EDISON

Mondo TV

World-class animations group

Initiation of coverage

Media

Mondo TV has radically improved its financial profile over the last three years and targets a tripling of EBITDA over the next five. Funding is in place and the new strategy is underpinned by a number of shows with high-margin licensing and merchandising potential. Announcements of additional licensing deals or significant new partners should help build confidence in the deliverability of its ambitious targets and close the 20% FY18 EV/EBIT discount to peers.

Year end	Revenue (€m)	EBIT (€m)	PBT* (€m)	EPS* (€)	DPS (c)	P/E (x)	Yield (%)
12/15	16.8	5.6	5.4	0.12	0.0	34.2	N/A
12/16	27.4	12.7	12.7	0.32	2.0	12.4	0.0
12/17e	37.6	17.9	17.6	0.41	0.0	9.7	N/A
12/18e	49.7	17.7	17.4	0.37	0.0	10.7	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Internationalisation strategy is paying off

Since changing its strategy in 2014 to increase its international exposure, Mondo has developed its network of Asian partners and now generates over 80% of revenues from the region. This has enabled it to almost quadruple investment in content and, as Mondo focuses on brands that have a high degree of licensing and merchandising potential, supported significant growth in these high-margin revenues; in FY16, sales increased by 55% and EBITDA more than doubled.

Business plan supported by strong pipeline

Management targets a near tripling of revenues, EBITDA and net income by 2021. The business plan is underpinned by a solid slate of productions, which include an additional three series of the successful *Sissi the Young Empress*; *Invention Story*, a new show in partnership with Chinese partner Henan York; the development of *YooHoo and Friends* with Korean toy group Aurora; as well as Mondo's first live teen series *Heidi, Bienvenida a Casa*. All of these shows have received strong licensing interest and we estimate c 70% of the current year budget is committed. Our forecasts assume management's targets in FY17. In FY18 and FY19 for now we err on the side of caution and build in a 10% contingency to EBIT targets by FY19; this still implies a three-year CAGR in EBIT of 18%.

Valuation: Discount to sector despite higher margins

The market for children's entertainment has been reinvigorated with the growth of VOD platforms looking for multi-territory content. Animations travel well and as seen from the success of eOne's *Peppa Pig*, brands that travel have the potential to yield significant returns. Smaller brands can also be very profitable; Mondo, with its flexible cost base and high share of revenues from licensing and merchandising sales, enjoys 46% EBIT margins. As one of the few international animation pure plays in Europe, with a strong and funded pipeline and an experienced management team, we think the shares should trade closer to peers in the kid's content and Italian media sector; this would imply a value per share closer to €5.6.

19 July 2017

Price	**€4.0**
Market cap	**€119m**

Net debt (€m) as at 31 December 2016	0.8
Shares in issue	29.7m
Free float	52%
Code	MTV
Primary exchange	Borsa Italiana Star
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(0.1)	0.2	(6.5)
Rel (local)	(1.8)	(8.4)	(27.2)
52-week high/low		€5.13	€3.60

Business description

Mondo TV is a global media group with a focus on the production, acquisition and exploitation of animated children's television series. Headquartered in Rome, it also holds controlling stakes in listed subsidiaries Mondo TV France (47%), Mondo TV Suisse (67%) and Mondo TV Iberoamerica (72%). It owns the rights to over 1,500 TV episodes and films, which it distributes across 75 markets. 80% of revenues are generated in Asia, 10% in Italy, 7% in Europe and 3% in America.

Next events

Interim 2017 results	September 2017

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Edison profile page

Mondo TV is a research client of Edison Investment Research Limited

Investment summary

Background: Children's TV producer and rights manager

Mondo TV has been producing and distributing children's animated TV series for over 50 years. It develops its own productions, co-produces with major broadcasters and toy companies, distributes its large library and licenses rights for merchandise sales. Unlike many of its peers, productions centre on the development of existing brands (from books, comics or toys), which reduces risk and can improve the returns. Historically, the bulk of Mondo's business was generated in Italy and France. However, with continued pressures on European broadcaster budgets, Mondo shifted its strategy in 2014 to increase its international sales, particularly in Asia where groups are increasingly seeking European input; it has scaled its production capacity significantly, and has invested in expanding its licensing capabilities.

Financials: Significantly improved financial profile

Mondo has made good progress executing its strategy. It has projects underway with Henan York and Studio 56 in China, Aurora World (Kosdaq: 039830 KQ, market Cap $99m) and CJ E&M in Korea, as well as for its largest customer, Abu Dhabi Media., A realignment of resources within the group has enabled Mondo to support the increase in business with a modest increase in the cost base. The outcome has been a 57% CAGR in revenues and a 73% CAGR in EBITDA over the last three years. The production pipeline includes some significant new shows (*YooHoo*, *Heidi*, *Invention Story*) alongside recurring series (*Sissi*) and licensing interest appears strong. Additional funding has been put in place via a €15m convertible bond facility (of which €12m have been issued, €8.5m converted), enabling it to maintain investment in content at approximately €20m pa over our forecast period. A key metric we look at is the revenue to investment multiplier; management's plan assumes that this peaks at approximately 2.7x. This is lower than that achieved historically (2.9x in FY16), which along with a number of multi-year deals announced, gives us additional confidence that budgets are underpinned.

Investment case: Pipeline & margin profile justify higher rating

Working capital requirements in TV production businesses are heavy; however, risks are mitigated through co-production and pre-sales agreements. For companies also involved in distribution and licensing as well as production, margins are high and successful shows can continue to deliver high-margin library sales over the long term.

After a period of consolidation in the European children's content industry, Mondo, which has a very experienced management team, has been able to adapt its strategy. It is building a strong position as a European partner to Asian broadcasters and toy companies and has a promising and fully funded pipeline of shows that should support strong growth in EBIT over the next few years. Given the group's recent track record, strong pipeline and significantly higher EBIT margins than peers, we would expect the shares to trade at least in line with peers in the children's entertainment content industry and the Italian media sector in FY18, implying a value per share of €5.6. Announcements of additional licensing deals or significant new partners should help build confidence in the deliverability of its ambitious targets and close the 20% FY18 EV/EBIT discount to peers.

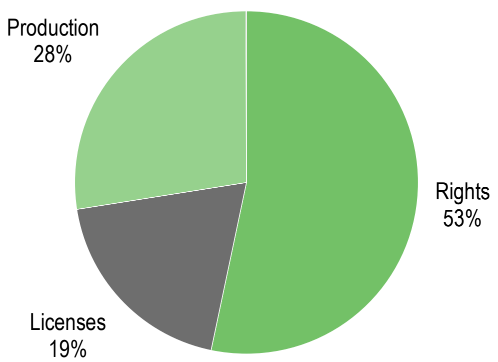
Sensitivities: Children's tastes

Forecasts may be subject to changes in delivery dates, but ultimately the success of a series is determined by children's tastes. We assume moderate success across Mondo's portfolio. A significant success or flop could have a considerable impact on forecasts.

Company description: Children's TV producer

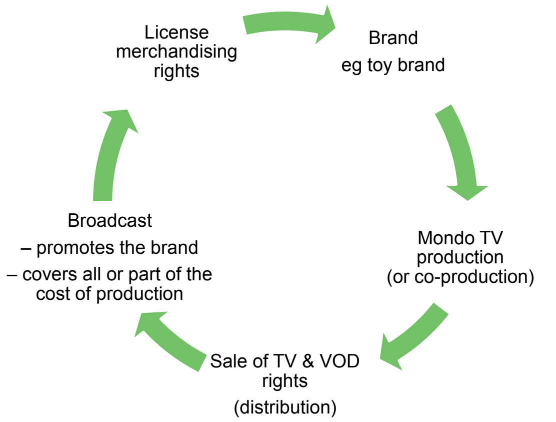
Mondo TV is a leading Italian producer and distributor of children's animated television series, and has also recently diversified into live teen fiction. It focuses on the production of content whose characters can be exploited for licensing and merchandising and which add value to its back catalogue of cartoons, which currently amounts to 1,500 hours of content. Mondo rarely uses its own IP; it typically co-produces TV series where the brand is already known either through toys (eg *YooHoo*), comic strips (eg *Sissi*) or books (eg *Treasure Island*) and brings them to life with animation. Partners tend to be toy companies looking to develop an existing toy brand (eg Aurora World Corporation), broadcasters (for instance its partnership with TF1 in France on *Lulu Vroumette*), or third-party producers looking to market an asset internationally. This gives Mondo an edge in a very competitive market place, de-risks its investment in production and supports a more rapid exploitation of higher-margin licensing and merchandising revenues. Mondo is also distinct from other Italian media groups in its international outlook; 83% of its FY16 revenues were derived outside Europe.

Exhibit 1: Revenues by type



Source: Mondo report and accounts

Exhibit 2: Business model



Source: Edison Investment Research

Revenues are generated from production services, rights sales, and licensing and merchandising, although often a single brand will drive revenues across all three categories (Exhibit 2):

- **Production services**: Production is done under the supervision of management but using third-party designers, screenwriters and directors, thus keeping its cost base flexible. However, during FY16 Mondo established its own in-house pre-production team in the Canary Islands to work on the development of concepts and storyboards. Mondo will either work for a fee (executive productions account for 28% of revenues), or will be involved in co-productions, retaining a share of the worldwide distribution rights. Co-productions support some of the financing of a production or part of the organisational requirements. Most of Mondo's productions target the under 10 audience, although it has recently expanded into live teen fiction with the co-production of *Heidi, Bienvenida a Casa*. Production revenues comprise a mix of recurring series and revenues from new shows.
- **Distribution**: Mondo has a team of nine employees involved in the sale of rights plus a number of sub-agents, which gives it permanent representation across Southern Europe, France, Middle East, Latin America and Russia. Successful animations have enduring appeal and as the children's audience is replenished yearly, can be re-sold to a new generation of kids over and over again. We estimate that approximately €3.5m of Mondo's licence sales are from its 'old library' (over three years old) and the remainder from more recent titles. Although Mondo is very conscious of regional tastes, most animations are dubbed into a number of languages and are marketable in multiple territories. As well as selling its own library, Mondo has a number of distribution deals, for instance with Turner, Cake and Your Family Entertainment.

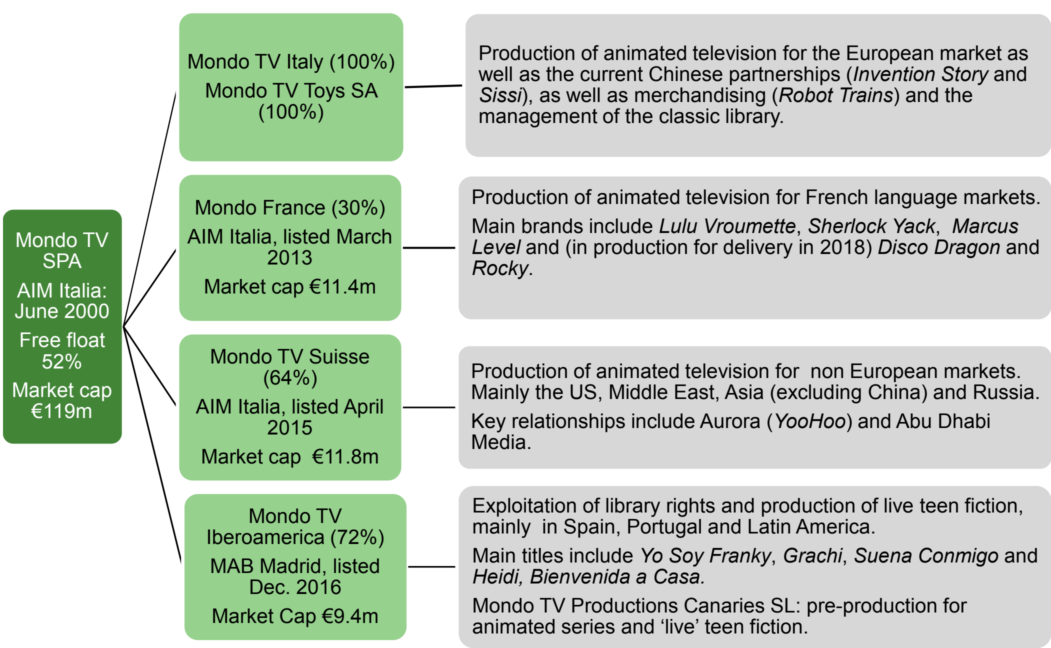
- **Licensing brands**: Licensing brands for merchandising has become an increasing focus for the group. As well as commercialising some of its own co-productions (such as *Sissi*), Mondo also licenses third-party brands for a commission (eg *Robot Trains*).

Background, organisation and management

Mondo TV has a long history in children's animation. The group was established in 1964 when Chairman Orlando Corradi (previously CEO) began importing Japanese cartoons for distribution in Italy and Europe. It began producing its own animated cartoon series for television in the late-1980s, focusing from the start on classic children's characters and stories such as *The Jungle Book* and *Robin Hood*. Orlando Corradi's son, Matteo Corradi, previously in charge of strategy and international sales, took over from his father as CEO in 2012. CFO Carlo Marchetti joined Mondo in 2007, having previously been chief of accounting at Datamat SpA. The group has been quoted on the Star segment of the Borsa Italiana since June 2000. Orlando Corradi owns 43% of the shares with the remainder free float.

To support liquidity, dividends and the group's profile internationally, the group has over the course of the last few years listed its three principal subsidiaries. Mondo TV SPA owns the majority of the group's classic library, which it manages, as well as the business in Italy. It also provides central functions and strategic direction for its three listed subsidiaries: 30% Mondo TV France; 64% Mondo TV Suisse; and 72% Mondo TV Iberoamerica, which was the most recent subsidiary to be spun off in December 2016, facilitating the distribution of a dividend in kind of 13c per share and a cash dividend of 2c per share. Each subsidiary has a regional bias, as summarised in Exhibit 3.

Exhibit 3: Group organisational structure; four listed entities



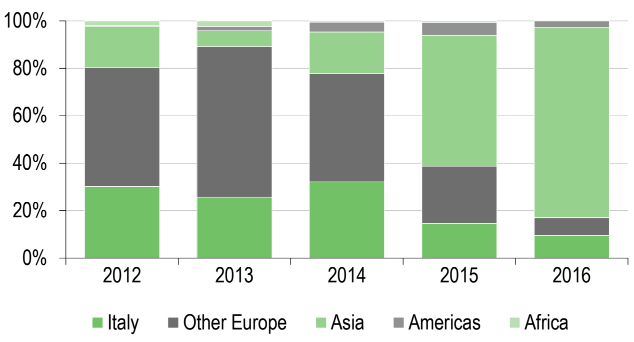
Source: Edison Investment Research

Strategy: Geared towards international partners

Historically, the bulk of Mondo's business was generated within Europe, principally in Italy and France, with the focus on production and licence sales to local broadcasters. However, since the advertising downturn following the 2008 financial crisis, European broadcaster budgets came under increasing pressure and by 2012/13 Mondo's business was struggling, prompting a review of the group's strategy in early 2014. Broadly, this involved an increasing focus on higher-growth international markets, a step change in the level of investment in programming and a re-organisation of the group. Management has made good progress delivering to this strategy:

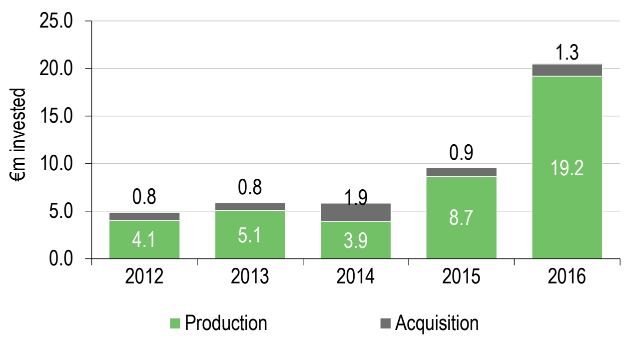
- **Strengthening international presence**: Management believes that the Asian markets, particularly China and the Middle East, present the largest opportunity for the group. Asian broadcasters are increasingly seeking European quality shows, but with a local market perspective delivered to tight budgets. They also value a European partner to help them export brands into Western markets, where the licensing and merchandising potential is larger. The group has strengthened its sales and scouting presence and has developed some strong partners in the region. Over the last two years, it has increased its share of revenues from outside Europe from 20% in FY13 to 83% in FY16, of which Asia represents the majority (Exhibit 4).
- **Increase in production capacity**: Management has increased the annual investment in content almost fourfold from approximately €5m a year in the three years to FY14 to €20m in FY16 and expects to maintain it at around this level over the forecast period (Exhibit 5).
- **Diversifying:** Following the group's success as distributor for a number of Latin American live teen titles (*Yo Soy Franky, Grachi* and *Sueña Conmigo),* Mondo co-produced its first live (ie non-animated, scripted) teen fiction *Heidi, Bienvenda a Casa*. The second season will be delivered this year and a third is planned for FY18.
- Enlargement of the structure dedicated to **licensing and merchandising**: The group is targeting mid-size toy companies, looking for a partner to help them expand their brand in European markets. In FY16 it reported a significant increase in licence sales, which increased to 19% of revenues (FY15: 4%). *Sissi* and *Robot Trains* are the key contributors currently and management is optimistic regarding the merchandising potential of *YooHoo* and *Invention Story*, currently in production.
- **Reorganisation of the group:** Resources have been optimised across the audio-visual, licensing and merchandising businesses in order to generate internal efficiencies and the production business has been re-organised. Despite increasing its investment in its sales effort internationally, operational expenses increased only modestly over the last three years.

Exhibit 4: Revenues by geography



Source: Mondo TV data

Exhibit 5: Investment in content



Source: Mondo TV data

Animation: Enduring appeal in changing markets

Children's changing viewing habits

The last 10 years have been a period of significant change in the television markets, and as is often the case in the media sector, children have been at the forefront of this change. Over the 10 years to 2010, children's viewing of linear TV decreased as the market became dominated by global specialist channels (Cartoon Network, Nickelodeon, Turner, Disney, Sky, etc). This has been compounded in the last decade by the fact that children are heavy device users and families with younger children are more likely to be video on demand (VOD) subscribers. VOD viewing of kids' content has shifted towards global VOD companies Netflix and Amazon, as well as YouTube, the 'go to' channel for many children.

Animation's enduring appeal

Kids TV is an important part of pay TV and SVOD schedules. The large number of themed channels and an increasing number of OTT channels underpin a strong demand for kids' content; according to Ampere, 12% of Netflix content is children oriented, 14% of Now TV and c 5% of Amazon's content (mipcom TV 2015). Animation forms the core of children's television schedules, accounting for approximately 60% of viewing (in the world's 10 largest markets). Animation also has the benefits for international channels of travelling fairly easily as there are fewer dubbing issues and it is less culturally specific than non-animated series.

Content owners target the production and acquisition budgets of broadcasters and platforms estimated to be worth $2.2bn (IHT technology 2015, across 33 markets). Brands that have merchandising potential can also tap the $160bn market for licensed merchandise (The Licensing Letter, 2015). For instance, a successful brand such as *Peppa Pig* (eOne) generates retail sales of over $1.5bn annually, *Peanuts* (DHX Media) generates retails sales over $1.3bn annually.

Industry consolidation, changing business models

Although demand for content remains strong, the pace of change has led to consolidation in the industry. Producers, traditionally aligned to the local free to air channels, have had a difficult time, resulting in a number of casualties; for example Entertainment Rights, EM-TV, TV Loonland, 4Kids.

Independent producers that flourish today are predominantly those that do not rely on the traditional 'cost-plus' model but have developed their own brands and forged alliances to support licensing and merchandising potential, mirroring the models of the larger vertically integrated groups. The UK's Entertainment One (*Peppa Pig*, *PJ Masks*) and Canada's DHX Media (*Peanuts*, *Strawberry Shortcake*, *Telly Tubbies*) are examples of independent groups that have had considerable success in creating sizeable kids IP business while remaining independent.

Deals done by the world's two largest toy companies include Hasbro's acquisition of 50% of Discovery Kids in 2009 and Mattel's acquisition of Hit Entertainment ($680m in 2011; *Thomas & Friends*, *Bob the Builder*, *Fireman Sam*). Mega-mergers like these make reaching audiences even more challenging for the smaller toy manufacturers.

With IP increasingly concentrated among a smaller number of groups, mid-sized toy companies may be motivated to forge closer partnerships with TV companies either to secure quality brands (to distribute) or to secure access to TV audiences to promote their brands (as there is no advertising on subscription channels). Mondo's co-production deals with Aurora World Corporation (039830. KQ), a leading provider of plush toys, is a case in point, as are previous relationships with Giochi Preziosi (Dinofroz, Gormiti) and Meg toys (Puppy in my pocket).

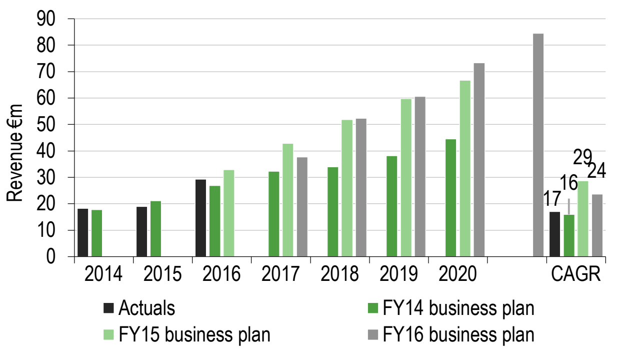
Asian perspective

China has the world's largest TV audience (both traditional and internet users). However, the media industry is highly regulated with foreign restrictions on both investment and importation of content. Nevertheless, co-production and joint ventures (where the Chinese party has the controlling share) are permitted and Asian networks appreciate the diversity and quality that partnering with European or US producers brings. Chinese rights owners also recognise the value in exporting brands to the US and Europe, which accounts for 78% of the value of the world's licensed merchandising (by retail sales; China on the other hand accounts for a mere 4%).

FY16 business plan

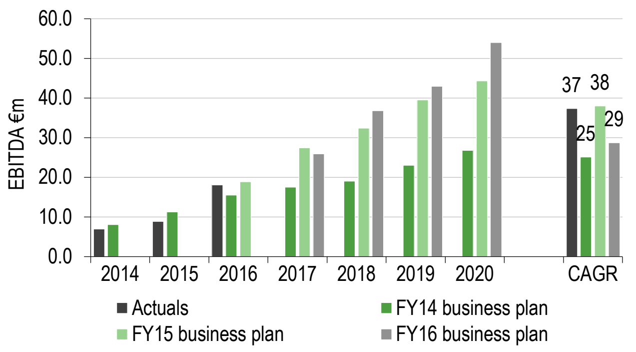
Budgeting in the production industry can be challenging as revenue recognition is driven by delivery dates, which will depend on broadcast schedules, and longer-term success is determined by children's tastes. Nevertheless, other than some fine-tuning year on year (which we would expect), in FY14 and FY15 the group delivered close to its FY14 plan. Although FY16 revenues were below those targeted in the FY15 plan, this was mainly due to slippage in delivery dates and EBIT was slightly ahead. Overall, we are encouraged to see that revisions to its budget over the last two years have been upwards (Exhibit 6 and Exhibit 7).

Exhibit 6: Revenue – summary of last three five-year plans (and reported)



Source: Mondo TV, Edison Investment Research. Note: CAGR rates are % and over five years, except for actuals, where they are over three years.

Exhibit 7: EBITDA – summary of last three five-year plans (and reported)



Source: Mondo TV, Edison Investment Research. Note: CAGR rates are % and over five years, except for actuals, where they are over three years.

Exhibit 8 presents the most recent business plan, from October 2016. Management's ambition is to almost triple revenues to €85m, EBITDA to €64m and net income to €25m over the next five years.

Exhibit 8: Mondo TV's October 2016 business plan

€m	2016	2017e	2018e	2019e	2020e	2021e	Growth	CAGR
Revenues	29.2	↓37.6	↑52.3	↑60.6	↑73.3	84.5	189%	23.6%
EBITDA	18.1	↓25.9	↑36.8	↑43.0	↑54.0	63.8	253%	28.7%
EBITDA margin	61.8%	69%	70%	71%	74%	76%		
EBIT	12.7	↑17.9	↑19.6	↑25.4	↑31.7	38.2	201%	24.7%
EBIT margin	43%	47%	37%	42%	43%	45%		
Net profit	8.6	11.6	12.7	17.0	20.4	24.6	187%	23.5%

Source: Mondo 2016 business plan. Note: ↓ and ↑ indicate direction of change from the previous budget published in November 2015.

Key productions and partnerships

Mondo's plan is underpinned by a number of key productions and relationships, and we estimate that approximately 70% of FY17 revenues are already committed.

Heidi, Bienvenida a Casa (co- production): Following its successful distribution of live teen fiction series (*Yo Soy Franky, Grachi* and *Suena Conmigo)*, Mondo is now undertaking its first co-production in this genre in partnership with Alianzas Productiones (*Chica Vampira*, *The World of Patti* and *Yo Soy Franky*) for the co-production of 60 episodes of 60 minutes each of a live teen drama *Heidi, Bienvenida a Casa*; a modern adaptation of the classic children's show following the adventures of a country girl in the city. It is investing €2.9m, retains 60% of the rights and Mondo will also be responsible for distributing the series worldwide (except in Argentina, Chile, Paraguay and Uruguay). The series started broadcasting in prime time on Nickelodeon across a number of markets in Latin America in Q117, covering the majority of development costs, and licensing interest is reportedly strong.

Final Fight (co-production): *Final Fight* (26 episodes, 22 minutes each) and *Naraka* (52 episodes, 11 minutes each) are Mondo's first two series developed specifically for Chinese audiences in partnership with Taiwan-based New Tech Information (NTI) for a total budget of $12m. 50% share in the distribution rights for both series in China for a period of five years has been sold to New Tech Information (NTI) for $10m over three years. Finding a local partner is a key step to growing this side of the business.

Sissi The Young Empress (co- production): Long-term partner of the group (*Eddie is a Yeti* and *Bug Rangers*), Studio 56 has commissioned Mondo for the pre- and post-production of three new 3D series of *Sissi* (the first series sold to 35 markets and is well known in the DACH region). Mondo will invest $6.2m for each series, which are to be delivered by 2020 ($19.5m total budget). Production of the second series started in March 2017 and Mondo has announced the sale of 50% of the distribution rights in India and China for a period of 15 years to Broadvision Rights Ltd for $4.8m (for each series). Shows with multiple series tend to generate strong licensing interest and *Sissi* has already become Mondo's most significant merchandising property.

Invention Story (production): In 2016 the group started work on a major new production for Chinese animation group Henan York (York), which has commissioned the production of 520 episodes of *Invention Story* for a total value of $25m paid in rising instalments by 2019. Mondo will be responsible for pre- and post-production and retains distribution rights outside China. *Invention Story* is based around the story of a fox that impresses the rabbit population in Carrot Town with his inventions. The series, which is still in production, is receiving considerable licensing interest.

Rowly Powly (co-production): A second deal with York has since been announced for the production of three series of another new brand, *Rowly Powly*. Production started in November 2016 and will be completed by 2020 for a total budget of $24m. Mondo has sold a 70% share in the rights to Nine Hong Kong Technology Limited I China (five years) and 10% elsewhere for €6.6m for each series (€19.9m in total).

YooHoo and Friends (co- production): A co-production with its creator, Korean manufacturer of plush (soft) toys Aurora World Corporation. The series (52 episodes, 11 minutes each) follows five animal friends who work to help tackle environmental issues, with characters based on the successful line of plush toys (c 80 million sold since 2007). Mondo is contributing $3m for production and retains 50% of the distribution and merchandising rights worldwide (although a smaller share in South Korea). In the past, the characters have been distributed by McDonalds, and Mondo management is excited about its prospects. Management has already signed a few rights deals and hopes to close an agreement with a global OTT platform.

Majed, Karamella and Casslan (Abu Dhabi Media – executive production): Abu Dhabi Media has been a key licensing partner for the group since 2014 with the transmission of four TV series (two produced by Mondo and two licensed). In 2015 it also agreed a major new direct production deal; Mondo will produce nine TV series over three years, each with 52 15-minute episodes. The series will be based on three characters who are already a success in the UAE: Majed, Karamella and Casslan. The total value of the production contract for Mondo is $14.4m. In FY16 Abu Dhabi Media accounted for 10% of group revenues.

Robot Trains (distribution and licensing): Mondo announced in February 2017 that it will be the key TV distributor and licensing agent in a number of territories (Turkey, Middles East, Africa, Portugal, Spain, Italy and Israel) for the popular Korean cartoon *Robot Trains* on behalf of Korean TV operator CJ E&M (which produced the popular series *Super Wings*). Mondo has already announced a number of deals (and retains a 30% share).

Exhibit 9: Summary of key co-production schedules

Show	H217	H118	H218	2019	2020
Invention story	In production	In production	In production	In production	In production
	Start deliveries	Deliveries	Deliveries	Deliveries	Deliveries
		TV sales	TV sales	TV sales	TV sales
			Worldwide licensing	Worldwide licensing	Worldwide licensing
.					
Heidi	Production S2	Production S3			
	TV sales S1 Latam	TV sales S1-2-3 worldwide	TV sales S1-2-3 worldwide	TV sales S1-2-3 worldwide	TV sales S1-2-3 worldwide
	Licensing Latam	Licensing worldwide	Licensing worldwide	Licensing worldwide	Licensing worldwide
.					
Sissi	End production S2	Production S3	End production S3	Production S4	Production S5
	Start production S 3	TV sales series 1-2	TV sales series 1-3	TV sales series 1-4	TV sales series 1-5
	TV sales series 1-2	Licensing series 1-2	Licensing series 1-3	Licensing series 1-4	Licensing series 1-5
	Licensing series 1-2				
YooHoo	Delivery first episodes	Delivery 39 episodes	Delivery all series		
	TV sales Pay/VOD	TV sales free TV	TV sales	TV sales	TV sales
	Worldwide licensing	Worldwide licensing	Worldwide licensing	Worldwide licensing	Worldwide licensing
		Master toy licence worldwide			

Source: Edison Investment Research, Mondo TV. Note: 'S' stands for season.

Financials

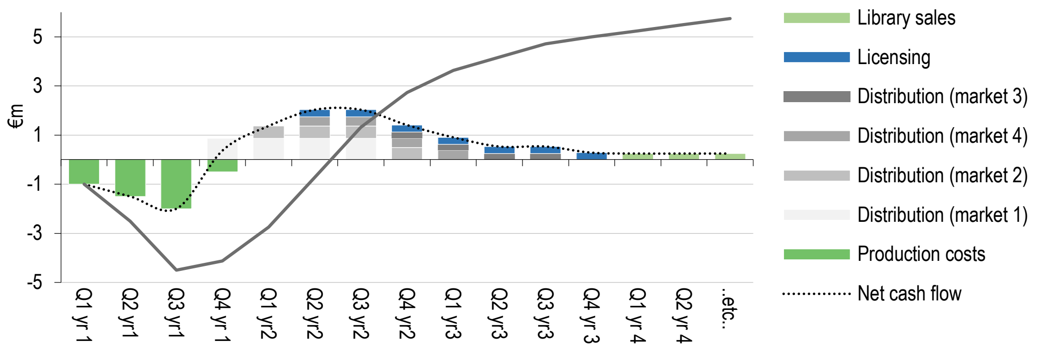
Business model and cash cycle

With the exception of pre-production, which Mondo brought in house last year, production is outsourced to a number of studios across India (Studio 56, Aries Epica) and China (Henan York Animation Film co) that Mondo works with regularly. Consequently, the cost base is adaptable, depending on the pipeline. For co-productions, management strives to break even on a production, and then multiplies the total return on a programme from the sale of broadcast rights and merchandising licences.

Animations are relatively expensive to produce, costing approximately $250k per 20 minute show. Production rarely starts before Mondo has found a partner to underwrite part of the production costs; this can either be by way of a co-production agreement, or by pre-selling the broadcast rights, reducing the financial risk considerably. While this reduces Mondo's financial exposure, it will still have to bear the production and marketing costs upfront as even in a pre-sales situation, broadcasters generally pay on delivery. Initial viewing including the pre-sale of rights tends to take place at major trade shows and it takes approximately 18 months between commissioning and delivery.

We present in Exhibit 10 an illustration of what the cash flows on a successful series might look like, with payback within a year of delivery and distribution, and rights and library sales contributing to a rising return over time, depending on the success of a brand.

Exhibit 10: Illustrative cash flow on a series with a total budget of €5m



Source: Edison Investment Research

Funding in place to finance increased investment

The funding has been put in place to finance the working capital required to support the planned increase in annual investment. Mondo TV has two facilities in place:

- In July 2016, it reached an agreement with Atlas Alpha Yield Fund and Atlas Capital Markets (Atlas) for the issue of up to €15m of convertible bonds (€250k each). €4.5m were issued during FY16 and a further €8.5m have been issued (and converted) since the year-end. Atlas is required to fully convert them into ordinary shares within five years of issuance at a 2% discount to the average price for the preceding five days' trading, and with a coupon of only 1% we expect them to be fully converted by the year end.
- During 2016 Mondo placed €5.3m of equity with GEM Global Yield Fund and GEM Investment America as part of a €30m share subscription facility of up to €35m. If required (we do not expect this), the group also has access to the remaining €30m share subscription facility with GEM.

Radically improved financial performance

Exhibit 11 summarises Mondo's historic KPIs. Since the change of strategy in 2014, the financial performance has improved considerably. In 2016, revenues increased 55% to €29.2m, EBITDA of €18.1m was a 109% increase on FY15, EBIT margins increased to 46% and net profit was €8.6m (FY15: €3.1m).

Exhibit 11: Summary historical performance

€m	2010	2011	2012	2013	2014	2015	2016
Sales	16.5	20.1	14.2	7.0	11.3	16.8	27.4
EBITDA	4.0	9.6	4.4	3.5	7.5	8.9	18.1
EBITDA margin	24%	48%	31%	49%	66%	53%	66%
EBIT	0.4	(0.4)	0.1	(12.2)	2.2	5.6	12.7
EBIT margin	2%	-2%	0%	-174%	20%	33%	46%
Net profit	0.4	1.1	1.5	(7.1)	1.7	3.1	8.6
Investment in content	(6.5)	(5.3)	(4.9)	(5.9)	(7.3)	(9.6)	(20.5)
Revenues: investment multiplier (lagged 12m)	N/A	3.1	2.7	1.4	1.9	2.3	2.9

Source: Mondo TV report and accounts

Edison forecasts

The group has a number of interesting new series in production and several long-term production commitments. With the budgeted level of investment, management is targeting a revenue to investment multiplier of 1.8x (we factor in a 12-month lag to take account of development time) in FY17, increasing to 2.4x in FY18 and 2.7x in FY19. Although one year can vary greatly to the next depending on the delivery schedule, this seems achievable given the FY15 and FY16 performance (2.9x in FY16) and the solid pipeline.

We estimate that 70% of management's current year budgeted revenues are committed and in FY17 our forecasts are in line with management's plan. In FY18, we err on the side of caution and apply a 5% contingency to management's targeted revenues and EBITDA, increasing to 10% by FY19. In our forecasts we expect EBITDA margins to increase to 71% by FY19 from 66% in FY16, reflecting operational gearing effects from high margin rights and licence sales. To put this in context, DHX Media reported EBITDA margins of 70% in FY16.

At the same time, we expect EBIT margins to decrease to 39% as amortisation (which is done on a straight-line basis over seven years) will have an increasing impact as new shows are delivered. The delivery of two new shows (*Disco Dragon* and *Rocky*) in France, where costs are amortised fully on delivery, results in a step change in amortisation in 2018, which explains the lower EBIT margin in FY18.

Nevertheless, Mondo enjoys high EBIT margins due to the significant share of revenues from distribution and licensing as well as the flexible cost base. Compared to the larger listed children's IP businesses, eOne and DHX Media, its margins are lower, as would be expected. eOne has higher profile assets and so direct like-for-like comparisons cannot be made; however, to add context, in FY16 the revenue multiplier at eOne's family division was 11.5x and its EBIT margin was 65%. DHX Media also reported EBIT margin of 65%, providing an indication of the potential should Mondo successfully globalise its brands. Our forecasts are summarised in Exhibit 12 and Exhibit 13 and presented in full at the back of this report (Exhibit 15).

Up to €30m of warrants have been issued, attached to the GEM and Atlas facilities: 20% at €6.5 per share, 60% at €8.0 and the balance at €10.0. We have demonstrated the potential dilution risk should the shares trigger these warrants, although with the shares currently trading so far below the strike price we do not include this potential dilution in our forecasts.

Exhibit 12: Summary forecasts

€m	2016	2017e	2018e	2019e
Total revenue from sales and services	27.4	37.6	49.7	54.6
EBITDA	18.1	25.9	35.0	38.7
EBITDA margin	66%	69%	71%	71%
EBITA	12.7	17.9	17.7	21.1
EBITA margin	46%	47%	36%	39%
PBT	12.7	17.6	17.4	20.8
Net profit (after minority interest)	**8.6**	**11.4**	**10.9**	**13.1**
EPS - adjusted basic (€)	0.32	0.41	0.37	0.45
Impact of warrants:				
EPS - adjusted diluted (0.715m warrants at €6.5) €	0.32	0.40	0.37	0.44
EPS - adjusted diluted (2.85m warrants at €6.5 and €8.0) €	0.32	0.37	0.35	0.41
EPS - adjusted diluted (3.57m warrants at €6.5, €8.0 and €10.0) €	0.32	0.36	0.34	0.40
Maximum dilution		-11%	-9%	-10%

Source: Mondo TV (2016), Edison Investment Research forecasts

Based on our forecasts, which are more conservative than management's (and factor in a fairly long receivables cycle), Mondo appears adequately funded to execute its plan. We assume all the convertibles are triggered (and converted) by the end of FY17 and forecast net debt of €2.0m at the end of FY17. In FY17 we expect another year of working capital outflow, but by FY18 we reflect a neutral working capital requirement; consistent with the typical cash flow profile in the production sector (Exhibit 10). On this basis, the group would be cash flow generative in FY18.

Exhibit 13: Summary cash flow forecasts

€m	2016	2017e	2018e	2019e
EBITDA	18.1	25.9	35.0	38.7
Exceptionals/ other	0.7	0.0	0.0	0.0
Tax	(4.5)	(5.8)	(5.8)	(6.9)
Changes in working capital	(1.9)	(6.9)	0.9	(3.9)
Operating cash flow	**12.5**	**13.2**	**30.1**	**28.0**
Capital expenditure (fixed assets)	0.0	(0.1)	(0.1)	(0.1)
Investment in content	(20.5)	(21.5)	(22.0)	(22.5)
Free cash flow	**(8.1)**	**(8.4)**	**8.0**	**5.4**
Share issue	7.2	0.0	0.0	0.0
Funding (convertible)	(0.2)	11.2	(0.3)	(0.3)
Net cash flow	**(1.0)**	**2.9**	**7.7**	**5.1**
Opening cash	2.9	1.8	4.7	12.4
Closing cash	**1.8**	**4.7**	**12.4**	**17.5**
Gross (debt)	(2.7)	(2.7)	(2.7)	(2.7)
Net cash/(debt)	**(0.9)**	**2.0**	**9.7**	**14.8**

Source: Mondo TV (2016), Edison Investment Research forecasts

Valuation

At this stage of its development we believe the most appropriate way to value Mondo is by looking at EV/EBIT and P/E multiples, both of which capture the amortisation of content libraries (which may or may not be included in some peers' EBITDA multiples, depending on a company's accounting treatment). We have adjusted (upwards by €13m) Mondo's headline enterprise value for the minority values of the listed subsidiaries. On this more conservative basis, Mondo trades on an EV/EBIT multiple of 7.0x in FY17 and 7.1x in FY18 and a P/E multiple of 9.7x in FY17 and 10.7x in FY18.

We have benchmarked its valuation against peers in the children's entertainment content industry (kids) around the world, as well as the Italian media sector (media). We also prefer to look to FY18 multiples given the expected increase in amortisation and the dilutive impact of the convertible.

The average EV/EBIT multiple in FY18 for the kids companies is 9.0x and the average P/E is 14.6x (33% premium). Media companies average an EV/EBIT of 9.4x and P/E of 15.4x. If we take the average of the two peer sets, this implies that Mondo trades on an 23% EV/EBIT discount to peers in FY18, despite its significantly higher EBIT margin, and a 36% P/E discount.

Given Mondo's recent track record, strong pipeline and significantly higher margins, we would expect this EV/EBIT discount to close. A peer average 9.2x EBIT multiple applied to FY18 EBIT forecasts implies a value per share of approximately €5.6.

Announcements of additional licensing deals or significant new partners should help build confidence in the deliverability of its ambitious targets and close the approximate 20% FY18 EV/EBIT discount to peers.

Exhibit 14: Summary peer comparison

Name	Market cap (m)	Sales growth (%)		EBIT margin (%)	EBITDA margin (%)	EV/sales (x)		EV/EBIT (x)		P/E (x)		
		1FY	2FY	last	last	1FY	2FY	1FY	2FY	last	1FY	2FY
MONDO TV SPA	**€122**	**35**	**31**	**43.5**	**61.8**	**3.3**	**2.5**	**7.0**	**7.1**	**12.4**	**9.7**	**10.7**
Children's entertainment:												
DHX Media	C$783	3	44	21	25.3	3.3	2.3	14.0	9.9	24.4	22.2	16.5
Entertainment One	£984	7	9	6	45.3	0.8	0.7	6.0	5.7	18.5	10.4	9.3
Xilam Animation	€122	59	19	27	96.8	5.4	4.6	18.0	14.8	36.3	19.6	16.1
Toei Animation	¥111,440	(1)	5	25	25.9	2.1	2.0	8.7	8.2	15.2	15.7	14.8
Amuse inc	¥54,679	(9)	2	11	12.3	0.7	0.7	7.5	7.1	17.0	17.5	16.4
Italian media peers:												
Mediaset	€3,837	4	(4)	(5)	32	1.5	1.6	13.8	9.6	100.3	24.8	13.6
Mondadori	€432	1	(0)	5	7	0.6	0.6	10.1	9.8	11.4	13.2	11.3
Rai Way spa	€1,208	1	2	30	48	5.6	5.5	15.8	14.6	26.0	23.0	21.2
Gedi Gruppo Editoriale	€372	11	0	4	7	0.5	0.5	9.0	7.7	20.2	14.6	11.1
Italiaonline	€373	(10)	1	0	14	0.7	0.7	13.2	8.6	11.6	28.7	16.4
Triboo	€90	134	5	10	16	0.7	0.7	10.9	8.3	15.6	17.4	13.1
Dada	€54.2	5	5	6	16	1.2	1.1	14.7	11.9	194.5	29.5	21.7
Axelero	€49.6	25	9	6	8	1.0	0.9	12.8	8.6	38.6	21.5	14.6
Digitouch	€18.8	16	11	2	11	0.8	0.7	8.0	5.7	99.4	N/A	N/A
Average children's entertainment		**11.8**	**15.9**	**13**	**35**	**2.5**	**2.1**	**10.8**	**9.0**		**17.1**	**14.6**
Average Italian media sector		**20.8**	**3.2**	**6.6**	**17.8**	**1.4**	**1.4**	**12.0**	**9.4**		**21.6**	**15.4**

Source: Bloomberg, Edison Investment Research. Note: Prices at 18 July.

Sensitivities

Mondo TV has more than 50 years' experience in animation and knows its markets well. However, it has invested considerable resources in developing new titles for licensing, which may be less successful than it hopes. Our estimates are based on management's business plan (allowing for contingencies) and the final outturn could be higher or lower depending on both internal and external factors.

- There is a risk that animations may take longer than expected to produce and hence deliveries are delayed, although Mondo is highly experienced
- The long-term success of a series is ultimately determined by children's tastes. We assume moderate success across Mondo's portfolio. A significant success or flop could have a considerable impact on forecasts.
- Following the tax audit (covering the period 2010 and 2011) that took place in 2014, Mondo was alerted that it may have additional liabilities, as well as penalties. The group filed an appeal in February 2017 and in July this year, was absolved of any liability relating to 2010. The appeal against the possible 2011 audit claim will be decided later this year, although as it is funded on the same principle as the 2010 claim, which Mondo successfully defeated, it has not made any provision.
- Mondo TV operates in international markets and many of its transactions are denominated in US dollars.
- Mondo is dealing with companies in Emerging Asia and Latin America, which, given the long working capital cycles in the production industry, increases credit risk. In FY16 Mondo provided €3.5m against its €4.6m receivables balance. That said, most of Mondo's larger customers are established groups, and many are repeat customers.
- There are a significant number of warrants attached to the Atlas convertibles and the GEM share subscription facility. Given the current share price, we have not reflected these in our forecasts. However, should the shares appreciate, these warrants could be triggered.

- Margins on library sales are high so that any variance from plan has a significant effect on profits. Sales of new titles are harder to predict although a significant proportion is pre-sold before production commences. The character licensing market is to some extent 'hit' driven, which makes forecasting medium-term licensing revenues difficult.
- Mondo's ability to forge partnerships with broadcasters and toy companies is also key to securing access to quality brands to develop.

Exhibit 15: Financial summary

€m	2014	2015	2016	2017e	2018e	2019e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	18.3	16.8	27.4	37.6	49.7	54.6
EBITDA	7.5	8.9	18.1	25.9	35.0	38.7
Normalised operating profit	2.2	5.6	12.7	17.9	17.7	21.1
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	2.2	5.6	12.7	17.9	17.7	21.1
Net Interest	(0.4)	(0.1)	0.0	(0.3)	(0.3)	(0.3)
Joint ventures & associates (post tax)	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	1.8	5.4	12.7	17.6	17.4	20.8
Profit Before Tax (reported)	1.8	5.4	12.7	17.6	17.4	20.8
Reported tax	(0.0)	(2.2)	(4.5)	(5.8)	(5.8)	(6.9)
Profit After Tax (norm)	1.8	3.3	8.3	11.8	11.7	13.9
Profit After Tax (reported)	1.8	3.3	8.3	11.8	11.7	13.9
Minority interests	(0.1)	(0.2)	0.3	(0.4)	(0.8)	(0.8)
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	1.7	3.1	8.6	11.4	10.9	13.1
Net income (reported)	1.7	3.1	8.6	11.4	10.9	13.1
Basic average number of shares outstanding (m)	26	26	26	28	29	29
EPS - basic normalised (€)	0.07	0.12	0.32	0.41	0.37	0.45
EPS - diluted normalised (€)	0.07	0.12	0.32	0.41	0.37	0.45
EPS - basic reported (€)	0.07	0.12	0.32	0.41	0.37	0.45
Dividend (€)	0.00	0.00	0.02	0.00	0.00	0.00
Revenue growth (%)	!	3.6	54.6	34.9	30.6	9.4
EBITDA Margin (%)	41.2	46.8	66.0	68.8	70.3	70.9
Normalised Operating Margin	12.1	29.5	43.5	45.3	34.4	37.4
BALANCE SHEET						
Fixed Assets	19.6	25.0	37.0	50.5	55.4	60.4
Intangible Assets	9.7	16.1	31.4	44.9	49.8	54.8
Tangible Assets	0.3	0.3	0.3	0.3	0.3	0.3
Investments & other	9.7	8.5	5.3	5.3	5.3	5.3
Current Assets	27.5	32.2	37.8	48.1	55.2	64.4
Stocks	0.0	0.0	0.0	0.0	0.0	0.0
Debtors	18.4	22.3	31.7	41.1	42.5	46.6
Cash & cash equivalents	0.4	2.9	1.8	4.7	12.4	17.5
Other	8.7	7.0	4.3	2.3	0.3	0.3
Current Liabilities	(15.4)	(14.5)	(14.1)	(14.7)	(14.9)	(15.2)
Creditors	(10.2)	(10.9)	(11.7)	(12.3)	(12.6)	(12.9)
Tax and social security	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)
Short term borrowings	(3.9)	(2.9)	(2.1)	(2.1)	(2.1)	(2.1)
Other	(1.3)	(0.7)	(0.1)	(0.1)	(0.1)	(0.1)
Long Term Liabilities	(0.6)	(0.4)	(0.8)	(0.8)	(0.8)	(0.8)
Long term borrowings	(0.2)	(0.2)	(0.6)	(0.6)	(0.6)	(0.6)
Other long term liabilities	(0.4)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Net Assets	31.2	42.3	59.9	83.2	94.9	108.8
Minority interests	1.0	1.4	0.6	0.6	0.6	0.6
Shareholders' equity	32.2	43.7	60.4	83.8	95.4	109.4
CASH FLOW						
Op Cash Flow before WC and tax	7.5	8.9	18.1	25.9	35.0	38.7
Working capital	(2.8)	(0.4)	(1.9)	(6.9)	0.9	(3.9)
Exceptional & other	(0.5)	1.0	0.7	0.0	0.0	0.0
Tax	(0.0)	(2.2)	(4.5)	(5.8)	(5.8)	(6.9)
Net operating cash flow	4.1	7.3	12.5	13.2	30.1	28.0
Capex	(7.3)	(9.8)	(20.6)	(21.6)	(22.1)	(22.6)
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(0.3)	(0.2)	(0.2)	(0.3)	(0.3)	(0.3)
Equity financing	3.4	6.1	7.2	11.5	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.2	0.1	0.3	0.0	0.0	0.0
Net Cash Flow	0.1	3.4	(0.7)	2.9	7.7	5.1
Opening net debt/(cash)	3.7	3.6	0.2	0.8	(2.0)	(9.7)
FX	0.0	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	0.0	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	3.6	0.2	0.8	(2.0)	(9.7)	(14.8)

Source: Mondo TV accounts (historic), Edison Investment Research (forecast)

EDISON

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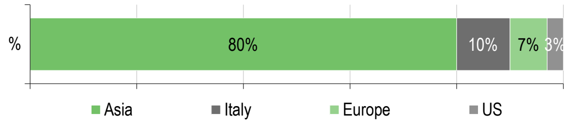
Revenue by geography



Management team

CEO: Matteo Corradi

Matteo Corradi is Orlando Corradi's son and has worked at Mondo TV since completing his studies in 1996. He has held various management positions in the group. He took over as CEO in 2012 and is also responsible for investor relations.

CFO: Carlo Marchetti

Carlo Marchetti joined Mondo TV in 2007. For 10 years before that, he was chief accountant at Datamat SpA, a listed Italian software and services group. Carlo is a chartered certified accountant and worked at Ernst & Young from 1994-97.

Chairman: Orlando Corradi

Orlando Corradi founded the Mondo TV businesses in 1964, initially importing Japanese cartoons then making its own animations. Orlando retired as CEO in 2012, passing the reigns to his son Matteo. He received the honour of 'Commendatore della Repubblica' from the Italian president in 2006.

Principal shareholders	(%)
Orlando Corradi	47.8

Companies named in this report

Entertainment One, DHX Media, Hasbro, Aurora World, TF1, Mattel, Xilam Animation, Toei Animation, Amuse inc, Mediaset

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