

THQ Nordic

Sector: Gaming

Accelerating game investments

Strong yet again

THQ Nordic produced, yet again, a strong quarter. There was no significant new release during the quarter, and despite that, the Group showed a net sales uptake of 36%, mainly fueled by a considerable increase in Backlog revenue. We have previously highlighted the importance of THQ Nordic's growing IP portfolio. This quarter is an excellent example of why the monetization of the back catalog is a real strength of the Group.

Six acquisitions

THQ Nordic presented no less than six acquisitions in conjunction with the Q1 report. The most significant was the racing studio/publisher Milestone and the studio Gunfire Games. Both companies have title releases during Q2, where at least Gunfire Games Remnants: Form the Ashes seems to have been a success.

Saint Row confirmed and a new parent company name

Other than the acquisitions, some more exciting news was presented. The Parent company will change its name to Embracer Group, creating less risk of more miscommunications. The name change will not affect the subsidiaries or their branding. The company confirmed that the Deep Silver studio Volition is working on a new Saints Row game, which is currently "deep" into development. THQ Nordic also states that they plan to release two AAA titles during FY21, where the new Saints Row likely is one.

A premium valuation is warranted

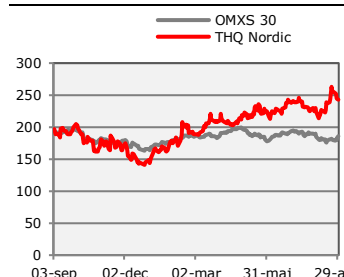
Our Base-case now stands at **300** (275) SEK per share. We have increased our estimates because of the latest acquisitions and due to more in-depth insight into the long-term pipeline. As always, the management and M&A is an essential part of the investment case in THQ Nordic; we patiently await the next bigger deal. The game investments are ramping up, and the pipeline seems strong. As such, we are positive about the company's prospects. Today THQ Nordic trades EV/Oper. EBIT FY20E of 21x, as the company has just recently conducted some acquisitions, we believe FY21 is more representative of underlying earnings which stand at 15x. We find that THQ Nordic's history of acquisitions, growth prospects, and IP portfolio strength should warrant a premium valuation and that 15x FY21 Operational EBIT is attractive.

KEY FINANCIALS (SEK)	2017	18/19	FY20E	FY21E	FY22E	FY23E
Net sales	508	5754	5572	6939	8118	9092
EBITDA	273	1592	1815	2478	2899	3420
Oper. EBIT	202	880	1080	1486	1765	1832
EPS (adj.)	1.8	3.5	3.8	6.6	9.0	11.3
EV/Sales	19.9	3.2	4.0	3.1	2.7	2.3
EV/EBITDA	37.0	11.7	12.4	8.8	7.4	6.2
EV/EBIT	50.0	20.9	21.1	15.4	12.9	12.5
P/E	77.0	59.9	63.7	36.6	26.9	21.4

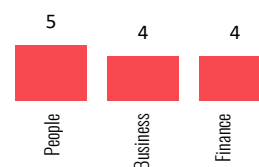
FAIR VALUE RANGE

BEAR	BASE	BULL
183.0	300.0	380.0

THQNO.ST



REDEYE RATING



KEY STATS

Ticker	THQNO.ST
Market	Nasdaq
Share Price (SEK)	242.0
Market Cap (MSEK)	25128
Net Cash 19E (MSEK)	2602
Free Float	50 %
Avg. daily volume ('000)	150

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Embracer Group

Estimates vs Outcome THQ Nordic				
MSEK	FY19- Q1*	FY20- Q1	FY20- Q1E	Diff %
Net sales	837	1 142	1 001	14%
<i>of which New releases Games</i>	98	117	110	7%
<i>Backlog Games</i>	386	524	432	21%
<i>Partner Publishing/Film</i>	354	501	460	9%
Gross profit	371	614	501	23%
EBITDA	207	389	327	19%
Operational EBIT	66	204	187	9%
EBIT	53	81	57	44%
Revenue growth	879%	36%	20%	
Gross profit margin	44%	54%	50%	
EBITDA margin	25%	34%	33%	
Opr. EBIT margin	8%	18%	19%	
EBIT margin	6%	7%	6%	

Source: Redeye Research

*FY19-Q1 was the second quarter of the extended year 19/20, but for easier comparison, we call it Q1.

- Strong report despite no significant new releases. Back catalog sales fuel both sales and profitability
- Sex new acquisitions, Milestone, and Gunfire being the most significant both have new games coming to the market during August.
- Game investment at new record levels, a strong indication of continued growth
- The parent company name will be changed to Embracer Group
- Confirmation that Volition is working on a new Saints Row game that is already "deep" into the development
- The company plans to release two AAA game in FY21, one of which we believe is the new Saints Row title
- CEO Lars Wingefors states that the pipeline of M&A candidates is solid

THQ Nordic showed, yet again, a strong quarter. There was no significant new release during the quarter, and despite that, the Group showed a net sales uptake of 36%, mainly fueled by a considerable increase in Backlog revenue. The company also states that the releases Fade to Silence has performed below expectations, so still producing growth in new releases was impressive. We have highlighted before the importance of THQ Nordic's growing IP portfolio. This quarter is a great example of why the monetization of the back catalog is a true strength of the Group. The main drivers of the steady sale of catalog games where Metro Exodus, Outward, Kingdom Come and Coffee Stain's Satisfactory.

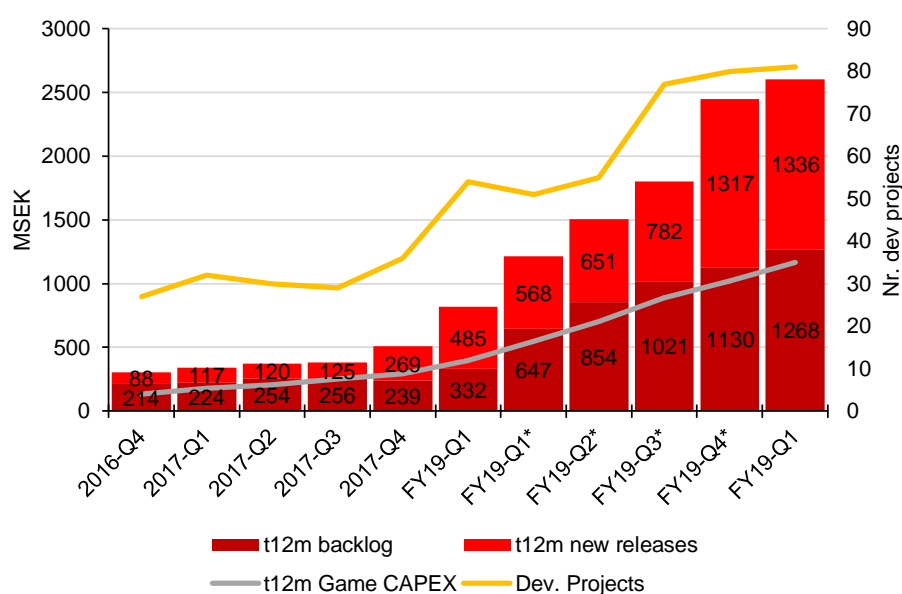
Margin wise the Gross profit margin came in at a high figure of 54%. The main driver of the healthy margin was that the significant portion of backlog sales, which is also digital. Digital sales summed up to 71% of the Games revenue, to be compared to the TTM (trailing twelve months) figure of 58%. The income mix was also favorable as Partner Publishing stood for a smaller portion of the Group sales. The Operational EBIT came in 9% higher than our estimate. Staff related cost was somewhat higher than we thought, likely driven by the new

cost structure after the latest acquisitions. We want to highlight yet again that THQ Nordic have roughly SEK 120m in acquisition-related amortization as they follow the K3 accounting standard. If IFRS reporting had been implemented, the EBIT would be more or less equal to Operational EBIT.

Game investments

Investment into game projects continued at a record pace and amounted to SEK 356m during the quarter; the new game projects, of course, be a driver of growth for many years. On a t12m (trailing twelve months) basis, game-related investments reached a record high of approximately SEK 1.3bn. At the end of June, there were 81 projects in development where 47 I still yet to be announced. The new acquisitions of Milestone and Gunfire also add more projects and increase the pipeline.

THQ Nordic: t12m; backlog, new releases, game CAPEX and dev. proj.



Source: Redeye Research

News from Gamescom

THQ Nordic had a significant presence at this year's Gamescom in Cologne where fans could test most of the upcoming games. To our understanding the reception has been good, there were also some announcements of new games; Comanche, Knights of Honor 2 and more.

Other announcements: Embracer Group and Saint Row

Other than the acquisitions, some more exciting news was presented. The Parent company will change its name to Embracer Group. Previously, some miscommunications within the Group has occurred because both the Parent and the subsidiary in Vienna was named THQ Nordic. The name change will not affect the subsidiaries or their branding.

The company now have confirmed that the Deep Silver studio Volition is working on a new Saints Row game, which is currently "deep" into development. THQ Nordic also states that they plan to release two AAA titles during FY21, where the new Saints Row likely is one. Dambuster is now leading the development of Dead Island 2. Fishlabs has started working on a new IP and Steve Ellis the co-creator of TimeSplitters has joined Deep Silver. Exciting times ahead to say the least!

Six new acquisitions

THQ Nordic presenter no less than six acquisitions in conjunction with the report. We go into them briefly here but advise a reader to look into the full presentation that was released in conjunction with the Q1 report. Found [here](#).

Milestone

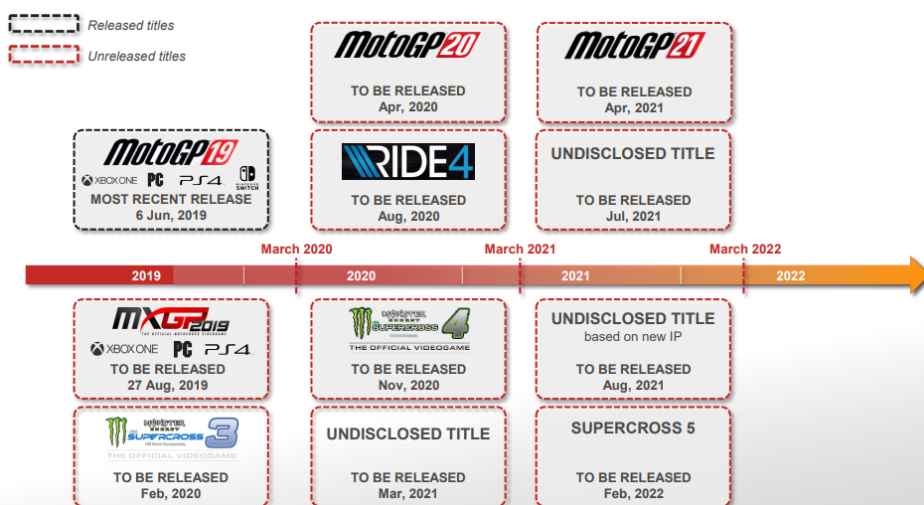
See the full presentation of the acquisition here. The most significant purchase was the Milano based racing focused developer and publisher Milestone. The main titles of Milestone are the licensed franchises of MXGP, MotoGP and Monster Energy Supercross and also their IP RIDE. What we like about this acquisition is the repetitive nature of Milestone’s games. In a simplified matter: they release a new MXGP and MotoGP game each year, MotoGP17, MotoGP18, etc. And create semi-annual games for Monster Energy Supercross and RIDE. The recurring nature of the game portfolio that Milestone have it’s easier, compared to most gaming companies, to estimate future revenue. The newest games released also have an increased focus on complete gameplay thought a multiplayer mode. MotoGP also have their own eSport [championship](#).



Milestone has a rich history and was founded in 1994. The company have sold 8 million copies and developed 50 games since the founding. Headquartered in Milan Italy with approximately 200 FTEs, the company transitioned from work-for-hire in 2013.



Financials and price-tag



During FY20 THQ Nordic have a target that Milestone will generate net revenues of EUR 27.5-32.25m, EBITDA of EUR 15.5-18.0 in EBITDA and EUR 10.75-12.5m in operational EBIT. During the year the studio will have, as shown in the picture above, three releases. MotoGP19

was released before the acquisition and will likely only moderately contribute to THQ Nordic's FY20. In FY21 and FY22 there will be four releases each year.

MXGP 2019 was released on the 27th of August, as of this writing (just a few days after) it looks like the critic reviews will land on roughly the same levels as the previous installment MXGP Pro.



Metascore
Mixed or average reviews
based on 6 Critics

Milestone Financials

Period	FY19	FY20T*	FY21E	FY22E
Net sales	28.2	29.9	35.9	41.2
EBITDA	15.0	16.8		
EBIT	9.3	11.6	13.3	15.3
Growth		6%	20%	15%
EBIT margin	33%	39%	37%	37%
Nr. yearly releases	1.0	2	1	1
Nr. bi-yearly releases	2.0	1	2	1
Undisclosed			1	2
Total releases	3.0	3.0	4.0	4.0
Avg. income per release (mEUR)	9.4	10.0	9.0	10.3
EV (up-front)	44.9			
EV (mid earn-out)	73.8			
EV (max earn-out)	82.5			
EV/EBIT multiples				
Up-front	5x	4x	3x	3x
With mid earn-out	8x	6x	6x	5x
With max earn-out	9x	7x	6x	5x

Source: Redeye Research

*T= target from THQ Nordic (assumed mid-range of target)

Based on the current release schedule, we believe that Milestone will produce net revenues of roughly EUR 35-40m per year during FY21 and 22. We expect that the margin will be in line with the FY20 target of 39% on the operational EBIT level. Believe that the recurring nature of Milestones creates more "New release" income during an ordinary year compared to the Group in total.

The price THQ Nordic is paying for Milestone corresponds to an EV of 44.9, there are also earn-outs based on future performance. Even if full earn-out is paid this only amount to 7x Operational EBIT during FY20 (mid-range).

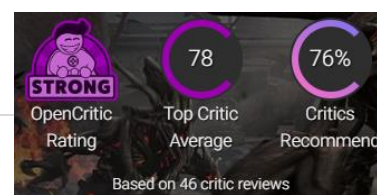
Gunfire games

Gunfire Games is a long collaborator to the Nordic, and they were the developer of Darksiders III. The Austin based studio has roughly 70 FTE's and extensive experience from the industry. The IP portfolio is also strong with; From other Suns, Remnant, and Chronos. THQ Nordic now won't have to pay royalties for Darksiders III, so the Group makes savings there. The price-tag was not disclosed, but the management expects to recoup the investment after 3-4 years, meaning they are paying a low single-digit multiple on Operational EBIT.



The success of Remnant: From the Ashes

Remnant is a new IP created by Gunfire, and the game was released on the 20th of August, just six days after



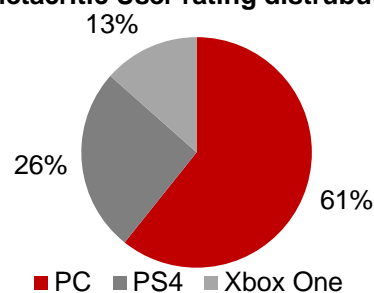
the acquisition. The title is in the AA class, meaning a smaller budget and a price of 39.99\$. Perfect World is the publisher, as such the profitability and income from the game is lower than if THQ Nordic would had published the title

It's always hard to gauge the sales figures for a game as there are no exact figures to look at. However, looking at the CCU on Steam, reviews from critics and Steamspy owner estimate it seems like the game has been a success. Especially for a wholly new IP.

The CCU has been climbing, which is a good indication of a stable release. According to Steamspy's estimate, the game had roughly 300k owners on Steam after one week and have 6k plus reviews with a score of 81%. We believe that the sales will be heavily tilted to digital and PC as the most significant platform. If we assume that the Metacritic user rating distribution is a representative measure for sales split

between the platforms. The indicated first-week units sold lands at roughly 490k. When it comes to game releases, week-one usually stand for 40-50% of the total sold units during the first three months. Using that estimation, Remnant will likely close in on one million units sold sometime in November. However, we want to stress that Gunfire was "only" the developer and Perfect World the publisher. Most of the income will go to the publisher and especially at the beginning from marketing recoups etc.

Metacritic User rating distribution



And four more....

THQ Nordic also announced that they had acquired Goodbye Kansas Game Invest, which is an investment vehicle previously owned by the Goodbye Kansas Group. The royalty contract for Biomutant was also included in the deal. The Group also acquired three more companies. Two; Gaya Entertainment and Game Outlet Europe, previously owned or controlled by the Group CEO Lars Wingefors, and were bought at very low prices. The purchase price amounted to 10 MSEK and 1 euro for the two business that together produced roughly SEK 150m in sales during 2018. The Film leg within the Partner Publishing business also acquired KSM, a leading provider of anime film in Germany. Foxglove, the free-to-play focused mobile studio within the Group, has been sold to the employees for a nominal amount.

A loaded gun for more acquisitions

In the investor presentation, CEO Lars Wingefors states that the pipeline of M&A objects is "solid". They are both looking at bolt-on acquisitions of studios and publishers but also adding a fourth "leg" to the Group. As of 30 Jun 2019, the company had cash and cash equivalents of SEK 3 159m. Available liquidity including credit facilities was SEK 4 671m, to there is still room for more significant deals.

Forecasts for the Group

Detailed estimates THQ Nordic (Group)							
Period	Quarterly projections				Yearly projections		
	FY19-Q1	FY20-Q2E	FY20-Q3E	FY20-Q4E	FY20E	FY21E	FY22E
Net sales	1142	1008	1447	1976	5572	6939	8118
Of which New releases games	117	249	577	884	1828	2650	3180
Backlog games	524	310	290	317	1441	1802	2252
Partner Publishing/Film	501	448	580	774	2303	2487	2686
Other income	176	132	205	281	794	834	875
CoS	-528	-484	-752	-988	-2752	-3331	-3897
Gross profit	614	524	694	988	2820	3608	4221
Other OPEX	-178	-151	-217	-277	-822	-971	-1055
Staff cost	-223	-191	-246	-316	-977	-1041	-1218
EBITDA	389	313	437	676	1815	2430	2824
Depreciation	-185	-156	-156	-237	-735	-943	-1059
Op. EBIT	204	157	280	439	1080	1486	1765
Amortization	-123	-121	-123	-158	-525	-545	-531
EBIT	81	36	157	281	555	941	1234
Gross profit margin	54%	52%	48%	50%	51%	52%	52%
EBITDA margin	34%	31%	30%	34%	33%	35%	35%
Op. EBIT margin	18%	16%	19%	22%	19%	21%	22%
EBIT margin	7%	4%	11%	14%	10%	14%	15%

Source: Redeye Research

For Q2'19/20: On the Group level, we project that the net sales will reach about SEK 1 008m, with an Operational EBIT of SEK 157m. We have also adjusted our estimates upwards for FY21 and FY22, as the company now have communicated two AAA releases during the next financial year. We will likely have to revise our projections upwards yet again when we have even more insight into the coming years' release schedule.

Key drivers:

- **Games:**
 - **New releases.** We believe that new releases will create an income of about SEK 249m with a significant contribution from the latest acquisitions. Main releases include among others; Remnant: From the Ashes (THQ Nordic is not the publisher), Wreckfest on console (which have received a very high critic rating for a racing game), Metro Exodus DLC, MXGP 2019, Darksiders 3 DLC, MX vs. ARV All Out! DLC, Red faction Re-mars-tered on Switch and more. During FY19'Q2 last year Games had SEK 117m in income from new releases, compared to the releases during that time the line-up, this year feels much stronger
 - **Backlog.** We expect that games will have a backlog sales of SEK 310m, this corresponds to a growth of 20% compared to the same period last year. We believe the main drivers will be Metro and Satisfactory sales, bundles, and subscription service inclusion. We also noticed that Darksiders III was included in PlayStation plus. Many of Milestones titles have already been included in different subscriber packages like PlayStation Now.
- **Partner Publishing:** The management indicates that the business unit has notably fewer releases during the quarter compared to the same period last year. The new acquisition conducted during Q1 will add some top-line revenue. We expect to see a revenue level of roughly SEK 448m, a 50% drop compared to last year.
- **Profitability:** We expect to see a healthy margin driven by digital sales and a relatively low-income share for Partner Publishing. Our assumptions lead to an Operational EBIT margin of 16%.

Valuation

We raise our Base-case valuation to **300** (275) SEK per share. In this research update, we have increased our estimates because of the latest acquisitions and due to more in-depth insight into the long-term pipeline. The company now states that we will see two AAA titles during FY21, one that we suspect will be the new Saint Row. As always, the management and M&A is an essential part of the investment case in THQ Nordic; we patiently await the next bigger deal. The game investments are ramping up, and the pipeline seems strong. As such, we are positive about the company's prospects.

Bear Case 183.0 SEK

Key model assumptions:

CAGR of 6% during forecast period
Average Op. EBIT margin of 16%
Terminal growth 2%
Terminal Op. EBIT margin of 15%

In our Bear-case, we have used much more conservative assumptions regarding the success of the larger upcoming releases. We also model a much slower growth long-term of new release revenue, as in this scenario the earlier disappointments makes the company more cautious of new larger projects. However, the catalog revenue continues to develop at a healthy pace. The lower assumed growth leads to less operational leverage, and we model a less aggressive margin uptake and that no real synergies between Koch Media and THQ Nordic manifest.

Base Case 300.0 SEK

Key model assumptions:

CAGR of 9% during forecast period
Average Op. EBIT margin of 21%
Terminal growth 2%
Terminal Op. EBIT margin of 23%

In our Base-case scenario, we model that the investment in new releases continues at a high phase the coming years. The size, regarding income, of the company, has increased significantly following the Koch Media acquisition, and the Group now has a huge partner publishing business. Profitability wise we believe it is possible that the gross margins will expand as the revenue streams from the own IPs will grow faster than the publishing revenue and that the Group turns their profitable asset care focus on Koch Media IP asset. There is of course also the inherent scalability of THQ Nordic's business model that will come into play.

Bull Case 380.0 SEK

Key model assumptions:

CAGR of 11% during forecast period
Average Op. EBIT margin of 24%
Terminal growth 2%
Terminal Op. EBIT margin of 25%

In our Bull-case we assume a larger success for the upcoming major releases during 2018, 2019 and 2020 the company then reinvest those cash flows into even greater projects, which also works out well. In this scenario, some sales and cost synergies between Koch Media and the "old" THQ Nordic creates higher margins and sales growth. Our assumptions in the Bull-case regarding commercial success for the larger upcoming releases should not be seen as any "Blue-sky" scenario with overly positive estimates.

Peer valuation

In the same manner, as how we treat our other Gaming companies, we have divided our peer-valuation into peer groups of Swedish and International Gaming to display valuation differences between sub-segments in the gaming industry better. Our prime valuation metric is EV/EBIT as it, at least in some way, take into account the investment needs of gaming companies. As THQ Nordic reports according to the accounting standard K4 their Operational EBIT is comparable to IFRS EBIT.

Nordic Gaming: At Redeye we also have coverage of Stillfront, G5, Remedy, Funcom, Atari, Nitro Games and Starbreeze. Overall, the companies within this peer group are expected to deliver healthy profit growth in the coming years.

International Gaming: The companies in this peer -group are the “whales” of the gaming industry. Most of these enterprises act both as publisher, developers and platform owners. Most of them are also active in all sub-segments of the industry (cross platform in all genres). THQ Nordic is similar to these companies as they have an extensive cross-selling IP portfolio. Still the size of these firms makes a comparison not directly applicable.

Peer valuation										
Company	EV (MSEK)	EV/Sales		EV/(Op.)EBIT			S. CAGR	EBIT margin		
		FY20E	FY21E	FY20E	FY21E	FY22E	18-21E	FY20E	FY21E	FY22E
Nordic Gaming										
Paradox Interactive	13 399	9.8x	7.9x	20.2x	16.4x	11.8x	20%	37%	39%	41%
Stillfront	8 348	4.0x	3.4x	14.1x	11.1x	9.9x	28%	29%	30%	30%
Remedy	1 294	3.1x	3.6x	19.0x	15.8x	13.8x	23%	33%	21%	20%
Funcom	901	3.2x	2.1x	14.9x	13.4x	13.0x	25%	7%	24%	27%
Atari	869	2.6x	2.2x	21.0x	19.8x	22.5x	40%	12%	13%	15%
G5 Entertainment	831	0.7x	0.6x	13.1x	12.1x	11.2x	1%	9%	10%	12%
Starbreeze	415	1.5x	2.2x	n.m.	n.m.	4.1x	0%	-95%	-23%	28%
Median	901	3.1x	2.2x	17x	15x	12x	23%	12%	21%	27%
International Gaming										
Tencent	3 881 780	6.0x	4.9x	20.2x	16.4x	11.8x	22%	30%	30%	34%
Nintendo	394 704	3.4x	3.3x	14.2x	12.2x	13.3x	14%	24%	27%	25%
Activision	360 081	5.9x	5.3x	19.0x	15.8x	13.8x	4%	31%	34%	36%
EA	228 572	4.6x	4.3x	14.9x	13.4x	13.0x	9%	31%	32%	31%
Take-Two	131 725	4.9x	4.8x	21.0x	19.8x	22.5x	30%	24%	24%	18%
Bandai Namco	110 842	1.6x	1.5x	13.1x	12.1x	11.2x	14%	12%	13%	13%
Ubisoft	91 398	3.9x	3.6x	17.7x	15.6x	15.0x	17%	22%	23%	23%
CD projekt	56 293	7.3x	10.9x	10.8x	15.4x	15.4x	72%	68%	70%	77%
Median	180 149	4.8x	4.5x	16x	16x	14x	15%	27%	28%	28%
Peer Group median	90 525	4.0x	3.4x	17x	15x	13x	19%	20%	24%	28%
THQ Nordic	22 838	4.1x	3.3x	21x	15x	13x	12%	19%	21%	22%

Source: Bloomberg & Redeye Research

Today THQ Nordic trades EV/Op. EBIT FY20E of 21x, as the company has just recently conducted some acquisitions, we believe FY21 is more representative of underlying earnings which stand at 15x. We find that THQ Nordic's history of acquisitions, growth prospects and IP portfolio strength should warrant a premium valuation compared to most peers. Our Base-case implies an FY21E Op. EBIT of 19x, a fair multiple in our view.

Investment Case

The acquisition of Koch Media is a prime example of THQ Nordic's acquisition strategy and why we continue to be positive to the investment case. We believe that the market is still to fully grasp the underlying value and cash flow generating capabilities of THQ Nordic's growing IP portfolio, which was enhanced to a significant degree following the purchase of the European publisher.

We believe that the markets overall low understanding of the Gaming industry and focus on the short-term creates an opportunity for the investor who see the bigger picture in THQ Nordic. The following bullet points summarize our investment thesis;

- The company showed significant growth during 2017 but a large part of the IP portfolio is still not generating any income, this will change in the coming years
- THQ Nordics IP portfolio grew significantly following acquiring Koch Media, the asset care possibilities and thus value enhancement is vast
- Owner operator with a highly skilled management team with the right focus on long-term value creation
- The core strategy is to acquire IPs at depressed prices and then enhancing their value, Koch Media acquisition as a prime example

A large part of the asset value is still untapped

The company showed significant growth during 2017, but a large part of the IP portfolio is still not generating any income. Development projects including a few AAA will be released in the years to come. This will take revenues and the profits to entirely new levels.

THQ Nordics IP portfolio grew significantly following acquiring Koch Media. We believe that the company will use its asset care expertise and unlock a lot of value from the long tail part of the game asset in the coming years

Some key franchises included in the IP portfolio are Darksiders, MX vs. ATV, Red Faction, Delta Force, Titan Quest, SpellForce, Saints Row, Dead Island, Metro and 100+ more.

Focus on long-term value and buying cheap

THQ Nordic is what we like to call an owner-operator company where the management team owns 50%+ of capital, has extensive experience from the industry and is highly committed to building "something big." We believe there should be a premium on the valuation because of the strong shareholder focus

THQ Nordic's core strategy is to acquire IPs at depressed prices and then enhancing their value. We view the Koch Media acquisition as a prime example of this approach. This focus will continue to keep risks at low levels and create significant investment returns for shareholders going onwards

Many public companies suffer from a short-term quarterly focus; this could not be further from the case when it comes to THQ Nordic. We find the long-term thinking as a distinct advantage; we also believe this way of business will further increase following the Koch acquisition as the company will be less dependent on single releases for cash flow.

Our forecast, and therefore also our DCF valuation, does not factor in possible future value-adding acquisitions of IPs or companies, but it is a fact that THQ Nordic will continue to acquire, and will do so with bravura.

Counterarguments (Bear-points)

It is always sensible to develop some counterarguments to an investment thesis. Below, we present some bear-points that an investor should consider and have in mind if the future development is not favorable.

- **Title risks of larger releases** – Despite THQ Nordic’s extensive portfolio there is always some title risk when releasing larger projects. Disappointing releases and/or reviews could dampen investors’ enthusiasm and hurt the company’s financials.
- **Rising competition in bidding for acquisitions** – As THQ Nordic is entering a new level as a company, so will the future acquisitions in terms of size and target reputation. Going from an unknown player to a more established company might make it harder to find cheap deals.
- **Management is paramount** – Just as much we love a strong and committed management team, it is also a fact that relying on a few key individuals also poses a risk.

Catalysts

More value adding acquisitions

THQ Nordic has a strong focus on acquiring IPs, franchises, and companies at low prices. They can do this by utilizing one of the best characteristics of a great investor; patience. Larger acquisitions of well-known IPs could and should enhance the valuation of the company.

AAA titles from Deep Silver and secret project announced

Deep Silver was a part of the Koch Media acquisition. Two studios within Deep Silver is currently developing two AAA titles, one is a new Saints Row game and the other one is unknown, but they will be released in FY21. The announcement of the unknown game would enhance the visibility of the IP portfolio and likely increase the valuation. One of the large development projects from the "original" THQ Nordic remains undisclosed. This title has the same type of budget as Darksiders 3 have, which should imply a similar sales potential.

Summary Redeye Rating

The rating consists of three valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 1 points. The maximum score for a valuation key is 5 points.

Rating changes in the report: New Rating structure.

People: 5

The management team of THQ Nordic is by our measures highly competent with extensive experience from the Gaming industry. The company continuously put emphasis on a shareholder focus to generate long-term value creation by keeping to their core strategy; acquiring IPs at the cheap and increase their value by asset care. Lars Wingefors, the CEO and co-founder, is an entrepreneur by heart; he started his first business at the age of 13 and has been selling video games for more than 20 years. We find the management of THQ Nordic as trustworthy as they have never tried to misguide the market; instead, they always make conservative statements and educate the market about their business. The ownership structure of THQ Nordic is, in our view, one of its key strengths. All the key personnel has substantial holdings in the company with the co-founder Lars Wingefors controlling more than 50% of the votes. The significant holdings create a focus on long-term value creation and not meeting short-term financial goals that a company led by "hired guns." In addition to the substantial holdings of the management team, some of the most renowned institutional owners show up on the shareholder's list of THQ Nordic.

Business: 4

THQ Nordic has an extensive portfolio of game franchises with multiple streams of income and a massive player base. Some of the IPs, like Darksiders, Spellforce, Red Faction and MX vs. ATV, Saints Row, Dead Island, and Metro has a large following and good reputation in the gamer community; this creates a pricing power and demand for new products. Following the acquisition of Koch Media, THQ Nordic has become a power-house, but as the gaming industry is so massive, they are still a relatively small player. The Partner Publishing business has lower margins than "Games", but still generates a substantial EBIT contribution and acts as a "funnel" for further business development relationships and possible acquisitions.

Financials: 4

THQ Nordic is an unleveraged company with a strong cash position. One of the company's core strategies is to acquire game IPs from companies in financial distress; this has led to a conservative approach regarding putting on debt. The income streams are diversified with a large portfolio of IPs and different games. Overall the video game industry is not sensitive to the business cycle which dampens the financial risk of downturns. During the past years, THQ Nordic has been growing heavily and still producing more than satisfying margins and return on asset. The future profitability levels will vary due to game release schemes as the business model inherits a high degree of scalability. Long-term increasing margins as the company continue to grow and the revenue streams from their own IPs increase even further.

INCOME STATEMENT	2017	18/19	FY20E	FY21E	FY22E
Net sales	508	5,754	5,572	6,939	8,118
Total operating costs	-235	-4,162	-3,757	-4,460	-5,220
EBITDA	273	1,592	1,815	2,478	2,899
Depreciation	0	-23	-26	-49	-75
Amortization	-84	-995	-1,234	-1,488	-1,590
Impairment charges	0	0	0	0	0
EBIT	188	575	556	941	1,234
Share in profits	0	0	0	0	0
Net financial items	-6	-33	-35	-35	0
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	182	542	521	906	1,234
Tax	-43	-183	-126	-219	-299
Net earnings	139	359	395	687	935

BALANCE SHEET	2017	18/19	FY20E	FY21E	FY22E
Assets					
<i>Current assets</i>					
Cash in banks	627	2,929	3,002	3,370	3,564
Receivables	90	1,297	1,560	1,388	1,624
Inventories	30	323	223	347	406
Other current assets	0	0	0	0	0
Current assets	747	4,549	4,785	5,105	5,594
<i>Fixed assets</i>					
Tangible assets	8	156	296	453	620
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	24	0	0	0	0
Cap. exp. for dev.	0	1,887	1,362	817	286
0 intangible rights	541	1,820	2,696	3,529	4,952
0 non-current assets	0	196	196	196	196
Total fixed assets	573	4,059	4,550	4,995	6,054
Deferred tax assets	2	0	0	0	0
Total (assets)	1,322	8,608	9,335	10,100	11,648
Liabilities					
<i>Current liabilities</i>					
Short-term debt	0	0	400	0	0
Accounts payable	208	2,018	1,950	2,429	3,247
0 current liabilities	0	0	0	0	0
Current liabilities	208	2,018	2,350	2,429	3,247
Long-term debt	0	0	0	0	0
0 long-term liabilities	0	211	211	211	211
Convertibles	0	0	0	0	0
Total Liabilities	208	2,229	2,561	2,640	3,458
Deferred tax liab	37	0	0	0	0
Provisions	4	667	667	667	667
Shareholders' equity	1,073	5,712	6,107	6,794	7,523
Minority interest (BS)	0	0	0	0	0
Minority & equity	1,073	5,712	6,107	6,794	7,523
Total liab & SE	1,322	8,608	9,335	10,100	11,648

FREE CASH FLOW	2017	18/19	FY20E	FY21E	FY22E
Net sales	508	5,754	5,572	6,939	8,118
Total operating costs	-235	-4,162	-3,757	-4,460	-5,220
Depreciations total	-84	-1,018	-1,260	-1,537	-1,665
EBIT	188	575	556	941	1,234
Taxes on EBIT	0	0	0	0	0
NOPLAT	188	575	556	941	1,234
Depreciation	84	1,018	1,260	1,537	1,665
Gross cash flow	273	1,592	1,815	2,478	2,899
Change in WC	73	310	-231	527	524
Gross CAPEX	-425	-4,504	-1,751	-1,983	-2,724
Free cash flow	-79	-2,601	-166	1,022	699

CAPITAL STRUCTURE	2017	18/19	FY20E	FY21E	FY22E
Equity ratio	81%	66%	65%	67%	65%
Debt/equity ratio	0%	0%	7%	0%	0%
Net debt	-627	-2,929	-2,602	-3,370	-3,564
Capital employed	447	2,783	3,505	3,423	3,958
Capital turnover rate	0.4	0.7	0.6	0.7	0.7

GROWTH	2017	18/19	FY20E	FY21E	FY22E
Sales growth	68%	1,034%	-3%	25%	17%
EPS growth (adj)	76%	100%	8%	74%	36%

DCF VALUATION		CASH FLOW, MSEK	
WACC (%)	8.0 %	NPV FCF (2018-2020)	775
		NPV FCF (2021-2027)	6546
		NPV FCF (2028-)	21495
		Non-operating assets	2929
		Interest-bearing debt	0
		Fair value estimate MSEK	31745
Assumptions 2017-2023 (%)			
Average sales growth	13.5 %	Fair value e. per share, SEK	305.7
EBIT margin	17.3 %	Share price, SEK	242.0

PROFITABILITY	2017	18/19	FY20E	FY21E	FY22E
ROE	20%	11%	7%	11%	13%
ROCE	26%	17%	9%	14%	17%
ROIC	91%	129%	20%	27%	36%
EBITDA margin	54%	28%	33%	36%	36%
EBIT margin	37%	10%	10%	14%	15%
Net margin	27%	6%	7%	10%	12%

DATA PER SHARE	2017	18/19	FY20E	FY21E	FY22E
EPS	1.75	3.50	3.80	6.62	9.01
EPS adj	1.75	3.50	3.80	6.62	9.01
Dividend	0.00	0.00	0.00	1.99	3.60
Net debt	-7.89	-28.58	-25.06	-32.46	-34.33
Total shares	79.36	102.49	103.84	103.84	103.84

VALUATION	2017	18/19	FY20E	FY21E	FY22E
EV	10,087.2	18,594.7	22,526.2	21,757.8	21,563.7
P/E	77.0	59.9	63.7	36.6	26.9
P/E diluted	77.0	59.9	63.7	36.6	26.9
P/Sales	21.1	3.7	4.5	3.6	3.1
EV/Sales	19.9	3.2	4.0	3.1	2.7
EV/EBITDA	37.0	11.7	12.4	8.8	7.4
EV/EBIT	53.6	32.4	40.5	23.1	17.5
P/BV	10.0	3.8	4.1	3.7	3.3

SHARE PERFORMANCE		GROWTH/YEAR	16/18E
1 month	8.0 %	Net sales	231.4 %
3 month	11.8 %	Operating profit adj	71.8 %
12 month	23.7 %	EPS, just	47.2 %
Since start of the year	67.6 %	Equity	138.5 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Lars Wingefors	35.1 %	51.5 %
Swedbank Robur Fonder	9.1 %	5.1 %
Erik Stenberg	7.6 %	11.2 %
Handelsbanken Fonder	5.7 %	3.2 %
CMB Holding AB	2.6 %	3.8 %
Första AP-fonden	2.3 %	1.3 %
Didner & Gerge Fonder	2.2 %	1.2 %
Skandinaviska Enskilda Banken S.A	2.2 %	1.2 %
SEB Fonder	2.2 %	1.2 %
Familjen Olsson med stiftelse	2.2 %	1.2 %

SHARE INFORMATION	
Reuters code	THONO.ST
List	
Share price	242.0
Total shares, million	103.8
Market Cap, MSEK	25128.1

MANAGEMENT & BOARD	
CEO	Lars Wingefors
CFO	Johan Ekstöm
IR	
Chairman	Kicki Wallje-Lund

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Redeye Rating and Background Definitions

Company Quality

Company Quality is based on a set of quality checks across three categories; PEOPLE, BUSINESS, FINANCE. These are the building blocks that enable a company to deliver sustained operational outperformance and attractive long-term earnings growth.

Each category is grouped into multiple sub-categories assessed by five checks. These are based on widely accepted and tested investment criteria and used by demonstrably successful investors and investment firms. Each sub-category may also include a complementary check that provides additional information to assist with investment decision-making.

If a check is successful, it is assigned a score of one point; the total successful checks are added to give a score for each sub-category. The overall score for a category is the average of all sub-category scores, based on a scale that ranges from 0 to 5 rounded up to the nearest whole number.

The overall score for each category is then used to generate the size of the bar in the Company Quality graphic.

People

At the end of the day, people drive profits. Not numbers. Understanding the motivations of people behind a business is a significant part of understanding the long-term drive of the company. It all comes down to doing business with people you trust, or at least avoiding dealing with people of questionable character.

The People rating is based on quantitative scores in seven categories: Passion, Execution, Capital Allocation, Communication, Compensation, Ownership, and Board.

Business

If you don't understand the competitive environment and don't have a clear sense of how the business will engage customers, create value and consistently deliver that value at a profit, you won't succeed as an investor. Knowing the business model inside out will provide you some level of certainty and reduce the risk when you buy a stock.

The Business rating is based on quantitative scores grouped into five sub-categories: Business Scalability, Market Structure, Value Proposition, Economic Moat, and Operational Risks.

Financials

Investing is part art, part science. Financial ratios make up most of the science. Ratios are used to evaluate the financial soundness of a business. Also, these ratios are key factors that will impact a company's financial performance and valuation. However, you only need a few to determine whether a company is financially strong or weak.

The Financial rating is based on quantitative scores that are grouped into five separate categories: Earnings Power, Profit Margin, Growth Rate, Financial Health, and Earnings Quality.

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Disclaimer

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Redeye Rating (2019-09-04)

Rating	People	Business	Financials
5p	11	8	1
3p - 4p	59	50	29
0p - 2p	14	26	54
Company N	84	84	84

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CONFLICT OF INTERESTS

Kristoffer Lindström, owns shares in the company THQ Nordic: Yes

Tomas Otterbeck, owns shares in the company THQ Nordic: Yes

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.