Mondo TV

Exploring new horizons

Results update

Media

The 50% increase in net profit in FY17 was delivered to budget and forecasts. We maintain our forecast for a further 45% increase in EBITDA in FY18, underpinned by existing relationships and returning brands. As Mondo scales up, new opportunities are presenting themselves: a potential minority investment in a new theme park in China provides evidence of the group's widening ambitions as its licensing business grows. The weakness in the share price this year leaves the company at a 40-50% discount to slower growing peers.

Year end	Revenue (€m)	EBIT (€m)	PBT* (€m)	EPS* (€)	DPS (€)	EV/EBIT (x)	P/E (x)
12/16	27.4	12.7	12.7	0.31	0.02	12.6	15.4
12/17	32.0	17.6	15.4	0.43	0.00	9.1	11.2
12/18e	47.0	22.1	21.6	0.49	0.00	7.3	9.8
12/19e	58.7	29.3	29.0	0.61	0.00	5.5	7.9

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

FY18 on course for another step increase in EBITDA

In FY17 revenues increased by 17% and EBITDA by 38% to €25m. In 2018, we expect delivery of some of Mondo's newer flagship series including a full series of *YooHoo & Friends*, *Sissi* and first rights sales of *Invention Story*, underpinning a significant increase in the revenue to investment ratio and a 45% increase in FY18e EBITDA. EBITDA increased by 20% yoy in Q118, which we believe leaves the group on track to deliver its 2018 budget. We therefore leave our forecast EBITDA and net profit broadly unchanged, although moderate our assumption for the unwinding of working capital in FY18.

Considering investment in new Chinese theme park

In March, Mondo announced that it is participating in a feasibility study, in partnership with Chinese animation group Henan York, for the potential development of a theme park based around Mondo's and other characters in Zhengzhou, the capital of the Henan region in China. Mondo's participation could be c 10% for €12.5m. Should the project go ahead, development is likely to start in 2020 for completion in 2023, targeting a 6% ROI in its first full year. Mondo expects the study to be completed by September 2019; the outcome is non-binding.

Valuation: Wider ambitions

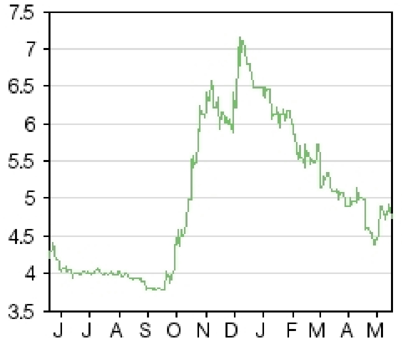
The increase in investment over the past few years, together with Mondo's successful pivot towards Asian relationships and a licensing-based model, has resulted in a fourfold increase in net earnings since 2014. As newer brands develop and partnerships become embedded, we expect to see continued double-digit earnings growth in FY18 and FY19. The potential theme park investment, which we estimate would represent less than 10% of FY19 net assets, provides evidence of the group's deepening relationships with its partners in China, which ultimately could establish a new business activity. The group's rating, a 40-50% EV/EBIT and P/E discount to peers in FY18, looks considerably overdone.

17 May 2018

Price	**€4.8**
Market cap	**€149m**

Net debt (€m) at December 2017	2.0
Shares in issue	31.0m
Free float	60%
Code	MTVI
Primary exchange	Borsa Italiana Star
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(4.5)	(15.3)	8.2
Rel (local)	(6.0)	(18.3)	0.1
52-week high/low		€7.2	€3.8

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 (25%), Mondo TV Suisse (57%) and Mondo TV Iberoamerica (72%). 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.

Next events

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Analysts

Bridie Barrett +44 (0)20 3077 5700

Fiona Orford-Williams +44 (0)20 3077 5739

media@edisongroup.com

Edison profile page

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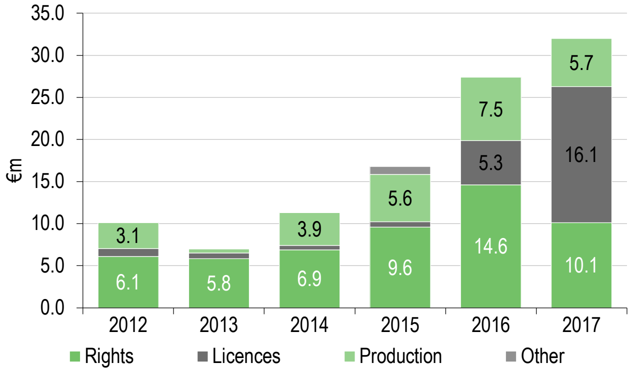
FY17 results overview: Delivering to ambitious budget

Revenues in 2017 increased by 17% to €32.0m, underpinned by a tripling of licence sales, which now account for 50% of revenues, while rights sales and content production fees decreased. The change in revenue mix is in part due to the current stage of the content production cycle, and we would expect content and rights sales to expand again in 2018 as key titles are delivered. It is also a reflection of management's strategy to scale the licensing part of its business, focusing on Asian markets, which represented 83% of revenues in 2017 (FY16: 80%). Revenues comprised:

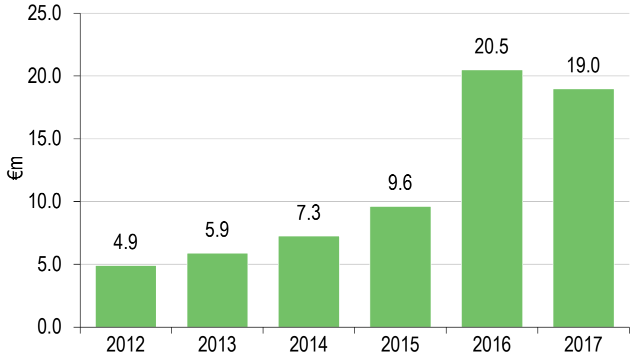
- Licensing sales of €16.1m (FY16: €5.3m) relate mainly to *Playtime Buddie*s, *The Rowly Powlys*, *Sissi*, *Dee&Doo*, *Final Fight, Naraka* and new brand, *Robot Trains*.
- Along with library sales and the titles named above, rights sales at €10.1m (FY16: €14.6m), reflect first sales for Season 1 (S1) of *Heidi*, *Yo Soy Franky* and the sale of S1 of live fiction *Isabel* to RAI.
- Production revenues of €5.7m (FY16: €7.5m) reflect mainly the delivery of *Invention Story* (part of the $25m four-year York contract), *Robot Trains* and its Abu Dhabi Media contract.

Exhibit 1: Revenue history



Source: Mondo TV

Exhibit 2: Investment in content



Source: Mondo TV

EBITDA margins at 78% (FY16: 66%) reflect the change in revenue mix towards high-margin licence sales, with EBITDA increasing 38% to €25m. The ramp-up in investment in content in recent years (Exhibit 2) has not yet filtered through to costs and, after only €6.2m of content amortisation costs, EBITA of €17.6m increased by 38%.

Finance costs of €2.2m largely relate to foreign currency translation effects in the value of the group's dollar-denominated trade receivables. Including this charge and €3.1m tax, net profit of €12.3m increased by 50% y-o-y, in line with management's budget and our forecasts. The 20% effective tax rate benefited from Patent Box R&D tax credits and ACE offsets available against capital increases.

EBITDA to operating cash conversion was only 17% (FY16: 69%). During the year, Mondo invested €19.0m in content and €11.2m of working capital was absorbed, principally in relation to the production of *Invention Story*, *Beastkeeper*, *Partidei*, *Sissi* and *The Rowly Powlys*, as well as *Heidi*.

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 FY16 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. After this capital increase, net cash flow was broadly neutral during 2017, with year-end net debt reported at €2.0m.

We summarise FY17 results and our forecasts in Exhibit 3.

Exhibit 3: Summary 2017 results and forecasts

€m	2016	2017	Change (%)	2018e	2019e
P&L					
Total revenue from sales and services	27.4	32.0	17	47.0	58.7
Other Revenues	0.6	0.6		0.6	0.6
Capitalisation of internally produced cartoon series	1.2	1.4		1.4	1.4
Total revenues	29.2	34.0	16	48.9	60.7
EBITDA	**18.1**	**25.0**	**38**	**36.2**	**45.0**
EBITDA margin	66%	78%		77%	77%
EBITA	12.7	17.6	38	22.1	29.3
EBITA margin	46%	55%		47%	50%
PBT	12.7	15.4	21	21.8	29.0
Net profit	8.6	12.8	50	15.2	19.0
EPS - adjusted basic (€)	0.3	0.43	38	0.49	0.61
Cash flow					
EBITDA	18.1	25.0	38	36.2	45.0
Exceptionals/FX	0.7	(2.1)		0.0	0.0
Tax	(4.5)	(3.1)		(5.9)	(7.8)
Changes in working capital	(1.9)	(11.2)		(0.0)	3.4
Operating cash flow	**12.5**	**8.7**	**(30)**	**30.3**	**40.5**
Capital expenditure (fixed assets)	(0.0)	(0.2)		(0.1)	(0.1)
Investment in content	(20.6)	(19.2)		(21.1)	(21.8)
Free Cash flow	**(8.1)**	**(10.5)**		**9.2**	**18.7**
Share issue	7.2	9.4		3.0	0.0
New borrowings		1.9			
Interest costs and change in borrowings	(0.2)	1.6		(0.5)	(0.3)
Net cash flow	**(1.0)**	**0.5**		**11.7**	**18.4**
Opening (cash)/debt	2.9	1.8		2.3	14.1
Closing (cash)/debt	1.8	2.3		14.1	32.5
Gross debt	(2.7)	(4.4)		(4.4)	(4.4)
Net (debt)/cash	**(0.9)**	**(2.0)**		**9.7**	28.2

Source: Monto TV (historics), Edison Investment Research (forecasts)

Outlook: Further step increase in revenues and EBITDA forecast in 2018

Key investments during 2017 included *Sissi*, *The Rowly Powlys*, *Invention Story*, *Partidei*, *Beastkeeper*, *Final Fight*, *Naraka* and *Robot Trains*, and *Heidi*. These key brands have now all moved beyond first deliveries, and as second and third series are produced, the rights and licensing potential should also increase. In 2018 we forecast a very similar level of investment in content and production (€21m), which will remain focused on these brands – along with the production of Mondo's new flagship show, *YooHoo & Friends*, which was recently acquired by Netflix to air in 2019 (for more detail, please refer to our last update note, published on 4 December 2017).

Sales can be fairly lumpy, but we believe that Q118 results, reported on 15 May, put the group broadly on track to deliver to forecasts in FY18, with EBITDA up 20% to €6.6m and net income up 22% to €3.2m.

We make no substantial changes to our forecast profitability for 2018, where we expect a 47% increase in revenues as a greater proportion of the increased investment in content over the last two years moves to the delivery stage. This should also mean a partial unwinding of the negative working capital seen in FY17. However, we moderate our forecast for working capital in FY18. We now assume a 350-day receivable cycle and forecast €11.7m net cash flow and a €9.7m year-end net cash position in FY18 (down from €20.2m previously).

All of the bonds relating to the €15m Atlas Alpha Yield Fund have now been issued and converted. Subsequently, Mondo has put in place an additional facility with Atlas Special Opportunities, which provides for the issuance of a €18m convertible bond in two tranches of €11m and €7m during 2018. Based on our forecasts, Mondo has no immediate cash requirements. However, working capital cycles can be protracted, and the additional finance will provide flexibility to participate in additional projects, such as the theme park project, or increase content investment over and above that forecast, should new opportunities present themselves.

Theme park: Feasibility study

In March, Mondo announced that it is participating in a feasibility study, in partnership with Chinese animation group, Henan York, for the potential development of a theme park based around Mondo's and other characters in Zengzhou, the capital of the Henan region in China. Of the total €250m investment considered, Mondo's participation is expected at approximately 10%, €12.5m.

Zhengzhou is the capital of the Henan province in the middle of China, an important transportation hub and one of the eight central Chinese cities which operate as the political, economic and technological centres. Population growth in the area has been rapid, and there are now c 10 million people in Zhengzhou, and 100m in the Henan region. There are currently no other theme parks of this scale in Zhengzhou although the Asia Pacific region more generally has been a major driver for theme park growth in recent years. The region's share of the global theme parks market grew from 35% in 2006 to 42% in 2015, according to the Themed Entertainment Association and AECOM.

Mondo's participation is subject to the outcome of the feasibility study and is non-binding. An initial analysis performed by Henan York indicates that, based on a total €250m investment, the park would break even on 1.5m annual ticket sales, and that revenues of €100m and net profit of €14m in the first year post launch (6% ROI) could be expected. Should the project go ahead, development is likely to start in 2020 for completion in 2023. Mondo would expect to share in any profits as a minority investor in the JV, but would also expect to generate royalties from its brands.

It is common for major studio groups to invest in theme parks as a way to market brands and diversify revenues (Disney, DreamWorks and Universal all have parks in China). For a company of Mondo's size, diversification of this kind is less common but does reflect the group's growing ambitions and network in Asia. However, we estimate that the capital exposure represents less than 10% of the group's FY19e net assets.

Valuation

The shares peaked at €7 per share in December 2017 (shortly after announcing a deal with Netflix for *YooHoo & Friends*), but since then have been weak relative to peers and we believe the current price offers good value.

Mondo trades on EV/EBIT multiples of 7.3x and 5.5x in in FY18e and FY19e, respectively and P/E multiples of 9.8x and 7.9x in in FY18e and FY19e, respectively. This is a c 40-50% discount to peers on both multiples in both years. Mondo is forecast to deliver the fastest organic revenue growth in its peer group and has the highest EBIT margin. As such, the size of this discount seems exaggerated. Having said that, an element of discount may be appropriate given its smaller scale, emerging market exposure and the fact that content amortisation is not forecast to catch up with investment until 2020. Applying a 10x EV/EBIT multiple in FY19e (an arbitrary 20% discount to the peer group average) implies a value per share of approximately €9.2.

Announcements of additional licensing deals or significant new partners, which provide comfort that the group is delivering to budget, should help build confidence in the deliverability of Mondo's ambitious targets and close the significant discount to peers.

Exhibit 4: Peer group comparison

	Market cap (m)	Sales growth (%)		EBIT margin (%)		EV/Sales (x)		EV/EBITDA (x)		EV/EBIT (x)		P/E (x)	
		FY1	FY2	Last	Next	FY1	FY2	FY1	FY2	FY1	FY2	FY1	FY2
Mondo TV*	**145**	**47**	**25**	**46.4**	**54.9**	**3.4**	**2.7**	**4.4**	**3.6**	**7.3**	**5.5**	**9.8**	**7.9**
Children's entertainment													
DHX Media	480	58	5	16.5	19.0	2.8	2.7	11.0	10.4	14.9	14.9	17.5	15.3
Entertainment One	1,254	2	8	5.8	13.6	1.5	1.4	9.4	8.3	10.9	9.5	13.3	11.6
Xilam Animation	286	24	27	17.6	31.4	9.9	7.8	10.1	7.5	31.5	24.1	35.1	26.2
Toei Animation	136,080	13	4	24.9	N/A	2.6	2.3	NA	NA	NA	NA	16.0	15.3
Amuse	59,223	(6)	4	10.6	N/A	0.8	0.8	NA	NA	NA	NA	31.4	15.7
Italian media peers													
Mediaset	3,925	(2)	(5)	8.8	12.8	1.7	1.7	4.2	4.4	12.9	9.4	20.3	13.2
Arnoldo Mondadori Editore	430	(2)	(1)	5.5	5.1	0.5	0.5	6.3	6.0	10.0	8.7	13.0	10.8
Rai Way	1,274	1	3	37.6	39.0	5.9	5.7	10.9	10.5	15.1	14.1	21.9	20.2
Gedi Gruppo Editoriale	214	5	(2)	4.5	5.2	0.5	0.5	5.9	5.8	9.4	8.9	10.2	9.1
Italiaonline	345	(1)	4	8.3	10.5	0.8	0.8	3.4	3.2	7.5	6.4	15.8	13.3
Triboo	63	17	10	8.5	4.1	0.8	0.7	6.4	5.0	20.1	10.8	29.7	18.9
Axelero	(17)	8	6.0	(8)	1.3	1.2	16.3	12.2	(16.3)	(24.4)	(7.7)	(10.9)	(17)
Digitouch	20.5	25	27	2.2	10	0.7	0.5	4.6	3.5	7.1	4.9	NA	N/A
Average children's entertainment		18.6	11.3	14.3	21.4	3.5	3.5	10.2	8.7	19.1	16.2	19.3	16.9
Average Italy media		11.9	9.7	8.5	12.2	1.4	1.4	6.7	5.9	11.3	8.9	17.2	13.6

Source: Bloomberg. Note: Priced at 15 May 2018. *Mondo adjusted for EV of listed minorities. Based on Edison forecasts.

Exhibit 5: Financial summary

€m	2014	2015	2016	2017	2018e	2019e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	11.3	16.8	27.4	32.0	47.0	58.7
Cost of Sales	(3.8)	(7.9)	(9.3)	(7.0)	(10.8)	(13.8)
Gross Profit	7.5	8.9	18.1	25.0	36.2	45.0
EBITDA	7.5	8.9	18.1	25.0	36.2	45.0
Normalised operating profit	2.2	5.6	12.7	17.6	22.1	29.3
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	17.6	22.1	29.3
Net Interest	(0.4)	(0.1)	0.0	(2.2)	(0.5)	(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	15.4	21.6	29.0
Profit Before Tax (reported)	1.8	5.4	12.7	15.4	21.6	29.0
Reported tax	(0.0)	(2.2)	(4.5)	(3.1)	(5.8)	(7.8)
Profit After Tax (norm)	1.8	3.3	8.3	12.3	15.8	21.2
Profit After Tax (reported)	1.8	3.3	8.3	12.3	15.8	21.2
Minority interests	(0.1)	(0.2)	0.3	0.5	(0.7)	(2.2)
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	1.7	3.1	8.6	12.8	15.1	19.0
Net income (reported)	1.7	3.1	8.6	12.8	15.1	19.0
Basic average number of shares outstanding (m)	26	26	27	30	31	31
EPS - basic normalised (€)	0.07	0.12	0.31	0.43	0.49	0.61
EPS - diluted normalised (€)	0.07	0.12	0.31	0.43	0.49	0.61
EPS - basic reported (€)	0.07	0.12	0.31	0.43	0.49	0.61
Dividend (€)	0.00	0.00	0.02	0.00	0.00	0.00
Revenue growth (%)		48.5	63.2	16.8	46.6	25.1
Gross Margin (%)	66.4	52.7	66.0	78.1	77.1	76.6
EBITDA Margin (%)	66.4	52.7	66.0	78.1	77.1	76.6
Normalised Operating Margin	19.6	33.2	46.4	54.9	47.1	49.9
BALANCE SHEET						
Fixed Assets	19.6	25.0	37.0	47.9	54.9	61.1
Intangible Assets	9.7	16.1	31.4	44.1	51.1	57.3
Tangible Assets	0.3	0.3	0.3	0.4	0.4	0.4
Investments & other	9.7	8.5	5.3	3.4	3.4	3.4
Current Assets	27.5	32.2	37.8	53.6	62.3	77.8
Stocks	0.0	0.0	0.0	0.0	0.0	0.0
Debtors	18.4	22.3	31.7	47.9	45.0	42.0
Cash & cash equivalents	0.4	2.9	1.8	2.4	14.1	32.5
Other	8.7	7.0	4.3	3.3	3.3	3.3
Current Liabilities	(15.4)	(14.5)	(14.1)	(19.0)	(16.0)	(16.4)
Creditors	(10.2)	(10.9)	(11.7)	(15.0)	(12.0)	(12.4)
Tax and social security	(0.1)	(0.1)	(0.2)	(0.4)	(0.4)	(0.4)
Short term borrowings	(3.9)	(2.9)	(2.1)	(3.6)	(3.6)	(3.6)
Other	(1.3)	(0.7)	(0.1)	(0.1)	(0.1)	(0.1)
Long Term Liabilities	(0.6)	(0.4)	(0.8)	(0.7)	(0.7)	(0.7)
Long term borrowings	(0.2)	(0.2)	(0.6)	(0.7)	(0.7)	(0.7)
Other long term liabilities	(0.4)	(0.2)	(0.2)	0.0	0.0	0.0
Net Assets	31.2	42.3	59.9	81.8	100.5	121.7
Minority interests	1.0	1.4	0.6	0.6	0.6	0.6
Shareholders' equity	32.2	43.7	60.4	82.4	101.1	122.2
CASH FLOW						
Op Cash Flow before WC and tax	7.5	8.9	18.1	25.0	36.2	45.0
Working capital	(2.8)	(0.4)	(1.9)	(11.2)	(0.0)	3.4
Exceptional & other	(0.5)	1.0	0.7	(2.1)	0.0	0.0
Tax	(0.0)	(2.2)	(4.5)	(3.1)	(5.8)	(7.8)
Net operating cash flow	4.1	7.3	12.5	8.7	30.3	40.5
Capex	(7.3)	(9.8)	(20.6)	(19.2)	(21.1)	(21.8)
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(0.3)	(0.2)	(0.2)	(0.2)	(0.5)	(0.3)
Equity financing	3.4	6.1	7.2	9.4	3.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.2	0.1	0.3	0.1	0.0	0.0
Net Cash Flow	0.1	3.4	(0.7)	(1.2)	11.7	18.4
Opening net debt/(cash)	3.7	3.6	0.2	0.9	2.0	(9.7)
FX	0.0	0.0	(0.1)	0.1	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	0.9	2.0	(9.7)	(28.2)

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

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia