

Friday, November 23, 2018 | update

CD Projekt: buy (upgraded)

CDR PW; CDR.WA | IT, Poland

RDR2 Triumph Sets Scene For Cyberpunk 2077

Shares in CD Projekt have fallen 12% since our last rating in mid-October, and at the same a broader index of major video game stocks sank 22%. The Polish game developer reported a dramatic but fully-expected slump in profits in Q3 2018, compounded by the underperformance of its latest releases, the *Gwent* digital card game, and *Thronebreaker: the Witcher Tales* for Windows PC. We have had to cut our 2018-2020 revenue expectations for Gwent by an average of 50% to account for the slower-than-hoped monetization. On the other hand, however, we used the record-breaking launch of *Red Dead Redemption 2* as an indicator for the future sales of CD Projekt's next big release, *Cyberpunk 2077* (C2077), resulting in an upward revision to the expected first-year sales from 14.6 to 17.9 million copies, with more likely to be sold at the original listing price. CD Projekt is successfully building up excitement and anticipation for C2077, which has just won the Golden Joystick Award for the Most Wanted Game of 2018, and it will no doubt continue the marketing efforts to keep interest in the game high through 2019. The revised expectations for Gwent and C2077 have prompted downward revisions of 33% and 69%, respectively, to our EBITDA forecasts for 2018 and 2019, but at the same time we have hiked the 2020 target by 72%. After all this, we upgrade CDR to buy, with the new price target set at PLN 170.40.

What RDR2's monster sales spell for C2077

Red Dead Redemption 2, released on Friday, 26th October, made over \$725 million in sales during the opening weekend, which at \$60 a copy implies about 12 million copies sold in three days (available for PS4 and Xbox One consoles only). According to Superdata, digital console sales of RDR2 totaled 4 million in less than a week from release, of which 67% coming on the PS4. When it comes to C2077, the game generates similar user interest to RDR2, but it will offer wider platform support, including PCs which bring in more digital sales.

Gwent & Thronebreaker underperform

Sales of Thronebreaker, the RPG game set in the Witcher universe, missed the targets in the weeks from its October 3rd release, offered exclusively on CD Projekt's own digital distribution platform, GOG.com. The game is now also available on Steam. The Gwent card game, released on October 23rd, is also doing more poorly than hoped despite a visual revamp.

Video game sentiment turns for the worse

CDR stock is down 27% since the beginning of October, a slightly less dramatic drop than the 29% beating registered by major global gaming companies like Activision, Capcom, Take Two, Ubisoft, and Electronic Arts. Looking at the industry's very solid prospects, with each new release selling more and more copies, we take this to be a temporary downward correction. CDR is trading at a 10.1% discount to the median 12M blended forward EV/EBITDA of its peers, a ratio approximately -1 standard deviation from the 5-year mean.

(PLN m)	2016	2017	2018E	2019E	2020E
Revenue	583.9	463.2	387.7	328.6	2,317.6
EBITDA	307.9	245.8	143.5	57.6	1,595.5
EBITDA margin	52.7%	53.1%	37.0%	17.5%	68.8%
EBIT	303.6	240.9	138.7	52.3	1,589.7
Net income	250.5	200.3	115.1	41.7	1,297.1
P/E	52.8	66.1	115.0	317.4	10.2
P/CE	52.0	64.5	110.4	281.7	10.2
P/B	17.0	15.0	13.1	12.6	5.6
EV/EBITDA	41.0	51.2	87.9	220.5	7.1
DPS	0.00	1.06	0.00	0.00	0.00
Dividend Yield	0.0%	0.8%	0.0%	0.0%	0.0%

Current Price	PLN 139.00
Target Price	PLN 170.40
Market Cap	PLN 13,235m
Free Float	PLN 9,917m
ADTV (3M)	PLN 125.9m

Ownership

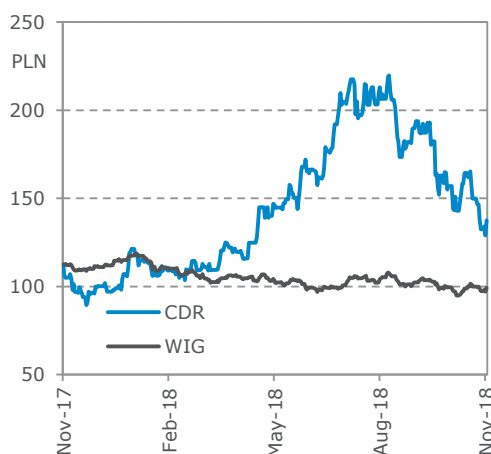
Marcin Iwiński	12.64%
Michał Kiciński	10.91%
Piotr Nielubowicz	6.38%
Nationale-Nederlanden PTE	5.20%

Others 64.87%

Business Profile

Game development is a project-based business where the success of each release is determined by the skills of each studio as well as its brand recognition, budget, and marketing strategy. Developers creating the next installments of already popular games are subject to less severe investment risks.

CDR vs. WIG



Company	Target Price		Rating	
	new	old	new	old
CD Projekt	170.40	136.60	buy	reduce

Company	Current Price	Target Price	Upside
	139.00	170.40	+22.6%

Forecast Update	2018E	2019E	2020E
Revenue	-18.0%	-30.3%	+48.0%
EBITDA	-32.9%	-68.9%	+71.5%
Net profit	-35.8%	-74.5%	+57.7%

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List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for CD Projekt in the 12 months prior to this publication:

Rating	reduce	sell	sell
Rating date	2018-10-16	2018-04-06	2018-02-02
Target price (PLN)	136.60	90.80	90.00
Price on rating day	158.60	114.90	115.00

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