

Tuesday, 26 May, 2020 | update

Ten Square Games: accumulate (upgraded)

TEN PW; TENP.WA | Gaming, Poland

Scaling to Win

Ten Square Games (TEN) grew 2020 first-quarter EBITDA by a staggering 205% compared to the same year-ago period, thanks mainly to smart scaling of the sales and marketing strategy for its hit mobile game, Fishing Clash. In April 2020, TEN registered an acceleration in the annual rate of sales expansion to 197% from an average of 126% experienced in the three months prior. This after the Company significantly scaled up marketing expenses for the month to PLN 19.2m versus a combined total of PLN 18.3m spent in the first three months of the year. In May, marketing spend in the month to date has already exceeded PLN 16m. TEN decided to up expenditures on user acquisition after conducting assessments into the impact of the coronavirus pandemic on gamer behavior, which identified potential to increase profits from greater traffic. An up-sized budget dedicated to driving users to Fishing Clash will pay dividends for several months to come. TEN can afford to freely and flexibly scale its marketing spend thanks to a comfortable cash position. The Fishing Clash team is constantly working on improving user experience and making the game more engaging. Based on the strong first-quarter performance, looking at the potential of Fishing Clash in the current reality, we opt to raise our 2020 sales growth forecast for the fame from 80% to 162%, and revise the 2021 projection upward from 20% to 30%. At the same time, we also adjust the expected 2020 ratio of marketing expenses to sales higher to 28% from the original estimate of 26.9%. Accordingly, we now expect TEN to generate revenues of PLN 588m in 2020 compared to the original estimate of PLN 417m, and we are anticipating the annual net profit to be PLN 179m, representing an increase on the previous forecast of PLN 131m. With that, we upgrade TEN to accumulate and we raise the target price to PLN 592 per share.

TEN posts stellar first-quarter results

Ten Square Games released preliminary first-quarter numbers shinged that, compared to the same period a year earlier, the quarterly sales increased by 110% to PLN 95m, and EBITDA (IAS 17) surged by 205% to PLN 38.1m. Cash as of 31 March 2020 is estimated at PLN 105m versus PLN 51m reported in March 2019. TEN revealed that sales in April continued their fast-paced growth.

Scaled-up ad spend

TEN has increased expenditures on user acquisition strategies in order to capitalize on a stronger mobile gaming momentum. In April, marketing spend amounted to PLN 19.2m, exceeding the combined monthly expenditures for the three months prior. Ad spend in May has already topped PLN 16m. We believe TEN can successfully boost sales of Fishing Clash with intensified advertising.

Improving KPIs

Fishing Clash had 2.9 million monthly active users (MAU) in Q1 2020, an increase of 45% from the same period a year earlier and a 56% rebound from the previous quarter. At the same time, average revenue per user (ARPU) grew by 55% y/y to PLN 9.75 (compared to the quarter prior ARPU was down 20%). TEN's hunting simulator, Wild Hunt, as well continued to improve performance in the first quarter, reflected in 52% y/y MAU growth to 1.3 million (+61% q/q). Looking ahead, we expect TEN's marketing strategy for Fishing Clash to continue driving user numbers, supported by new features and upgrades, new gameplay modes, and smart deployment of live ops.

(PLN m)	2018	2019	2020E	2021E	2022E
Revenue	115.3	241.1	587.7	782.6	885.5
EBITDA	45.0	85.7	199.7	261.4	292.5
EBITDA margin	39.1%	35.6%	34.0%	33.4%	33.0%
EBIT	44.3	84.6	196.8	257.5	288.1
Net profit	36.3	76.3	178.5	231.6	259.2
P/E	108.0	51.4	22.4	17.2	15.4
P/CE	106.0	50.6	22.0	16.9	15.1
P/B	93.2	42.6	16.3	11.7	9.3
EV/EBITDA	86.2	44.9	19.0	14.2	12.4
DPS	0.87	3.75	3.70	18.09	23.47
Dividend Yield	0.2%	0.7%	0.7%	3.4%	4.4%

Current Price	PLN 539.00
Target Price	PLN 592.00
MCap	PLN 3.9bn
Free Float	PLN 1.9bn
ADTV (3M)	PLN 24.3m

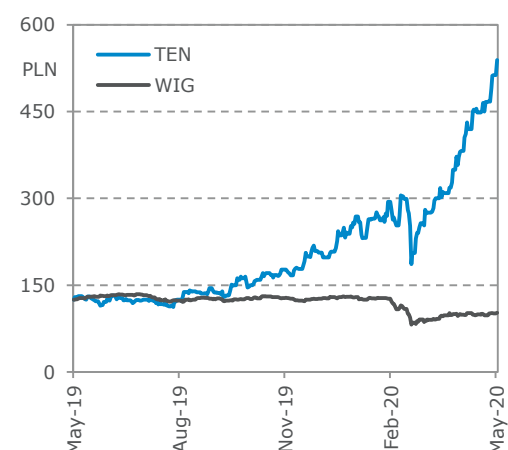
Ownership

Agreement of Shareholders	50.15 %
Others	49.85 %

Business Profile

Ten Square Games was formed in 2011, first as a browser game company which gradually shifted toward developing games for mobile. Toward the end of 2017 TEN released Fishing Clash, which quickly became the most popular of the Company's games and its s #1 best-seller.

TEN vs. WIG



Name	Target Price		Recommendation	
	new	old	new	old
TEN	592.00	462.00	accumulate	hold

Name	Current Price	Target Price	Upside
	539.00	592.00	+9.8%

Forecast Update	2020E	2021E	2022E
Revenue	+41.0%	+49.6%	+48.2%
EBITDA	+35.6%	+42.2%	+38.6%
Net Profit	+36.7%	+42.0%	+38.4%

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Valuation

We used discounted cash flow analysis and relative valuation to assess the value of Ten Square Games. The DCF model yielded a per-share valuation of PLN 523.80 per share, and the per-share value obtained with multiples comparison amounted to PLN 589.50. Based on this, we set our 9-month target price at PLN 592 per share.

(PLN)	weight	price
Relative Valuation	50%	589.50
DCF Analysis	50%	523.80
	price	556.65
9M target price		592.00

DCF Valuation

Assumptions:

- Cash flow is discounted as of the end of May 2020. Equity value calculations factor in net cash as of 31 December 2019.
- We assume that Ten Square Games will report EBITDA growth at an average annual rate of 39% in the 2019-23 period to a target PLN 317m.
- We assume an annual tax rate of 10% in 2020-28 thanks to Poland's "IP Box" innovation tax incentive scheme.
- The risk-free rate is 3.5%.
- We assume that FCF after FY2029 will grow at an annual rate of 2.5%.
- Beta=1.0.

Sales projection

(PLN m)	2015	2016	2017	2018	2019	2020P	2021P	2022P	2023P
Fishing Clash	0.0	0.0	3.8	88.8	206.5	543.1	706.0	776.6	815.5
Let's Fish	14.3	13.0	12.8	16.5	15.2	15.0	15.0	14.8	14.5
Wild Hunt	0.0	0.0	0.9	4.9	9.6	11.4	12.6	13.9	15.2
Other games	0.0	0.0	9.6	5.2	9.8	18.2	48.9	80.1	116.8

DCF Model

(PLN m)	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	2029P	2029P+
Revenue	587.7	782.6	885.5	962.1	1,028.8	1,091.9	1,023.8	966.8	920.4	881.4	
change	143.7%	33.1%	13.2%	8.6%	6.9%	6.1%	-6.2%	-5.6%	-4.8%	-4.2%	
EBITDA	199.7	261.4	292.5	317.4	341.4	362.4	340.9	323.5	310.6	299.7	
EBITDA margin	34.0%	33.4%	33.0%	33.0%	33.2%	33.2%	33.3%	33.5%	33.7%	34.0%	
D&A expenses	2.9	3.9	4.4	4.8	5.1	5.5	5.1	4.8	4.6	4.4	
EBIT	196.8	257.5	288.1	312.6	336.3	356.9	335.8	318.7	306.0	295.3	
EBIT margin	33.5%	32.9%	32.5%	32.5%	32.7%	32.7%	32.8%	33.0%	33.2%	33.5%	
Tax on EBIT	19.6	25.7	28.8	31.3	33.6	35.7	33.6	31.9	30.6	29.5	
NOPLAT	177.2	231.7	259.3	281.4	302.7	321.2	302.2	286.8	275.4	265.8	
CAPEX	7.3	9.8	11.0	12.0	12.9	13.6	12.8	12.1	11.5	4.4	
Working capital	-22.7	-12.9	-6.8	-5.1	-4.4	-4.2	4.5	3.8	3.1	2.6	
FCF	150.1	213.0	245.8	269.1	290.5	308.9	299.0	283.4	271.5	268.4	275
WACC	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	
discount factor	95.2%	87.8%	80.9%	74.5%	68.7%	63.3%	58.4%	53.8%	49.6%	45.7%	
PV FCF	142.9	186.9	198.8	200.6	199.6	195.6	174.5	152.4	134.6	122.6	

WACC	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	
Cost of debt	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	
Risk-free rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	
Credit risk premium	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	
Effective tax rate	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	
Net debt / EV	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
Cost of equity	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	

FCF growth after the forecast period	2.50%
Terminal value	4,585
Present value of terminal value	2,095
Present value of FCF in the forecast period	1,709
Enterprise value	3,803
Net debt	-75
Equity value	3,879
Shares outstanding (millions)	7.41
Equity value per share (PLN)	523.80
9M cost of equity	6.4%
9M target price (PLN)	557.20
EV/EBITDA('21) at target price	14.8
P/E('21) at target price	17.8
TV / EV	55%

Sensitivity Analysis

	FCF growth in perpetuity				
	1.5%	2.0%	2.5%	3.0%	3.5%
WACC -1.0 p.p.	565.50	589.50	617.50	650.60	690.40
WACC -0.5 p.p.	528.80	550.80	576.40	606.70	643.00
WACC	511.70	532.70	557.20	586.10	620.90
WACC +0.5 p.p.	495.30	515.40	538.80	566.50	599.80
WACC +1.0 p.p.	464.50	482.90	504.40	529.70	560.20

Relative Valuation

We compared the forward P/E and EV/EBITDA multiples of Ten Square Games with the multiples of comparable companies as projected for FY2020 through 2022. The peer group consists of global video game developers, Internet-based companies, and mobile social groups. All the forecast years and both multiples are assigned equal weights.

Multiples Comparison

	price	P/E			EV/EBITDA		
		2020E	2021E	2022E	2020E	2021E	2022E
NEXON CO LTD	2,204	14.2	16.4	18.6	12.0	10.7	10.5
NETEASE INC-ADR	372	22.7	20.6	19.1	13.3	11.6	12.1
IGG INC	5	6.9	5.5	5.2	2.6	2.3	2.0
KOEI TECMO HOLDI	3,110	23.0	24.1	24.4	29.5	19.8	15.5
WUHU SANQI IN-A	34	24.2	24.7	21.9	19.6	16.5	13.9
TENCENT	417	32.7	30.1	25.7	21.2	17.6	15.0
Minimum		6.9	5.5	5.2	2.6	2.3	2.0
Maximum		32.7	30.1	25.7	29.5	19.8	15.5
Median		22.9	22.3	20.5	16.5	14.1	13.0
TEN	539.0	22.3	17.2	15.4	19.0	14.2	12.4
premium / discount		-2%	-23%	-25%	15%	1%	-4%
Implied Valuation							
Median		22.9	22.3	20.5	16.5	14.1	13.0
Multiple weight			50%			50%	
Year weight		33%	33%	33%	33%	33%	33%
Equity value per share (PLN)	589.5						

Earnings History and Future Projections

(PLN m)	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Revenue	27.0	115.3	241.1	587.7	782.6	885.5	962.1	1,028.8
change	55.8%	326.4%	109.2%	143.7%	33.1%	13.2%	8.6%	6.9%
COGS	5.8	7.4	11.4	29.4	38.8	43.8	47.6	50.8
Gross profit	21.2	107.9	229.8	558.3	743.7	841.6	914.5	978.0
Gross margin	78.4%	93.6%	95.3%	95.0%	95.0%	95.0%	95.1%	95.1%
SG&A	10.3	62.9	144.2	360.8	486.3	553.6	601.8	641.7
Other operating activity (net)	0.0	-0.7	-1.0	-0.8	0.0	0.0	0.0	0.0
EBIT	10.9	44.3	84.6	196.8	257.5	288.1	312.6	336.3
change	172.9%	308.0%	90.9%	132.7%	30.8%	11.9%	8.5%	7.6%
EBIT margin	40.2%	38.4%	35.1%	33.5%	32.9%	32.5%	32.5%	32.7%
Net financing gains/losses	-0.6	0.6	0.0	1.6	0.0	0.0	0.0	0.0
Pre-tax profit	10.2	44.9	84.6	198.4	257.5	288.1	312.6	336.3
Tax	1.8	8.4	8.2	19.8	25.7	28.8	31.3	33.6
Minority interests	17.8%	18.7%	9.7%	10.0%	10.0%	10.0%	10.0%	10.0%
Net profit	8.2	36.3	76.3	178.5	231.6	259.2	281.3	302.6
change	165.2%	340.8%	110.2%	134.0%	29.7%	11.9%	8.5%	7.6%
margin	30.5%	31.5%	31.6%	30.4%	29.6%	29.3%	29.2%	29.4%
D&A expenses	0.6	0.7	1.2	2.9	3.9	4.4	4.8	5.1
EBITDA (IFRS 16)	11.4	45.0	85.7	199.7	261.4	292.5	317.4	341.4
change	153%	293%	90%	133%	31%	12%	9%	8%
EBITDA margin	42.3%	39.1%	35.6%	34.0%	33.4%	33.0%	33.0%	33.2%
Shares outstanding at eop (millions)	7.3	7.3	7.3	7.4	7.4	7.4	7.4	7.4
EPS	1.1	5.0	10.5	24.1	31.3	35.0	38.0	40.9
ROA	119.3%	249.1%	221.0%	222.5%	121.9%	79.8%	67.1%	59.6%
ROE	151.2%	310.5%	283.7%	266.0%	137.7%	88.4%	73.1%	64.2%

Balance Sheet

(PLN m)	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
ASSETS	14.6	54.5	106.0	274.0	375.6	463.1	551.6	644.6
Fixed assets	2.2	2.7	4.9	15.1	21.0	27.6	34.8	42.5
Property, plant and equipment	1.6	2.2	3.4	3.6	3.6	3.6	3.6	3.6
Intangible assets	0.1	0.2	0.6	10.4	16.3	22.9	30.1	37.8
Equity investments	0.2	0.0	0.6	0.7	0.7	0.7	0.7	0.7
Other fixed assets	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Current assets	12.4	51.8	101.1	258.9	354.7	435.6	516.8	602.1
Inventory	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current receivables	4.6	10.7	20.7	50.5	67.3	76.2	82.7	88.5
	0.3	0.8	1.6	1.5	1.5	1.5	1.5	1.5
Other current assets	6.6	39.8	75.2	202.9	281.9	353.9	428.6	508.1
Cash and cash equivalents	1.0	0.5	3.6	3.9	3.9	3.9	3.9	3.9

(PLN m)	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
EQUITY & LIABILITIES	14.6	54.5	106.0	274.0	375.6	463.1	551.6	644.6
Equity	11.7	42.1	92.1	244.3	342.1	427.5	514.4	606.1
Non-current liabilities	0.3	0.4	0.5	6.3	6.3	6.3	6.3	6.3
Tax provisions	0.3	0.4	0.5	0.8	0.8	0.8	0.8	0.8
Other	0.0	0.0	0.0	5.5	5.5	5.5	5.5	5.5
Current liabilities	2.6	12.0	13.4	23.4	27.2	29.3	30.8	32.1
Loans and borrowings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Trade payables	1.0	2.7	4.6	12.0	15.8	17.9	19.4	20.7
Payable taxes	1.1	7.7	6.1	8.0	8.0	8.0	8.0	8.0
Other reserves	0.1	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Other	0.4	1.4	2.3	2.9	2.9	2.9	2.9	2.9
Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net debt	-6.6	-39.8	-75.2	-202.9	-281.9	-353.9	-428.6	-508.1
Net Debt / Equity	-56.2%	-94.5%	-81.6%	-83.0%	-82.4%	-82.8%	-83.3%	-83.8%
Net Debt/ EBITDA	-0.6	-0.9	-0.9	-1.0	-1.1	-1.2	-1.4	-1.5
BVPS	1.6	5.8	12.7	33.0	46.2	57.7	69.5	81.8

Cash Flow

(PLN m)	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Cash flow from operating activities	7.7	41.2	66.4	161.4	222.7	256.9	281.1	303.4
Net profit	10.2	44.8	84.6	198.4	257.5	288.1	312.6	336.3
D&A expenses	0.6	0.7	1.2	2.9	3.9	4.4	4.8	5.1
Working capital	-2.3	-4.1	-11.6	-22.7	-12.9	-6.8	-5.1	-4.4
Other	-0.9	-0.2	-7.7	-17.3	-25.7	-28.8	-31.3	-33.6
Cash flow from investing activities	-0.4	-1.8	-3.5	-7.3	-9.8	-11.0	-12.0	-12.9
CAPEX	-0.4	-1.8	-3.5	-7.3	-9.8	-11.0	-12.0	-12.9
Other	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Cash flow from financing activities	-2.7	-6.3	-27.3	-27.4	-134.0	-173.8	-194.4	-211.0
Share issue	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repurchase of treasury stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends/Buyback	-2.9	-6.3	-27.3	-27.4	-134.0	-173.8	-194.4	-211.0
Other	0.0	0.0	0.0	-0.2	0.0	0.0	0.0	0.0
Change in cash	4.5	33.2	35.6	126.7	79.0	72.0	74.7	79.5
Cash at eop	6.6	39.8	75.2	203.1	282.1	354.1	428.8	508.3
DPS (PLN)	0.39	0.87	3.75	3.70	18.09	23.47	26.26	28.50
FCF	6.8	30.9	62.4	150.1	213.0	245.8	269.1	290.5
CAPEX/Sales	1.7%	1.5%	1.4%	1.2%	1.2%	1.2%	1.2%	1.2%

Trading Multiples

	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
P/E	476.2	108.0	51.4	22.4	17.2	15.4	14.2	13.2
P/CE	445.0	106.0	50.6	22.0	16.9	15.1	14.0	13.0
P/B	335.4	93.2	42.6	16.3	11.7	9.3	7.8	6.6
P/S	145.1	34.0	16.3	6.8	5.1	4.5	4.1	3.9
FCF/EV	0.2%	0.8%	1.6%	4.0%	5.7%	6.8%	7.6%	8.3%
EV/EBITDA	342.2	86.2	44.9	19.0	14.2	12.4	11.2	10.2
EV/EBIT	360.4	87.6	45.5	19.3	14.4	12.6	11.4	10.4
EV/S	144.8	33.7	15.9	6.4	4.7	4.1	3.7	3.4
DYield	0.1%	0.2%	0.7%	0.7%	3.4%	4.4%	4.9%	5.3%
Price (PLN)	539.00	539.00	539.00	539.00	539.00	539.00	539.00	539.00
Million shares outstanding at eop (adj.)	7.3	7.3	7.3	7.4	7.4	7.4	7.4	7.4
MC (PLN m)	3,921	3,921	3,921	3,991	3,991	3,991	3,991	3,991
Minority interest (PLN m)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EV (PLN m)	3,915	3,881	3,846	3,788	3,709	3,637	3,563	3,483

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

Recommendations of Biuro maklerskie mBanku:

A recommendation is valid for a period of 9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
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mBank issued the following recommendations for Ten Square Games in the 12 months prior to this publication:
Ten Square Games

recommendation	hold	buy
date issued	2020-05-05	2020-04-23
target price (PLN)	462.00	462.00
price on rating day	450.00	371.00

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