



**Extraordinary General Meeting of Shareholders**

**13 March 2017 (single call) at 15.30**

**Directors' illustrative report on the sole item on the agenda for the extraordinary general meeting prepared in accordance with Art. 2441, paragraph six of the Italian Civil Code and Art. 125-ter of Legislative Decree 58/1998, as subsequently added to and amended, as well as pursuant to Art. 70 of the Listing Rules and in accordance with tables 2 and 3 of appendix 3A thereto.**

Dear Shareholders,

This report has been provided pursuant to article 2441, paragraph six of the Italian Civil Code and article 125-ter of Legislative Decree 58 of 24 February 1998, as subsequently added to and amended (the “**Consolidated Finance Act**”) in accordance with tables 2 and 3 of Appendix 3A to the Listing Rules.

BOARD OF DIRECTORS' REPORT PREPARED IN ACCORDANCE WITH ARTICLE 70 OF CONSOB REGULATION 11971/99 AND SUBSEQUENT ADDITIONS AND AMENDMENTS THERETO (“LISTING RULES”)

### **Foreword**

Dear Shareholders,

This report, which has been prepared in accordance with article 70 of the Listing Rules and, specifically, in accordance with tables 2 and 3 of Appendix 3A thereto, aims to provide the necessary information on the proposal submitted in connection with the sole item on the agenda for the extraordinary general meeting of the shareholders of Digital Bros S.p.A. (“Digital Bros” or the “Company”) to be held on 13 March 2017 at 15.30 at the registered office thereof, to discuss and vote on the following:

**“Proposed capital increase, pursuant to and for the purposes of article 2441, paragraphs 4, 5 and 6, of Euro 60,000.00 (sixty thousand/00) via the issue of 150,000 shares with a par value of Euro 0.40 each, with the application of a share premium of Euro 10.21 per share and thus with a total premium of Euro 1,531,500.00, to be paid by contribution in kind.”**

### **1. Reasons for and Aim of Capital Increase**

The proposed capital increase hereby submitted for your approval forms part of a wider transaction aimed at the acquisition, by Digital Bros, of a 100% equity interest in Kunos Simulazioni S.r.l., which has its registered office at Via degli Olmetti 39/b, Formello (Rome) and the Rome Business Register number and tax code of which is 12417031007 (“Kunos”). Kunos holds all the property rights to the Assetto Corsa video game for PC, PS4 and Xbox One platforms and has ceded the distribution of the console versions to 505 Games S.p.A.

The acquisition is deemed to be strategic for the Company and the Group and it pursues the aims of the Group's strategic plan to acquire intellectual property.

The investment agreement (the “Agreement”) provides for the acquisition by Digital Bros of a 100% equity interest in Kunos from the sellers, Messrs. Stefano Casillo and Marco Massarutto (both owners of a 50% interest in Kunos). Specifically, the Agreement provides for:

the acquisition by Digital Bros of a 63.34% equity interest in Kunos for a cash consideration of Euro 2,750,000.00;

the contribution to Digital Bros by Marco Massarutto and Stefano Casillo of the residual 36.66% equity interest in Kunos (the “Equity Interest Constituting the Contribution”) whereby the Equity Interest Constituting the Contribution has been valued at Euro 1,591,500.00 (the “Contribution” or the “Value of the Equity Interest Constituting the Contribution”).

The Contribution, together with the sale and purchase as per the first point above, collectively constitute “the Transaction”.

In relation to the Contribution, it is envisaged that Digital Bros' shareholders in general meeting shall be called upon to approve a capital increase (“Capital Increase”) with disapplication of pre-emption rights pursuant to Art. 2441, paragraph four, of the Italian Civil Code, reserved equally for Marco Massarutto and Stefano Casillo and to be subscribed thereby via a contribution in kind of the Equity Interest Constituting the Contribution that has been valued at Euro 1,591,500.00 and which consists of the following: par value of Euro 60,000.00 and share premium of Euro 1,531,500.00, with a consequent capital increase by the Company of Euro 60,000.00 and the issue of 150,000 ordinary shares pertaining to the same class as those already outstanding and with the same rights.

On completion of the Contribution, Marco Massarutto and Stefano Casillo shall each hold an equity interest of approximately 0.5% in the Company.

Lastly, the Agreement envisages that Marco Massarutto and Stefano Casillo shall agree to a cooperation undertaking with Kunos and each shall earn remuneration with an annual cost for Kunos of €120,000 plus variable remuneration equating to approximately 10% of net revenue arising from Kunos's business generated solely by Assetto Corsa.

The Agreement is subject to suspensive conditions concerning the completion of due diligence and the obtainment by Digital Bros of necessary approvals required by law.

## **2. Reasons for the Transaction, expected benefits and impact on Issuer's operations**

The Transaction forms part of the Group's growth strategy as a game publisher and developer, capable of achieving success worldwide and of always being ready to satisfy the needs of an increasingly demanding public. The acquisition brings with it control over intellectual property pertaining to Assetto Corsa and the possibility for the Group to invest in future developments of new versions of Assetto Corsa, thus providing the chance to benefit from a brand that is extremely well positioned and known in the global video games market. The fact that the Group already holds publishing rights for the console versions of Assetto Corsa will lead to synergies in terms of brand positioning and the optimisation of advertising expenditure when the rights shall be fully held by the Group.

The decision to proceed with a capital increase via a contribution in kind was based, inter alia, on the fact that such a structure limits Digital Bros' cash outlay on the Transaction.

Lastly, with regard to the impact of the Transaction on the Company's operations, it is not envisaged that the acquisition will significantly impact the Group's previously released prospective financial information.

### **3. Indication of the value attributed to the assets constituting the contribution contained in the valuation report pursuant to article 2440 of the Italian Civil Code**

The board of directors, on establishing the terms of the contribution of the Equity Interest Constituting the Contribution, adopted appropriate procedures designed to protect the integrity of the Company's share capital and shareholders' interests in view of the disapplication of their pre-emption rights. Accordingly, criteria were identified for the determination of the equity value of both Kunos and the Company as generally applied to transactions of a similar nature and which were compatible with the characteristic features of the company being valued.

The amounts assessed were based on a going concern assumption and on reasonably forecastable elements without taking account of the occurrence of extraordinary events. Specifically, the valuation work was based on known information and market conditions. These amounts do not reflect the potential synergies that could arise from the Transaction.

#### *3.1 Valuation criteria adopted*

The choice of criteria to be applied for the determination of the equity value of a company depends on the features of the entity being valued and the purpose of the valuation. Specifically, the criteria selected have been deemed capable of encompassing the elements on which the equity value of the company in question is based. The foregoing, however, may not disregard valuation criteria compliant with generally accepted practice procedures and widespread doctrine and, obviously, criteria laid down by legislation in force.

Given the above, it was deemed appropriate to proceed with the valuation of Kunos by means of the application of the methodologies indicated in paragraph 3.2.

### 3.2 Valuation of the Equity Interest Constituting the Contribution

The board of directors has conducted the required analysis and valuation aimed at ascertaining the fairness of the value of the Equity Interest Constituting the Contribution compared to the corresponding increase in the Company's share capital. As a result of this analysis and valuation, the board of directors has deemed as fair the total amount determined for the acquisition of the Equity Interest Constituting the Contribution of Euro 1,591,500.00.

In order to verify this amount, reference was made to the valuation of Kunos performed by an independent expert, who applied a financial method known as discounted cash flow (DCF) as his principal method.

Discounted Cash Flow (DCF) is a financial method, which considers a company's ability to generate cash flow as the key factor underlying its valuation. The key feature of financial methodology consists of compliance with the principle of valuation theory via an appreciation of the ability to generate cash flow, the risk profile thereof and its distribution over time.

The equity value of a company is the sum of the following components:

- (i) its enterprise value, which is based on operating cash flows that a company will be capable of generating in the future, discounted using a discount rate that equates to the weighted average cost of capital (WACC);
- (ii) the market value of any surplus assets that are not essential for the operation of the business nor which have been taken into account, due to specific methodological reasons, for the determination of operating cash flows;
- (iii) the net cash/debt of the company determined with reference to the valuation date.

As far as the determination of enterprise value is concerned, an estimation of prospective operating cash flows requires a precise analysis for the foreseeable time horizon and an estimate of the future value of the company at the end of the explicit projection period.

In order to arrive at an estimate of the equity value, net cash/debt and the market value of any surplus assets need to be added to the enterprise value, as shown by the following formula:

$$W_e = \sum_{t=1}^n \frac{FCFF_t}{(1+wacc)^t} + \frac{TV}{(1+wacc)^n} + L + SA$$

where:

$W_e$  = equity value of the company;

$FCFF$  = free cash flows to the firm;

$n$  = explicit projection period;

WACC = weighted average cost of capital;  
TV = terminal value;  
L = net cash/debt at the valuation reference date;  
SA = value of surplus assets.

The valuation of the Equity Interest Constituting the Contribution was performed based on documentation made available by Kunos, being:

- KUNOS's 2017-2021 business plan;
- Preliminary agreement between Digital Bros S.p.A. and the owners of KUNOS;
- Results and financial position of KUNOS up to and as at 31 December 2016;
- Financial statements of KUNOS for the year ended 31.12.2014;
- Financial statements of KUNOS for the year ended 31.12.2015;
- Rome Chamber of Commerce certificate dated 13 January 2017;
- KUNOS's deed of incorporation.

The valuation was performed based on a going concern assumption regarding Kunos, inclusive of from a financial perspective, not taking account of any synergies arising from integration with Digital Bros Group.

### *3.3 Conclusion*

Based on the valuation performed by the independent expert and the documentation examined, the board of directors of Digital Bros has arrived at a valuation of Euro 2,082,528 in relation to the Equity Interest Constituting the Contribution, which exceeds Euro 1,591,500.00 (that is, the Value of the Equity Interest Constituting the Contribution for the purpose of payment for the Capital Increase).

### *3.4 Fair value resulting from Independent Expert's valuation*

The Company did not take advantage of the provisions of Art. 2343-ter, paragraph 2 b) of the Italian Civil Code, which, specifically, for the purpose of the valuation of assets constituting a contribution, state it is not necessary to obtain a sworn appraisal of the value of the contributed assets performed by an expert appointed by the Court in the district where the conferee company's head office is located, if the value attributed to the assets contributed in kind, for the purpose of the determination of the share capital and any share premium, is equal to or lower than a valuation performed by an expert independent of the party making the contribution of the company and of the owners that individually or jointly exercise control over the contributor or over the company, as well being equipped with adequate, proven skills.

In order to proceed with the valuation of the 36.66% equity interest in Kunos, the parties have appointed, pursuant to and for the purposes of Arts. 2440 and 2343 ter paragraph 2 b), Studio Associato Legale e Tributario – BDO as an independent expert, in the person of Mr. Gianluca Marini (the “Independent Expert”).

The Independent Expert's conclusion is as follows:

“Based on the previously described work performed and pursuant to Art. 2343-ter, paragraph 2 b), of the Italian Civil Code, an estimate has been made of the fair value of the equity interest representing 36.66% of the capital of KUNOS constituting the Contribution.

*The reference date of the estimate is 31 December 2016. The Fair Value of the above mentioned equity interest representing 36.66% of the capital of KUNOS is estimated, as at 31 December 2016, to be Euro 2,000,000 (rounded-off amount).*

*Given the above, the value of the equity interest representing 36.66% of the capital of KUNOS constituting the Contribution represents the upper limit in order to establish the capital increase of DB and any premium relating to the shares issued in view of the contribution”*

The Independent Expert's report is available at the registered office and has been published on the Issuer's website [www.digitalbros.com](http://www.digitalbros.com)

### 3.5 *Fairness of the issue price of the new shares pertaining to the Capital Increase to service the Contribution*

As regards the disapplication of pre-emption rights pursuant to Art. 2441, paragraph 4.1, of the Italian Civil Code, paragraph six of the same article states that the issue price of the shares be determined by the directors “*based on equity value, taking account, for listed shares, of the trend in share prices over the last six months*”.

On account of the nature of the Transaction and of the capital increase to service it, the directors have passed a motion to propose to the shareholders in general meeting that the issue price of the new shares pertaining to the Capital Increase to service the Contribution shall equate to the share price recorded in the six months prior to the motion passed by the board of directors on 20 January 2017 that approved the Transaction. More specifically, the directors have determined the issue price by applying a principal method tested via the application of financial criteria.

#### *Principal methodology: quoted prices*

The stock market price method consists of the recognition, for the company being valued, of a valuation that equates to that attributed thereto by the market on which its shares are traded, by considering the actual prices determined by the market to be an indicator of equity value. This criterion assumes the company is listed on an efficient market whereby its equity value is reflected by the value determined by stock market prices recorded over an appropriate time period.

Under the specific circumstances, the board of directors has deemed the average reference price of Digital Bros' shares recorded on the STAR segment of the MTA market in the six months prior to the motion passed by the board of directors that approved the Transaction (equating to Euro 10.61) to be representative of the Company's equity value.

#### *Control methodology; Unlevered discounted cash flow.*

For the purpose of the determination of the Company's equity value, use was made, as a control method, of a financial method known as unlevered discounted cash flow (“DCF”).

In accordance with the DCF method, a company's equity value is represented by the sum of the following elements, net of net cash/debt at the reference date of the valuation:

1. enterprise value, equating to the present value of cash flows generated by operations of the company, consisting of two parts estimated autonomously:
  - (i) present value of cash flows generated by the company's operations over a defined time period (explicit projection period);



- (ii) present value of the company's cash flows beyond the explicit projection period (terminal value);

2. value of surplus assets at the reference date.

Based on the foregoing, a company's equity is thus determined by the following formula, where:

- W: equity value of the company being valued;
- F(t): unlevered cash flows for each of the n years considered in the explicit projection period;
- F(tv): value of the company's cash flows beyond the explicit projection period (terminal value);
- WACC: weighted average cost of capital;
- SA : fair value of surplus assets;
- L: net cash/debt at the reference date.

The choice of DCF as the control methodology is justified by the Group's international expansion, which is reflected by significant capital investment and earnings growth over the period covered by the Company's three year strategic plan.

The main assumptions applied in determining Digital Bros' equity value are set out below:

- (i) the valuation was based on the three year plan approved by the board of directors for the period 2017-2019;
- (ii) in order to discount the company's unlevered prospective cash flows, use was made of a weighted average cost of capital (WACC) of 11.9%, calculated based on current market parameters and the risk profile relating to the video games and entertainment sector. This percentage corresponds to the Company's unlevered cost of capital, given that the Group's financing structure mainly consists of liquid funds. The assumed WACC incorporates a specific risk premium for the remuneration of risks arising from the implementation of the three year plan (which envisages significant growth in the product portfolio and in profit margins);
- (iii) an assumed growth rate of 2% was used to estimate the terminal value;
- (iv) terminal cash flow was estimated based on the following assumptions:
  - 1) EBIT for the last year of the plan, given that it is deemed to be representative of earnings generated by a fully operational business
  - 2) depreciation and amortisation shall equate to capital expenditure
  - 3) NWC and capital expenditure shall remain constant. No valuation was estimated for the *Italian Distribution* business unit, given that it is believed that the prospects for this business unit, beyond the explicit three year plan period, are difficult to predict;
- (v) the enterprise value was adjusted to take account of:
  - the Group's net cash/debt at 31 December 2016;

- the amount of unconsolidated equity investments held, stated at historical cost, adjusted to reflect the pro-rata interest in equity, where applicable, at latest market value;
- the amount of employee termination indemnity.

These valuations have established a price per share of between **€9.84** and **€11.70**. Note that the price per share arising from the application of the principal stock market price method falls within this range and, accordingly, it is believed that the principal method is corroborated by the control method.

#### **4. Indication of the number, the class, the dividend entitlement date and the issue price of the new shares pertaining to the Capital Increase**

Following the Capital Increase, the Company shall issue 150,000 new ordinary shares of the same class as those already outstanding that shall enjoy regular dividend rights (except as described below concerning the checks required by Art. 2343-quater of the Italian Civil Code) amounting in total to the Value of the Equity Interest Constituting the Contribution.

The issue price of the new shares pertaining to the Capital Increase equates to Euro 10.61 each, of which Euro 10.21 constitutes share premium.

Pursuant to Art. 2343-quater, paragraph four, of the Italian Civil Code, the new Digital Bros shares are inalienable and must remain deposited with the Company until the registration of the directors' declaration containing the following information:

- a) a description of the assets or receivables contributed for which no recourse was made to a report pursuant to Art. 2343, paragraph one, of the Italian Civil Code;
- b) the value attributed thereto, the source of the valuation and, if appropriate, the valuation method;
- c) confirmation that the value is at least equal to that attributed for the purpose of the determination of the share capital and any share premium;
- d) confirmation that no exceptional or significant events have occurred that impact the valuation as per b) above; and
- e) confirmation that the expert meets the requirements of professionalism and independence as per Art. 2343-ter, paragraph two b), of the Italian Civil Code.

Pursuant to Art. 2343-quater, paragraph one, of the Italian Civil Code, the checks to be performed prior to the issue of the above declaration must be completed within thirty days of the closing date of the Contribution.

It should also be noted that, pursuant to Art. 2440, paragraph six, of the Italian Civil Code, within thirty days of the closing date of the Contribution (or, if later, within thirty days of the date of registration of the approval of the Capital Increase by the relevant Business Register) shareholders representing at least one twentieth of the Issuer's share capital may request, at the Directors' initiative, that a new valuation be performed pursuant to and for the purposes of article 2343 of the Italian Civil Code. This request shall be ineffective if the directors, on completion of the checks required by article 2343-quater, paragraph one, proceed in accordance with article 2343-quater, paragraph two, of the Italian Civil Code.

## **5. Tax impact of the Transaction on the Company**

The Contribution will not lead to the emergence of taxable income attributable to the Company. From a tax standpoint, the transaction may have direct tax consequences for the parties making the contribution.

## **6. Indication of the Company's shareholding structure following the capital increase in kind and the impact of any significant shareholder agreements pursuant to Art. 122 of the Consolidated Finance Act pertaining to the Company's shares.**

Following subscription of the Capital Increase, Stefano Casillo and Marco Massarutto will each hold an interest of approximately 0.5% in the Company's post-Capital Increase share capital.

Based on publicly available information, the shareholders of Digital Bros, which, subsequent to the Capital Increase, will hold an equity interest greater than 5% are Abramo Galante (34.39%) and Raffaele Galante (32.81%); following the Capital Increase, the market (meaning each shareholder with an equity holding lower than 5%) will hold a total equity interest in the Company of 32.80%. As of the date of this report, no shareholder agreements have been notified to us.

## **7. Formalities and timing**

Today the board of directors transmitted this report to the audit firm, Deloitte & Touche S.p.A., to enable them to take steps to issue, pursuant to Art. 158 of Legislative Decree 58/1998, a fairness opinion on the issue price of the shares.

We remind you that, in accordance with article 2343 ter, paragraph 2 b), today the independent appraiser, Studio Associato Legale e Tributario – BDO, in the person of Mr. Gianluca Marini, who was appointed by the parties, issued a report containing a description of the equity interest contributed and confirmation that the value is at least equal to that attributed for the purpose of the determination of the share capital and any share premium and the valuation criteria applied. Today this report was also sent to the expert.

The opinion issued by the audit firm and the valuation report prepared by the expert shall be filed within the statutory deadline.

It is envisaged that the execution of the Equity Interest contribution deed shall take place by 30 April 2017.

It should also be noted that there is no requirement to publish an information document pursuant to Art. 70, paragraph 6, of the Listing Rules, given that the transaction does not qualify as a “significant” capital increase via a contribution in kind, in accordance with the criteria set out in Appendix 3B to the Listing Rules.

## 8. Amendments to Art. 6 of the Articles of Association

As a consequence of the proposed resolution submitted for your approval, it will be necessary to amend Art. 6 of the Articles of Association by the insertion of a clause relating to the shareholders' resolution concerning the capital increase, the proposal of which is the subject of this Report.

The amendment shall not constitute a withdrawal right provided for by legislation in force or by the Articles of Association. Set out below is the current text of the relevant paragraph of Art. 6 of the Articles of Association together with the proposed text.

Current text	Proposed text
CAPITAL Article 6) [omitted]	CAPITAL Article 6)  [unchanged/omitted] <i>An extraordinary general meeting held on 13 March 2017 approved a capital increase, pursuant to and for the purposes of Art. 2441, paragraphs 4, 5 and 6, of the Italian Civil Code, and thus with disapplication of pre-emption rights, of Euro 60,000.00 (sixty thousand/00) via the issue of 150,000 shares with a par value of Euro 0.40 each, with the application of a share premium of Euro 10.21 per share and thus with a total premium of</i>

	<p><i>Euro 1,531,500.00, to be subscribed and paid by Messrs. Stefano Casillo and Marco Massarutto, via the contribution by each of them of an equity interest, with a nominal value of Euro 1,833.00, in "KUNOS SIMULAZIONI S.R.L.", which is located at Via Mola Maggiorana 4/6, Campagnano di Roma, with paid-up capital of Euro 10,000.00 (ten thousand point zero zero) and the Rome Business Register number and tax code of which is 12417031007.</i></p> <p><i>The subscription and contribution shall be effective as of the date of registration in the Business Register, by means of the registration of this resolution to increase the Company's capital in the relevant Business Register pursuant to Art. 2436 of the Italian Civil Code; to establish a final deadline for the capital subscription of 30 April 2017.</i></p>
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In light of the foregoing, the board of directors intends to submit for your attention the following proposed resolution.

#### Proposed resolution

if you agree with the proposal submitted, you are kindly invited to pass the following resolutions:

“The extraordinary general meeting of shareholders of Digital Bros S.p.A.

- having examined and discussed the proposed capital increase, via a contribution of an equity interest with a consequent disapplication of pre-emption rights;
- having examined the illustrative report of the board of directors;
- having acknowledged the valuation prepared in accordance with articles 2440 and 2343-ter, paragraph two b), of the Italian Civil Code by Studio Associato Legale e Tributario – BDO, in the person of Mr. Gianluca Marini in his capacity as independent expert;
- having seen and approved the fairness opinion issued by the audit firm Deloitte & Touche S.p.A.,

hereby resolves:

- A) to approve a capital increase, pursuant to and for the purposes of Art. 2441, paragraphs 4, 5 and 6, of the Italian Civil Code, and thus with disapplication of pre-emption rights, of

Euro 60,000.00 (sixty thousand/00) via the issue of 150,000 shares with a par value of Euro 0.40 each, with the application of a share premium of Euro 10.21 per share and thus with a total premium of Euro 1,531,500.00, to be subscribed and paid by Messrs. Stefano Casillo and Marco Massarutto, via the contribution by each of them of an equity interest, with a nominal value of Euro 1,833.00, in "KUNOS SIMULAZIONI S.R.L.", which is located at Via Mola Maggiorana 4/6, Campagnano di Roma, with paid-up capital of Euro 10,000.00 (ten thousand point zero zero) and the Rome Business Register number and tax code of which is 12417031007.

The subscription and contribution shall be effective as of the date of registration in the Business Register, by means of the registration of this resolution to increase the Company's capital in the relevant Business Register pursuant to Art. 2436 of the Italian Civil Code.;

- B) to establish a final deadline for the capital subscription of 30 April 2017;
- C) to grant a mandate to the Company's legal representatives, severally, to proceed with the execution of the aforementioned contribution deed in compliance with the foregoing resolution, by signing all the necessary and appropriate agreements, clauses and conditions;
- D) as a consequence of the resolution as per point A above, to amend article 6 of the Articles of Association by inserting the following new paragraph:

"Paragraph 3

An extraordinary general meeting held on 13 March 2017 approved a capital increase, pursuant to and for the purposes of Art. 2441, paragraphs 4, 5 and 6, of the Italian Civil Code, and thus with disapplication of pre-emption rights, of Euro 60,000.00 (sixty thousand/00) via the issue of 150,000 shares with a par value of Euro 0.40 each, with the application of a share premium of Euro 10.21 per share and thus with a total premium of Euro 1,531,500.00, to be subscribed and paid by Messrs. Stefano Casillo and Marco Massarutto, via the contribution by each of them of an equity interest, with a nominal value of Euro 1,833.00, in "KUNOS SIMULAZIONI S.R.L.", which is located at Via Mola Maggiorana 4/6, Campagnano di Roma, with paid-up capital of Euro 10,000.00 (ten thousand point zero zero) and the Rome Business Register number and tax code of which is 12417031007.

The subscription and contribution shall be effective as of the date of registration in the Business Register, by means of the registration of this resolution to increase the Company's capital in the relevant Business Register pursuant to Art. 2436 of the Italian Civil Code.;

to establish a final deadline for the capital subscription of 30 April 2017."

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Milan, 20 January 2017

DIGITAL BROS S.P.A.  
CHAIRMAN OF THE BOARD OF DIRECTORS  
signed ABRAMO GALANTE