

# 11 bit Studios - Accumulate

Target Price: PLN 567.51 | Close as of 27/04/2021: PLN 525.00

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## 4Q'20 earnings below expectations, weak cash generation, net cash level decline (NEGATIVE)

11 bit studios published its 4Q'20 earnings with following highlights:

- **Revenues of PLN 19.1mn vs. PLN 16.0mn expected by us**
- Own games revenues of c. PLN 12.8mn vs. PLN 10.9mn expected by us
- Publishing sales of c. PLN 6.3mn vs. PLN 5.1mn in our forecast
- Royalties of PLN 5.4mn vs. PLN 2.9mn expected, on higher than expected share of publishing in the sales structure
- EBIT of PLN 5.7mn vs. PLN 7.7mn expected by us, on higher royalties, PLN 1mn one-off
- **Net income of PLN 5.3mn vs. PLN 7.1mn in our forecast**
- Effective tax rate at 8.7% vs. 10.0% expected by us
- Capitalized development costs of PLN 25.5mn vs. PLN 18.3mn at the end of the previous quarter
- Off balance sheet liabilities of PLN 20.4mn (EUR 3.4mn & PLN 4.8mn) vs. PLN 23.9mn in the previous quarter
- **OCF of PLN -5.6mn on PLN 11.9mn negative working capital change**
- **FCF of PLN -13.5mn vs. PLN -0.6mn year ago**
- **Net cash position of PLN 85.3mn vs. PLN 98.9mn at the end of 3Q'20 (in line with FCF momentum)**

Standalone, IFRS (PLN, mn)	Reported			Expected		Reported	
	4Q20	4Q19	y/y	Erste Group	Consensus	Erste Group vs. Consensus	
Revenues	19.1	22.0	-13%	16.0	17.6	19.1%	8.4%
EBITDA	8.6	12.5	-31%	10.2	10.5	-15.6%	-17.9%
EBIT	5.7	10.7	-46%	7.7	8.0	-25.4%	-28.1%
Net income	5.3	11.8	-55%	7.1	6.9	-26.1%	-23.7%
EBITDA margin	45.2%	57.0%		63.7%	59.7%		
EBIT margin	30.1%	48.7%		48.1%	45.5%		
Net income margin	27.6%	53.6%		44.4%	39.2%		

**OPINION: NEGATIVE**

**11 bit studios 4Q'20 figures came above our expectation in terms of the top line level, but 26/24% below our/consensus forecast on the net income line, predominantly due to higher than anticipated royalties level (less favourable sales structure with higher share of publishing vs. own portfolio) and PLN 1mn one-off impairment (PLN 0.9mn for game engine**

and PLN 0.1mn for Foxhole project where the development is not going in line with expectations). **Cash generation also surprised to the downside, as 11 bit delivered negative OCF for the first time since 1Q'18, mainly due to unfavourable working capital change of PLN -11.9mn. That coupled with development CAPEX of PLN 7.9mn translate into negative FCF of PLN -13.5mn, which fairly explaining observed decrease in net cash position from PLN 98.9mn at the end of 3Q'20 up to PLN 85.3mn at the end of the year. Such situation should however, in our opinion, reverse in 1Q'21, which suggest FCF generation weakness is a temporary issue. Taking all that into account, we are looking for a slight negative market reaction today, as approx. 50% of the underperformance on the P&L might be explained by one-offs, while FCF weakness should reverse in the next quarter.**

**Looking forward, 11 bit studios should reveal more details on its Vitrol publishing project in May, which may trigger some positive market reaction, at least initially. In fact, Foxhole project (which was a first one to be released from the publishing portfolio) will be rather postponed, while the impairment mentioned in the report might be seen as a red flag for the title. Own game releases should not come earlier than in 2023e, which suggest we are still far away from the most important releases and potential earnings improvement.**

As usual, Management provided an inside picture of the situation for the upcoming quarters. Based on the statement, pace of the development process on the new franchises is "satisfactory", and the company is getting closer to the moment when it will be able to reveal more details on the projects (we suspect Project Eleanor and Dolly may release in 2023e, Project 8 rather in 2024e). This also applies to the publishing franchises (we suspect Vitrol may debut in 2022e, Foxhole in 2022-23e, Botin and Ava in 2023e). Current team size is close to 170 people, while the target for 2021 is to expand the team up to 200 people. MB also revealed some financial data in terms of the games' revenues. Frostpunk franchise revenues in 2020 amounted to PLN 51.5mn and exceeded PLN 130mn since the release up to the end of 2020. In the same time, Moonlighter and Children of Morta lifetime sales exceeded PLN 44/24mn respectively as of the end of the year.

**Going into details, based on the provided revenues split (29% share of publishing segment in 2020, 33% in 4Q'20 alone based on our calculations) own games sales came in at 12.8mn vs. PLN 10.9mn expected by us, while publishing revenues amounted to PLN 6.3mn vs. PLN 5.1mn in our forecast. We suspect c. PLN 10.9mn of revenues came from Frostpunk and its DLCs, c. PLN 1.9mn came from TWoM, c. PLN 4.1mn from Children of Morta and PLN 2.3 from Moonlighter.**

From the cost side perspective, employee benefits came in at PLN 1.7mn, i.e. slight ahead of our forecast of PLN 1.4mn. External services amounted to PLN 7.0mn vs. PLN 4.1mn expected by us, which is linked directly to higher than anticipated publishing segment sales. Royalties paid to external developers came in PLN 5.4mn in 4Q'20 and PLN 18.3mn in the 12M'20 vs. publishing revenues of c. PLN 25.4mn in the same period.

P & L (PLN m)	4Q19	1Q20	3Q20	3Q20	4Q20	YoY	QoQ	12M'19	12M'20	YoY
<b>Revenues</b>	<b>22.0</b>	<b>30.5</b>	<b>19.7</b>	<b>18.1</b>	<b>19.1</b>	<b>-13%</b>	<b>5%</b>	<b>71.7</b>	<b>87.4</b>	<b>22%</b>
Am&Dep	1.8	2.4	2.5	2.5	2.9	56%	13%	6.4	10.3	60%
Raw materials	0.1	0.1	0.1	0.1	0.1	-19%	24%	0.4	0.4	-20%
Services	5.2	7.0	6.6	5.3	7.0	33%	32%	26.4	25.9	-2%
Employee benefits	2.9	3.5	0.3	1.3	1.7	-41%	30%	12.3	6.8	-44%
Taxes & charges	0.1	0.1	0.1	0.1	0.1	24%	15%	0.2	0.3	23%
Other expenses	1.1	0.4	1.0	0.1	1.6	46%	2804%	2.0	3.0	49%
<b>Operating profit (loss)</b>	<b>10.7</b>	<b>17.2</b>	<b>9.1</b>	<b>8.7</b>	<b>5.7</b>	<b>-46%</b>	<b>-34%</b>	<b>23.9</b>	<b>40.8</b>	<b>71%</b>
Financial revenues	0.4	1.4	-0.5	0.8	-1.2	-383%	-245%	1.4	0.5	-60%
Financial expenses	-0.1	0.8	-0.2	1.3	-1.2	1304%	-194%	0.2	0.7	234%
Extraordinary gains/loss	0.0	0.0	0.0	0.0	0.0			0.0	0.0	
Profit (loss) before tax	11.2	17.8	8.8	8.3	5.8	-49%	-30%	25.0	40.7	62%
Income tax	-0.6	3.3	-1.7	1.1	0.5	-187%	-55%	3.3	3.3	-1%
<b>Net profit (loss)</b>	<b>11.8</b>	<b>14.4</b>	<b>10.5</b>	<b>7.2</b>	<b>5.3</b>	<b>-55%</b>	<b>-26%</b>	<b>21.7</b>	<b>37.4</b>	<b>72%</b>
Am&Dep	1.8	2.4	2.5	2.5	2.9	56%	13%	6.4	10.3	60%
<b>EBITDA</b>	<b>12.5</b>	<b>19.5</b>	<b>11.6</b>	<b>11.3</b>	<b>8.6</b>	<b>-31%</b>	<b>-24%</b>	<b>30.3</b>	<b>51.1</b>	<b>69%</b>
Tax rate	-5.1%	18.8%	-19.0%	13.5%	8.7%			13%	8%	
EBITDA margin	57.0%	64.0%	58.8%	62.3%	45.2%			42%	58%	
EBIT margin	48.7%	56.3%	46.3%	48.3%	30.1%			33%	47%	
Net profit margin	53.6%	47.3%	53.2%	39.5%	27.6%			30%	43%	
<b>Main BS &amp; CF items</b>	<b>4Q19</b>	<b>1Q20</b>	<b>3Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>YoY</b>	<b>QoQ</b>	<b>12M'19</b>	<b>12M'20</b>	<b>YoY</b>
OCF	5.0	24.3	4.6	14.3	-5.6	-211%	-139%	41.6	37.7	-10%
FCF	-0.6	12.6	1.3	7.5	-13.5	2334%	-280%	27.2	7.9	-71%
Total Assets	155.7	171.2	176.4	187.6	186.3					
Net debt (cash)	-70.5	-83.0	-83.7	-98.9	-85.3					
Equity	119.7	0.0	0.0	0.0	164.6					

Source: Company Data, Erste Group Research

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