EDISON

Mondo TV

Child's play

Outlook

Media

10 May 2019

Mondo TV has started FY19 in much improved financial health, with a more concentrated portfolio centred on properties with good potential globally. *YooHoo* has been sold to Netflix as an original series and is now airing internationally, generating revenues and also acting as a flagship project. Licensing revenues should pick up in its wake. *Robot Trains* should also contribute from this year. The highly competitive environment between terrestrial and SVoD carriers provides a strong trading backdrop as they vie for content. Post the re-basing, Mondo TV is a far less risky investment proposition, yet is priced at a substantial discount to global peers.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	EV/EBIT (x)	P/E (x)
12/17	32.0	15.4	43.0	0.0	1.9	3.1
12/18	18.9	(30.1)	(56.3)	0.0	N/A	N/A
12/19e	20.8	6.0	11.0	0.0	5.3	12.3
12/20e	27.8	7.8	14.0	0.0	4.1	9.6

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

FY19: The start of the recovery

FY18 was a very difficult year for the group, with the untimely death of founder Orlando Corradi and the deterioration in trading, particularly in Asia. This was both macro-related (weakening Chinese consumer economy) and specific, reflecting customers cancelling previous projects, leading to a €32.9m write-down in the value of the library and a fundamental rethink of the group strategy. The decision taken to focus on fewer properties in less volatile markets gives us greater confidence in our financial projections (and those of management). This should allow the group to rebuild revenues and profitability off the lower base. The funding secured during FY18 with the Atlas bonds, subsequently converted, allowed Mondo to close the year with a much healthier balance sheet, with net cash of €8.1m.

Q119 results show plan on track

Outline Q1 figures show production value (revenues plus capitalised production costs) of €5m, with net profit of €1m, which sits comfortably with the first year of the projections under the five-year plan. FY19 will include revenues from the *YooHoo and Friends* series, already airing with Netflix; from *Robot Trains* from Q219; and from *Rocky Kwaternaire*, produced by Mondo TV France. Revenues are expected to be H2-weighted, with around 35% of forecast annual revenues generated in Q4.

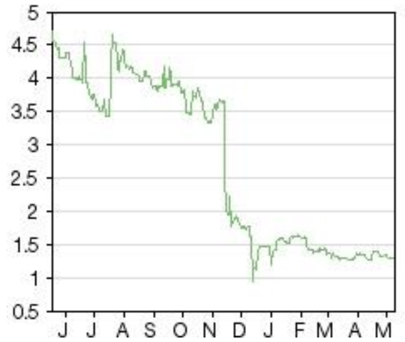
Valuation: Heavily discounted

The difficult year in FY18 weighed heavily on the share price, along with some possible investor concern over dilution from conversion of the Atlas bonds. The rebasing of financial expectations and confirmation that Orlando Corradi's shareholding would pass to his immediate family helped steady the share price. It still stands at a substantial discount to global peers (parity on EV/EBIT would indicate a share price of €2.89; on a P/E basis €1.95). A DCF at a WACC of 11.5% and terminal growth of 2% suggests a price of €2.23. The average of these three values is €2.36, 75% ahead of the current market price.

Price	**€1.35**
Market cap	**€46m**

Net cash (€m) at 31 December 2018	8.1
Shares in issue	34.4m
Free float	64%
Code	MTVI
Primary exchange	Borsa Italiana Star
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.4)	(8.9)	(73.1)
Rel (local)	1.6	(14.9)	(68.6)
52-week high/low		€4.91	€0.95

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 (23%), Mondo TV Suisse (56%) and Mondo TV Iberoamerica (71%). It owns the rights to over 1,500 TV episodes and films, which it distributes across 75 markets. 83% of revenues are generated in Asia, with the remainder from Europe and South America.

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Mondo TV is a research client of Edison Investment Research Limited

Investment case

- **Structural changes to the market mean strong demand in the short to medium term**. The rapid take-up of video on demand (VoD) and streaming video on demand (SVoD) globally has fuelled a well-documented thirst for content from the major players such as Netflix, Amazon and Hulu. With Disney+ also entering the fray and other Pay-TV channels looking to retain market share, this heightened appetite for content is set to continue, with high-quality content that can drive new subscription and stimulate viewer loyalty particularly sought after. Children's content is a key element of the various providers' offerings.
- **Well-established player in children's scripted market with reputation for quality animation**. Mondo TV was founded in 1985, bringing Japanese cartoons to European markets, before starting to produce its own content based on classic characters. Its production capabilities and distribution network are well recognised by the market and it has a strong presence at the relevant trade fairs.
- **Animation suitable for wide geographic distribution.** Mondo TV's core offering suits the international market well. Animated content is more easily dubbed into other languages and (generally) has less cultural sensitivity. 81% of FY18 revenues were generated by sales to Asian customers.
- **Live action capability broadens commercial offering.** Mondo's new business plan also allows for scripted live action within the portfolio, extending its target market to older children and young adults.
- **Management experienced and committed.** The death of co-founder Orlando Corradi in November 2018 has forced a generational change at the group, but it should be noted that his son, Matteo, has been working for the company since graduating in 1996 and has been CEO since 2012. His sister Monica is also an executive director. CFO Carlo Marchetti has also been with the group for 11 years. The Corradi family hold 34% of the equity. The group has recruited a new head of content sales, Luana Perrero, from Rainbow, to drive the international revenues.
- **Atlas funding means secure balance sheet.** Convertible bonds issued to Atlas and subsequently converted have raised €20.9m in FY18, putting the balance sheet in a cash positive position and facilitating the funding of investment in IP.
- **New investment strategy and five-year business plan.** Following the disruption to the business in Q3 and Q418 post the death of the co-founder and subsequent withdrawal of key Asian customers, management re-examined all aspects of strategy. The revised plan, focusing on fewer properties, with greater pre-financing and co-production, has reduced inherent risks in the business, albeit that the enterprise is at a reduced scale from the previous plan.
- **Better geographic mix under new plan.** While Asian customers will remain an important part of the mix, Mondo is looking at achieving a better balance, with more revenues to be derived from Europe and from North America.
- **Growing licensing and merchandising business streams.** Licensing and merchandising have always formed an important element, but the new business plan places a greater emphasis here, including striking deals where Mondo has no associated TV content. The first such deal, *Feisty Pets*, has already been struck.
- **Deal with Netflix for YooHoo and Friends first breakthrough with the US major.** A new 3D CGI 52 × 11-minute series called *YooHoo to the Rescue* was launched globally in March 2019 in 20 different languages in over 190 countries. Deals of this type are potentially transformative.

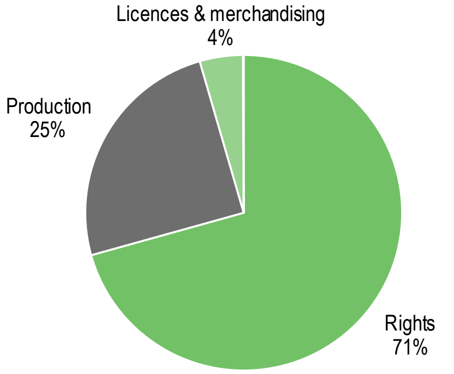
Company description: Children's TV producer

Mondo TV is a leading Italian producer and distributor of children's animated television series, with additional interests in live teen fiction. It has one of the largest animation libraries in Europe, with more than 2,000 episodes of television series and more than 75 feature-length animated films. Over the last year, Mondo TV has adapted its production and sales strategy, focusing its efforts and investments mainly on new productions with high licensing potential, co-produced with third parties, and on the distribution of third-party libraries. Its properties (both owned and licensed) are predominantly character-based. Mondo rarely uses its own IP, as this requires far greater levels of upfront investment to familiarise the market to the characters. 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 would typically 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.

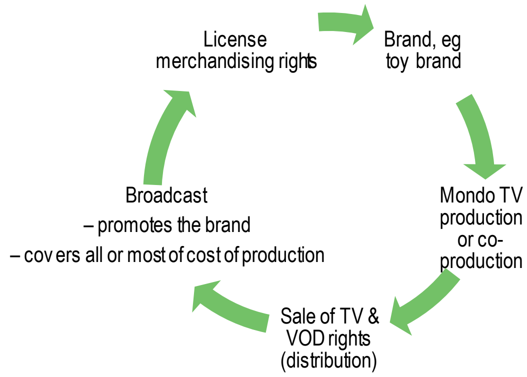
This approach gives Mondo an edge in a very competitive market place, de-risks its investment in production and supports a more rapid exploitation of higher-margin licensing and merchandising revenues. These individual properties are described on page 7, below.

Exhibit 1: Revenues by type, FY19e



Source: Mondo TV report and accounts

Exhibit 2: Business model



Source: Edison Investment Research

Mondo TV started out importing Japanese animation into the Italian market, which was greatly underserved with animated content at the time. The group listed in June 2000, with a business model focused on production and distribution. The basic premise stayed the same until around 2012, working with toy companies and distributors as well as publishers and producing animated series based on the group's own IP. Management then sought to replicate this with third-party IP, looking to create global brands with significant merchandising opportunities based on localised IP. Asian markets (Korea, China) were particularly targeted due to their size and structure, particularly as the local Italian market was struggling. The Mondo TV portfolio was greatly expanded in order to build a market presence that would be sufficient to attract higher-quality IP propositions. This gave the group a high level of knowledge and understanding of the market, designed to support building global brands from local intellectual property.

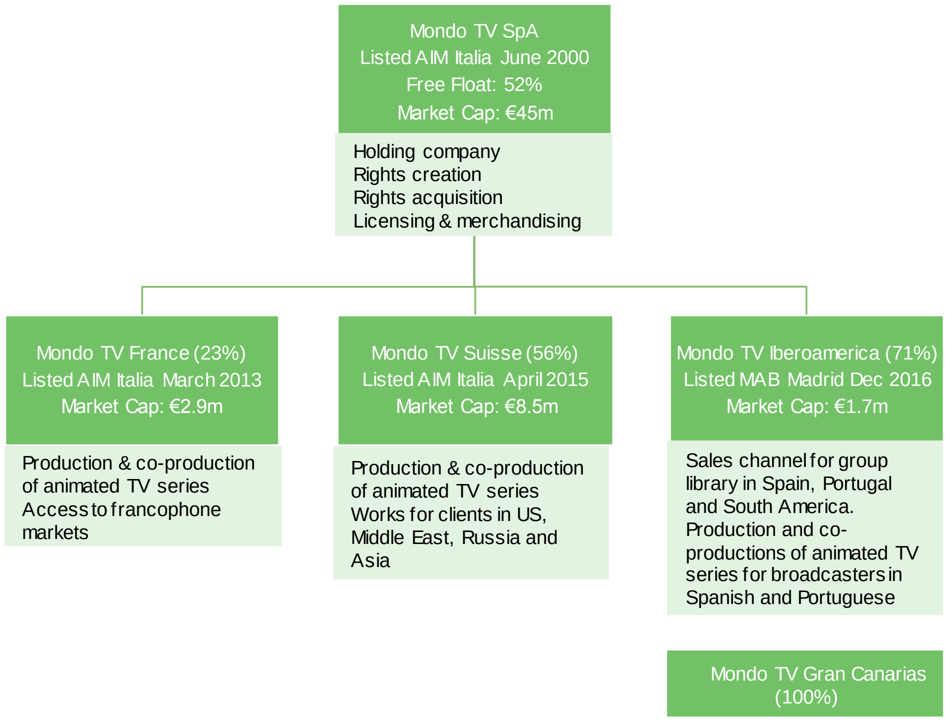
Revenues are generated from production services, rights sales, and licensing and merchandising, although often a single brand will drive revenues across all three categories (Exhibit 2). The group has commercial relationships with over 150 TV networks and digital platforms worldwide. In digital media, it works with all the US-based major platforms, including Netflix, YouTube, Facebook, Apple and Amazon, as well as with global players such as Huawei (China), ICFlix (Middle East and North Africa) and Megogo.net (CIS).

Mondo TVs revenues derive from three categories:

- **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, in 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 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, with new shows becoming a more important part of the mix through the next five-year business plan.
- **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, the 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 €3.0m of Mondo's licence sales are from its library 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**: Mondo TV handles both its own brands and third-party properties for which it is the representative, where it receives a commission. Rights are sold to merchandisers and toy manufacturers and there is therefore no physical stock risk. In December 2018, Mondo became the sub-licensee for *Feisty Pets* in Italy and the Iberian Peninsula, the first brand it represents not linked to a TV series. This broadens out the potential pool of licences that the group can acquire.

Structured to address geographic markets

Exhibit 3: Group organisational structure – four listed entities



Source: Edison Investment Research

Mondo TV Group, based and quoted in Italy, is the main operation, but the group has operating subsidiaries in Iberia, France and Switzerland, with local stock market quotes. The deal with Netflix/Aurora for *YooHoo and Friends* was struck via Mondo TV Suisse, with the property becoming a Netflix Original series. It is to be co-produced with Aurora and Netflix and will premier in spring 2019 globally. The importance of this deal should not be underestimated as it launches Mondo TV as a serious global player and raises its profile in the important US market. In April 2019, Mondo TV Iberoamerica announced a major deal with Amazon for Latin America for a large proportion of the Mondo TV library to be distributed on the Amazon Prime Video Direct platform. The deal includes animated properties including *The Treasure Island*, *The Drakers* and *The Jungle Book*.

Mondo TV Iberoamerica, founded as Mondo TV Spain in 2008, is not just active in distributing Mondo TV's animated catalogue in the region but has recently begun producing, and co-producing, original series.

Clearly drawn revised strategy

During FY18, particularly during the second half, the group encountered a combination of issues that compromised its strategy. Sales in Asia slowed markedly in Q3. Having reported revenues ahead by 5% and EBITDA up 16% in September, all looked to be on track for delivering full year figures in line with the previously published five-year business plan. However, as Q3 progressed, and exacerbated by the death of co-founder Orlando Corradi, trading took a turn down. The principal client for *Rowly Powlys*, and *Dee and Duh*, withdrew shortly after. Then, in the second half of November, three major Asian customers gave notice that they wished to review their investments in various properties following weak demand in their local markets. Consequently, Mondo decided to suspend further investment in these projects, which have now been completely written off. The write-down in the library value was €32.9m, with a further adjustment to working capital in trade receivables (mainly from advance sales on these projects) of €23.9m. Net of the related tax offset, this made a total extraordinary non-recurring charge in FY18 of €43.8m.

These issues threw the group strategy into some disarray, prompting a fuller reappraisal of the state of the market and the best way for Mondo to re-establish profitable growth. This remains predicated on a core business model of the production of cartoon series in co-production with toy makers, particularly in Asia.

Matteo Corradi, son of the founder, is now the president and CEO of the group, having joined the group after graduating in 1996. He was appointed CEO in 2012. The CFO is Carlo Marchetti, an accountant who joined the group in 2008 and was appointed a director the following year. The other executive director is Monica Corradi and the board is completed with two independent directors. This team has drawn up and published a revised strategy that seeks to broaden the revenue generation model. In particular, it has identified the following strands:

- Focusing on higher-yield properties with more support from pre-sales, particularly prior to the production phase. Greater emphasis is being put on selectivity (as opposed to the previous 'wide net' approach), based on thorough market research and working with more internationally credible partners and broadcasters on co-productions. Digital opportunities are to be preferred.
- Achieving a better balance between Asia and other territories to reduce the overall risk levels within the business. No specific target has been set, but we understand that having half group revenues from Asia and the balance from the rest of the world would be a more comfortable position for management.
- Increasing the exposure to licensing and merchandising, with a strengthening of internal resource.
- Diversify the range of products offered through a greater volume of third-party deals, including those where Mondo is not involved in production. The *Feisty Pets* deal mentioned above is a clear example of this strategy being implemented. This should deliver increased margin without major requirements for funding investment or working capital.
- Increasing the volume of live action fiction properties in the portfolio, in response to high levels of demand from the SVoD platforms, Netflix, Amazon and HBO in particular. Having European production facilities and experience is a major advantage here, where the North American platforms are seeking out local content in order to meet the appetite from regional audiences (and, at least in part, to appease local regulators). Mondo Iberoamerica is the subsidiary with the greatest strengths here and its teen-oriented property *2050* (see graphic below) is generating good interest.
- Improving cash generation moves up the list of priorities, with management targeting becoming cash flow neutral in FY19 and returning to cash flow positivity in FY20.

Funding in place

In July 2016 Mondo reached an agreement with Atlas Alpha Yield Fund (Atlas) and Atlas Capital Markets (ACM) for the issue of up to €15m of convertible bonds (€250k each). €4.5m were issued during 2016 and a further €7.5m were issued during 2017, with €9.4m of these converting during 2017. The final €3m was issued in January 2018 and has also subsequently converted.

In April 2018, the board agreed a further investment agreement with Atlas Special Opportunities for a new line of convertible bonds for up to €18m in two tranches of €11m and €7m. The first tranche of these were issued in June 2018 and fully exercised by mid-July 2018 and the second tranche followed soon after, with all exercised by mid-September 2018.

As part of the April 2018 deal, Mondo TV also issued Atlas a global warrant, exercisable within five years from the issue date, for the subscription of 450,000 Mondo TV shares at a price of €7.5 per share (a total maximum value of €3.375m, but clearly well out of the money).

The Atlas funding has given the group the confidence to be able to support the investment programme in its key properties, which are identified below.

Key properties

Exhibit 4: Current production schedule

Programme		Production end date	Delivery to market	Commercial partner
Invention Story	Co-production	26 episodes pa	Beginning 2019	York
Bat Pat/Bat Pat 2	Third Party	End 2019	End 2019	Atlantyca
MeteoHeroes	Co-production	End 2020	End 2019	Epson Meteo
Robot Trains	Third Party	Mid 2019	End 2019	CJ&M Corporation
YooHoo and Friends	Co-production	Sept 2019	H219	Netflix, Aurora
Rocky Kwaternaire (Mondo TV France)		2019	2019	France 4, Monello
Disco Dragoon		2021	2021	Various pre-sales
Sissi 3	Co-production	2020	2020	N/a
Heidi – The Film	Co-production	2019	2019	Alianzas

Source: Mondo TV

Exhibit 5: YooHoo and Friends

Source: Mondo TV

Exhibit 6: Invention Story

Source: Mondo TV

Exhibit 7: Rocky Kwaterner

Source: Mondo TV

Exhibit 8: 2050

Source: Mondo TV

Exhibit 9: Heidi Bienvenida

Source: Mondo TV

Exhibit 10: MeteoHeroes

Source: Mondo TV

Exhibit 11: Robot Trains

Source: Mondo TV

Exhibit 12: Sissi the Young Empress

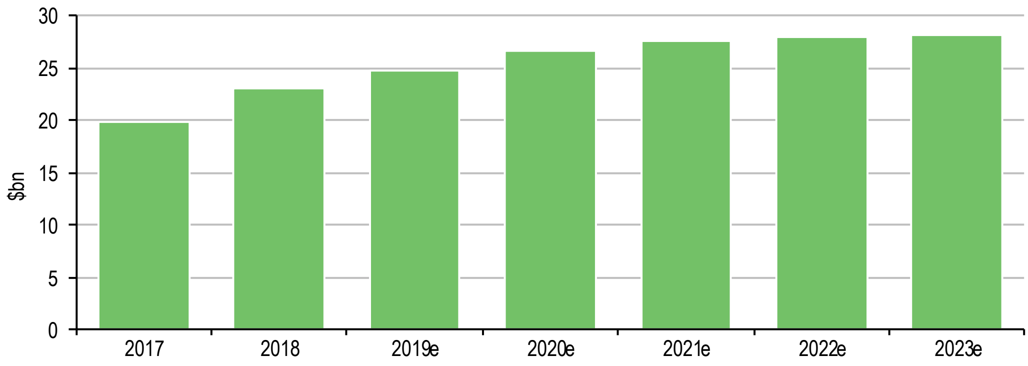
Source: Mondo TV

Shifting sands of consumption fuel content appetite

The content market has been undergoing structural changes for a number of years and the pace of that change shows no sign of easing.

- The channels through which television content is consumed have shifted substantially over the last couple of decades as the terrestrial broadcasters first found themselves competing with the Pay-TV cable and satellite channels and then more recently with the over the top (OTT) models of advertising-funded video on demand (AVoD, as epitomised by YouTube) and subscription video on demand (SVoD, as epitomised by Netflix).
- The changing demand is being driven by a combination of content and convenience, with original content particularly important in driving the success of the subscription models. However, it should be noted that SVoD tends to be taken by households in addition to terrestrial and traditional pay-TV content and that the different requirements for individuals and within households mean that it is common to have more than one subscription. Ofcom research in the UK market indicates that for 2018 39% of households with SVoD took two subscriptions, while 12% took three.
- Netflix remains the largest player in the global SVoD market, with Amazon in second position, although the Prime offering obscures some of the metrics. Apple has announced its intention to be the third major international player in OTT, with a commitment to invest US$1bn in high-end original programming. Disney+ is due to launch in the US in November 2019, and its intentions on pricing are at the lower end of the anticipated range, which will prove an interesting case study into how many services viewers are willing to subscribe to in order to access their preferred content categories. With the launch of the new service, Disney content will be withdrawn from other providers, including Netflix. Traditional TV providers, paid and public service, are responding by investing in their own VOD and stand-alone OTT services, such as the intended offering by ITV and the BBC in the UK market.

Exhibit 13: Global SVoD revenue forecasts



Source: Statista

- Emerging markets, which have gone straight to mobile/smartphones as the primary delivery devices, are driving much of the global growth in OTT video services. The Chinese market is already well developed, with Digital TV Research suggesting that it becomes the largest market by number of subscribers in 2019, overtaking the US. Their projections suggest that the US and China will together account for half of global subscriptions by 2023. Neither Netflix nor Amazon are present in the Chinese market. The largest incumbent is Youku Tudou, part of Alibaba, alongside iQiyi (part of the Baidu Group) and Tencent Video.
- The children's market is especially attractive for all video media content channels. A parent is unlikely to cancel a subscription to a SVoD that carries a favourite series, while the lifetime value of a customer brought to the platform as a child is self-evidently potentially greater. In the pay-TV market, Disney, Nickelodeon and Cartoon Network, among others, all provide a safe environment for children's viewing, with no inappropriate adverts or pre-rolls.
- With issues surrounding discoverability, given the huge quantities of content available, coupled with limits to the number of properties to which a child has notable allegiance (particularly at pre-school), there are obvious attractions to the channel providers of proven properties and hit series. Successful properties, such as Entertainment One's *Peppa Pig*, consequently get recommissioned many times over, with the library also constantly being aired.
- Within the children's segment, again particularly for pre-school, animation is especially attractive, as the cultural sensitivities are often more blurred than in live action. Animation is also more flexible for adaptation to different language territories.
- These have been key drivers behind the growth in the global animation market: Statista reports the value of the market at an estimated US$257bn in FY18, forecast to rise to US$270bn in FY20. Streaming is currently estimated to account for a little over 1% of the global market, but is growing at a faster pace.
- The various international trade shows are extremely important as this is where distribution and licensing deals are struck. There is a rolling schedule of such fairs around the world, with the most important being MipTV (April at Cannes)/Mipcom (October, Cannes), NATPE (January, Florida), Kidscreen (February, Miami) for content deals, with licensing deals also struck at these and the licensing-centric shows such as BrandLicensingEurope (October, London) and Licensing Expo (June, Las Vegas). Having a strong presence at these shows is crucial to staying front of mind with the major commissioners.
- The latest LIMA Annual Global Licensing Industry Survey showed revenues from trademarked licensing up 3.3% in FY17 to US$271.6bn, with entertainment/character licensing the largest category, at 45% of the total. The North American market is the largest territory, representing 58% of the global total. The potential rewards from a successful offering on a popular property are transformative.

- The valuation of licences has become markedly more complex as the channels to market have multiplied, particularly as viewership ratings are often opaque on the platforms. Fewer, more substantial brands are therefore going to have greater visibility and traction when it comes to negotiating the rights.

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 at managing this type of project.
- 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.
- Mondo TV operates in international markets and many of its transactions are denominated in US dollars, whilst it reports in Euros.
- Credit risk. Most of Mondo's larger customers are established groups, and many are repeat customers. However, some of the largest can be relatively aggressive regarding payment terms and are increasingly seeking to push working capital back up the supply chain.
- There are a significant number of warrants (4.02m) attached to the Atlas convertibles and the GEM share subscription facility. Given the current share price, we have not reflected these in our forecasts, as they are set with exercise prices ranging from €6.5 to €10. However, should the shares appreciate, these warrants could be triggered. The 2.5m GEM warrants expire at end-August 2019. 1.07m of the Atlas warrants expire on 1 April 2021 with the final 0.45m running out to 19 April 2023.
- 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. The group has a broad spread of customers and partners, and the shift in strategy to focus less on Asia should reduce risk further.

Valuation

From a peak of €7.5 in December 2017, the shares drifted through the first half of FY18, reaching a low of €3.43 in early July. Although causality cannot be directly determined, it is likely that this reflected a combination of a lack of substantive contract announcements and shareholder disillusionment with the dilutive impact of the stream of Atlas bond conversions. There was also some uncertainty surrounding a proposed joint venture on a theme park in China, which management evaluated and from which it then withdrew in July, which may account for a bounce in the share price around that time. The combination of disappointing Q318 numbers and the death of the co-founder (and major shareholder) in November led to a further sharp decline in the share price to a low of €1.13 in mid-December. The confirmation that Orlando Corradi's shareholding would pass to his immediate family, several of whom are actively involved in the business, has reassured investors that his death will not result in an overhang.

Substantial discount to peers

Exhibit 14: Peer group valuations

Name	Curr	Price	Market cap (m)	Ytd perf (%)	P/E last (x)	P/E 1FY (x)	P/E 2FY (x)	EV/ Sales last (x)	EV/ EBITDA last (x)	EV/ EBITDA 1FY (x)	EV/ EBITDA 2FY (x)	EV/ EBIT last (x)	EV/ EBIT 1FY (x)	EV/ EBIT 2FY (x)	Yield 1FY (%)
eOne	GBp	473.00	2,346	32.6	30.1	19.6	17.2	2.4	5.3	12.8	11.0	38.3	16.3	13.1	0.3
Xilam Animation	€	37.95	186	0.8	36.0	23.0	16.2	6.9	7.6	5.5	4.6	23.6	16.0	12.1	0.0
Mediawan	€	11.62	370	5.6	17.0	12.2	10.4	1.6	8.4	6.6	6.0	16.8	7.5	6.5	0.0
Lions Gate Ent	US$	14.05	2,926	(12.7)	15.8	18.7	10.9	1.7	17.0	11.9	10.2	30.0	13.1	22.9	1.9
Toei	JPY	5580	234,360	38.0	21.0	20.7	18.5	4.5	17.5			18.3	13.2	12.0	1.2
Corus Ent	C$	5.88	1,243	67.9	8.2	9.6	8.7	2.2	6.3	6.2	6.3	7.3	9.0	8.5	3.0
Spin Master	US$	45.78	4,660	19.3	22.4	20.3	18.7	2.0	11.7	10.6	9.8	15.9	13.6		0.0
Amuse	JPY	2,600	48,421	11.4	13.1	12.2	17.0	0.6	8.0			9.0	7.9	7.5	1.5
Average				**20.4**	**20.4**	**16.8**	**14.7**	**2.7**	**10.2**	**8.9**	**8.0**	**19.8**	**12.1**	**11.8**	**1.0**
Mondo TV	€	1.35	46	(5.7)	(2.4)	12.3	9.6	1.8	3.0	2.4	1.8	-1.1	5.3	4.1	0
Discount					N/A	27%	34%	36%	71%	73%	78%	N/A	56%	65%	100

Source: Refinitiv, Edison Investment Research. Note: Prices as at 7 May 2019.

We have adjusted Mondo TV's enterprise value to strip out the value of quoted subsidiaries. It is clearly trading at a substantial discount to the global peer set across all relevant metrics. EBITDA ratios are difficult to compare in this peer group due to the varying treatments of capitalisation of production costs, which is less of an issue for Mondo TV than for some of the others. We would therefore prefer to compare on EV/EBIT. Parity on this basis would imply a share price of €2.89, more than double the current level. On a P/E basis, again averaged across years one and two, parity equates to a share price of €1.95.

DCF sense check

Exhibit 15: DCF (€/share)

		Terminal growth rate				
		0.00%	1.00%	2.00%	3.00%	4.00%
WACC	13.00%	1.74	1.82	1.92	2.03	2.17
	12.50%	1.82	1.91	2.01	2.14	2.30
	12.00%	1.90	2.00	2.12	2.26	2.45
	11.50%	1.99	2.10	**2.23**	2.40	2.61
	11.00%	2.08	2.21	2.36	2.56	2.81
	10.50%	2.19	2.33	2.51	2.73	3.03
	10.00%	2.31	2.47	2.68	2.94	3.29
	9.50%	2.44	2.63	2.86	3.17	3.59
	9.00%	2.59	2.80	3.08	3.45	3.96
	8.50%	2.75	3.00	3.32	3.77	4.41

Source: Edison Investment Research

The company's report and accounts show management's calculation of the group's WACC at 11.6%. Using 11.5% and a terminal growth rate of 2%, our DCF shows a suggested share price of €2.23, based on our medium-term modelling, which builds in a level of contingency against the published management five-year business plan. This nevertheless indicates that the current market share price sits at a discount of 72%.

Financials

Mondo TV issues its five-year business plan targets to the market to facilitate understanding of the business model. It last revised these numbers in December 2018 (see update note), significantly rebasing expectations by reducing forecast revenues by 50–60% over the period, resulting in EBIT projections lower in a range of 62–79%.

Exhibit 16: FY18 vs forecasts (€m)

	2018 (Edison forecast)	2018 (actual)	Difference
Revenue differential			
Revenue – 12/18	23.7	18.9	-20%
Revenue – previous	47.0		
Change – revenues	-50%		
EBITDA differential			
12/18 EBITDA	17.9	11.2	-37%
Previous EBITDA	36.2		
Change – EBITDA	-51%		
12/18 D&A	(9.4)	(41.8)	345%
Previous D&A	(14.1)		
EBIT differential			
12/18 EBIT	8.5	(30.6)	N/A
Previous EBIT	22.1		
Change – EBIT	-62%		
Net profit differential			
12/18 profit	5.9	(22.0)	N/A
Previous net profit	15.8		
Change – net profit	-63%		

Source: Mondo TV accounts, Edison Investment Research estimates

As shown above, we had significantly lowered our FY18 numbers at the end of the year. In the event, revenues undershot our revised forecasts, but the degree of change that the group has undergone meant that forecasting a specific period was always going to be a challenging proposition. As well as the revenue number, the group also discloses the value of production, being the total of the revenues earned in a period added to production costs capitalised in that period. For FY18, this value was €22.2m, down 40% from the prior year.

The decrease in FY18 over FY17 primarily reflects the termination of contracts with four major Asian clients in November, referred to above, on top of a more general slowdown of growth in Asia that had been experienced through Q318. This prompted a more thorough re-evaluation of the library, resulting in an amortisation and impairment charge of €41.7m being taken through the income statement, of which €24.5m related directly to the termination of the Asian clients.

Earnings prospects set out in business plan

As is clear, FY18 was a very difficult year for the business, in trading and with the death of the founder, which led to a significantly poorer financial outcome. The consequent root-and-branch reappraisal of the existing business and its prospects resulted in the rebased five-year plan (FY19–23), as published in December 2018. The pivot from Asia, which represented 81% of FY18 revenue, will be substantial in FY19, although we have not modelled the group on a geographic basis.

Exhibit 17: Key earnings metrics (€m)

	2017	2018	2019e	2020e	2021e	2022e	2023e
Value of production	34.0	22.2	24.5	34.0	38.5	40.8	44.4
EBITDA	23.7	11.2	14.3	19.9	24.2	28.2	31.5
EBITDA mgn to prod. value	*69.7%*	*50.5%*	*58.4%*	*58.5%*	*62.9%*	*69.1%*	*70.9%*
EBIT	17.6	(30.6)	6.8	9.0	11.7	14.0	16.9
EBIT mgn to prod. value	*51.8%*	*N/A*	*27.8%*	*26.5%*	*30.4%*	*34.3%*	*38.1%*
Net profit	12.3	(42.5)	4.1	5.4	7.0	8.4	10.5

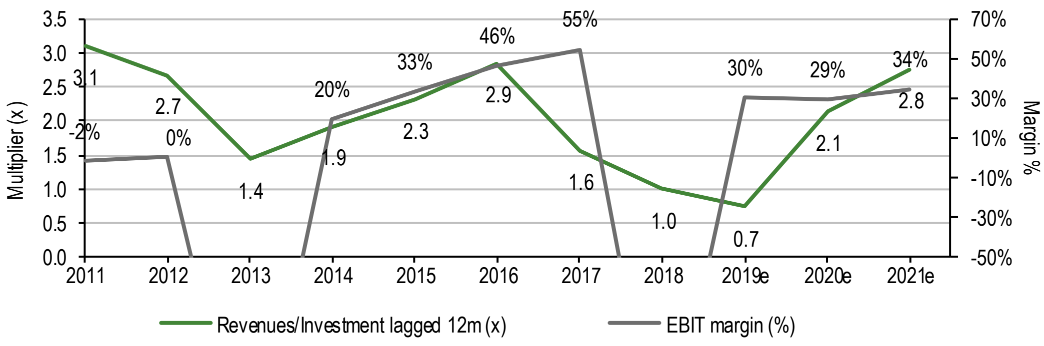
Source: Mondo TV accounts, Mondo TV business plan, Edison Investment Research

The value of production metric shown above is the total revenue from rights sales, production plus licensing and merchandising revenues together with the capitalised production costs. These capitalised production costs relate to Mondo TV's own productions.

The exhibit above clearly shows the rebasing of the group, with FY18 set to have been the nadir of its fortunes. With the shift in business strategy as explained above, there should now be a greater degree of confidence in the management projections. Given that these are issued directly from the company, we have reviewed the numbers for reasonableness and compiled our own internal thoughts on how revenues and costs break down in light of historical reports and comments made in various management statements. Edison forecasts for Mondo TV Group are therefore based in this context on the company's own published business plan, rather than from the ground up. However we have included an inbuilt contingency, increasing over time from 2% in FY19 to 10% from FY21, to reflect the execution risk. We will revisit these discount factors over time.

Investment in content remains a key lead indicator and we demonstrate that here. Without investing in production, there is nothing to sell in future periods. The shift towards greater pre-sales should mean that the risk profile associated with the investment improves.

Exhibit 18: Earnings and investment



Source: Mondo TV accounts, Edison Investment Research

Exhibit 18 above shows that there is a fair degree of inbuilt visibility of earnings from new productions over the short to medium term, but individual contract values are not disclosed for reasons of commercial sensitivity. Library sales, which we estimate constitute about 15% of revenues, are fairly steady, with growth over management's business plan forecast period of a little over 10%.

Cash flow set to strengthen

The FY18 cash flow position showed lower operating cash before changes in working capital, primarily due to the deferred tax effects of the write-offs, with a large swing in working capital meaning that the overall operating cash flow was slightly ahead of the prior year. The cash brought into the business from the conversion of the Atlas bonds (€20.9m net) covered much of the investment in intangible assets in the period of €28.5m.

The forecast period will have different cash requirements. The emphasis on a smaller number of properties, a larger proportion of co-productions and pre-sales should mean lower capital investment in FY19 and on through the rest of the five-year plan. We are also assuming in our modelling that no cash tax will be paid. Management has suggested that the group will be broadly cash neutral in the current year before turning cash positive. We have built in a slightly more cautious scenario, with an outflow of €1.8m in FY19e, followed by an inflow of €6.9m for FY20e and €9.6m for FY21e. This is based on capex of €13.1m followed by €11.1m in subsequent years.

Balance sheet buoyed by Atlas funding

As at 31 December 2018, Mondo TV had net cash of €8.1m on the face of the balance sheet, consisting of cash and cash equivalents of €12.5m less short-term financial payables of €3.1m and longer-term financial payables of €1.3m. This compares to the prior year-end position of €1.9m of net debt. The key factor behind this strengthening is the capital raised through the conversion of the Atlas bonds, as described above.

Library value written down

The other important alteration to the balance sheet is the write-down in the value of the library.

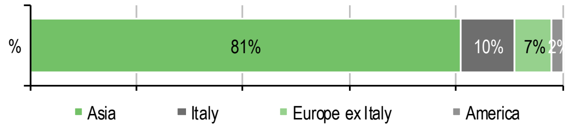
Hong Kong Nine Technology, the principal client for *Rowly Powlys*, and *Dee and Duh,* withdrew shortly after the death of Orlando Corradi. Then, in the second half of November, three major Asian customers (Broadvision Rights Ltd., Hong Kong Yiqi Culture Film & Television Media Co. Ltd. and New Information Tech.) gave notice that they wished to review their investments in *Naraka, Final Fight, Play Time Buddies, Beast Keepers, Partidei and Adventures in Duckport* following weak demand in their local markets. Consequently, Mondo decided to suspend further investment in these projects, which have now been completely written off. The value of the assets has been written down with the FY18 results for a total of €56.8m at the consolidated level. This represents a write-down of the library value of €32.9m, with a further adjustment to working capital in trade receivables (mainly from advance sales on these projects) of €23.9m. Net of the related tax offset, this made a total extraordinary non-recurring charge in FY18 of €43.8m.

Our modelling indicates that net cash at the end of FY19 will be a little lower at €6.3m, then starting to build, reflecting the reduced capital investment requirement under the five-year business plan.

Exhibit 19: Financial summary

€m	2016	2017	2018	2019e	2020e	2021e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	27.4	32.0	18.9	20.8	27.8	30.3
Cost of Sales	(9.3)	(8.3)	(7.7)	(7.0)	(9.2)	(9.3)
Gross Profit	18.1	23.7	11.2	13.9	18.6	21.0
EBITDA	18.1	23.7	11.2	13.9	18.6	21.0
Operating Profit (before amort. and except.)	12.7	17.6	(30.6)	6.3	8.1	10.5
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	(23.9)	0.0	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	12.7	17.6	(54.5)	6.3	8.1	10.5
Net Interest	0.0	(2.2)	0.5	(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)	12.7	15.4	(30.1)	6.0	7.8	10.2
Profit Before Tax (reported)	12.7	15.4	(54.0)	6.0	7.8	10.2
Reported tax	(4.5)	(3.1)	11.5	(1.6)	(2.0)	(2.6)
Profit After Tax (norm)	8.3	12.3	(22.0)	4.5	5.8	7.5
Profit After Tax (reported)	8.3	12.3	(42.5)	4.5	5.8	7.5
Minority interests	0.3	0.5	3.0	(0.7)	(1.0)	(1.3)
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	8.6	12.8	(19.0)	3.8	4.8	6.3
Net income (reported)	8.6	12.8	(39.5)	3.8	4.8	6.3
Average Number of Shares Outstanding (m)	27	30	34	34	34	34
EPS - normalised (c)	31.1	43.0	(56.3)	11.0	14.0	18.2
EPS - normalised fully diluted (c)	31.1	43.0	(56.3)	11.0	14.0	18.2
EPS - (c)	31.1	43.0	(117.0)	11.0	14.0	18.2
Dividend per share (c)	2.0	0.0	0.0	0.0	0.0	100.0
Revenue growth (%)	63.2	16.8	(40.9)	10.2	33.2	9.3
Gross Margin (%)	66.0	74.0	59.2	66.6	66.9	69.2
EBITDA Margin (%)	66.0	74.0	59.2	66.6	66.9	69.2
Normalised Operating Margin	46.4	54.9	(162.0)	30.4	29.4	34.5
BALANCE SHEET						
Fixed Assets	37.0	47.9	46.0	51.6	52.3	50.9
Intangible Assets	31.4	44.1	30.9	36.5	37.1	35.7
Tangible Assets	0.3	0.4	0.4	0.4	0.4	0.4
Investments & other	5.3	3.4	14.7	14.7	14.7	14.7
Current Assets	37.8	53.6	37.2	36.4	50.4	63.3
Stocks	0.0	0.0	0.0	0.0	0.0	0.0
Debtors	31.7	47.9	20.6	21.5	28.7	32.0
Cash & cash equivalents	1.8	2.4	12.5	10.7	17.6	27.2
Other	4.3	3.3	4.2	4.2	4.2	4.2
Current Liabilities	(14.0)	(22.6)	(25.2)	(23.8)	(30.7)	(34.1)
Creditors	(11.7)	(15.0)	(21.6)	(20.3)	(27.2)	(30.5)
Tax and social security	(0.2)	(0.4)	(0.5)	(0.5)	(0.5)	(0.5)
Short term borrowings	(2.1)	(3.6)	(3.1)	(3.1)	(3.1)	(3.1)
Other	0.0	(3.7)	(0.0)	0.0	0.0	(0.0)
Long Term Liabilities	(0.8)	(1.2)	(1.9)	(1.4)	(1.4)	(1.4)
Long term borrowings	(0.6)	(0.7)	(1.3)	(1.3)	(1.3)	(1.3)
Other long term liabilities	(0.2)	(0.5)	(0.6)	(0.1)	(0.1)	(0.1)
Net Assets	60.0	77.7	56.1	62.7	70.6	78.7
Minority interests	0.0	(0.6)	2.1	0.7	1.0	1.4
Shareholders' equity	60.0	77.1	58.2	63.4	71.6	80.1
CASH FLOW						
Op Cash Flow before WC and tax	18.1	23.7	11.2	13.9	18.6	21.0
Working capital	(1.9)	(11.2)	6.0	(2.2)	(0.3)	0.0
Exceptional & other	0.7	(0.8)	(11.0)	0.0	0.0	0.0
Tax	(4.5)	(3.1)	11.5	0.0	0.0	0.0
Net operating cash flow	12.5	8.7	17.7	11.6	18.3	21.0
Capex	(20.6)	(19.2)	(28.6)	(13.1)	(11.1)	(11.1)
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(0.2)	(0.2)	0.0	(0.3)	(0.3)	(0.3)
Equity financing	7.2	9.4	20.9	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.3	0.1	0.0	0.0	0.0	0.0
Net Cash Flow	(0.7)	(1.2)	10.1	(1.8)	6.9	9.6
Opening net debt/(cash)	0.2	0.9	2.0	(8.1)	(6.3)	(13.2)
FX	(0.1)	0.1	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)	0.9	2.0	(8.1)	(6.3)	(13.2)	(22.8)

Source: Mondo TV accounts, Edison Investment Research

Contact details	Revenue by geography
Via Brenta, 11 00918 Roma Italy +39 06 8632 3293 www.mondotv.it	

Management team

CEO: Matteo Corradi	CFO: Carlo Marchetti
Matteo Corradi is the son of the late founder, Orlando Corradi, 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.	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.

Principal shareholders	(%)
Giuliana Bertozzi	18.31
Matteo Corradi	5.60
Ricardo Corradi	5.58
Monica Corradi	5.58
Invesco Ltd	4.75

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