

11 bit Studios - Accumulate

Target Price: PLN 567.51 | Close as of 12/05/2021: PLN 500.00

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1Q'21 below consensus on weak sales mix & one-offs

11 bit studios published its 1Q'21 earnings with following highlights:

- **Revenues of PLN 14.9mn vs. PLN 12.9mn expected by us**
- Own games revenues of c. PLN 10.9mn vs. PLN 9.7mn expected by us
- Publishing sales of c. PLN 4.0mn vs. PLN 3.3mn in our forecast
- Royalties of PLN 3.3mn vs. PLN 1.8mn expected, on higher than anticipated share of publishing in the sales structure
- EBIT of PLN 3.4mn vs. PLN 5.5mn expected by us, on higher royalties, PLN 1.0mn incentive scheme provision and PLN 0.3mn one-off related to game engine
- **Net income of PLN 3.6mn vs. PLN 5.1mn in our forecast**
- Effective tax rate of 17.0% vs. 10.0% expected by us
- Capitalized development costs of PLN 32.3mn vs. PLN 25.5mn at the end of the previous quarter
- Off balance sheet liabilities of PLN 23.3mn (EUR 3.7mn & PLN 6.8mn) vs. PLN 20.4mn in the previous quarter
- OCF of PLN 7.8mn on PLN 1.7mn positive working capital change
- **FCF of PLN 0.3mn vs. PLN 12.6mn year ago**
- **Net cash position of PLN 85.9mn vs. PLN 85.3mn at the end of 4Q'20 (in line with FCF momentum)**

Standalone, IFRS (PLN, mn)	Reported			Expected		Reported	
	1Q21	1Q20	y/y	Erste Group	Consensus	Erste Group	vs. Consensus
Revenues	14.9	30.5	-51%	12.9	14.1	15.4%	5.8%
EBITDA	6.4	19.5	-67%	8.0	8.1	-20.2%	-20.9%
EBIT	3.4	17.2	-80%	5.5	5.4	-37.4%	-36.0%
Net income	3.6	14.4	-75%	5.1	5.0	-30.2%	-28.1%
EBITDA margin	42.9%	64.0%		62.0%	57.4%		
EBIT margin	23.1%	56.3%		42.6%	38.2%		
Net income margin	23.9%	47.3%		39.5%	35.2%		

Source: Company Data, PAP, Erste Group Research

OPINION: SLIGHTLY NEGATIVE

11 bit studios' 1Q'21 earnings came 20/21% below our/consensus forecast on the EBITDA level despite rather solid top line which came above our expectations. Lower than expected performance is linked to weak sales mix (higher than we assumed share of publishing triggered higher royalties), first time recognition of PLN 1mn incentive scheme

provision (to be recognize until the end of 2025) and PLN 0.3mn impairment charge on game engine. **The company's bottom line came in at PLN 3.6mn i.e. 28% below consensus**, triggered by mentioned above factors but also **high effective tax rate of 17% vs. 9%** recorded in the previous quarter and 10% in our forecast (higher than expected tax rate linked to non-tax treatment of royalties due to delayed receipt of invoices). 11 bit delivered **relatively solid OCF of PLN 7.8mn**, boosted by 1.7mn change in payables. That together with development CAPEX of PLN 7.5mn translated into **FCF of PLN 0.3mn**, which corresponded to **net cash increase of PLN 0.6mn up to PLN 85.9mn**. Taking all of that into consideration, we are looking for only slightly negative or even neutral market reaction, as approx. 50% of underperformance is linked to non-cash charges, while the remaining part of it looks negligible in the nominal terms.

Looking forward, the company revealed that it planning its annual investor conference for 10th of June. During the event, we suspect that **11 bit may reveal more details on its Vitrol publishing project** (biggest project in the portfolio, Frostpunk size, production budget of c. PLN 10mn, we are looking for the release in 2022). Foxhole project (which was the first one to release) is not going according to the schedule and should be likely postponed for 2022/23. **We don't expect any material details regarding the own projects, as we are still at least 2 years before the release.** The earnings perspective of the company looks rather bleak in the short run, as **the only hope for the improvement is linked to Frostpunk mobile.** Nonetheless, it's difficult to create any large expectations here as 11 bit has very limited influence on the game marketing & user acquisition, hence the company is fully relying on the Netease decisions (we expect 11b share in net revenues of c. 20%)

According to the Management comment, development works on own games accelerated during the first months of 2021, which resulted in high development expenses (we suspect Project Eleanor and Dolly may release in 2023e, Project 8 rather in 2024e). Current team size is close to 180 people (vs. c. 170 at the end of 2020), the company is intensifying its efforts in this field. **Team size for Project 8, Dolly and Eleanor amounts to 45,20 and over 50 people respectively.**

Going into details, based on the provided revenues split (27% share of publishing segment in 1Q'21 vs. 24% year ago), own games sales came in at 10.9mn vs. PLN 9.7mn expected by us, while publishing revenues amounted to PLN 4.0mn vs. PLN 3.3mn in our forecast. We suspect c. PLN 9.2mn of revenues came from Frostpunk and its DLCs, c. PLN 1.3mn came from TWoM, c. PLN 2.4mn from Children of Morta and PLN 1.3 from Moonlighter.

P & L (PLN m)	1Q20	3Q20	3Q20	4Q20	1Q21	YoY	QoQ	3M'20	3M'21
Revenues	30.5	19.7	18.1	19.1	14.9	-51%	-22%	30.5	14.9
Am&Dep	2.4	2.5	2.5	2.9	2.9	24%	2%	2.4	2.9
Raw materials	0.1	0.1	0.1	0.1	0.1	38%	38%	0.1	0.1
Services	7.0	6.6	5.3	7.0	5.5	-22%	-22%	7.0	5.5
Employee benefits	3.5	0.3	1.3	1.7	2.5	-28%	44%	3.5	2.5
Taxes & charges	0.1	0.1	0.1	0.1	0.1	1%	-12%	0.1	0.1
Other expenses	0.4	1.0	0.1	1.6	0.4	1%	-78%	0.4	0.4
Operating profit (loss)	17.2	9.1	8.7	5.7	3.4	-80%	-40%	17.2	3.4
Financial revenues	1.4	-0.5	0.8	-1.2	0.9	-33%	-179%	1.4	0.9
Financial expenses	0.8	-0.2	1.3	-1.2	0.1	-88%	-108%	0.8	0.1
Extraordinary gains/loss	0.0	0.0	0.0	0.0	0.0			0.0	0.0
Profit (loss) before tax	17.8	8.8	8.3	5.8	4.3	-76%	-26%	17.8	4.3
Income tax	3.3	-1.7	1.1	0.5	0.7	-78%	46%	3.3	0.7
Net profit (loss)	14.4	10.5	7.2	5.3	3.6	-75%	-32%	14.4	3.6
Am&Dep	2.4	2.5	2.5	2.9	2.9	24%	2%	2.4	2.9
EBITDA	19.5	11.6	11.3	8.6	6.4	-67%	-26%	19.5	6.4
Tax rate	18.8%	-19.0%	13.5%	8.7%	17.0%			19%	17%
EBITDA margin	64.0%	58.8%	62.3%	45.2%	42.9%			64%	43%
EBIT margin	56.3%	46.3%	48.3%	30.1%	23.1%			56%	23%
Net profit margin	47.3%	53.2%	39.5%	27.6%	23.9%			47%	24%
Main BS & CF items	1Q20	3Q20	3Q20	4Q20	1Q21	YoY	QoQ	3M'20	3M'21
OCF	24.3	4.6	14.3	-5.6	7.8	-68%	-240%	24.3	7.8
FCF	12.6	1.3	7.5	-13.5	0.3	-98%	-102%	12.6	0.3
Total Assets	171.2	176.4	187.6	186.3	192.5				
Net debt (cash)	-83.0	-83.7	-98.9	-85.3	-85.9				
Equity	0.0	0.0	0.0	164.6	0.0				

Source: Company Data, Erste Group Research

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14 May 2021

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