

Starbreeze AB (STAR B)

Sweden | Game development | MCAP SEK 1 060.8mn

09 June 2021

Buy

Target price: SEK 2.6
Current price: 1.5
Upside: 78.5%

Waiting for a hefty PAYDAY

Starbreeze AB ("Starbreeze") is an independent developer, creator, publisher and distributor, of PC and console games. The Company is mostly known for its release of PAYDAY 2 and ownership of the PAYDAY IP, which has sold over 18 million copies across all platforms. Starbreeze has during the last couple of years focused on the *Games as a service model* by releasing DLC (Downloadable content) packs for PAYDAY 2, which in 2020A generated SEK 39.4mn in revenue. PAYDAY 2 has seen a 50.0% jump in CCU (concurrent users) since the release in 2013. Although today, most of the company's investments have gone to develop a new PAYDAY mobile game (PAYDAY: Crime War) and a new issue of the PAYDAY franchise (PAYDAY 3). With the launch of PAYDAY 3, the revenue is expected to grow with a CAGR of 410.4% between 2020A and 2023E. An estimated EV/EBITDA multiple of 4.7x in 2023E indicates a potential upside of 78.5% and a target price of 2.6 SEK.

Key takeaways

- **The publishing deal secures the future of PAYDAY 3:** Starbreeze announced in March 2021 that the company and Koch Media had signed off on a publisher agreement for PAYDAY 3. They set forth that the game will be released in 2023 and that Koch Media will proceed to invest substantial amounts into the development of the game. The agreement means reduced elements of uncertainty, and a strengthened financial position with investments of up to EUR 50.0mn into PAYDAY 3. The release of PAYDAY 3 in 2023E is estimated to contribute with SEK 1 365.2mn in revenue.
- **Exciting opportunities in the mobile games market with PAYDAY Crime War:** The mobile game application was released at the end of 2019 and generated SEK 28.9mn in sales in the fourth quarter of 2019A. Disappointingly, the publisher deal for the game was terminated due to reasons beyond the company's control and the game was postponed. In April 2021 Starbreeze reached a licensing agreement with PopReach and the application is expected to be released again in 2022, which is estimated to boost revenue by SEK 115.6mn in 2022E.
- **The market does not seem to see the potential in the PAYDAY franchise:** By November 2014, PAYDAY 2 (released August 2013) and PAYDAY: The Heist (released October 2011) had in total sold over 9 million copies. PAYDAY 2 is averaging double the number of concurrent players eight years after releasing compared to its first year of release¹. The overall penchant for the PAYDAY franchise and the fact that PAYDAY 3 is expected to generate revenue for years to come due to Starbreeze having its ten-year game life cycle and Games as a service model, is something that the market does not seem to realize.

Analysts

Maximus Stael Von Holstein Equity Analyst
Hugo Freij Equity Analyst

Market Data, SEK

Exchange	OMX Stockholm Small Cap
Shares (mn)	724.6
MCAP (mn)	1 060.8
EV (mn)	959.7

Metrics & Drivers	20A	21E	22E
EV/EBIT	76.0x	34.2x	8.9x
EV/EBITDA	21.7x	29.1x	8.5x
EV/S	9.2x	9.1x	4.3x
ND/EBITDA	5.7x	8.5x	2.5x

Forecast, SEKmn	20A	21E	22E
Total revenue	118.0	106.0	221.5
Rev. growth	-57.9%	-10.2%	109.0%
Gross Profit	108.6	96.4	191.7
Gross Margin	92.0%	90.9%	86.5%
EBITDA	49.3	32.9	112.8
EBITDA Margin	41.8%	31.0%	50.9%
EBIT	10.9	28.1	107.8
EBIT Margin	9.2%	26.5%	48.7%

Major Shareholders

Digital Bros S.p.A	28.6%
Swedbank Robur	12.9%
Första AP-fonden	9.5%

Price Development, SEK



Investment thesis

Undiscovered potential in a long-tailed franchise

The stock market does not seem to understand the potential of revenue growth in Starbreeze, nor how big of an IP PAYDAY is. The PAYDAY 2 Steam community has become the biggest gaming community on Steam, with 7.1 million members. This has in total amounted to 18.0 million sold copies. During 2020 PAYDAY 2 saw a twofold increase in the number of concurrent users compared to the first year of release, which shows that the general "hype" around the game has not fully faded. The PAYDAY franchise has generated revenue for more than ten years and in 2020 Payday accounted for SEK 111.5mn in sales. It is estimated that the release of PAYDAY 3 will result in revenue streams for years to come and increase sales in 2023E by 609.2%. Additionally, once the game is released the costs related to maintaining the quality of the content will decrease exponentially due to decreasing marginal costs. This has been very visible for PAYDAY 2 considering how long-tailed the game has been with decreasing production and distribution costs combined with stable revenues from DLCs (SEK 39.4mn in 2020A).

Mobile game PAYDAY: Crime War provides an exciting opportunity in a growing market

The re-release of PAYDAY: Crime War is expected to generate revenue of SEK 115.6mn in 2022E. The game will be free to download, and it has been stated that user acquisition will be used with the help of the licensor PopReach's expertise. The target with a user acquisition is to acquire LTV users and increase downloads of the app ². 60.0% of the revenue is estimated to come from in-game purchases and 40.0% from advertisement. The reason why the game was not published is that the former publisher decided to phase out its mobile games publishing business. The exposure towards the mobile games market provides an exciting opportunity as the market is estimated to grow with a CAGR of 15.0% until 2025E ³.

Divestments and full focus on PAYDAY

The former management has been replaced and unprofitable parts of the company have been sold, with divestments of Psychonauts 2, Dhruva, 10 Crowns, System Shock 3, and Parallax which amounted to SEK 227.6mn in total. The money from the divestments has been used to pay creditors. This leaves Starbreeze with a less diversified games portfolio, but it also provides the opportunity to fully focus on PAYDAY, which to this day, still generates solid revenue streams (SEK 111.5mn in 2020A).

Debt to Nordea and Digital Bros

The debt related to the reconstruction in 2018 has been cleared. However, the convertible bond to Digital Bros of SEK 215.0mn and the interest-free loan to Nordea of SEK 165.0mn remain unpaid. The convertible bond and the loan are both due in 2024. If converted, Digital Bros will receive 95 578 667 B-series shares with a strike price of 2.3 SEK per share, equivalent to 20.9% of the shares in Starbreeze. This would result in a dilution of the shares. If the bond does not get converted, payments of the loans will still have to be made, both to Nordea and Digital Bros. However, the loyal player base with over ten years of commitment to the franchise decreases the risk of underperforming sales figures upon the release.

Financial forecast breakdown

Net sales are expected to grow with a CAGR of 410.4% between 2020A and 2023E

The estimate is that PAYDAY 2 will have an increase in sales during 2021E compared to 2019A, yet a decrease from 2020A due to sales increasing because of the global pandemic. During 2022E the estimates are that PAYDAY 2 net sales will have a small decrease yet similar results to 2021E. Thereafter, the net sales are expected to decrease by 30.0% during 2023E due to players migrating to the sequel. Starbreeze also has other smaller games that amounted to net sales of SEK 6.4mn in 2020A. It is estimated that these sales will decrease during 2021E and amount to SEK 5.3mn. During 2022E these sales are expected to stay relatively similar since they have seen previous growth, yet Starbreeze is expected to move its focus to PAYDAY 3.

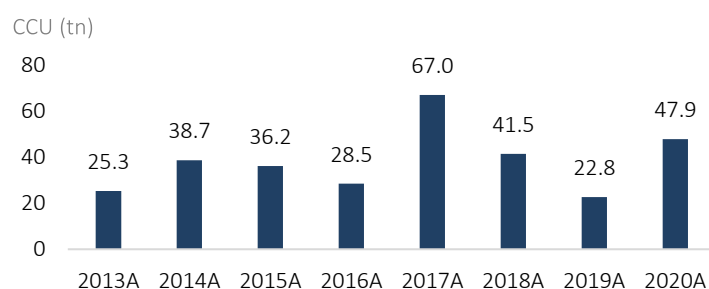
The re-release of PAYDAY: Crime War

When PAYDAY: Crime War was first released, the application generated SEK 28.9mn in revenue (Q4-19). Starbreeze now aims to re-release the application in 2022E. The estimates are based on the fourth quarter of 2019A. It is expected that Crime War will show similar figures during its first year, thus amounting to SEK 115.6mn in net sales. When looking at bigger games such as *Clash of Clans*, it is observed that these games increase in revenue during their second year of release. It is therefore estimated that Crime War will see an increase of 12.5% in revenue during 2023E amounting to SEK 130.1mn.

Starbreeze accomplished great heights with PAYDAY 2 and aspire to do the same with PAYDAY 3

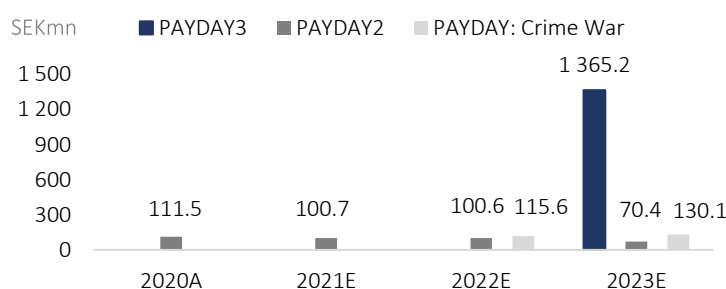
Larger games such as *Blacks Ops 2* and *3* have shown that sequels generally perform similar figures, if not better, than its predecessor ⁴. During the first year of releasing PAYDAY 2, Starbreeze had approximately 1.7 million active members on Steam. Since then, there is a 50.0% higher number of concurrent players (CCU). There is a strong loyalty within the gaming customer base, specifically in the case of PAYDAY where the number of concurrent players have remained high for eight years. It is estimated that a similar amount to the first year's active players with an increase of 50.0% (due to the CCU increase) will purchase the new edition of PAYDAY 3. Therefore 2.6 million copies are estimated to be sold in the first year of release on PC. Although all the players will not buy the game, the remaining copies estimated would be a result from new players. With a current 70/30 market split between PC and console PAYDAY 3 is projected to sell 1.1 million copies on consoles. The total copies estimated to be sold for PAYDAY 3 is 3.7 million. There is also a large possibility of a price increase in price per copy. It is estimated that the company will sell the game for SEK 460. The sales are also including a VAT of 10.0%. Starbreeze has indicated that they will put a large amount of focus on delivering DLC-packs for the game, which gives PAYDAY 3 the potential to bring revenue for years to come.

Increasing Concurrent users (CCU) as average per day.



Source: Steam Charts

Release of PD3 in 2023E implies substantial increase in revenue.



Source: Starbreeze AB and Analyst Estimates

Publisher deals and Distribution cuts regarding PAYDAY: Crime War and PAYDAY 3

Starbreeze has during 2021 signed publisher agreements for both Crime War and PAYDAY 3. Regarding Crime War, it is estimated that the revenue split will revolve around 82.5/17.5 (Starbreeze/PopReach). This revenue split leads to the publisher receiving SEK 20.0mn during 2022E and SEK 14.0mn during 2023E for PAYDAY: Crime War. Regarding Starbreeze's publisher agreement with Koch Media for PAYDAY 3, it is estimated that there will be a revenue split of 50/50. This publisher agreement for PAYDAY 3 means that Koch Media is estimated to receive SEK 665.0mn during 2023E. Starbreeze also possesses a settlement with 505 Games regarding PAYDAY 3 profits. 505 Games will receive 33.0% of Starbreeze PAYDAY 3 revenue until USD 40.0mn is collected. This is estimated to be SEK 220.0mn in 2023E and to be fully paid off during 2024E. The estimated net sales of PAYDAY 3 also include a 30.0% sales commission to product distributors. This commission differs between platforms and total sales.

Operating expenses

Selling and Marketing expenses consist mainly of personnel expenses. Starbreeze has indicated an increase of 40 new employees before the release of PAYDAY 3. This leads to an estimated increase of 79.7% (SEK 15.2mn) from 2020A in Selling and Marketing expenses to when PAYDAY 3 releases in 2023E.

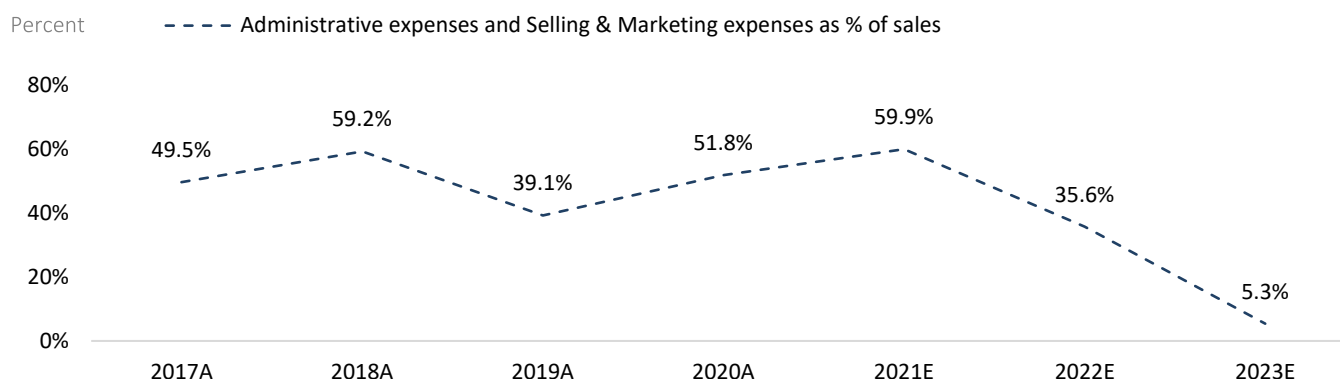
Administrative expenses

The administrative expenses primarily consist of office expenses, cost of premises, and payroll expenses for employees not working directly on game development. Based on the increase in personnel during 2012A (the year before the release of PAYDAY 2), the Administrative expenses are estimated to amount to SEK 67.8mn during 2022E. During 2023E a significant increase is not expected.

Depreciation and amortization

Depreciation and amortization consists of property plant and equipment (PPE) and capitalized development costs and is expected to remain at a steady level before the release of PAYDAY 3. It is estimated that no additional offices will be needed until at least 2024. The process of depreciation and amortization for capitalized development costs for PAYDAY 3 begins when the game has received income. The total capitalized development costs for 2023E are estimated by the indicated 40 new developers being employed and previous investments in PAYDAY 3. The expected total capitalized development costs in 2023E is SEK 627.8mn. This results in D&A of SEK 62.8mn from capitalized development costs in 2023E and an additional SEK 4.9mn in PPE.

Significant decrease in Administrative expenses and Selling & Marketing expenses as % of sales.



Source: Starbreeze AB and Analyst Estimates

Valuation

Waiting for a hefty PAYDAY

The mismanagement of the company, with poor acquisitions and absence of financial control is now in the past. Starbreeze has restructured and paid off most of its debts, reorganized the company, and has a stronger financial position than in 2018. The company has chosen to move its focus to the PAYDAY franchise, which is the one thing that the company truly has succeeded in. The launch of PAYDAY 3 in 2023 is expected to take the company to new heights as the revenue is projected to increase by 609.2% from SEK 221.5mn in 2022E to SEK 1571.0mn in 2023E. A target price of 2.6 SEK deriving from an EV/EBITDA multiple of 4.7x implies an upside of 78.5%.

A straight comparison with peers not justified

The multiple used for the valuation is EV/EBITDA which provides a clear image of the financial position and evens out dissimilarities in capital structure. In 2023E Starbreeze is estimated to trade at an EV/EBITDA of 1.7x compared to the peer median of 9.4x. However, advocating that Starbreeze should trade at a similar multiple in 2023 is not realistic at this stage. Although Starbreeze is expected to show a significantly larger revenue growth compared to peers, one must consider that not all peers will release games in 2023, and that the valuation also derives from what the game will bring in many years after the release. Furthermore, the risk with the convertible bond of SEK 215.0mn and the loan of SEK 165.0mn to Nordea need to be acknowledged. There could also be a scenario with bad negotiations in terms of profit splits. This portrays a worst-case scenario and is thus not very likely to occur with the loyal player base behind the PAYDAY franchise.

EV/EBITDA of 4.7x in 23E implies a promising upside

It is more reasonable to motivate that Starbreeze should trade at 50.0% of the peer median EV/EBITDA, mainly because of the risks involved in the case. Although the company is estimated to have a CAGR of 410.4% until 2023E, the risks remain. Starbreeze is relying on a successful follow-up of PAYDAY 2, compared to other peers who already have released successful games within the last two years and additionally possess large portfolios of various games. Additionally, one game does not necessarily make the company comparable to peers with more titles. However, the primary strength of Starbreeze lies in how long-lived the PAYDAY franchise has proven to be. PAYDAY is as of today, the biggest community on Steam and DLCs in 2020A generated SEK 39.4mn. PAYDAY 3 is expected to exhibit the same durability, thus enabling a stronger long-term financial position. Therefore, an EV/EBITDA multiple of 4.7x is sensible, deriving from a 50.0% discount to peers. A discount rate of 13.5% conveys a target price of 2.6 SEK, which implies an upside of 78.5%.

Peer table	Market Data (SEKmn)		Financials		Valuation
Company Name	MCAP	EV	EBITDA Margin 23E	CAGR (2020A-2023E)	EV/EBITDA 23E
Remedy	5 285.8	5 121.7	42.7%	34.0%	22.6x
Enad Global 7	8 676.0	8 355.8	34.9%	102.6%	8.4x
M&G Invest	6 404.4	7 216.1	12.7%	24.5%	9.4x
Paradox	19 166.4	18 643.2	60.5%	19.6%	11.7x
Thunderful	4 180.0	3 894.1	15.5%	3.1%	7.9x
Median	6 404.4	7 216.1	34.9%	24.5%	9.4x
Average	8 742.5	8 646.2	33.3%	36.7%	12.0x
Starbreeze	1 060.8	959.7	35.0%	410.4%	4.7x

Source: Bloomberg and Analyst Estimates

Management and board

Tobias Sjögren, CEO & Member of the board

Sjögren has over 25 years of experience in the computer gaming industry. Sjögren was appointed CEO in March 2021. Before joining Starbreeze, Sjögren was CEO of White Wolf Entertainment and he also has experience from Paradox Interactive, Stardoll and DICE.

Tobias Sjögren Owns 30 000 shares of series A and 70 000 shares of series B.



Mats Juhl, Chief Financial Officer

Juhl was appointed CFO in May 2020 and has previously worked as CFO at Mips AB, Tengbomgruppen AB and Sweden Arena Management KB. Additionally, he holds a Master's Degree in Finance from Lunds University.

Mats Juhl owns 100 000 shares of series B



Petra Takeva, Chief Growth Officer

Petra became a part of the company during the beginning of 2021 and will contribute to marketing and business development with more than 18 years of experience within the field.

Petra Takeva owns 0 shares of series B



Torgny Hellström, Board of Directors Chairman

Hellström was appointed as the chairman of the board in 2019 and has previously held leading positions within DDM Holding AG and MagComp AB. He also served as CEO of Anoto Group. Furthermore, he has had positions such as Vice President of Litigation within Ericsson Group and positions within IBM Europe and IBM Nordic.

Torgny Hellström directly or indirectly owns 500,000 Class B shares.



Appendix

Income statement, SEKmn	2020A	2021E	2022E	2023E
Net sales	118.0	106.0	221.5	1 571.0
COGS	-9.4	-9.6	-29.8	-712.1
Gross profit	108.6	96.4	191.7	858.9
Gross profit margin	92.0%	90.9%	86.5%	54.7%
Selling & marketing expenses	-8.5	-9.8	-11.1	-15.2
Administrative expenses	-52.6	-53.7	-67.8	-68.1
Other expenses	1.8	0	0	-225.3
EBITDA	49.3	32.9	112.8	550.3
EBITDA margin	41.8%	31.0%	50.9%	35.0%
Depreciation & Amortization	-38.4	-4.9	-5.0	-67.7
EBIT	10.9	28.1	107.9	482.7
EBIT margin	9.2%	26.5%	48.7%	30.7%
Net financial items	-141.3	-44.1	-25.0	-17.4
EBT	-130.5	-16.0	82.8	465.3
Taxes	-0.2	-3.3	-17.1	-95.8
Net income	-130.3	-12.7	65.8	369.4
Net income margin	-110.4%	-12.0%	30.0%	24.0%

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