key variable determining the ultimate financial success of an animated series.

***Most importantly, Lions Gate's television strategy is being executed by a group of seasoned industry veterans.***

- ***Dennis Miller, president of Lions Gate Media, came to the Company in early 1998 from Sony Pictures Entertainment where he was in charge of all television operations.*** In that position, Miller also handled identification of strategic opportunities throughout Sony's core businesses as well as in new and emerging markets. Previous to Sony, he was president of Turner Pictures where he was responsible for the TNT Network, Turner feature animation and the Turner Entertainment Company. Earlier, Miller served as president and COO of Think Entertainment, a cable programming production company, and he was founder and president of Access Syndication, a live action and animated television production and distribution entity.
- ***Jacques Pettigrew founded Ciné-Groupe in 1979 and currently serves as the animation unit's president and CEO.*** Under his guidance, Ciné-Groupe has produced more than 400 half-hour animated episodes for television. In just the past year—reflecting the re-invigoration of this unit since its purchase by Lions Gate—Ciné-Groupe has delivered 88 episodes of that 400-plus total.

- ***Kevin Beggs, senior vice president of drama development, Lions Gate Media, is responsible for developing new one-hour primetime dramas with a particular focus on the cable, syndication and international markets.*** He served as a producer of *Baywatch*, the world's most popular one-hour series, from 1991 to 1998.
- ***Ken Katsumoto, senior vice president of Lions Gate Family Entertainment, came to Lions Gate from Paragon Entertainment*** where he served as vice president, Family Entertainment and developed highly-successful family oriented programming for CBS, Fox Kids, Nickelodeon Jr., and PBS.

### ***Lions Gate's Television Outlook***

***Lions Gate's television-related production activities—excluding animation—should generate an estimated C\$79.5 million in revenue in FY 2000, a meteoric rise since its early 1998 formation. Operating profit, we estimate, will reach the C\$9.8 million level in FY 2000, indicating an operating profit margin of 12.3%.*** We expect that Lions Gate will deliver approximately 25 total hours of non-fiction programming and produce roughly 10 to 14 hours of long form programming during FY 2000.

***Lions Gate's animation business—as indicated earlier, this is nearly all television related—should generate, we estimate, C\$31.6 million in revenue in FY 2000 versus just C\$9.1 million in FY 1998. Operating profit, we project, should reach the C\$7.5 million in FY 2000 versus C\$2.1 million in FY 1998.*** Projects that Ciné-Groupe now has in place should result in the delivery of an estimated 130 half-hour episodes in FY 1999—this compares with 100 half-hours in FY 1998—and about 170 half-hours in FY 2000. Additionally, we expect that Ciné-Groupe will benefit significantly from the industry relationships that Ken Katsumoto brings to Lions Gate. Katsumoto has already arranged two deals for Ciné-Groupe that involve partners beyond Lions Gate's Fox Family Worldwide relationship.

### **LIONS GATE STUDIOS**

***Lions Gate Studios, the former North Shore Studios, operates six state-of-the-art sound stages in the Vancouver metro area.*** These sound stages range in size from 11,000 to 15,000 square feet and are supported by more than 130,000 square feet of production, and office space, and a 40-seat screening room.

### ***The Market***

***Lions Gate Studios is a prime beneficiary of the dramatic rise seen in motion picture and television production over the past five years.*** This increase reflects the confluence of several important developments: 1) production costs are generally lower in Canada versus the US due to lower labor union minimum pay levels, 2) the \$US / \$C exchange rate has favored the production of US content in Canada, 3) Canadian Government tax incentives encourage the production of foreign content on Canadian soil, 4) many Canadian cities and several provinces offer free location assistance to motion picture and television producers, 5) Canada's variety of topography combined with a sparse population is ideal for location shooting, and 6) Canada's close geographic proximity to the US and the two countries' shared values and lifestyles have led to the development of close professional ties between Canadian and US studios, independent producers, distributors and buyers.

### ***Lions Gate's Studio Strategy***

In general, Lions Gate management attempts to maximize both the profitability and predictability of this operation's financial results by balancing the benefits of mid- to long-term bookings with the benefits of serving "one-off" users such as advertising agencies.

- ***Lions Gate currently operates six sound stages—a total of 82,000 square feet—at a single site in North Vancouver.*** Once the Company obtains final parking approvals from the city, it plans to begin construction on a seventh stage of roughly 17,000 square feet. This new stage could be in operation by late calendar 1999.
- ***The Company is also considering the construction of its eighth and ninth stages—17,000 square feet each—at a site close to its core sound stage site in North Vancouver.*** Lions Gate is unlikely, we feel, to have any interest in owning these new stages outright, given that they would be located on a separate site. While the construction of these stages might be financed primarily by third party investors, it appears that the Province of British Columbia may provide financing for up to half of the project's total cost. Lions Gate management is optimistic that virtually all of this new space could be leased before these stages are even open for business.

***The Company's six existing sound stages, booked mid- to long-term by Fox and Disney, generally operate at about 95% of capacity.*** The stage space vacated by Fox's *X-Files*—production of that show was moved to Los Angeles at the behest of *X-Files* star David Duchovny—has been picked-up by Fox at higher rent rates. The Fox hit *Millennium* occupies sound stages "1" and "2", while the new Fox primetime series *Strange World* occupies stages "4" and "6". Stages "3" and "5" are leased on a "one-off" basis for the production of feature films, movies-of-the-week and television commercials.

Long-term service occupants include ***William F. White***, Canada's largest lighting company, ***Pinewood Sound***, a post-production sound company, and ***Sim Video***, a supplier of cameras and post-production editing equipment.

- ***According to management, a key attraction of the Company's North Vancouver studio facility is its high-quality ancillary office space.*** A production company can move into office space on the Lions Gate lot—fully equipped with furniture, functioning telephones and wastepaper baskets—within an hour of rental.
- ***The Province of British Columbia owns a sound stage rental operation called The Bridge—this is booked long-term by MGM—which is Lions Gate's only significant stage rental competition on the West Coast of Canada.*** This facility is comprised of one 40,000 square foot stage—the largest in North America—two 15,000 foot stages, three 12,000 foot stages and one 9,000 foot stage.

***Lions Gate expects that its North Vancouver sound stages will be used increasingly for the in-house production of Lions Gate television content.*** To date, such synergies have not been fully exploited because the stages are in such high demand. When in-house use does ramp-up, management indicates that there will be no significant intra-company discounts.

### ***The Operating Outlook for Lions Gate Studios***

***As shown in Table I on page four of this report, we estimate that revenue and operating profit generated by Lions Gate Studios will grow at compound annual rates of 28.3% and 26.8%, respectively, during the FY 1998 through FY 2000 period.***

- In FY 1999, we estimate, the revenue, operating profit and operating profit margin generated by Lions Gate's studio rental business will be C\$5.8 million, C\$3.5 million and 22.6%, respectively.
- We expect that, in FY 2000, the addition of new sound stage space will boost revenue and operating profit at Lions Gate Studios, but will reduce this division's occupancy rate and profit margin. We are projecting that the studio rental operation will generate FY 2000 revenue and operating profit of C\$6.0 million and C\$3.7 million, respectively, and a corresponding operating profit margin of 18.5%.

### RECENT OPERATING RESULTS

***On November 24, Lions Gate announced operating results for FQ2:99 ended September 30.*** A key point in understanding a company-in-active-development like Lions Gate, we feel, is that the early achievements of such companies are often best measured not in current earnings per share, but in the development of the business model that is expected to generate future revenue and profit growth. Evaluated from this perspective, we view Lions Gate's FQ2 as having been extraordinarily successful. Please see Tables IV, V, and VI on pages 19, 20, and 21, respectively.

- ***On July 30, Lions Gate Films announced that it had opened an office in London*** as a base for all of LGF's European acquisitions, productions and distribution.
- ***On August 28, Lions Gate Media acquired Termite Art Productions, a highly successful provider of documentary and reality-based television content.*** This acquisition, in our view, is a major step towards positioning Lions Gate to meet the surging worldwide demand for non-fiction programming. At the time of the acquisition, Termite was in production on 14 one-hour specials for the Discovery Channel, four mini-series for the Learning Channel and a variety of programs for A&E's History Channel, PBS and Fox Prime Time.
- ***On September 14, Lions Gate Films announced that it had partnered with Rentrak Corporation to form Locatrak, Inc., a video revenue sharing distribution company.*** This new company will allow video rental retailers to acquire rental rights to videos as opposed to having to purchase those videos outright. In our view, this operation has the potential to rapidly penetrate its first video rental target market, Quebec Province.
- ***On August 28, Lions Gate Media announced the hiring of Kevin Beggs as senior vice president of drama development.*** Beggs, who served as producer for the commercial blockbuster *Baywatch* during 1991 through 1998, will be responsible for developing one-hour dramas, particularly for the cable, syndication and international television markets.

***The impact of this important foundation building activity, and lower-than-expected box office results from several Lions Gate Films productions, was reflected in Lions Gate's FQ2 operating results.*** Revenue in the quarter was C\$24.3 million, 19.6% ahead of the year-ago C\$20.4 million. Operating profit was C\$5.7 million versus C\$4.5 million, +26.5%. A 106.4% jump in general and administrative expenses, though, held FQ2:99 EBITDA to C\$464,000 compared with the year-ago C\$2.0 million. EPS for the quarter came in at C\$(0.03) versus C\$(0.01).

Table IV  
Lions Gate Entertainment Corp.  
**Operating Profit Model**  
FY 1998 through FY 2001 E (March Fiscal Year)  
(C\$ millions)

	FQ1:98 (June, '97)	FQ2:98 (Sept., '97)	FQ3:98 (Dec., '97)	FQ4:98 (Mar., '98)	FY 1998 (Mar., '98)	Pro Forma FY 1998 (Mar., '98)	FQ1:99 (June, '98)	FQ2:99 (Sept., '98)	FQ3:99 E (Dec., '98)	FQ4:99 E (Mar., '99)	FY 1999 E (Mar., '99)	FY 2000 E (Mar., '00)
<b>REVENUE</b>												
Production and distribution	\$ 1,896	\$ 16,400	\$ 12,879	\$ 20,232	\$ 51,407	\$ 63,881	\$ 14,831	\$ 15,292	\$ 26,552	\$ 32,369	\$ 89,044	\$ 170,409
Animation	0,418	3,217	1,979	3,465	9,079	11,834	1,939	7,530	7,850	3,965	21,284	31,600
Studios	-	0,741	1,107	1,814	3,662	5,402	1,414	1,523	1,464	1,422	5,823	6,030
Total	2,314	20,358	15,965	25,511	64,148	81,117	18,184	24,345	35,866	37,756	116,151	208,039
<b>OPERATING EXPENSES</b>												
Production and distribution	1,557	13,380	9,850	16,103	40,890	50,610	11,530	11,932	21,517	26,379	71,358	143,193
Animation	0,294	2,349	1,490	2,821	6,954	9,422	1,163	6,154	5,970	2,974	16,261	24,134
Studios	-	0,117	0,245	0,968	1,330	1,970	0,595	0,550	0,574	0,566	2,285	2,297
Total	1,851	15,846	11,585	19,892	49,174	62,002	13,288	18,636	28,061	29,919	89,904	169,624
<b>OPERATING PROFIT</b>												
Production and distribution	0,339	3,020	3,029	4,129	10,517	13,271	3,301	3,360	5,035	5,990	17,686	27,216
Animation	0,124	0,868	0,489	0,644	2,125	2,412	0,776	1,376	1,880	0,991	5,023	7,466
Studios	-	0,624	0,862	0,846	2,332	3,432	0,819	0,973	0,890	0,856	3,538	3,733
Total	\$ 0,463	\$ 4,512	\$ 4,380	\$ 5,619	\$ 14,974	\$ 19,115	\$ 4,896	\$ 5,709	\$ 7,805	\$ 7,837	\$ 26,247	\$ 38,415
<b>OPERATING PROFIT MARGIN</b>												
Production and distribution	17.9%	18.4%	23.5%	20.4%	20.5%	20.8%	22.3%	22.0%	19.0%	18.5%	19.9%	16.0%
Animation	29.7%	27.0%	24.7%	18.6%	23.4%	20.4%	40.0%	18.3%	23.9%	25.0%	23.6%	23.6%
Studios	n.m.	84.2%	77.9%	46.6%	63.7%	63.5%	57.9%	63.9%	60.8%	60.2%	60.8%	61.9%
Average	20.0%	22.2%	27.4%	22.0%	23.3%	23.6%	26.9%	23.5%	21.8%	20.8%	22.6%	18.5%

Source: Company publications.  
Estimates: Laguna Research Partners LLC.

Table V  
Lions Gate Entertainment Corp.  
**Consolidated Statements of Income**  
FY 1998 through FY 2001 E (March Fiscal Year)  
(C\$ millions)

	FQ1:98 (June, '97)	FQ2:98 (Sept., '97)	FQ3:98 (Dec., '97)	FQ4:98 (Mar., '98)	FY 1998 (Mar., '98)	Pro Forma FY 1998 (Mar., '98)	FQ1:99 (June, '98)	FQ2:99 (Sept., '98)	FQ3:99 E (Dec., '98)	FQ4:99 E (Mar., '99)	FY 1999 E (Mar., '99)	FY 2000 E (Mar., '00)
Revenue	\$ 2.314	\$ 20.358	\$ 15.965	\$ 25.511	\$ 64.148	\$ 81.117	\$ 18.184	\$ 24.345	\$ 35.866	\$ 37.756	\$ 116.151	\$ 208.039
Operating expenses, divisions	1.851	15.846	11.585	19.892	49.174	62.002	13.288	18.636	28.061	29.919	89.904	169.624
Operating profit, divisional	0.463	4.512	4.380	5.619	14.974	19.115	4.896	5.709	7.805	7.837	26.247	38.415
General & administrative expe	0.449	2.541	2.714	4.633	10.337	12.139	4.739	5.245	5.652	5.843	21.479	21.135
EBITDA	0.015	1.971	1.666	0.986	4.637	6.976	0.157	0.464	2.153	1.994	4.768	17.280
Interest expense	0.029	0.643	0.776	0.917	2.365	2.846	0.791	1.082	0.984	0.971	3.828	2.636
Interest income	0.084	0.266	0.794	0.270	1.414	1.409	0.158	0.159	0.050	0.040	0.407	0.026
Depreciation and amortization	0.025	0.260	0.322	0.316	0.923	1.501	0.445	0.427	0.466	0.489	1.827	2.000
Amortization of goodwill	0.038	0.125	0.325	0.370	0.858	1.257	0.402	0.487	0.515	0.515	1.919	2.060
Equity in Mandalay Pictures pr	-	-	-	-	-	-	-	-	-	-	-	1.000
Dilution gain	-	-	-	-	-	-	0.839	-	-	-	0.839	-
Profit before taxes and minorit	0.007	1.209	1.036	(0.346)	1.906	2.782	(0.484)	(1.373)	0.238	0.059	(1.560)	11.610
Taxes	0.076	0.719	0.524	0.120	1.439	2.107	0.459	0.262	0.684	0.553	0.516	4.655
Minority interest	0.054	(0.593)	0.280	0.092	1.019	0.357	-	(0.237)	0.314	0.085	0.636	0.941
Net profit	(0.123)	(0.103)	0.232	(0.558)	(0.552)	0.318	(0.025)	(1.348)	(0.760)	(0.579)	(2.712)	6.014
EPS	\$ (0.04)	\$ (0.02)	\$ 0.02	\$ (0.02)	\$ (0.04)	\$ 0.02	\$ -	\$ (0.06)	\$ (0.04)	\$ (0.02)	\$ (0.12)	\$ 0.20
Shares outstanding, average	3.419	9.110	16.929	23.326	14.160	15.702	23.528	24.348	24.348	24.348	23.993	29.681

Note: Historical EPS and average shares outstanding have been adjusted to reflect a 1-for-2 common share consolidation effective November 17, 1998.

Table VI  
Lions Gate Entertainment Corp.  
**Consolidated Statements of Income**  
FY 1998 through FY 2001 E (March Fiscal Year)  
(as a % of revenue and year-over-year % change)

	FQ1:98 (June, '97)	FQ2:98 (Sept., '97)	FQ3:98 (Dec., '97)	FQ4:98 (Mar., '98)	FY 1998 (Mar., '98)	Pro Forma FY 1998 (Mar., '98)	FQ1:99 (June, '98)	FQ2:99 (Sept., '98)	FQ3:99 E (Dec., '98)	FQ4:99 E (Mar., '99)	FY 1999 E (Mar., '99)	FY 2000 E (Mar., '00)
<b>As a % of revenue</b>												
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Operating expenses, divisional	80.0%	77.8%	72.6%	78.0%	76.7%	76.4%	73.1%	76.5%	78.2%	79.2%	77.4%	81.5%
Operating profit, divisional	20.0%	22.2%	27.4%	22.0%	23.3%	23.6%	26.9%	23.5%	21.8%	20.8%	22.6%	18.5%
General & administrative expe	19.4%	12.5%	17.0%	18.2%	16.1%	15.0%	26.1%	21.5%	15.8%	15.5%	18.5%	10.2%
EBITDA	0.6%	9.7%	10.4%	3.9%	7.2%	8.6%	0.9%	1.9%	6.0%	5.3%	4.1%	8.3%
Interest expense	1.3%	3.2%	4.9%	3.6%	3.7%	3.5%	4.3%	4.4%	2.7%	2.6%	3.3%	1.3%
Interest income	3.6%	1.3%	5.0%	1.1%	2.2%	1.7%	0.9%	0.7%	0.1%	0.1%	0.4%	0.0%
Depreciation and amortization	1.1%	1.3%	2.0%	1.2%	1.4%	1.9%	2.4%	1.8%	1.3%	1.3%	1.6%	1.0%
Amortization of goodwill	1.6%	0.6%	2.0%	1.5%	1.3%	1.5%	2.2%	2.0%	1.4%	1.4%	1.7%	1.0%
Equity in Mandalay Pictures pr	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.5%
Dilution gain	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	4.6%	0.0%	0.0%	0.0%	0.7%	0.0%
Profit before taxes and minorit	0.3%	5.9%	6.5%	-1.4%	3.0%	3.4%	-2.7%	-5.6%	0.7%	0.2%	-1.3%	5.6%
Taxes	1085.7%	59.5%	50.6%	-34.7%	75.5%	75.7%	-94.8%	-19.1%	287.4%	937.3%	-33.1%	40.1%
Minority interest	2.3%	-2.9%	1.8%	0.4%	1.6%	0.4%	0.0%	-1.0%	0.9%	0.2%	0.5%	0.5%
Net profit	-5.3%	-0.5%	1.5%	-2.2%	-0.9%	0.4%	-0.1%	-5.5%	-2.1%	-1.5%	-2.3%	2.9%
<b>Year-over-Year % Change</b>												
Revenue							685.8%	19.6%	124.7%	48.0%	81.1%	79.1%
Operating expenses, divisional							617.9%	17.6%	142.2%	50.4%	82.8%	88.7%
Operating profit, divisional							957.5%	26.5%	78.2%	39.5%	75.3%	46.4%
General & administrative expenses							955.5%	106.4%	108.3%	26.1%	107.8%	-1.6%
EBITDA							946.7%	-76.5%	29.2%	102.2%	2.8%	262.4%
Interest expense							2627.6%	68.3%	26.8%	5.9%	61.9%	-31.1%
Interest income							88.1%	-40.2%	-93.7%	-85.2%	-71.2%	-93.6%
Depreciation and amortization							1680.0%	64.2%	44.7%	54.7%	97.9%	9.5%
Amortization of goodwill							957.9%	289.6%	58.5%	39.2%	123.7%	7.3%
Equity in Mandalay Pictures profits							0.0%	0.0%	0.0%	0.0%	0.0%	n.m.
Dilution gain							n.m.	0.0%	0.0%	0.0%	0.0%	0.0%
Profit before taxes and minority interest							n.m.	n.m.	-77.0%	n.m.	n.m.	n.m.
Taxes							503.9%	-63.6%	30.5%	360.8%	-64.1%	802.1%
Minority interest							-100.0%	-60.0%	12.1%	-7.6%	-37.6%	48.0%
Net profit							n.m.	n.m.	n.m.	n.m.	n.m.	n.m.
EPS							n.m.	n.m.	n.m.	n.m.	n.m.	n.m.
Shares outstanding, average							588.1%	167.3%	43.8%	4.4%	69.4%	1.5%

Source: Company publications.  
Estimates: Laguna Research Partners LLC.

## PROFIT AND CASH FLOW OUTLOOK

*In the unbelievably brief span of 18 months—and with limited commitment of its own capital—adept execution of Phase I of its strategic growth plan has provided Lions Gate with an exhaustive list of potential revenue and profit growth drivers.* The Company now commands: 1) an impressive presence in the production and distribution of independent films, 2) a powerful home video distribution arm in the US and Canada, 3) exposure to the sizable potential upside of a 20-film production slate at Mandalay Pictures, 4) a leadership position in the production of non-fiction television content, 5) a sharply expanding animation business with the strongest possible distribution partner in the television marketplace, and 6) one of the entertainment industry's most successful sound stage operations.

*In our view, this combination of growth drivers should provide Lions Gate with the foundation to achieve a solid profit in FY 2000.* Following projected losses of C\$(0.04) and C\$(0.02) in FQ3:99 (December) and FQ4:99 (March), respectively, we expect that Lions Gate's EPS will generate EPS of C\$0.20 in FY 2000. Please see Tables IV, V, and VI on pages 19, 20, and 21, respectively.

- *A projected 81.1% increase in FY 1999 revenue is likely to be accompanied by a jump in operating expenses related to infrastructure building.* Divisional operating expenses will be up, we expect, 82.8%. General and administrative expenses are projected to increase by 107.8% reflecting support activities for the Company's fast-growing operating divisions, increased investor relations activity and costs associated with the Company's November listing on the American Stock Exchange.
- *In FY 2000, a powerful 79.1% jump in revenue to the C\$208.0 million level, combined with flat general and administrative expenses, should, we estimate, propel EPS solidly into the black.* We are conservatively estimating that growth in divisional operating expenses will outpace this 79.1% jump in revenue. A projected 1.6% decline in general and administrative expenses plus an estimated C\$1.0 million equity interest in anticipated Mandalay Pictures profits, though, are expected to drive pretax profit to C\$11.6 million—a positive year-over-year swing of C\$13.2 million—and EPS to an estimated C\$0.20.

*EBITDA, which has been solidly in the black in every quarter since the Company's formation, is projected to expand by more than threefold in FY 2000.* We are projecting that FY 1999 EBITDA will come in at C\$4.8 million, roughly in line with the year-earlier C\$4.6 million. Another sharp jump in revenue combined with tight control of general and administrative expenses as discussed above, should lead to a 262.4% surge in FY 2000 to the C\$17.3 million level.

## FINANCIAL RESOURCES

*Despite nearly 18 months of aggressive internal development accompanied by a steady stream of acquisitions and impressive hires, Lions Gate continues to boast a solid balance sheet.* As of September 30, 1998—please see the Company's most recent balance sheet in Table VII on the following page—Lions Gate's financial profile is most notably characterized by a cash balance of C\$11.8 million and shareholders' equity of C\$154.6 million.

- *Cash at the end of FQ2:99—September 30, 1998—was C\$11.8 million, 30.5% above the C\$9.1 million level of March 31, 1998.* Cash per share was C\$0.24 at the end of FQ2, +19.7%.
- *The Company's investment in films and television rose 41.0% to C\$79.4 million.* This jump reflected, primarily, Lions Gate's acquisitions of Termite Art and International Movie Group.

Table VII  
Lions Gate Entertainment Corp.  
**Consolidated Balance Sheets**  
March 31, 1998 and September 30, 1998  
(C\$ millions)

	March 31,	September 30,	Change	
	1998	1998	\$	%
<b>ASSETS</b>				
Cash and short-term investments	\$ 9.064	\$ 11.828	\$ 2.764	30.5%
Accounts receivable	47.816	51.021	3.205	6.7%
Investment in films and television programs	56.305	79.414	23.109	41.0%
Investment in Mandalay Pictures, LLC, at cost	71.048	76.412	5.364	7.5%
Capital assets, net of amortization	38.757	39.002	0.245	0.6%
Goodwill, net of amortization	27.206	31.314	4.108	15.1%
Other	0.318	1.395	1.077	338.7%
Total assets	<u>\$ 250.514</u>	<u>\$ 290.386</u>	\$ 39.872	15.9%
<b>LIABILITIES</b>				
Bank loans	\$ 15.581	\$ 12.669	\$ (2.912)	-18.7%
Accounts payable	26.441	31.726	5.285	20.0%
Production loans	30.227	33.612	3.385	11.2%
Long-term debt	27.414	42.243	14.829	54.1%
Deferred revenue	4.999	11.978	6.979	139.6%
Other	1.901	3.530	1.629	85.7%
Total liabilities	<u>\$ 106.563</u>	<u>\$ 135.758</u>	\$ 29.195	27.4%
<b>SHAREHOLDERS' EQUITY</b>				
Capital stock	144.524	151.157	6.633	4.6%
Deficit	(0.553)	(1.926)	(1.373)	n.m.
Translation adjustments account	(0.020)	5.397	5.417	n.m.
Total shareholders' equity	<u>143.951</u>	<u>154.628</u>	10.677	7.4%
Total liabilities and shareholders' equity	<u>\$ 250.514</u>	<u>\$ 290.386</u>	\$ 39.872	15.9%
<b>CALCULATIONS:</b>				
			Change	
Cash and short-term investments per share	\$ 0.20	\$ 0.24	19.7%	
Long-term debt-to-capitalization	28.6%	32.9%	432	basis points
Book value	\$ 3.22	\$ 3.18	-1.5%	
Shares outstanding	44.652	48.695	9.1%	

Source: Company publications.  
Calculations: Laguna Research Partners LLC.

- **Long-term debt was up 54.1% to C\$42.2 million during the March 31 through September 30 timeframe**, as a result of financings related to the Company's Lions Gate Studios and the Termite Art acquisition.
- **Shareholders' equity increased 7.4% to C\$154.6 million.** This figure compares with shareholders' equity of C\$144.0 million on March 31 and with the Company's current equity market capitalization of US\$77.6 million.

**Just prior to the end of FQ2, Lions Gate announced a share repurchase program.** During the 12-month period commencing September 23, 1998, Lions Gate may purchase up to 1.9 million of its common shares. This amounts to approximately 10% of the Company's float at the time of the announcement.

**On November 17, Lions Gate's common shares commenced trading on the American Stock Exchange under the symbol LGF.** This move should dramatically boost the visibility of the Company's accomplishments and prospects among US investors. Simultaneous with this listing on the AMEX, LGF shares were consolidated one for two.

### RISK FACTORS

Among the risks for Lions Gate Entertainment are 1) the unpredictability of filmed entertainment product performance, and 2) the potential for budget overruns and other production risks related to the generation of filmed entertainment product, particularly motion pictures.

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Companies mentioned in this report:

AMC Entertainment, Inc. (AEN, AMEX)  
Fox Entertainment Group, Inc. (FOX, NYSE)  
Gramercy Pictures (privately held)  
Loews Cineplex Entertainment Corp. (LCP, NYSE)  
Metro-Goldwyn-Mayer, Inc. (MGM, NYSE)  
News Corporation Ltd., The (NWS, NYSE)  
October Films (privately held)

Regal Cinemas, Inc. (privately-held)  
Samuel Goldwyn Films, LLC (privately held)  
Seagram Company Ltd., The (VO, NYSE)  
Sony Corporation. (SNE, NYSE)  
Time Warner, Inc. (TWX, NYSE)  
Viacom, Inc. (VIA.B, AMEX)  
Walt Disney Company (DIS, NYSE)

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