

11 bit Studios - Buy

Target Price: PLN 493.36 | Close as of 14/11/2019: PLN 354.00

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Q3'19 earnings 7% below our forecast

11b posted its Q3'19 figures with following highlights:

- Revenues of PLN 18.9mn vs. PLN 18.8mn in our forecast
- EBITDA of PLN 6.1mn vs. PLN 6.7mn in our forecast (-9% vs. our forecast and -21% vs. consensus)
- Net profit of PLN 3.6mn vs. PLN 3.9mn expected (-7% vs. our forecast and -23% vs. market expectations)
- Decent OCF of PLN 16.7mn vs. PLN 10.6mn year ago

Standalone, IFRS (PLN, mn)	Reported			Expected		Reported	
	3Q19	3Q18	y/y	Erste Group	Consensus	Erste Group	vs. Consensus
Revenues	18.9	14.0	35%	18.8	19.5	0.5%	-3.3%
EBITDA	6.1	6.6	-7%	6.7	7.8	-8.6%	-21.4%
EBIT	4.6	5.0	-9%	5.2	6.3	-11.9%	-27.0%
Net income	3.6	3.6	0%	3.9	4.7	-7.5%	-22.6%
EBITDA margin	32.4%	46.7%		35.6%	39.9%		
EBIT margin	24.3%	35.9%		27.7%	32.1%		
Net income margin	19.1%	25.7%		20.7%	23.9%		

Source: Company Data, PAP, Erste Group Research

OPINION: NEGATIVE

With reported net income 23% below market expectations we believe that share price reaction might be negative today. Company's EBITDA margin came in at 32.4% - below market expectations of 39.9% and our forecast of 35.6% due to higher than expected cost of services linked to royalties payment.

Costs of services are mainly linked to royalties paid to Moonligher (c.a. 70% of revenues going back to Digital Sun) and Children of Morta developers (royalties amounts to 50% of sales). In the third quarter, company paid PLN 7.35mn in royalties vs. PLN 6.35mn in our forecast due to higher than expected sales of Moonligher and Children of Morta. On the other hand, company's top line came in line with our and consensus expectations, which means, that company sold less own franchises (Frostpunk & TWoM) and more games from the publishing segment. The remaining part of services position is linked to the required provision created for the incentive scheme in the amount of PLN 2.05mn.

Company enjoyed solid OCF of PLN 16.7mn which we believe is partially linked to the agreement with online distributors (Microsoft, EA, Epic Games

and Humble Store) worth USD 3mn in total. We believe that 11 bit recognized c.a. PLN 3.9mn sales linked to the agreement in the third quarter.

Capitalized costs of development work in progress came in at PLN 9.8mn which means that company spend c.a. PLN 1.62mn for new games development in Q3'19. 11 bit studios disclosed that approx. 10 people are working on Project 9 and few developers are already focusing on Project 10. Project 8 team size amount to 30 people.

After the third quarter company has a net cash position of PLN 70.9mn, which coupled with expected PLN 13.4mn cash inflow linked to the incentive program finalization, should allow for the share buyback mentioned by CEO in the last interview. Assuming buyback of PLN 13.4mn, 11 bit studios should be able to purchase c.a. 1.64% of the share capital.

Looking forward, we believe that 11 bit studios should be able to deliver top line improvement in the fourth quarter due to solid sales of publishing segment franchises, but on the other hand, earnings might be rather flat or even slightly down y/y. Any improvement in 2020e seems also challenging to us, as company is not planning any major release in the upcoming year.

P & L (PLN m)	3Q18	4Q18	1Q19	2Q19	3Q19	YoY	QoQ	9M'18	9M'19	YoY
Revenues	14.0	22.6	14.2	16.6	18.9	35%	14%	60.2	49.7	-17%
Am&Dep	1.5	1.6	1.6	1.5	1.5	2%	5%	2.9	4.6	58%
Rawmaterials	0.0	0.1	0.1	0.1	0.1	99%	-27%	0.2	0.3	98%
Services	4.8	4.8	3.4	8.6	9.2	94%	7%	11.7	21.2	81%
Employee benefits	2.5	4.0	3.3	2.9	3.2	26%	10%	8.9	9.3	5%
Taxes & charges	0.0	0.1	0.1	0.1	0.1	183%	14%	0.2	0.2	16%
Other expenses	0.1	0.2	0.1	0.6	0.2	56%	-61%	1.1	0.9	-20%
Operating profit (loss)	5.0	11.7	5.7	2.9	4.6	-9%	56%	35.2	13.2	-63%
Financial revenues	-0.1	0.2	0.3	0.1	0.4	-418%	203%	1.2	0.9	-18%
Financial expenses	0.0	0.2	0.1	0.1	0.1	n/a	8%	0.0	0.3	n/a
Extraordinary gains/loss	0.0	0.0	0.0	0.0	0.0			0.0	0.0	
Profit (loss) before tax	4.9	11.7	5.9	3.0	4.9	1%	64%	36.4	13.8	-62%
Income tax	1.3	2.7	1.5	1.0	1.3	3%	30%	7.9	3.9	
Net profit (loss)	3.6	9.0	4.3	2.0	3.6	0%	83%	28.5	9.9	-65%
Am&Dep	1.5	1.6	1.6	1.5	1.5	2%	5%	2.9	4.6	58%
EBITDA	6.6	13.3	7.2	4.4	6.1	-7%	39%	38.1	17.8	-53%
Tax rate	26.5%	23.0%	26.0%	34.2%	27.0%			22%	28%	
EBITDA margin	46.7%	59.0%	50.9%	26.5%	32.4%			63%	36%	
EBIT margin	35.9%	52.0%	39.9%	17.7%	24.3%			58%	27%	
Net profit margin	25.7%	40.0%	30.7%	11.9%	19.1%			47%	20%	
Main BS & CF items	3Q18	4Q18	1Q19	2Q19	3Q19	YoY	QoQ	9M'18	9M'19	YoY
OCF	10.6	4.3	15.6	4.3	16.7	58%	287%	34.7	36.6	5%
FCF	8.3	8.7	12.9	1.7	13.1	58%	673%	28.4	27.8	-2%
Total Assets	86.7	109.3	115.5	126.6	138.8					
Net debt (cash)	-61.7	-43.6	-56.4	-58.0	-70.9					
Equity	78.8	89.9	96.4	0.0	0.0					

Source: Company Data, Erste Group Research

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