SOUNDVIEW RESEARCH

CINEDIGM (CIDM - $1.40)

FY 2012 RESULTS UPDATE

JUNE 26, 2012

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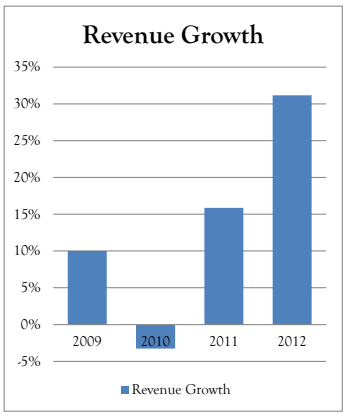
UPDATE

Full-year results for FY2012, ended March, demonstrated accelerating revenue growth (+31%), improved profitability, and a "restacking" of the business to align with profitable growth opportunities in software and content.



Fiscal Q4 was a little weaker than planned due to a few software deals slipping out of the quarter and the completion of a major acquisition (New Video) that will now serve as the foundation of the content business.

Forward guidance for the current fiscal year came in a little below where most people were thinking due to expected flattish deployment revenues and planned investments in new content to support long term revenue growth. We've recast our IV model and a preliminary version is included in this update.

Overall, investors saw the report as a "mixed bag" made up of strong operating results for the fiscal year with greater planned investments in the coming year to drive long-term revenue and profitability. We see it a bit differently because we expect that announcement of additional content acquisitions will drive the stock before subsequent revenue and earnings. Overall management has executed well, continues to own ~40% of the equity and is making the right long-term moves that support our current $5.62 IV estimate. Additional details are below.

EXTENDED COMMENTARY

Software and non-deployment revenues basically doubled for FY 2012 but were flattish due to three customer acceptance delays; these are scheduled for completion in the next two quarters.

For the rest of the fiscal year we expect further development of the business in terms of new installations, business pipeline and the launching of new releases with additional functionality. Cinedigm has also hired a head of software sales and marketing to handle the growing pipeline and more fully capitalize on the global market opportunity.

Based on the market demand, product pipeline, competitive positioning and management focus we expect the software growth rate to be sustainable for the next two fiscal years. By then we also expect a meaningful portion of the software revenues to be cloud-based and using the SaaS delivery and business model. Overall, we expect the growth and profitability of the software group to be the star in the medium-term while the content business ramps up.

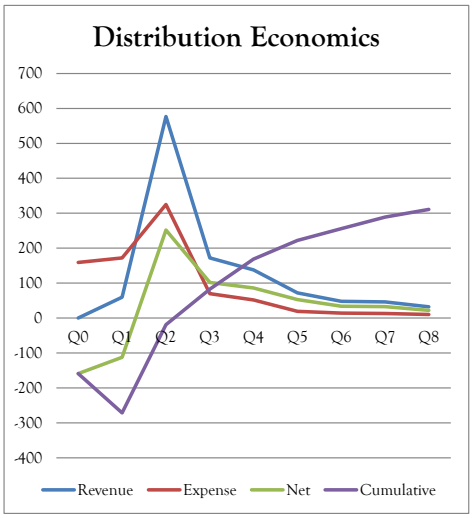
Turning to **content business**, the acquisition of New Video (NV) has already led to a number of notable content acquisitions targeted to avid audiences in theaters and subsequently downstream to mobile devices, televisions and laptops through online content providers (iTunes, Netflix, Amazon.com, etc.)

For the first time the company mapped out some details of their New Video content strategy. The company is investing in new content during the F2013 fiscal year, which means acquisition and related costs will impact the P&L before revenues begin to kick in.

In essence, the company will be taking a data and business model driven approach to licensing and distributing content that represents a de-risking of the digital content market. Management likes to describe this as the "Moneyball approach" to the content industry. For those not familiar with the book and movie by the same name, it shuns gut feelings, big names, ego and other adverse selection criteria in favor of an analytical, results-focused approach that is geared to optimizing returns.

That doesn't mean that the content doesn't have to be good. The New Video acquisition puts the company at the nexus between a plethora of independent content providers and the massive global but fragmented audience of consumers.[1]

As an investor, this means that Cinedigm provides "last dollar in, first dollar out" capital. They also receive a 25% distribution fee and up to 20% of back-end profits after all fees and expenses. However, these favorable investment terms won't show up in revenues and profits until after newly-licensed content gets into the release schedule.



The graph here illustrates the dynamics starting in the quarter before release. Up-front marketing costs must be expensed as incurred in advance of revenue. As the film goes through release and then downstream monetization the expenses are recovered and period losses turn into period profits, which eventually result in a cumulative gain that benefits some from long-tail demand.

Each release will vary considerably in terms of details but the overall shape of the business will be the same: pre-release marketing and other expenses incurred and reported, followed by revenues. After a year results will be steady enough to offset upfront investments so the P&L will become more balanced.

VALUATION

The balance sheet and reporting structure of Cinedigm make it hard for some investors to understand valuation, but the business has been simplified and today it is much easier to understand. We deconstruct EBITDA for all the companies we follow anyway. Most management teams find the notion of "adjusted EBITDA" appealing but it must be parsed and reclassified for use in any sensible intrinsic valuation (IV) model.

In the case of Cinedigm we include all (core and non-recourse debt) interest expenses but exclude depreciation. On the side of the balance sheet we include only core debt as part of the total capitalization of the company. Applying this to the IV model using a10x earnings multiple we arrive at our IV of $5.62. We'd also note that the "period share price" that measures purely current numbers comes to $3.00, also well above the current share price of $1.40.

Just for fun we ran a version of the IV model with the non-recourse debt included in the total. It drops the IV substantially but it still comes out to $3.65 per share using a 10x multiple.

[1] For more background on the acquisition see: Cinedigm's Acquisition into Content and Distribution, April 23, 2012. http://blog.research2zero.com/2012/04/cinedigms-acquisition-into-content-and-distribution/

CONCLUSION

Cinedigm has come a long, long way in just over a year and has entered a new phase of growth. Because they are blazing a new trail in terms of theatrical content in a digital world it's going to take a little time for investors to embrace the business, but we expect that as more top flight content comes to the big screen from Cinedigm with all the little screens following right behind, people will begin to take notice.

We will be covering the newly digital world of cinema more completely in our next basic report on the company.

Meanwhile, the upside in the shares provides a strong incentive to put some patient money to work in this name.

Cinedigm Digital Cinema Corp.	**Price**	**$1.41**
CIDM	**IV**	**$5.62**
25-Jun-12	**Delta**	**299%**

March Fiscal	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Revenue	$47.4	$52.1	$50.5	$58.4	$76.6	$94.0	$105.0	$117.0	$130.0
YoY Growth		9.9%	-3.1%	15.6%	31.2%	22.7%	11.7%	11.4%	11.1%
Direct Costs	$4.3	$5.8	$4.9	$4.5	$7.5	$8.0	$9.0	$10.0	$11.0
Gross Margin%	90.9%	88.9%	90.3%	92.3%	90.2%	90.0%	90.0%	90.0%	90.0%
Gross Profits	$43	$46	$46	$54	$69	$85	$95	$105	$117
R&D%	0.3%	0.3%	0.3%	0.3%	0.8%	0.7%	1.0%	1.0%	1.0%
R&D Expense	$0.15	$0.15	$0.13	$0.26	$0.18	$0.66	$1.05	$1.17	$1.30
SG&A%	25.3%	20.3%	19.6%	22.6%	22.8%	23.0%	22.5%	22.0%	21.5%
SG&A Expense	$12.0	$10.6	$9.9	$13.2	$17.5	$21.6	$23.6	$25.7	$28.0
Direct Margin %	65.3%	68.2%	70.4%	69.3%	67.1%	66.3%	66.5%	67.0%	67.5%
Pre-Interest Income	$31	$36	$36	$40	$51	$62	$70	$78	$88
Interest Expense	$29	$27	$34	$27	$30	$30	$28	$26	$26
Net Operating Income	$2	$9	$2	$13	$21	$32	$42	$52	$62
Taxed Operating Income	$1	$6	$1	$9	$15	$23	$29	$37	$43
Market Value Using P/E	$14	$63	$14	$94	$150	$226	$293	$367	$432
Cash Position					-$93	-$71	-$41	$15	$59
Shares (M)	48	48	49	49	50	50	51	51	52
Period Share Price	$0.3	$1.3	$0.3	$1.9	$3.0	$4.5	$5.7	$7.1	$8.3
PV of MV 4 Years Out	$86	$129	$167	$210	$247				
PV of Cash 4 Years Out	-$53	-$40	-$24	$9	$34				
PV MV + Cash	$32	$89	$144	$218	$281				
PV Value Per Share	$0.68	$1.84	$2.94	$4.42	$5.62				

CIDM	Ticker
Nasdaq	Exchange
15%	Rev Growth
$1.41	Current Price
48	Shares Out
1%	Avg. Dilution
$68	Cap (M)
$18	Cash
$111	Core Debt
$172	Passthru
$20	Warrant Cash
$0.37	Cash/Share
30%	Tax Rate
10	P/E Multiple
15%	Discount Rate
$5.62	IV
299%	Up/Downside

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[1] Bloomberg, Thomson/Reuters/FirstCall, S&P Capital IQ and FactSet.