

# Iervolino Entertainment

Sector: Media content production

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## The show must go on

Iervolino Entertainment (IE) is an Italian cinema and TV production company with a *Hollywood* footprint, listed on AIM Italia since August 2019. It produces diversified contents for an international audience, focusing on the core production phases and IP ownership and exploitation.

### A play on the increasing appetite for visual contents

While the global content distribution industry is facing the arm-twist among streaming platforms, content producers are benefitting from distributors' deep pockets to be invested in original contents. IE, which is becoming a provider of diversified video contents - ranging from Hollywood style movies to TV film and series and web animation series - should benefit from such an increasing appetite.

### Buoyant 2019 and further €320mn revenues over 2020-22E (on current slate)

Our 2020-22E forecasts are based on the current Company's pipeline, i.e. only on those productions secured with formalised agreements. Yet, our model shows further average 28% growth at top line and 9% at bottom line in 2020-21E after the buoyant 2019 results (doubling revenues and profits). We assume negative top line growth in 2022E, as current pipeline starts fading, but this suggests some upside risks from 2021E onwards. Also, forecasts do not capture most of FCF expected from IE's slate (as free cash flow lags behind revenues recognition in this industry): model shows positive FCF only from 2021E, but we estimate cumulated 2020-24E FCF at around €70m or 60% of current market cap.

### Risk factors are more over the longer term

IE offers good growth potential at attractive value, but it also incorporates two specific risks in our view: 1) Role and relationships of its founder and CEO are still key to operations, also given the very lean management team; 2) The industry is extremely dynamic (technology, innovation, tastes) and keeping the pace may be challenging for smaller players as IE. On the other hand, with most of revenues linked to short animation web contents, we see the company as relatively safe from potential implications of Covid19 outbreak (eg temporary collapse in theatrical revenues).

### Base fair valuation supports good upside to €5.1

We value the stock relative to a peers' group, based on EV multiples on Sales and EBIT and P/E, while we see EBITDA as not meaningful given accounting practices. We focus on European small and mid size content producers and set our base fair value at €5.1 per share corresponding to 1.7x EV/Sales, 7.7x EV/EBIT and 8.5x P/E for 2020E. These multiples would put IE at material premium to most Italian peers, not directly comparable in our view, and at discount to closest French peers.

**Fair Value (€) 5.10****Market Price (€) 3.30****Market Cap. (€m) 115.5**

KEY FINANCIALS	2019A	2020E	2021E
REVENUES	80.0	108.8	130.4
EBITDA	75.4	102.2	124.1
EBIT	22.6	24.3	28.3
NET PROFIT	20.3	21.0	24.1
EQUITY	47.6	68.8	92.9
NET FIN. POS.	-0.5	-7.4	-4.3
EPS ADJ. (€)	0.60	0.60	0.69
DPS (€)	0.00	0.00	0.00

Source: Company (historical figures),  
Value Track (2020E-21E estimates)

RATIOS & MULTIPLES	2019A	2020E	2021E
EBITDA MARGIN (%)	94.3	94.0	95.2
EBIT MARGIN (%)	28.3	22.3	21.7
NET DEBT / EBITDA (x)	0.0	0.1	0.1
NET DEBT / EQUITY (x)	0.0	0.1	0.1
EV/SALES (x)	1.5	1.1	1.1
EV/EBIT (x)	5.1	5.1	5.1
P/E ADJ. (x)	5.5	5.5	5.5
DIV YIELD (%)	nm	0.0	0.0

Source: Company (historical figures),  
Value Track (2020E-21E estimates)

STOCK DATA	
FAIR VALUE (€)	5.10
MARKET PRICE (€)	3.30
SHS. OUT. (m)	35.0
MARKET CAP. (€m)	115.5
FREE FLOAT (%)	17.1
AVG. -20D VOL. (#)	54,000
RIC / BBG	IE.MI / IE IM
52 WK RANGE	1.68-6.06

Source: Stock Market Data



## Table of Contents

<b>Executive Summary</b>	<b>3</b>
<b>Iervolino Entertainment at a glance</b>	<b>5</b>
<b>Reference market</b>	<b>9</b>
<b>Iervolino Entertainment Business Model</b>	<b>15</b>
<b>Corporate Strategy</b>	<b>25</b>
<b>Recent results &amp; developments</b>	<b>27</b>
<b>Forecasts 2020E-22E</b>	<b>32</b>
<b>Valuation</b>	<b>37</b>

## Executive Summary

### Iervolino Entertainment in a nutshell

Iervolino Entertainment (IE) is an **Italian cinema and TV production company** with a Hollywood footprint. It produces diversified contents - ranging from Hollywood style movies, to TV film and series and web animation series - for an international audience.

IE focuses on the core production phases and IP ownership and exploitation, with a very risk-adverse approach: it tends to get full funding of new productions ahead of kick-off and leaving most of box-office risk to Sales Agents and distributors. The stock was listed on AIM Italia in August 2019 with an IPO that brought to the Company ca €9mn net cash to fund its growth in content production and the recent diversification into new segments, as animated web series and short contents.

**We initiate coverage with a fair value of €5.1 per share**, which offers a material upside to the current market price.

### Still top line potential after +130% y/y in 2019 and FCF will follow

Our forecasts are based on the existing pipeline, i.e. on those revenues already secured via formalised agreements with Sales Agents and distributors. Among these we include the delivery of five movies to Paradox for a total value of \$12mn over 2020-21E, whose final details have not been released yet, but where a framework agreement already provides good visibility on terms.

On our assumptions the Company should deliver another two years of **strong top line growth (average 28%) into 2021E after the 130% recorded in 2019. We also expect 12% for EBIT and 9% for Net Profit** and over this period, we expect IE not to absorb any free cash flow, which together with the IPO proceeds, should help maintaining net debt at very low levels (2021E net debt at €4.3mn, with Net Debt/EBIT at 0.1x).

From 2022E we assume results to start weakening as the existing pipeline is mostly delivered and hence, given our key assumptions in terms of productions and content deliveries over our forecast horizon, we see more upside than downside risks. In fact, some **potential upside for 2021-22E forecasts** is linked to productions already identified but not formalised yet and from new projects, while the major downside risk on what has been already incorporated is mostly related to delays, i.e. shifting of planned deliveries from one quarter to the following(s). Having said this, the **actual timing of content deliveries is a generalised risk for this industry**, where revenues recognition may easily switch from a quarter to another, potentially depending on a delay of a few weeks.

Finally, it is worth adding that **forecasts into 2022 do capture only part of the FCF expected** from the existing slate, as in the content production industry free cash flow of a certain production lags behind its revenues recognition. We estimate 2020-24E cumulated FCF (assuming productions planned as of today) to be around €70mn or 60% of market cap.

### Growth driven by the increasing appetite for audio-visual content

The **global demand for audio-visual contents (e.g. movies, short content, series) is increasing**, driven by streaming platforms, which are facing dramatic changes at global level.

These changes in the global distribution industry, with new platform launches, M&A with content providers and massive production budgets to secure (and retain) subscribers and usage – are boosting appetite for video contents and are likely to favour pure content providers with a diversified offer.

We believe this represents **a window of opportunity also for the smaller independent names** as IE.

### Base fair valuation at €5.1 per share

In terms of valuation we see a material upside in the stock and set a **base fair value at €5.1 per share** (compared to August 2019 IPO price of €1.95 and current market price of €3.3).

This value comes from a peers' multiples approach, based on average 2019-21E EV/Sales, EV/EBIT and P/E multiples of a relatively small group of EU peers.

Within these names we believe IE deserves a premium to most of the Italian peers, given their different size, international exposure and business mix, while we see as more comparable its French competitors, less exposed to distribution and active in the animation segment.

Our fair value put the stock at 1.7x EV/Sales, 7.7x EV/EBIT and 8.5x P/E for 2020E.

### Iervolino Entertainment multiples at current market price and at fair value

	EV / Sales (x)		EV / EBIT (x)		P / E (x)	
	2020E	2021E	2020E	2021E	2020E	2021E
IE @ €3.3 mkt price	1.1	0.9	5.1	4.2	5.5	4.8
IE @ €5.1 fair value	1.7	1.4	7.7	6.5	8.5	7.4

Source: Value Track Analysis

As a **cross check** we have also run a “**reverse valuation**” to calculate what is the amount of new production projects (still to be formalised or announced) implied in the current market capitalization and in our multiple-driven fair value. This exercise - based on a simplified DCF model - hints that:

- ◆ Current market value of the Company mirrors long term additional annual revenues at €18mn (excl. tax credits and all the rest being equal), well below 2019-22E average of €90mn per year;
- ◆ Our fair value (derived from the selected peer group's market multiples) implicitly incorporates long term annual revenues of €44mn or, alternatively, it assumes that management is able to secure new productions worth €340mn, on a cumulate basis, by 2024 (which is to replicate what already achieved for delivery over 2020-22E).

### Key concerns

- i) The main element of risk for the stock is in our view related to the **key role of Mr Andrea Iervolino**, founder, CEO and Chairman of the company. Given the lean management structure and the importance of Mr Iervolino's relationships in the industry, the Company is still highly dependent upon its founder. While the increasing number of people in the corporate structure and the new Los Angeles branch should support a gradual transition to a more managerial structure, the process is likely to take some time;
- ii) IE currently benefits from **State contributions** – mostly via tax credits – to support domestic content productions. While we do not see at this stage a short-term risk for this supports to be frozen, we reckon that any change in fiscal legislation making more difficult for IE to achieve these benefits or any material reduction of funds supporting these tax credits may affect the Company. These funds also represent a competitive advantage within the industry, as most UE members provide this kind of supports to incentivise local content development;
- iii) Last but not least, we highlight that the content industry is facing massive changes from many standpoints: distribution channels, technologies, regulations and consumption patterns. The **pace of innovation** is faster and faster, and it will be crucial for IE to keep the pace despite its relatively smaller size within the global industry.

## Iervolino Entertainment at a glance

*Iervolino Entertainment is an Italian cinematographic production company with a global footprint that, through its headquarters in Rome and thanks to its founder and CEO's relationships and experience in the world of Cinema, is able to produce "Hollywood Style" movies and web series. These contents appeal to the international viewers and, on the other hand, they are eligible to Italian tax credits.*

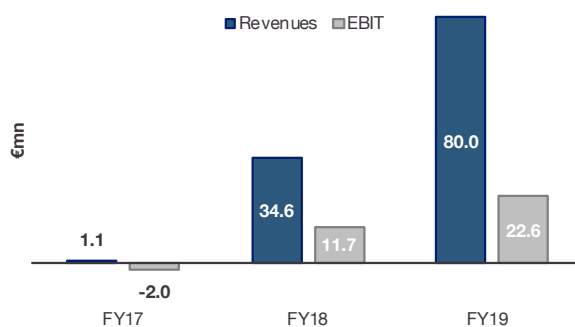
*The company was listed in August 2019 on AIM Italia and the IPO proceeds are funding the accelerating growth in high quality and innovative contents for cinema, TV and streaming platforms.*

Iervolino Entertainment (IE) is a young company that has been able to grow exponentially over 2018-2019E, thanks to new movies and web series of high value such as, in the last two years alone, the Venice Film Festival acclaimed *Waiting for the Barbarians* (starring Mark Rylance, Johnny Depp and Robert Pattinson), *The Poison Rose* (starring John Travolta and Morgan Freeman) and the animated web series of *Arctic Justice*.

Iervolino Entertainment also entered the celebrity management businesses in the last two years, with not significant revenues yet from these activities, but this is an "ancillary" business to core activity.

IE started to invest into Hollywood-style content-productions directly only in 2018 and hence its P&L has dramatically changed over 2018 and 2019 (see chart below).

### Iervolino Entertainment: Financials in a snapshot - Revenues and EBIT



Source: Iervolino Entertainment

The company business is highly correlated and tied with its founder, Mr. Andrea Iervolino, who has an extensive career in the Cinema industry and has been involved in the production and co-production of movies since 2004. Boasting more than 60 movies produced or co-produced he has been able to build his network both in Hollywood as well as in Italy.

## Historical Milestones

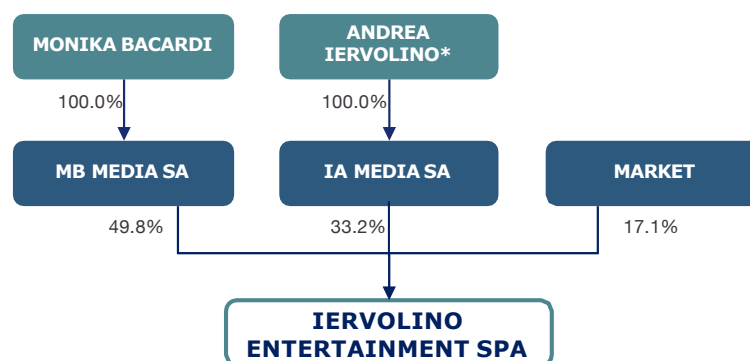
Iervolino Entertainment is a young but “experienced” company as its founder and CEO, Mr. Andrea Iervolino has an enormous amount of experience in the Cinema Production Industry :

- ◆ Since 2003 Mr. Iervolino has been involved in the Cinema Production Industry as a producer, co-producer and assistant producer, working in the United States with acclaimed stars such as Oscar winner Mark Rylance, John Travolta, Morgan Freeman and Robert Pattinson among the many.
- ◆ Iervolino Entertainment was founded in 2011 by Mr. Andrea Iervolino and Monika Bacardi in Rome, in order to establish an Italian production company capable of selling its products in the global markets and appealing to an international and cosmopolitan audience. In 2014 Mr. Iervolino received the “Mimmo Rotella” Award as Best Producer, in 2015 becomes “Ambassador of Italian Cinema in the World” and received further awards since then
- ◆ In 2018 Mr. Iervolino merged all the production activities into Iervolino Entertainment Spa that in the same year started the production of the animated Web Series *Arctic Justice* and the movie *The Poison Rose*.
- ◆ In 2019 IE produced the movie “Waiting for the Barbarians”, starring Oscar Award winner Mark Rylance , Johnny Depp and Robert Pattinson.
- ◆ On the 5<sup>th</sup> of August 2019 Iervolino Entertainment become a publicly traded company on AIM Italia, the MTF regulated by the Milan Stock Exchange, with an initial market capitalization of €43mn and almost €10mn gross proceeds.

## Shareholders' structure

The company is controlled by Mr. Andrea Iervolino who owns, through his company IA Media SA, 33.17% of the shares (but holds 59.7% of voting rights thanks to multiple-voting shares), Mrs. Monika Bacardi owns 49.75% of the company through her company MB Media SA while 17.09% of the shares are on the market.

### Iervolino Entertainment: Shareholding structure

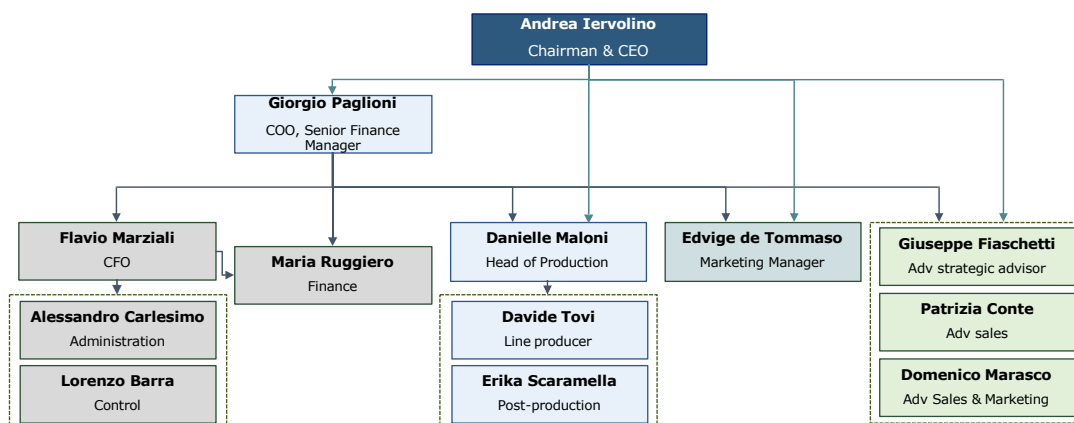


Source: Iervolino Entertainment (\*) Andrea Iervolino owns 59.7% of voting rights

## Top Management

Iervolino Entertainment has a very “lean” management structure with experienced professionals that have spent a considerable part of their careers in the cinema and TV industry as well as other members with more “administrative” roles in primary consultancy and audit companies.



## Iervolino Entertainment: Management structure



Source: Iervolino Entertainment

The founder, CEO and Chairman of Iervolino Entertainment, Mr. Andrea Iervolino, has been working in the world of Cinema for more than 20 years as of today and, together with his team, they form a group of experienced professionals that has collaborated for more than 15 years, producing and co-producing an extensive number of movies (see list below).

### Andrea Iervolino track record

	Film	Role	Year	Film	Role	Year
	1. Memento (announced)	P	--	32. Tutte le strade portano a Roma	P	2015
	2. The Devil May Care (pre-production)	P	--	33. Bilal: A New Breed of Hero	ExP	2015
	3. Trophy Wife (pre-production)	P	--	34. Andr�n: The Black Labyrinth	P	2015
	4. Bernie the Dolphin 2 (post-production)	P	--	35. Septembers of Shiraz	Co-P	2015
	5. This Is the Year (post-production)	P	--	36. Hope Lost	ExP3D/P	2015
	6. Lamborghini (post-production)	P	2020	37. Tre tocchi	P	2014
	7. Waiting for the Barbarians	P	2019	38. The Humbling	Co-P	2014
	8. Arctic Justice (completed)	P	2019	39. 2047: Sights of Death	P	2014
	9. The Poison Rose	P	2019	40. Fear (TV Series)	P	2014
	10. Safe Spaces	ExP	2019	41. Il telefono (Short)	P	2014
	11. Trading Paint	P	2019	42. Bad Girl (Short)	P	2013
	12. Bernie The Dolphin	P	2018	43. L'invito (Short)	P	2013
	13. Welcome Home	ExP	2018	44. Come il vento	Co-P	2013
14. Future World	P	2018	45. Il weekend degli eroi (Short)	P	2013	
15. Qui e ora	P	2018	46. The Stalker	P	2013	
16. The Guardian Angel	ExP	2018	47. Outing - Fidanziati per sbaglio	P	2013	
17. Bent - Polizia criminale	P	2018	48. La mia mamma suona il rock	P	2013	
18. Finding Steve McQueen	P	2018	49. Una notte da paura (TV Movie)	P	2012	
19. Za granyu realnosti	ExP	2018	50. Si pu� fare l'amore vestiti?	ExP	2012	
20. Beyond the Sun	P	2017	51. E io non pago	P	2012	
21. La musica del silenzio	ExP	2017	52. Il paese delle piccole piogge	P	2012	
22. Black Butterfly	P	2017	53. Operazione vacanze	P	2012	
23. In Search of Fellini	P	2017	54. Napoletans	P	2011	
24. Fino all'osso	P	2017	55. L'arrivo di Wang	Co-Ex-P	2011	
25. Finding Soraya (Documentary)	P	2016	56. Almeno tu nell'universo	Co-Ex-P	2011	
26. East End	P	2016	57. Una cella in due	Co-P	2011	
27. This Beautiful Fantastic	P	2016	58. Gorbaciof	Co-Ex-P	2010	
28. In Dubious Battle	P	2016	59. Dopo quella notte	P	2010	
29. The Bleeder	P	2016	60. L'allenatore nel pallone 2	Ass. P	2008	
30. Rupture	EP	2016	61. Il mercante di Venezia	Co-Ex-P	2004	
31. Lavender	ExP	2016				

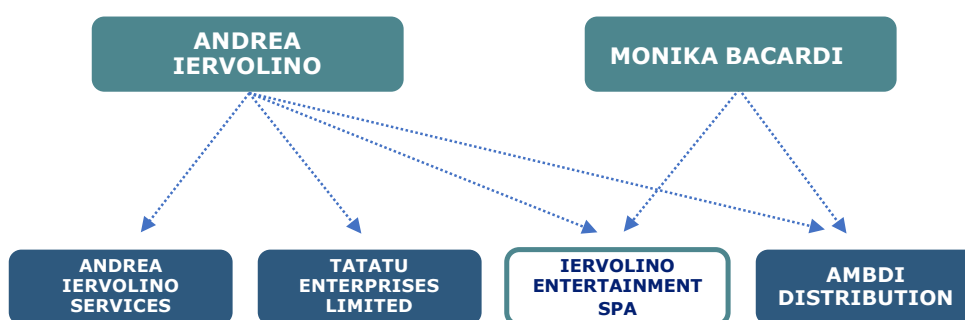
Source: Iervolino Entertainment

## Group structure

As of today Iervolino Entertainment does not have subsidiaries or any minority interest in other entities but it nonetheless has many correlated business through its owners Andrea Iervolino and Monika Bakardi, with the main ones being “AMBI Distribution”, active in the cinema distribution business, Ladybug Film SRL until 2019 (year in which the CEO decided to take personal ownership of the company), Iervolino Services Inc. and TaTaTu Enterprises LTD. The main related companies are graphed in the chart below, but we expect interests and deals with related parties to reduce significantly after 2019.

Iervolino Entertainment financial statements are presented according to IFRS guidelines.

### Mr. Iervolino and Ms. Bakardi interest stakes in related companies



Source: Company Documents

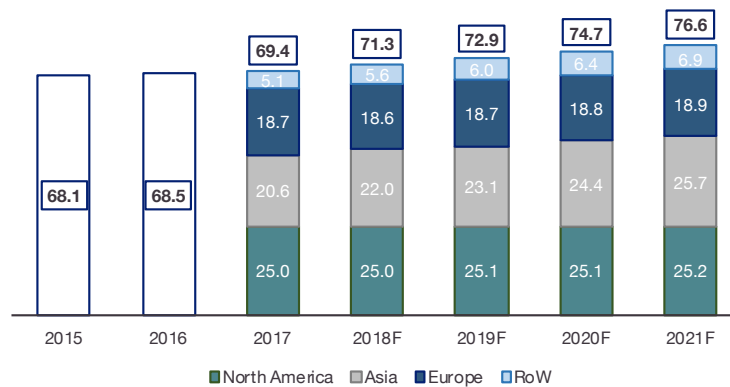


## Reference market

The “Media and Entertainment” is a subcategory of the broader “Media” market and it encompasses the activities of production and distribution of films, video content and music production, in 2017 the “Media and Entertainment” market was worth, on a global scale, 70 billions dollars out of which roughly 30% is represented by the United States of America.

The main forecasts see a moderate growth until 2021.

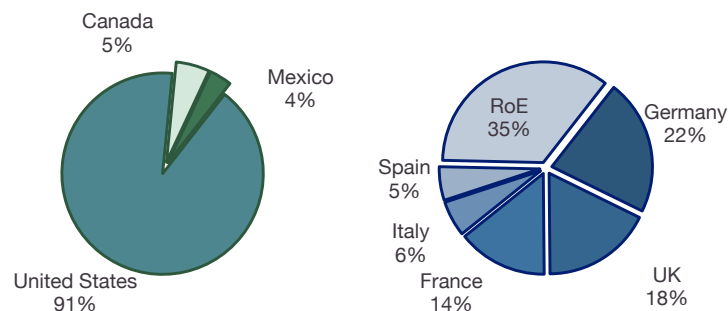
### Forecasted growth for the “Media and Entertainment” by markets



Source: Market Line –“Movies & Entertainment”, July 2018 – MarketLine – “Media”, July 2018

Italy is the fourth market in Europe in terms of films production and distribution, while it represents only 1.5% of the global market.

### Market share of single countries in North America and Europe



Source: Market Line –“Movies & Entertainment”, July 2018 – MarketLine – “Media”, July 2018

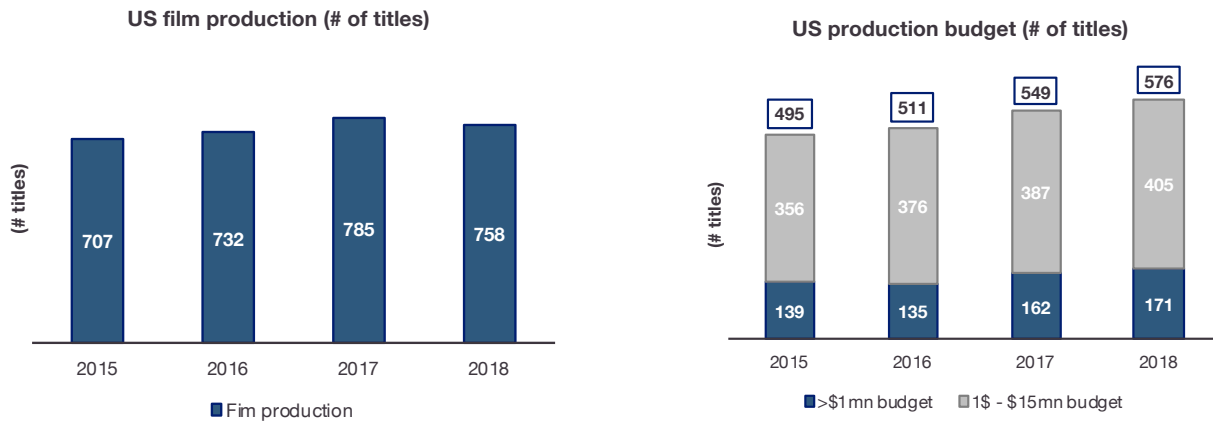
## The Film Production Market

In the biggest market in the world, **North America**, about 760 films were distributed in 2018, this figure is slightly lower compared to the previous year but it confirms the growth trend of the past years.

In terms of Box Office revenues, it is important to highlight that

- i) 95% of the overall revenues went to the top 140 grossing movies (18% of total movies distributed);
- ii) more than 75% of titles had budgets below \$15mn in 2018 (vs ca 70% over 2015-2017);
- iii) the budget for North American movies is steadily increasing boasting a CAGR above 5% in the period from 2015 to 2018.

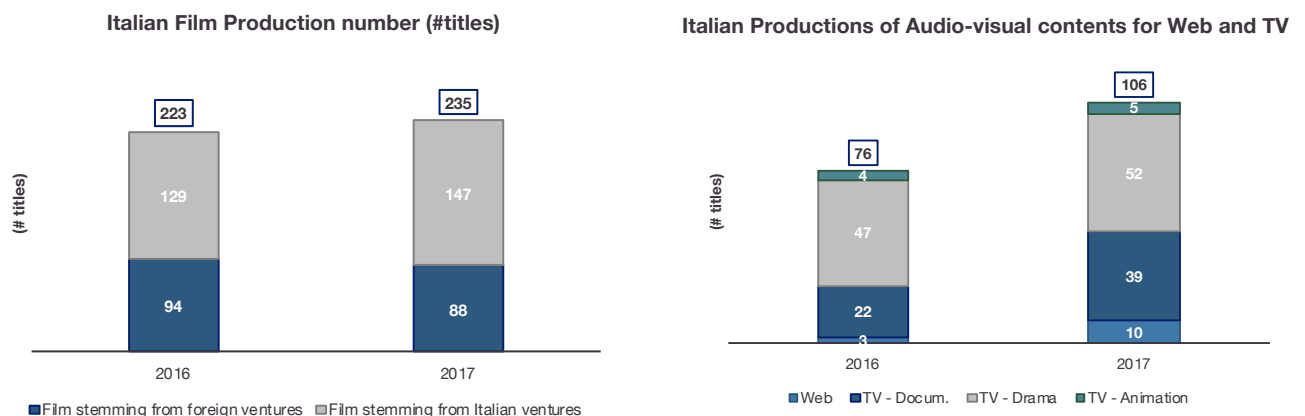
**North American Film Production and split by Budget (# of titles)**



Source: MarketLine – ‘Movies & entertainment’, July 2018; MarketLine – ‘Media’, July 2018

In Iervolino Entertainment’s home country, **Italy**, film production continues to rise each year especially thanks to the favourable Tax Credit regime introduced in 2016 and extended to non-film related audiovisual contents more recently. Yet, almost one third of films produced in Italy, is not considered to be Italian as they do not meet the criteria set out in the Franceschini Law while IE’s productions are considered to be Italian and thus they have access o the favourable Tax Credit regime.

**Italian Film and other Audiovisual productions (# of titles)**

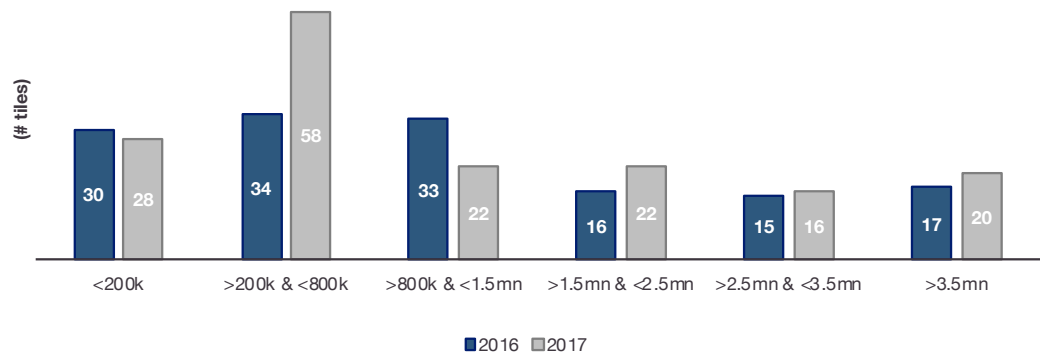


Source: MarketLine – ‘Movies & entertainment’, July 2018

Source: ANICA (Italian National Association for the Film Sector) - 2017

The average budget of Italian productions and co-productions in 2017 was equal to €1.5mn, slightly lower than 2016 which stood at €1.8mn. The chart below shows how the Italian production was split by film’s budget..

**Italian productions and co-productions by budget**

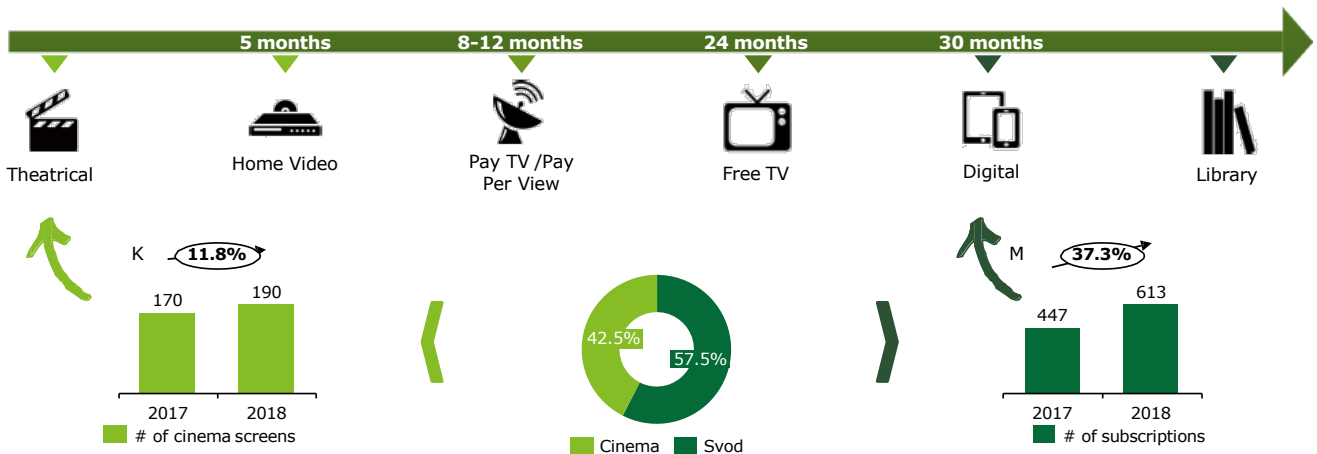


Source: ANICA (Italian National Association for the Film Sector) - 2017

**The Global Film Distribution**

The “Distribution” phase of the “Media & Entertainment” sector value chain has witnessed a profound and ever-lasting transformation related to the development of the new digital technologies, among which the main one is the Internet, that have widened the ways of fruition of the contents and subsequently also the revenue sources for the production companies, while it is reshuffling the competitive scenario of distributors.

**Film Distribution Supply Chain and Time to Screen on different platforms**



Source: MPAA, THEME Report 2017

Theatres and Cinemas nowadays represent only the first phase of a distribution supply chain that throughout the years has seen the entrance of new players and platforms (Free TV and Home Video back first, Pay TV and digital devices later) and, today, Cinemas and Theatres represent one of the two

ways through which a Film or a video content can reach the audience whilst the other is represented by “Subscription Video On Demand” providers.

In 2018 the total “Box Office” revenues represented less than half of the total revenues stemming from the cinematic distribution on a global level and at the same time, the growth rate of the subscriptions to Video on Demand Providers is way higher than the number of cinema screens.

### Focus on the Video On Demand market

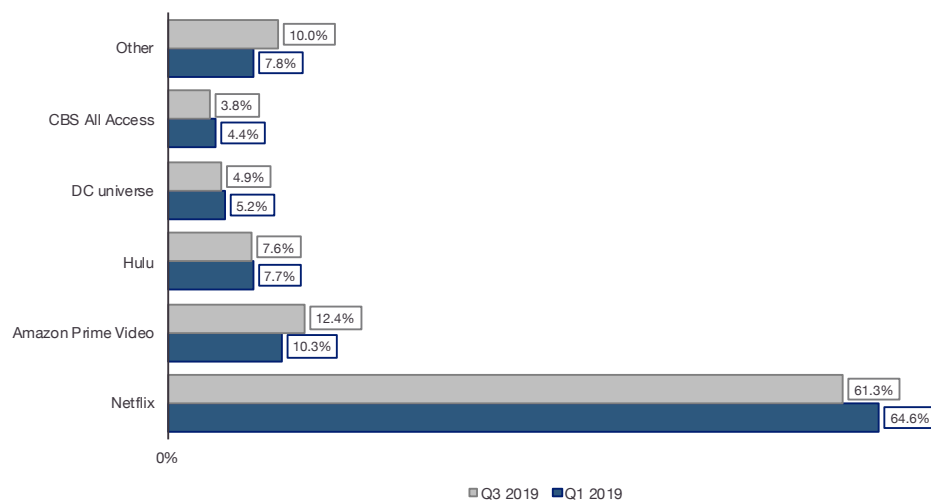
The explosive growth in the diffusion of the Internet in the entire World has allowed new and agile platforms and distributors to reap the benefits of a global audience reachable in every moment.

More than 92% of Internet users watches video online with streaming services comprising 58% out of that figure.

The market of On-Demand-Videos includes the:

- ◆ The “Subscription Video On Demand”, also known with the acronym of “Svod” with Netflix being a notable example representing, as of Q3 2019 61% of all the subscribers.
- ◆ The “Transactional Video-On-Demand” category “TvoD” includes instead the contents acquired through a unique transactions, popular examples of “TvoD” services providers are “Sky Box Office”, “Amazon Video Store” and “Apple’s iTunes”.
- ◆ The “Advertising-based video on demand” (“Avod” that, unlike Svod and Tvod, is free to consumers but the costs are recovered through advertising, as “YouTube”).

#### Market share of main Video-on-Demand player (# of subscribers)

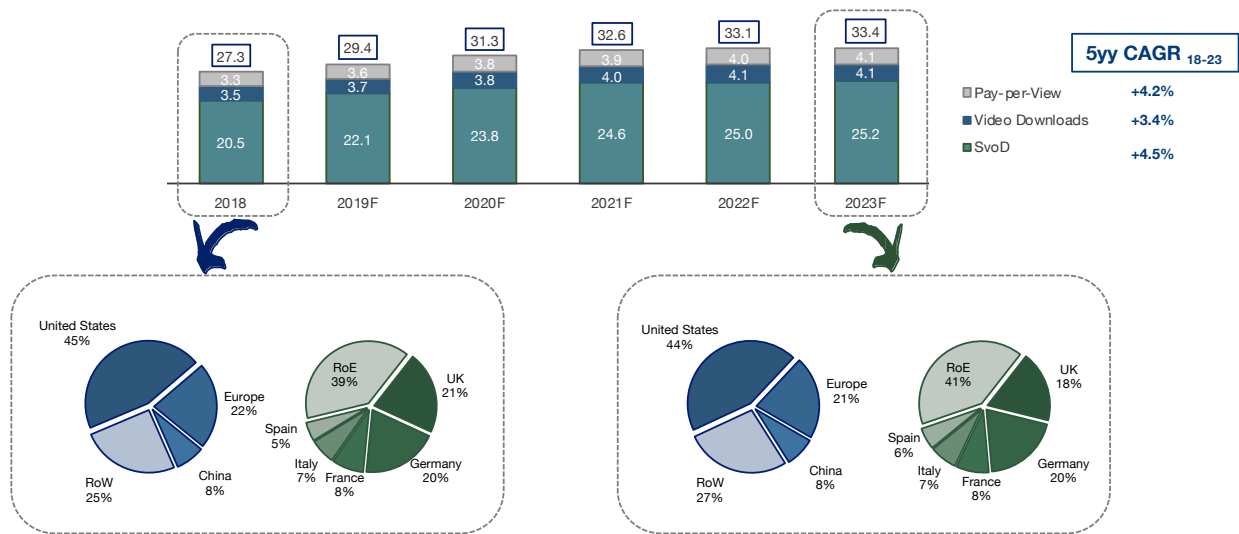


Source: Statista, Parrott Analytics , 2020

The market for On-Demand-Videos has reached in 2018 the milestone of 28 billion euros of revenues and it is expected to grow at a CAGR equal to 4.1 % until the year 2023.

The growth of the market is strictly connected to the easiness of access to contents granted by mobile devices and digital platforms that allow the user to enjoy a vast choice of Media and Entertainment products how and when they like.

The Video-on-Demand Market at a Glance



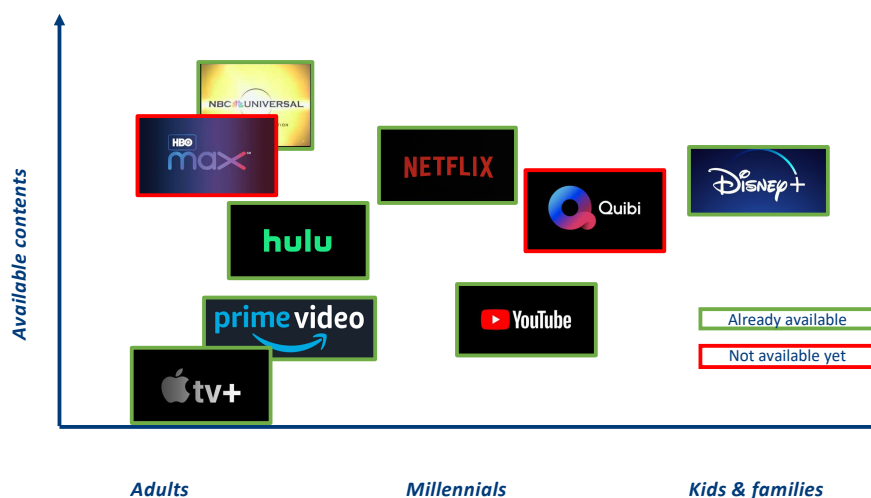
Source: Statista Digital Market Outlook, 2019

The OTT platforms phenomenon

The easiness of access and the development of contents which are really “ubiquitous” – i.e. can be viewed from virtually any device (smartphone, console, tablet) and any connection (in-house or in mobility) – have paved the way for OTT distributors. **These streaming services in fact bypass all the platforms that traditionally controlled or distributed media contents** (cable, broadcast and satellite) and stream contents directly to viewers/customers.

The graph below shows the market positioning of the most popular video streaming platforms, based on the amount of media contents currently available to their viewers and their specific target market (kids, millennials and adults).

Market positioning of most popular OTT video streaming platforms



Source: Various, Value Track Analysis

The key implications of this competitive scenario are:

- ◆ Rising appetite for original contents in general, as the new platforms need to secure new subscribers and position in their target audience;
- ◆ Increasing demand for short contents, as discussed below, due to the changing patterns of view and listening;
- ◆ Increasing interest for Millennials, Plurals and kids contents, being a highly valuable marketing target, less loyal and more dynamic than adults.

### The rising demand for short-form videos

Thanks to the rise in the last decade of mobile-devices as medium to consume Entertainment Products short-form contents are becoming evermore important for entertainment producers given the fact that consumers of short-form contents are more eager to watch advertising if targeted.

According to a survey conducted by Deloitte US 74% of American consumers watch short-form contents, as well as being much more receptive to advertising thus making short-form content a very lucrative market segment.

In a “vicious circle” tough to fully evaluate, all the latest researches highlight **how the attention span for Millennials and young children has dramatically shortened and a totally new phenomenon as “binge viewing” has emerged**. In this context notable shows and series both on Youtube as well as on different platforms such as the Disney backed Hulu or Netflix or Amazon Prime Video are broadcasted each day in short form by different producers of the likes of BuzzFeed, Condé Nast, Verizon, WarnerMedia, Disney, Discovery Channel etc. Some of these contents are distributed through platforms that are set up as SvoD (Netflix, Disney, Amazon Prime) while others are AvoD (Youtube).

Important examples of short form series (both traditional and animated) are the Millennials-appealing “Worth It” and “Try Guys” by BuzzFeed that air on Youtube, “Guardians of the Galaxy” animated series by Disney aimed at children which airs on TV, “City Girls” by WarnerMedia, the comedy series “Robot Chicken” by Sony Pictures Television and many others.

**All the important distributors are thus targeting the evermore important market for short video streaming and this trend is expected to continue.**

One of the most important Hollywood producers and media proprietor, Jeffrey Katzenberg, is about to launch, on the 6<sup>th</sup> of April “2020, the new short-form contents streaming service designed exclusively for mobile, called “Quibi”. The project has raised more than \$ 1.4 Bn of funding from investors like Disney, Viacom, Alibaba, Liberty Global, Goldman Sachs, JP Morgan and the Walton family.

## Iervolino Entertainment Business Model

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*Iervolino Entertainment produces high-quality, “Hollywood Style” movies and contents appealing to an international audience: movies, TV movies and series, short videos as well as animated web series. IE has been able to find a niche in the international cinematographic market in that it is an Italian production company with an international audience, this allows IE to circumvent the restrictions placed on Hollywood Productions in key markets such as China while at the same time employing American Star Actors that are easily recognizable worldwide. Being an Italian company also allows IE to benefit from the tax credits and incentives supporting the Cinema Industry as well as to comply with the EU contents’ quotas required to EU broadcasters (and likely also to VoD and streaming platforms in the future).*

*Besides the production business, IE has also become manager of important international actors for the Italian Market, but Celebrity Management should be seen as an “ancillary” business. In 2019 IE also announced the launch of an Advertising Agency Business, however this project is likely to be reconsidered.*

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### Production business

IE is positioned in a unique niche of the Cinema and production industry since it is an Italian and European company with Hollywood actors and style of play, this allows the development of products that can have a big appeal to international viewers and are not designed exclusively for the Italian audience, but also reaping the benefits of being an Italian company, thus:

- ◆ not facing the sort of limitations that American companies face in China;
- ◆ benefitting from Tax Credits (mostly granted by the Franceschini Law of 2016) on a considerable amount of costs related to domestic production;
- ◆ entering in the EU contents’ quota already applied to EU broadcasters but likely to be imposed to VoD and streaming platforms in the next future - the European Parliament has agreed on updated rules on audiovisual media services, including a 30% quota for UE contents, which still need to be formally approved by the Council of EU ministers before the revised law can enter into force.

IE produces the entirety of its production in English in order to reach all of the World’s markets as well as being easy to dub and mix. Also, the Company is a pioneer in the Italian Market for the production of short video contents that, according to the latest industry trends will represent an ever more important market segment in the coming years, especially for kids and Millennials.

The production of short animated web series is also a distinctive feature of IE and the positive experience of the first season of “Arctic Justice” (a contract for a 190 episode series was already formalized) brought another multiannual contract with Paradox.

### The Cinema Production Process and Distribution

IE is a “pure” cinema production company in that it does not take care of the Distribution and Print&Advertising phases, a feature that allows IE to pass many risks typical of the Cinema Industry to the Distributors and Sales Agents.

IE generates or buys ideas from scratch from different sources both internally and externally (for example, the movie “Waiting for the Barbarians” is based on a script from the homonymous book) and, through the development of the idea and screen adaptation, IE creates valuable Intellectual Properties.

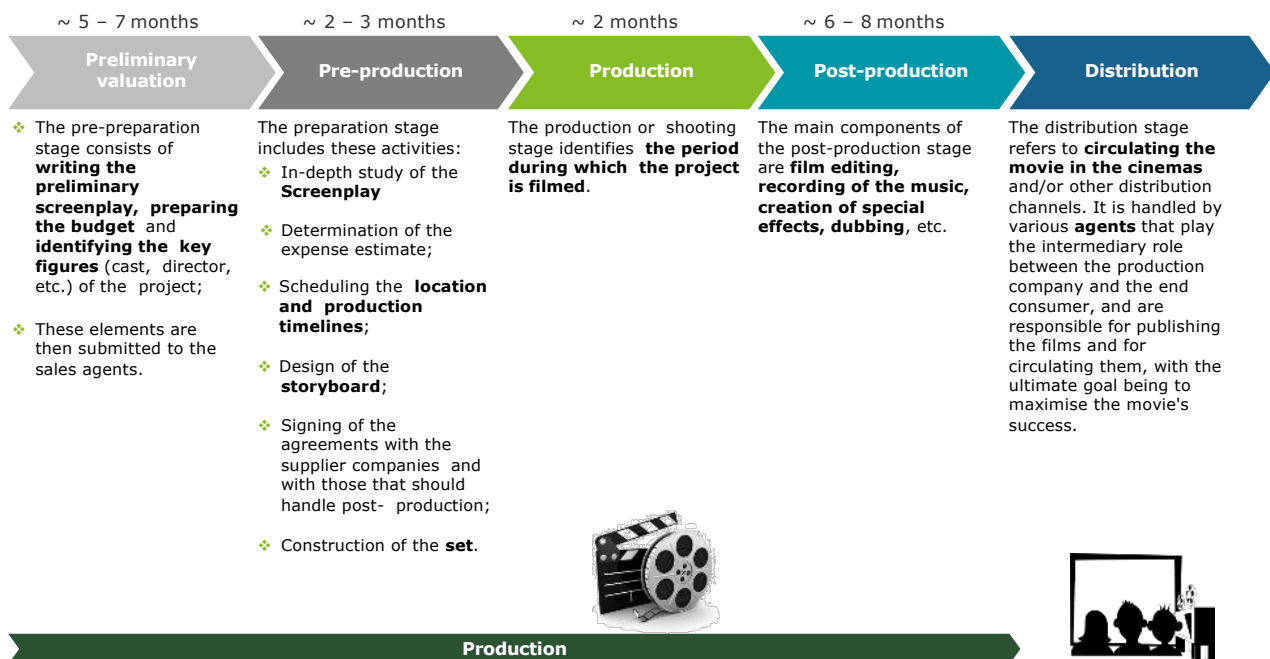
There are four different phases of the Value Chain that IE engages to bring an idea to a movie (or short content) ready to be displayed on the screens, while the last phase is left to sales agents and distributors.

These steps represent the “core” of IE business (albeit “Production” and “Post-Production” may be outsourced under strict supervision of IE):

- ◆ “Preliminary Valuation” is the first stage of idea generation and preliminary screenplay writing which includes the identification of key figures such as cast and directors;
- ◆ After the “Preliminary Valuation” IE engages in the “Pre-Production” stage in which the Company studies the screenplay, determines expenses and locations and designs the storyboard;
- ◆ In the “Production” stage the Company carries out the filming and shooting of the movie;
- ◆ In the “Post-Production” stage the content is edited, mixed, modified with special effects, dubbed.

Usually, once a movie is created, the production company sells its distribution rights or grants them in license to sales agents that are responsible for finding the right channels of distributions. At that point IE starts to get paid (typically via minimum guaranteed), although producers often receive early payments as production starts/progresses.

### The different stages of the Production process



Source: Iervolino Entertainment

### Many distributors and channels to reach viewers

IE, as a Production Company, buys, creates and manages Intellectual Property Rights that represent the bulk of its revenues. Once IE creates a new movie, web series or short video, that content becomes indefinitely protected by Intellectual Property Rights, IE will then sell some of its rights to agents (usually the Distribution Rights of the content) who will then proceed to find suitable distributors for the end users.

Nowadays end users can reach new video contents through different distributors such as cinemas, television, pay-tv, AVOD distributors (Advertising-based video on demand), SVOD (Subscription-based video on demand), TVOD (transactional video on demand). The crowded arena of Over The Top



(OTT) platforms is widening the spread of new distributors and channels of distribution and should allow production companies and IE to gain faster recognition and better leverage of IPs.

**Some of the main Distributors in the Italian market**



Source: Iervolino Entertainment

**Many ways to exploit Intellectual Property Rights**

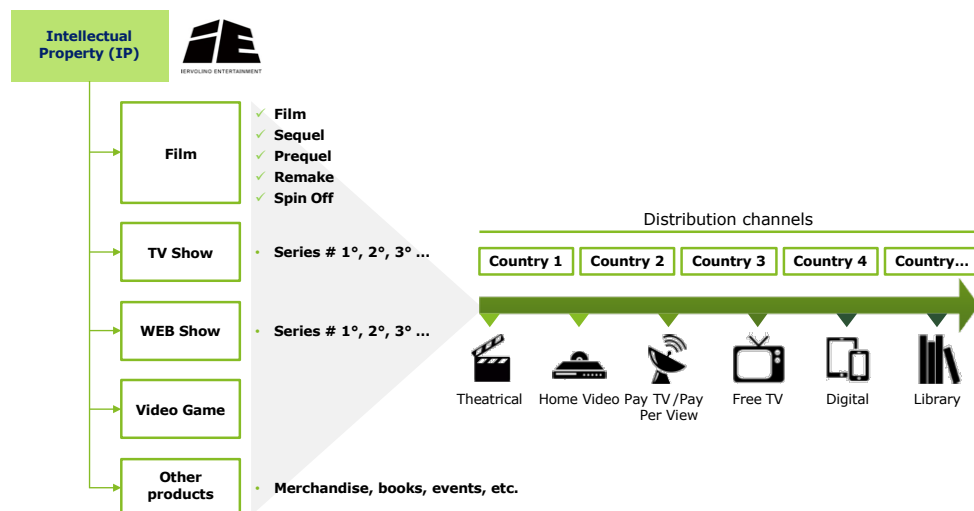
Producers and owners of Intellectual Property can enjoy additional revenues streams besides the core distribution rights agreements and can exploit the success of productions besides the revenues negotiated with the sales agents for the single production’s distribution rights.

IE can in fact obtain revenues streams

- ◆ from its core distribution rights sale/license agreements, representing most of the short term revenues (12/24 months from content delivery) and, to a lesser extent, the so called “back end” revenues, typically cashed in over a longer time horizon;
- ◆ from ancillary license agreements or sales of its Intellectual Property Rights for other uses, for example by granting permissions to commercialize merchandising of its own characters protected by IP, by allowing the production of sequels or prequels, spin-offs based on their characters or by granting licenses for videogames, TV shows, web series etc.

Hence, even if Distribution Rights have been granted to third parties, IE still owns the IP of its productions thus allowing for other uses of its Intellectual Property beside Distribution.

**Intellectual Property Rights possible exploitations**



Source: Iervolino Entertainment

## A Business Model with low risks

Once IE productions are completed, the company acquires automatically the full property of all the exploitation rights of the production (or a percentage in case it acted as co-producer) perpetually and valid for the entire World.

IE exploits its IP rights by definitely selling them to Sales Agents for particular territories, languages or channels of distributions or by granting them a distribution license (and in the latter case at the end of the licensing period the IP rights go back in full possession of IE). The agreement with the Sales Agent typically includes:

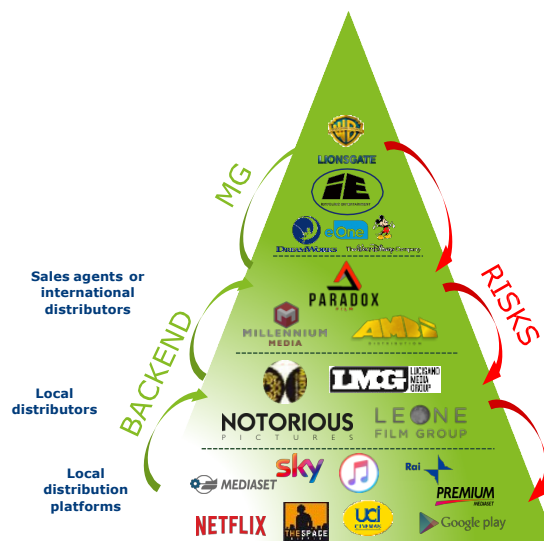
- ◆ **Minimum Guaranteed** - It is common practice for production companies to receive the “Minimum Guaranteed Amount” from Sales Agents before or during the production phases i.e. when the movie is still not over yet. The “Minimum Guaranteed Amount” is a payment in advance made by the sales agents to the production company for the future profits stemming from the distribution of a production company’s Intellectual Property Rights and it is used by the production companies to cover the majority or even more of the production costs associated with a particular product.
- ◆ **Backend profits** - IE also retains the right to some “backend revenues (profits)” that may arise by the sales agent distribution of the company’s IP rights once he has covered some distribution costs and the Minimum Guaranteed amount paid to IE. Backend profits are earnings that a Production Company is entitled to receive once a movie’s earnings exceed the Guaranteed Minimum Amount and the distribution costs paid by the sales agent to the final distributors. Backend profits are usually 30% of the extra profits earned by a movie.

IE is very strict in its execution in that three conditions must be met for a production to start :

- ◆ Productions are started only when State incentives, Tax Credits and Minimum Guaranteed amounts cover the entire forecasted costs;
- ◆ No Print&Advertising activities must be carried out by IE;
- ◆ Productions are insured against the risk of non-execution caused by the operating risks typical of cinema and tv productions.

By receiving the “Minimum Guaranteed Amounts” from sales agents and enjoying tax credits and incentives, IE is able to avoid the “Performance Risk”, which is the risk of Box Office failure, thus passing it to sales agents and final distributors.

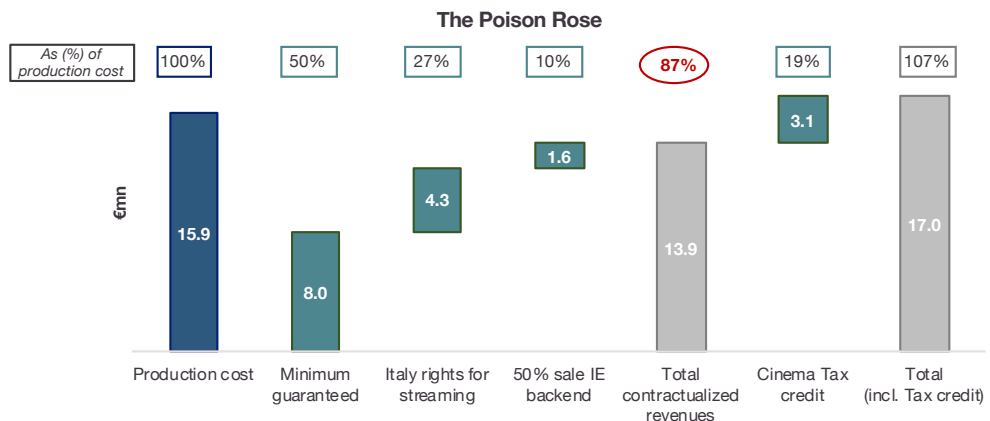
### The Pyramid of Risks and Revenues in the Cinema Industry



Source: Iervolino Entertainment

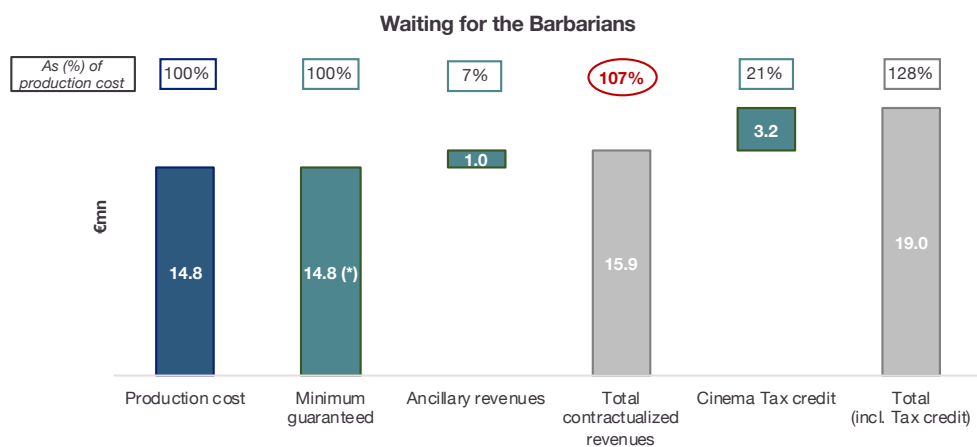
The peculiar nature of payments and of the agreements between producers, sales agents and distributors allows IE to promptly recognize revenues and tax credits. These may offsets in the same year most or all the production costs for the productions, following a scheme such as the ones presented below:

#### Production Costs and Revenues recognition – The Poison Rose (2018)



Source: Iervolino Entertainment

#### Production Costs and Revenues recognition – Waiting for Barbarians (2019)



Source: Iervolino Entertainment (\*) of which €4mn paid in advance

### Tax Credits

The Cinema and audio-visual market in Italy enjoys sizable Tax Credits and State Incentives that to a large extent offset the tax expenses faced by producers.

All cinematic and visual content productions (thus including web series, TV series and TV movies) that meet the required criteria for being considered of “Italian nationality” are eligible for Tax Credits granted by the Italian State to bolster the Italian cinematic industry, according to the guidelines of the Law Number 220 of 2016, “The Franceschini Law”.

The most consistent funds are related to the “Cinema Tax Credit” that are Tax Credits received by production companies that can cover up to 30% of a production’s costs thus making domestic locations and projects more attractive for international or co-productions. Cinema Tax Credits are

granted to Production companies with a cap of €10mn per year for the development of TV series or web series and €8mn per year for movies.

Since 2018 production companies are allowed to sell their tax credits to financial intermediaries, in order to reduce working capital and free up cash flows. Tax credits are accounted as revenues in the top line, according to industry common practice (see more details below).

## What else you need to know about the production business

The peculiar nature of the Entertainment Industry and its product process can create confusion about the accounting practices as well as about the free cash flow profile of each production and consequently of the content provider as a whole.

### The business from the accounting point of view

Here, we try to explain how the accounting of Entertainment and Media Industry works, particularly for Production Companies, limited to the key features of revenues recognition, capitalization and amortisation of production costs and tax credits treatment.

◆ **Revenue Recognition** – the different revenues streams related to the content business are, according to consolidated industry practices and IAS guidelines:

1. *Sale or license of distribution rights* of the Intellectual property through the payment of the “Minimum Guaranteed Amount” must be recognised as revenue at the moment in which the IP Distribution rights are passed to the customer (i.e. the content is accepted by the agent/distributor);
2. *Ancillary Revenues*, revenues from further exploitation of IP through merchandising, spin-offs, books etc., are recognised as they occur;
3. *So-called “Backend Revenues”*, a share of the extra profits earned by the Distributor that are owed by contract to the Producer and must be recognised as they occur.

◆ **Capitalisation of Production Costs** - the production costs in the content industry are capitalised, as production leads to an Intellectual Property, not to a “good”. These costs can be capitalised and recognised both as “Intangible Assets” as well as “Inventory” according to the different criteria: guidelines suggest that in case of the sale or license of distribution rights only (i.e. when the production company retains the majority of its rights on the IP) expenses should be capitalised as “Intangible Assets” thus falling into the guidelines established by IAS 38 (Work in progress).

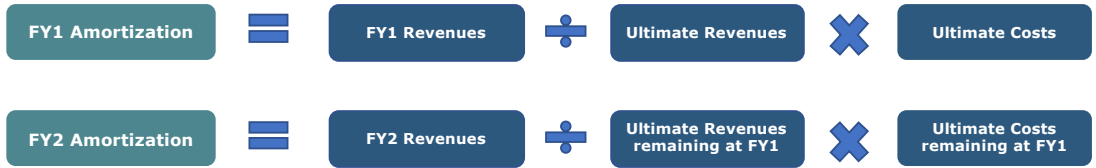
Production costs that can be capitalised are all those costs directly related to the production of the Intellectual Property, including some direct overhead costs, administrative costs and, if any, related interest expenses.

◆ **Amortization of Intangible Assets** – i.e. the amortization of the rights of exploitation of the Intellectual Property stemming from the production or acquisition of movies or other video contents’ rights. In the Cinema Industry the rights of movies and series are amortized using the “individual-film-forecast-computation-method”.

Under this method and in the absence of changes in estimates, an entity amortizes capitalized film costs in a manner that yields a constant rate of profit over the ultimate period, which considers a film’s actual current-period revenue and estimated remaining “Ultimate Revenue”. “Ultimate Revenue” is an estimate of all revenues expected to be received from the exploitation, exhibition and sale of a film in all markets and territories.

The following graphical example can yield a clearer picture of the calculation involved:

**Graphical representation of individual-film-forecast computation method**



Source: Ernst & Young

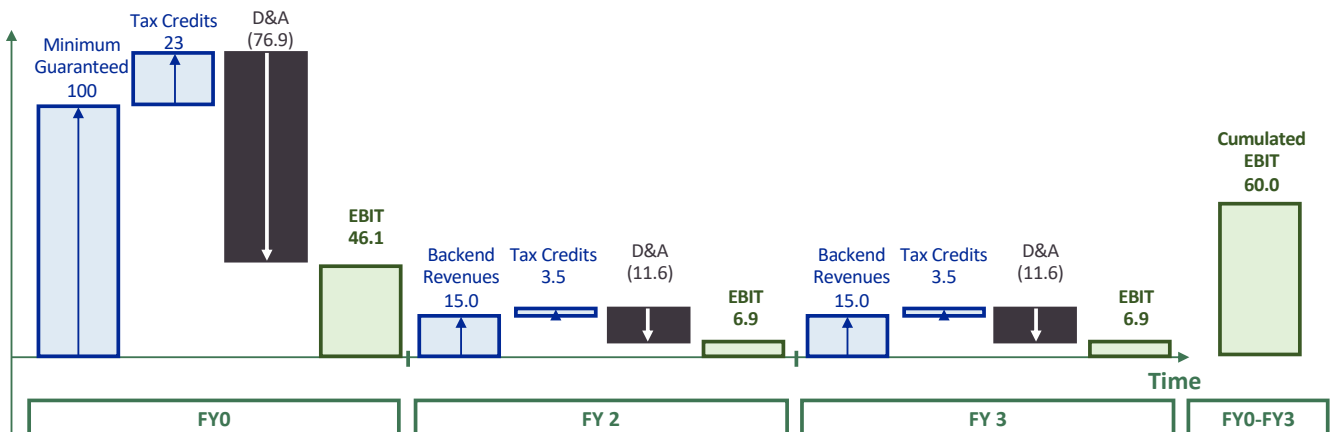
Hence, for each period, there is an amortization schedule that follows the predicted percentage of revenues coming from the movie in all forms (so comprehensive of expected royalties, merchandising sales, usage etc.).

- Tax Credit Recognition** – the accounting of the Cinema Tax Credits follows the industry common practice that includes them among the other revenues, following the same distribution of the specific costs they refer to, i.e. the amortisation of the production costs. As for R&D tax credit they are also included among other revenues in the year they are recognised.

**The free cash flow dynamics of content providers**

The revenues and costs (read “amortization”) recognition of the typical content providers offers a certain profile in terms of P&L and margins, and this could be simplified as from the table below, in the case of IE average economics (with minimum guaranteed equal to 100% of production costs).

**Iervolino Entertainment: Single Content P&L over time (Production cost = 100) (\*)**



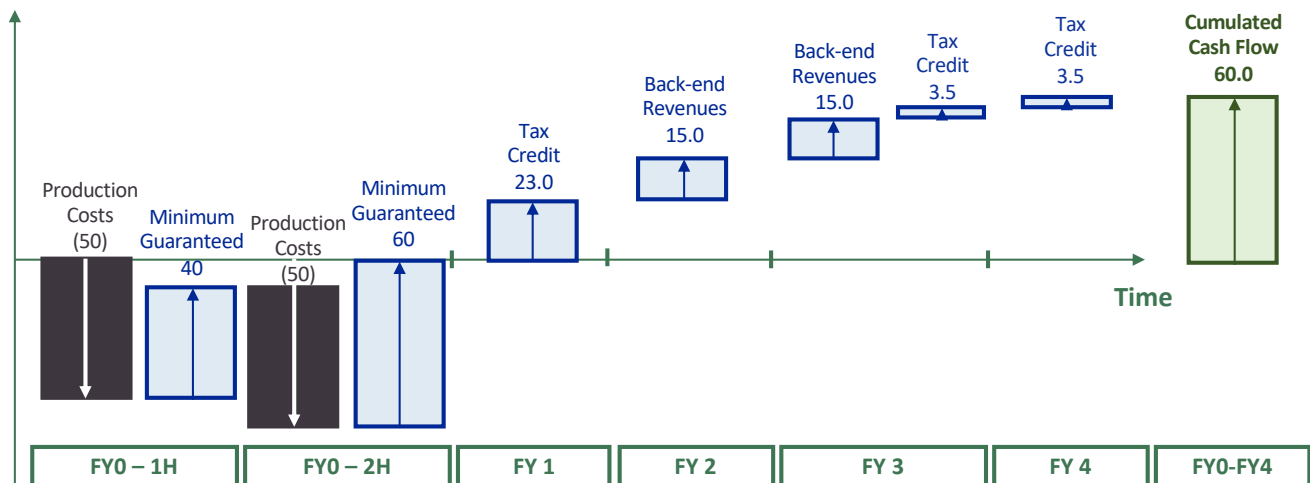
Source: Value Track Analysis (\*) we assume not meaningful revenues and costs in FY1

However, **revenues and margins of a production could differ materially** from the trend recorded in terms of **cash flow**. The following chart shows a simplified history of a single project’s free cash flow, which is very similar to an “average” production by IE, given common terms of its agreements. However, it is worth to point out that:

- Each production depends on the agreements signed with the Sales Agents/distributors and it may imply advance payments to cover most or all the production costs;
- If there are no advance payments to the producer, it has to fund the whole process, which normally lasts around one year.

Having said this, it is common **in the content industry** that **the cash flow** generated by the single production **lags by one-two years its revenues** recognition.

#### Iervolino Entertainment: Single Content Free Cash Flow over time (Production cost = 100)



Source: Value Track Analysis

The direct implication for a young producer like IE is that a growing business, with more and more productions of a certain size, may require sizeable funding – despite each production has a relatively short funding requirement. The more the new productions to deliver relative to those already delivered the worst for the company’s funding needs. Therefore, this issue may become a constraint to growth (or at least a headache for management), given these companies have typically very little underlying assets.

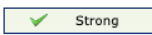
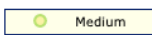
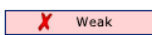






#### A niche position in the market

IE is a relatively “new” and “innovative” company in the context of the Italian market where production companies are usually relatively small and often produce movies and contents for Italian viewers only thus with limited or no access to the international markets.

Moreover, IE can boast the production of many different forms of video contents spanning from movies to web series and animation pictures. According to management, IE positioning is quite unique within the Italian competitive landscape of content producers (see picture below).

On the other hand, IE is also not comparable to most of its international mail competitors: it is of a much smaller size and without the distribution activities.

## Iervolino Entertainment: The Italian Competitive Landscape

		 Strong	 Medium	 Weak		
COMPANY	FILM PRODUCTION	INTERNATIONAL FILM PRODUCTION SPECIALIZATION	WEB PRODUCTION	ANIMATION PRODUCTION	INTERNATIONAL MARKET FOOTPRINT	LOCAL MARKET FOOTPRINT
	✓	✓	✓	✓	✓	✓
NOTORIOUS	✓	○	✗	✗	✓	✓
LEONE FILM GROUP	✓	○	✗	✗	✓	✓
	✓	○	✗	✗	○	✓
Rai Cinema	✓	○	○	✗	○	✓
*indigo film	✓	○	✗	✗	✓	✓
	✓	✗	✗	✗	✓	✓
	✓	○	✗	✗	✓	✓
	✓	✗	✗	✗	○	✓
FANDANGO	✓	✗	✗	✗	○	✓
▲▲INDIANA	✓	○	✗	✗	○	✓
	✗	✗	✗	✓	✗	✓

Source: Iervolino Entertainment

## Iervolino Entertainment: The Global Competitive Landscape

		 Strong	 Medium	 Weak	
COMPANY	INTERNATIONAL FILM PRODUCTION SPECIALIZATION	WEB PRODUCTION	ANIMATION PRODUCTION	INTERNATIONAL MARKET FOOTPRINT	DISTRIBUTION
	✓	✓	✓	✓	✓
	✓	✓	✓	✓	✓
	✓	✓	✓	✓	✓
	✓	✓	✓	✓	✓
LIONSGATE	✓	✓	✓	✓	✓
	✓	✓	✓	✓	✓
	✓	✓	✓	✓	✓
eOne	✓	✓	✓	✓	✓
	✓	✓	✓	✓	✗

Iervolino Entertainment's productions are present in international markets as **European productions**, not American ones

Source: Iervolino Entertainment

## Celebrities Management Business and others

IE has started in 2019 the activity of **Celebrities Management** that aims to leverage Mr. Iervolino extensive network in Hollywood and Italy in order to manage celebrities' image rights and marketing in Italy mainly through the participation in Italian TV programmes.

As of the 21<sup>st</sup> of January 2020 IE, has been able to organize two separate interviews on the popular Italian TV show “Amici di Maria de Filippi” for the actors Johnny Depp and John Travolta, with a major impact on audience levels.

Iervolino Entertainment receives a fee related to the service performed, but we do not expect this to become a sizeable stream in terms of revenues and margin.

In 2019 IE started to develop an ancillary activity regarding the development, ideation and management of **advertising** campaigns as well as the sale of advertising spaces. However, after a few months of test, management is considering if discontinuing the activity, given its negative contribution in terms of margins, and Board of Directors has announced the termination of the contract with the AVOD platform TaTaTu (owned by Mr Andrea Iervolino).



## Corporate Strategy

The entertainment market is about to experience fundamental changes in its structures and operations and **Iervolino Entertainment wants to be at the forefront of this revolution** by becoming an agile and flexible player **capable of producing high-quality contents** in all formats and **establish its presence in the main markets of the World** while at the same time reaping the benefits of being an Italian company. In a nutshell we expect IE to focus on the following main strategies:

- ◆ Focus on top quality productions;
- ◆ Strengthening the international footprint;
- ◆ Widening of product range;
- ◆ Production cost optimization.

### IE Corporate Strategy

#### Increasing focus on top quality productions

IE, as a production company, earns the bulk of its revenues and profits from the sale and licenses of its Intellectual Property.

In a crowded marketplace, where giants like Netflix, Apple, Amazon and Disney are increasingly producing more and more contents of high quality it is vital for every production company to be able to differentiate its library and contents from the crowd by focusing solely on the development of contents of the highest quality and aligned to the most recent trends.

Iervolino Entertainment is aware that the final consumer is overwhelmed by a myriad of different high quality productions thus, in order to be recognizable and provide the end user with the best content, all the phases of productions, starting from the selection of the screenplay, the writing and the choice of the actors and directors for each production must be carefully thought of and developed with the highest standards, **that's why IE has put the manufacturing of only the best contents at the centre of its strategy and plans.**

For all the aforementioned reasons IE wants to continue to acquire the best IP from writers and screenplay, signing multi-year contracts with the best actors and directors in order to gain stronger bargaining power with distributors.

In September 2019 IE signed an agreement with Paradox Studio worth \$12 mn for the production of five movies to be distributed by Paradox and presented at the Venice International Film Festival the movie *Waiting for Barbarians* receiving strong reception by critical.

#### Strengthening the International footprint

It is essential for young companies like Iervolino to be able to attain, in a short time period, the size and the internationalization of revenues, in order maintain its strategic positioning.

Mr. Iervolino intends to accelerate company's international growth by :

- ◆ **Opening of a new office in Los Angeles:** by opening a new office in the world capital of Cinema IE wants to gain better access to new contacts among distributors, directors and actors, acquire invaluable "know-how", be always at the forefront of the new trends and becoming even more recognizable and known. This should also support/be supported by the Celebrity Management business;
- ◆ **Co-Productions with renowned and international producers:** by developing close relationships with the most important producers IE expects to be able to further improve the quality of generated Intellectual Property.

- ◆ **Focusing on production of “internationally-appealing” movies and series:** IE wants to leverage its Italian identity by specializing in products that can be accessible and enjoyable in all the main markets worldwide.

### Extension of the product range (beyond traditional movies and animation)

The possibilities in the current market landscape to develop diverse contents that target different segments and provide opportunities for diversification and risk absorption are vast and IE is eager to be at the forefront in diverse contents.

In particular, IE management reckon that market trends and the preferences with regards to video content consumption and patterns of consumption in the Millennials and Plurals generations point towards more “short-form content” - loosely defined as video products with a running time lower than 22 minutes - and a more “mobile device friendly” consumption (see previous section for more details).

Hence, **IE wants to become one of the main players also in the market for short-form video content** and has started to develop and deliver the *Arctic Justice* web series based on the *Arctic Justice* movie, as well as short movies under innovative patterns (e.g. *Together Now*).

The Management is also aware of the importance of how contents are delivered and is engaging in further development of web series to better reach younger viewers (*The Puffins*).

### Product cost optimization

Current production techniques of high-quality animated series are very expensive and can represent a heavy burden for a producer, especially when initiating a project.

Therefore, **IE is investing heavily in the research for new techniques of production for animated series, which will enhance productivity and reduce average costs thus creating a competitive advantage.**

Below are listed some examples of production cost (per minute) for famous animated productions as well as for IE’s *Arctic Justice* series :

#### Cost per minute for selected animated productions

Title	Cost per Minute
Gli Incredibili 2	\$ 1.69 mn
Coco	\$ 1.67 mn
The Secret Life of Pets	\$ 1.62 mn
Baby Boss	\$ 1.29 mn
Ferdinand	\$ 1.03 mn
Zootopia	\$ 862 k
Hotel Transylvania 3	\$ 825 k
The Little Prince (independent)	\$ 752 k
The Nut Job (independent)	\$ 494 k
Leap (independent)	\$ 337 k
<b>Arctic Justice – Web Series</b>	<b>\$200 k</b>

Source: IMDB, Iervolino Entertainment

As can be seen from the table above IE can already boast lower production costs than many established players, however IE is determined and is investing heavily in order to find new ways to lower the average cost of its animated series to \$ 100k per minute through its project “Pipeline 0.1/0.2” with a budget above €25mn. IE is also interested in obtaining a better productivity rate in the post-production and production phases of the value chain also through M&A activity, in fact, in 4Q19, IE bought a small studio in Italy specialized in the post-production phase.

## Recent results & developments

### FY2018 results: the first year “up & running”

2018 has been a “set-up” year for IE, they established headquarters, studios and started the development of cinematic ideas. In FY18, IE has been able to produce and sell its first movie *The Poison Rose*, starring John Travolta and Morgan Freeman.

Further, it was also able to seal important contracts for the production of its first ever web series *Arctic Justice* and deliver the first 15 episodes, out of a total of 190 episodes to be delivered.

By looking at financial figures, FY18 proved to be, even if not completely dedicated to “operational” activities, a particularly brilliant year for as the company generated **€34.6mn** of revenues and an operating profit of **€11.7mn**, corresponding to **33.7% margin**.

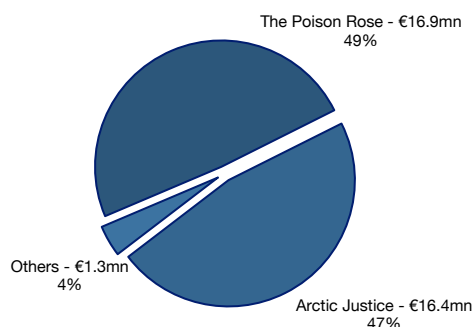
### Iervolino Entertainment: Income Statement (FY17-18)

(€mn)	2017A	2018A
Revenues from Sales	0.0	26.3
Revenues/other	1.1	1.3
Tax credits	0.0	7.0
<b>Total Revenues i.e. VoP</b>	<b>1.1</b>	<b>34.6</b>
Cost of Sales	-0.4	-0.3
Labour Costs	-0.2	-0.2
<b>EBITDA</b>	<b>0.5</b>	<b>34.1</b>
<b>EBITDA margin (%)</b>	<b>45.1%</b>	<b>98.6%</b>
Depreciation	0.0	0.0
Amortization	-0.8	-22.5
<i>o/w Poison Rose</i>	0.0	-12.3
<i>Arctic Justice (web series)</i>	0.0	-10.2
<i>other rights</i>	-0.8	0.0
Impairment and Provisions	-1.7	0.0
<b>EBIT</b>	<b>-2.0</b>	<b>11.7</b>
<b>EBIT Margin (%)</b>	<b>nm</b>	<b>33.6%</b>
Interest expenses / income & others	0.0	-0.2
Pre-Tax Profit	-2.0	11.4
Taxes	0.4	-1.2
<b>Net Profit</b>	<b>-1.6</b>	<b>10.2</b>

Source: Iervolino Entertainment, Value Track Analysis

The two main productions delivered in 2018 - the noir film *The Poison Rose* and the first delivery of 15 episodes of the web series *Arctic Justice* - contributed with **€16.9mn** and **€16.4mn** respectively, including tax credits.

### Iervolino Entertainment: FY18 Revenue Breakdown



Source: Iervolino Entertainment

As for the balance sheet structure, Net Fixed Assets reached €22.3mn in FY18 thanks to the completed and “in development” productions, up €19mn YoY, highlighting the capabilities of IE team to deliver sizeable productions in short time.

In fact, this increase in “Intangible Assets” comes from the capitalisation of all the costs attributable to productions, i.e. expenses for salaries, casts, locations and all the other items directly related to the production, namely of *The Poison Rose* and of the web series *Arctic Justice*, which corresponds to roughly **€42mn Capex**.

### Iervolino Entertainment: Cash Flow Statement (FY17-18)

(€mn)	2017A	2018A
<b>EBITDA</b>	<b>0.5</b>	<b>34.1</b>
NWC Requirements	0.0	4.6
Capex	-0.9	-41.9
Change in Provisions	0.0	0.0
Cash Taxes	0.4	-1.2
<b>OpFCF a.t.</b>	<b>0.0</b>	<b>-4.4</b>
Capital Injection	0.0	0.0
Other (Incl. Fin. Inv.)	-0.8	-0.4
Net Financial Charges	0.0	-0.2
Dividends paid	0.0	0.0
<b>Change in Net Fin. Position</b>	<b>-0.8</b>	<b>-5.1</b>

Source: Iervolino Entertainment, Value Track Analysis

Due to business nature, IE benefits from tax Credits concerning cinema productions as well as R&D, which amounted to ca. **€9.4mn** as of end of FY18, likely to be used to offset tax liabilities or to be sold towards financial intermediaries to obtain liquidity for fuelling business development.

Net Working Capital was negative by **€5.5mn** mainly due to the production costs of the *The Poison Rose* and the development of *Arctic Justice* web series.

**Net Financial Debt for €5.9mn**, was mostly funded via bank loans.

### Iervolino Entertainment: Balance Sheet (FY17-18)

(€mn)	2017A	2018A
Net Working Capital	-0.9	-5.5
Net Fixed Assets	1.6	22.3
Provisions	0.0	0.0
<b>Capital Employed</b>	<b>0.7</b>	<b>16.8</b>
<b>Group Net Equity</b>	<b>-0.1</b>	<b>10.9</b>
<b>Net Financial Position</b>	<b>-0.8</b>	<b>-5.9</b>

Source: Iervolino Entertainment, Value Track Analysis

### An impressive acceleration in FY19

2019 turned out to be a significantly positive year for Iervolino Entertainment, with Revenues and Net Profit at €80.0mn and €20.3mn respectively, more than doubled YoY, broadly confirming financial targets released by company management. Operating profit (EBIT) – the most useful measure to gauge the company's profitability – stood at € 22.6mn, matching a 28.3% EBIT margin.

Sounding results came in through the deliveries of *Waiting for the Barbarians* (€19mn total revenues, including tax credits), *Arctic Justice* episodes (€32mn), the first 20 episodes of *Puffins* (€12mn), as well as other smaller productions, i.e. the first two episodes of the five short movies project provisionally entitled *Together Now* and the web content *Giving Back Generation*. The majority of these productions (roughly 90%) were delivered across 2H, as highlighted in the bridge charts below.

### Iervolino Entertainment: Key financials in FY19

€ mn	FY18	FY19
<b>Value of Production</b>	<b>34.6</b>	<b>80.0</b>
y/y change		+131%
<b>EBITDA</b>	34.1	75.4
Depreciation / Provisions	0.0	-0.4
Amortisation of Intangible Assets	-22.5	-52.3
<i>o/w Poison Rose</i>	-12.3	-2.2
<i>Arctic Justice (web series)</i>	-10.2	-24.6
<i>WFTB</i>		-11.0
<i>Puffins</i>		-10.5
<i>Others</i>		-3.9
<b>EBIT</b>	<b>11.7</b>	<b>22.6</b>
<i>EBIT Margin %</i>	33.6%	28.3%
<b>Net Profit (Loss)</b>	<b>10.2</b>	<b>20.3</b>
Net Fixed Assets	22.3	53.2
Net Working Capital	-5.5	-4.6
<b>Group Net Equity</b>	<b>10.9</b>	<b>47.6</b>
<b>NFP [i.e. Net Debt (-) Cash (+)]</b>	<b>-5.9</b>	<b>-0.5</b>
<b>Change in Net Financial Position</b>		<b>5.3</b>

Source: Iervolino Entertainment

**Iervolino Entertainment: Revenue and EBIT walk in FY19**


Source: Iervolino Entertainment, Value Track Analysis

Balance Sheet reported Intangible Assets, which represent the combined IP rights on the productions and acquired, at € 49.2mn, split between “in development” and “finished” productions; Tax Assets at €22mn, a sizable figure that should provide IE with liquidity in following quarters and Net Debt at €0.5mn (including the proceeds of the IPO occurred in August).

In 2019 IE carried also an intense activity of funding, with the issue of two convertible bonds (including the one expired in Dec 2019 and the *Convertendo* due in Dec 2020) to finance productions and acquisition of Intellectual Properties.

The table below shows the situation at the end December and underlines that most of funding will expire by end of 2020. Following the IPO and the Q4 content deliveries, however, IE reported a negligible net financial debt, that's why the First “Mediocredito Contract” facility has been repaid as of January 2020.

**Iervolino Entertainment - Outstanding Debt/Equity Instruments as of Dec 2019**

€mn	Maturity	Interest rate (%)	Dec'19
First "Mediocredito Contract"	24/04/2020	2.8%	6.1
Second "Mediocredito Contract"	18/09/2020	2.8%	1.5
Banca Progetto Mortgage	31/07/2024	5.0% + Libor	1.9
Banca Mediolanum Credit Facility	--	6.0% + Eurib 3M	0.5
Convertendo Bond (*)	23/12/2020	3.0%	7.7 (*)
<b>Total</b>	<b>--</b>	<b>--</b>	<b>17.7</b>

Source: Iervolino Entertainment, Value-Track Analysis (\*) This bond was issued in Dec 2019 and is accounted as equity

**Recent developments**

2019 represents the first year at full speed for Iervolino Entertainment as the set-up phase brought away a lot of time from normal production activities in 2018.

- ◆ From a “corporate” and “financial” point of view, 2019 was mainly characterized by the IPO on the 5<sup>th</sup> of August that raised € **10.5mn** including the partial convertible bond conversion (€**8.7mn** net of fees, we estimate) and the issuance of a mandatory convertible bond with a nominal value of €**7.7mn** called “Iervolino Entertainment 2019-2020 Convertendo 3%”;
- ◆ In January 2020 a capital increase worth €**149k** (equal to **30k** new shares) was called (with no option rights) in order to complete the acquisition of the remaining 49% not owned by IE of the post-production company “**Arte Video**” announced in 4Q 2019.

On a more “production-related” side 2019 marked the development and conclusion of many interesting projects, movies as well as animated series and documentaries.

- ◆ On the 22<sup>nd</sup> of August 2019 IE signed a distribution license contract with “Hadid Design and Entertainment LLC” (Hadid D&E) for the movie *Together Now* (provisional title). The contract, worth **\$9.8mn** of minimum guaranteed, requires IE to deliver the first two episodes (out of five) in 2019 while the delivery for the others is set for 2020;
- ◆ In September, the movie *Waiting for the Barbarians* (produced in 2019) was screened at the Venice Film Festival receiving critical acclaim;
- ◆ In September IE signed a production contract with Paradox Studios for the production of 5 movies to be delivered in 2020 and 2021, the contract, worth at least **\$12mn**, allows IE to cover its production costs and to gain from the backend and ancillary revenues in a relatively innovative agreement, according to management. More recently (Feb 2020), details of the first movie “*Eddie & Sunny*” were announced, with minimum €4.6mn revenues and delivery expected by end 2020.
- ◆ On the 18<sup>th</sup> of October IE has reached an agreement with Paradox Studios LLC to produce and deliver, from 2019 onwards up to 500 episodes of the Web Series *Puffins*, with a compensation per episode of about **\$600k**;
- ◆ In December 2019 IE has acquired from Paradox the Intellectual Property Rights for 7 characters from the series *Arctic Justice*, for a consideration of **\$12.3mn**;
- ◆ In January 2020 IE has announced the start of the project for the realization of a Thriller **TV series** with **Dario Argento** as a director, the series will be made up of 4 episodes with airing time of 50 minutes each

## Pipeline as of March 2020

As of March 2020 IE has 8 movies and 2 web series that still contribute to its revenues, as well as owning 7 IPs for 7 different *Arctic Justice*'s characters to develop into other web series and other framework agreements.

The projects are all fully formalized via signed contracts (with the exception of the TV 4 episodes) and as for the 5 movies with Paradox, there is a global contract for the overall project that offers good visibility, but full details on the single production are released step by step (see above).

### Pipeline and delivering planning as of March 2020

Title	Film/Serie	Episodes	Status	2018	2019	2020E	2021E	2022E
The Poison Rose	Film	--	Delivered	√				
Waiting for the Barbarians	Film	--	Delivered		√			
Giving Back Generation	VoDcast	--	Delivered		√			
Arctic Justice	Web Series	190	Delivering	15	35	60	80	
Together Now (provisional title)	Short Film	5	Delivering		2	3		
Puffins	Web Series	up to 500	Delivering		20	50	60	80
Paradox Production	Films	5	Production			1 or 2	3 or 4	
Italian TV Series by Dario Argento	TV Series	4	Pre-production				na	na
IPs spun-off Arctic Justice	TBD	TBD	Pre-production				na	na

Source: Iervolino Entertainment

## Forecasts 2020E-22E

*In the forecast period (2020E-22E), we expect the company to deliver ca. 70% of the already announced deals and production agreements, keeping a sound profitability with EBIT margin estimated to lay in the 21%-23% region, and cumulated earnings to be ca. €61mn, i.e. an average EPS of €0.58. Our model does not assume any new production and hence shows top line to peak in year 2021 and then to start fading as all productions are delivered.*

*This approach offer high visibility to forecasts, but has two limits: a) given the lag between content delivery and free cash flow generation in the content business, our model does not capture the full potential of IE pipeline, as material cash will be produced after 2022, when revenues weakness and working capital is cashed; b) it does not mirror the most likely scenario, i.e. management will keep announcing new production and distribution agreements. These factors will be considered (and factored) in our Valuation model/sensitivities.*

*Finally, the company should maintain a light Net Financial Position and is expected to become cash positive by 2022E, thanks to reducing capex/productions and favorable working capital dynamics. Again this assumes no new productions beyond what already formalized as of now.*

**Our forecasts are based on the announced deals and production agreements** (see table above about current pipeline), which include the productions for which we have no full details yet, but a good visibility on timing and values, namely the Paradox agreement for five movies (the total contract with Paradox is worth roughly \$12mn). This implies that our forecasts **assume no launch of new productions** in the forecast period.

Revenues, tax credits, production costs and amortization **estimates are worked by single production**, based on the following average assumptions:

- ◆ Cinema Tax Credit of roughly 30% of production costs (while we expect a drop in R&D tax credit following changes in fiscal regulations);
- ◆ Backend revenues of roughly 30% for each production as this is a common feature of the industry;
- ◆ Virtually no ancillary revenue in forecast years.

### Iervolino Entertainment: 2018A-22E Revenues breakdown by title (€mn)

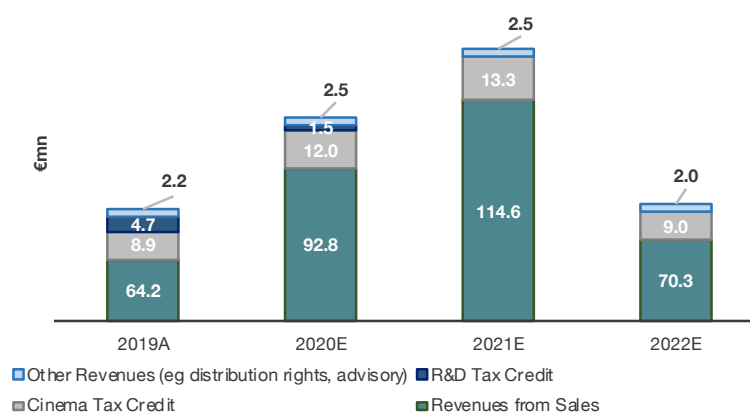
Title	2018A	2019A	2020E	2021E	2022E
The Poison Rose	16.9	3.1	0.5	0.3	--
Arctic Justice	12.4	32.9	59.6	79.3	17.1
Waiting for the Barbarians	--	19.0	2.4	2.4	1.6
Puffins	--	12.2	31.2	37.8	53.5
Together Now (provisional title)	--	4.5	7.0	1.5	4.1
Giving Back Generation	--	1.4	--	--	--
Paradox Productions	--	--	4.1	6.7	3.1
Italian Series by Dario Argento	--	--	--	--	--
IPs spun-off Arctic Justice	--	--	--	--	--
<b>Revenues (incl. Tax credits)</b>	<b>29.4</b>	<b>73.1</b>	<b>104.8</b>	<b>127.9</b>	<b>79.4</b>
R&D Tax Credit	3.9	4.7	1.5	0.0	0.0
Other Revenues (eg. rights, advertising)	1.3	2.2	2.5	2.5	2.0
<b>Total Revenues</b>	<b>34.6</b>	<b>80.0</b>	<b>108.8</b>	<b>130.4</b>	<b>81.4</b>

Source: Value-Track Analysis



That said, we expect cumulated revenues to be close to €320mn in the forecast horizon, reaching annual peak in 2021E (€130mn), growing at 56% 3yr CAGR<sub>18-21</sub>, again not considering a) the revenues stream arising from projects in pre-production and without distribution agreement and b) all new productions.

#### Iervolino Entertainment: 2019A-22E Revenues breakdown



Source: Iervolino Entertainment

We expect operating and corporate expenses to be a residual item (6%-7% of revenues), mainly relating to the acceleration in the internationalization process, including the opening a new office in LA and strengthening close relationships to join co-productions with renowned and most importance producers worldwide. These will more than offset the savings relative to FY2019, as some costs related to the IPO and to the launch of the advertising projects will not repeat.

As described above, the bulk of the company's costs are related to costs of productions, which are capitalised. Hence, given the blooming production and distribution agreements, we assume amortization of intangible assets (i.e. IPs) to increase and peak to €96mn as of 2021E.

While we estimate operating margins directly attributable to productions to remain around 28%, EBIT margin at company level (after corporate costs) is seen in the 21%-23% region over the forecast period.

#### Iervolino Entertainment: 2018A-22E from top line to EBIT

(€mn)	2018A	2019A	2020E	2021E	2022E
Total Revenues	34.6	80.0	108.8	130.4	81.4
<b>Margin from Productions</b>	<b>12.1</b>	<b>27.7</b>	<b>30.8</b>	<b>34.6</b>	<b>23.5</b>
<b>(as % of Revenues)</b>	<b>35.1%</b>	<b>34.6%</b>	<b>28.3%</b>	<b>26.6%</b>	<b>28.9%</b>
Corporate Costs	-0.5	-4.6	-6.5	-6.3	-4.5
Impairments and Provisions	0.0	-0.4	0.0	0.0	0.0
<b>EBIT</b>	<b>11.7</b>	<b>22.6</b>	<b>24.3</b>	<b>28.3</b>	<b>19.0</b>
<b>EBIT Margin (%)</b>	<b>33.7%</b>	<b>28.3%</b>	<b>22.3%</b>	<b>21.7%</b>	<b>23.4%</b>

Source: Value-Track Analysis

We expect the company to keep paying limited financial charges and enjoying a favourable tax rate (in the 10-15% range), delivering an annual EPS of €0.58 over 2020-22E.

**Iervolino Entertainment: 2018A-22E Profit & Loss**

(€mn)	2018A	2019A	2020E	2021E	2022E
Revenues from Sales	26.3	64.2	92.8	114.6	70.3
Other Revenues	1.3	2.2	2.5	2.5	2.0
Tax credits	7.0	13.6	13.5	13.3	9.0
<b>Total Revenues i.e. VoP</b>	<b>34.6</b>	<b>80.0</b>	<b>108.8</b>	<b>130.4</b>	<b>81.4</b>
Cost of Sales	-0.3	-4.2	-6.0	-5.7	-3.8
Labour Costs	-0.2	-0.4	-0.5	-0.6	-0.6
<b>EBITDA</b>	<b>34.1</b>	<b>75.4</b>	<b>102.2</b>	<b>124.1</b>	<b>76.9</b>
<b>EBITDA Margin (%)</b>	<b>98.6%</b>	<b>94.3%</b>	<b>94.0%</b>	<b>95.2%</b>	<b>94.5%</b>
Depreciation / Provisions	0.0	-0.4	0.0	0.0	0.0
Amortization	-22.5	-52.3	-78.0	-95.8	-57.9
<i>o/w Poison Rose</i>	-12.3	-2.2	-0.4	-1.1	0.0
<i>Arctic Justice (web series)</i>	-10.2	-24.6	-43.1	-58.2	-10.9
<i>WFTB</i>	0.0	-11.0	-1.4	-1.4	-1.1
<i>Puffins</i>	0.0	-10.5	-24.3	-29.7	-41.5
<i>Together Now (prov.)</i>	0.0	-2.8	-2.8	-1.0	-2.1
<i>Paradox Productions</i>	0.0	0.0	-2.4	-4.0	-1.8
<i>other rights</i>	0.0	-1.1	-3.5	-0.5	-0.5
<b>EBIT</b>	<b>11.7</b>	<b>22.6</b>	<b>24.3</b>	<b>28.3</b>	<b>19.0</b>
<b>EBIT Margin (%)</b>	<b>33.6%</b>	<b>28.3%</b>	<b>22.3%</b>	<b>21.7%</b>	<b>23.4%</b>
Net Fin. charges & others	-0.2	-0.2	-0.4	-0.1	-0.1
<b>Pre-Tax Profit</b>	<b>11.4</b>	<b>22.4</b>	<b>23.9</b>	<b>28.2</b>	<b>18.9</b>
Taxes	-1.2	-2.6	-2.9	-4.2	-2.8
<b>Net Profit</b>	<b>10.2</b>	<b>20.3</b>	<b>21.0</b>	<b>24.1</b>	<b>16.2</b>

Source: Value-Track Analysis

At balance sheet level, we expect Net Working Capital to gradually increase and cautiously assume it to move into a positive territory, while Net Fixed Assets should peak to around €90mn at the end of 2021E and then declining, following the execution of the pipeline (and assuming no new projects).

**Iervolino Entertainment: 2018A-22E Balance Sheet**

(€mn)	2018A	2019A	2020E	2021E	2022E
Net Working Capital	-5.5	-4.6	6.0	7.6	5.5
Net Fixed Assets	22.3	53.2	70.2	89.6	79.5
Provisions	0.0	0.3	0.0	0.1	0.1
<b>Capital Employed</b>	<b>16.8</b>	<b>48.2</b>	<b>76.2</b>	<b>97.1</b>	<b>85.0</b>
<b>Group Net Equity</b>	<b>10.9</b>	<b>47.6</b>	<b>68.8</b>	<b>92.9</b>	<b>109.0</b>
<b>Net Financial Position</b>	<b>-5.9</b>	<b>-0.5</b>	<b>-7.4</b>	<b>-4.3</b>	<b>24.0</b>

Source: Value-Track Analysis

As discussed in the previous sections, the free cash flow dynamics can differ a lot from those of revenues and margins in the content production business, and also in the case of IE the cash flow generation is expected one-two years later than profits.

As shown in the cash flow model below, the company should start delivering the **cash flow arising from its current productions from 2021E**, while the reduction in net debt seen in 2019 is fully attributable to the capital injections/proceeds of the IPO and of the “Convertendo bond” (due for conversion in December 2020 but accounted as equity already at issue, given its terms).

#### Iervolino Entertainment: 2018A-22E Cash Flows Statement

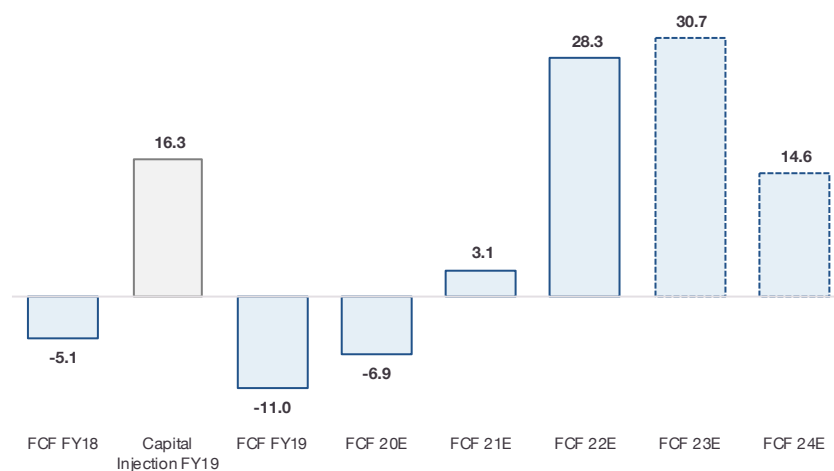
(€mn)	2018A	2019A	2020E	2021E	2022E
<b>EBITDA</b>	<b>34.1</b>	<b>75.4</b>	<b>102.2</b>	<b>124.1</b>	<b>76.9</b>
Op. WC Requirements	4.6	-0.8	-10.7	-1.5	2.1
Capex	-41.9	-80.9	-94.8	-115.2	-47.8
Change in Provisions	0.0	0.3	-0.3	0.0	0.0
Cash Taxes	-1.2	-2.1	-2.9	-4.2	-2.8
<b>OpFCF a.t.</b>	<b>-4.4</b>	<b>-8.2</b>	<b>-6.5</b>	<b>3.2</b>	<b>28.4</b>
Capital Injection	0.0	16.3	0.1	0.0	0.0
Other (Incl. Fin. Inv.)	-0.4	-2.5	-0.1	0.0	0.0
Net Financial Charges	-0.2	-0.3	-0.4	-0.1	-0.1
Dividends paid	0.0	0.0	0.0	0.0	0.0
<b>Change in Net Fin. Position</b>	<b>-5.1</b>	<b>5.3</b>	<b>-6.9</b>	<b>3.1</b>	<b>28.3</b>

Source: Value-Track Analysis

Thus, we expect **IE to generate ca €31mn cash over 2021-22E**, but the existing slate should deliver further free cash flow in excess of **€45mn over 2023-24E**, according to our forecasts. Needless to say, that the actual free cash flow that will be generated by the company will also depend on the new productions that will be launched in the meantime, as these initially absorb cash.

**The smaller and faster growing is the content producer, the more the cash absorbed from new productions** relative to the cash generated by the productions delivered.

#### Iervolino Entertainment: 2018A-22E Free Cash Flows dynamics (€mn)



Source: Value-Track Analysis

## A few considerations about the Coronavirus potential implications

The recent Coronavirus outbreak is having a massive impact on the rating of many sectors, beginning with the travelling industry but now widespread to many others. The **entertainment industry has also been severely hit**, following the decision of closing cinemas and theatres in China as well as in other regions (e.g. some areas in Italy) and given rising worries that larger areas will follow the same patterns or at least that audience in cinemas will be massively below normal levels.

Also, worries are linked to likely cancellations (or low attendance) of film festivals, delays of movie release dates and freeze of productions of new films slated in the coming months. All these events are already occurring, not only in China, and Italy is one of the countries mostly hit by the virus outbreak and by the consequent measures taken by the Government.

However, not all the content providers should be hit in the same way, as contents are still likely to be consumed and **cables, OTTs, web based and all the streaming platforms enjoy much safer streams of revenues** than theatrical or advertising ones. The online premiere of two major Chinese films due to release during the New Year holiday are a proof of this.

Having said all the above we do not see a major threat over IE operations at the moment and point out the following **considerations as for IE forecasts**:

- ◆ IE revenues (in terms of minimum grated and backend revenues) are related to the **international movie market and not to the Italian one**, and hence the backend revenues could be impacted only if the current situation persists beyond Q2 at world level;
- ◆ IE is expected to get revenues from the distribution of the movie **Lamborghini** in Italy and hence, if this is postponed after December 2020, the potential impact would be around €2mn at top line (below €500k at EBIT) moving from FY2020 to FY2021;
- ◆ The distribution of the movie **Arctic Justice** in Italy (by Notorious Picture) is likely to be delayed but we do not believe this can cause a delay in the delivery of the web episodes planned in year 2020, as these follow the release in the international markets;
- ◆ The **shooting** of the movies to be delivered by end of year may be affected by the restrictions and fears of the Covid19 virus, however this will depend on the precise timing of restrictions and on the single production (i.e. as long as the contents are delivered by December 2020 the impact on P&L is negligible). As a reference, in our forecasts these deliveries are worth ca €11mn or 10% of total 2020E revenues, split over 4 titles;
- ◆ Finally we expect a generalised slowdown in the industry as long as the picture remains uncertain, and we see as **unlikely** to hear major announcements about **new projects and film productions in the short term**. However, we believe that all the projects linked to animation and web/streaming platform distribution are unlikely to see any problem and may rather face increasing interest. In this respect it is worth to underline that **we forecast ca 83% of IE 2020E revenues to come from animation short contents** (90% in 2021E).

## Valuation

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*The valuation of Iervolino Entertainment boasts a few challenges: the company is incorporated and listed in Italy, it carries a good part of its productions in Italy but is not comparable to most of its domestic peers. Also, the Company has little history in itself, but its founder and team have outstanding track record and have recently entered the animated web series segment, which is highly promising in our view and should call for a premium. In addition, such segment (representing 83% of 2020E revenues) is expected to be resilient also in respect to the expected implications of the Covid19 virus outbreak (e.g. temporary collapse in theatrical revenues).*

*Finally, the specific accounting principles of this industry and the differences among peers' accounting methodologies suggest avoiding a very "popular" multiple like EV/EBITDA. Hence, we focus our valuation on selected peers and multiples and get to a €5.1 per share fair valuation, compared to August 2019 IPO price of €1.95 and to €3.3 current share price. At fair value the stock would trade at 1.7x EV/Sales, 7.7x EV/EBIT and 8.5x P/E for 2020E i.e. at material premium to most Italian peers and at some discount to the medium-sized independent French producers.*

*We estimate that our multiple-based valuation implies a material premium to the value of existing pipeline, this being in our view fully justified by management proven capacity to secure new profitable productions and by increasing appetite of video contents on OTT (streaming) platforms.*

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### A combination of an experienced team of producers and a high potential start-up

Iervolino Entertainment Spa entered the production business in the movie and animation segments as a legal entity only recently, with the first year of meaningful results in 2018, followed by its listing in August 2019. However, the business was created with the conferral of Mr Iervolino's 15-years-old business and small team of professionals. Hence, we believe the company deserves the "goodwill" of its core team and of the production and co-production track record cumulated since 2004 (see more details in previous sections).

In addition, IE entered in 2018 the animation production segment with *Arctic Justice* (the web series), again as a spin-off of Mr Iervolino production *Arctic Justice* the movie (aka *Arctic Dogs*). This production set in our view a cornerstone in the IE strategy, as this movie together with the acquisition of the IPs relative to the *Puffins* and to other seven characters spun-off from *Arctic Justice*, let the company enter the very attractive segment of short animation contents for family and kids.

As already outlined, **animation content productions and web series represent very promising segments**, driven by a few key factors:

1. Original contents are facing a booming demand – given the increasing competition from OTT players, it seems content producers are gaining the whip hand relative to distributors;
2. European content is gaining traction at word level, compared to the past. This trend is also supported by a more favourable regulation both in Europe (minimum 30% share of EU contents likely to be set for all OTTs, according to the revised Audiovisual Media Services Directive) and in other key markets (eg. China);
3. Average length of contents is reducing – with growing demand for web series of short episodes (from 5 to 7 minutes), backed also by the binge-viewing phenomenon. The announced launch of **Quibi** – the "quick bites" OTT platform – due in April 2020 with a billionaire budget goes in this direction;
4. World-wide demand for kids-oriented (short) contents is rising - deliverable through mobile devices videos and animations targeting these segments are also considered "sticky" contents that will become key to reduce churn rates as multiple platform usage develops.

## Market multiples better capture IE prospects

### Valuation considerations

The above features of IE lead to the following valuation considerations:

- ◆ A valuation only based on the existing “contractualized” pipeline (DCF over 2020-2024) provides a bullet-proof “floor” valuation, but it does not incorporate the goodwill of the team and the longer-term potential of the company on both movies and animation;
- ◆ Market multiples do incorporate the “goodwill” of production companies, and the multiples applied to their “current” and “visible” revenues and earnings mirror their perceived sustainability.  
In this respect, we reckon a clear valuation gap between leading international players, whose businesses are seen as *overall* sustainable and recurring, and smaller domestic producers, which are perceived as much weaker and risky, and are valued accordingly;
- ◆ Within the Italian universe of listed content producers, most players are also local distributors and two of them directly run a cinema/multiplex business too. Again, the patterns, capital intensity and risk profile of the various businesses along the value chain differ a lot and this drives stock rating and trading multiples;
- ◆ Within the international peers on the one hand IE compares better with smaller French players, focused on content production (including animation) and “distribution channel” neutral, while on the other hand we believe IE risk profile remains completely different from the large leading global players (eg. Lionsgate).

### Best peers? French ones

On the back of all the considerations above we believe that:

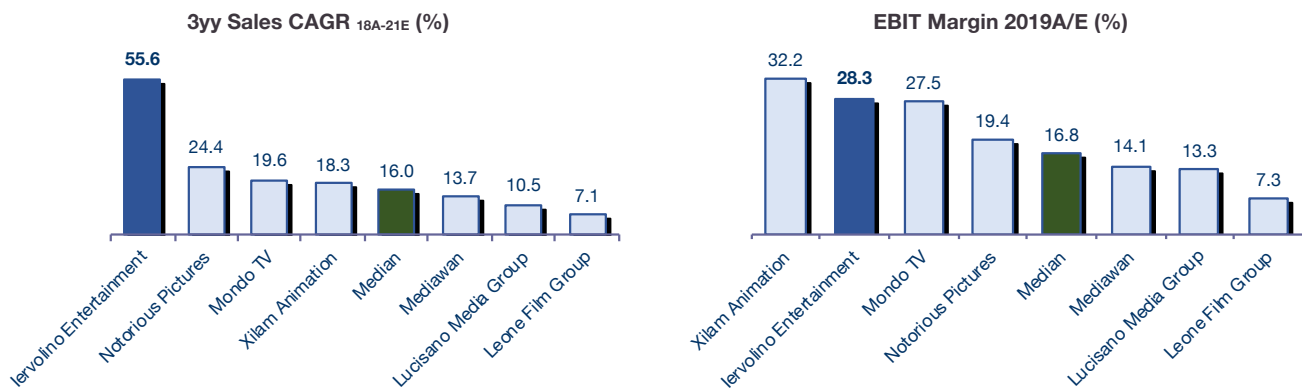
- i) IE should be valued on market multiples;
- ii) IE best peers are the likes of French companies Xilam and Mediawan and Italian Mondo TV;
- iii) IE deserves a premium to “integrated” domestic players as Lucisano and Notorious, exposed and increasingly invested in the theatrical buzz;
- iv) Peers group should not include large US players and media conglomerates, which we see as too far models.

The table below summarises the key info relative to our “all European” peer group compared to IE.

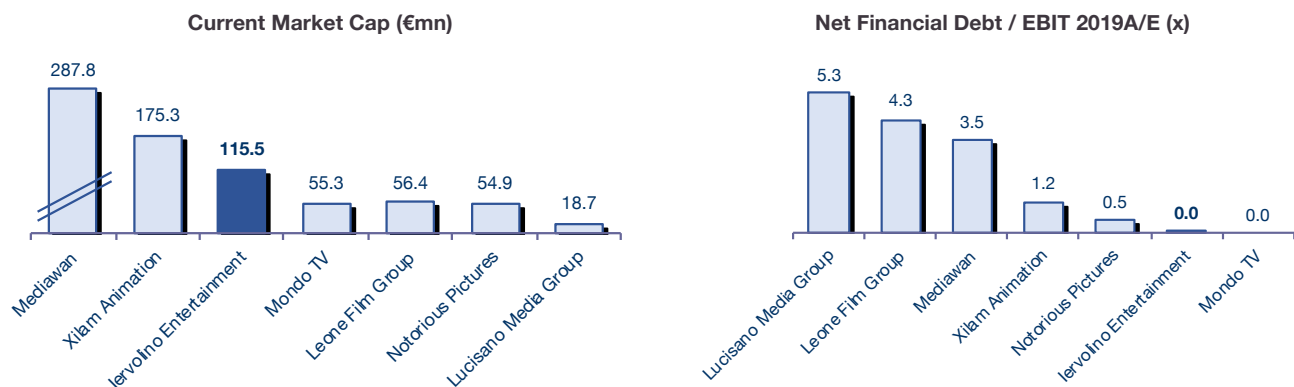
### Iervolino Entertainment: Positioning vs. peers

Company	Country	Revenue 2019 A/E (€mn)	Revenues composition			
			Production	Distribution	Cinema	Other
Notorious Pictures	Italy	41.7	--	95%	5%	--
Leone Film Group	Italy	130.6	15%	85%	--	--
Lucisano Media Group	Italy	42.9	-----54%	-----	46%	--
Xilam Animation	France	33.2	100%	--	--	--
Mediawan	France	329.0	62%	9%	--	29%
Mondo TV	Italy	22.9	75%	25%	--	--
<b>Iervolino</b>	<b>Italy</b>	<b>80.0</b>	<b>100%</b>	<b>--</b>	<b>--</b>	<b>--</b>

Source: Value Track Analysis

**Iervolino Entertainment: Key financial figures vs. peers**


Source: Value Track Analysis

**Iervolino Entertainment: Key financial figures vs. peers (cont.)**


Source: Value Track

**Best multiples? EV/Sales, EV/EBIT, P/E**

As for multiples, we would avoid those based on metrics that are not fully comparable, because of the difference in accounting methodologies.

In particular, all the companies taken into consideration report under IFRS/IAS and follow the so-called individual-film-forecast-computation-method in assessing the value (and the depreciation rate) of their IPs.

However, there is a certain degree of subjectivity in this methodology (e.g. the time horizon considered ranges from 4 to 20 years and it is not fully attributable to differences in IPs life cycle). Moreover, there are also differences in reporting a key alternative performance indicator as EBITDA (e.g. Mediawan reports EBITDA after amortization of audiovisual rights).

As a consequence, we prefer to focus our analysis on **EV/Sales, EV/EBIT and P/E**, bearing in mind that, all the rest being equal, IE seems to have one of the strictest amortization policy among peers (full amortization of IPs over four years).

### Iervolino Entertainment: Peers' stock trading multiples

Company	EV / Sales (x)			EV / EBIT (x)			P / E (x)		
	2019A/E	2020E	2021E	2019A/E	2020E	2021E	2019A/E	2020E	2021E
<b>Italian content producers</b>									
Notorious Pictures	1.4	1.1	0.9	7.3	6.7	5.5	8.1	7.6	6.4
Leone Film Group	0.7	0.6	0.5	10.2	7.2	6.2	6.9	5.1	4.5
Lucisano Media Group	1.1	0.9	0.8	8.5	6.3	5.1	5.3	3.9	3.6
Mondo TV	2.4	1.9	1.2	8.6	6.5	3.2	14.8	11.8	8.1
<b>Average</b>	<b>1.4</b>	<b>1.2</b>	<b>0.8</b>	<b>8.7</b>	<b>6.7</b>	<b>5.0</b>	<b>8.7</b>	<b>7.1</b>	<b>5.7</b>
<b>Median</b>	<b>1.3</b>	<b>1.0</b>	<b>0.9</b>	<b>8.6</b>	<b>6.6</b>	<b>5.3</b>	<b>7.5</b>	<b>6.3</b>	<b>5.5</b>
<b>Players focused on Production</b>									
Xilam Animation	5.7	4.6	3.6	17.6	13.1	9.7	26.0	18.4	13.8
Mediawan	1.4	1.3	1.1	9.8	8.4	7.2	18.1	14.6	10.2
Mondo TV	2.4	1.9	1.2	8.6	6.5	3.2	14.8	11.8	8.1
<b>Average</b>	<b>3.1</b>	<b>2.6</b>	<b>2.0</b>	<b>12.0</b>	<b>9.4</b>	<b>6.7</b>	<b>19.6</b>	<b>14.9</b>	<b>10.7</b>
<b>Median</b>	<b>2.4</b>	<b>1.9</b>	<b>1.2</b>	<b>9.8</b>	<b>8.4</b>	<b>7.2</b>	<b>18.1</b>	<b>14.6</b>	<b>10.2</b>
<b>IE @ €3.30 mkt price</b>	<b>1.5</b>	<b>1.1</b>	<b>0.9</b>	<b>5.1</b>	<b>5.1</b>	<b>4.2</b>	<b>5.7</b>	<b>5.5</b>	<b>4.8</b>

Source: Value Track Analysis

### Base fair value set at €5.1 per share

We set our “base” fair value for IE shares at €5.1, based on the average of its peers' group multiples over 2019E-21E.

At fair value the stock would trade at **1.7x, 7.7x and 8.5x EV/Sales, EV/EBIT and P/E for 2020E**, implying an average 40% premium to the Italian names (which we see as fully justified) and ca. 20% discount to Xilam, Mediawan and Mondo TV which we see as the closest peers.

### Iervolino Entertainment: Sensitivity of implicit stock trading multiples in the €3.6 - €6.6 range

Share price (€)	EV / Sales (x)			EV / EBIT (x)			P / E (x)		
	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
€ 3.6	1.6	1.2	1.0	5.6	5.5	4.6	6.3	6.0	5.2
€ 4.1	1.8	1.4	1.1	6.3	6.2	5.2	7.2	6.8	6.0
€ 4.6	2.0	1.6	1.3	7.1	7.0	5.8	8.1	7.7	6.7
<b>€ 5.1</b>	<b>2.2</b>	<b>1.7</b>	<b>1.4</b>	<b>7.9</b>	<b>7.7</b>	<b>6.5</b>	<b>9.0</b>	<b>8.5</b>	<b>7.4</b>
€ 5.6	2.4	1.9	1.5	8.7	8.4	7.1	9.9	9.3	8.1
€ 6.1	2.7	2.0	1.7	9.4	9.1	7.7	10.8	10.2	8.9
€ 6.6	2.9	2.2	1.8	10.2	9.8	8.3	11.6	11.0	9.6

Source: Value Track Analysis



## How is the long-term outlook of the business priced?

The Enterprise Value of IE - ca. €116mn based on current market price - implies a premium of ca €44mn to the net present value of its pipeline, which we estimate at around €72mn as of end 2019 assuming it is equal to i) the stream of profits expected over 2020-2024 from the productions already secured with formalized contracts, plus ii) the IPs acquired valued at cost (see table below).

### Iervolino Entertainment: Value exceeding current pipeline

	€mn
Market Cap	115.5
Net Debt FY19	0.5
<b>Enterprise value</b>	<b>116.0</b>
NPV current pipeline (WACC 10.5%, time horizon 2020-24E, incl. corporate costs)	72.0
<b>Implied premium to pipeline</b>	<b>44.0</b>

### Iervolino Entertainment: WACC calculation

Risk free	2.0%
Risk Premium	7.4%
Credit spread	3.0%
Beta Levered	1.1
Small Cap Mkt Risk Premium	1.0%
<b>Cost of Equity</b>	<b>11.3%</b>
<b>Cost of Debt a.t.</b>	<b>3.8%</b>
D/D+E	10.0%
<b>WACC</b>	<b>10.5%</b>

Source: Value Track Analysis

The premium relative to the value of the pipeline (as it is today) represents the net present value of the productions not yet subject to any distribution contract (as the TV movies by Dario Argento or the productions based on the seven characters acquired from *Arctic Justice*) and clearly of all the new productions to come (IE evaluates 15 screenplays per month).

## Market value incorporates very undemanding long-term picture

With an exercise of “reverse DCF”, we estimate that such a premium implies as a terminal value an annual free cash flow from new productions of €5.6mn, i.e. annual revenues of around €18mn. If we run the same model on our fair value instead than on market price, the implied annual revenues from new productions to be secured with formalized contracts increases to €43.7mn (see table below).

### Iervolino Entertainment: Reverse DCF valuation

(€mn)	@ mkt price	@ fair value
Implied premium to pipeline	44.0	107.0
Implied FCF (Wacc 10.5%)	5.6	13.7
<b>Implied annual EBIT (30% margin, 15% tax rate)</b>	<b>6.7</b>	<b>16.2</b>
<b>Implied Annual revenues from new productions (excl. tax credits)</b>	<b>18.0</b>	<b>43.7</b>

Source: Value Track Analysis

Is €18-44mn production per year a demanding target for the company? We do not think so, as it compares to average revenues of €90mn in the 2019-21E period and €18mn corresponds to ca. 30 episodes per year (Puffin style/value), or one movie with budget in line with those delivered over 2018-2019 (ca €15mn each), or a combination of the two. As a reference, since 2012 Mr Iervolino has been finalizing 3-5 productions per year (excluding executive and co-productions).

### New 2021-24E productions priced in

Finally, we run a sensitivity analysis over a medium term horizon to show what the implied assumptions in terms of expected new productions are at different share prices.

This exercise focuses on the amount of productions to be launched every year between 2021 and 2024 and offers also an instrument to calculate what is the additional value that new productions may (or may not) bring to the stock assuming certain values of distribution contracts, direct margins of productions, etc..

This exercise is based on central assumptions in line with company's recent announcements and with those assumed in our detailed model - in terms of EBIT margin of the single production (i.e. prior to corporate costs), tax credits, tax rate - and on the same WACC of the model above.

The following table highlights that:

- i) Current market price assumes either margins to reduce massively for new productions compared to those recorded in the last distribution agreements or new projects to average around €35mn per year, almost one third compared to the current delivery rate;
- ii) Our fair value assumes stable margins and launch of new projects worth on average €85mn per year, still below what recorded by management in recent past, and leveraging upon the animation projects identified with recent IPs acquisitions.

### Iervolino Entertainment: Fair Equity Value per share - What if analysis

€/share	Annual revenues from new productions in 2021-24E				
	35	60	85	110	135
32.5%	3.1	3.9	4.7	5.5	6.2
35.0%	3.2	4.1	4.9	5.7	6.6
<b>EBIT Margin (%)</b> 37.5%	3.3	4.2	<b>5.1</b>	6.0	6.9
40.0%	3.4	4.3	5.3	6.2	7.2
42.5%	3.5	4.5	5.5	6.5	7.5

Source: Value Track Analysis

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