

Rovio Entertainment Oyj (ROVIO)

Finland | Gaming | MCAP EUR 577.6

13 August 2021

Buy

Target price: EUR 8.4
 Current price: EUR 6.2
 Upside: 36.2%

Rovio – Slingshot loaded for growth

Rovio Entertainment Oyj is a Finnish entertainment, and game development Company focused on mobile games. While Rovio has previously been heavily dependent on its flagship, Angry Birds, Rovio is now focusing on diversifying its product portfolio through new games and acquisitions of smaller studios. By focusing on its core strength and more disciplined user acquisition spending, EBIT margin is estimated to increase with 20.0% between 2020A and 2023E. Rovio is currently trading at an all-time low EV/EBIT multiple of 8.0x during the past 12 months, compared to a historical average of 15.9x despite a record high EPS, with a 59.5% growth YoY 2019A-2020A. A target multiple of 10.9x EV/EBIT applied to the year 2023E estimated EBIT of EUR 57.6mn implies a target price per share of EUR 8.4 and a potential upside of 36.2%.

Key takeaways

- **A strong cash position of EUR 90.7 mn enables future growth opportunities through acquisitions:** The global mobile gaming market is growing with an estimated CAGR of 10.8% in 2019A-2023E, according to Newzoo. However, the playing field is ever-changing, and acquisitions are common. With a net cash position of EUR 45.4m, Rovio is in a solid financial situation, which opens for further growth by acquiring smaller players in the industry, taking advantage of the valuation gap between listed and unlisted companies. Furthermore, this cash position is estimated to compound EPS with a CAGR of 20.8% between 2020A-2023E, through buybacks of outstanding shares.
- **Disciplined user acquisition spending is estimated to increase EBIT margin from 15.5% in 2020A to 18.6% in 2023E:** In 2020A the Company showed almost 50% lower marketing costs than 2019A, primarily related to user acquisition and enabled through focusing on “whales” – the most profitable players. Although UA costs were cut by almost 60.0%, revenue was in line with previous years - improving EBIT margin from 6.2% in 2019A to 15.5% in 2020A which is expected to further increase to 18.6% in 2023E. UA spending is closely related to gross bookings from the Game segment and is expected to decrease from 22.7% of gross game bookings in 2020A to 20.5% in 2023E, due to continued efforts related to user acquisition spending.
- **Future growth undervalued by market - currently trades at 8.0x EV/EBIT for 2023E, a 43.5% discount to peers median:** Due to a lower historical growth profile, the market has severely discounted Rovio to its peers. However, considering the future growth prospects of Rovio, this discount is too large. When comparing average return on equity to its peers as a discount measure, a 16.8% discount is appropriate to account for Rovio’s lesser growth profile in historic years. Yet despite this discount, Rovio shows a 36.2% upside to the median EV/EBIT of its peers.

Analysts

Anton Flygare Equity Analyst
 Hugo Schyberg Equity Analyst

Market Data, EUR

Exchange OMX Helsinki Mid Cap
 Shares (mn) 81.5
 MCAP (mn) 546.4
 EV (mn) 458.9

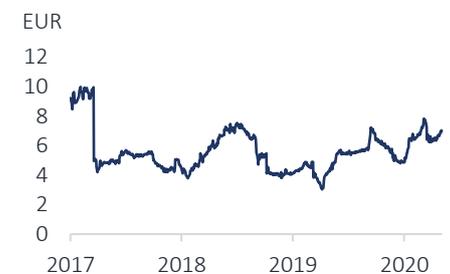
Metrics & Drivers	20A	21E	22E	23E
EV/Sales	2.0x	1.9x	1.8x	1.7x
EV/EBIT	12.4x	12.9x	10.2x	8.0x
P/E	15.5x	13.8x	11.0x	9.8x

Forecast, EURmn	20A	21E	22E	23E
Revenue	272.8	285.2	295.4	309.1
Rev. growth y/y	-5.8%	4.6%	3.6%	4.6%
EBITDA Margin	22.0%	19.8%	21.9%	24.3%
EBIT Margin	15.5%	14.1%	16.2%	18.6%
EPS	0.42	0.47	0.59	0.74

Major Shareholders

Moor Holding AB 15.9%
 Rovio Entertainment Oyj 9.6%
 Total Institutional 40.7%
 Total Insider 3.2%
Total 43.9%

Price Development



Investment thesis

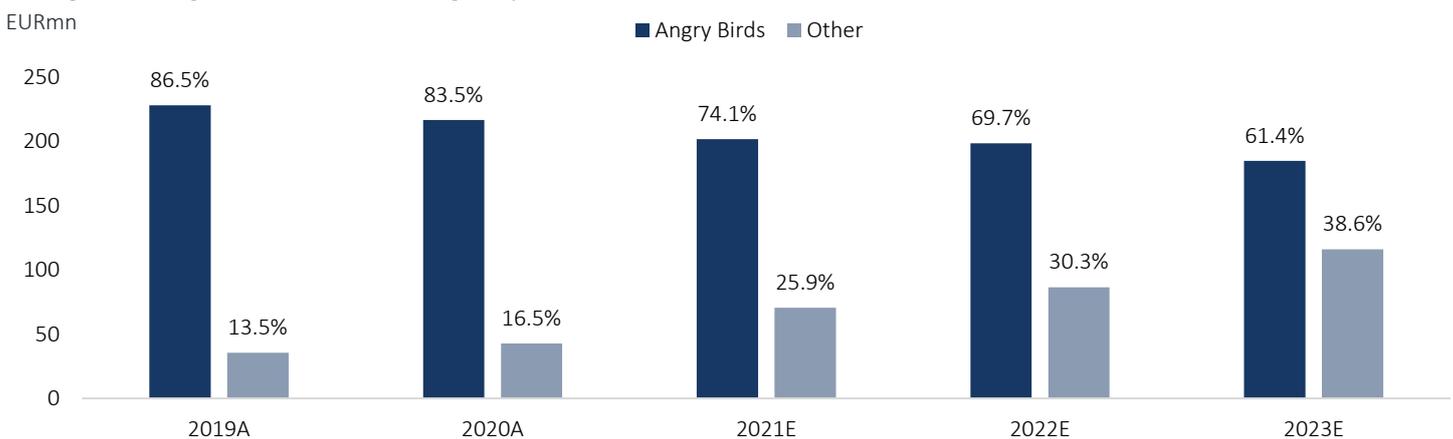
Further acquisitions allows for strong synergies and diversification of the game portfolio

In 2020A Rovio set up a studio in Montreal and acquired one in Copenhagen, to further diversify the game portfolio and allow for growth in the upcoming years. Rovio Copenhagen formerly known as Darkfire Games and developer of Darkfire Heroes, is a prime example of strong synergies in the form of centralized user acquisition, technology and analytics. The game is already showing promising gross bookings and climbed on App Store lists after launch. The game is estimated to add another EUR 24.3mn to the topline in 2022E, amounting to 8.5% of revenue. Further investments in these studios are possible due to the Company's strong cash position of EUR 88.0mn, which allows for additional acquisitions to expand to new genres and utilize synergies related to UA and technology.

Steady revenue streams are set to increase EBIT margin from 15.5% in 2020A to 18.6% in 2023E

In 2019 Rovio made several unsuccessful attempts to acquire new users, which took a toll on the year's profit. Since then, the UA strategy have been revamped to focus on the most profitable players and pave the way for solid growth in the upcoming years. User investments amounted to 22.7% of revenue from the games segment in 2020A, compared to 37.7% in 2019A. UA spending is estimated to decrease from 22.7% of revenue from the games segment in 2020A to 20.5% in 2023E. UA spending is estimated to equal EUR 64.8mn in 2021E, EUR 63.1mn in 2022E and EUR 61.6mn in 2023E. Following this, revenue is expected to grow to EUR 309.1mn in 2023E, compared to EUR 272.8mn in 2020A, implying a CAGR of 4.3%. This is primarily driven by focusing user acquisition investments on the most profitable players. However, as the Company switches to more focus on growth games, profitability is estimated to take a hit in the short term, due to increased UA investments in the game's launch phase. This is estimated to lower the profit margin to 11.2% in 2021E, compared to 12.0% in 2020A, followed by an estimated profit margin of 12.9% in 2022E and 14.8% in 2023E. Taking advantage of synergies in the form of centralized data could drive margins from potential acquisitions.

Game gross bookings estimated to increase as game-portfolio is diversified



Source: Analyst estimates, Company reports

Changes in Apple's Privacy Policy related to iOS 14 may pose a threat to UA investments

Upcoming changes in Apple's privacy policy puts UA investments at risk. The update will be rolled out with the next version of iOS 14, and it will require the user's permission to track user data across applications. Today, not much is known regarding how this change will affect user interaction and data gathering from users. Rovio are however well-prepared for this change, as mentioned in earlier company reports. In addition to a well-prepared team, Rovio's cash position and previous data allow for further flexibility if needed.

Financial forecast breakdown

Revenue expected to grow to EUR 309.1mn in 2023E due to Angry Birds 2 and new games

Game gross bookings are estimated to rise from EUR 259.2 in 2020A to EUR 300.5mn in 2023E, primarily driven by reliable income from Angry Birds 2, growing revenue from Darkfire Heroes and future game launches. Currently, 3 games are in the soft launch phase, with 1 more game expected to go live in 2021E. Licensing revenue is expected to keep declining due to a continued decrease of merchandise sales. However, this decrease in licensing revenue is estimated to enter a slower phase due to the launch of the Netflix series in 2021E. For this reason, licensing revenue of EUR 8.1mn is projected in 2023E compared to EUR 13.9mn 2020A. Altogether, revenue is estimated to be EUR 309.1mn in 2023E compared to EUR 272.8mn in 2020A, implying a CAGR of 4.3% between these years.

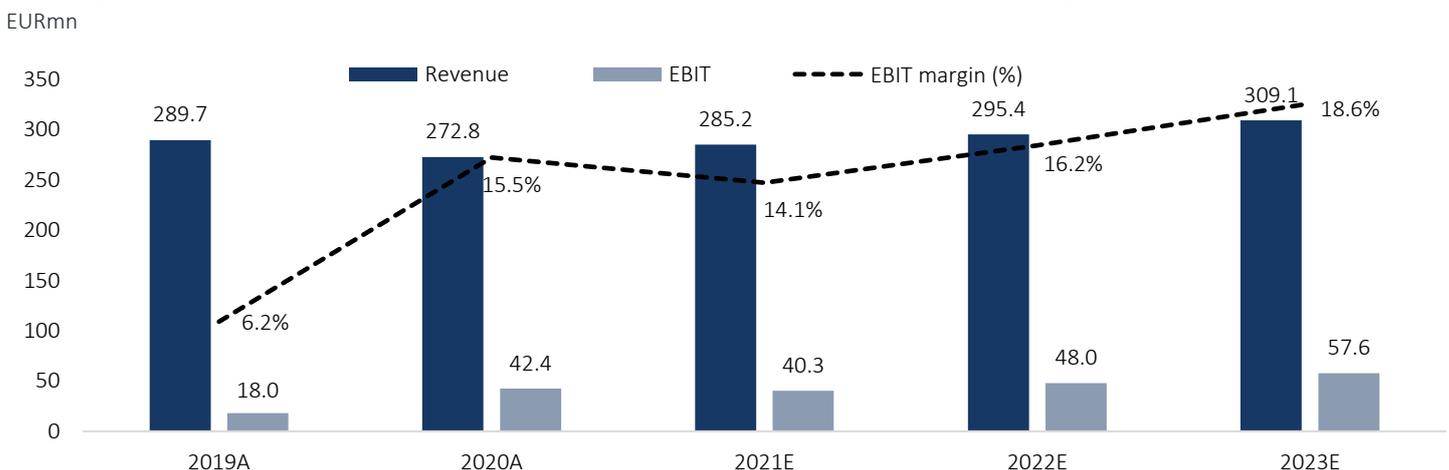
Operating expenses estimated to increase from EUR 212.9mn in 2020A to EUR 233.9mn in 2023E

Operating expenses are estimated to increase from EUR 212.9mn in 2020A to EUR 233.9mn for 2023E, due to increased personnel cost and scaling of UA investments. Driven by further acquisitions and new studios, average employees are expected to increase to 485 in 2023E from 470 in 2020A. This means increased personnel expenses of EUR 52.2mn for 2023E, compared to EUR 48.9mn in 2020A. Marketing expenses, of which 93.0% are estimated UA costs, are expected to increase to EUR 66.2mn until 2023E, from EUR 62.6mn in 2020A, primarily driven by UA investments into new games and extending the life cycle of Angry Birds 2. Materials & services and other operating income are expected to be stable in relation to revenue and are estimated to equal 27.2% and 10.2% of revenue in 2023E, equalling EUR 78.1mn and EUR 29.2mn. Altogether, this leads to an estimated EBITDA of EUR 75.2mn in 2023E, compared to EUR 59.9mn in 2020A and an EBITDA-margin of 24.3% in 2023E, compared to 22.0% in 2020A.

EBIT margin expected to decrease slightly to 14.1% in 2021 from 15.5% in 2020A

Higher operating expenses means EBIT is estimated to show a short-term decrease from EUR 42.4mn in 2020A to EUR 40.3mn in 2021E, followed by EUR 48.0mn in 2022E and growing even further in 2023E to EUR 57.5mn. This is in line with the Company's guidance in regards to UA spending on growth games leading to a short-term hit on profitability. For this reason, EBIT margin is expected to decrease from 15.5% in 2020A to 14.1% for 2021E. However, as new games gain traction, the EBIT margin is estimated to increase to 18.6% in 2023E, driven by a mature UA spending and game diversification. Depreciation and amortization are expected to be in line with previous years, and is therefore estimated to equal to 5.7% of revenue in the years 2021E-2023E. By 2023E this equals to EUR 17.6mn, compared to EUR 17.5mn in 2020A.

EBIT margin to further increase to 18.6% in 2023E after a decrease in 2021E related to UA investments in new games



Source: Analyst estimates, Company reports

Valuation

Low valuation compared to peers

Through a peer valuation method, Rovio shows excellent upside potential. Four of its peers show a median EV/EBIT of 14.1x on 2023E estimates compared to Rovio with an EV/EBIT of 8.0x. Due to Rovio's decreasing brand value and decreased revenue YoY 2019A, attributing a discount to the peer valuation is appropriate to account for its recent track record. Yet, it should be noted that Rovio's EBIT margin has in fact, increased. Considering the company's projected growth outside of Angry Birds in the years to come, looking at the forecasted multiples for 2023E illustrated in the peer table below gives a fair picture of the value of Rovio as an investment. Using the average return on equity of its peers from the 3 last years compared to Rovio, a 16.8% discount is applied to make up for its lower ROE. Applying this discount to the median EV/EBIT of its peers indicates a fair value of 10.9x EV/EBIT and an upside of 36.2% with a fair share price of EUR 8.4. Since the decline of Angry Birds in late 2017 and onwards, Rovio has been heavily discounted by the market while its future prospect is brighter than seen in recent years.

Company name	MCAP (EURmn)	EV (EURmn)	P/E (2023E)	EV/EBIT (2023E)	ROE (Avg. 2018A-2020A)
Zynga (US)	9 348.8	9406.8	22.3	13.0x	1.5%
Stillfront (Sweden)	3 210.2	2336.0	16.1	15.2x	13.8%
Glu Mobile (US)	1 411.5	1411.5	16.6	N/A	5.5%
G5 entertainment (Sweden)	410.0	392.2	17.4	7.5x	29.2%
MAG Interactive (Sweden)	111.5	138.7	57.8	21.3x	N/A
Peer average	2 898.4	2609.3	26.1	14.3x	17.1%
Peer median	1 411.5	1411.5	17.4	14.1x	9.7%
Rovio (Finland)	546.4	458.9	9.8	8.0x	14.2%
Discount to average			66.3%	44.1%	16.8%
Discount to median			49.4%	43.5%	-47%

Large cash holdings in relation to low debt

While Rovio has been vocal about its strategy to grow its game business through strategic acquisitions, the cash balance is at this point appropriately considered a safety net for unpredictable events with the potential for value creation. A core factor in the case of growth through acquisitions is Rovio's successful transition into targeting the most valuable players for its games. Due to this proficiency, they are well-equipped to improve the margin of potential acquisitions by lowering user acquisition costs. This favourable position in the market enables Rovio to acquire others and gain market share, thereby justifying a valuation more in line with peers than its current valuation.

Lower valuation compared to historical average

Rovio is currently trading at a 49.7% discount to their 4-year historical average EV/EBIT. While this discrepancy can be partly attributed to a lower growth prospect than before, Rovio showed record earnings per share of EUR 0.42 in 2020A, which is estimated to keep growing further to EUR 0.74 in 2023E. This is largely due to Rovio's streamlined marketing strategy and continued share buyback that has started to show results on the income statement and per share metrics. In addition, their stable revenue stream provides a lucrative business model to scale as the company invests outside of the Angry Birds Franchise. Considering Rovio's strong financials, future prospects and record low valuation, they are currently undervalued by 36.2%, indicating a target price of EUR 8.4.

Management and board

Alexandre Pelletier-Normand, CEO & Member of The Board

Alexandre Pelletier-Normand joined Rovio in 2019 as Head of Games. After the planned departure of previous CEO Kati Levoranta in 2020, Alexandre assumed the position of CEO at the beginning of this year. He has previously held several leadership positions at Gameloft 2003-2012 and 2014-2018, latest Executive Vice President, Games. Pelletier-Normand is also a co-founder at the investment platform Execution Labs.

Ownership (private and through companies): 11 982 shares or 0.01% of the company.



René Lindell, CFO & Member of The Board

René Lindell has been part of Rovio since 2014, holding several leadership roles. He has been in his role as CFO since 2017. Before Rovio, he has worked as Strategy Director at Nokia and Management Consultant at BCG. Lindell holds a Msc in Economics and a PhD in Engineering Physics.

Ownership (private and through companies): 19 720 shares or 0.02% of the company.



Kim Ignatius, Chairman Of The Board

Kim Ignatius has been sitting on the board of directors since 2017, assuming the role of chairman in 2020. From 2012 to 2020 he was also sitting as a member of the board at Fortum Oyj (2012-2020). Previously, he worked as executive vice president at Sonera, Telia Sonera and CFO at Tamro. He is also vice-chairman of the board of directors' Institute, Finland. Ignatius holds a BSc of Economics from the Helsinki School of Economics and Business Administration.

Ownership (private and through companies): 9 000 shares or 0.01% of the company.



Kaj Hed, Vice-Chairman Of The Board

Kaj Hed has held the position Of vice-chairman since 2017. Being one of the first investors in the Company, he has previously served as chairman of the board in 2005-2006 and 2008-2017. Kaj Hed is the cousin of founder Niklas Hed and owns approximate 15.88% of the Company through his holding Company Moor Holding AB. Before his engagement in Rovio, he served as long-time CEO of asset management firm Trema Group.

Ownership (private and through companies): 12 919 000 shares or 15.86% of the company.



Management and board

Björn Jeffery, Member of the board

Björn Jeffery joined the board of directors in 2020 and has an extensive background in digital commerce and IOS development. He has founded multiple companies and served on several leadership positions, notably Director of Future Media & Technology R&D at Bonnier. Jeffery also sits on the board of directors at Swedish companies Acast and Kinzoo Technologies.

Ownership (private and through companies): None



Jeferson Valadares, Member of The Board

Jeferson Valadares joined as a member of the board in 2019. He holds an MSc in Computer Science and Artificial Intelligence. His background is within digital games, where he has founded multiple successful companies and has been creative director and general manager of firms such as Electronic Arts and Namco Entertainment.

Ownership (private and through companies): None



Leemon Wu, Member of The Board

Leemon Wu has been sitting on the board of directors since 2020. She has her background in the financial sector, working as an analyst for Carnegie Investment Bank and C Worldwide Asset Management. She currently sits as Chief Investment Officer of Moor Holding AB, Rovio's biggest shareholder. Her current positions of trust outside of Rovio include member of the board at Avanza Fonder and Acast. Wu holds a MSc in Economics and Business Administration from Stockholm School of Economics.

Ownership (private and through companies): None



Camilla Hed-Wilson, Member of The Board

Camilla Hed-Wilson is the longest-serving member of the board of directors, assuming the role in 2011. Being a beneficial owner of Brilliant Problems Oy, she owns 7.94% of the outstanding shares.

Ownership (private and through companies): 6 459 500 shares or 7.94% of the company.



Management and board

Minna Raitanen, General Counsel

Minna Raitanen has been serving as general counsel at Rovio since 2016. She became part of Rovio in 2012 in the role of Senior Legal Counsel, a position she held until her promotion in 2016. Before joining Rovio, she served as Senior Legal Counsel at Nokia Siemens Network Oy and Nokia Oyj for seven years.

Ownership (private and through companies): 9 127 shares or 0.01% of the company.



Heini Kaihu, Senior Vice President, Human Resources

Heini Kaihu stepped into the role as Senior Vice President of HR in 2019. Before this, she served as Director of games portfolio (2012-2014) and Head of Games Studio (2014-2019). She holds an MA of Communications, Interactive and digital media. Prior to joining Rovio, she worked in multiple leadership roles at Finnish video game Company Sulake, creator of Habbo among others.

Ownership (private and through companies): 21 731 shares or 0.03% of the company.



Jacob Longer, Head of Corporate Development

Jacob Longer took on the role as Head of Corporate Development in 2020 and has been working at Rovio since 2012. He holds a Bachelor of Business in Financial Planning & Financial Management. After starting as controller of the Company, he has progressed into roles such as Business Development Specialist and Product Manager before assuming his current role.

Ownership (private and through companies): None



Ben Mattes, Head of Rovio Montreal and SVP of Future of Gaming & Angry Birds Brand Strategy

Ben Mattes joined Rovio in 2020 after an extensive background in Ubisoft Montreal and WB Games Montreal. Just before joining Rovio, he was VP of R&D and Product Management at IntelliSports, a developer of fitness applications. He holds a BSc in Computer Science from Concordia University.

Ownership (private and through companies): None



Appendix: Income Statement

Income statement, EURmn	2016A	2017A	2018A	2019A	2020A	2021E	2022E	2023E
Games	159 040.0	248 004.0	250 403.0	264 783.0	258 201.0	271 882.3	284 625.7	300 508.5
Licensing	32 664.0	49 155.0	30 767.0	24 273.0	13 956.0	12 839.5	10 271.6	8 114.6
Other operating income	50.0	767.0	1 075.0	605.0	595.0	500.0	500.0	500.0
Total revenue	191 754.0	297 926.0	282 245.0	289 661.0	272 752.0	285 211.8	295 397.3	309 123.1
Materials and services	(52 949.0)	(81 796.0)	(79 823.0)	(77 331.0)	(74 577.0)	(80 733.9)	(81 941.8)	(84 034.3)
Personnel expenses	(49 532.0)	(51 947.0)	(42 639.0)	(41 675.0)	(48 905.0)	(49 226.3)	(50 705.4)	(52 223.9)
Marketing expenses	(20 139.0)	(73 555.0)	(83 140.0)	(108 272.0)	(62 632.0)	(69 718.3)	(67 882.9)	(66 231.1)
Other operating expenses	(33 758.0)	(30 639.0)	(28 802.0)	(30 064.0)	(26 744.0)	(29 002.1)	(30 036.7)	(31 432.4)
EBITDA	35 376.0	59 989.0	47 841.0	32 319.0	59 894.0	56 541.3	64 830.5	75 201.4
EBITDA margin	18.4%	20.1%	17.0%	11.2%	22.0%	19.8%	21.9%	24.3%
D&A	(18 490.0)	(28 609.0)	(16 334.0)	(14 278.0)	(17 489.0)	(16 284.7)	(16 865.6)	(17 649.3)
EBIT	16 886.0	31 380.0	31 507.0	18 041.0	42 405.0	40 256.6	47 964.9	57 552.1
EBIT margin	8.8%	10.5%	11.2%	6.2%	15.5%	14.1%	16.2%	18.6%
Net financial items	(1 514.0)	(4 750.0)	726.0	(345.0)	(1 817.0)	(500.0)	(500.0)	(500.0)
EBT	15 372.0	26 630.0	32 233.0	17 696.0	40 588.0	39 756.6	47 464.9	57 052.1
Taxes	(4 813.0)	(6 032.0)	(7 661.0)	(4 508.0)	(8 601.0)	(7 951.3)	(9 493.0)	(11 410.4)
Net income	10 559.0	20 598.0	24 572.0	13 188.0	31 987.0	31 805.3	37 971.9	45 641.7
Net income margin	5.6%	6.9%	8.7%	4.6%	11.7%	11.2%	12.9%	14.8%

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Other

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