Equity Research

# Embracer

SEB INVESTIGATES

Please note: the statement at the rear of this report contains details of investment banking services recently provided by SEB which could be considered relevant to the subject matter of this report.

| Buy | Company Update | Media | Sweden | 01 June 2023 |
|---|---|---|---|---|

## Embracing change

**After recent turbulence we break down debt, capex and have in this report walked through each operating unit in Embracer, highlighting larger and smaller potential divestments and restructuring options to consider. In our view, investors see divestments as a pragmatic step from here, despite suboptimal conditions. After this exercise, we are more convinced that Embracer can solve both temporary and structural issues. We reiterate Buy.**

### Fully feasible to cut annual capex by up to SEK 3bn, we estimate

Besides poor communication, a high debt level with weak reported cash flow explains the weakness in the Embracer share over the last year. Given its debt today and considering its target to reduce net debt to below SEK 10bn by March 2024, we find that c. SEK 8bn of net cash proceeds is required. Operationally, capex could be reduced by >SEK 1bn over a couple of years by stopping externally developed game projects. Furthermore, we conclude up to SEK 2bn of a lower run-rate capex in one year is achievable for Embracer, assuming it can move around 10 AAA projects from being internally to externally financed. This would de-risk releases, front-load earnings generation but cap upside.

### Walking through each operating unit – restructuring or divestment thoughts

In this report, we discuss Embracer's 12 operating units, highlighting their relation to the central transmedia strategy and recent performance. We also consider various alternatives for management, such as restructuring and divestments. Top candidates for restructuring, in our view, are THQ Nordic and Plaion (where we think a potential merger should be explored), while we reiterate our view that Embracer's Mobile business is feasible to sell, potentially bringing SEK 8-11bn in proceeds although it would also mean losing c. SEK 1bn in free cash flow per year.

### We do a SOTP including the PC/Console unit to breakdown the value

We make no changes to our estimates or SEK 35 target price but have done a sum-of-the-parts to show the current value in PC/Console units, specifically.

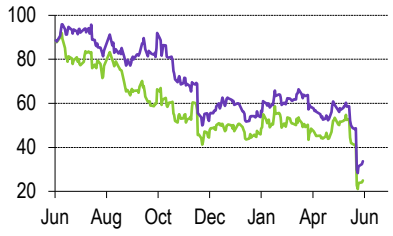
**Key Data (23/24E)**

| | |
|---|---|
| Price (SEK) | 24.96 |
| Target price (SEK) | 35.00 |
| Recommendation | Buy |
| Risk | Normal |
| Reuters | EMBRACB.ST |
| Bloomberg | EMBRACB SS |
| Market cap (SEKm) | 31,424 |
| Market cap (USDm) | 2,895 |
| Market cap (EURm) | 2,708 |
| Net debt (SEKm) | 23,022 |
| Net debt (ex. IFRS-16 debt | 21,534 |
| Shares fully dil. (m) | 1,259 |
| Avg daily turnover (SEKm) | 262.5 |
| Free float | 62% |

**Estimate Revisions (%)**

| | 23/24E | 24/25E | 25/26E |
|---|---|---|---|
| Revenues | 0 | 0 | 0 |
| Adj. EBIT | 0 | 0 | 0 |
| Adj. EPS | 0 | 0 | 0 |

**Share Price (12M)**




Absolute (green) / Relative to Swedish Consumer Goods (purple)


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**Financials (SEK)**

| Year end: Mar | 21/22 | 22/23 | 23/24E | 24/25E | 25/26E |
|---|---|---|---|---|---|
| Revenues (m) | 17,400 | 38,074 | 44,894 | 48,927 | 51,648 |
| Adj. EBIT | 4,465 | 6,366 | 7,489 | 8,906 | 9,610 |
| Pre-tax profit (m) | 1,659 | 5,016 | 1,454 | 3,694 | 4,763 |
| EPS | 0.95 | 3.57 | 0.87 | 2.29 | 2.95 |
| Adj. EPS | 3.49 | 4.14 | 4.36 | 5.04 | 5.39 |
| DPS | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Revenue growth (%) | 87.3 | 118.8 | 17.9 | 9.0 | 5.6 |
| Adj. EBIT growth (%) | 56.2 | 42.6 | 17.6 | 18.9 | 7.9 |
| Adj. EPS growth (%) | 10.9 | 18.7 | 5.2 | 15.7 | 6.8 |
| Adj. EBIT margin (%) | 25.7 | 16.7 | 16.7 | 18.2 | 18.6 |
| ROE (%) | 3.1 | 8.4 | 1.7 | 4.3 | 5.3 |
| ROCE (%) | 10.4 | 8.0 | 7.9 | 9.4 | 9.9 |
| PER (x) | 13.5 | 6.0 | 5.7 | 4.9 | 4.6 |
| Free cash flow yield (%) | 0.4 | (5.0) | 8.4 | 13.1 | 18.4 |
| Dividend yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| P/BV (x) | 1.28 | 0.49 | 0.48 | 0.46 | 0.43 |
| EV/Sales (x) | 4.04 | 1.52 | 1.22 | 1.04 | 0.87 |
| EV/Adj. EBITDA (x) | 11.6 | 5.8 | 4.4 | 3.4 | 2.6 |
| EV/Adj. EBIT (x) | 15.4 | 9.0 | 7.3 | 5.7 | 4.6 |
| Operating cash flow/EV (%) | 6.2 | 9.4 | 19.9 | 24.9 | 32.2 |
| Net debt/EBITDA (x) | 9.28 | 3.82 | 2.23 | 1.40 | 0.83 |

Source for all data on this page: SEB (estimates) and Millistream/Thomson Reuters (prices)

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# Summary

The basis for this report is Embracer's high debt (particularly in light of its relation to the equity value) and poor free cash flow as of recent quarters. We conclude that in order to reach below SEK 10bn in financial net debt by March 2024, which was identified as a target in its latest quarterly report, divestments or obtaining external financing for AAA development is likely needed. SEK 8bn of cash generation is needed to reach the target, while we estimate SEK 2.6bn in FCF this year for reference.

**Invested cash flow** can take time to recoup in the gaming industry for publishers due to long project durations, but we see a number of ways that Embracer could gradually lower capex (we estimate up to a SEK 3bn run-rate in a couple of years). Around SEK 1bn could be achieved by simply reducing the focus of publishing externally developed games, while a further, up to c. SEK 2bn of capex could be reduced by using external partners to publish a share of Embracer's currently internally published AAA pipeline. We assess that up to SEK 3-4bn in capitalised assets can be sold in external publishing agreements, which can be compared to Embracer's total capitalised value of SEK 9.3bn in ongoing game development as of Q4 22/23.

**In terms of reducing opex** and addressing any structural issues in Embracer, we believe major cost savings could be achieved by shrinking the Group's publishing organisation which we think can encompass >1,000 people, particularly within THQ Nordic and Plaion. This would be especially relevant if Embracer decides to use more external publishing partners. We also ponder on the feasibility of merging the two units, which would be a long process but potentially beneficial in the longer run.

**For divestments**, we have walked through each operating unit in Embracer and singled out potential studios and units that could be divested. These encompass both small and large units that would either bring a major cash boost to address the current debt situation, or simply improve the prospects of stronger margins and cash generation for Embracer. When doing this exercise, we have kept Embracer's central transmedia strategy in mind, assuming that units that can be considered strategically non-core would make the most sense to divest from an investor perspective.

**Among larger potential divestments**, we continue to argue Embracer's mobile business as the most reasonable, all things considered. Even when assuming conservative transaction multiples, we still expect the businesses in the segment to bring up to SEK 11bn in cash proceeds, but this would mean simultaneously losing c. SEK 1bn in free cash flow per year. Further, Coffee Stain is an option that could be worth at least SEK 10-12bn at 12-15x EV/EBIT, but while it is not necessarily core to transmedia, it will likely be met with mixed reception among investors.

**After doing this exercise**, we conclude that a large part of the challenges at hand could be addressed by approaching these three issues: 1) external publishing, 2) funding the AAA pipeline, and 3) streamlining the group towards what is core. This leaves us more optimistic that Embracer can come out of this stronger but reiterate our view that such a change will take time.

# Where we are today

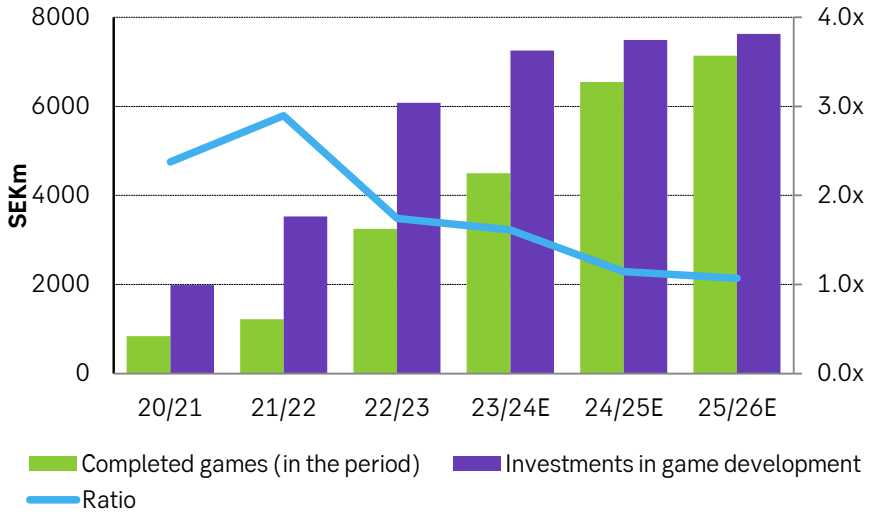
## Debt

Embracer has financial net debt of SEK 15.6bn as of Q4 2023/24, corresponding to 1.6x adjusted EBITDA versus covenants of SEK 2.5x, meaning the cap at full leverage is SEK 25bn in net debt. Utilising that headroom is unlikely however and would be a poor decision, in our view. Embracer has set the bar at reaching net debt below SEK 10bn by March 2024, as per its Q4 results announcement on 24 May. From a financial net debt of SEK 15.6bn, plus SEK 2.6bn in cash earnouts in FY 2023/24 (as estimated by Embracer), we estimate net cash proceeds of SEK 8.2bn are needed this year to reach the above-mentioned SEK 10bn target.

Debt is high, and is too high from an investor perspective, when considering total cash earnouts of SEK 8.6bn (as estimated by Embracer) and the current market cap of c. SEK 32bn plus weak reported cash flow. When comparing PC/Console capex and the capitalised value of released games, we estimate the gap will close over the next two to three years, which would set a better baseline to cover investments. Investments would be covered today if games released were to make a 2x return, but this has not been the case in the last year. In other words, the more games that are released, the better the opportunities to generate cash flows, regardless of returns continuing to be lower than historically.

In our view, the chart below illustrates that increasing capex has been a conscious decision by Embracer as a long-term growth initiative. As we see it, this was not an issue for investors previously but has become increasingly so due to rising interest rates, higher debt and a weak game ROI. Given the investment dynamics of the gaming market, where a project typically could proceed for two to four years before being released and make an ROI, steering a gaming company towards better cash flows takes time.

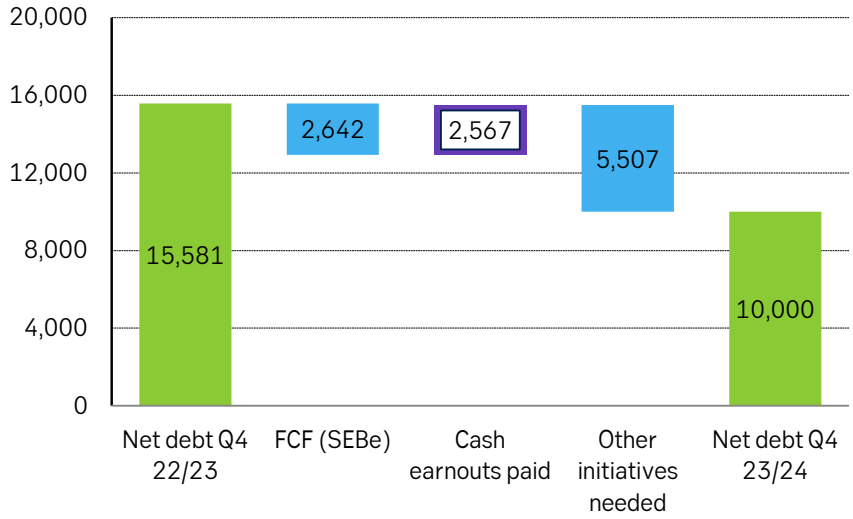
**PC/Console capex versus (balance sheet) value of games released by year**




Source: SEB, Embracer

While waiting for this gap to close, we believe reducing debt (and net debt to below SEK 10bn) would be a pragmatic step, although it would mean balancing the underlying value of an asset, what could be returned from a potential divestment and what value could be generated in the long term if the asset is kept. From our discussions with investors, we conclude that most agree with this view. We do not see a base case where capex reductions and opex savings resulting in net debt declining below SEK 10bn by March 2024. Hence, either large publishing agreements or divestments are needed. In total, we assume SEK 2.6bn in underlying FCF, meaning at least SEK 5.5bn is needed to reach SEK 10bn by FY 2023/24.

**Net debt bridge: How to get to SEK 10bn by FY 23/24-end (SEKm)**

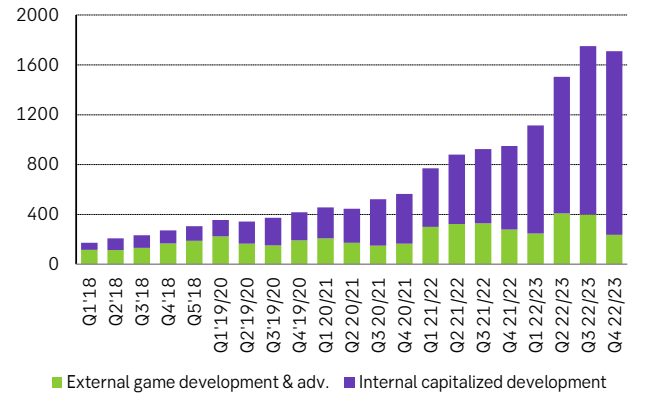



Source: SEB, Embracer

# Capex breakdown

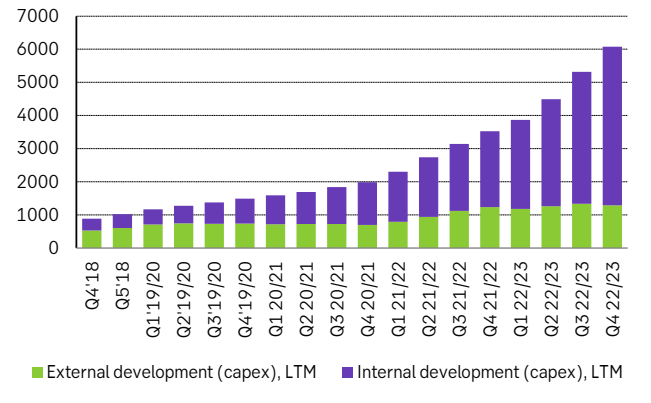
Capex challenges in Embracer stem from too aggressive investments in PC/Console while newly released games in the last quarters have generated low returns (lower than the historical average), meaning operational cash flow has not covered investments. See below for the capex development in PC/Console since 2018.

**PC/Console capex by quarter (SEKm)**




Source: SEB, Embracer

**PC/Console LTM capex by quarter (SEKm)**



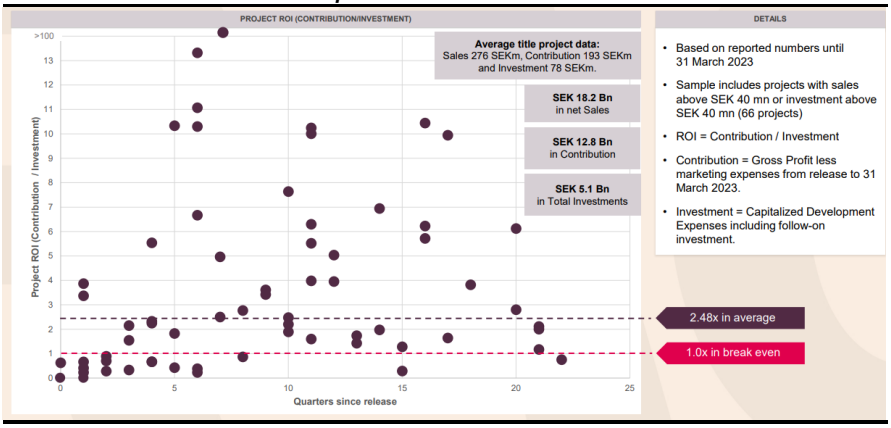

Source: SEB, Embracer

Intangible capex in Embracer is concentrated to PC/Console. This totalled SEK 6.1bn in FY 2022/23 (see above), with additional intangible capex primarily in Entertainment & Services, amounting to SEK 416m during FY 2022/23. Of the SEK 6.1bn in PC/Console capex, SEK 1.3bn pertains to projects developed externally and SEK 4.8bn to projects developed internally. The annual capex run rate (the last quarter at SEK 1,710m x four) for PC/Console amounts to SEK 6.8bn, which is a slight decline from the run rate of SEK 7bn in Q3 2022/23.

In Q3, Embracer shared some details about its games pipeline including AAA games. At that time, there were four AAA and 30 AA, A and Indie (budget over SEK 40m) projects in the pipeline for FY 2023/24. The total number of projects was 94 for FY 2023/24E. Interestingly, while accounting for about one-third of the pipeline, these two segments represented 62% of the total number of developers working on the FY 2023/24E pipeline (development teams for big games tend to naturally be larger). Our point here is that despite FY 2023/24E having a low number of large releases versus subsequent years, it already accounts for a large share of engaged developers, i.e., capex.

**High levels of capex are of course sustainable if you can be confident in a high ROI** – and easy for investors to stand behind. While Embracer's project ROI historically has been strong, the last year has offered very weak returns, taking the average project ROI from 3.22x in Q4 21/22 to 2.48x in Q4 22/23. We explore this further down in the report.

**Embracer ROI chart as of Q4 22/23**

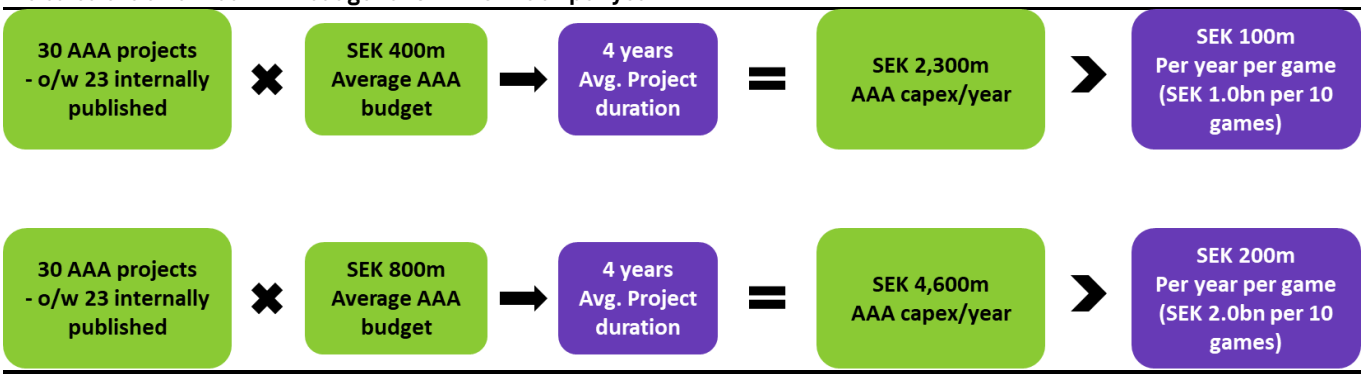



Source: Embracer

Thus, we believe that external capex is an issue that should be addressed because it has generated low returns in the last year (returns are volatile but were much stronger in previous years) and is not central to the company's strategy. Shifting what is currently internally published (= internal capex if developer is also internal) to external parties for large games can have tangible impact quickly. As mentioned previously, we think taking the *Tomb Raider* sequel to Amazon as an external publisher has had a positive effect on capex by lowering it c. SEK 400m per year. Of Embracer's 31 AAA games in the pipeline, 24 were internally published as of Q3, meaning there is a lot of headroom to make additional deals. Further, of these 31 AAA games, Embracer is the developer for 28 and owns the IP for 23. As such, finding an external party to publish these games would in most cases still mean that Embracer has financial interest in them, and could therefore still leverage its transmedia strategy in other media simultaneously.

Assuming an average development budget of SEK 400-800m for the 23 internally published AAA games (24 in Q3 2022/23 but now excluding Dead Island 2), we estimate a total capex budget of SEK 9.2-18.4bn for the full projects. With an average project duration of four years, we derive annual capex of SEK 2.3-4.6bn for the internally funded AAA pipeline alone. Note that development budgets can vary significantly (e.g., *Saints Row* had a budget above USD 100m).

**We calculate an annual AAA budget of SEK 2.8-4.6bn per year**




Source: SEB

We think the planned platform deal covered a fair share of these AAA titles, which are now open to be negotiated with other publishing parties. Making up to ten such deals in the coming year is feasible we think, which could lower the capex run rate by up to SEK 2bn per year. This figure could be even higher if the largest games are prioritised, or alternatively if Embracer can find a counterpart and negotiate a deal in which it packages a handful of AAA games, but to a smaller extent than was planned with its platform deal.

Such deals would bring cash on day one as well since they would mean a transfer of already capitalised development, similar to what was done with Amazon and *Tomb Raider* in December 2022. In Q3 22/23, Embracer reported SEK 451m in cash proceeds from sales of intangible assets, all of which relating to the *Tomb Raider* deal, as we have interpreted it.

# Sum-of-the-parts (SOTP)

Later in this report, we go through each operating unit and its performance. As a complement, we have assessed the value of Embracer from a SOTP valuation approach. This includes assumptions on the EBIT generation for each operating unit within PC/Console, where there are limited details available. Also, we think it is important to highlight that some operating units (such as THQ Nordic and Plaion) have underperformed in FY 2022/23, where performance and thus margins (and earnings) have been much better than previous years. It is worth keeping in mind that when assessing units such as Gearbox and Saber, reported earnings do not capture the prospects of future growth when the AAA pipeline matures (Gearbox and Saber together hold 19, or 62%, of the 31 AAA games in the pipeline, according to Embracer's Q3 22/23 presentation).

**Indicative sum-of-the-parts valuation (SEB estimates on adjusted EBIT and sales by PC/Console operating unit) (SEKm)**

| SOTP based on 22/23 earnings | Value/share | EV | Multiple | Valuation | EBIT 22/23 | Sales 22/23 | Margin |
|---|---|---|---|---|---|---|---|
| THQ Nordic | 1 | 1,050 | 7x | EV/EBIT | 150 | 1,200 | 13% |
| Coffee Stain | 10 | 12,000 | 15x | EV/EBIT | 800 | 1,300 | 62% |
| Plaion | 2 | 2,100 | 7x | EV/EBIT | 300 | 2,800 | 11% |
| Saber | 9 | 10,800 | 12x | EV/EBIT | 900 | 3,600 | 25% |
| Amplifier | 0 | 300 | - | Invested pipeline | -50 | 50 | - |
| Gearbox | 8 | 9,600 | 12x | EV/EBIT | 800 | 3,000 | 27% |
| Crystal Dynamics/Eidos | 2 | 3,000 | - | Last transaction | 0 | 1,500 | 0% |
| **PC/Console, total** | **31** | **38,850** | **13x** | **n.a.** | **2,900** | **13,450** | **22%** |
| Mobile | 9 | 11,048 | 8x | EV/EBIT | 1,381 | 5,819 | 24% |
| Tabletop | 19 | 24,120 | 12x | EV/EBIT | 2,010 | 13,132 | 15% |
| Entertainment & Services (excl ME) | 2 | 2,526 | 0.5x | EV/Sales | 136 | 5,052 | 3% |
| - Middle-Earth | 3 | 4,265 | - | Last transaction | 145 | 218 | 67% |
| **SUM** | **64** | **80,809** | **12x** | **n.a.** | **6,572** | **37,671** | **17%** |
| Central costs | -2 | -2,496 | 12x | | -208 | | |
| **Enterprise value** | **62** | **78,313** | **12x** | | **6,364** | | |
| Financial net debt | 12 | 15,581 | | | | | |
| Cash earnouts | 7 | 8,595 | | | | | |
| **Total net debt** | **19** | **24,176** | | | | | |
| **Equity value** | **43** | **54,137** | | | | | |

Source: SEB

**Arguably, one could put a higher multiple on "trough" earnings for units like THQ Nordic and Plaion** as both companies had a central role in the strong growth and success of Embracer in previous years. Furthermore, it is worth mentioning Saber peers like Keywords currently trading at 15x EV/EBIT could warrant a higher multiple (besides considering the anticipated strong growth as the pipeline matures). Similarly, Coffee Stain is arguably worth an EV/EBIT of more than 20x when comparing to peers such as Paradox and CD Projekt. Lastly, our valuation multiple of 12x EV/EBIT for Asmodee/Tabletop is comparable to Hasbro and Mattel which both trade at 13x 2023E EV/EBIT (according to FactSet). This SOTP valuation is not part of our valuation methodology and derivation of our target price, but hopefully provides a more detailed look when assessing the fair value of Embracer and its operating units.

# Deep dives by unit

It is now clear that restructuring and capex reductions are needed. Following our discussions with investors over the last few days, we conclude that most are open to divestments and would see them as a pragmatic step forward. Debt is the main issue at hand, and when looking at various assets, the transaction multiple for a potential asset (versus its "fair" or Embracer's current value) is a secondary consideration. Paramount is whether the asset is aligned with the company's strategy and whether it aligned to what investors wish to be exposed to when investing in Embracer. Accepting defeat and selling an asset that is suboptimal from a valuation or timing standpoint would be acceptable if the upside meaningfully reduces debt or structurally supports improvements in margins and/or cash flow.

What exposure are investors seeking when investing in Embracer? In our view, they are seeking:

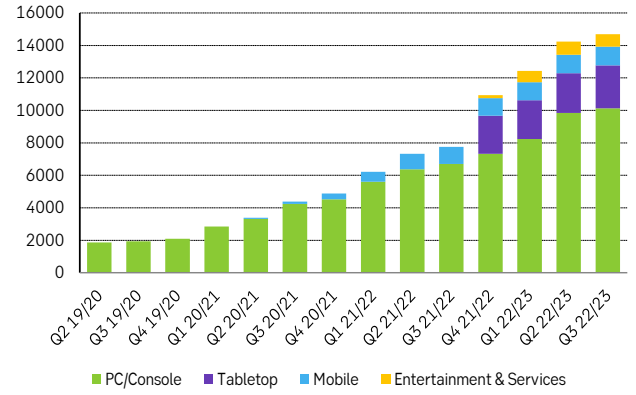
- Gaming as a structurally growing market
- AAA and AA games exposure
- World-renowned IP and asset management of this IP across media

With regard to divestments, we have considered some options for each operating unit and the relation of these options to the overarching strategy, which we see as transmedia, possibly including the internal production of such transmedia entertainment in gaming. Embracer's 12 operating units, split into reporting segments, are outlined below.

- **PC/Console (7)**: THQ Nordic, Plaion, Coffee Stain, Amplifier Game Invest, Saber Interactive, Gearbox, Crystal Dyamics/Eidos Montreal
- **Tabletop (1)**: Asmodee
- **Mobile (2)**: DECA, Easybrain
- **Entertainment & Services (2)**: Dark Horse, Freemode (+ Plaion physical games distribution)

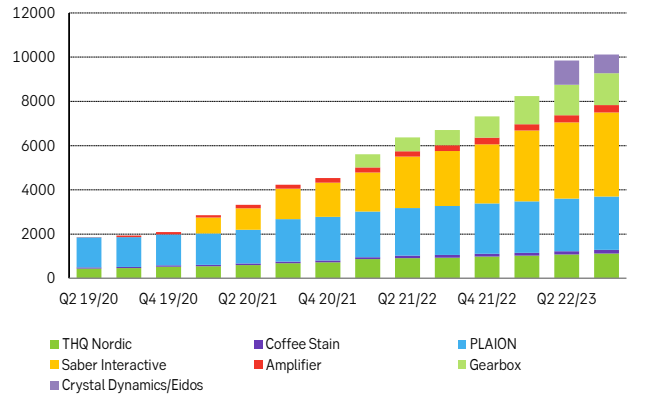
Embracer does not currently report revenue by operating unit, but there are historical numbers (old segment reporting until Q4 20/21) and press release statements that provide some hints. Alternatively, we can look at the internal headcount by unit to get a sense of each unit's size and its pace of growth over the last couple of years. Given the cash flow issues at hand for Embracer are within PC/Console, we believe it is worth singling out this segment. Figures for Q4 2022/23 are not yet available, but we do not believe they would change the overarching picture. Note that revenue from the physical distribution of games is reported in Entertainment & Services, while headcount is under Plaion (which is added in PC/Console). We derive a headcount of 161 people in Plaion's physical distribution business based on Q3 2022/23 company filings.

**Headcount by segment (based on operating units)**




Source: SEB, Embracer

**Headcount by PC/Console operating unit**



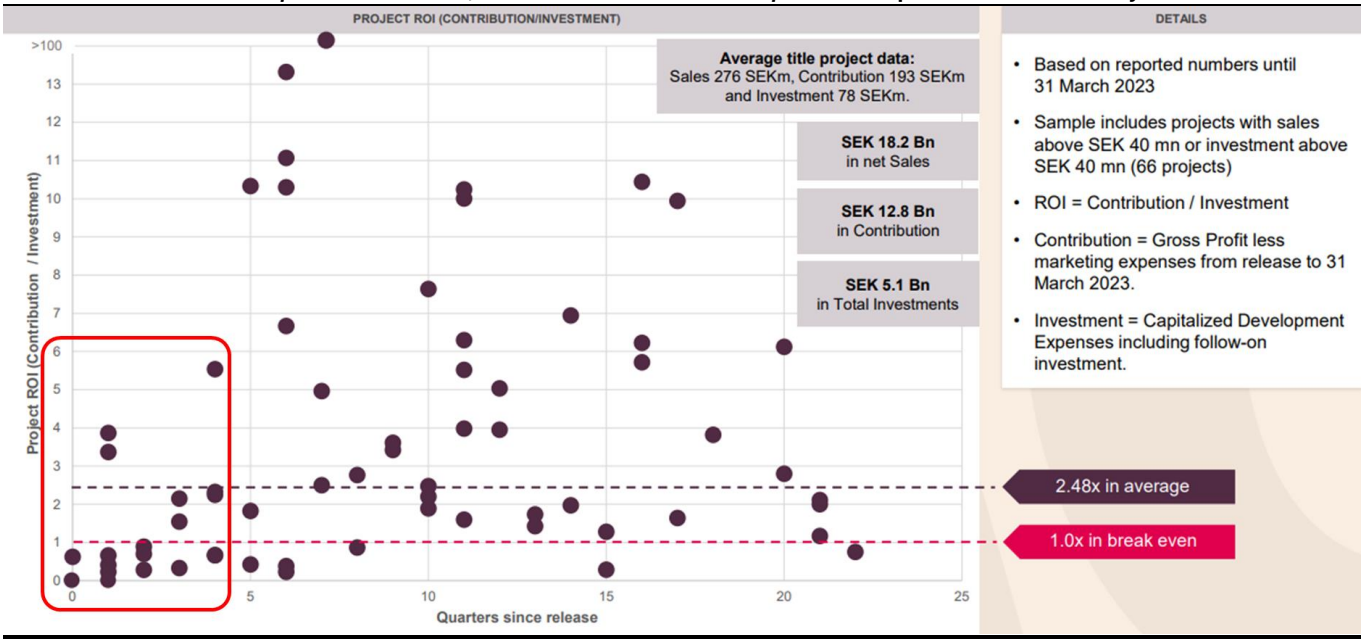

Source: SEB, Embracer

Headcount has climbed from 2,000 at the beginning of 2020 to 15,000 today, with around 10,000 in PC/Console. Operating units that stand out include Saber (720 employees to 3,800, an increase of 5x in 11 quarters) and Gearbox (593 to 1,400, up 2.5x in seven quarters). We know from the Q3 2022/23 presentation that Saber and Gearbox are important pillars for AAA development, with 11 and eight AAA projects, respectively, corresponding to 61% of the total of 31 AAA games that are under development through FY 2027/28.

# PC/Console

Before going through each segment, we describe the performance of PC/Console as a whole. The ROI chart below is from Q4 22/23 and is provided by Embracer for each quarter, showing the performance of released games. The weighted average lifetime ROI (defined as gross profit less marketing divided by investment) is as of Q4 22/23 2.48x. Looking at the chart, it is clear the recent year has been terrible for Embracer – in previous years, there has essentially been at most one project per year not making a return, whereas the majority of releases in FY 22/23 is currently below 1x lifetime ROI. For reference, one year ago (Q4 21/22), the weighted average ROI was 3.22x. One major reason for the dip in the last year includes the release of Saints Row, which had a >USD 100m development budget, with an ROI of c. 0.9x.

**Embracer ROI chart for PC/Console releases, as of 31 March 2023: FY 22/23 is not representative of history**




Source: Embracer

In light of this, we think the weakness is not just attributable to company-specific factors. Since the pandemic, many games across the industry have faced delays, while the outlook from management from various industry players in the last couple of quarters has indicated smaller titles doing worse while the largest games are holding up well. Regardless, weakness is reasonably partly related to company-specific factors that can be addressed and improved. We go through such points below.

# Walkthrough of each operating unit

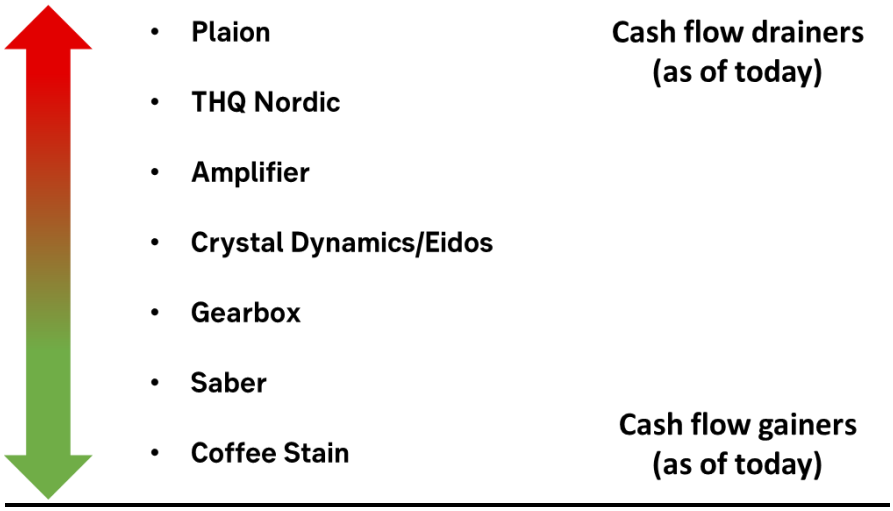
Our thoughts on each operating unit are outlined below. We single out any potential underperformers and suggest what could be addressed to improve margins, cash flow or which entities could be divested if debt is to be addressed.

- **THQ Nordic:** Shrink the publishing organisation, go through potential studios and/or IPs to divest. Consider the feasibility of merging the unit with Plaion.
- **Coffee Stain:** Not necessarily core to transmedia, but has quality, generates cash flow and is liked by investors. Keep unless debt needs to be immediately addressed.
- **Plaion:** Shrink the publishing organisation, evaluate studios and/or IPs, including Vertigo Games, Volition (now under Gearbox) and Saints Row. Consider the feasibility of merging the unit with THQ.
- **Saber:** Important for the transmedia strategy and generates positive cash flow and stable earnings. Holds more AAA projects than any other operating unit. Potential divestments like Aspyr could provide up to SEK 1bn in cash proceeds, but Aspyr could still have a role to play in the group.
- **Amplifier:** Consider stopping new investments or divest, if possible, which should support cash flow generation. If there are any specific IPs or studios that are to be kept, then carve them out.
- **Gearbox:** Important for the transmedia strategy and holds the second most AAA projects among operating units. No clear need for restructuring or as a candidate for divestment, but PWE Publishing could be considered.
- **Crystal Dynamics/Eidos:** Could be sold for more than SEK 3bn and makes limited earnings contributions today, but is important from an AAA and transmedia perspective. A sale is feasible, as strategic buyers like Amazon could see it as synergistic, crystallising value.

# Summary: cash flow drainers and gainers

Below is a simplified but indicative view of how we see the various operating units in PC/Console and whether they currently burden or support cash flow generation for Embracer. It is worth keeping in mind that this is based on how companies operate today, i.e., it does not reflect cash flow potential three years from now. The current primary cash flow drainers, in our view, are Plaion and THQ Nordic, while cash flow gainers are Coffee Stain and Saber. While good cash flows should be generated from Plaion through the recent release of Dead Island 2, the unit has five AAA games (excluding DI2) in the pipeline (according to Embracer's Q3 22/23 report).

**SEB simplified assessment of cash flow drainers and gainers in PC/Console**




Source: SEB

# THQ Nordic

THQ Nordic, the foundation of what today is Embracer, has around 1,100 employees in 22 studios. Together with Plaion, THQ Nordic represents a tangible part of external publishing, meaning that it finances projects (i.e., incurs capex and takes balance sheet risk) made by external studios, with IP often also being owned externally. However, there are also many examples of internal projects. Typically, THQ Nordic publishes and develops small to mid-sized projects, and for reference only has one AAA game in development according to an Embracer communication in February 2023. THQ Nordic had revenues of SEK 1.7bn in FY 2021/22, with particular success from *Biomutant* in early FY 2021/22.

Looking at its releases over the last financial year, there have been few commercial successes for THQ Nordic, although some games have received good reviews. Historically, the unit has had multiple successes and supported growth for Embracer, with games including *Biomutant*, *Spongebob SquarePants: BFBB* and *Darksiders*.

**THQ Nordic games released 2022/23 and announced pipeline**

| Games released during FY 2022/23 | Platform(s) | IP | Developer (internal/external) | Publisher |
|---|---|---|---|---|
| **THQ Nordic** | | | | |
| MX vs. ATV Legends | PC, PS5, XSX, PS4, Xbox | Own | Internal (Rainbow Studios) | Internal (THQ) |
| Spellforce 3 Reforced - Console | PS5, PS4, XSX, Xbox | Own | Internal (Grimlore Games) | Internal (THQ) |
| Wreckfest (Switch) | Switch | Own | Internal (Bugbear Entertainment) | Internal (THQ) |
| Destroy All Humans! Clone Carnage | PC, PS4, Xbox, XSX | Own | Internal (Black Forest Games) | Internal (THQ) |
| Way of the Hunter | PC., PS5, XSX | Own | Internal (Nine Rocks Games) | Internal (THQ) |
| Destroy All Humans 2 - Reprobed | PC, PS5, XSX | Own | Internal (Black Forest Games) | Internal (THQ) |
| Endling: Extinction is forever | PC; PS5, PS4 , Xbox, XSX, Switch | External | External (Herobeat Studios) | Internal (HandyGames) |
| The Valiant | PC, PS4, PS5, Xbox, XSX | Own | External (KITE Games) | Internal (THQ) |
| Knights of Honor II: Sovereign | PC | Own | External (Black Sea Games) | Internal (THQ) |
| Remnant: From the Ashes (Switch) | Switch | Own | Internal (Gunfire Games) | Internal (THQ) |
| Spongebob Squarepants Cosmic Shake | PC, PS4, Xbox, Switch | External | Internal (Purple Lamp Studios) | Internal (THQ) |
| SpellForce: Conquest of Eo! | PC | Own | External (Owned By Gravity) | Internal (THQ) |
| Perish | PC | External | External (Item42) | Internal (HandyGames) |
| | 20 | | | |
| **Announced games and games released in 23/24** | | | | |
| DE-EXIT - Eternal Matters | PC, PS5, PS4, XSX, Xbox, Switch | External | External (SandBloom Studio) | Internal (HandyGames) |
| Jected: Rivals (prev. Stuntfest) | PC | Own | External (Pow Wow Entertainment) | Internal (THQ) |
| Airhead | PC, PS4, Xbox, Switch | External | External (Octato Studios) | Internal (HandyGames) |
| Jagged Alliance 3 | PC | Own | External (Haemimont Games) | Internal (THQ) |
| Outcast 2 - A new beginning | PC, PS5, XSX | Own | Internal (Appeal Studios) | Internal (THQ) |
| All Elite Wrestling: Fight Forever | PC, PS5, PS4, Xbox, XSX, Switch | External | External (Yuke's Co Ltd) | Internal (THQ) |
| Tempest Rising | PC | Own | Internal/External (Slipgate, 2B Games) | Internal (THQ) |
| A Rat's Quest | PC, PS4, Xbox, Switch | External | External (The Dreamerians) | Internal (HandyGames) |
| Gothic - Remake | PC, PS5, XSX | Own | Internal (Alkimia Interactive) | Internal (THQ) |
| Alone in the Dark | PC, PS5, XSX | Own | Internal (Pieces Interactive) | Internal (THQ) |
| Wreckreation | PC, PS5, PS4, XSX, Xbox | External | External (Three Fields Entertainment) | Internal (THQ) |
| Space For Sale | PC | Own | Internal (Mirage Game Studios) | Internal (THQ) |
| Lethal Honor Essence | PC, PS5, PS4, XSX, Xbox, Switch | External | External (Viral Studios) | Internal (HandyGames) |

Source: SEB

It is clear that THQ Nordic and particularly the publishing label HandyGames have had strong ambitions for external titles and IP (which was also the case historically). Most of projects are small or mid-sized games, and some are sequels to previous successful releases (such as *Destroy All Humans* and *Spongebob Squarepants Cosmic Shake*) that performed below expectations. Over the last 2-4 quarters industry participants including Embracer have noted that consumer sentiment is soft with weakness in commercial performance particularly visible among smaller titles. There may be a rebound in the future, but all things considered we think the focus on publishing small external titles should be scrapped as their performance is weak, from a strategic perspective they are typically not relevant from a transmedia point of view, and in our view, they are not what investors have in mind for Embracer.

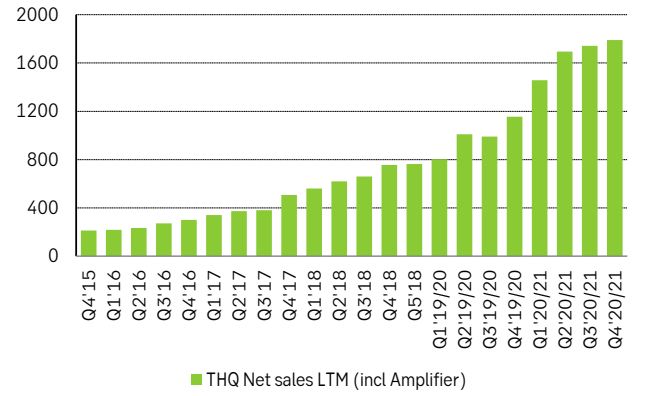
THQ Nordic consists of 22 internal studios. It is difficult to single out a specific underperformer, and the announced pipeline gives little indication of what is coming from which studios. In additional to considering the external product strategy, it could make sense for management to go through the portfolio of internal studios and IP at THQ Nordic and see whether parts of it could be packaged and sold to another party. Is IP such as *Destroy All Humans* worth keeping and trying to revive in yet another sequel after the last release was a flop? What is the approach with a game like *Way of the Hunter*, which has good reviews in an interesting niche but a low player base today? Why did some of these games not succeed despite having good reviews and/or established IP?

In our view, THQ Nordic could benefit from first focusing its strategy on internal projects and subsequently identifying success factors for its type of games, and better establishing processes for evaluating ongoing projects. It is clear to us that many releases should not have happened in the first place, and perhaps in some cases this could have been identified before the actual release.

As THQ Nordic consists of both publishing and internal development, its value could be assessed in various ways. A publishing organisation without a meaningful back catalogue contribution is essentially worthless in our view as it consists of only costs in the form of personnel and it would likely be easier to shut down such an organisation rather than sell it. If packaged with a catalogue of games from previous releases and some ongoing projects, then such a business could be valued at mid- to high-single-digit earnings we believe (assuming margins in the low teens this should be c. 1x sales).

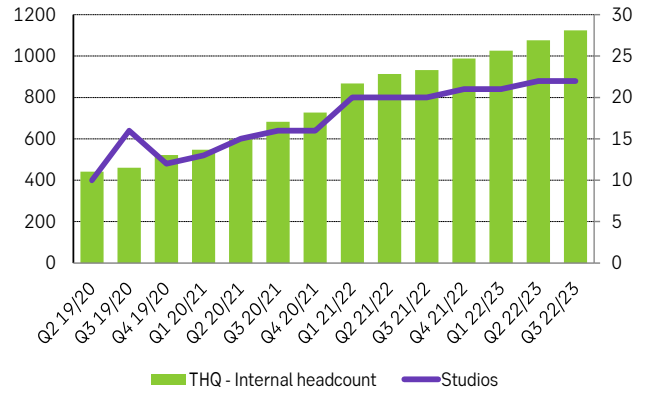
For internal studios working on games and IP that would be deemed by Embracer not necessary to keep (e.g., the titles mentioned above) and assuming a counterpart would take up the challenge to revive the IP, we think the value would be higher than for a publishing organisation. Again, it is difficult to single out specific studios to find a value, but Embracer could evaluate a package deal as we see it. The internal headcount (including publishing) of THQ Nordic comprises about 10% of Embracer's total headcount within PC/Console.

**THQ Nordic LTM net sales, 2015-FY 2020/21**




Source: SEB

**THQ Nordic internal headcount, Q2 19/20-Q3 22/23**




Source: SEB

When accounting for the publishing organisation, we think THQ Nordic is currently slightly dilutive to Embracer's current margins in PC/Console with recent releases making a minimal contribution to cash flow while capex remains as long as a hefty external games pipeline is projected.

# Coffee Stain

Coffee Stain is the gem of Embracer, as we stated in our last report (25 May). Behind successes like *Valheim*, *Satisfactory* and *Deep Rock Galactic*, Coffee Stain is probably Embracer's most successful acquisition. Today it provides interesting exposure in the form of *Welcome to Bloxburg*, which is among the most popular games on the entire Roblox platform (as of Sunday, 29 May, the game peaked at 99k concurrent users and has averaged about 40k users over the last 14 days, according to site RoMonitor Stats).

As of end-Q2 2022/23, Coffee Stain had generated pro forma LTM net sales of SEK 1,300m and adjusted EBIT of SEK 835m for a 64% margin, while games such as *Valheim* and *Satisfactory* are still in early access.

We have discussed Coffee Stain frequently with investors, particularly since Embracer announced the group's strategic review in Q2 2022/23. The general feedback regarding a spin-off of Coffee Stain was mixed. Some see the clear-cut exposure as appealing while others mentioned potential challenges for ownership such as market cap, liquidity and limited guarantees for crystallising the value in the form of a higher trading multiple than for the Embracer Group.

Our view is that a sale is possible and given the unit's track record and quality slate of games, there should be plenty of buyers. In our last note, we assumed an EV/EBIT of 12-15x on the TTM SEK 835m EBIT yielding c. SEK 10-13bn in proceeds. Considering Coffee Stain's strong growth prospects and qualities, this might be conservative, but we think it is reasonable as a baseline. That said, a value above SEK 15bn is not far-fetched, in our view.

In terms of transmedia strategy, we think Coffee Stain has limited alignment with the rest of the group. There are examples such as board games for *Deep Rock Galactic* being planned, meaning its collaboration with other units within Embracer could strengthen over time. We note Coffee Stain has no AAA projects in the pipeline as per the Q3 2022/23 presentation from February 2023. Post a potential transaction, Embracer would likely lose a run-rate adj EBIT of up to SEK 1bn per year that is tangibly cash flow positive. Hence, a possible sale is not optimal from such a perspective, unless debt needs to be immediately addressed.

We conclude that some investors are open to a sale of Coffee Stain (which would immediately resolve most of the debt concerns), but some investors are less happy with the idea. Regardless, we believe that Coffee Stain alone should give the market a sense that the risk of a new share issue for Embracer is likely limited, as it clearly highlights high value within the group.

# Plaion

Plaion was acquired as Koch Media in February 2018. Today, it is a publisher and developer of both internal and external PC/Console projects, including games such as *Metro*, *Saints Row* and *Dead Island*. Parts of the Plaion business operate in the Entertainment & Services segment, which relates to film and the physical distribution of games. Within PC/Console, Plaion employs c. 2,400 people at 13 studios.

In our view, Plaion has many similarities with THQ Nordic. Together, the two entities largely represent the "old" Embracer and most of what is external publishing that we have highlighted has underperformed recently. After the release of *Saints Row*, which performed below expectations, the internal developer Volition was moved from Plaion to Gearbox. This is one example of restructuring within the Embracer Group.

Publishing labels within Plaion are Deep Silver, Prime Matter, Ravenscourt, Milestone and Vertigo Games. A couple of weeks ago, news came out that Plaion would merge the labels Deep Silver, Prime Matter and Ravenscourt into the Plaion brand, with sources (in an article from Gamesindustry.biz) claiming that the aim is to produce fewer titles at a higher quality. While Embracer has not revealed any major plans, we see this as a first step towards ending a large part of the external publishing operations, which have been skewed to a large extent towards small titles, most of which have been commercially unsuccessful (similar to the situation at THQ Nordic).

**Plaion games released during FY 2022/23**

| Games released during FY 2022/23 Plaion | Platform(s) | IP | Developer (internal/external) | Publisher |
|---|---|---|---|---|
| Trek to Yomi | PC, PS5, XSX | External | Internal (Flying Wild Hog) | External (Devolver) |
| Let's get fit | Switch | Own | Internal (Voxler) | Internal (Ravenscourt) |
| Crossfire: Legion | PC | External | External (Blackbird Interactive) | Internal (Prime Matter) |
| MotoGP 2022 | PC, PS5, PS4, XSX, Xbox, Switch | Own | Internal (Milestone) | Internal (Milestone) |
| Saints Row | PC, PS5 PS4, XSX | Own | Internal (Volition) | Internal (Deep Silver) |
| Evil West | PC, PS5, PS4, XSX, Xbox | External | Internal (Flying Wild Hog) | External (Focus Entmt.) |
| The Chant | PC, PS5, PS4, XSX, Xbox | External | External (Brass Token) | Internal (Prime Matter) |
| The Last Oricru | PC, PS5, XSX | External | External (GoldKnights) | Internal (Prime Matter) |
| Gungrave G.O.R.E | PC, PS5, PS4, XSX | External | External (Iggymob) | Internal (Prime Matter) |
| Scars Above | PC, PS5, PS4, XSX, Xbox | Own | External (Mad Head Games) | Internal (Prime Matter) |
| Warlander | PC, PS5, PS4, XSX | External | External (Toylogic) | Internal (Plaion) |
| After the fall: Complete Edition | PSVR2 | Own | Internal (Vertigo Games) | Internal (Vertigo) |
| Mato Anomalies | PC, PS5, PS4, XSX, Xbox, Switch | External | External (Arrowiz) | Internal (Prime Matter) |

Source: SEB

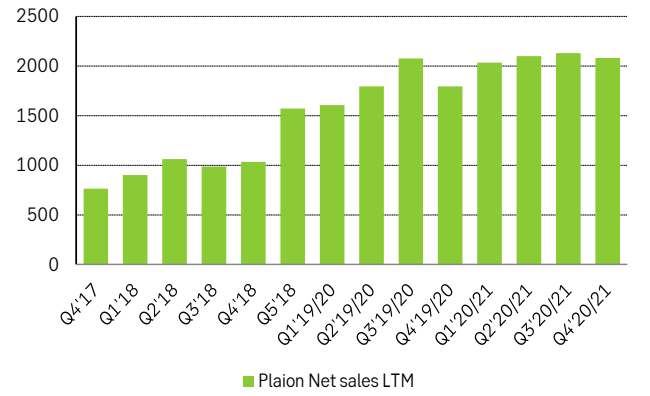
The internal headcount at Plaion and THQ Nordic exceeds 3,500. As these two operating units hold a large share of Embracer's publishing organisation, we would not rule out that there are c. 1,000 people working solely in publishing at these two companies alone. Besides capex, this means a lot of operating expenses when unsuccessful games are released and salaries are still being paid, which results in a negative earnings contribution as has been seen during the last few quarters for PC/Console as a whole.

We think the portfolio of Plaion is similar to that of THQ Nordic with regard to what IP is held and what studios are owned. Following the poor reception of *Saints Row*, should the IP and associated developers in Volition be kept within Embracer, or is this a good time to seek other owners to have their go at the franchise? During development, Volition employed c. 200 people and judging by employees on LinkedIn, this number does not appear to have changed, making an earnings contribution from a *Saints Row* perspective likely to be negative if one would attribute employee costs in Volition to Saints Row. Volition is now under the Gearbox umbrella, and we do not know if parts of the studio are working on other projects instead.

Another question worth asking in our view is whether it is essential for Embracer to own Vertigo Games (from a standpoint of transmedia strategy and what investors are seeking when investing in Embracer), which develops and publishes VR games. Despite having a strong position in the industry, the VR games market is still emerging and not generating significant revenues for content creators on a broader basis. For reference, Embracer paid EUR 45m in upfront consideration for Vertigo in 2020, with EUR 10m of that in shares. Upon the acquisition (September 2020) Vertigo was estimated by Embracer to generate sales of EUR 10-12m with an EBIT of EUR 6-8m, and was in FY 2021/22 expected to post net sales of EUR 18-24m with an EBIT of EUR 11-17m.

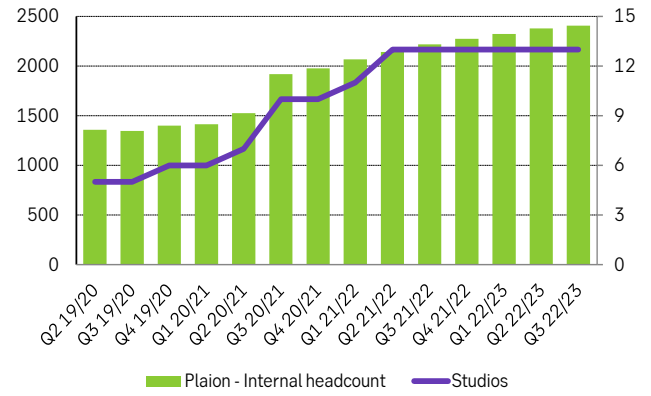
Almost three years have passed since Vertigo was acquired, with industry-driving hardware releases such as Oculus Quest 2 and Sony PSVR2 plus a rumoured entry by Apple in the coming years (speculation was made by several news outlets, such as The Verge, Macworld and TechRadar to name a few). We think it is fair to assume that Vertigo is worth EUR 45m as a minimum, with good prospects of a value of EUR 70-80m if the growth projections were generally correct. All in all, in our view, Vertigo seems like a good company with an interesting exposure, but is a divestment option from the perspective of reducing debt.

**Plaion: LTM net sales, Q4/17-Q4 2020/21**




Source: SEB

**Plaion: Headcount, Q2 2019/20-Q3 2022/23**




Source: SEB

**Merge THQ Nordic and Plaion?**

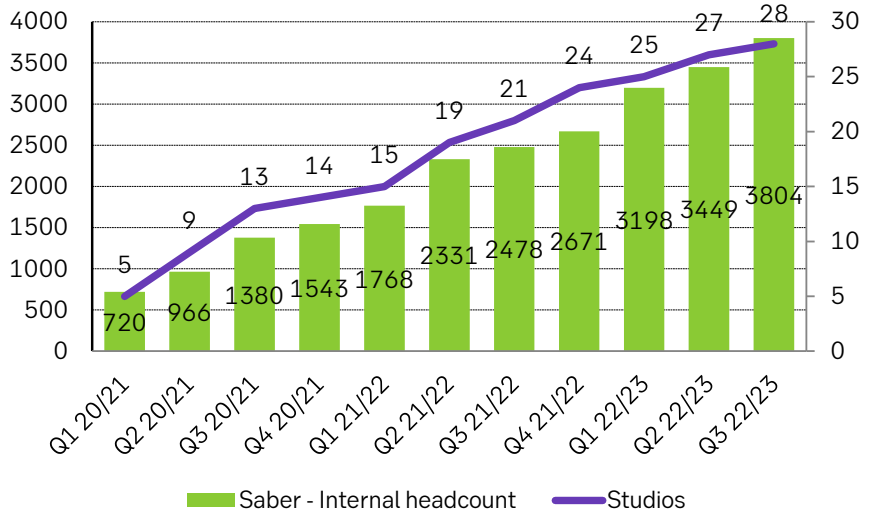
We have also pondered the feasibility of merging THQ Nordic and Plaion. There are a lot of common denominators: both have been in the Embracer Group for a long time, both hold substantial investments in small and mid-sized games, and both represent a large part of Embracer's external publishing initiatives. The units are based in Austria and Germany.

Merging the entities would not be a quick fix as such a process hardly takes only a year. However, we think merging these units could address a tangible part of the issues in Embracer's capex structure, meaning consolidation opens for improvements. A merger could be beneficial from a governance perspective as it would improve the monitoring of performance, simplify the organisation and pave the way for the establishment of an enhanced publishing organisation with better processes and models for how to operate within the group. Merging the two companies could also result in opex savings from support functions, we believe.

# Saber Interactive

Saber was acquired by Embracer in February 2020 for an upfront consideration of USD 150m, plus an earnout consideration on a maximum basis amounting to USD 375m lasting for six years after the acquisition date. USD 325m (62%) of the total USD 525m consideration constituted shares. In 2019, Saber generated revenues and EBIT of USD 105m and USD 62m respectively, leading to a total consideration of 8.4x EV/EBIT upon acquisition. Saber CEO and co-founder Matthew Karch is a board member of Embracer Group. Today, Saber consists of 28 studios and c. 3,800 headcount, which (as most of these are developers) represents almost 40% of Embracer's development capabilities.

**Saber Interactive, headcount development since acquisition**




Source: SEB

Saber has some publishing, but its business model largely relates to the development of games in the form of work-for-hire and games development. We believe roughly 30-35% is work-for-hire, while the rest is mainly externally financed games development. Business model-wise, Saber typically works with an external publisher that finances ongoing development and takes balance sheet risk of a project. Saber is compensated throughout the development period, upon reaching milestones (or the consultancy-like support provided through work-for-hire). Such compensation (revenue) can be received with and without a margin on the development (labour) cost for Saber, meaning it can generate a profit margin during the development, regardless of the game's success. We believe this margin typically stands at around 10-15%. Once a game is released, Saber generates revenue through a revenue-share model with the publisher, after the publisher has recouped its investment. Whether this revenue split is, i.e. 70/30, 50/50 or 30/70 to publisher/developer, it is subject to negotiation and margin during development, among other things. We believe Saber typically captures 50-70%.

As stated above, Saber's 2019 numbers indicate a margin of 60%, although the business has grown (>5x in terms of headcount) since being acquired by Embracer through acquisitions. High margins for Saber are driven by 1) efficient production of games, which can be accentuated by producing the games in low-cost geographies like Eastern Europe and 2) producing good games that sell well.

Saber has a publishing organisation (through labels Saber, Aspyr and 3D Realms) but as a whole, it is a small part of its business. Given a limited publishing organisation and a business that largely relies on development that is externally financed, we think Saber today generates stable margins and is cash flow positive. From a strategic point of view, Saber plays an important role in Embracer's general pipeline (c. 20% of all projects) and in particular AAA pipeline (11 according to Embracer's Q3 2022/23 presentation, 35% of the total 31). Given 23 of the 31 IPs are owned by Embracer, a few of those developed by Saber are without a doubt internal Embracer IP.

**Aspyr – the most evident "dog" if any**

Aspyr is a publisher and studio within Saber, acquired in February 2021 for an upfront consideration of USD 100m on a 2020 EBIT base of USD 11.4m (9x EV/EBIT). Interestingly, a tangible earnout consideration of USD 350m until 2028 was announced upon the acquisition. USD 25m of this was "conditioned on management releasing certain commercial products prior to 31 March 2026", and USD 325m pertaining to financial performance up until 31 March 2028, both suggesting an expected major revenue-generating inflection point.

We think this inflection point partly relates to the remake-release of the game Star Wars: Knights of the Old Republic ("KOTOR"), a game that was reportedly delayed in July 2022 (according to an article in Bloomberg). This has not been confirmed by Embracer, but it was rumoured that development has shifted from Aspyr to another part of Saber. The game is published by Sony, meaning the balance sheet risk does not sit with Embracer. As we understand it (and judging by Embracer's announced pipeline of games), the game is still in development, but points to Aspyr's performance as mixed post-acquisition. Regardless, we believe the upfront purchase price is acceptable for the rest of the (profitable) business, which relates to porting existing games to new platforms where said game is not available. Hence, divesting Aspyr could realize about SEK 1bn in cash proceeds assuming a similar price tag, but the unit does not seem problematic today from an outside view.

**More of PC/Console being like Saber in the future would be a good thing**

For Saber as a whole, operating through a model that takes limited to no project risk on the balance sheet could be an operating model that large parts of the Embracer PC/Console business could strive for. It typically means generating stable earnings and cash flow during development, and then by making good games generating revenues from successful game releases. We believe a franchise like Saber is strengthened by having access to Embracer's vast IP catalogue, opening substantial opportunities for finding and establishing projects with which to approach external publishers. The company has a track record of successfully working with licensed IP from companies like Paramount (World War Z and Evil Dead, for example).

# Amplifier Game Invest

Founded in 2015, Amplifier was acquired by Embracer in 2019 under the name Goodbye Kansas Game Invest (GKGI) for SEK 42m. Amplifier today consists of 17 studios and 331 employees as per 31 December 2022. The operating unit invests in early-stage projects and teams in a start-up or VC-like manner, and as of Q2 2022/23 Embracer claimed that total net investments into Amplifier reached SEK 550m including SEK 315m in capex. Amplifier generated SEK 80m in net sales in FY 2021/22.

Amplifier studios have developed and own IP for successes like *Biomutant* (published by THQ) and *Little Nightmares* (published by Bandai Namco). Still, we think making early-stage and VC-like investments cannot be considered core to Embracer's strategy. The business as it stands today, given revenue generation and high capex, is a small and potentially negative contributor on a group level from an earnings and cash flow perspective. We think it is possible that Embracer could carve out attractive IP or specific projects it wishes to keep but should seek alternatives for Amplifier operating outside the group, which would likely have a small positive impact on margins and cash flow.

When mentioning a strategic review of the group in Q2 2022/23, Embracer spent a few minutes discussing Amplifier, hinting that it could be a candidate as part of its search for strategic alternatives (which was interpreted by the market as spin-offs or divestments, primarily in the form of a package deal with Coffee Stain, we believe). If a sale is not feasible, we think it should be considered to limit further investments.

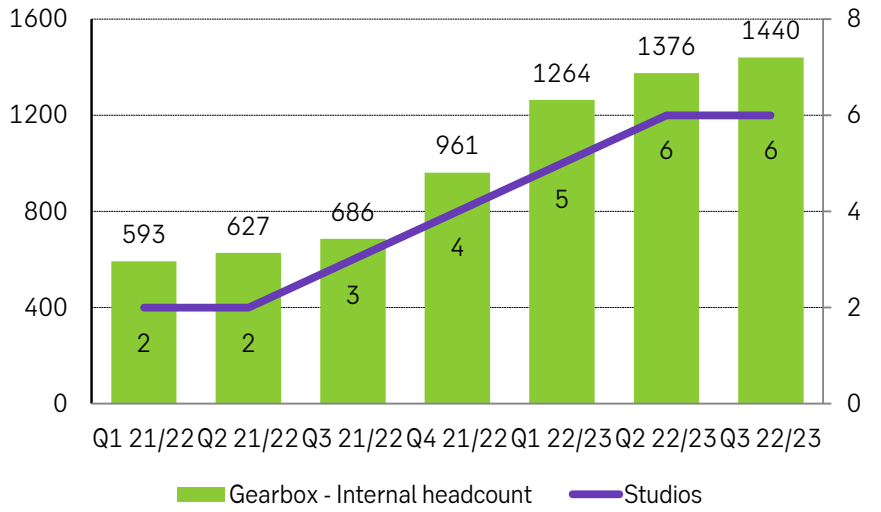
It is difficult to assess the value of Amplifier given the dearth of details, but judging by past revenue numbers, it could be worth SEK 100-200m with a limited earnings contribution but could be positive for Embracer from a cash flow run-rate perspective. Net investments in Amplifier were slightly above SEK 300m according to Embracer's Q2 22/23 report. This invested capital is another way of determining the value of Amplifier, in our view.

**Tarsier studios – a single studio possible to sell**
Tarsier was acquired by Embracer in 2019 and is the developer behind Little Nightmares (published by Bandai Namco which also owns the IP). The franchise is highly successful (both editions selling millions of copies, according to the company) and a carve-out and divestment of Tarsier to a player like Bandai Namco (who should see it as synergistic) could crystallise strong value for Embracer, as we see it.

# Gearbox

Gearbox was acquired by Embracer in February 2021. Today, Gearbox consists of six studios and has a headcount of 1,440 (more than 2x increase since being acquired). The upfront consideration of USD 363m consisted of USD 188m in cash, and the remaining USD 175m in shares. In the first nine months of 2020, Gearbox generated c. SEK 1bn in net sales and SEK 417m in adjusted EBIT, suggesting an annual run-rate of SEK 556m, translating the upfront consideration into about 5.5x EBIT (assuming USD/SEK of 8.5).

**Gearbox, headcount development since acquisition**




Source: SEB

Further, earnouts over the following six years amount to up to a potential of USD 1,015m divided into three tranches. These earnouts encompass both cash and shares, and the amount to be paid depends on what level of accumulated adjusted EBITDA (excluding capitalisation) is generated by Gearbox. To receive the total purchase consideration of USD 1,378m, Gearbox would need to generate an accumulated adjusted EBITDA (excluding capitalisation) of USD 1,300m over the six years following the acquisition.

Gearbox is primarily a developer of games, that also owns several strong franchises such as Borderlands, Risk of Rain and Duke Nukem. Gearbox has a publishing organisation that we estimate consists of up to 200 people, around half of which come from Perfect World Entertainment North America (acquired in December 2021). Gearbox publishing consists of both internal and external development and IP, but as we see it, is tilted towards in-housing projects while most external projects are of a smaller size. Moreover, Gearbox seemingly strives towards internal projects, one example being buying the Risk of Rain IP from Hopoo Games in October 2022 after publishing the game which was a successful release.

From a strategic perspective, Gearbox plays an important role, in our view. It has the second most AAA projects in the pipeline (eight according to Embracer's Q3 2022/23 presentation) after Saber and is also behind leading IPs within the Embracer Group such as the abovementioned Borderlands franchise. Moreover, Gearbox and CEO Randy Pitchford have in various presentations shown clear optimism and engagement in the transmedia strategy – with actual projects already in place, such as a Borderlands movie that could be released in the near future (no release date announced), starring actors such as Jack Black, Kevin Hart and Jamie Lee Curtis to name a few.

In a long-term perspective, Gearbox has not spent enough time within the Embracer Group to prove itself in our view, as the games pipeline upon the acquisition in February 2021 mostly have not matured yet. Some games have been released, such as Tiny Tina's Wonderlands (which was a success) and New Tales of the Borderlands (which was a disappointment but not as large of a project).

**Perfect World and Cryptic Studios**

In December 2021, Embracer acquired Perfect World Entertainment's North American business, consisting of PWE publishing (publishing Cryptic Studios games among others, c. 100 employees) and Cryptic Studios, which has developed and operated multiple MMOs (c. 140 employees). These two businesses are today part of Gearbox. The attractiveness of MMOs is high player engagement and a games-as-a-service-like business model – in Embracer's Q4 2022/23, Star Trek Online and Neverwinter Online were among the top 10 back catalogue revenue drivers in PC/Console, showcasing just that.

If we were to identify anything divestible within Gearbox, we would single out PWE publishing. On the one hand it generates revenue streams as it is the publisher of, i.e. abovementioned *Star Trek Online*. We however question the strategic role of MMOs in Embracer's transmedia strategy – it could be viable but the current games are at the same time decade-old franchises that might serve better as generating cash and managing the existing player base rather than over time be expanded into new games or sequels.

As such, there could be optionality on restructuring parts of the Gearbox publishing business (in the PWE publishing case, it was a total of 100 people on the acquisition date as stated above). The guidance on financial performance from PWE and Cryptic Studios was EBIT breakeven in FY 2022/23 and SEK 200-300m in FY 2023/24, with a low earnings base coming from a then recently failed project. The acquisition consisted of an upfront purchase price of USD 125m, of which USD 60m was in cash and the rest in shares.

# Crystal Dynamics/Eidos Montreal

Embracer acquired Crystal Dynamics/Eidos Montreal (CDE) in 2022 for USD 300m from Square Enix, without any contingent (earnout) considerations on future performance. According to the last available figure (reported by Embracer in conjunction with Q3 2022/23), CDE had a headcount of 851, down from 1,100 when the acquisition was announced (due to the closure of its mobile business post-acquisition).

CDE brought Embracer substantial AAA development capabilities, and strong IP including *Tomb Raider*, *Deus Ex* and *Legacy of Kain*. Upon the acquisition, Embracer said that it expected CDE to have a breakeven or low EBIT contribution over the upcoming two financial years (2022/23-2023/24) driven mainly by sales of back catalogue titles. It also stated that this could change positively if the company decided to enter a deeper strategic relationship with one or more platforms around the upcoming pipeline. When the product pipeline matures in the years ahead, Embracer expected the acquired companies to generate on average at least SEK 0.5bn in EBIT per year with notable upside potential.

Two major things have happened since the acquisition: the closure of CDE's mobile entity Onoma and the external publishing agreement made with Amazon regarding an upcoming *Tomb Raider* game. The closure of Onoma, including some other internal resources of CDE, affected about 200 people. Judging by data on mobile games released by the studio, the earnings contribution from the entity was likely negative. The second change since the acquisition of making a *Tomb Raider* sequel to be published externally by Amazon was announced in December 2022. We think this game has annual capex of about SEK 400m, that now instead generates revenues including a small earnings contribution as we see it.

So, what about the value? All else equal, after these changes CDE should have better earnings generation than the breakeven it was guided by Embracer to report through FY 2023/24. Removing the mobile exposure also makes the unit's business more clear-cut and thus possibly increases the value. On the other hand, while having major IP and a project such as *Tomb Raider* be published externally is positive from the perspective of project risk and near-term earnings generation, some potential buyers (such as those seeking to publish major AAA titles) might see it as making CDE less appealing as a takeover target if Embracer would consider a divestment.

Overall, we think CDE has a value of at least the USD 300m for which it was acquired after the changes were made but is likely worth more after changes made. Considering there is strong IP and more potential AAA projects (a total of five are ongoing in CDE as per the Q3 2022/23 report), we would not rule out the unit's attractiveness as an acquisition target for larger players. Amazon itself may see buying CDE as synergistic, as it already has made a major commitment through the publishing agreement, and we speculate that Amazon might have further transmedia initiatives such as films and series for the IP.

Selling CDE could at least bring SEK 3bn in proceeds to Embracer without meaningfully lowering near-term EBIT contribution. It could also lower capex although this would mean a tangible part of the AAA pipeline would be removed and great transmedia IP would be lost (a deal making Embracer keep certain IP or such cannot be ruled out, but that should equally affect the value of CDE). Selling CDE is possible even though the unit is a central part of the transmedia strategy, as we see it.

# Tabletop – Asmodee

Embracer announced the acquisition of Asmodee in December 2021, for an upfront consideration of EUR 2.75bn including EUR 2.4bn in cash. Based on the assessed financial performance in CY 2021 (adjusted EBITDA of EUR 240m and adjusted EBIT of EUR 206m), the upfront consideration represented a transaction EV/EBITDA of 11.5x and EV/EBIT of 13.3x.

In FY 2022/23, Asmodee generated SEK 2bn in adjusted EBIT and was cash flow positive but burdened by excess inventory buildup. Historically, Asmodee has converted 70-80% of adjusted EBITDA to pre-tax free cash flow, which should correspond to 80-90% of adjusted EBIT. As such, a normalised pre-tax FCF in FY 2022/23 should have been c. SEK 1,700m (post-tax SEK 1,275m assuming a 25% tax rate). Considering the more than 100% pre-tax FCF to adjusted EBIT conversion that Asmodee management guides for FY 2023/24, and assuming an equivalent negative effect on the last fiscal year (c. SEK 400-500m), we calculate pre-tax FCF from Asmodee in FY 2022/23 of c. SEK 1,250m (c. SEK 950m post-tax).

Asmodee is the second-largest board game company globally after Hasbro and is the leading player in Europe. It has a strong track record and has enjoyed strong growth over the last decade. As we understand it, there were other potential buyers in the process of the Asmodee transaction, such as the private equity firm Carlyle (according to an article from Unquote in December 2021, a few days before the acquisition was announced). Asmodee's closest peer is Hasbro, which currently trades on a FY 2023E EV/EBIT of 13x, or alternatively an EV/EBITDA of 10x according to FactSet. Both Asmodee and Hasbro own strong IP, with Hasbro on an aggregate basis probably drawing the longer straw. At the same time, gaming only represents one-third of Hasbro's revenue. It has a major exposure to toys that Asmodee does not have. Overall, we think a multiple for Asmodee on par with Hasbro is fair and would represent a multiple corresponding to the upfront consideration when Embracer bought it. In such a case, on a LTM adjusted EBIT of SEK 2bn, Asmodee would be worth c. SEK 26bn. Assuming a more conservative multiple of 10x, we land at a fair value of SEK 20bn.

Asmodee is central to Embracer's transmedia strategy, and is highly synergistic with entities such as Middle-Earth Enterprises, leveraging an internally owned IP to drive both additional revenue streams and strengthen the IP, which in turn would support the sales of other products such as video games based on the same IP. Asmodee's management and other Embracer operating unit managers alike have identified multiple transmedia projects over the last year.

Since the acquisition, we believe investors have come increasingly to appreciate the Asmodee model and its stability of earnings as other segments have been weaker, although Asmodee's cash generation has been hampered by inventory build-up. Selling Asmodee would resolve Embracer's debt issue, but it would be mean a substantial blow to the underlying cash generation, diversification and earnings stability of the group. A potential sale would further call into question Embracer's actual strategy. Our conclusion is that a sale of Asmodee is possible and would resolve debt issues, but it would also concentrate earnings and cash flow generation risk in PC/Console.

# Mobile

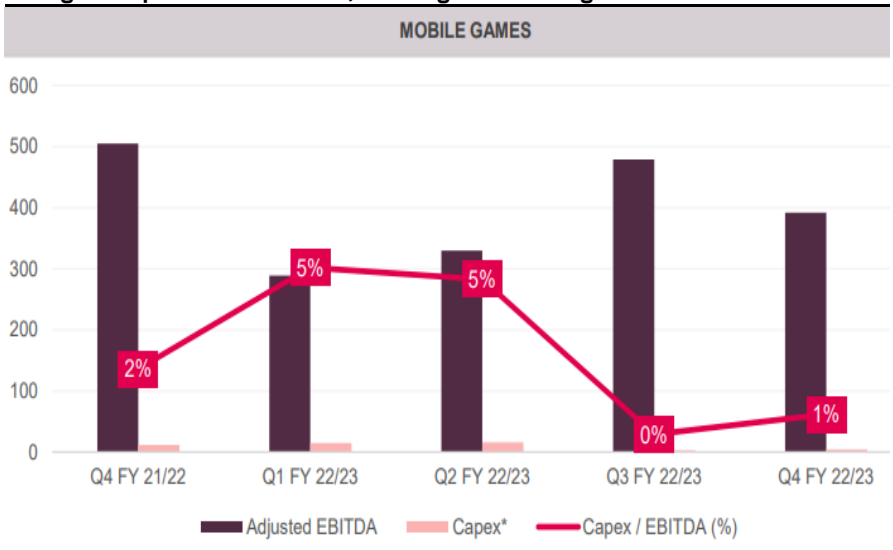
**Conclusion**

Below, we outline Embracer's mobile business, its earnings and FCF generation. We think a potential sale of this business could generate SEK 8-11bn in cash proceeds depending upon whether the entire segment is sold or only perhaps just Easybrain. We estimate the total mobile games segment generate SEK 1bn in FCF per year, the loss of which would be the flipside of a sale. Nevertheless, the proceeds would likely be sufficient to address the debt issue and provide headroom for the organisational changes needed to improve cash generation in the rest of the group, along with the maturing of the AAA-games pipeline.

Embracer's mobile games business is primarily conducted by three subsidiaries: Deca, CrazyLabs (under Deca) and Easybrain. In aggregate, Embracer is the world's fifth-largest mobile games publisher, according to SensorTower data in terms of downloads, and is the fourth largest in Europe. The mobile games business is tilted towards hypercasual and casual games, particularly from CrazyLabs and Easybrain.

The mobile segment generated SEK 5.8bn in net sales and SEK 1.4bn in adjusted EBIT in FY 2022/23. It is highly cash-generative, as there are few investments (game development is largely reflected in opex) and instead of capex, the key growth investment is taken over operating expenses in the form of user acquisition. Judging by the chart provided by Embracer (below), capex is less than SEK 50m annually, or less than 1% of sales.

**Intangible capex in mobile is low, meaning most earnings turn into FCF**




**investments in intangible assets*

Source: Embracer

The business model for mobile games generating revenues through in-app purchases typically has neutral or slightly negative working capital, while revenues generated through advertising mean slight working capital driven by payment cycles from ad mediators and exchanges (assuming topline growth). Embracer generates most of its mobile revenues through advertising. Embracer's mobile business is highly cash-generative (we estimate around a 90% pre-tax FCF conversion to adjusted EBIT). Assuming a 25% tax rate, we estimate Embracer's mobile business will post FCF of SEK 0.9-1.0bn in 2022/23-2023/24. As such, the segment serves as a solid cash generator and should have more stable earnings generation than PC/Console over time.

From a strategic perspective though, Mobile has little overlap and alignment with transmedia. In the mobile games industry, there are examples of large video game IP getting a mobile version (e.g., *Call of Duty* and *Diablo*), but typically these mobile games do not address the same type of player (a PC player is not the primary target audience for a mobile game). In terms of AAA mobile games, which is an emerging segment, Embracer appears to hold no ambition and we believe it is open to licensing IP to external parties should the opportunity arise, which we see as a reasonable approach.

In our last note (25 May), we highlighted that Easybrain, a single unit comprising c. 300 people, is generating up to SEK 1bn in adjusted EBIT by our assessment. This leaves Deca and Crazylabs generating c. SEK 400m. We think these units could be sold as a package deal or Easybrain could be sold alone for a high-single digit multiple, implying a value for Easybrain of c. SEK 8bn (assuming 8x EBIT), or for the entire mobile game segment of up to SEK 11bn. This would more than resolve Embracer's elevated debt situation from an investor point of view, we think.

The flipside of selling the mobile business would be c. SEK 1bn less in FCF per year. However, as we see it, the potential cash proceeds would be sufficient to bridge the gap over the coming years until the PC/Console games pipeline matures, while other possible initiatives for capex and opex could set cash generation at a better baseline. Further, we do not think investors are seeking mobile game exposure when looking at Embracer (15% of net sales in 2022/23 or 22% of adjusted EBIT), as more clear-cut exposure is available both locally and globally.

**Potential buyers**

The mobile games industry is undergoing consolidation just like the broader gaming industry. One potential 'deep-pocketed' buyer is Savvy Games Group, which recently acquired US-based Scopely for USD 4.9bn. In 2022, Savvy stated that among other planned investments, it sought to spend USD 13bn to acquire a leading game publisher. Whether that was Scopely is unclear, but we note that leaves c. USD 8bn available in the budget for bolt-on acquisitions.

Scopely is a free-to-play mobile games company that has developed games based on strong external IP (Monopoly, Marvel, and WWE among others). We think both Deca and Easybrain's casual and hypercasual games could serve as a complement from a user-acquisition perspective. Further, the owner Savvy is an existing shareholder of Embracer and a deeper partnership could come in the form of Embracer licensing its IP for Savvy/Scopely to develop mobile games, which would be beneficial for both parties.

# Entertainment & Services

Entertainment & Services consists of the operating units Dark Horse and Freemode, and the physical distribution arm Plaion, previously known as partner publishing. In FY 2022/23, the segment generated net sales of SEK 5.3bn (14% of the group total) and adjusted EBIT of SEK 281m (4%). The segment holds a tangible part of Embracer's IP catalogue through Dark Horse and Middle Earth. The Entertainment & Services headcount as of end-Q4 2022/23 was 900.

**Overview of Entertainment & Services**

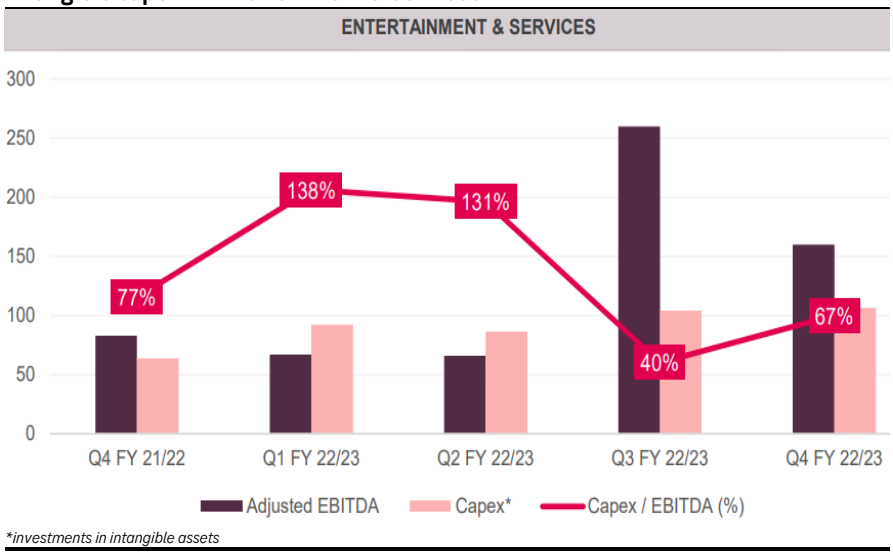
| OPERATIVE GROUPS | COMPANIES |
|---|---|
| PLAION | PLAION PICTURES, SPOT FILM, DEVplus, solamedia |
| DARK HORSE MEDIA | THiNGS FROM ANOTHER WORLD, DARK HORSE ENTERTAINMENT |
| FREEMODE BY EMBRACER | C77, TOAPLAN, BIT WAVE, QUANTIC LAB, GOE, LIMITED RUN, GRIMFROST, GIOTECK, TATSUJIN, sing trix |

Source: Embracer

Besides Entertainment & Services holding IP that opens up the possibility of cross-collaboration for video games and other media (the best example being Middle Earth with the *Lord of the Rings* franchise), physical distribution capabilities in Plaion are complementary to the PC/Console business. Notable examples of partner publishing include Plaion physically distributing *Call of Duty: Modern Warfare II* (2022) in Europe. Partners include major gaming publishers such as Activision, Square Enix and 2K Games, to name a few.

Q4 2022/23 was the first time Embracer provided a definitive split of capex in all segments (PC/Console is continuously reported). We were surprised by the high (intangible) capex in Entertainment & Services. The run rate from the last two quarters indicates capex of SEK 400-450m (see chart below).

**Intangible capex in Entertainment & Services**




**investments in intangible assets*

Source: Embracer

As we see it, capex in the form of film and IP rights investments is being made largely in Plaion and Dark Horse. There are also a handful of small-team studios in Freemode likely incurring capex, such as Bitwave (retro games), Tatsujin (Japanese arcade games) and C77.

Overall, despite having few details we think the current investment pace within Entertainment & Services looks unsustainable and that now is a good opportunity for management to evaluate the necessity of things such as film investments with regard to its central strategy. Freemode consists of several small units such as the studios mentioned above, but also units like Grimfrost (a Viking merchandise e-commerce operation). Complete divestments might not move the needle in these cases, but they add to the complexity of evaluating Embracer as an investment, in our view.

# Dark Horse

Dark Horse was acquired in December 2021 and was at that time the third-largest publisher of comics in the United States, with a track record of producing films and TV content. Dark Horse owns or controls more than 300 IP which, together with its operations, was seen as providing complementary transmedia capabilities for Embracer. Upon the acquisition, Dark Horse said that it had a pipeline of c. 40 content projects at Netflix, Amazon, Syfy, Sony, MGM, Universal and Warner Media. The company was assessed at end-2021 with total net sales of SEK 900m with EBIT of SEK 130m. EBIT guidance for FY 2022/23E is SEK 140-180m and for FY 2023/24 is SEK 170-200m.

We think there are interesting synergies for Dark Horse within the group, particularly with Asmodee, but also through the cross-fertilisation of IP with PC/Console games. Hence, we see Dark Horse playing a role in the transmedia strategy, which includes adding touch points to the leading entertainment and non-gaming content producers mentioned above.

That said, we cannot help but wonder whether investors see Dark Horse and the comic books market as key exposure for Embracer. Even though it is a profitable business with a broad IP catalogue, Dark Horse adds to the complexity to an investment in Embracer and to its exposure. From such a perspective, we think divesting Dark Horse could be considered, optimally leaving it in the hands of a strong potential partner for collaboration with the rest of Embracer. Such an option is appealing from an outside view.

Assuming the low-end of FY 2022/23 EBIT guidance of SEK 140m at the time of the acquisition, and assuming a multiple of 4-5x EBIT as fair (as it is a niche industry in an arguably legacy market), Dark Horse is worth SEK 0.6-0.7bn we believe. A higher value could be extracted from a strategic buyer seeing synergies (given Dark Horse is "only" the third-largest player in the US), which might push the value north of SEK 1bn.

Divesting Dark Horse would likely also be accretive from a margin standpoint. Given that the entirety of Entertainment & Services has high capex (a SEK 400-450m run rate over the last two quarters as per the Q4 2022/23 presentation), its earnings and subsequent operational cash flow generation are likely to be offset to a certain extent by capex, leaving a rather neutral impact on cash flows at the group level.

# Middle-Earth

Middle-Earth enterprises was acquired in August 2022 and is now part of the operating unit Freemode. According to the Q3 2022/23 report, the consideration paid for Middle-Earth was SEK 4,265m, and according to the Embracer prospectus from December 2022, Middle-Earth in FY 2021/22 generated net sales of SEK 218m with EBIT of SEK 145m (67% margin) based on US GAAP. It is worth noting that royalty revenue streams from such a business could be lumpy in the event of a large film or game being released, with earnings being substantially higher in certain years than in others. Regardless, the Middle-Earth transaction represents a purchase price of 29x EBIT on available numbers which we think was reasonable all things considered.

Two major things have happened since the acquisition of Middle-Earth was completed: a film publishing dispute has been resolved, and a major AAA massive multiplayer online role-playing game (MMORPG) has been announced, that is to be published and developed by Amazon. Both of these things support a higher value of Middle-Earth today versus what Embracer paid, in our view.

**Film dispute ended**

Given the fierce competition in the world of content (across gaming, film, video streaming, etc.), we think there were many parties interested in Middle-Earth. However, an ongoing dispute with Warner Bros (WB) likely prevented direct WB competitors from making the acquisition as the outcome of the dispute was still uncertain. A summary of Embracer's new deal with WB including all of the background from February 2023 can be found here, but the gist of it is that a new set of feature films based on the *Lord of the Rings* IP will be made by WB in the coming years, which is paramount in terms of generating interest in the IP and driving royalty revenue for Middle-Earth. The six major films made (the original *Lord of the Rings* series plus the Hobbit trilogies) generated more than USD 6bn in box office sales.

**Amazon to make a major AAA MMORPG**

A couple of weeks ago, Embracer and Amazon announced that a new AAA MMORPG was in development based on the *Lord of the Rings* IP. The game will be published and developed by Amazon, meaning that Embracer's financial interest comes in the form of royalty revenues to Middle-Earth, as well as any potential direct or indirect synergies from films, board games, trading cards, other games or miniature figures that are produced simultaneously. We do not expect the game to be finished for at least another three years.

As we see it, Embracer does not hold major (in particular AAA) MMO game development capabilities internally, which explains why it has taken development externally. However, the start of production could already have been initiated (either internally or by an external developer) which could result in the transfer of capitalised development in Q1 2023/24. The announcement indicated a minimal near-term earnings contribution though.

We think the prospects for a value for Middle-Earth are now set to be higher than the SEK 4.3bn it was acquired for. We believe more games are planned on Embracer's side for the franchise, along with board game and trading card initiatives from Asmodee in the coming years. Divesting Middle-Earth would have minimal impact on earnings and cash flow for the group, but it would be a major blow to the transmedia strategy and likely to investors' perception of the long-term case.

# Role models for Embracer

We think Embracer today holds many great assets and IPs in a structurally growing gaming market, while ever-growing competition for content will give strong IP owners an advantage over time, we believe.

In such a future, we think Embracer could look at two companies as role models as to how it could approach the future business and transmedia strategy: Keywords Studios and Games Workshop. The two companies currently trade at 2023E EV/EBIT of 15x and 19x, respectively. Keywords is appreciated by the market due to its consultancy-like work-for-hire business, taking limited to no balance sheet risk and generating strong cash flows. Games Workshop is a prime example of IP asset management, where the company nurtures its IP and continuously finds additional revenue streams by licensing the IP to media outside its own core business.

Parts of Embracer have strong similarities to these two companies (such as Saber, Asmodee and Middle-Earth), and gradually steering Embracer towards these types of business models operated by these role models should mean more stable earnings and FCF generation, while enabling cross-fertilisation of IP across different medium. Judging by current valuations of the two, it would also be supportive for multiple expansion over time, even though such a shift could take many years.

## Keywords Studios

- Market cap: c. GBP 1.5bn
- 18% organic growth on average between 2014 and 2022
- Asset-light business model, generating good cash flow and stable margin

**The gaming consultant**

Founded in 1998, Keywords Studios is a leading global provider of fully integrated creative and technical services throughout the game development lifecycle. Through its global platform it can deploy its talent and expertise to help clients to create high-quality games worldwide. The service offering is wide and includes art services (animations and visual effects), game development services, audio services, functionally and quality testing services, marketing services etc.

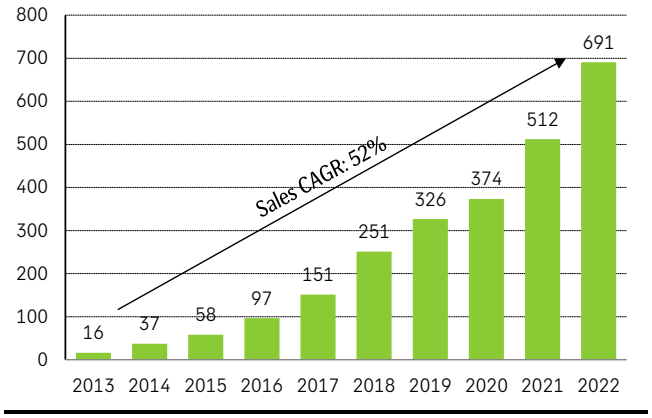
**Customer examples for Keywords Studios**




Source: Keywords Studios

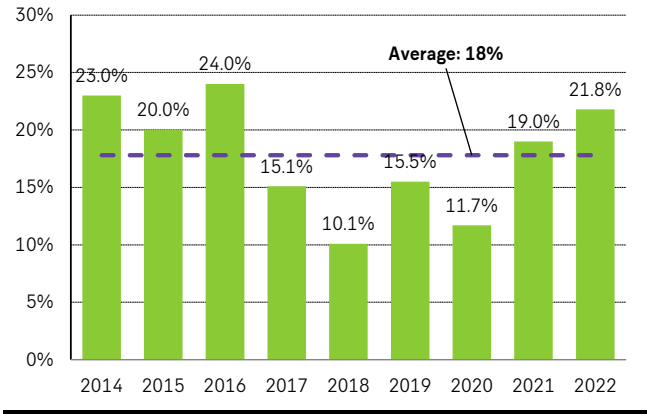
As games are becoming more complex, requiring skilled resources in order to deliver on a tight timeline, there has been an accelerating shift towards utilising external partnerships (i.e., like Keywords) to support the game development cycle. Today, Keywords' client list includes industry leaders, such as Nintendo, Take-two interactive, EA, Ubisoft, SEGA, Microsoft and Tencent.

**Net sales (GBPm)**




Source: Keywords Studios

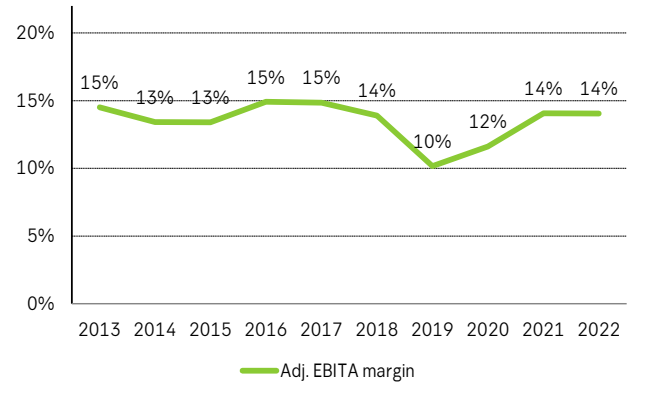
**Organic growth pa**




Source: Keywords Studios

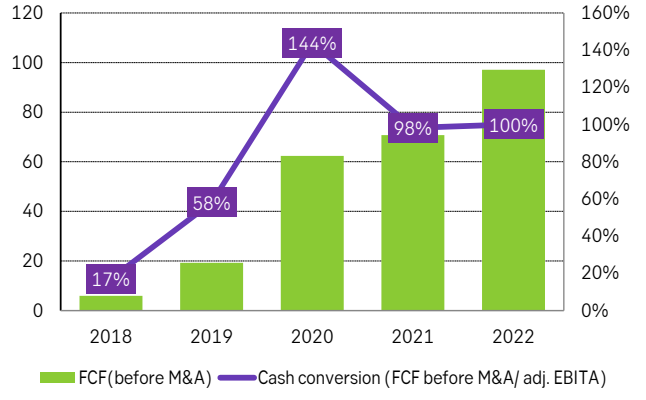
Historically, Keywords has shown an impressive financial development. Since the IPO in 2013, the company has grown its total sales at a 52% CAGR, while posting 18% organic growth on average (according to the company's definition, measured as if all the acquisitions made during the year had been owned at the beginning of the period). During the same period, EBITA adjusted for integration costs and NRIs (i.e., IPO costs and Covid-19 aid) has grown at a 51% CAGR while delivering a margin averaging 13.5%. Furthermore, due to its asset-light "consulting model" the need for capex is low (historically capex excluding M&A has been c. 3% of sales), which allows for good cash flow and cash conversion.

**Adj. EBITA margin**




Source: Keywords Studios

**FCF before M&A (GBPm)**




Source: Keywords Studios

# Games Workshop

- Market cap: c. GBP 3.1bn
- Exceptional EBIT margin, averaging 36% over the last five years
- Stable cash flow

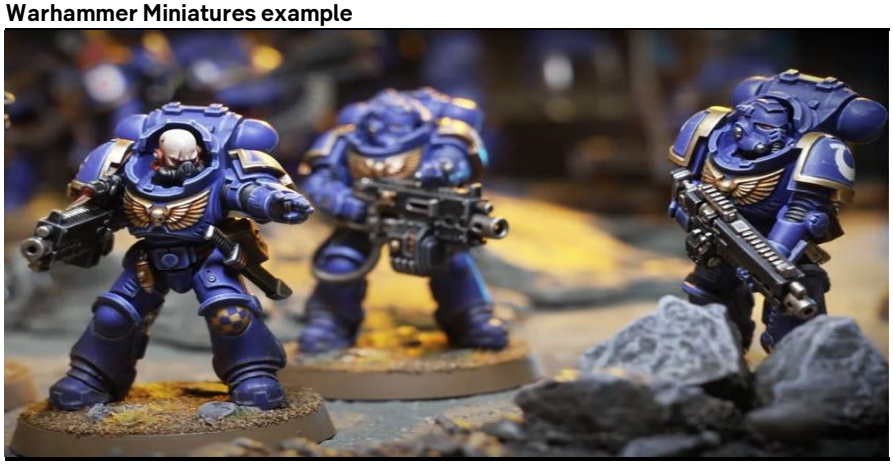
**Fantasy miniatures**

Games Workshop is a manufacturer specialising in designing, producing and distributing fantasy miniatures and associated products. It is best known for its flagship brand, Warhammer, which encompasses various tabletop games in fictional settings and an extensive range of miniatures. The business model is built around a dedicated community of gamers who continuously want to expand their collections surrounding these fantasy objects and participate in events and immerse themselves in the worlds create by Games Workshop.

Moreover, Games Workshop has leveraged its brands to strengthen its IPs and generate revenue streams across various media. For instance, there are multiple video games made surrounding the Warhammer universe, one being Warhammer 40,000: Space Marines 2, which is developed by Embracer through Saber.

The Warhammer brand is among the most popular miniature wargames in the world, particularly in the UK, which is reflected in Game Workshop's strong margins (EBIT margin more than 40% in 2021/22). Revenue is generated through three channels: 1) retail – own stores, 2) trade – third-party independent retailers and 3) its online store.

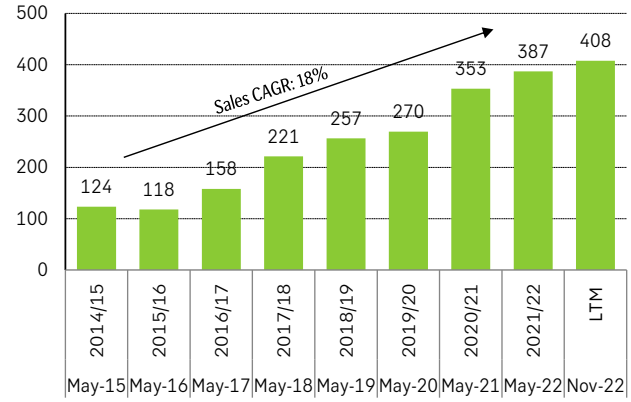
**Warhammer Miniatures example**



Source: Games Workshop

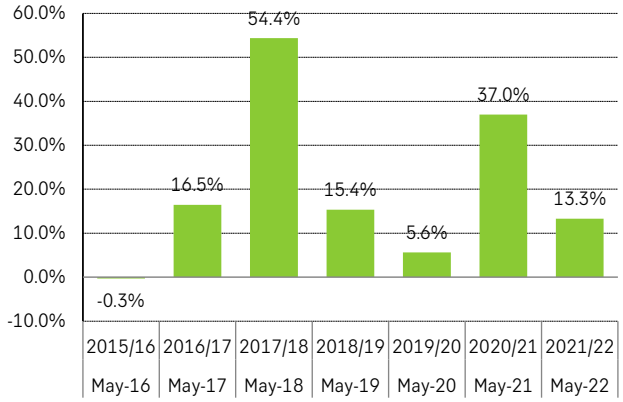
Between 2014/15 and 2021/22, Games Workshop grew sales at an 18% CAGR. Alternatively, defining organic growth as sales growth in constant currency, Games Workshop grew organic sales at a 19% CAGR during the same period. Looking at the EBIT margin, we note impressive growth from c. 10% in 2014/15 to an average of c. 36% during the last five years.

**Sales (GBPm)**



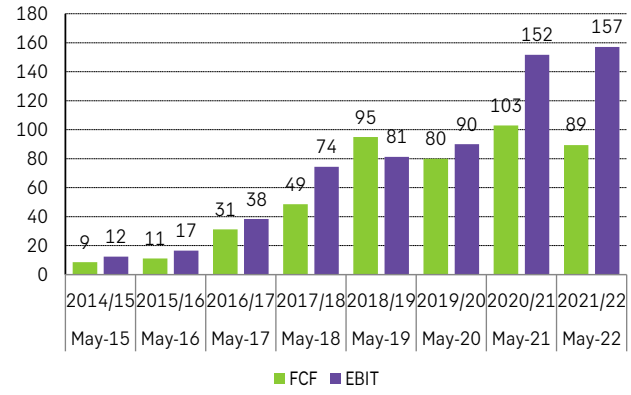

Source: Games Workshop

**Organic growth per annum**



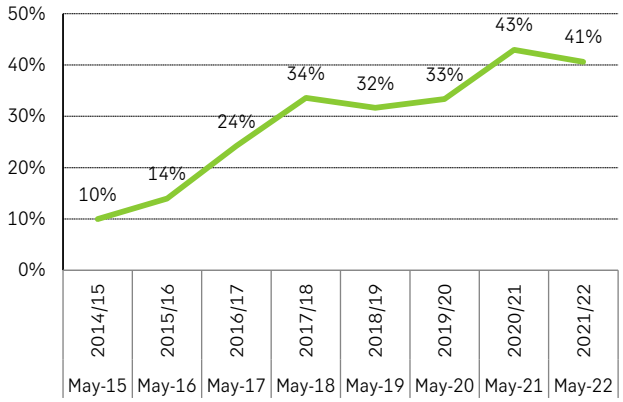

Source: Games Workshop

**FCF and EBIT (GBPm)**




Source: Games Workshop

**EBIT margin**




Source: Games Workshop

# Conclusion

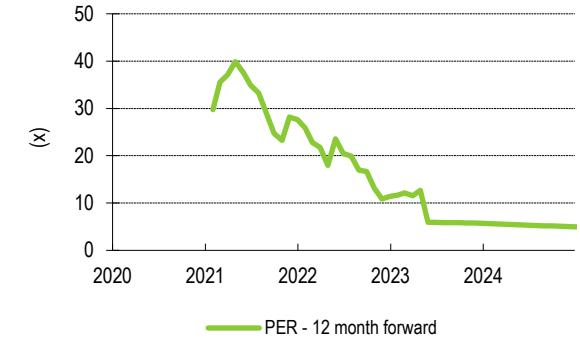
To summarise, many parts of the issues at hand for Embracer relate to addressing cash flow improvement. This includes divestments to reduce debt, but also adjusting the level of business and project risk in terms of game releases, particularly for large games. By having a transmedia strategy in mind, certain parts of the business can be streamlined, as they are not key in the strategy, which should lower the complexity of Embracer and make it more appealing to investors.

Over time, there are other companies in the industry that Embracer and investors alike can look at, such as Keywords Studios and Games Workshop. If such strategies and business models are emulated by Embracer, we believe underlying cash and earnings generation should be more stable. In such a scenario, Embracer would be able to return to the acquisitive strategy of building a leading house of strong IPs with a network of strong entrepreneurs and partners to nurture its assets across different media. This, in turn, should warrant a higher multiple, in our view.

# Overview

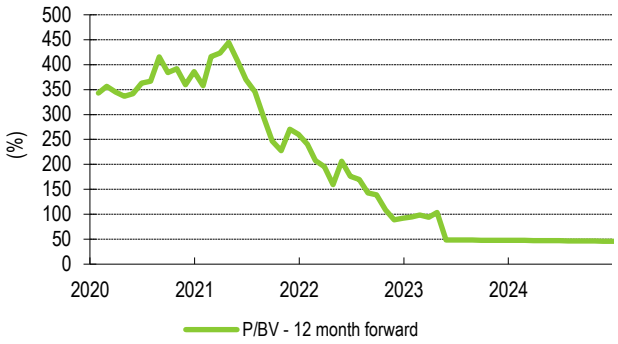
| | |
|---|---|
| **Investment case** | The global games industry is growing rapidly, but we think that Embracer's large new games pipeline has the potential to offer above-market growth. Embracer aims to release a total of 19 AAA games by March 2026, which will become important triggers given the investment size and potential earnings generation. |
| **Company profile** | Embracer Group is one of Europe's largest developers/publishers of video games for PCs, consoles and mobile. Through its 190-plus internal and external development studios, Embracer engages more than 11,000 video game developers, which has created one of the broadest portfolios and new game pipelines in the industry. Embracer currently has over 200 game projects under development. |
| **Valuation approach** | We derive our target price using a multiples-based approach. |
| **Target price risks** | The timing of individual game releases makes quarter-on-quarter forecasting difficult; Embracer's financial performance may be volatile, which could spill over to the share price. Write-downs or the postponement of large development projects, or launches failing to attract popularity, pose risks to the investment case. Its aggressive M&A strategy also comes with risks. |

**PER - 12 month forward**



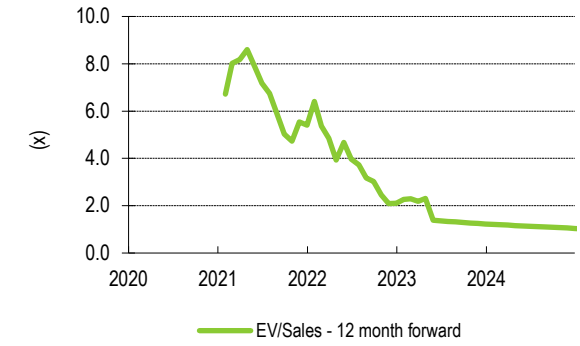

Source: SEB

**P/BV - 12 month forward**



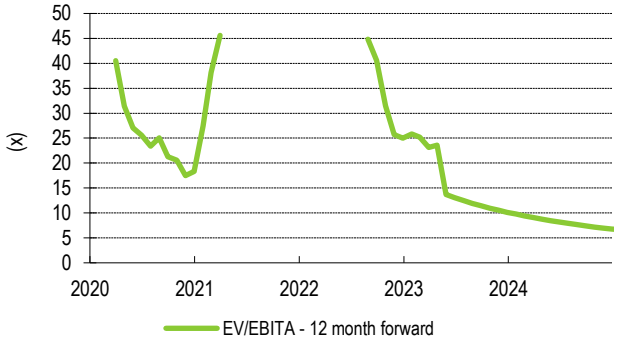

Source: SEB

**EV/Sales - 12 month forward**



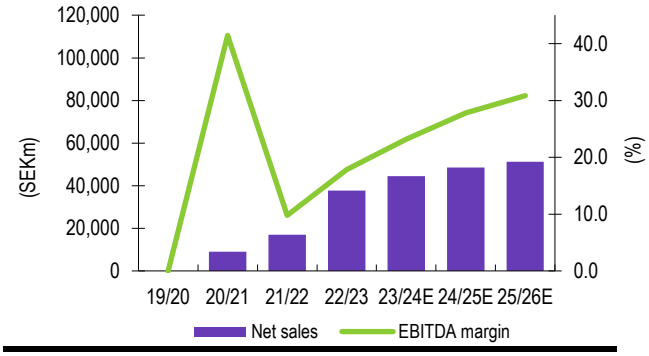

Source: SEB

**EV/EBITA - 12 month forward**



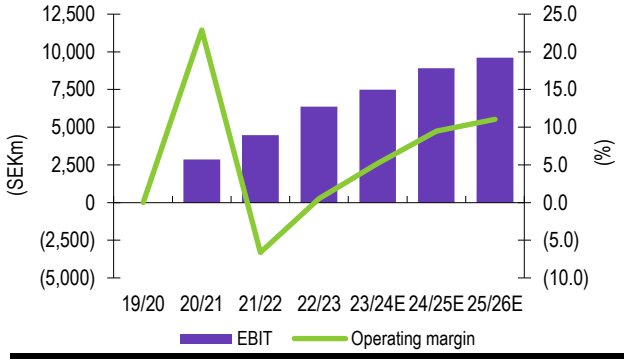

Source: SEB

**Net sales & EBITDA margin**



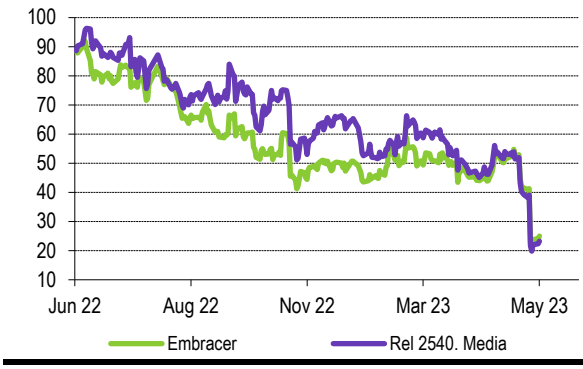

Source: SEB

**EBIT & Operating margin**



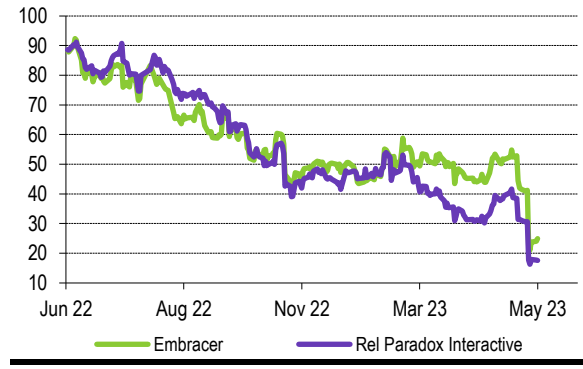

Source: SEB

**Comparison with sector index - 1 year**




Source: SIX

**Comparison with Paradox Interactive - 1 year**




Source: SIX

| Profit & loss statement - Embracer | | | | | | | |
|---|---|---|---|---|---|---|---|
| **(SEKm)** | **19/20** | **20/21** | **21/22** | **22/23** | **23/24E** | **24/25E** | **25/26E** |
| Net Sales | 0 | 9,000 | 17,067 | 37,665 | 44,494 | 48,527 | 51,248 |
| Other revenues | 0 | 288 | 333 | 409 | 400 | 400 | 400 |
| **Total revenues** | **0** | **9,288** | **17,400** | **38,074** | **44,894** | **48,927** | **51,648** |
| | | | | | | | |
| Total expenses | 0 | (5,560) | (15,733) | (31,356) | (34,567) | (35,443) | (35,841) |
| **Profit before depreciation** | **0** | **3,728** | **1,667** | **6,718** | **10,327** | **13,483** | **15,806** |
| | | | | | | | |
| Depreciation - Fixed assets | 0 | (125) | (262) | (743) | (1,000) | (1,000) | (1,000) |
| Depreciation - Other assets | 0 | (1,032) | (1,215) | (2,809) | (3,950) | (5,013) | (6,400) |
| Depreciation of right-of-use assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Amortisation - Goodwill | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Amortisation - Other intangibles | 0 | (510) | (1,316) | (2,972) | (3,073) | (2,876) | (2,744) |
| **Operating profit** | **0** | **2,061** | **(1,126)** | **194** | **2,304** | **4,594** | **5,663** |
| | | | | | | | |
| Net interest expenses | 0 | (4,102) | 2,785 | 4,822 | (850) | (900) | (900) |
| Foreign exchange items | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other financial items | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Value changes - Fixed assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Value changes - Financial assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Value changes - Other assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Reported pre-tax profit** | **0** | **(2,041)** | **1,659** | **5,016** | **1,454** | **3,694** | **4,763** |
| | | | | | | | |
| Minority interests | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total taxes | 0 | (471) | (692) | (553) | (364) | (813) | (1,048) |
| **Reported profit after tax** | **0** | **(2,512)** | **967** | **4,463** | **1,091** | **2,881** | **3,715** |
| | | | | | | | |
| Discontinued operations | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Extraordinary items | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Net Profit** | **0** | **(2,512)** | **967** | **4,463** | **1,091** | **2,881** | **3,715** |
| | | | | | | | |
| Adjustments: | | | | | | | |
| Discontinued operations | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Interest on convertible debt | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Minority interests (IFRS) | 0 | (1) | 9 | (9) | 0 | 0 | 0 |
| Value changes | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Goodwill/intangibles amortisations | 0 | 510 | 1,316 | 2,972 | 3,073 | 2,876 | 2,744 |
| Restructuring charges | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other adjustments | 0 | 4,509 | 1,500 | (1,911) | 1,792 | 1,136 | 903 |
| Tax effect of adjustments | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Adjusted profit after tax** | **0** | **2,506** | **3,792** | **5,515** | **5,956** | **6,893** | **7,362** |
| | | | | | | | |
| **Margins, tax & returns** | | | | | | | |
| Operating margin | 0.0 | 22.9 | (6.6) | 0.5 | 5.2 | 9.5 | 11.0 |
| Pre-tax margin | 0.0 | (22.7) | 9.7 | 13.3 | 3.3 | 7.6 | 9.3 |
| Tax rate | 0.0 | (23.1) | 41.7 | 11.0 | 25.0 | 22.0 | 22.0 |
| ROE | 0.0 | (18.9) | 3.1 | 8.4 | 1.7 | 4.3 | 5.3 |
| ROCE | 0.0 | 18.9 | 10.4 | 8.0 | 7.9 | 9.4 | 9.9 |
| | | | | | | | |
| **Growth rates y-o-y (%)** | | | | | | | |
| Total revenues | n.a. | n.a. | 87.3 | 118.8 | 17.9 | 9.0 | 5.6 |
| Operating profit | n.m. | n.m. | n.m. | n.m. | 1,085.6 | 99.4 | 23.3 |
| Pre-tax profit | n.m. | n.m. | n.m. | 202.4 | (71.0) | 154.0 | 28.9 |
| EPS (adjusted) | 0.0 | 0.0 | 10.9 | 18.7 | 5.2 | 15.7 | 6.8 |

| Cash flow | | | | | | | |
|---|---|---|---|---|---|---|---|
| **(SEKm)** | **19/20** | **20/21** | **21/22** | **22/23** | **23/24E** | **24/25E** | **25/26E** |
| Net profit | 0 | (2,512) | 967 | 4,463 | 1,091 | 2,881 | 3,715 |
| Non-cash adjustments | 0 | 6,181 | 4,405 | 3,082 | 8,861 | 9,800 | 10,743 |
| **Cash flow before work cap** | **0** | **3,669** | **5,372** | **7,545** | **9,951** | **12,682** | **14,458** |
| | | | | | | | |
| Ch. in working capital / Other | 1 | 157 | (1,106) | (2,162) | 860 | (131) | (97) |
| **Operating cash flow** | **1** | **3,826** | **4,266** | **5,383** | **10,811** | **12,551** | **14,361** |
| | | | | | | | |
| Capital expenditures | 0 | (2,210) | (4,061) | (6,937) | (8,170) | (8,438) | (8,576) |
| Asset disposals | 0 | 6 | 8 | 451 | 0 | 0 | 0 |
| L/T financial investments | 0 | (9) | (71) | 0 | 0 | 0 | 0 |
| Acquisitions / adjustments | 0 | (4,441) | (33,403) | (8,532) | 0 | 0 | 0 |
| **Free cash flow** | **1** | **(2,828)** | **(33,261)** | **(9,635)** | **2,642** | **4,113** | **5,785** |
| | | | | | | | |
| Net loan proceeds | 0 | 30 | 18,844 | (1,000) | 0 | 0 | 0 |
| Dividend paid | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Share issue | 0 | 14,695 | 6,310 | 10,326 | 0 | 0 | 0 |
| Other | 0 | (81) | (156) | (704) | (2,567) | (1,076) | (605) |
| **Net change in cash** | **1** | **11,816** | **(8,263)** | **(1,013)** | **75** | **3,037** | **5,180** |
| | | | | | | | |
| **Adjustments** | | | | | | | |
| C/flow bef chng in work cap | 0 | 3,669 | 5,372 | 7,545 | 9,951 | 12,682 | 14,458 |
| Adjustments | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Int on conv debt net of tax | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cash earnings | 0 | 3,669 | 5,372 | 7,545 | 9,951 | 12,682 | 14,458 |
| | | | | | | | |
| **Per share information** | | | | | | | |
| Cash earnings | 0.0 | 4.61 | 5.21 | 6.05 | 7.9 | 10.1 | 11.5 |
| Operating cash flow | 0.0 | 4.81 | 4.14 | 4.31 | 8.59 | 10.0 | 11.4 |
| Free cash flow | 0.0 | (3.55) | (32.3) | (7.72) | 2.1 | 3.27 | 4.59 |
| | | | | | | | |
| **Investment cover** | | | | | | | |
| Capex/sales (%) | 0.0 | 0.8 | 2.0 | 1.2 | 1.1 | 1.0 | 1.0 |
| Capex/depreciation (%) | 0 | 57 | 131 | 60 | 47 | 50 | 50 |

Source for all data on this page: SEB

| Balance sheet - Embracer | | | | | | | |
|---|---|---|---|---|---|---|---|
| **(SEKm)** | **19/20** | **20/21** | **21/22** | **22/23** | **23/24E** | **24/25E** | **25/26E** |
| Cash and liquid assets | 2,511 | 14,299 | 5,810 | 4,679 | 4,754 | 7,791 | 12,971 |
| Debtors | 1,468 | 2,033 | 5,954 | 8,238 | 9,143 | 9,756 | 10,120 |
| Inventories | 353 | 243 | 3,162 | 4,081 | 3,968 | 4,327 | 4,570 |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Current assets** | **4,332** | **16,575** | **14,926** | **16,998** | **17,864** | **21,874** | **27,661** |
| Interest bearing fixed assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other financial assets | 251 | 572 | 1,716 | 2,399 | 2,399 | 2,399 | 2,399 |
| Capitalized development cost | 2,592 | 3,733 | 6,073 | 9,309 | 13,059 | 15,983 | 17,659 |
| Goodwill | 1,412 | 11,381 | 42,624 | 48,524 | 48,524 | 48,524 | 48,524 |
| Other intangibles | 1,867 | 1,853 | 25,298 | 36,270 | 33,197 | 30,321 | 27,577 |
| Right-of-use lease assets | 240 | 329 | 1,062 | 1,423 | 1,423 | 1,423 | 1,423 |
| Fixed tangible assets | 185 | 238 | 720 | 1,148 | 618 | 118 | (382) |
| Other fixed assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Fixed assets** | **6,547** | **18,106** | **77,493** | **99,073** | **99,220** | **98,768** | **97,201** |
| **Total assets** | **10,879** | **34,681** | **92,419** | **116,071** | **117,084** | **120,643** | **124,862** |
| Creditors | 845 | 774 | 3,602 | 2,809 | 3,318 | 3,486 | 3,541 |
| Other trade financing | 977 | 1,945 | 4,466 | 6,299 | 7,442 | 8,116 | 8,571 |
| S/T lease liabilities | 67 | 98 | 297 | 444 | 444 | 444 | 444 |
| S/T interest bearing debt | 1,243 | 1,230 | 12,949 | 701 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Current liabilities** | **3,132** | **4,047** | **21,314** | **10,253** | **11,204** | **12,046** | **12,556** |
| L/T interest bearing debt | 222 | 244 | 7,232 | 19,560 | 20,261 | 20,261 | 20,261 |
| L/T lease liabilities | 176 | 237 | 800 | 1,044 | 1,044 | 1,044 | 1,044 |
| Other long-term liabilities | 0 | 1 | 112 | 52 | 52 | 52 | 52 |
| Convertible debt | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Pension provisions | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other provisions | 541 | 9,323 | 14,618 | 12,476 | 10,747 | 10,581 | 10,576 |
| Deferred tax | 415 | 560 | 6,170 | 7,965 | 7,965 | 7,965 | 7,965 |
| **Long term liabilities** | **1,354** | **10,365** | **28,932** | **41,097** | **40,068** | **39,903** | **39,897** |
| Minority interests | 25 | 13 | 228 | 53 | 53 | 53 | 53 |
| **Shareholders' equity** | **6,368** | **20,256** | **41,945** | **64,668** | **65,758** | **68,640** | **72,355** |
| **Total liabilities and equity** | **10,879** | **34,681** | **92,419** | **116,071** | **117,084** | **120,642** | **124,861** |
| Net debt (m) | (803) | (12,490) | 15,468 | 25,663 | 23,022 | 18,909 | 13,124 |
| Working capital (m) | (1) | (443) | 1,048 | 3,210 | 2,350 | 2,481 | 2,578 |
| Capital employed (m) | 8,101 | 22,078 | 63,451 | 95,063 | 93,587 | 95,392 | 98,502 |
| Net debt/equity (%) | (13) | (62) | 37 | 40 | 35 | 28 | 18 |
| Net debt/EBITDA (x) | n.a. | (3.1) | 2.6 | 2.6 | 1.9 | 1.3 | 0.8 |
| Equity/total assets (%) | 59 | 58 | 46 | 56 | 56 | 57 | 58 |
| Interest cover | 0.0 | 0.5 | 0.4 | (0.0) | 2.7 | 5.1 | 6.3 |

| Valuation | | | | | | | |
|---|---|---|---|---|---|---|---|
| **(SEK)** | **19/20** | **20/21** | **21/22** | **22/23** | **23/24E** | **24/25E** | **25/26E** |
| No of shares, fully dil. (y/e) | 606.0 | 796.0 | 1,131.5 | 1,259.2 | 1,259.2 | 1,259.2 | 1,259.2 |
| No of shares, fully dil. avg. | 606.0 | 796.0 | 1,031.0 | 1,247.4 | 1,259.2 | 1,259.2 | 1,259.2 |
| Share price, y/e | 98.3 | 96.5 | 47.3 | 25.0 | 25.0 | 25.0 | 25.0 |
| Share price, high | 101.0 | 134.7 | 101.0 | 58.8 | 58.8 | | |
| Share price, low | 34.6 | 74.5 | 41.0 | 21.0 | 21.0 | | |
| Share price, avg | 66.0 | 105.1 | 71.1 | 47.6 | 47.6 | | |
| EPS (reported) | 0.00 | (3.16) | 0.95 | 3.57 | 0.87 | 2.29 | 2.95 |
| EPS (adjusted) | 0.00 | 3.15 | 3.49 | 4.14 | 4.36 | 5.04 | 5.39 |
| Cash earnings/share | 0.00 | 4.61 | 5.21 | 6.05 | 7.90 | 10.1 | 11.5 |
| Dividend/share | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Enterprise value/share | 0.0 | 81 | 61 | 45 | 43 | 40 | 35 |
| Book value/share | 10.5 | 25 | 37 | 51 | 52 | 55 | 57 |
| Adjusted equity/share | 10.5 | 25 | 37 | 51 | 52 | 55 | 57 |
| PER (adjusted) | 0.0 | 30.7 | 13.5 | 6.0 | 5.7 | 4.9 | 4.6 |
| CEM | 0.0 | 20.9 | 9.1 | 4.1 | 3.2 | 2.5 | 2.2 |
| Dividend yield | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EV/EBITDA | 0.0 | 16.0 | 11.6 | 5.8 | 4.4 | 3.4 | 2.6 |
| EV/EBITA | #DIV/0! | 25.0 | 363.0 | 18.0 | 10.1 | 6.7 | 5.3 |
| EV/EBIT | 0.0 | 22.5 | 15.4 | 9.0 | 7.3 | 5.7 | 4.6 |
| EV/Sales (x) | 0.00 | 7.15 | 4.04 | 1.52 | 1.22 | 1.04 | 0.87 |
| Price/Book value | 9.35 | 3.79 | 1.28 | 0.49 | 0.48 | 0.46 | 0.43 |
| Price/adjusted equity | 9.35 | 3.79 | 1.28 | 0.49 | 0.48 | 0.46 | 0.43 |
| Free cash flow/Market cap (%) | n.a. | 2.1 | 0.4 | (5.0) | 8.4 | 13.1 | 18.4 |
| Operating cash flow/EV (%) | n.a. | 5.9 | 6.2 | 9.4 | 19.9 | 24.9 | 32.2 |
| EV/Capital employed (x) | 0.0 | 2.9 | 1.1 | 0.6 | 0.6 | 0.5 | 0.5 |

| Main shareholders | | | Management | | Company information | |
|---|---|---|---|---|---|---|
| **Name** | **(%) Votes** | **Capital** | **Title** | **Name** | **Contact** | |
| Lars Wingefors AB | 42.2 | 23.2 | COB | Kicki Wallje-Lund | Internet | 0.0 |
| S3D Media | 11.5 | 7.4 | CEO | Lars Wingefors | Phone number | 0 |
| Swedbank Robur | 3.8 | 5.8 | CFO | Johan Ekström | | |
| Foreign owners (total) | 31.2 | 31.2 | IR | | | |

Source for all data on this page: SEB

# Target prices and risks

**Target price definition and associated risks**
Our target price is the analyst's assessment of what total return an investor should expect over the coming six to 12 months. The target is based on fundamental equity research and other factors at the analyst's discretion.

Our current target price of SEK 35 was set on 25 May 2023 where a more detailed explanation was given. The main risk to our target price on Embracer is as follows. The timing of individual game releases makes quarter-on-quarter forecasting difficult; Embracer's financial performance may be volatile, which could spill over to the share price. Write-downs or the postponement of large development projects, or launches failing to attract popularity, pose risks to the investment case. Its aggressive M&A strategy also comes with risks.

**Risk levels**
The risk level is the analyst's view of the uncertainty in the earnings forecasts based on an assessment of the company's business model, operating risk as well as financial risk. We use two risk levels with the following explanations:

- **Normal risk:** All forecasts involve uncertainty and we view companies in this risk level to have normal forecast risks
- **High risk:** The earnings forecasts are more uncertain than for an average instrument due to business model, operating risk, financial risk or any other reason at the analyst's discretion. All instruments with shorter track record than 12 months as a listed company are by definition classified as high risk according to SEB.

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**Methodology**
Our target price is based on valuation approaches described in the Overview section of this report, unless our estimates are in the process of being updated. Final consideration as to any valuations, projections and forecasts contained in this report are based on a number of assumptions and estimates and are subject to contingencies and uncertainties, and their inclusion in this report should not be regarded as a representation or warranty by or on behalf of the Group or any person or entity within the Group that they or their underlying assumptions and estimates will be met or realized. Different assumptions could result in materially different results. Past performance is not a reliable indicator of future performance. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related investment mentioned in this report. In addition, investors in securities, such as ADRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk.

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SEB or its affiliates is, or has within the last 12 months been or expects in the next 3 months to be, party to an agreement relating to the provision of investment banking services and/or other material services to Embracer or an affiliate, or has received from it fees or the promise of fees in respect of such services.

The analyst(s) responsible for this research report (jointly with their closely related persons) hold(s) 3660 shares in Embracer and do(es) not have holdings in other instruments related to the company.

Current recommendation for Embracer - Buy - was set on 22 Nov 2021, changed from Unrated. The dates of previous recommendation changes in relation to Embracer can be found on our Research Online website.

**SEB's standardised recommendation structure**

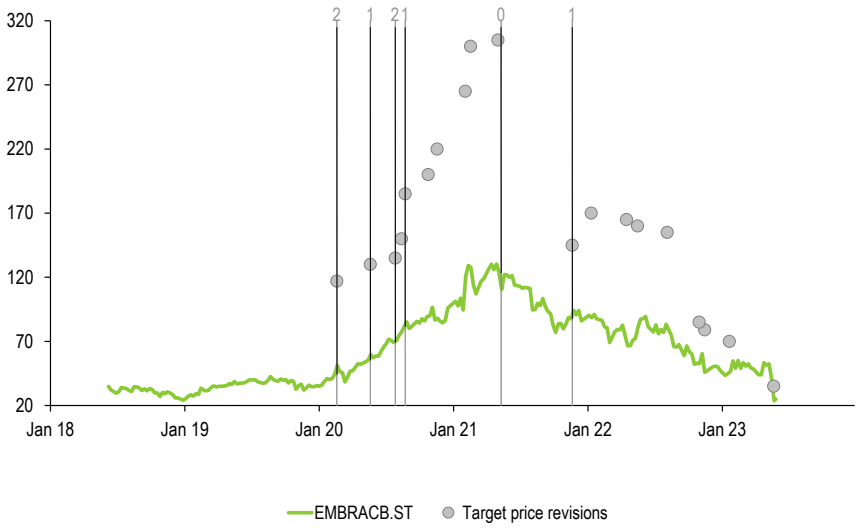
| | Consolidated distribution as per 31 Mar 2023 (%) | Clients to whom SEB has provided material investment services, last 12M (%) | Clients from whom SEB has received investment banking income, last 12M (%) |
|---|---|---|---|
| **Buy** | 63.5 | 17.3 | 14.0 |
| **Hold** | 30.6 | 10.7 | 8.5 |
| **Sell** | 5.9 | 1.3 | 1.3 |

| | |
|---|---|
| Buy | Attractive risk/reward - at least 10% upside to target price. |
| Hold | Fairly valued – the security / instrument is trading close to target price. |
| Sell | Unattractive risk/reward - security / instrument is trading above target price. |
| Unrated | Company not covered, or we are not allowed to have a recommendation for compliance reasons |

Source: SEB

**Please note, in the chart to the right:**
**1=Buy**
**2=Hold**
**3=Sell**
**The grey spots mark the point where target prices have been changed. The price chart is not adjusted for dividends paid, whereas our recommendations are based on expected return including dividends**

**Target price and recommendation revision history**




Source: Thomson Reuters / Millistream / SEB

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