Media and Games Invest

Sector: Technology

Crowning KingsIsle

Redeye initiates coverage of Media and Games Invest with a positive stance on this strong organic growth story bolstered by M&A. Although the share has rallied strongly since the autumn, we judge that investors have yet to fully recognise how transformative the acquisition of KingsIsle Entertainment will prove, nor how substantial MGI's synergies and media strength are – but see good scope for the resulting valuation gap to close this year.

Stable and diversified

MGI's income streams are both very diversified, thanks to its broad portfolio of games, and predictable. Besides stable media cash flow, the bulk of game revenues derive from MMOGs, which generally have very long lifetime value. As concentration risk is very low, the business is not 'hit-driven'.

'Buy, Integrate, Build and Improve'

While the M&A market for larger gaming companies is highly competitive, MGI focuses on the smaller A and AA segments. It has typically acquired distressed quality assets to integrate and improve, leading to increased efficiency and profitability. More recently it has also targeted highly accretive EBITDA-positive acquisitions. We expect its high quality and experienced management team, with skin in the game, to maintain its track record of outstanding returns.

Gaming and Media synergies

Synergies between the media and games segments lead to a 200% efficiency improvement of User Acquisition payback. Moreover, data from MGI's vast portfolio of games and media segment give it competitive advantage in evaluating potential targets and managing and monetizing its current portfolio. This also benefits the media division's attraction for gaming company ad buyers and advertising within gaming publishers' games.

+55% upside potential

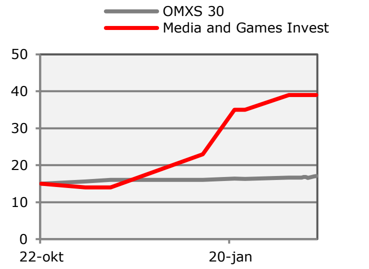
Redeye expects the media division to achieve strong organic growth and margin expansion, while localization and cross-platform pushes to grow the gaming division. The value-added synergies between the two will strengthen even further as mobile gaming becomes a larger part of revenues. Against this background, our base case fair value of SEK 59 offers upside north of 55%.

KEY FINANCIALS (EURm)	2018	2019	2020E	2021E	2022E	2023E
Net sales	45	84	140	176	211	241
EBITDA	11	16	27	48	61	77
EBIT	3	5	11	28	36	50
EPS (adj.)	0.0	0.0	0.1	0.1	0.2	0.2
EV/Sales	0.0	0.9	5.0	4.1	3.8	3.5
EV/EBITDA	0.0	18.0	61.5	14.1	11.0	9.8
EV/EBIT	0.0	18.0	61.5	30.1	24.5	21.6
P/E	0.0	0.0	49.4	17.6	13.7	11.8

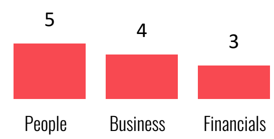
FAIR VALUE RANGE

BEAR	**BASE**	BULL
25	**59**	77

VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	M8G
Market	First North
Share Price (SEK)	37.2
Market Cap (SEK)	4789
Net Debt 21E (MSEK)	628
Free Float	58%
Avg. daily volume ('000)	

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Investment case

An entrepreneur with skin in the game

The CEO and founder Remco Westermann have a lot at stake as he owns 33% of the Company's capital. The whole management team's incentives are aligned with the shareholders as they own large amounts of phantom stock and regular shares, which we view as very positive as it indicates that all of them have a long-term view. The CFO Paul Echt and board member Tobias Weitzel acquired a considerable number of shares in MGI during Q1 21.

MMOGs - Loyal player base
MGI is focused on the MMOG market, which is a market with higher barriers to entry due to the high initial development cost and recurring costs associated with MMOGs. MMOGs tend to have a very long lifespan, and the player base typically shows a high degree of stickiness, in contrast to casual games where "easy come, easy go" applies. It is not unusual for revenues from MMOGs to be generated from players that have been active for over five years, which lowers the operational risk of the Company as revenues are stable.

Games and Media synergies

User Acquisition (UA) is an important piece of the gaming puzzle, and the media segment has a natural fit with the gaming segment. UA is 200% more efficient through synergies as the UA cost (UAC) is lower, and the advertising-income is higher when it is done in-house. There are clear cost and data advantages gained via synergies. Data on important metrics are valuable for evaluating M&A targets when improving and monetizing current games in the portfolio and advertising within games. MGI has a lot of data and know-how from both segments.

Growth platform - Buy, Integrate, and Improve

MGI has a platform to grow from, which enables a low-risk business model. Acquired games have already been developed, and the bulk of the costs are behind them. The risk is lower since the game is already developed and has been proven in the market. MGI achieves a very high return on investment as it can integrate and improve these games via its platform and UA capabilities, leading to efficiency gains, economies of scale, and improved profitability for its portfolio of games.

Diversified and stable income streams

MGI's income streams are highly diversified, with income from both the games and media segments. MGI has a broad games portfolio and is not "hit-driven," and the concentration risk is low, as the largest game represents less than 25% of total revenues. MGI has over 30 MMOGs (Massive Multiplayer Online Games) and over five thousand casual games in its portfolio that are played by over five million active players. The game's revenues are very stable and predictable in nature as the games have a very long lifetime, lowering the overall risk profile as a gaming company.

A growing market with structural tailwinds

The gaming industry is the largest entertainment industry in the world today. Over 2.7 billion people play games, and the market is expected to grow with a CAGR of 8% between 2020 and 2023, and the total market is expected to surpass USD 159bn in 2020. It is eventually forecasted to exceed USD 200bn by the end of 2023. Mobile gaming is the largest gaming segment and is expected to grow the fastest. The opportunity is huge, and the gaming market is very fragmented with a vast amount of independent developers. MGI has recognized this and has carved out a niche in the market.

Catalysts

M&A

There are a lot of gaming companies that have an outspoken M&A-strategy, and competition for gaming studios is high, with big players like Tencent, Microsoft, Amazon, Google, Embracer, Stillfront, EG7, and others all looking to consolidate the gaming market. There is a lot of competition in the M&A market for larger companies, but Media and Games Invest is focusing on the smaller A and AA segments of the market where there is less competition. Indeed, the companies mentioned previously are all eyeing much bigger game companies. In the near term, the focus will lie on acquiring gaming companies, but they also have and will acquire media companies. Value-accretive acquisitions through a business model that has been proven via their extensive track record. MGI's management is acutely aware of the risks and opportunities surrounding the gaming and media industries and is financially incentivized to continue the value-accretive journey. Future M&A is not included in our estimates nor valuation and thus provides nice optionality on the upside.

Integration and improvement of KingsIsle Entertainment

The latest acquisition by MGI was a transformative one as the group EBITDA increase 63% and revenues increase 20% on a pro forma basis. MGI can unlock synergies and increase the profitability of the already profitable games Wizard101 and Pirate101. There is a lot of optionalities in porting the games to other platforms and in internationalizing the games as they only are available in NA and EU at the moment. Redeye is of the opinion that the markets have not fully priced in the acquisition. Perhaps due to "seeing is believing," and we, therefore, think that upcoming earnings reports with consolidated financials will be a catalyst.

Increased valuation on the capital markets

The share price has increased sharply (by over 220%) since the parallel listing on the First North stock exchange in October 2020, enabling MGI to tap into the equity markets to raise capital. This was evident from the acquisition of KingsIsle Entertainment, as MGI raised EUR 25m from a directed share issue. A higher share price means less dilution, and MGI previously has felt that its shares were too undervalued for equity issuance. This opens up more opportunities as the Company can acquire larger companies if they want.

Organic growth opportunities

There are a lot of opportunities for organic growth via cross-platform as MGI can launch many of the IPs in the current games portfolio on other platforms such as console and mobile. The bulk of the revenues are coming from NA and EU today. Thus, another growth opportunity is to internationalize and localize current games into other markets. MGI is currently porting its most successful game, Trove, to Switch. It is also launching Trove in South Korea, driving organic growth in 2021.

Internally developed games

One natural step for the Company is to start developing completely new games internally as it becomes larger. The revenue potential could be large if MGI can develop a sequel or a game based on a new IP. The risks are higher when developing games in-house. However, MGI has communicated that it does not expect to start developing games based on new IPs in the coming years.

Counter-thesis

Biting off more than they can chew

KingsIsle Entertainment is MGI's largest acquisition to date. The acquisition is transformative but also increases the risk. Larger acquisitions might prove to be the norm rather than the exception. It could prove to be risky if MGI acquires significant assets and overestimates said asset's lifetime value, albeit we view this risk as low, as MGI has acquired many companies in the past, with great success.

Concentration risks

Roughly 25 percent of total game revenues are expected to be derived from Wizard101. The concentration risk is, therefore, higher post-acquisition. Before the acquisition, the largest contributor to gaming revenue was Trove, making up roughly 18% of total game revenues in Q3 20. Albeit the concentration is higher, it is still quite low considering the group's total revenues, as Wizard101 only accounts for roughly 15% of total group revenues.

Spread to thinly

The Company acquires companies, and instead of having them act completely decentralized, the business model is to integrate and improve companies. This requires a lot of management attention and resources. Mergers are being carried out in many different countries, and this presents a lot of different challenges specific to certain markets. Regional differences in consumer behavior, different business models, competitive landscapes, and regulations are some examples of challenges that might arise.

Conflict of interest

MGI often markets direct competitors through its media segment. Trust is important, and the data that MGI receives from this must not be shared with the gaming segment. Separation of the business segments is very important. There are risks concerning customer relationships connected to this issue if the trust would somehow be tarnished. However, MGI keeps the media and games segments at arms lengths because of this, and the risk of this happening is low.

Privacy concerns

Privacy initiatives like GDPR and the coming update to Apple's iOS 14 are a threat to online advertisers. Targeted ads rely on the collection of user data in order to have high precision. Thankfully, MGI has a lot of first-party data and is also working on a technology called Verve Edge, which will solve many of the problems concerning privacy issues. Contextual targeting is also set to benefit due to the coming changes, and advertising within games provides quite a nice avenue for contextual ads.

Table of Content

Q1 21 Preview – M&A 101

Transformative acquisition

The first quarter of 2021 saw Media Games Invest (MGI) make a transformative value-accretive acquisition of KingsIsle Entertainment, a US-based game developer located in Austin, Texas, best known for two MMORPGs: 'Wizards 101' and 'Pirates 101'. MGI's biggest acquisition to date, this added more than EUR 25m in revenue to the group, which was on the higher side versus its typical acquisition targets of EUR 5-30m in revenues. We consider the games portfolio of KingsIsle a very good fit with MGI's portfolio. We also view the acquisition as very positive since the company is already highly profitable, has a large player base, and has stable and sustainable revenues. More than 31% of its revenues stem from subscription sales. The KingsIsle team is located in Austin, Texas, where MGI already has a development hub (home to Trion Worlds).

The deal consists of a fixed upfront cash payment of USD 126m on a cash and debt-free basis and up to USD 84m in potential earnout payments, depending on future revenue milestones. The price target is around 6-7x EBITDA, which we consider cheap for a highly profitable company.

KingsIsle is very profitable, with revenues amounting to EUR 18m during the first nine months of 2020 and EBITDA of EUR 12m, corresponding to an EBITDA margin of 67%. MGI's revenues totalled EUR 92m, with an EBITDA of EUR 19m for the same period, or an EBITDA margin of 20%. The deal increases the group's EBITDA by 63% and its revenues by 20% on a pro forma basis. Combined pro forma results for Q1-Q3 20 compared with MGI's financials for the same period in 2019 suggest revenue growth of 98% YoY and adjusted EBITDA growth of 158% YoY.

MGI expects considerable growth capabilities thanks to the acquisition, as the bulk of the users are from the US. Internationalization is a logical step since 90% of current revenues stem from the US, and we believe it can achieve great organic growth in the games portfolio through MGI's strong user acquisition (UA) capabilities.

As part of the transaction, MGI carried out a directed share issue of 11,676,241 new ordinary MGI shares at a price of EUR 2.14, corresponding to a small discount of 4% based on the average closing share price on Xetra over the previous 20 trading days. We find it both positive and interesting that Oaktree Capital Management participated in the share issue and is now a shareholder at 9% of the company. Oaktree is well-respected worldwide and has a very long investment horizon. It is a great stamp of approval to have Oaktree as an investor, in our view.

Expansion of board and management team

On 4 February 2021, MGI announced the expansion of the current executive top management team and the Board of Directors. MGI's media segment, branded Verve Group, is demonstrating robust organic growth and becoming a substantial player in the global media space. MGI has thus decided to strengthen its executive management team, appointing Sameer Sondhi (Chief Revenue Officer) and Ionut Ciobotary (Chief Product Officer) as members of the executive top management team of MGI.

Sameer has more than 20 years of experience in the digital advertising space. He was recruited in May 2020 from InMobi and has previously held positions at Opera Media, GroundTruth, Infospace, and LiveWire.

Ionut founded ad tech SSP PubNative and has more than 15 years of experience in the advertising technology segment. He has previously held positions at Applift, Weebo, and Electronic Arts.

MGI also announced that it would make some additions to the Board of Directors, welcoming Antonius Fromme, who will bring media and marketing expertise. Antonius is Chief Customer Experience Officer at Freenet AG and has previously worked at telecommunication company debitel AG.

We view these recent additions as very positive as they show that MGI's media division is growing into a real powerhouse. This should only continue with these key people in place.

Q4 20 Review

MGI's financial performance during 2020 was stellar, with net revenues amounting to EUR 140.2m (83.9) and growing 67% YoY. Adjusted EBITDA grew 61% YoY to EUR 29.1m (18.1). Adjusted EBIT increased to EUR 17.5m (10.5), up 67% YoY. Its games division saw revenues and adjusted EBITDA expand by well over 50% YoY. COVID-19 was a factor, no doubt, but the boost many thought temporary has proven more permanent. Of course, last year's growth might not be repeated in 2021, but a sudden drop from current levels is highly unlikely, especially considering the acquisition of the EBITDA-accretive KingsIsle.

Advertising initially took a smaller hit, but the beauty of MGI's business model is that the gaming business is very resistant to cyclicality and can take up some of the slack of the media division, if necessary. The media division rebounded very quickly after the worst of the pandemic was over, and it is quite resistant to cyclicality as more than 50% of its revenues come from gaming clients. The media division rebounded strongly in the second half of the year, with exceptional growth in the fourth quarter, growing 43% QoQ.

MGI was stronger than ever at the end of 2020 thanks to these very strong financial results, its transformative acquisition, and a robust balance sheet.

Company Profile

Media and Games Invest is, first and foremost, a gaming company, but it is also active in the media segment. The company defines its strategy as 'Buy, Integrate, Build and Improve,' and it has a clear strategy for M&A. It strives to create synergies and efficiencies through this strategy, and the synergies between its media and gaming segments are obvious. It is a small but fast-growing company with a market capitalization of EUR 471m. In 2020, revenues and adjusted EBITDA amounted to EUR 140m (83.9) and EUR 29.1m (18.1), respectively. Revenues have grown at a CAGR of more 45% in 2014-20E, while adjusted EBITDA has increased by a CAGR in excess of 53% over the same period. This rapidly growing and profitable company is active in the largest entertainment industry in the world.

The company has 10 top massive multiplayer online games (MMOGs) and more than 5,000 casual games in its portfolio, used by more than 5 million monthly active players. Its media segment reaches in excess of 5 billion monthly video and ad views and has more than 750 million subscribers across all influencer channels. The media segment has a reach spanning 5,000-plus advertisers. The company currently employs more than 800 people.

Historical highlights

Year	Comment
2000 - 2007	Gamigo is founded as an online PC and gaming magazine, and later starts publishing online role playing games.
2008 - 2009	Gamigo expands in Europe with internally developed games and becomes a 100% subsidiary of Axel Springer in 2009.
2010 - 2012	Gamigo purchases a stake in German developer Reakktor Media in 2010. Axel Springer sells its entire stake in Gamigo AG to strategic investor Samarion SE, and Remco Westermann is announced CEO of gamigo AG.
2013 - 2014	Gamigo AG is restructured, lowering costs, ceasing risky internal development activities. Gamigo reaches 30 million registered users.
2015	Gamigo acquires various companies, eg. Looki Publishing GmbH, an independent publisher.
2016	Gamigo acquires aeria games and seven games media from ProSiebenSat1 Media SE, which becomes a shareholder of gamigo. All B2B media activities integrated under adspree.
2017	Gamigo AG repays its 2013/2018 bond issued in 2013 and acquired the video and social media specialist Mediakraft to improve user acquisition.
2018	Media and Games Invest (MGI) acquires the majority of gamigo AG and Remco Westermann becomes major shareholder and Chairman of the Board of MGI. Gamigo issues EUR 32m in bonds which are listed on Nasdaq Stockholm and FSE. Acquisition of the major assets of US-publisher and game developer Trion Worlds Inc.
2019	Several acquisitions by MGI including WildTanget assets, ReachHero GmbH, Applift GmbH and PubNative GmbH. Issues further EUR 18m in bonds with a premium.
2020	MGI acquires Verve Wireless Inc and in February 2020 MGI bought out the minority shareholders of gamigo and increases its stake to 99.9%. Acquires Freenet Digital, mobile game publisher. Listing on the First North Stockholm stock exchange.
2021	MGI acquires KingsIsle Entertainment, its biggest acquisition to date.

Source: Redeye Research

The core of the games segment is built around Gamigo AG, which was founded in 2000 as an online gaming magazine for PC client and browser games. This later evolved into a publisher of MMOGs and online browser-based RPGs (role-playing games). The first purchase of licensing rights dates back to 2001, followed by Last Chaos and Fiesta Online's launches, before Axel Springer acquired 100% of Gamigo's shares in 2009. What followed was a string of unsuccessful game launches, combined with a large customer data leak, a lack of focus on games with recurring revenues, and non-alignment of management and shareholder's interests, all of which culminated in Axel Springer selling Gamigo AG to Remco Westermann.

With the acquisition in 2012, Remco Westmann became the CEO of Gamigo AG. This is when the company we see today emerged from an operational perspective. Media and Games Invest plc came to fruition via a reverse merger. Remco acquired a majority stake in the publicly listed Solidare Real Estate Holding plc and was appointed CEO and executive director of the board. Gamigo AG was consolidated into the MGI group, which was subsequently renamed blockescence plc. All real estate assets were divested. The name was changed as the initial focus was going to be on the implementation of blockchain technology within the gaming industry. Ultimately, the group decided to focus on Gamigo's buy-and-build strategy and on creating fast-growing companies in the media and games segments through acquisitions and synergy-driven organic growth. The group was rebranded as Media and Games Invest in 2019 and has since acquired eight additional companies in the gaming and media sectors.

Remco's vision was to reduce risk by ceasing the internal development of games and instead opting for an M&A business model. He and his experienced management team have since acquired more than 30 value-accretive companies, strengthening MGI's games portfolio and user acquisition (UA) strength. The acquisition of Aeria games GmbH and Adspree in 2016 marked an important milestone for the company, adding an online media advertising segment. This was closely followed by Mediakraft (2017), Trion Worlds (2018), and WildTangent (2019). Since 2018, Gamigo AG has been fully consolidated under Media and Games Invest, which acquired the remaining 46% stake in Gamigo in 2020. It currently holds 99.9% of the shares of Gamigo.

Management and Board

Remco Westermann has been the CEO of Gamigo since 2012 and the chairman of MGI's Board of Directors since 2018. Remco holds a Master's degree in business economics and has more than 25 years of professional experience, 15 of which have been in the mobile and online entertainment industry. A previous entrepreneur, he founded listed company Bob Mobile AG and also helped to build mobile media company Sonera Zed and was CEO of its German subsidiary for several years. He acquired a majority stake in Gamigo and shifted the business model to the 'Buy, Integrate, Build and Improve' strategy it employs today. Indeed, Remco owns a considerable number of shares via German holding company Bodhivas GmbH, which we view as very positive: his incentives are clearly aligned with shareholders' and he has skin in the game. He indirectly owns more than 50% of the voting rights in MGI, and he holds 34% of the outstanding shares.

Management team and key figures				
Name	**Position**	**Since**	**Ownership**	**Experience**
Remco Westermann	CEO, founder and Chairman of the board	2012	34%	Born in 1963, Remco Westermann has been the CEO of Gamigo since November 2012 and the chairman of the Board of Directors since May 2018. He holds a Master's degree in business economics and has more than 25 years of professional experience, over 15 years of which he has worked in the mobile and online entertainment industry. Previously founded Bob Mobile AG (later Cliqdigital AG). He helped build the mobile media company Sonera Zed and managed its German subsidiary as its CEO. Held managerial positions at Balance Point and Rost & Co.
Paul Echt	CFO	2018	Phantom Stock and shares	Born in 1990, Paul has more than 10 years of experience in the tech and finance industry. Previous positions at UniCredit Bank in Berlin, Munich and New York and at Shopgate Inc. in San Francisco. He holds a Masters in Business Management and a Bachelor of Law. Paul joined MGI as CFO in 2018.
Jens Knauber	COO	2018	Phantom Stock	Born in 1980, Jens Knauber has been the COO at MGI since 2017. He has over 10 years of experience as a manager within the gaming industry - with more than 300 published games. Has held leadership positions at Hamburg publisher dtp entertainment AG. Strong background in games publishing and has a wide global network in the gaming industry. Jens is CEO of the Gamigo group.

Source: Holdings & Redeye Research

The rest of the management team are very experienced, and their incentives are also aligned with shareholders'. CFO Paul Echt has more than ten years of experience in the tech and finance industries, having held positions at UniCredit Bank and at Shopgate in San Francisco. The management team has extensive experience in the gaming and media industries. Jens Knauber has more than ten years of experience as a manager within the gaming industry, publishing in excess of 300 games. Jens leads the Gamigo group within MGI.

The team's M&A track record is stellar, as the financial results demonstrate, and the group has undertaken more than 30 value-accretive acquisitions since 2012.

The management team has a lot of skin in the game, their incentives being aligned with shareholders' via regular shares and phantom stocks that offer many of the benefits of stock ownership without holding equity in the company. The phantom stocks are similar to synthetic options. Up to 15m shares will be issued in April 2024 at the earliest to cover the pay-out for the phantom shares, at a strike price of EUR 2.6 (we outline the ownership below). Owners of the phantom stock can choose to receive MGI shares or cash.

Board of Directors				
Name	**Position**	**Since**	**Ownership**	**Experience**
Remco Westermann	CEO and Chairman	2018	34.0%	Born in 1963, Remco Westermann has been the CEO of Gamigo since November 2012 and the chairman of the Board of Directors since May 2018. He holds a Master's degree in business economics and has more than 25 years of professional experience, over 15 years of which he has worked in the mobile and online entertainment industry. Previously founded Bob Mobile AG (later Cliqdigital AG). He helped build the mobile media company Sonera Zed and managed its German subsidiary as its CEO. Held managerial positions at Balance Point and Rost & Co.
Tobias M. Weitzel	Debuty Chairman	2018	Phantom Stock and shares	Born in 1973, Tobias is board member and founder of CREDION AG, a private debt provider and special alternative investment fund (since 2017); CEO and sole shareholder of Becker+Schreiner Kommunikation GmbH. He has been a board member in Financial Experts Association, one of the leading organizations for corporate governance and independent financial expert in supervisory boards in Germany. He has vast experience of M&A, fostering growth programmes, debt solutions for small and medium-sized businesses.
Elizabeth Para	Board member	2020	Phantom Stock and shares	Born in 1972, Elizabeth has worked in the financial markets since 1997. She has a strong technical background spanning public and private fixed income and equity markets. She holds a Masters degree in economics and holds the title Chartered Financial Analyst (CFA)

Source: Holdings & Redeye Research

We consider it positive that the Board of Directors is headed by Remco Westermann, as he can influence important decisions for the company, which is very important to the success story that is MGI. Tobias Weitzel and Elizabeth Para have extensive experience in the capital markets and own phantom stock and shares in the company.

We hold the management team and the Board of Directors at MGI in very high regard. They are very experienced, and their track records speak for themselves. We feel confident in how the team and Remco are spearheading the company. The financial incentives are excellent, and we are confident the management team will do what is best for MGI and its share price.

Ownership and Company Structure

The company structure is quite complicated due to its history. MGI is currently based in Malta, but the company has decided to change its domicile to Luxembourg.

MGI has had a positive experience in Malta, but many investors are sceptical of companies based there. MGI has even encountered some who have avoided investing in the company as their statutes do not allow for investments in Maltese companies. MGI has decided to relocate to the internationally accepted domicile of Luxembourg, which has an excellent reputation in the capital markets. The relocation is based on requests from several current shareholders and potential investors. We like that the company is making this move and believe it might enable more institutional investors to invest in MGI. The domicile in Luxembourg is expected to be effective from 1 January 2022.

Major Shareholders

#	Owner	No. of shares	Capital
1	Remco Westermann	43 179 501	33%
2	Oaktree Capital Management LP	11 676 241	9%
3	UBS	4 243 732	3%
4	Nordnet Pensionsförsäkring	1 892 375	1%
5	Avanza Pension	1 485 110	1%
	Total:	62 476 959	**48%**

Source: Holdings & Redeye Research

As mentioned earlier, CEO and founder Remco Westermann owns a very large portion of the company, at 33%, which translates into more than SEK 1.5bn. This leaves us in no doubt he will do what is best for the company and the share price. Oaktree Capital Management is a new minority anchor investor, and its investment can be seen as a stamp of approval from a credibility standpoint. This is welcome since increased credibility is part of the reason for the domicile relocation. Oaktree Capital is extremely well-respected globally and is known for being very risk-averse and prudent. Its decision to invest in MGI is particularly positive, in our opinion, underlining the company's quality.

Management and Board of Director holdings

#	Owner	Stock	Phantom Stock
1	Remco Westermann	43 179 501	
2	Jens Knauber		2 550 000
3	Paul Echt	43 429	1 500 000
4	Elizabeth Para	584 088	500 000
5	Tobias M. Weitzel	479 728	500 000
	Total:	44 286 746	5 050 000

Source: MGI & Redeye Research

As mentioned before, the management team and Board of Directors own shares and phantom stock in the company worth tens of millions of Swedish crowns, and all have large financial incentives for the share price to appreciate. MGI also wants to incentivize its employees via a stock option programme, which is positive in the very competitive gaming industry where it is difficult to hold onto talented employees.

The Stock

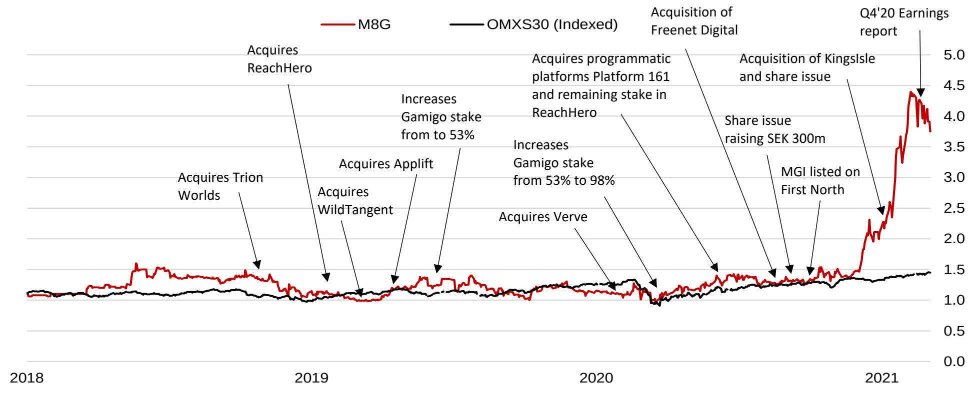
The MGI share is listed on the Frankfurt Stock Exchange and was recently listed on the Nasdaq First North Premier Growth Market in Stockholm (6 October 2020) as well. The CEO has stated that the dual listing is because the company feels the German stock market is not the best home for tech and gaming companies. MGI is still the only gaming company listed in Germany. German investors are not that used to digital business models, more specifically gaming companies, and their lack of understanding has resulted in the MGI share being underappreciated.

MGI considers the Swedish capital markets to be educated when it comes to gaming companies; hence the dual listing. The Stockholm stock exchange is home to a lot of exciting gaming companies – a club MGI has now joined.

The decision to list the company on the First North Stockholm stock exchange has proven beneficial. The share price has appreciated sharply by +220% since 6 October 2020 listing, climbing to more than SEK 45 per share thanks to solid underlying operational performance. The pandemic has been a tailwind for MGI and its gaming division, propelling revenues by 67% YoY to new highs in 2020.

The transformative acquisition of KingsIsle that was announced on 15 January 2021 also acted as a catalyst for the share price. Institutional capital has also found its way to MGI, most notably from Oaktree Capital, plus Nordic institutions and family offices, such as Skandia Fonder, Atlant Fonder, and Knutsson Holdings. Part of the share appreciation has thus been due to investors discovering what we believe was an undervalued company.

M8G share price (EUR)



Source: Bloomberg and Redeye Research

Free float shares are held by retail and institutional investors who purchased them in the secondary market and institutional investors who participated in the share issue carried out in September 2020 in conjunction with the dual listing. The free float is roughly 58% of all outstanding shares.

MGI intends to introduce a new share class, B-shares, to further optimize the company structure. The B-shares will act as a new share class with fewer voting rights than the current shares, which will become A-shares. This will allow MGI to issue shares with less dilution of voting rights. We consider this a wise move as the share price has appreciated, and it allows the company to raise equity, which is common among Nordic gaming peers such as Embracer and Stillfront.

As we touched on before, MGI has decided to launch a new employee stock ownership plan (ESOP) to issue up to 15 million new MGI shares, from April 2024 at the earliest and until December 2030 at the latest, via an option at a minimum strike price of EUR 2.6 per share. The strike price must be at least 20% over previous last five days' average MGI share closing price on Nasdaq Sweden at the point of issue of the ESPO to an employee. The purpose of the ESOP is to hire, motivate, and retain hire key personnel, and the programme will be available to C-level and key management of MGI and its subsidiaries. Overall, this is good news as more people in the organization with skin in the game is always positive.

MGI's Focus Markets

Around 70% of MGI's revenues comes from free-to-play games. This area of gaming dominates in Asia and generated approximately USD 42 billion in 2020. By comparison, free-to-play games generated around USD 21 billion in North America and Europe, where the clear majority of MGI's revenues come from. Outside Asia, most of its free-to-play revenues stem from mobile games.

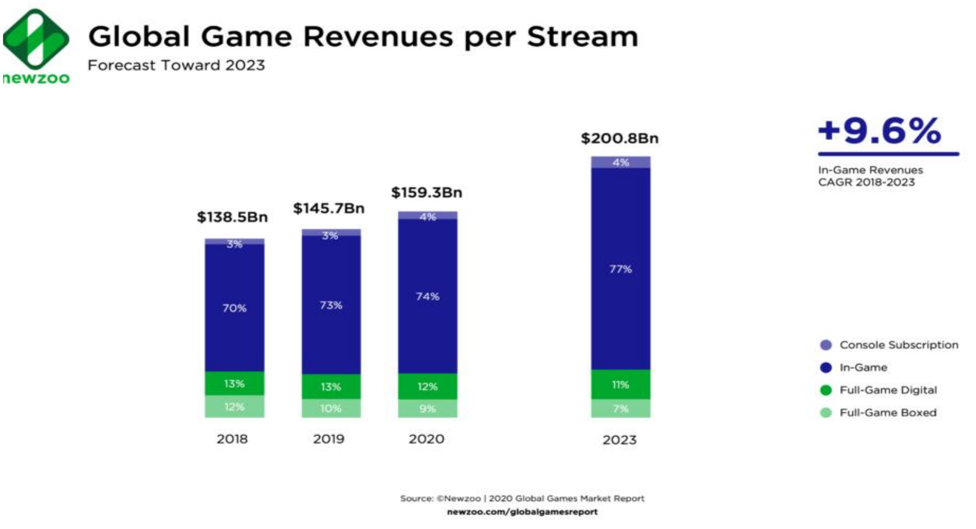
MGI's focus is on free-to-play PC-games with a so-called games as a service (GaaS) business model. The game genre is most often massive multiplayer online games (MMOGs) beyond Asia, a lucrative and fast-growing market. Most of the game revenues in MGI's portfolio are from MMOGs, at around 85%, with roughly 15% of revenues stemming from casual games.

Free-to-Play

Free-to-play games are, as they sound, free to play, but are monetized by players' ability to purchase in-game goods and items (also referred to as in-game transactions). Free-to-play games can also be monetized through advertising.

In-game revenues are the dominant force in the gaming market, with boxed revenues losing share to in-game transactions. Free-to-play is the most common monetization model for mobile and PC gaming, and console games are increasingly shifting towards this, too. According to Newzoo, 74% of global game revenues came from the in-game segment in 2020, while full-game sales only represented 21% of revenues. In-game revenues are expected to grow at a CAGR of 10% in 2018-23E, representing 77% of global game revenues by 2023E, while full-game revenues will have shrunk to 18% of total games revenues.

Global Game Revenues per Stream



Source: Newzoo & Redeye Research

It should come as no surprise that the lion's share of revenues on mobile comes from in-game transactions, owing to the lack of boxed games, and there are few full-priced games for mobile. However, there is a growing market for paid games on mobile through subscription services such as Apple Arcade, digital board games, and well-known titles being ported from other platforms. This segment is not gaining market share though, as the free-to-play segment is growing even faster. Newzoo estimates that 98% of all mobile game revenues were generated through in-game transactions in 2020. MGI has not disclosed how much of its total revenues derive from in-game purchases, but we believe it is safe to assume that it represents the bulk of the total revenues from the gaming division.

Massive Multiplayer Online Games

MMOGs are games that connect many players, often several hundred or thousand, on the same server. People interact with each other online through these games, and the games have strong communities, making them a very social experience.

One common theme for MMOGs is live-service games, which means they often require regular content updates to maintain a high retention rate. Events, competitions, new areas, new items, new levels, and new skills and abilities need to be added consistently to keep the community engaged with the game. It is not unusual for players to remain active within MMOGs for several years. In fact, the majority of the revenues of many such games are generated by users who have been active in the game for more than five years. These games are the opposite of casual games; they often require a lot of time and effort to excel at and are typically content-rich and require a higher skill level than casual games. MMOGs can be considered ‘hardcore’ games, targeting niche audiences or hobbyist gamers.

Engagement is the key to live-service games. Revenues follow if engagement is high, and so engagement comes before revenues. When players become more engaged, emotionally and socially, with the game, they are more willing to spend.

The market for MMOGs is large, and revenues are expected to reach USD 24 billion by 2021, according to Statista, growing at a CAGR of 7.4% during 2021-25E. China is the biggest market for MMOGs, and roughly one-quarter of revenues are expected to come from the country in 2021.

The nature of the MMOGs means they require ongoing investments to maintain their longevity and keep players engaged. This makes live-service games more costly over the long term than casual games, but the barriers to entry are higher than for mobile games. The upside is the higher stickiness of the user base. Hard to catch but not easily lost. The stickiness is high because the players see them as more than just games; they are social communities and platforms, a place to connect with friends known for several years. It is hard to compete with that.

Games-as-a-Service

Back when games were almost exclusively sold for full price, consumers would buy a game and then complete it over a period of time. After finishing the game, there would be no new content; the only option would be to repeat the game. Some game titles introduced expansion packs, which were basically larger additions to the game, almost like a smaller sequel – introducing new game areas, characters, abilities, objects, or an extended storyline. Expansion packs require the original game in order to play and are usually priced much lower than the original game. Their purpose was to extend the life cycle of games. It was not unusual for games to have two to three expansion packs.

This trend has only continued to evolve, and today games are either sold or are free-to-play but are continuously updated. This differs from the old business model, where the expansion packs released were few and far between. A year or two in between expansion was not unusual in the past.

Games today undergo several updates a year, and many of these are free. Like expansion packs, updates can also be sold via downloadable content (DLC). DLCs can be as large as expansion packs, or they could be very small, containing just in-game soundtracks or skins (in-game clothes). The price for these DLCs can range anywhere from USD 2 to USD 30, but they are normally priced at USD 20 or USD 30 for larger DLCs.

GaaS compared to fully paid games

Source: Appsamurai & Redeye Research

The industry is moving away from the traditional hit-driven, pay-to-play, and cyclical business model of old, where user engagement is low and focus is more on individual consoles than multi-platform. The focus here is on game experience and the number of units sold; more akin to blockbuster movies.

Conversely, the focus with live services is on user engagement and is very player-centric. Rather than being cyclical, it is more recurring in nature, and the lifetime value of games is prioritized over the number of units sold. GaaS or live services are thus being adopted by a growing number of gaming companies as they seek to gain more recurring and stable revenues by extending the lifetime of games.

Free-to-play games are more often monetized via in-game transactions, also called microtransactions, rather than DLCs. Fully paid games, on the other hand, typically opt for monetization via DLCs. In-game transactions were first implemented in free-to-play games for smaller additional content, such as in-game items or loot boxes, but have since also been implemented in fully paid AAA games. Consumers feel that gaming companies are over-monetizing some games by first selling a game for full price and then also monetizing the user base through in-game transactions. Monetization is a balancing act, as large gaming companies such as EA have received a lot of blowback for overextending into monetization, which can disrupt the gaming experience. Players are usually happy with monetization via DLCs, rather than in-game transactions, when it comes to fully paid games.

The key to converting free players into paying players is player engagement. New content creates engagement, which allows companies to start monetizing the user base. User acquisition is another important piece of the puzzle, of course.

Player engagement is monitored, and the retention rate is measured using metrics such as:

- CCU: concurrent users — how many players are active at any given time.

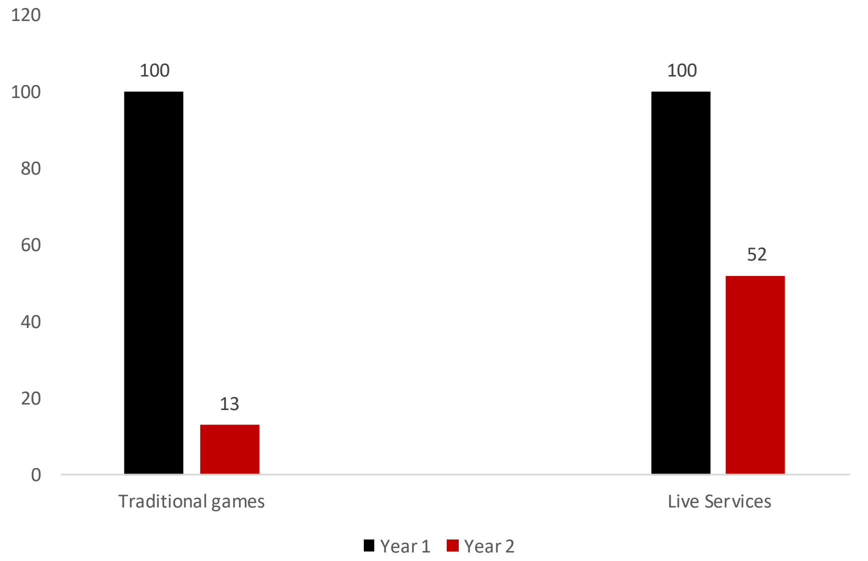
- DAU: daily active users — the number of unique players active on a given day.
- MAU: monthly active users — the number of unique players active in a given month.

Games such as 'Fortnite' and 'Candy Crush' are among the largest in the world and dominate when it comes to player engagement. Monetization typically follows. Both are free-to-play, and it is, of course, easier to attract a lot of users with a free product. What separates the wheat from the chaff is the degree of monetization achieved – the conversion rate.

This shift in the gaming business model has resulted in extended lifetimes for games. It is not unusual for live-service games to live on for decades. MMORPG game 'World of Warcraft' is still going strong 17 years after its release. The game is monetized via a monthly subscription model. 'Tibia,' a free MMORPG, still has a large user base 24 years after release. The game is monetized via in-game transactions and an optional monthly premium subscription.

One of the best examples of the successful implementation of the GaaS model is Ubisoft's 'Rainbow Six: Siege'. Ubisoft shared the chart below in an investor presentation a while back, showing the difference in monetization between traditional games and live services. In year two, a traditional pay-to-play game typically generates only 13% of the revenues generated in year one, whereas a live-service game typically generates 52% of year one revenues during its second year.

Traditional Games vs. Live Services



Source: Ubisoft & Redeye Research

In fact, there are many examples of games making more money several years after release than they did initially. In the typical scenario, revenues in year three are higher than in year two and so on. The interesting thing about 'Rainbow Six: Siege' is that the base game costs money and is not free-to-play. But Ubisoft has still found a way to continuously add content and monetize the title. The game set new records during 2020, six years after its release, amassing a total of 60 million registered players last year. Compare this to the 20 million registered players in 2017, two years after the launch.

PC and video games are no longer a static product; they are now a service and an ever-changing organic one that is constantly being customized to attract and engage as many players as possible. The player base is then monetized via:

- Microtransactions: In-game purchases to buy items, in-game currency, or other things

- Expansions packs: Paid additional content
- DLCs: Smaller paid expansion packs
- Subscriptions: A monthly fee

Subscription Services

Subscription services have already disrupted other forms of entertainment, such as music and video. Gaming is next in line, as consumers are used to getting their entertainment via the subscription delivery method, which entails paying a fixed monthly fee to gain access to a library of continuously updated content.

There are already many subscription services for gaming on the market, such as Xbox Game Pass, Apple Arcade, PlayStation Now, and Uplay+. This is something we probably will see more of in the years to come.

Demographics

According to Newzoo, there are roughly 2.7 billion gamers worldwide today, and it expects this figure to rise to 3 billion by 2023. A common misconception is that most gamers are penniless teenagers. Clearly, that is not the case as the biggest demographic (35%) is people aged 21-35. Newzoo research suggests that more than half of all gaming enthusiasts are aged 30 or above, and the vast majority of gamers are medium to high-earners with full-time jobs. Another common misconception is that gaming is a male-dominated market, but roughly 46% of game enthusiasts are female, according to Newzoo.

Digital advertising market

Statista expects the total market for digital ad spending to have grown to USD 356 billion in 2020 and forecasts a CAGR of around 6.5% for 2019-24E. Search and social media advertising are the largest segments, representing 45% and 28%, respectively, while banner advertising accounts for 15% of global digital advertising spending.

Programmatic advertising

Programmatic ads dominate the advertising space, and this trend is only expected to continue. This is the process of automated buying and selling of ad inventory in real-time using a software platform utilising algorithms, rather than buying the ads directly from a publisher. The transaction is completed within about 100 milliseconds.

Programmatic advertising reduces the need for human involvement, enabling brands or ad agencies to buy ad impressions via a complex ecosystem.

The traditional or offline advertising market is riddled with inefficiencies as the buying and selling of ad inventories is a manual process between buyers (advertising agencies) and sellers (publishers). There is extensive paperwork, negotiation, and administrative work involved, making the process time-consuming and expensive.

Statista estimates that 81% of global digital ad spending is distributed via programmatic advertising and it expects this to increase to 82% in 2024, with programmatic display advertising spending estimated to have grown to USD 126 billion in 2020. Programmatic advertising is predicted to grow faster than the digital advertising market overall.

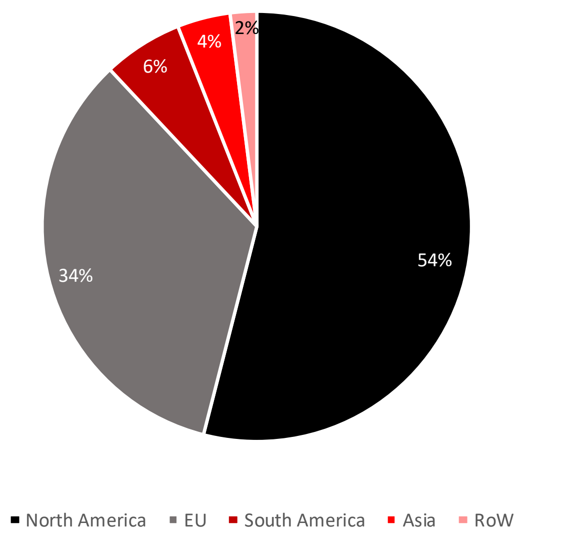
The Appendix of this report offers an overview of the gaming market and takes a deeper dive into the digital advertising market and the programmatic advertising process.

Business overview

Media and Games Invest is, as its name implies, a media and a gaming company. It is first and foremost a gaming company, with 54% of revenues and 80% of its total EBITDA derived from the gaming division in 2020. The company focuses on A and AA game titles in the MMOG and the casual games segments of the gaming market. Its media division accounted for 46% of total revenues and 21% of total EBITDA in 2020. Taking the acquisition of KingsIsle into account on a pro forma basis for 2020, media revenues amounted to 39% of the total, gaming for 61% of total revenues, and KingsIsle for 15% of the total.

MGI's business model is to acquire, integrate, and improve gaming and media companies, and the company has bought more than 30 companies in the gaming and media sectors. MGI does not have any independent game studios; its 60-70 developers work in teams responsible for supporting the current games in the portfolio to create DLCs, updates, new content, and to maintain the games overall. The teams are located at studios in Berlin and Darmstadt, Germany, and in Austin, USA. The Austin-based developers are from Trion Worlds and are responsible for the Trove, Defiance, and Rift games.

Media and Games Invest: Revenue per region



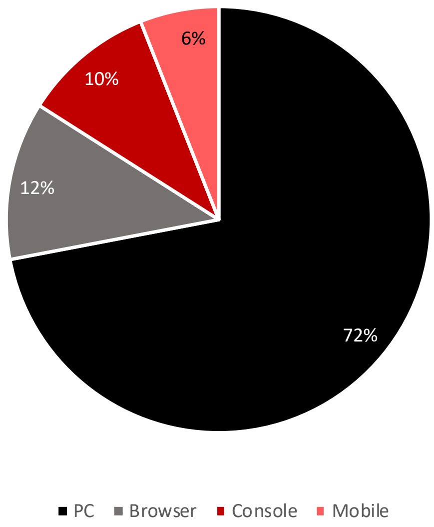
Source: Media and Games Invest & Redeye Research

The revenue streams are regionally diversified, with 54% of all revenues flowing from North America and 34% from Europe. South America and Asia are faster-growing markets, but represent only 6% and 4% of gaming revenues, respectively, according to the 2020 earnings report. North America accounts for 60% of total revenues, including the KingsIsle pro forma figures.

Gaming Division

The strategy for the gaming division is to employ the GaaS strategy with the portfolio of games and to expand this organically and via acquisitions. MGI has done so successfully before, acquiring and integrating more than 30 companies.

Media and Games Invest: Revenue per device



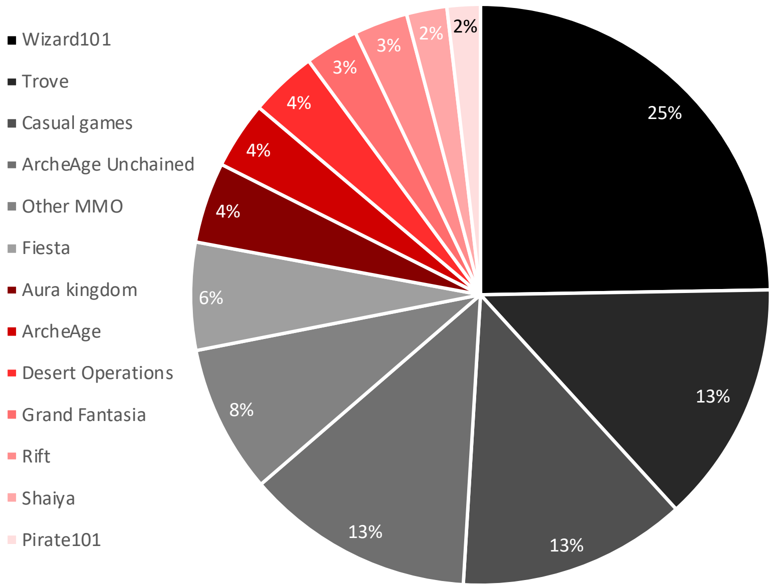
Source: Media and Games Invest & Redeye Research

According to the 2020 earnings report, the bulk of the gaming revenues are derived from PC games, at 72%. Browser and console games account for 12% and 10% of revenues, respectively. Mobile games currently account for 6% of gaming revenues. Although mobile revenues are a small contributor to overall gaming revenues today, MGI is looking to expand more into mobile games. On 1 October 2020, the company acquired mobile games company Freenet Digital, adding 1,500-plus mobile games to its portfolio. We consider this a wise decision to increase reach into the mobile segment, as it diversifies the revenue streams even more, and mobile games are one of the fastest-growing gaming niches.

Diversification

The company has more than 10 top MMOGs and in excess of 5,000 casual games in its games portfolio. Its revenue streams from the gaming division are very diversified, and there is little to no concentration risk in its games portfolio. It has no dependence on 'one-hit-wonders', keeping its revenues much more stable than is the case for many other gaming companies. MGI's gaming portfolio is a broad range of online PC, console, and mobile games, within several different gaming genres, such as roleplaying, strategy, and casual games.

Media and Games Invest Games Portfolio



Source: Media and Games Invest & Redeye Research

The revenue figures in the chart are approximated from the YTD Q3 20 pro forma figures provided by MGI in conjunction with the KingsIsle acquisition. No single game accounts for more than 25% of total game revenues (15% of total revenues) thanks to the high portfolio diversification, which we view as very positive. This diversification brings with it several other positive factors, such as:

- Stable revenues: The company has a lot of titles in its portfolio, and the portfolio is expanding. The revenues from the portfolio are quite predictable, and there is a high degree of customer stickiness, leading to stable revenues with high visibility.
- No concentration risk: MGI is not dependent on individual titles performing well. It is not a 'hit-driven' gaming company. Revenues are stable, and the company will still perform well financially if a future game were to prove unsuccessful.
- The optionality of a hit: Although MGI is not 'hit-driven,' there is still upside from a potential blockbuster game.
- Data advantage: MGI has a lot of data on essential metrics such as lifetime value (LTV), retention rate, customer acquisition cost (CAC), and other vital KPIs for its portfolio of games. This data is essential when analysing potential acquisition targets and launching new games. This know-how provides great synergies with the media division and can be applied to games' marketing, both in-house and third-party games.

MMOGs account for the largest share of revenues at 78% of gaming revenues, according to the figures from Q3 20. This increased to 84% of gaming revenues after the acquisition of KingsIsle.

Games Portfolio				
Title	Genre	Monetization	Rev. share (%)	Own IP
Wizard101	MMO	Free-to-Play	25%	Yes
Trove	MMO	Free-to-Play	13%	Yes
Casual games	Casual	Unknown	13%	NA
ArcheAge Unchained	MMO	Paid	13%	No
Other MMO	MMO	Unknown	8%	NA
Fiesta	MMO	Free-to-Play	6%	Yes
Aura kingdom	MMO	Free-to-Play	4%	No
ArcheAge	MMO	Free-to-Play	4%	No
Desert Operations	Strategy/War Game	Free-to-Play	4%	Yes
Grand Fantasia	MMO	Free-to-Play	3%	No
Rift	MMO	Free-to-Play	3%	Yes
Shaiya	MMO	Free-to-Play	2%	Yes
Pirate101	MMO	Free-to-Play	2%	Yes

Source: Media and Games Invest & Redeye Research (revenue share figures from the Q3'20 report)

Around 60-80% of revenues stem from free-to-play games. More than 55% of gaming revenues derive from fully owned IPs. 13% of the gaming division's revenues come from casual games on the WildTangent and Deutschland-Spielt platforms, with a monthly subscription business model that provides subscribers with access to the games on the portal.

Focus on publishing and improving existing games

The core business is publishing and improving existing fully owned games; no game development is done from scratch in-house. The focus is purely on enhancing and improving current games by providing new and exciting content to keep the player base engaged. Indeed, this strategy means no development risk, and the business model keeps MGI's maintenance capex low compared with gaming companies that develop games internally.

MGI conducts no internal development of completely new projects, something that carries with it higher risk owing to the sky-high development costs for games. MGI wants to become much larger before delving into internally developed projects. Instead, the company exclusively licenses games from external development studios, which means limited downside as MGI typically does not pay any development costs but instead has a minimum guarantee for marketing. However, the upside is significant as the revenue share is typically 25-30%. Potential blockbusters would, therefore, provide significant revenues.

The lack of development costs for completely new games translates into an asset-light company. Most of the capex investments go towards adding content to existing games that are already proven in the market. MGI can achieve a very high cash conversion of +80% thanks to this, and the return on investment is usually quite predictable. Some development costs are also allocated towards porting parts of the existing portfolio to new platforms. For example, MGI is currently working on bringing PC browser game 'Desert Operations' to mobile and moving the MMOG 'Trove' to the Nintendo Switch. Many MMOGs are complex, and there is a bigger challenge to port these games to mobile. Typically, MGI spends roughly 5-10% of revenues on maintenance capex for its games. This strategy reduces the risk substantially and allows MGI to focus instead on maximizing its return on investment.

Games-as-a-Service

Free-to-play MMOGs account for the largest share of gaming revenues, and MGI's main strategy for monetization is in-game transactions via the purchase of in-game goods. MGI has gathered a lot of knowledge and data about the MMOGs market and its users' behaviour through its many MMOG titles in its portfolio. MMOGs are live-service games that operate quite differently to most other games. This know-how is essential since live-service games can live for many years, often decades, if handled correctly, allowing MGI to acquire MMOGs that are of high quality but perhaps not engaging their player base sufficiently and are under-monetizing their player base. MGI's business model reduces the risk substantially as development costs are for a title. The game is already proven and has already attracted a player base. The return on investment can thus remain high as MGI can polish the diamonds in the rough.

Another risk-lowering factor is that the bulk of MGI's revenues derive from games with a long life cycle, translating into stable, recurring, and visible revenues for the company. Roughly 85% of the games division's revenues come from non-casual games with a very long lifespan, while more than 70% of the revenues generated from games stem from players who have been playing them for more than five years – true stickiness.

Live-service games need to be continuously updated to keep player engagement high, to attract new players via organic growth and UA, and finally to monetize the player base – rinse and repeat. MGI is very good at this thanks to its in-house media capabilities.

Organic growth via internationalization and porting

There is a large opportunity for organic growth by converting titles to other platforms through porting current games in the portfolio. This can cannibalize to some extent, but it probably leads to more hours played in total.

'Desert Operations' is currently being ported to mobile, a niche that is set to grow thanks to the acquisition of Freenet Digital (closed on 1 October 2020), which added 1,500 mobile games to MGI's portfolio. The acquisition will be accretive from Q4 20.

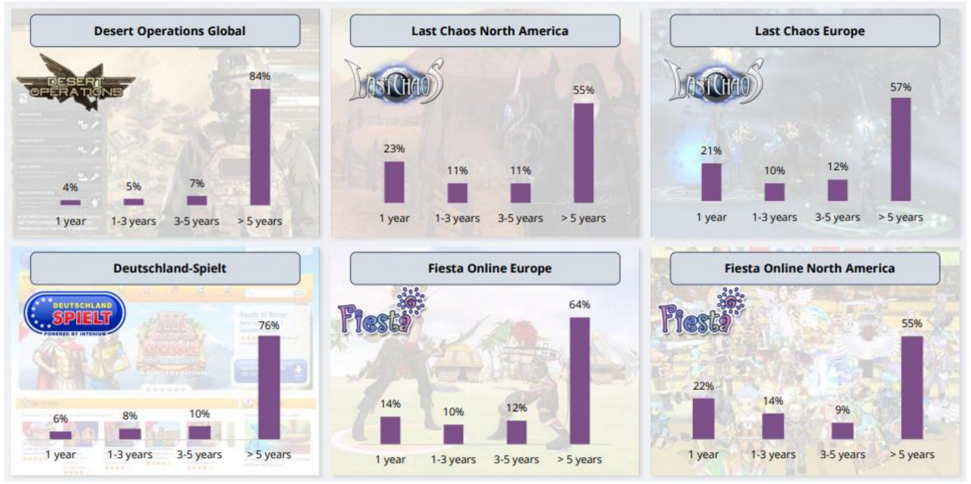
Mobile is one of the fastest-growing niches in gaming and will probably account for 10% of total game revenues in the future. As previously mentioned, 'Trove' is currently being ported to the Nintendo Switch by an external development studio that is being paid in cash and royalties of 10% of the game's revenues on the Switch.

Internationalization of the portfolio is another great growth opportunity for MGI. 'Trove' is one of the most income-rich games in MGI's portfolio, and the company announced on 1 July 2020 that it had partnered with South Korean publisher Aprogen Games to release the game on the PC in South Korea. The game is now in closed beta. 'Trove' is very successful, and the South Korean gaming market is large, so the potential upside is substantial — a great example of the internationalization optionality within MGI's gaming portfolio.

MMOGs and their stickiness

MGI has a large focus on PCs and consoles at present and focuses on MMOGs. We see this as a competitive advantage as this market has high barriers to entry and thus also to exit. Once a player starts investing time in an MMOG, the chances are high that they stick with the game for a long time. The LTV of an MMOG player is higher than for a casual gamer player. There is also greater competition for UA for casual games, driving the user acquisition cost (UAC) up and taking down the UAC/LTV ratio for MMOGs versus casual games.

Revenue split by user tenure for selected games



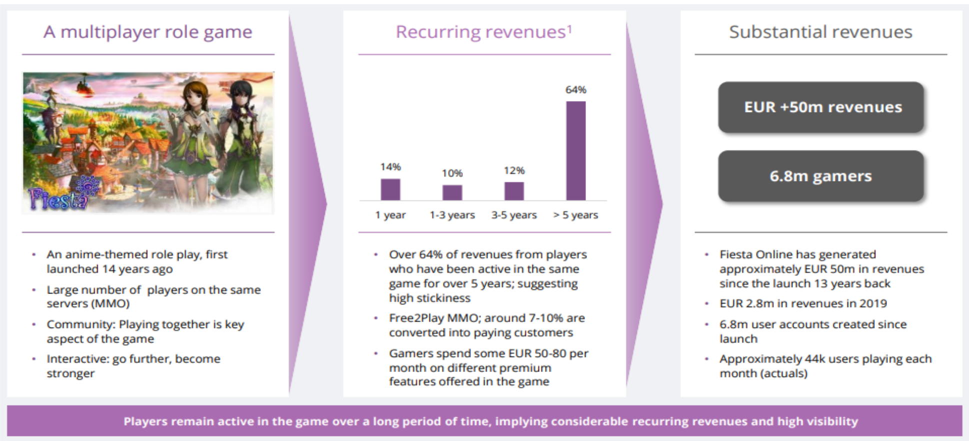
Source: Media and Games Invest Q3'20 earnings presentation & Redeye Research (figures Q1-Q3 2020)

The revenues from most of the games in MGI's portfolio are generated from players who have been playing the games for more than five years, underlining the long lifetime of players. More than 51% of the revenues generated from 'Wizard101' are from players who have played the game for more than five years. And this game is no exception, as can be seen from the diagram above. Other examples are 'Desert Operations' at 84% of revenues, the subscription service Deutschland-Spielt at 76%, 'Fiesta Online' at 64%, and 'Last Chaos' at more than 55%.

Case Study: 'Fiesta Online'

'Fiesta Online' is a great example of a game with a long lifecycle and players with a high LTV. The game was launched 14 years ago and has a loyal community thanks to the social experience the game offers. Playing together is a key aspect of the game.

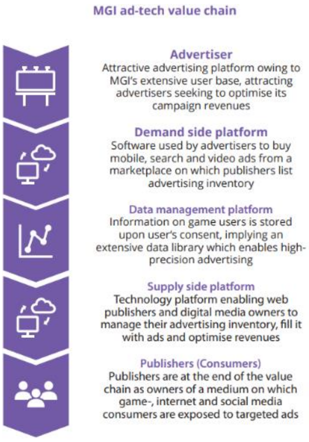
Case Study: Fiesta Online



Source: Media and Games Invest Q3'20 earnings presentation & Redeye Research

Revenues are recurring in nature because more than 64% stem from players who have been active in the game for more than five years. The game has generated more than EUR 50m in revenues since its launch, and in excess of 6.8m accounts have been created.

More interestingly, it has generated EUR 2.8m in revenues since 2019, and 44,000 users play each month at present. Not bad for a game that was launched 14 years ago.



Media Division

Digital media is a critical part of the value chain for online games, especially for free-to-play games, as the key here is to attract a large player base. Customer acquisition often accounts for a significant part of a free-to-play game company's total cost. The in-house media segment ensures very efficient customer acquisition for existing games and for the release of new games. MGI has a lot of advertising space within its games portfolio that can be marketed via the media segment. Advertising revenue in the gaming segment is growing, as roughly 50% of advertising revenues now derive from gaming channels. MGI has a data advantage as it is both a gaming and a media company.

MGI's media division, Verve Group, covers the whole value chain for digital advertising with its full-stack platform – everything from ad agencies, data management platforms (DMPs), and trading desks to demand-side platforms (DPSs), advertising networks/exchanges, supply-side platforms (SSPs), and publishers.

It acquired Adspree and Mediakraft in 2016 and 2017, and then a further three media companies (Applift, Pubnative, and ReachHero) during 2019.

It acquired all the assets of Verve Wireless, Inc., and together with Verve, Applift, and Pubnative formed Verve Group, Inc.

The recently acquired programmatic Platform 161, together with programmatic platforms Applift and PubNative, were added to Verve Group, which is set to benefit from the current media content from the current games portfolio and the media infrastructure of ad exchanges, DSPs, and SSPs.

Verve Group focuses on the fast-growing programmatic and advertising technology segments. Based on company data, Verve's open exchange is one of the top 20 programmatic marketplaces worldwide. It recently added video capabilities through its acquisition of LKQD. Smart TV and over-the-top (OTT) are fast-growing sectors within the media industry, and the acquisition is already showing significant growth.

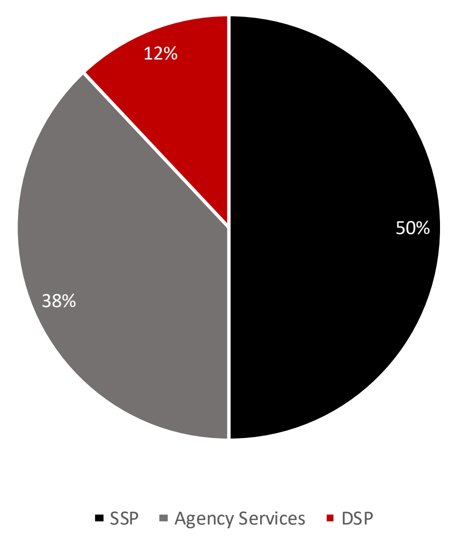
MGI has built a platform for the media unit that is similar to that for the games unit. All the acquired media companies are integrated, bringing cost advantages, consolidated expertise, and optimized development processes. Several strong game companies such as Zynga and King have been added as partners and are now counting on MGI's media capabilities. Many other well-known brands, such as Amazon and others, are among its customers.

Verve Group: Serving Fortune 500 advertisers

Source: Media and Games Invest FY2020 earnings presentation & Redeye Research

The media division of MGI has partnered with top Fortune 500 brands and advertisers, and its reach spans more than 20 countries. The media division has partnered with publishers that can be found in the top 100 in relevant app stores.

Media division revenue split



Source: Media and Games Invest FY2020 earnings presentation & Redeye Research

The income streams from the media division are very diversified, with 62% of total media revenues stemming from programmatic advertising, according to the 2020 earnings presentation, rendering them stable and predictable. Agency services accounted for 38% of total media revenues.

The SSP and DSP income are very scalable and stable. Advertisers and publishers that are connected to MGI's DSPs and SSPs pay a SaaS tech fee and a provision based on the amount of traffic they route over the platform. MGI's share of this revenue share model is typically 25-30%. This model also allows MGI's revenues to grow with the advertisers. The publishers and advertisers connect to MGI's platforms, and as they increase traffic and volume, MGI scales with them. The provision paid is relatively high, and programmatic bidding is automatic, resulting in a scalable business model. The programmatic market is quite fragmented (like the gaming market), offering opportunities for further acquisitions in the future. We summarize the acquired media companies below.

Verve Group

Verve Group was formed to unify Verve, Platform 161, PubNative, and Applift, Adspree, Mediakraft, ReachHero, and LKQD – all are media companies owned by MGI. Together they form Verve Group, a data-first brand performance ad platform, with more than 200 employees and over 25 offices worldwide. Verve is active in more than 20 countries. Among the group's clients are most of the top Fortune 500 global digital brands, plus many other smaller brands. Verve Group has a strong technology stack with an in-app ad platform based on a unified supply cloud and a widely adopted SDK base. All the media companies are consolidated under the Verve Group, which is now an advertising powerhouse and a top 20 programmatic marketplace globally.

Verve is a location-based mobile marketing platform powered through Movement Science, where the location data is sourced via the Verve SDK integrated into its publisher partners' mobile apps. Verve can quickly and accurately determine a device's location directly from the device itself. This data enables Verve to target users with highly contextually relevant ads.

Applift is an international mobile performance advertising agency based in Berlin that helps advertisers to acquire users for their apps. It specializes in customer target and re-engagement measures. It is integrated with more than 35 SSPs and exchanges and reaches in excess of 1.5 billion mobile users. Publishers can access the aggregated demand that Applift generates via its solutions, enabling programmatically processed ads.

Pubnative is an Applift subsidiary and an SSP for mobile programmatic in-app advertising, enabling app publishers to monetize and maximize their advertising inventory. This is made possible through an API (application programming interface) rather than the SDK (software development kit) that is typically required to integrate apps with a monetization platform.

Mediakraft is an online advertising agency that focuses on social, influencer, and video marketing. The company produces content and manages YouTube channels, and also produces entire influencer advertising campaigns. This type of marketing is increasingly popular. Among its customers are advertisers, influencers, and YouTube channels, especially in the gaming sector. Mediakraft manages a portfolio of YouTubers and influencers and offers advertisers a way to reach consumers through them.

Adspree is a digital advertising agency that helps game publishers market, advertise, and monetize their games. Adspree advertises both within MGI's own available advertising space in its games portfolio and wholly owned gaming portals and also across major channels, such as SEO, SEA social media, programmatic media buying, affiliate marketing, TV advertising, and other external games. Adspree also acts as an advertiser for MGI's own portfolio of games and provides advertising for third-party publishers and game developers.

MGI owns 100% of ReachHero, an ad agency that connects appropriate social media influencers and creators with brands, products, and advertisers. ReachHero operates a software-as-a-service (SaaS) platform that allows agencies and advertisers to manage influencer marketing campaigns and gain access to more than 70,000 registered influencers. ReachHero also acts as a pipeline for Mediakraft because it is also an ad agency. Services are offered as a traditional agency model and as a SaaS model.

Platform 161, previously known as Clickdistrict, is a DSP for programmatic advertising that was founded in 2008 and is headquartered in Amsterdam, Netherlands. The company offers advertising space offered through real-time bidding (RTB) via its programmatic platform. Platform 161 has offices in Barcelona, Hamburg, Istanbul, New York, and Stockholm.

Verve Group acquired Nexstar Inc.'s digital video advertising platform, formerly known as LKQD, on 11 January 2021. The platform reaches more than 200 million unique monthly users in the US across desktop, mobile, in-app, and connected TV devices. Connected TV (CTV) ad spending is a fast-growing market, and 80%-plus of LKQD's video platforms business in 2020 came from CTV and OTT advertising spending.

Innovative privacy solutions

MGI is currently working on an innovative privacy solution in Verve Edge, a product aimed at solving the increasing privacy challenges related to the collection of user data and mobile IDs. This is much needed owing to the introduction of GDPR and Apple's coming update to iOS 14, which will give users the choice to block IDFA identifiers at the app level. The product will solve many key issues for external partners and also for MGI's own portfolio of games. We do not know any details about this technology, other than that it will allow MGI to generate audience data on a device without the use of personally identifiable information (PII). We do know it is entering testing phases with some well-known publishers and advertisers. Launches are planned for more clients in the coming quarters.

Synergies

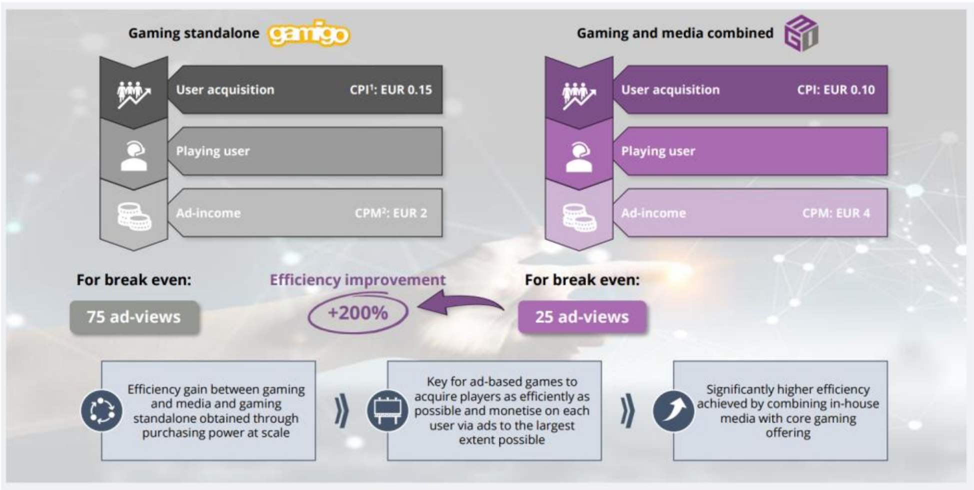
Gaming and Media Synergies

As the company states, media is a very logical and natural extension to the gaming value chain. User acquisition (UA) is an essential piece of the gaming puzzle, and media is the missing piece. This is especially true for free-to-play games, which account for much of the gaming division's revenues.

MGI's belief is that the gaming and media segments will act synergistically and that the sum is greater than the parts. These synergies act in either direction. The media segment enables MGI to lower the UA cost for the gaming division as the media segment can provide this at a much cheaper rate because the margin from ad-buying remains in-house. Having media in-house also allows for high volumes of UA when needed.

The gaming division receives more users and generates revenues from in-game transactions and also ad-income for both the gaming division and the media division. This reduces the need for external UA. The gaming division offers advertising space that results in efficient media buying, and the margin from ad-selling remains in-house.

Gaming standalone vs. Gaming and Media combined



Source: Media and Games Invest Q3'20 Presentation & Redeye Research

We offer a simplified example to show the economics: Cost per install (CPI) for a gaming application is typically EUR 0.15, and ad income cost per mille (CPM) is EUR 2, which nets EUR 0.002 per ad view for standalone gaming companies. This means that 75 ad views are required for a gaming company to break even.

The equation looks much better when there are synergies between media and gaming though: only 25 views are needed to break even as the UA cost drops to EUR 0.1 per install and the ad income at EUR 0.004 per view is higher because the margin remains in-house.

The diagram above illustrates this well. The efficiency gained from the synergies results in an efficiency improvement in excess of 200%.

All of this brings a positive spiral where games that are a part of MGI's portfolio can acquire users at a lower cost than standalone games. This translates into more players playing the game and spending money on the game, which in turn also means that the media companies can sell more available in-game advertising space.

As both a media and a gaming company, MGI has a lot of know-how and data on UA marketing. We believe it should be viewed as an expert gaming marketer for gaming companies thanks to its wide-ranging data on different demographics among gamers and their user behaviour. MGI has an extensive database of information about game users that enables high-precision advertising. MGI knows how to market to attract the right users to games, resulting in efficient UA for its gaming ad buyers.

MGI also has a lot of insight into gamer demographics, which it can use when marketing towards gamers. MGI should be the obvious choice for a partner publisher looking to monetize games via in-game advertising.

In conclusion, we see MGI gaining considerable efficiencies thanks to the know-how and data it receives from its media and gaming division, resulting in MGI being very efficient not only in acquiring users for other gaming companies via its marketing channels, but also in monetizing other companies' games via in-game ads. As mentioned before, more than 50% of revenues from the media division are derived from gaming, which highlights these competitive advantages.

Cost Synergies

Synergies via cost savings can be centralized through a unified management structure and personnel in administration, payroll, human resources, IT, marketing/distribution, and investor relations, which reduces overhead costs. There are also significant cost synergies related to the unified cloud platform that the company provides. MMOGs typically run on expensive data centres, which constitutes a considerable share of the cost base. The costs are reduced by migrating acquired games to MGI's cloud platform. Data centres are expensive and get cheaper when leveraging economies of scale, but smaller game companies have high fixed costs, high personnel costs, and data centre capex.

Cross-selling

Similar MGI-owned games can be advertised to the current user base across its games portfolio. This brings a risk of cannibalization, but if a game is nearing the end of its life cycle, it is a good way to attract new players to a similar game within the portfolio. This can keep the retention rate within the portfolio to a minimum.

Case Study: 'ArcheAge Unchained' Launch

'ArcheAge Unchained' is an exclusively licensed game in MGI's portfolio, and its launch is a perfect example of MGI's synergies as a company and its user acquisition capabilities. MGI used the data it had to its advantage when acquiring the right players for the game. Gamigo's internal market graphics team co-operated with Verve's production capabilities, powered by enriched data, resulting in a highly successful market campaign for the game.

A video spot was created in-house, and more than 65 influencer marketing campaigns were booked in-house. A total of 2.4 million views were achieved, resulting in organic revenues of EUR 10m-plus. This was made possible thanks to the powerful synergies between gaming and media.

M&A Strategy - Buy, Integrate, Build, and Improve

Buy

MGI has acquired more than 30 companies to date, and it has a proven track record of acquiring assets and improving them, with very satisfactory results. The typical acquisition payback time is under 24 months for EBITDA-negative companies, and EBITDA positive companies are acquired at less than 6x EBITDA (after synergy effects, which allows MGI to also acquire companies at higher multiples based on capitalizing on substantial synergies).

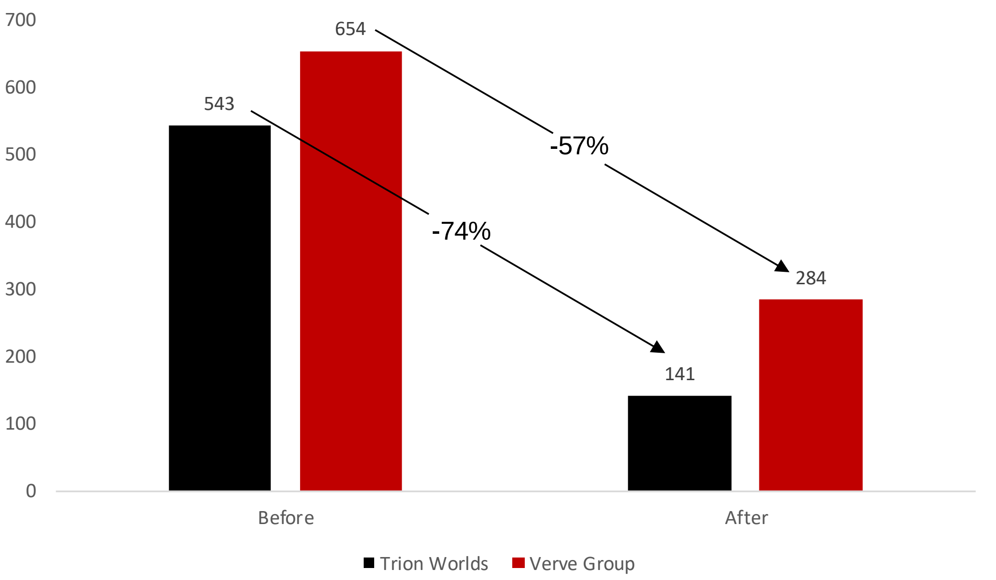
Its ideal acquisition targets are smaller companies with revenues of EUR 5-30m. MGI focuses on this segment because smaller acquisitions are less risky if they fail and as the competition for smaller companies is less fierce. Larger gaming companies typically look at larger companies, which often translates to higher price targets and multiples.

MGI is always looking for potential acquisition targets, and it is currently in discussions with five or more companies in both the gaming and media segments. MGI has chosen to focus more on EBITDA-positive cases from now on.

Integrate

A pre-set integration and enhancement plan is established prior to closing any acquisition. Integration is a high priority after a target has been acquired. Initial measures are taken to enhance the efficiency and profitability of the acquired company. MGI's synergy-based platform enables the acquired target to contribute around a 20-30% EBITDA margin post-acquisition and integration. Cost efficiencies are identified and technical integration to MGI's cloud-based platform is carried out. Cost savings are also achieved through cancellations or renegotiations of current, non-favourable contracts.

Tech Costs Savings (EURk)



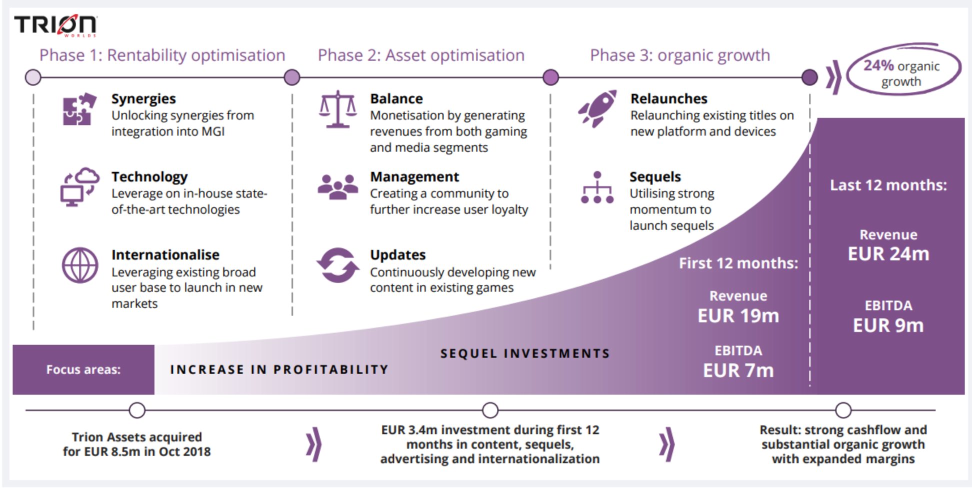
Source: Media and Games Invest & Redeye Research

MGI's cloud platform allows the acquired targets to become more efficient by reducing tech-related costs. Trion Worlds had monthly tech costs of EUR 543,000 as of September 2018 (developed by Gamigo on 22 October 2018), but MGI managed to reduce these to EUR 141,000 by July 2020, down 74%. Verve Group had monthly costs of EUR 654,000 in November 2019, which MGI reduced to EUR 284,000 by July 2020, a decrease of 57%. Moving services to the cloud not only saves costs but also reduces the risk and the downtime.

Improve

The focus is on buying distressed assets or inefficient targets and then investing in their organic growth. An example would be a good-quality game that MGI then improves the UA for through its media division. The game can be monetized by selling in-game advertising spaces for MGI's media companies via the media division. Depending on the success of the game, it can also be ported to other platforms. Improvements are made to the game, if needed, to keep player engagement high. After this, steps are taken to grow the existing user base via the media division's strong UA capabilities. Finally, further organic growth can be achieved by internationalizing current products to new markets or new platforms, which results in a very efficient business with a high return on investment.

Integrate and Improve



Source: Media and Games Invest & Redeye Research

The diagram above offers a good illustration of the process of integrating and improving games. MGI acquired Trion Worlds for EUR 8.5m in October 2018. The first step on its agenda was to unlock synergies by integrating the company into MGI, merging the services onto its cloud platform, which resulted in increased profitability on the legacy business. That was followed by increasing investments into content, user acquisition, advertising, and internationalizing the portfolio. Finally, the third phase of the process was organic growth by relaunching existing titles on new platforms and devices and utilizing the strong momentum to launch sequels to games.

MGI spent EUR 3.4m on investments into Trion Worlds' assets during the first 12 months. Revenues amounted to EUR 19m and EBITDA was EUR 7m during the period, resulting in a return on investment of a spectacular 459%, which we believe shows that the company's strategy is working. The following 12 months were even better, with organic growth surpassing 24%. This example might not be illustrative of every asset MGI buys, but it does show the potential in acquired assets.

Risk-averse management

We view the management team as very risk-averse. It does not chase deals and instead acquires companies with distressed assets at a relatively low multiple – typically below 6x EBITDA for EBITDA-positive companies. We consider this important in the current market climate. The gaming market is being consolidated at a rapid pace. Large companies such as Microsoft, Tencent, TakeTwo, EA, Embracer, Stillfront, and Epic Games are acquiring gaming developers at a staggering rate. Valuation multiples have increased because of the increased competition for game developers. We favour MGI's disciplined approach to acquisitions and believe it has the track record to back this up.

Many smaller acquisitions

MGI typically acquires smaller game companies, as this reduces concentration risk should an acquired acquisition fail to materialize. Another benefit is the less fierce competition surrounding smaller A and AA gaming companies, allowing MGI to acquire these at lower multiples. Its latest acquisition, of KingsIsle, shows that MGI is capable of acquiring larger targets as well. We do not know if this is a change in strategy, but we assume that its acquisitions will become larger as MGI grows in size.

We also believe MGI is opportunistic and that KingsIsle presented a good deal. This acquisition does not necessarily reflect a new normal for the company. We favour MGI's strategy, and as long as it does not bite off more than it can chew, bigger acquisitions are not necessarily bad. We would prefer if MGI still focused on smaller companies just because of the M&A competition surrounding larger companies. KingsIsle was a smaller acquisition in absolute terms, but it was big in relation to MGI's market capitalization.

Internally Developed Games

The next natural step for the company is to start developing games internally. CEO Remco Westermann has stated that MGI needs to be substantially bigger before this becomes a reality, again showing the company to be risk-averse. Although there are no current plans for internal game development, this remains a long-term growth catalyst.

Games Portfolio

MGI's games portfolio is extensive, and so we only cover the more significant games here.

'Wizard101' (PC, Mac)

'Wizard101' is a popular MMORPG in which players take the role of students at a school for wizards. More than 50 million accounts have been created. The game has been developed and published by KingsIsle Entertainment and was released in 2008. It is currently only available for PC, run from a North American and an EU server. The game is rated 13+ years old but is still very popular. The game is monetized via free-to-play or the choice of a subscription model. The game mainly caters to younger people.

'Trove' (PC, Mac, PS4, Xbox One)

'Trove' is a free-to-play Voxel-based action MMOG, developed and published by Trion Worlds in July 2015. 'Trove' is a very successful game and is played by nearly 10 million players across four different platforms in more than 100 countries and regions worldwide. The game is available on Xbox One, PlayStation 4, PC and Mac. It is coming to the Nintendo Switch in the future (release date to be announced). MGI owns the IP through its acquisition of Trion Worlds in 2018. The game has received favourable reviews, with an Opencritic score of 67/100 and 80% positive reviews from more than 78,000 players. It is currently the biggest title in MGI's portfolio. The game is monetized through in-game transactions.

'ArcheAge Unchained' (PC)

'ArcheAge Unchained' is an MMORPG developed by XLGAMES (the developers of 'Lineage') and published by Gamigo. It was released in October 2019. The game received mixed reviews, scoring a 70/100 on Opencritic and 64% positive reviews on Steam from more than 2,600 users. The game is pay-to-play but also features in-game transactions and a subscription.

'Fiesta Online' (PC)

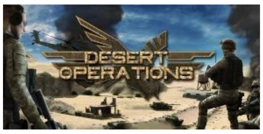
'Fiesta Online' is a free-to-play 3D anime-style MMORPG that was launched in July 2006, making it almost 15 years old and showing the stickiness of the player base. The game is monetized through in-game transactions where in-game currency can be purchased using real money. The game was originally developed by Ons On SOFT and published by Outspark, but Gamigo acquired the North American licensing rights from Outspark in 2013.

'Aura Kingdom' (PC and mobile)

'Aura Kingdom' is a free-to-play anime MMORPG with a focus on PVE (player versus environment). The game was developed by X-Legend and published by Aeria Games in 2014 as a free-to-play game. It has received favourable reviews, with 79% positive reviews on Steam from more than 8,000 players. The game is monetized via in-game transactions.

'ArcheAge' (PC)

'ArcheAge' is a free-to-play fantasy sandbox MMORPG developed by XLGAMES and published in EU and North America by Trion Worlds. The game was released in 2014 and received positive reviews, with an Opencritic score of 83/100. It is the predecessor to 'ArcheAge: Unchained'. It is monetized via in-game transactions.



'Desert Operations' (PC browser)

'Desert Operations' is a free-to-play military strategy game available on PCs as a browser game. The game is developed and published by Looki and was released in 2009. 'Desert Operations' features in-game transactions. The game is also being ported to mobile (launch date not yet announced).

'Pirate101' (PC, Mac)

'Pirate101' is a pirate-themed MMORPG developed and published by KingsIsle Entertainment in 2012. The game is very popular, with roughly 10 million registered players. It has the same payment model as 'Wizard101'.

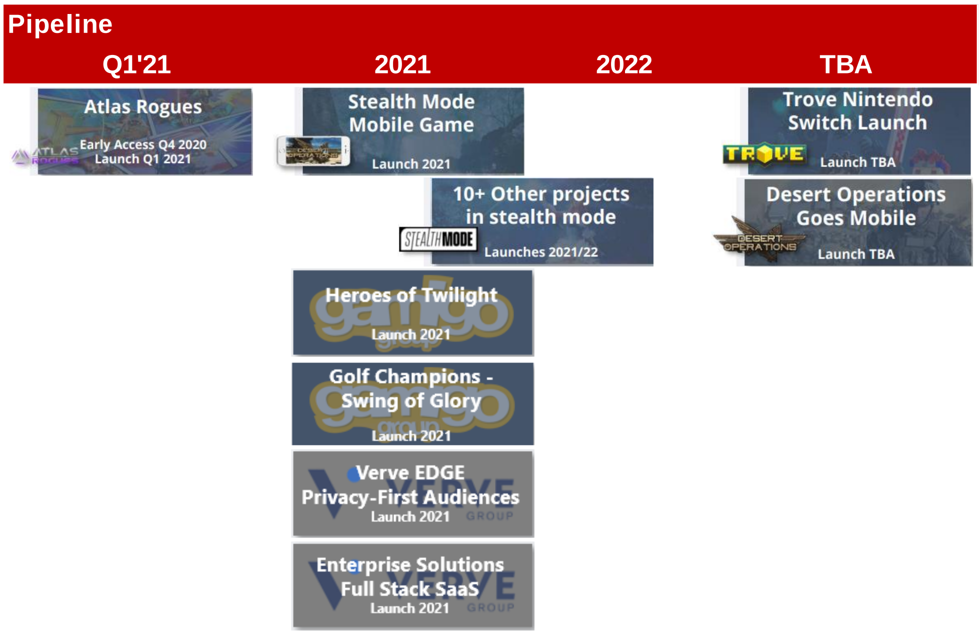
'Grand Fantasia' (PC)

'Grand Fantasia' is a free-to-play anime-themed MMORPG developed by X-Legend Entertainment and published by Aeria Games in 2009. The game features in-game transactions and is only available on the PC.

'Rift' (PC)

'Rift' is a free-to-play MMORPG developed and published by Trion Worlds in 2011. The game is very polished and was pay-to-play during its first two years on the market. It was originally monetized via a monthly subscription but became free-to-play in 2013. The game received positive reviews upon release, scoring 84/100 on Metacritic, and it has 74% positive reviews on Steam from more than 10,000 users.

Pipeline



Source: Media and Games Invest FY2020 Presentation & Redeye Research

MGI has a well-stocked pipeline with a lot of exciting launches due in 2021. We deem the launch of 'Trove' on the Nintendo Switch to have the most potential. The game is already very popular and is a superb match with the Switch, where the player base is quite young. 'Trove' will also be launched in the South Korean market during 2021 and this is currently in closed beta.

'Desert Operations' on the mobile has not been announced yet, but we believe this game is perfectly suited for the mobile platform. UAC for the game will probably be very low as a large number of players from PC can be converted. Although this can lead to some cannibalization, of course, the time spent in the game will still be higher as players will probably play both at home and on the go.

The rest of the pipeline is made up of larger game updates, DLCs, and the launch of a new game called 'Atlas Rogues', which already is in early access (EA). Reviews for the game have been mixed, but changes are ongoing, and it will hopefully be better received upon release. 'Atlas Rogues' is a paid game, currently priced at USD 19.99. The game is based on the Atlas IP owned by MGI. 'Atlas Reactor' (released in 2016) can be considered its predecessor, and that received favourable reviews, scoring 8/10 from several outlets and garnered a cult following. However, the game was closed down in 2019 due to a lack of successful monetization.

MGI has more than ten other projects not yet announced but set to launch in 2021 or 2022. We will keep an eye out for exciting announcements in the future.

MGI will launch two new mobile games. The games are not fully owned but are license and publishing deals. 'Golf Champions - Swing of Glory' and 'Heroes of Twilight' will be released in 2021.

Financials and Estimates

Financial estimates and historical financials are detailed in this section. We provide balance sheet and cash flow estimates on page 44.

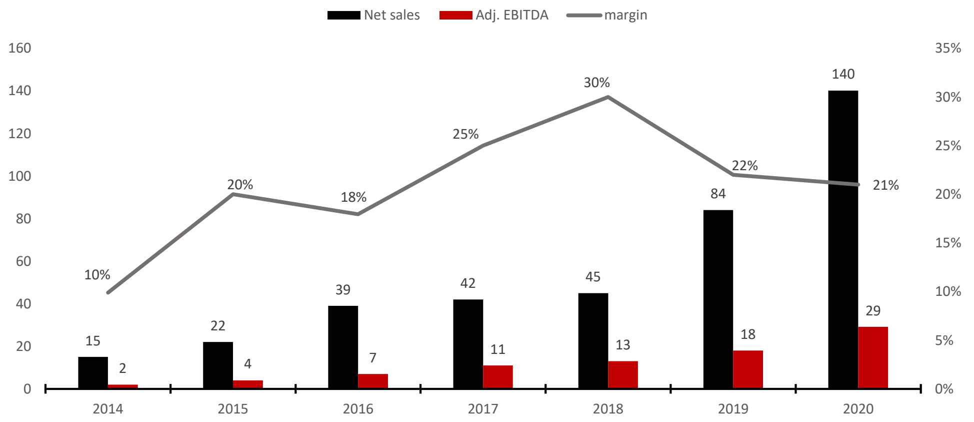
MGI financial projections

MGI announced its medium-term financial targets for 2021 at the investor presentation for the KingsIsle Entertainment acquisition. The company expects revenue growth of 25-30% and an EBITDA margin of 25-30%. It projects an EBIT margin of 15-20% while still maintaining net leverage of 2-3x. MGI expects KingsIsle to contribute EUR 26m to its top line and EUR 17m to its EBITDA in 2021, based on a USD-EUR currency ratio of 0.81. Visibility into the revenues derived from KingsIsle is high, as 31% of revenues comes from subscription sales (57% from in-game transactions). Moreover, historical financials indicate stable revenues.

Historical financials

MGI has a history of strong growth while maintaining profitability. Revenues and adjusted EBITDA (excluding non-recurring costs, M&A, and financing costs) have grown at a CAGR of 45-56% for 2014-20. Financials figures between 2014 and 2018 are Gamigo numbers, and figures from 2019 and onwards are fully consolidated MGI figures; 2019 was the first 12-month period that Gamigo was fully consolidated.

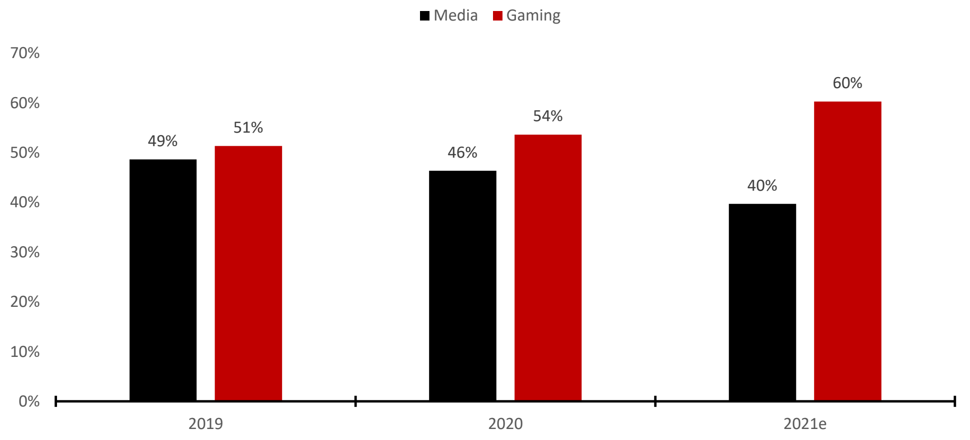
Media and Games Invest: Sales & EBITDA, '14-'20 (MEUR)



Source: MGI & Redeye Research

The adjusted EBITDA margin has fluctuated between 10% and 30% but at an upward trajectory, which can be attributed to the successful M&A and organic growth strategy. MGI has carried out more than 30 acquisitions to date, and the proof is in the pudding – the financials in this case. The reason for the improved margins is that the strategy of integrating and improving acquired companies has been successful in achieving synergies. Another reason is that the gaming division is growing faster than the media division and now accounts for a larger share of total revenues than before.

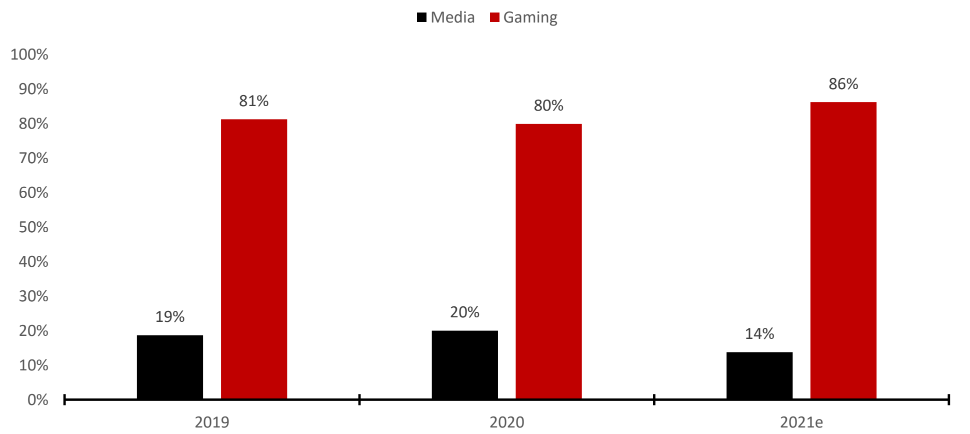
Media and Games Invest: Sales composition, '19-'21e (%)



Source: MGI & Redeye Research

The gaming division's share of total revenues increased from 51% in 2019 to 54% in 2020 as the pandemic bolstered the gaming division. KingsIsle will aid this further, as pro forma FY2020 financials show that the gaming division now accounts for 61% of total revenues.

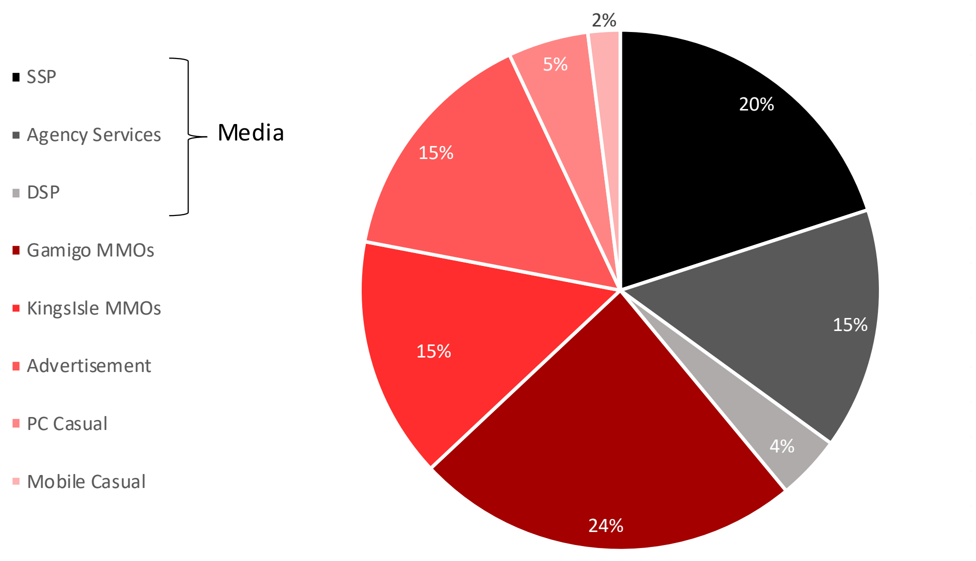
Media and Games Invest: EBITDA composition (%)



Source: MGI & Redeye Research

Gaming accounts for the lion's share of EBITDA as its margins are higher, which will increase further as KingsIsle is very EBITDA-accretive. KingsIsle had an adjusted EBITDA margin of 66% for Jan-Sep 2020. Gaming accounted for 79% of adjusted EBITDA and 81% of EBITDA in 2020; on a pro forma basis this was 89% of adjusted EBITDA in Q1-Q3 20. The acquisition of KingsIsle added more than 60% to the group's adjusted EBITDA and 20% to group revenues. The group's combined adjusted EBTIDA margin expands from 21% to 28% on a pro forma basis for Jan-Sep 2020.

Media and Games Invest: Revenue per division



Source: Media and Games Invest & Redeye Research

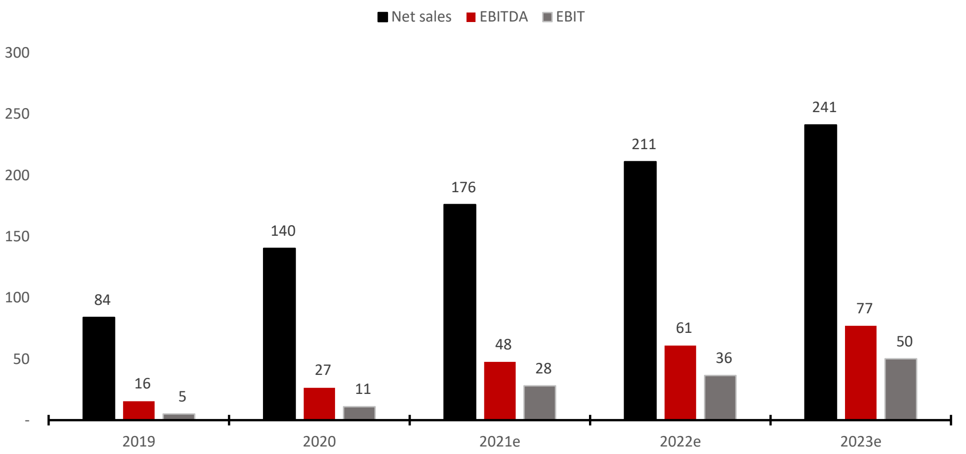
Media accounted for 39% of total revenues and gaming for 61% of total revenues, based on 2020 numbers and KingsIsle pro forma figures. KingsIsle games accounted for 25% of gaming revenues and 15% of total revenues.

Financial outlook

We expect strong organic growth and increased profitability from MGI thanks to the transformative acquisition of KingsIsle Entertainment. The gaming market will act as a strong tailwind as the gaming division takes a larger share of total revenues. Profitability will increase materially as KingsIsle is very profitable, and the gaming division will account for a larger share of total revenues.

The media division will continue to grow by at least double digits, and the margin will improve based on a larger share of programmatic revenues.

Media and Games Invest: Sales, EBITDA & EBIT, '19-'23e (MEUR)



Source: MGI & Redeye Research

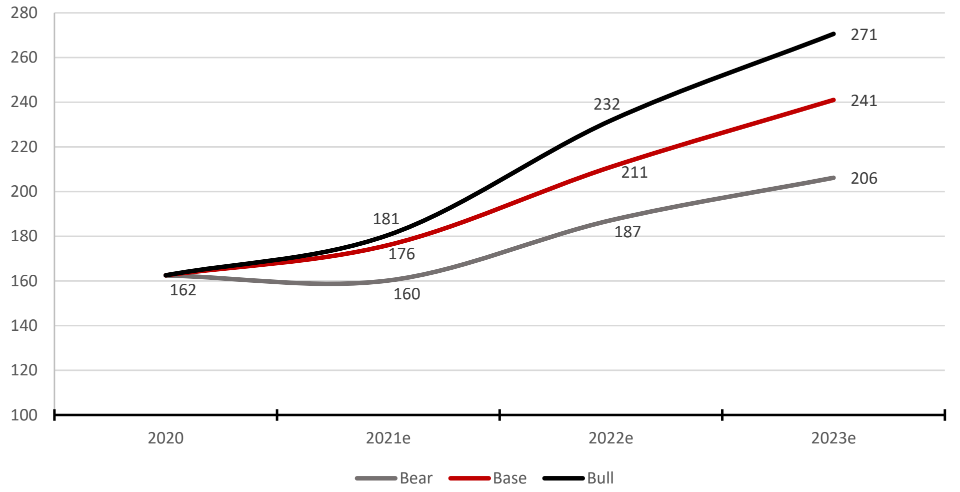
MGI will enter a more profitable stage of its journey this year. We expect EBITDA margins of more than 27% in 2021E, climbing to 32% by 2023E. We project that KingsIsle will add EUR

27m in revenues in 2021E and EBITDA of EUR 17m, in line with MGI's communicated forecasts for KingsIsle. We expect an EBIT margin of 16% for 2021E, climbing to 21% in 2023E.

We expect sales to grow at a CAGR of 20% for 2020-23E, amounting to EUR 241m in 2023E in our base case. We forecast EBITDA growing at a CAGR of 42% over the same period and expect EBIT to grow at a CAGR of 66% for 2020-23E. The increased profitability is driven by the consolidation of KingsIsle – which is much more profitable than MGI pre-acquisition – as well as increased profitability through efficiencies and scale, and finally, a larger percentage of revenues coming from the more profitable gaming division.

The graph below outlines our net sales forecast in our bear, base, and bull scenarios.

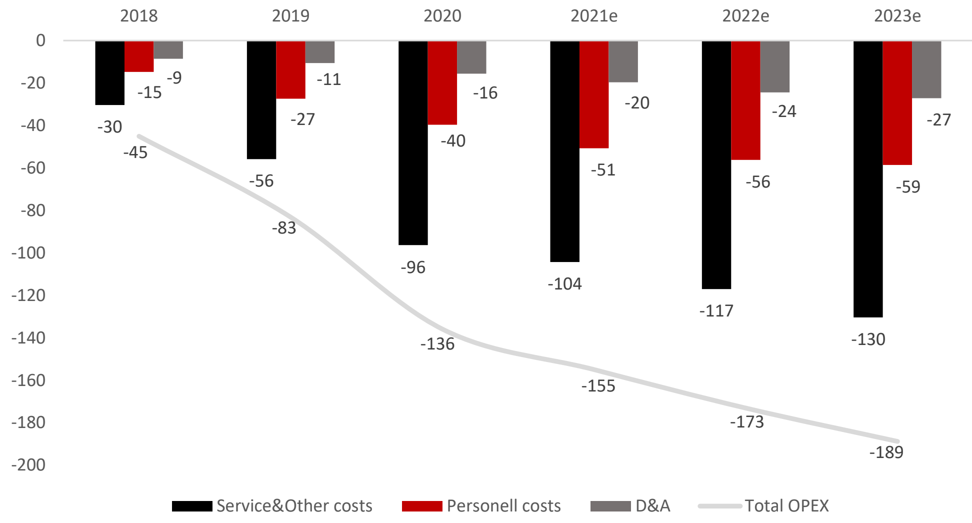
Media and Games Invest: Sales forecast, '20-'23e (MEUR)



Source: MGI & Redeye Research

Costs

Media and Games Invest: Cost base, '19-'23e (MEUR)



Source: MGI & Redeye Research

Services purchased & other operating expenses

Services and other operating expenses consist mainly of purchased services costs — expense items such as revenue shares, royalties/licensing fees, games marketing, media buying, and technology costs. The revenue share expenses, marketing, media buying, and royalty expenses will grow in line with revenues, although other operating expenses will remain quite flat.

Personnel expenses

The acquisition of KingsIsle added roughly 60 developers who will stay within MGI. The company had more than 700 employees before the acquisition, as of the end of Q3 20, and so we estimate increased personnel expenses as MGI now has 800-plus staff. We do not believe the company needs to increase its staffing further in the coming years. The centralized approach and the integration strategy will enable MGI to grow without expanding its staff base, especially considering that it is not currently pursuing new, internally developed games.

Detailed financial forecast

Below are our detailed financial forecasts for 2019-23E.

Media and Games Invest: Profit & Loss, base case, '18-'23e

EURm	2018	2019	2020	Q1'21	Q2'21	Q3'21	Q4'21	2021e	2022e	2023e
Net sales	**45**	**84**	**140**	**33**	**38**	**44**	**61**	**176**	**211**	**241**
YoY growth		85%	67%					26%	20%	14%
Capitalized costs	4	10	16	5	5	5	5	19	18	20
Other income	7	5	6	2	2	2	2	8	5	5
Total income	**56**	**99**	**162**	**40**	**45**	**51**	**67**	**203**	**234**	**266**
Service&Other costs	(30)	(56)	(96)	(20)	(23)	(26)	(35)	(104)	(117)	(130)
Personell costs	(15)	(27)	(40)	(10)	(11)	(13)	(17)	(51)	(56)	(59)
Total OPEX	**(45)**	**(83)**	**(136)**	**(30)**	**(34)**	**(39)**	**(51)**	**(155)**	**(173)**	**(189)**
EBITDA	**11**	**16**	**27**	**9**	**11**	**12**	**16**	**48**	**61**	**77**
EBITDA margin	25%	19%	19%	28%	28%	27%	26%	27%	29%	32%
Adj. EBITDA	13	18	29	10	12	13	16	51	64	80
D&A	(9)	(11)	(16)	(5)	(5)	(5)	(5)	(20)	(24)	(27)
EBIT	**3**	**5**	**11**	**4**	**6**	**7**	**11**	**28**	**36**	**50**
EBIT margin	6%	6%	8%	13%	14%	16%	18%	16%	17%	21%
Net financials	(2)	(6)	(7)	(2)	(2)	(2)	(2)	(7)	(9)	(8)
EBT	**1**	**(1)**	**4**	**3**	**4**	**5**	**9**	**21**	**27**	**42**
Tax	1	2	(1)	(1)	(1)	(2)	(3)	(4)	(5)	(8)
Net income	**2**	**1**	**3**	**2**	**3**	**4**	**6**	**17**	**21**	**33**

Source: Redeye Research

Financial position

MGI announced a new bond placement of EUR 80m on 13 November 2020, increasing financial flexibility and reducing interest expenses. The new bond's coupon is three months Euribor plus 5.75% per annum and a tenure of four years, which reduces the interest expense by 2.00%, as the current EUR 50m bond has a coupon of 3mE +7.75%. Part of the EUR 80m proceeds was used to redeem the existing bond (ISIN: SE0011614445) and to finance the acquisition of KingsIsle Entertainment. The new bond underlines the capital markets' increased confidence in MGI, as the company's strong operating performance speaks for itself.

MGI carried out a heavily oversubscribed directed share issue during Q3 20, raising SEK 300m. Net interest-bearing debt amounted to EUR 61.6m as of 31 December 2020.

The balance sheet is healthy, with an interest coverage ratio of 4.1 (3.1) and a leverage ratio of 2.1 (1.9) as of the end of Q4 20. This is conservative considering three M&A transactions and the minority buyout of Gamigo during 2020. MGI has a stated net leverage ratio target of 2-3x, which it is now comfortably at the lower end of. Cash and cash equivalents amounted to EUR 46.3m.

Valuation

Peer Valuation

Peer valuation

Company	EV (MSEK)	EV/Sales 2020	EV/Sales 2021E	EV/EBITDA 2020	EV/EBITDA 2021E	EV/EBITDA 2022E	SALES CAGR 19-22E	EBIT margin 2020	EBIT margin 2021E	EBIT margin 2022E
Nordic Gaming										
Embracer Group	89 551	10.2x	6.1x	23.4x	13.6x	12.5x	46%	4%	7%	11%
Stillfront	32 033	8.0x	5.3x	13.7x	11.7x	10.0x	52%	25%	28%	29%
Paradox Interactive	18 970	10.6x	9.6x	16.6x	12.9x	12.1x	23%	35%	36%	38%
EG7	6 163	9.4x	3.9x	12.6x	9.9x	7.8x	129%	-9%	0%	4%
Remedy	5 091	11.8x	10.2x	33.9x	24.2x	22.0x	19%	35%	42%	41%
G5 Entertainment	3 925	2.9x	2.6x	12.6x	10.4x	8.6x	11%	14%	16%	18%
Median	**12 567**	**9.8x**	**5.7x**	**15x**	**12x**	**11x**	**35%**	**19%**	**22%**	**24%**
Mobile/casual										
Zynga	94 149	5.2x	4.1x	-49.7x	17.5x	14.6x	27%	-19%	23%	24%
GLU	15 998	3.2x	3.2x	67.1x	19.8x	16.4x	13%	4%	12%	17%
Com2us	8 539	2.2x	1.7x	8.1x	6.5x	5.2x	14%	22%	26%	29%
Rovio	4 358	1.5x	1.6x	6.9x	9.5x	9.7x	-2%	16%	13%	12%
G5 Entertainment	3 925	2.9x	2.6x	12.6x	10.4x	8.6x	11%	14%	16%	18%
Median	**8 539**	**2.9x**	**2.6x**	**8x**	**10x**	**10x**	**13%**	**14%**	**16%**	**18%**
International Gaming										
Activision	573 265	7.7x	8.1x	19.1x	18.1x	15.4x	9%	34%	42%	39%
Nintendo	531 358	4.6x	4.1x	16.7x	11.2x	11.7x	9%	27%	36%	34%
EA	281 062	5.3x	5.5x	17.6x	15.4x	14.0x	7%	26%	32%	32%
Take-Two	149 581	5.1x	5.3x	22.6x	21.0x	20.3x	7%	14%	23%	22%
Bandai Namco	129 977	2.0x	2.3x	14.4x	15.9x	12.2x	2%	11%	11%	13%
Ubisoft	87 097	5.1x	3.8x	14.6x	9.2x	8.3x	10%	-4%	18%	19%
CD projekt	50 484	9.2x	10.6x	12.9x	14.6x	18.7x	44%	65%	64%	60%
Median	**149 581**	**5.1x**	**5.3x**	**17x**	**15x**	**14x**	**9%**	**26%**	**32%**	**32%**
Media (Adtech)										
The Trade Desk	261 867	34.0x	27.8x	134.5x	81.9x	60.7x	25%	17%	17%	19%
Magnite	37 955	18.6x	14.1x	NA	60.5x	42.2x	32%	NA	6%	13%
Pubmatic	19 888	14.5x	12.9x	NA	48.2x	38.2x	20%	NA	NA	NA
Criteo	13 441	0.7x	1.8x	NA	6.0x	5.8x	-29%	5%	17%	18%
Quotient	10 895	2.7x	2.6x	-79.3x	21.7x	15.9x	5%	-12%	NA	NA
Median	**19 888**	**14.5x**	**12.9x**	**28x**	**48x**	**38x**	**20%**	**5%**	**17%**	**18%**
Peer Group median	**16 227**	**7.5x**	**5.5x**	**16x**	**14x**	**13x**	**16%**	**17%**	**19%**	**21%**
Media and Games Invest	**4 851**	**2.9x**	**2.3x**	**18x**	**10x**	**8x**	**33%**	**7%**	**15%**	**15%**

Source: Bloomberg *Redeye Research

We divided our peer-valuation table into four peer groups: Nordic Gaming, Mobile/Casual, International Gaming, and Media/ad tech to better reflect the differences in valuation across the different segments. Media and Games Invest appears undervalued when looking at peers, albeit it is hard to find a direct peer. Valuation multiples are affected by expected growth, margins, the risk profile of the company, and return on capital (higher returns on capital suggests higher competitive advantages).

Nordic gaming companies are valued higher than international gaming companies on EV to sales ratios due to them being smaller and growing faster. Nordic investors have recently also started to appreciate gaming companies quite a lot, driving up multiples. We find this group to be the best peer group for MGI as it is listed on the First North stock exchange and is growing in-line with this peer group. Although most of the companies in the Nordic Gaming peer group are mostly selling fully paid games, with the exception of Stillfront.

Mobile/Casual gaming companies typically enjoy lower margins as the competition within the mobile gaming market is higher as the barriers to entry are lower. Mobile gaming companies are, therefore, typically valued lower, despite the mobile gaming market growing faster than the gaming market overall. We do not find this peer group to be indicative of MGI's valuation, as only 6% of MGI's revenues are derived from mobile games. However, almost all of MGI's revenues are derived from free-to-play games, which also is true for most mobile game companies. But MGI is focused on the MMOGs market, which has a very loyal player base and requires less investment into UAC.

International gaming companies are valued slightly below Nordic gaming companies due to them being larger stalwarts and thus are not growing that fast. However, they enjoy quite high margins due to them having strong IPs and competitive advantages, and reinvestments into growth being lower compared to the Nordic peer group. As mentioned previously, the Nordic peer group is the closest to MGI since MGI is listed on a Swedish stock exchange, is growing faster, and is entering a phase of margin expansion.

Advertising technology (ad tech) companies are typically valued higher than gaming companies, and the media peer group is valued at a median of 13x sales in 2021e. Compared to PC/Console gaming companies that are valued at a median of roughly 5-6x sales in 2021e.

Closing the gap

Roughly 50% of MGI's revenues are derived from advertising, which mostly comes from ad tech business models (over 60% from programmatic marketplaces). MGI only trades at 2.3x sales in 2021e while growing faster than the median of our peer groups. Looking at EV/EBITDA tells the same story, MGI is valued below peers while growing faster and also, to a large extent being an ad tech company, which typically are higher valued than gaming companies.

MGI is on track to close the valuation gap after the shares rose by over 200% after the Swedish listing, but it still has some ways to go. We think being on the Swedish capital markets for a bit longer and becoming more visible to Nordic investors will lead to the trend continuing. Another catalyst will be the integration of KingsIsle Entertainment during 2021, when investors get to see the results first hand. And finally, we think the market has not yet fully appreciated the growing media segment and the synergies that the company enjoys by combining its media and gaming divisions.

DCF

We use a WACC of 9% across our three scenarios. MGI has an extensive track record of value accretive acquisitions. However, M&A is hard to estimate, and we maintain a conservative view of valuing MGI based on its current operations. Future M&A is cherry on top and provides nice optionality to the upside.

Bear Case 25 SEK

The Company has somewhat overestimated the lifetime value of its games but still manages to monetize them via its superior UA capabilities. UA cost in relation to revenues has increased due to increased competition. The Company has a hard time acquiring new studios and developing new games from scratch.

The gaming market continues to grow, and MGI manages to remain profitable while revenues grow at a slow pace. The media division picks up some of the gaming divisions slack.

Sales '23: SEK 2345m
Sales CAGR '23-'31: 3%
Terminal growth: 2%
Avg. EBIT-m '23-'31: 15%
Terminal EBIT-m: 15

Base Case 59 SEK

MGI successfully integrates the highly EBITDA accretive KingsIsle and manages to unlock organic growth via its current portfolio of games; meanwhile, the media segment continues to grow while margins expand as Verve Group continues to be a programmatic advertising powerhouse.

Strong underlying growth in the gaming market supports MGI's growth. Revenues grow at a moderate pace, but margins remain high as UA cost is kept at quite a low rate in relation to revenues. The media division is a large part of that.

Our mid-term and long-term EBIT margins are quite conservative considering peers, and we feel confident that MGI can achieve this with ease. We believe there is a high degree of margin of safety due to our estimates being conservative.

Sales '23: SEK 2700m
Sales CAGR '23-'31: 7%
Terminal growth: 2%
Avg. EBIT-m '23-'31: 22%
Terminal EBIT-m: 21%

Bull Case 77 SEK

KingsIsle is integrated, and synergies are unlocked. The media division continues to grow and becomes very profitable as more and more revenues come from programmatic marketplaces, which is a very scalable business model. The group continues to grow its portfolio of free-to-play games through cheap UA cost and internationalization, and cross-platform activities.

Underlying organic growth in the gaming market will continue to support the growth for a long time. Mobile games will become a larger part of revenues.

Our growth and EBIT margin estimates are quite conservative and very achievable even in our bull case. Again, reiterating that we feel that there is a high degree of margin of safety in our valuation.

Sales '23: SEK 3004m
Sales CAGR '23-'31: 7%
Terminal growth: 2%
Avg. EBIT-m '23-'31: 25%
Terminal EBIT-m: 24%

Summary Redeye Rating

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

People: 5
The management team is excellent as their track record speaks for itself. Over 30 companies have been acquired by the management team, and their acquisition has overall been very value-accretive. And all of them own a significant number of shares and are incentivized to do what is best for shareholders. The CEO and founder Remco Westermann own a vast amount of the company's capital (33%), and he has been with the company from the start. The launch of the ESOP will help retain key people within the management team, and our overall view of the management team is very positive.

Business: 4
The synergies that MGI obtains between its media and gaming divisions result in operational excellence. Revenues and adj. EBITDA has compounded at impressive rates, and we believe there is much more to come. The fit between the media and gaming segments is obvious, and the media division has grown into a real programmatic powerhouse. We expect continued growth and margin expansion in the future on the back of the recent acquisition, efficiencies, high degree of stickiness within its user base, and high growth within its media division.

Financials: 3
MGI has a history of a strong return on investment, revenue growth, and return on equity. The company has not been that profitable in the past but has recently become very profitable on an EBITDA level. We expect margin expansion on an EBIT and EBITDA level starting in 2021. The outlook for the programmatic advertising and the gaming markets is very positive, and we strongly believe MGI will benefit from this.

INCOME STATEMENT	2018	2019	2020	2021E	2022E
Net sales	56	99	162	203	234
Total operating costs	-45	-83	-136	-155	-173
EBITDA	11	16	27	48	61
Depreciation	0	0	0	-1	-1
Amortization	-9	-11	-16	-20	-24
Impairment charges	0	0	0	0	0
EBIT	3	5	11	28	36
Share in profits	0	0	0	0	0
Net financial items	-2	-6	-7	-7	-9
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	1	-1	4	21	27
Tax	1	2	-1	-4	-5
Net earnings	2	1	3	17	21

BALANCE SHEET	2018	2019	2020	2021E	2022E
Assets					
Current assets					
Cash in banks	4	33	46	21	15
Receivables	12	23	46	47	54
Inventories	0	0	0	0	0
Other current assets	0	0	0	0	0
Current assets	16	56	92	68	69
Fixed assets					
Tangible assets	4	4	2	4	6
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	0	0	0	0	0
Cap. exp. for dev.	0	0	0	0	0
O intangible rights	204	233	273	369	363
O non-current assets	12	20	19	19	19
Total fixed assets	220	257	293	378	388
Deferred tax assets	0	0	0	0	0
Total (assets)	236	312	386	461	458
Liabilities					
Current liabilities					
Short-term debt	24	34	48	111	88
Accounts payable	0	20	30	0	0
O current liabilities	0	0	0	0	0
Current liabilities	24	55	78	111	88
Long-term debt	53	89	131	131	131
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	77	144	209	242	219
Deferred tax liab	0	0	0	0	0
Provisions	0	0	0	0	0
Shareholders' equity	67	98	177	218	239
Minority interest (BS)	0	0	0	0	0
Minority & equity	91	70	1	1	1
Total liab & SE	236	312	386	461	458

FREE CASH FLOW	2018	2019	2020	2021E	2022E
Net sales	45	99	162	203	234
Total operating costs	-45	-83	-136	-155	-173
Depreciations total	-9	-11	-16	-20	-25
EBIT	3	5	11	28	36
Taxes on EBIT	1	2	-1	-6	-7
NOPLAT	4	7	10	22	28
Depreciation	9	11	16	20	25
Gross cash flow	0	5	12	42	53
Change in WC	0	67	-34	-31	-7
Gross CAPEX	0	-44	-6	-119	-22
Free cash flow	0	28	-29	-108	25

CAPITAL STRUCTURE	2018	2019	2020E	2021E	2022E
Equity ratio	0%	32%	29%	27%	30%
Debt/equity ratio	0%	123%	222%	252%	222%
Net debt	0	90	244	348	386
Capital employed	0	190	354	486	560
Capital turnover rate	0.0	0.3	0.4	0.4	0.4

GROWTH	2018	2019	2020E	2021E	2022E
Sales growth	7%	85%	67%	26%	20%
EPS growth (adj)	NA	NA	NA	450%	36%

DCF VALUATION		CASH FLOW, MEUR	
WACC (%)	9.0 %	NPV FCF (2021-2022)	-63
		NPV FCF (2023-2030)	310
		NPV FCF (2031-)	555
		Non-operating assets	61.6
		Interest-bearing debt	-107.9
		Fair value estimate MEUR	759
Assumptions 2021-2026 (%)			
Average sales growth	14.5 %	Fair value e. per share, SEK	59
EBIT margin	19.5 %	Share price, EUR	37.0

PROFITABILITY	2018	2019	2020	2021E	2022E
ROE	5%	Neg.	2%	8%	9%
ROCE	3%	2%	4%	9%	10%
ROIC	4%	3%	3%	6%	7%
EBITDA margin	19,9%	15.7%	16.3%	23.5%	26%
EBIT margin	4,7%	5.1%	6.8%	13.8%	15.6%
Net margin	2.8%	Neg.	1.7%	7.2%	8.1%

DATA PER SHARE	2018	2019	2020	2021E	2022E
EPS	n.m.	n.m.	0.02	0.11	0.15
EPS adj	n.m.	n.m.	0.02	0.11	0.15
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	0.00	0.70	62	2.70	3.00
Total shares	59.9	70	117.1	128.70	128.70

VALUATION	2018	2019	2020	2021E	2022E
EV	NA	NA	543	544	544
P/E	NA	NA	162	33	25
P/E diluted	NA	NA	162	33	25
P/Sales	NA	NA	3	2.4	2.1
EV/Sales	NA	NA	5.1	4.1	3.5
EV/EBITDA	NA	NA	31	17	14
EV/EBIT	NA	NA	74	29	23
P/BV	NA	NA	4.3	4.0	3.6

SHARE PERFORMANCE		GROWTH/YEAR	18/20E
1 month	-	Net sales	19,135.4 %
3 month	-	Operating profit adj	0.0 %
12 month	-	EPS, just	0.0 %
Since start of the year	-	Equity	0.0 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Remco Westermann	33.5 %	33.5 %
Oaktree Capital Management LP	9.1 %	9.1 %
Clearstream Banking S.A. W8imy	2.5 %	2.5 %
Luxembourg Branch, UBS Europe Se	1.8 %	1.8 %
UBS Switzerland AG	1.5 %	1.5 %
Nordnet Pensionsförsäkring	1.5 %	1.5 %
Avanza Pension	1.2 %	1.2 %
Skandia Fonder	0.7 %	0.7 %
Atlant Fonder AB	0.6 %	0.6 %
Finlandia Rahastoyhtiö Oy	0.6 %	0.6 %

SHARE INFORMATION	
Reuters code	
List	First North
Share price	37.0
Total shares, million	128.7
Market Cap, MEUR	494.0

MANAGEMENT & BOARD	
CEO	Remco Westermann
CFO	Paul Echt
IR	Sören Barz
Chairman	Remco Westermann

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Redeye Rating and Background Definitions

Company Quality

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

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

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

People

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

The People rating is based on quantitative scores in seven categories:

- Passion, Execution, Capital Allocation, Communication, Compensation, Ownership, and Board.

Business

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

The Business rating is based on quantitative scores grouped into five sub-categories:

- Business Scalability, Market Structure, Value Proposition, Economic Moat, and Operational Risks.

Financials

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

The Financial rating is based on quantitative scores that are grouped into five separate categories:

- Earnings Power, Profit Margin, Growth Rate, Financial Health, and Earnings Quality.

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Disclaimer

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Redeye Rating (2021-03-07)

Rating	People	Business	Financials
5p	23	18	3
3p - 4p	96	79	39
0p - 2p	6	28	83
Company N	125	125	125

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CONFLICT OF INTERESTS

Danesh Zare. owns shares in the company : No

Tomas Otterbeck. owns shares in the company : No

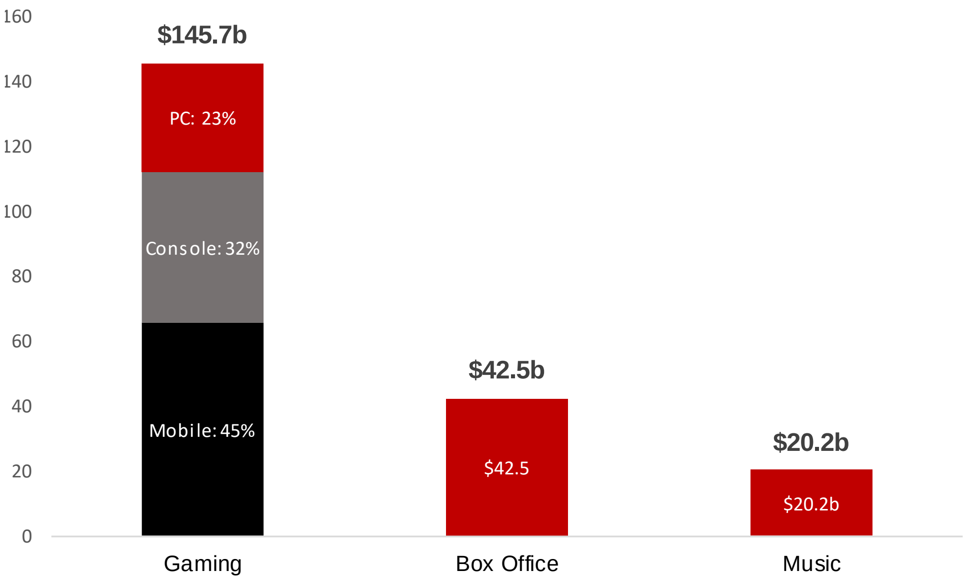
Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.

Appendix

The Gaming Market

Gaming is the most extensive form of entertainment today: more than 2.7 billion people play some type of game today. It is bigger than either the TV, the film, or the music industries. In fact, it is larger than the film and music industries combined. Newzoo forecasts that the gaming market will grow by about an 8% CAGR in 2020-23E.

Gaming market



Source: Newzoo & Redeye Research

The total market is predicted to have surpassed USD 159 billion in 2020, a 9.3% YoY increase, and eventually to exceed USD 200 billion by the end of 2023.

It is no secret that COVID-19 helped spur the growth of the gaming market during 2020. Among the proof for this is that Steam users spent 31.3 billion hours playing games on the platform during 2020, an increase of 51% compared to 2019. Streaming platform Twitch saw a similar increase, with the number of viewing hours amounting to 18.6 billion in 2020, up 69% compared to the previous year. Many thought this would only be temporary, but much data indicates that the user base has stuck around and that it can grow from this new higher base, although at a lower growth rate, of course.

Traditional media was disrupted by social media ten years ago, and according to Newzoo's 2020 Global Games Market Report, games are disrupting social media today, as games offer a more interactive experience as well as a social aspect. Game worlds are, for the most part, more immersive than social media apps. The feedback loop gained from gaming is more instantaneous and satisfying while still being very social. Games are playing an increasingly large role in society as a staple of entertainment, offering social connection and relief, and entertaining millions of people during the pandemic.

Mobile gaming remained king of the hill in the gaming segment in 2020 with revenues of USD 77 billion, up 13% YoY. Browser games will continue to decrease as more gamers move to mobile gaming. Console gaming will have a good year in 2021 as the release of the PlayStation 5 and the Xbox Series X should boost the sales of games.

The gaming market is quite fragmented and has traditionally been very 'hit-driven' in nature. However, this is gradually changing as more gaming companies adopt different business models.

Margins are typically very high in the gaming market and are only increasing, owing to digital distribution taking market share over the lower physical distribution margins. Copying ones and zeroes basically costs nothing, and so the scalability is high. Although digital distribution is taking precedence over physical, this does not mean that the physical distribution market is shrinking. It is growing, albeit quite slowly. However, digital distribution is growing so rapidly that the physical distribution market share is shrinking.

Mobile Gaming

Mobile games (including both smartphone and tablet) revenues are forecast by Newzoo to account for 49% of the global gaming market, with revenues of USD 77 billion, and it expects the mobile gaming market to grow faster than the gaming market overall, at around a 13% CAGR for 2020-25E.

The mobile gaming industry has seen accelerated growth due to COVID-19. Mobile games revenues grew by 21% YoY in H1'20, according to Sensor Tower. Downloads increased 44% YoY in Q2 20. These numbers do not include revenues from third-party Android stores in China and other regions. Games now represent 72% of all app store spending, according to App Annie, and games accounted for 40% of total app downloads in 2020, up from 37% in 2019, according to Sensor Tower.

There are several reasons why the mobile gaming industry will grow faster than the gaming market overall. It has the lowest barriers to entry. Games development is not as complex for mobile games, which means working from home was easier for employees in this segment. Newzoo estimates that, of the 2.6 billion mobile gamers in 2020, only 38% paid for games.

Time spent on mobile outpaced time spent watching TV in 2019. The trend is expected to continue, and 91% of the time spent on mobile devices is spent in-app, according to eMarketer, and games are some of the most engaging mobile app categories.

Casual Games

Casual games are targeting mass-market audiences rather than 'hardcore' gamers. These games are normally fun, simple games that require less skill than 'hardcore' games. A simple user interface is typical; for example, mobile games with a tap-and-swipe interface or a one-button mouse interface for a PC browser game. The game sessions are typically short, so a game can be enjoyed during short breaks. The barriers to entry in this market are typically much lower than for hardcore games, so the competition is very high. Development costs are much lower since the games are fairly basic. Casual games are very popular and attract many players. For instance, Candy Crush is the most downloaded game of all time on iOS, according to App Annie. A range of different monetization methods can be used for casual games, but the most common are in-game transactions and advertising.

Brand Marketing and Performance-Based Marketing

There are two categories of digital marketing: brand marketing and performance-based marketing. Brand marketing is used to build brand awareness, influencing the consumer to gravitate towards a particular brand. For example, getting the customer to buy Nike shoes the next time they are shopping for footwear. Brand marketing can be viewed as traditional product placement marketing: the likes of billboards, posters, static banners, and television commercials.

With performance-based advertising, on the other hand, the purchaser of the ad space only pays when there is a measurable result. These ads typically have an element of call-to-action (CTA). The following pricing models are usual:

- Cost-per-mille (CPM) is a model that charges the customer for each impression –when an ad has been viewed. The CPM cost is for every thousand views.
- Cost-per-click (CPC) charges the purchaser for each click on an advertisement.
- Cost-per-lead (CPL) only charges the purchaser when a customer performs a desired action, such as purchasing or signing up for something, irrespective of the number of clicks and impressions.

Mobile Advertising Spending

Mobile ad spending is forecast by Statista to account for 55% of global digital ad spending in 2020 and predicted to grow to 62% in 2024.

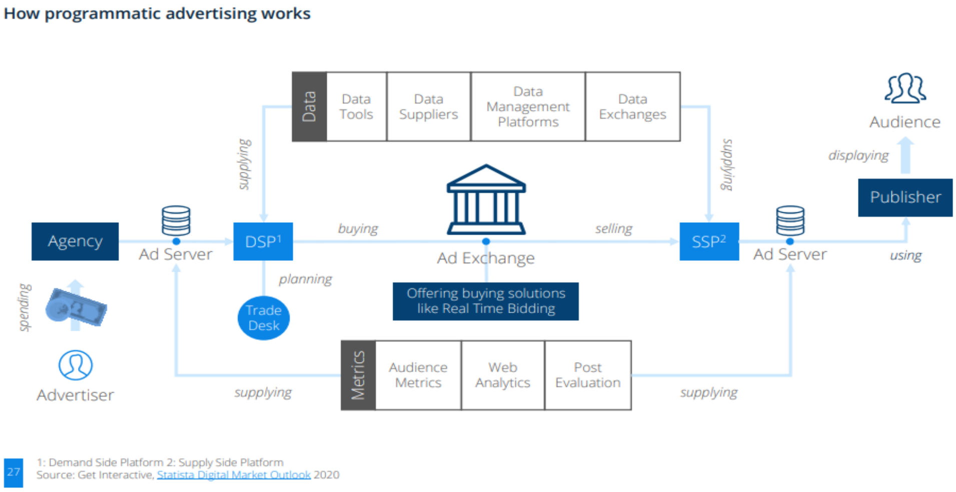
Mobile advertising dominates in the US and China. Mobile advertising only accounted for 39% of digital advertising spending in Europe in 2019. At 62% in China and 58% in the US, in-app advertising is gaining market share over mobile web advertising. It is expected to grow by a CAGR of 19.4% in 2019-25E, reaching USD 226 billion.

Programmatic Advertising

Programmatic advertising is employed by companies active within the advertising technology (ad tech) space. It aims to replace human negotiations with machine learning and AI optimization, driving efficiency and transparency for advertisers and publishers.

The diagram below explains the process and is best viewed from right to left. It starts with a consumer visiting a website or an app. The publisher ad server announces via the supply-side platform (SSP) that ad space is available for purchase – this is called an ad request – to the ad exchange and sends information regarding the user to the demand-side platform (DSP).

The programmatic advertising process



Source: Statista & Redeye Research

The DSP communicates to advertisers via an ad server that there is available ad space directed at the type of consumer they are trying to reach and states the current bid price. Advertisers then place bids on the most attractive ads through a DSP, and the highest bidder wins the ad inventory. The ad request has thus been filled.

Advertisers use the DSPs to help reach their target audience, while publishers use the SSPs to sell ad space on ad exchanges. The publisher can provide details about the user, such as search history. Advertisers can then decide if they want to bid on that specific impression and how much to bid for it. This real-time bidding (RTB) process takes place in a matter of milliseconds.

Hence, programmatic is much more scalable than direct bookings and enables advertisers to reach their target audience at a lower cost. Programmatic advertising also benefits from real-time advertising statistics, where the advertisers can see the number of impressions, conversions, and useful user data. Ad campaign data can also be provided, showing how specific keywords or different advertising campaigns are performing.