

March 12, 2011

Europe | Video Games

DR. KALLIWODA  
RESEARCH GmbH

## Sector update

## Video Games

## A highly promising media segment

**Company name:** City Interactive S.A.  
**Country:** Poland  
**ISIN:** PLCTINT00018  
**Reuters:** CIAT.WA  
**Bloomberg:** CIA PW  
**Website:** www.city-interactive.pl

**Price target:** 36.79  
**Rating:** Buy  
**Last price:** 28.31  
**Market Cap. (PLNm)** 358.12

**Company name:** CD Projekt RED S.A.  
**Country:** Poland  
**ISIN:** PLOPTTC00011  
**Reuters:** OPTI.WA  
**Bloomberg:** CDR PW  
**Website:** www.cdprojektred.com

**Price target:** 6.21  
**Rating:** Hold  
**Last price:** 6.00  
**Market Cap. (PLNm)** 569.70

**Company name:** Ubisoft Entertainment SA  
**Country:** France  
**ISIN:** FR0000054470  
**Reuters:** UBIP.PA  
**Bloomberg:** UBI FP  
**Website:** www.ubisoftgroup.com

**Price target:** 7.79  
**Rating:** Buy  
**Last price:** 6.09  
**Market Cap. (€m)** 583.72

- 2011 has seen another record set by Activision Blizzard's game "Call of Duty: Modern Warfare 3 (CoD3)". The game, which was released in November, generated revenues of c. USD 400m within 24 hours in UK and the US and thus more than any other form of entertainment in history. CoD3 also dominated the 2011 game charts as its console versions achieved the first and second position respectively in the global sales ranking.
- According to the latest report by DFC Intelligence, which accounts for sales of console hardware and software, portable hardware and software, PC games and games for mobile devices, the market for video games will increase its volume from USD 66bn in 2010 to USD 81bn in 2016. The main growth driver is expected to be the online channel, with online sales surpassing physical retail software already in 2013. The report also forecasts that most games will be sold for PCs and mobile devices such as smart phones and tablets.
- In a recent press release the German association Entertainment Software Self-Control (USK) stated that based on its statistics for 2011, which showed a lower number of age-checks for new game releases y-o-y, new console versions will likely be introduced soon. Such an event would spur the growth of the game industry. The current hardware cycle in case of consoles has been the longest in history, with the Xbox, Playstation 3 and Wii having been on the market for 5-6 years.
- Due to successful new releases in 2011 all our coverage companies have already reported or will likely release excellent fiscal-year 2011 results. After adjusting our models, we have changed our price targets, which now are a weighted average of our DCF models and peer group. Our top pick in Europe remains the Polish company City Interactive with a PT of PLN 36.79 (previously: PLN 34.85) and an upside of 29.9% at current level.

in m	City Interactive		CD Projekt RED		Ubisoft Entertainment	
	2012E	2013E	2012E	2013E	2011/12E	2012/13E
Revenues	199.50	281.40	199.61	198.09	1,074.51	1,138.78
EBITDA	76.81	99.62	46.91	51.50	371.24	386.00
EBIT	65.84	84.42	43.92	48.53	59.10	75.16
Net Income	54.70	69.77	38.88	40.46	34.50	42.89
EPS	4.30	5.48	0.41	0.43	0.37	0.46
BVPS	7.96	12.39	1.74	2.16	7.94	8.26
RoE	68.75%	53.88%	26.73%	21.86%	4.72%	5.62%
EBIT margin	33.00%	30.00%	22.00%	24.50%	5.50%	6.60%
P/E	6.59	5.16	14.65	14.08	16.63	13.37
P/BVPS	3.55	2.29	3.46	2.77	0.77	0.74
EV/EBITDA	4.48	3.46	12.14	11.06	1.66	1.60

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## 1 Software and hardware charts in 2011

In the US and Europe, 2011 software charts were dominated by Activision Blizzard's hit-title "Call of Duty: Modern Warfare 3", which again beat its own record. Only in the US and UK, the game sold more than 6.5m copies within 24 hours after release and generated sales of c. USD 400m. No other form of entertainment has ever reached such a figure in history. Other games, which had top rankings on both sides of the Atlantic, were Nintendo's "Pokemon Black/White version" and Ubisoft's "Just Dance 3". In calendar year 2011, Ubisoft sold more than 13m copies of its Dance titles and was a leader of the casual game segment.

### Software charts USA, 2011

Pos	Title	Publisher
1	Call of Duty: Modern Warfare 3 (X360)	Activision
2	Kinect Adventures!	Microsoft
3	Pokemon Black/White Version	Nintendo
4	Call of Duty: Modern Warfare 3 (PS3)	Activision
5	Just Dance 3 (Wii)	Ubisoft
6	Gears of War (X360)	Microsoft
7	Battlefield 3 (X360)	Electronic Arts
8	The Elder Scrolls V: Skyrim	Bethesda Softworks
9	Mario Kart Wii	Nintendo
10	Wii Sports	Nintendo

Source: Dr. Kalliwoda Research GmbH, VGChartz.com

**Software charts Europe, 2011**

Pos	Title	Publisher
1	Call of Duty: Modern Warfare 3 (PS3)	Activision
2	Call of Duty: Modern Warfare 3 (X360)	Activision
3	FIFA Soccer 12 (PS3)	Electronic Arts
4	Pokemon Black/White Version	Nintendo
5	Just Dance 3 (Wii)	Ubisoft
6	FIFA Soccer 12 (X360)	Electronic Arts
7	Wii Sports	Nintendo
8	Wii Sports Resort	Nintendo
9	Mario Kart Wii	Nintendo
10	Zumba Fitness	505 Games

Source: Dr. Kalliwoda Research GmbH, VGChartz.com

The hardware charts from March 2012 show that most consoles, which have been on the market for several years, sold worse than in the previous year. Only Sony's PS3 and Microsoft's Xbox 360 slightly improved their results. In our view, the reasons for lower sales are the (expected) releases of new devices such as Nintendo 3DS, Wii U or Sony Playstation Vita.

It is worth noting that the current hardware cycle is the longest in history, with current versions of the consoles having been on the market for 5-6 years. Therefore, we expect that Sony, Nintendo and Microsoft will all introduce next generation consoles within the next 18 months.

**Installed hardware base worldwide, March 2012**

Pos	Console/handheld	Number of units sold	change y-o-y
1	Nintendo 3DS	14,417,134	n.a.
2	Sony Playstation 3	14,042,153	+1%
3	Microsoft Xbox 360	13,464,569	+1%
4	Nintendo Wii	11,834,837	-32%
5	Nintendo DS	8,856,307	-57%
6	Sony PSP	7,313,055	-21%
7	Sony Playstation Vita	481,573	n.a.

Source: Dr. Kalliwoda Research GmbH, VGChartz.com

## 2 Future outlook: dynamic growth likely to continue

### 2.1 Market forecasts

In its latest report on the industry, DFC Intelligence forecasts that the global market for video games will grow from USD 66 billion in 2010 to USD 81 billion in 2016 (CAGR of 3.5%). In contrast to other research firms, DFC's volume figures include revenues from console hardware and software (both physical and online), portable hardware and software, PC games and games for mobile devices such as smart phones and tablets.

Similar to PWC or Gartner, the report concludes that the main source of growth in the coming years will be online games, which are expected to grow from USD 19.3bn to USD 37.9bn (CAGR 10-16 of 11.9%). According to DFC, the retail delivery of physical software has been steadily declining since its peak in 2008 and will be surpassed by the online channel in 2013, which benefits from (1) increasing popularity of such portals as steampowered.com or GOG.com and (2) new business models such as subscription-based and free-to-play-with-item-sales games.

As future growth will be primarily driven by the online channel, the gaming platforms, which will likely benefit the most, are PCs and mobile devices (mainly smart phones, tablets). Online games such as "Aion", "Guild Wars 2" or "World of Warcraft" are being played on the PC because they require a broadband internet connection and offer the possibility to compete with gamers from all over the world. According to DFC, a positive aspect of the increasing popularity of online, social and mobile games is that they help expand the audience and the way products are delivered and thus do not take customers away from existing platforms e.g. consoles.

In February 2012, Sony introduced the new handheld Playstation Vita, which is the successor of its successful Playstation Portable (PSP). According to Wikipedia.de, the handheld is a completely new device with several new features such as (1) a GPS sensor (2) 6-axis controller sensor (3) Flash memory cards and (4) 3G modem/WiFi module. In late 2012, Nintendo is expected to release its next generation console Wii U. As social and online games are increasingly popular, DFC estimates that the console will not be as successful as its predecessor Wii, which is the most common current generation console. In contrast to for example the German association USK, DFC believes that Sony and Microsoft will only present new console versions in a few years as PS3 and Xbox 360 continue to generate strong sales.

## 2.2 Market trends

According to US-based company Electronic Arts, which is the second biggest worldwide, the video game industry is currently driven by the following trends:

- (1) **Digital content distribution and services:** Consumers are spending an increasing portion of their budget and time on interactive entertainment that is accessible online, through mobile digital devices (e.g. smart phones) or social networks (e.g. Facebook).
- (2) **Advances in mobile technology:** The introduction of fast wireless internet connections, smart phones with sophisticated graphics and displays as well as tablets that are increasingly popular with different groups of customers has resulted in new sales models, such as subscription services, online downloads for a one-time fee, and advertising-supported free-to-play games.
- (3) **Wireless and other emerging platforms:** Due to technological advances a variety of platforms has been introduced, which in overall broaden the customer base for the video games industry. Examples include wireless technologies, streaming gaming service and internet-connected TVs.
- (4) **Concentration of sales among the most popular games:** Today, a larger portion of physical game sales is concentrated on the most popular titles, which are typically sequels of prior games. The biggest video games companies have responded to this trend by significantly reducing the number of games that they produce.
- (5) **Catalog sales:** Nowadays, many console games experience sales cycles that are shorter than in the past, which leads to decreasing catalog sales. The video games companies have responded by offering their consumers a direct-to-consumer service (such as “head-to-head” play or other multiplayer options) and/or additional content available through online services, which further enhance the gaming experience and extend the time that consumers play the games after their initial purchase.
- (6) **Used games:** The market for used video games is experiencing a strong growth. Used games are usually priced lower than new video games and do not result in revenue to the publisher of the games from the sale.

## 2.3 Most expected games in the next 12 months

The tables below show titles, which were most expected by gamers in March 2012. A top position in these charts usually results in very good sales for the respective titles. Especially, EA's games such as "Mass Effect 3" and "The Sims 3" perform well in the rankings, which is in our view one of the reasons, why the company's stock is currently relatively expensive.

### Pre-order charts USA, March 2012

Pos	Title	Publisher	Release
1	Mass Effect 3 Xbox	Electronic Arts	Mar 12
2	Diablo 3	Activision Blizzard	n.a.
3	Tom Clancy's Ghost Recon: Future Soldier	Ubisoft	May 12
4	Kinect Star Wars	Microsoft	Apr 12
5	Mass Effect 3 PS3	Electronic Arts	Mar 12
6	Halo 4	Microsoft	n.a.
7	Resident Evil: Operation Raccoon City Xbox	Capcom	Apr 12
8	Resident Evil: Operation Raccoon City PS3	Capcom	Apr 12
9	Xenoblade Chronicles	Nintendo	Apr 12
10	SSX	Electronic Arts	Mar 12

Source: Dr. Kalliwoda Research GmbH, VGChartz.com

### Pre-order charts UK, March 2012

Pos	Title	Publisher	Release
1	Mass Effect 3 Xbox	Electronic Arts	Mar 12
2	Mass Effect 3 PS3	Electronic Arts	Mar 12
3	FIFA Street Xbox	Electronic Arts	Mar 12
4	Mass Effect 3 PC	Electronic Arts	Mar 12
5	FIFA Street PS3	Electronic Arts	Mar 12
6	The Sims 3: Showtime - Limited Edition	Electronic Arts	Mar 12
7	Street Fighter X Tekken - Special Edition Xbox	Capcom	Mar 12
8	The Sims 3: Showtime - Kate Perry's Edition	Electronic Arts	Mar 12
9	Total War: Shogun 2 Limited Edition	SEGA	Mar 12
10	Street Fighter X Tekken - Special Edition PS3	Capcom	Mar 12

Source: Dr. Kalliwoda Research GmbH, Play.com

**Pre-order charts Germany, March 2012**

Pos	Title	Publisher	Release
1	Mass Effect 3 PC	Electronic Arts	Mar 12
2	The Sims 3 - Showtime (Add-on)	Electronic Arts	Mar 12
3	Mass Effect 3 - N7 Collector's Edition PEGI	Electronic Arts	Mar 12
4	Guild Wars 2	NCsoft	Jun 12
5	The Sims 3 - Showtime Kate Perry's Edition	Electronic Arts	Mar 12
6	TERA	Bluehole Studio/Frogster	May 12
7	Mass Effect 3 - N7 Collector's Edition	Electronic Arts	Mar 12
8	TERA - Collector's Edition	Bluehole Studio/Frogster	May 12
9	The Sims 3 - Traumsuite Accessoires	Electronic Arts	Jan 12
10	Bus-Simulator 2012	TML Studios	Feb 12

Source: Dr. Kalliwoda Research GmbH, Amazon.de



### 3 CD Projekt RED S.A.

**CDPROJEKTRED**

#### Company description

CD Projekt RED S.A. (formerly Optimus S.A.) was founded in 1988 as a company assembling computers and fiscal registers as well as delivering integrated IT solutions to the public sector and large companies. The company also established the leading Polish online portal Onet.pl. In 2009, after the merger of Optimus S.A. with CD Projekt Group (CDP Investment Sp. z o.o.), the company changed its business model towards electronic entertainment. Today, CD Projekt RED S.A. operates in the following business areas: (1) development of video games, especially the international hit-title "The Witcher"; selling licenses to third-party distributors; (2) publishing and distribution of third-party video games, DVD and Blu-ray movies in Poland (including localisation/translation of content); (3) operation of the online portal GOG.com for digital distribution of computer games. Including freelancers, CD Projekt RED S.A. currently employs c. 230 people.

#### Financials

##### CD Projekt RED S.A.

in PLN	2008	2009	2010	2011	2012E	2013E
EPS	0.05	-0.08	-0.06	0.28	0.41	0.43
ROE	21.7%	-48.8%	-8.5%	25.7%	26.7%	21.9%
P/E	120.00	-75.00	-100.00	21.78	14.65	14.08
P/FCF	-54.83	-31.00	55.23	-102.28	49.53	14.86
EV/Sales	12.14	447.80	11.29	4.07	2.85	2.88
EV/EBITDA	185.90	-319.64	661.56	18.02	12.14	11.06
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
P/BVPS	26.02	48.17	4.44	4.52	3.46	2.77

Source: Dr. Kalliwoda Research GmbH, company information

#### Shareholder structure

Holder Name	Position	% O/S
Michał Kiciński	16,261,313	17.1%
Marcin Iwinski	15,810,313	16.7%
PKO TFI	9,000,000	9.5%
TFI Allianz Polska	6,644,570	7.0%
Piotr Nielubowicz	6,092,072	6.4%
Adam Kiciński	3,137,601	3.3%

Source: Dr. Kalliwoda Research GmbH, company website

#### CD Projekt RED S.A.

##### PC and Console

**12.03.2012**

**Reuters: OPTI.WA**  
**Bloomberg: CDR PW**

**Last price: PLN 6.09**  
**Market capitalisat.: PLN 569.70m**  
**Free float: 40.0%**

##### 12-months chart



##### 52 weeks

**High: PLN 9.88**  
**Low: PLN 3.20**

##### Stock performance

**4 weeks: +3.05%**  
**1 year: -17.03%**  
**3 years: +600.00%**

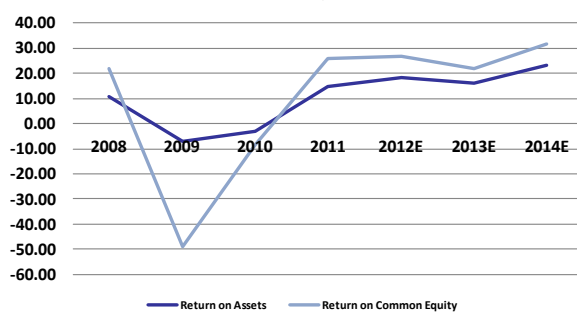
Revenues - yoy growth



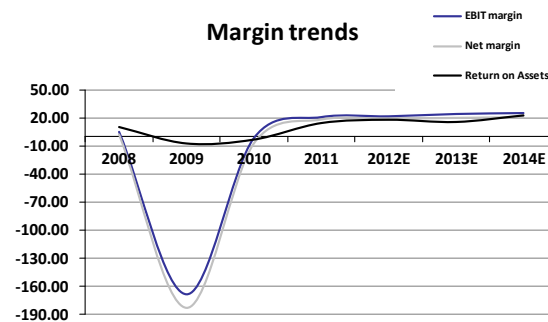
Sales split 2011



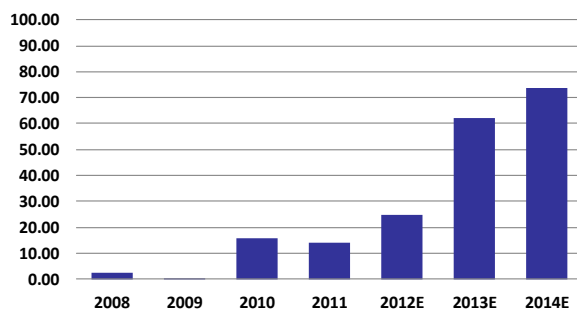
Return development (%)



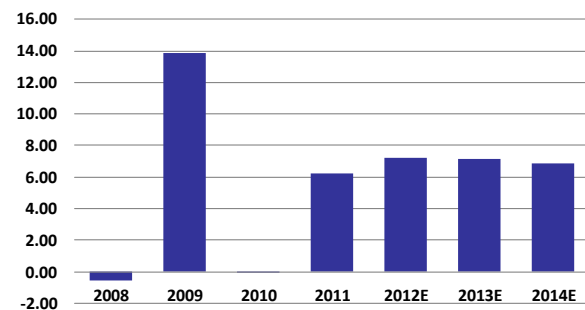
Margin trends



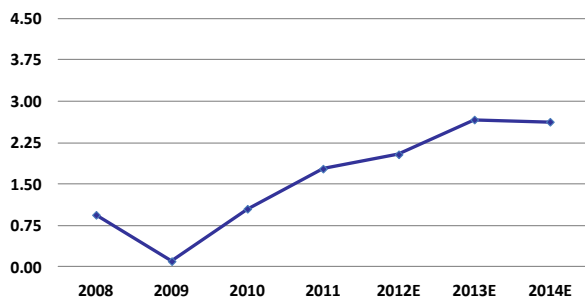
Liquid funds (PLNm)



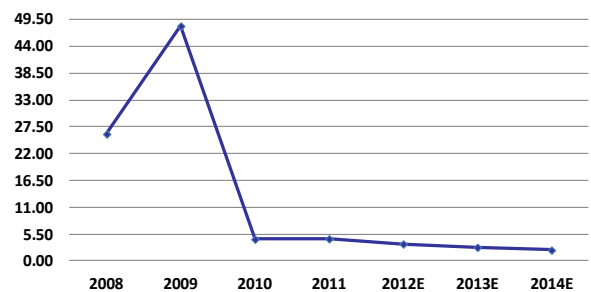
CAPEX (PLNm)



Current ratio



P/BVPS



## SWOT

### Strengths

- Developer and publisher of the internationally well-known title “The Witcher”, which has won numerous awards worldwide since 2007; the game has received excellent ratings on IGN.com and other gaming websites
- “The Witcher 1+2” for PC sold in total 1.5m copies in 2011 (“The Witcher 1”: 400k)
- Operator of GOG.com, the number 1 online distribution platform worldwide for older classical and popular games; older games generate higher gross margins than new ones (c. 80% vs. c. 40%)
- In the distribution segment, CD Projekt RED (CDR) co-operates with the largest video game and entertainment companies worldwide (e.g. Disney, EA, Touchstone Pictures)
- Distribution agreements with the largest Polish retailers e.g. Empik, Media Markt
- Founders of CDR are still shareholders and head the management team
- The RED Engine, CDR’s proprietary games engine, accelerates the production of games and reduces development costs

### Weaknesses

- CDR has only developed “The Witcher 1 & 2” so far
- No presence in the area of online and mobile games
- CDR has only worked with third-party publishers so far, thus generated relatively low gross margins on game sales (only gets 20-30% of the retail price)
- Distribution of DVDs and Blu-rays has limited growth potential due to increasing popularity of online Video-on-Demand services
- Announced move into new games with GOG.com could be difficult due to strong competition e.g. from steampowered.com

### Opportunities

- The US media giant Warner Bros. Interactive Entertainment is in charge of marketing and sales of “The Witcher 2 for Xbox” in North America
- Exploitation of the global popularity of the “The Witcher” brand, especially by the GOG.com platform, which is highly profitable
- Better terms from retailers (higher gross margins) due to the success of “The Witcher”
- New games: “The Witcher 3” in 2014 (KRe), new RPG in 2015, smaller titles
- Expansion into mobile & social games; acquisition of new third-party games and films
- Refund of PLN 35m + interest from the Polish treasury, which sued the company because of VAT debts worth PLN 16.4m in 2001, a decision which was declared illegal by the Polish Highest Administrative Court
- Dividend payments from 2014 possible due to strong cash flow generation

### Threats

- Risk that games do not meet customers’ expectations
- Breach of copyrights
- Currency and interest-rate risk
- Loss of key personnel, especially in the game development segment

## 2011 financial results and outlook

In 2011, CD Projekt RED generated net sales of PLN 140m, which equalled to a y-o-y increase of 177.4% y-o-y, but missed our estimate by 28.4% due to the fact that the release date of “The Witcher 2 for Xbox” was moved from 2011 to 2012. The growth stemmed from CDR’s hit title “The Witcher”, whose second version was introduced on 17 May 2011. Although it had already been released in 2007, the first version of the game also sold well.

Sales of “The Witcher 1+2 for PC” were mainly booked in the segment „Development of games”, which had a share of 31.5% in total sales. The online platform GOG.com, where “The Witcher” games are also available, accounted for 17.8% of total sales. With a net margin of 44.5%, “Development of games” was CDR’s most profitable segment in 2011, while in case of GOG.com, the respective figure was 19.5%. Through its online distribution platform GOG.com CDR currently offers over 300 games from partners such as Electronic Arts, Activision, Codemasters and Ubisoft.

With a share of 49.3%, CDR’s most important segment in terms of sales was however „Publishing & distribution of games, DVDs and Blu-rays”. Between January and December 2011, it generated sales of PLN 69m and a net margin of 0.5%. The segment comprises sales of third-party video games, DVD and Blu-ray movies, which are sold through the most important retail chains in Poland such as Empik, Media Markt, Saturn, Tesco and Carrefour. Both for video games and movies published by CD Projekt in Poland, CDR is usually responsible for the product localization (e.g. translation of content), marketing and PR as well as manufacturing of DVDs/Blu-rays and product packages. For local publishing and distribution, the company has agreements with such well-known entertainment companies as Disney Interactive, Walt Disney Studios Home Entertainment, THQ, Sega, Blizzard, Codemasters, NCsoft, Polsat and Wizards of the Coast.

## 2011 financial results vs. our estimates and previous year

in PLNm	2011	2011E	2010	2011 vs 2011E	2011 vs 2010
<b>Net sales</b>	<b>139.95</b>	<b>195.56</b>	<b>50.45</b>	-28.4%	177.4%
<b>EBITDA</b>	<b>31.60</b>	<b>66.49</b>	<b>0.86</b>	-52.5%	3570.4%
<i>EBITDA margin</i>	22.6%	34.0%	1.7%		
<b>EBIT</b>	<b>29.62</b>	<b>62.58</b>	<b>-0.68</b>	-52.7%	-4488.7%
<i>EBIT margin</i>	21.2%	32.0%	-1.3%		
<b>Net income</b>	<b>26.16</b>	<b>48.81</b>	<b>-3.45</b>	-46.4%	-858.0%
<i>Net margin</i>	18.7%	25.0%	-6.8%		

Source: Dr. Kalliwoda Research GmbH, company information

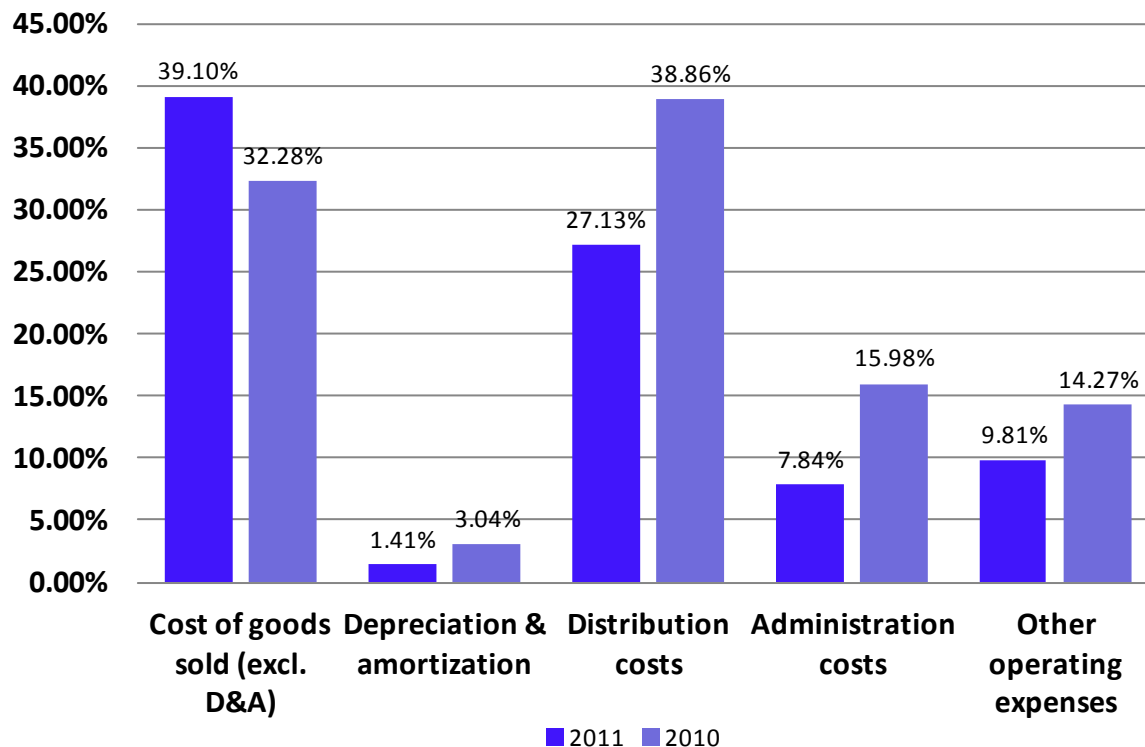
## Sales split according to segments 2011 and 2010

in PLNm	2011	2010
<b>Publishing &amp; distribution of games/DVDs etc.</b> (% of net sales)	<b>69.01</b> 49.3%	<b>36.91</b> 73.2%
<b>Development of games</b> (% of net sales)	<b>44.06</b> 31.5%	<b>1.59</b> 3.1%
<b>GOG.com</b> (% of net sales)	<b>24.89</b> 17.8%	<b>9.28</b> 18.4%
<b>Others</b> (% of net sales)	<b>1.99</b> 1.4%	<b>2.67</b> 5.3%
<b>Total net sales</b>	<b>139.95</b>	<b>50.45</b>

Source: Dr. Kalliwoda Research GmbH, company information

The strong development of high-margin segments “Development of games” and “GOG.com” resulted in significant profit margins. Compared to 2010, EBIT increased from PLN -0.7m to PLN 29.6m and reached a margin of 21.2%. At the same time, the net income improved from a loss of PLN 3.5m in 2010 to a profit of PLN 26.2m. In 2011, CD Projekt RED was able to significantly reduce the share of distribution, administration and other operating costs.

## CDR's cost structure in 2011 and 2010 (as % of net sales)



Source: Dr. Kalliwoda Research GmbH, company information

Despite a strong increase of profitability in 2011, CDR reported an operating cash flow of just PLN 0.7m. The reasons were (1) an increase of trade receivables of PLN 13m, which stemmed from higher “The Witcher 2” open receivables and (2) a reduction of payables amounting to PLN 10m as advances received prior to the release of “The Witcher 2” (payables) were moved to P&L upon the date of release of the game. Together with a cash flow from investing and financing activity of PLN -6.2m and PLN 0.3m respectively, the total cash flow in 2011 amounted to PLN -5.3m. As of 31 December 2011, CDR had cash of PLN 9.8m and financial assets of PLN 4.2m. With interest-bearing debt of PLN 14m and equity of PLN 126m, the net gearing amounted to -0.1%.

### Our forecasts

in PLNm	2012E		2013E		2014E	
	old	new	old	new	old	new
<b>Net sales</b>	<b>122.86</b>	<b>199.61</b>	<b>196.96</b>	<b>198.09</b>	<b>315.07</b>	<b>344.07</b>
<b>EBITDA</b>	<b>39.32</b>	<b>46.91</b>	<b>68.94</b>	<b>51.50</b>	<b>103.97</b>	<b>92.90</b>
<i>EBITDA margin</i>	32.0%	23.5%	35.0%	26.0%	33.0%	27.0%
<b>EBIT</b>	<b>36.86</b>	<b>43.92</b>	<b>65.00</b>	<b>48.53</b>	<b>97.67</b>	<b>87.74</b>
<i>EBIT margin</i>	30.0%	22.0%	33.0%	24.5%	31.0%	25.5%
<b>Net income</b>	<b>29.52</b>	<b>38.88</b>	<b>53.43</b>	<b>40.46</b>	<b>80.62</b>	<b>73.19</b>
<i>Net margin</i>	24.0%	19.5%	27.1%	20.4%	25.6%	21.3%

Source: Dr. Kalliwoda Research GmbH

### Sales model

in PLNm	2012E	2013E	2014E
<b>Publishing &amp; distribution of games/DVDs etc.</b>	<b>85.78</b>	<b>75.49</b>	<b>68.88</b>
<i>(change y-o-y)</i>	24.3%	-12.0%	-8.8%
<i>(% of total sales)</i>	43.0%	38.1%	20.0%
<b>Development of games</b>	<b>62.60</b>	<b>52.31</b>	<b>120.33</b>
<i>(change y-o-y)</i>	42.1%	-16.4%	130.0%
<i>(% of total sales)</i>	31.4%	26.4%	35.0%
<b>Digital distribution of games (GOG.com)</b>	<b>49.22</b>	<b>68.26</b>	<b>152.81</b>
<i>(change y-o-y)</i>	97.8%	38.7%	123.9%
<i>(% of total sales)</i>	24.7%	34.5%	44.4%
<b>Others</b>	<b>2.01</b>	<b>2.03</b>	<b>2.05</b>
<i>(change y-o-y)</i>	1.0%	1.0%	1.0%
<i>(% of total sales)</i>	1.0%	1.0%	0.6%
<b>Total net sales</b>	<b>199.61</b>	<b>198.09</b>	<b>344.07</b>
<b>Game sales in k units</b>			
<b>The Witcher 1+2 for PC</b>	<b>900</b>	<b>400</b>	<b>200</b>
<b>The Witcher 2 for Xbox</b>	<b>700</b>	<b>350</b>	<b>200</b>
<b>The Witcher 2 for PS3</b>		<b>650</b>	<b>300</b>
<b>The Witcher 3 for PC/Xbox/PS3</b>			<b>2,000</b>

Source: Dr. Kalliwoda Research GmbH

Due to new information about its strategy and planned releases we have adjusted our estimates for CD Projekt RED. For 2012, we now expect revenues of PLN 199.6m (previously: PLN 122.9m), with “The Witcher 1+2” contributing 1.6m units (thereof 700k “The Witcher 2 for Xbox”). CDR also announced that it wants to publish two smaller proprietary titles in 2012, which will however only have neglectable sales potential in our view. In 2013, we believe that the company will release “The Witcher 2 for PS3”. Our sales estimate is PLN 198.1m (PLN 197m), with “The Witcher” selling in total 1.4m units.

Based on CDR’s strategy, which was announced in Q4/11, it is in our view likely that the company will release “The Witcher 3” in 2014 and after that a sequel every two years. In 2015, CDR will in our view publish a RPG with a similar sales potential to “The Witcher”, for which it will also release a new version every second year.

Despite new releases and a dynamic growth of high-margin GOG.com platform, we forecast that the overall margin trend will be negative from 2014. CDR puts its focus on high-quality RPGs, which cost much, however so far have not generated a high ROI. Also, we do not welcome the plan to start selling new high-quality games on GOG.com, which is market leader in the niche for older classical games, as (1) new games generate gross margins of only c. 40% (most get the developers) vs. 80% for older games and (2) GOG.com would face intense competition, especially from market leader steampowered.com.

After adjusting our model, we have increased our price target from previously **PLN 5.01** to **PLN 6.21** and our recommendation from **Reduce** to **Hold**. We still favour other video game companies due to (1) CDR’s dependence on “The Witcher 1+2” (2) its Distribution & Publishing segment, which in our view will suffer from the increasing popularity of Video-on-Demand services and (3) the stock’s high multiples valuation. Our price target is a weighted average of our DCF model (70%) and peer group (30%).



## DCF model

For our DCF model, we have used the following assumptions:

- Risk-free rate of 5.5%, which is the current yield of long-term Polish government bonds
- Beta of 1.10
- Target equity ratio of 100%
- Terminal sales growth rate of 3%
- Effective tax rate of 17.3% (company has tax-loss carry forwards; in Cyprus, where GOG.com is registered, corporate tax rate is 10% vs. 19% in Poland)
- Sales assumptions:
  - ➔ 2012E: Our estimate is PLN 199.6m (+42.6% y-o-y); we assume sales of “The Witcher 1+2” of in total 1.6m copies, thereof 700k of “The Witcher 2 for Xbox”; GOG.com should grow the most (+97.8% to PLN 49.2m);
  - ➔ 2013E: Our estimate is PLN 198.1m (-0.8% y-o-y), we assume sales of “The Witcher 1+2” of in total 1.4m copies (400k PC, 350k Xbox, 650k PS3); the segments “Distribution & publishing of games, DVDs and Blu-rays” and “Development of games” should again contribute the most (64.5%); we forecast high-margin GOG.com to generate 34.5% of total sales
- EBIT assumptions:
  - ➔ 2012E: We forecast PLN 43.9m (+48.2% y-o-y, 22% margin); main reason should be strong revenues of “The Witcher 1+2”; also excellent performance of high-margin GOG.com; in our view the operating margin will be negatively affected by lower other operating income y-o-y (PLN 3.9m vs. PLN 9.1m), which in 2011 was affected by dissolution of reserves for licenses among others
  - ➔ 2013E: Our forecast is PLN 48.5m (+10.5% y-o-y, 24.5% margin); we believe there will be a positive effect from “The Witcher 1+2” and growth of high-margin GOG.com; however, after 2014E, when we expect the release of “The Witcher 3”, we forecast that the EBIT margin will go down due to (1) increasing costs associated with development and marketing of new games due to high quality requirements by customers (2) margin pressure on GOG.com and (3) competition from Video-on-Demand services, which will negatively affect the Distribution & Publishing segment



in PLNm	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Total revenues</b>	<b>199.61</b>	<b>198.09</b>	<b>344.07</b>	<b>306.05</b>	<b>254.43</b>	<b>451.05</b>	<b>344.92</b>	<b>293.04</b>	<b>490.16</b>
(y-o-y change)	42.6%	-0.8%	73.7%	-11.0%	-16.9%	77.3%	-23.5%	-15.0%	67.3%
<b>EBIT</b>	<b>43.92</b>	<b>48.53</b>	<b>87.74</b>	<b>74.37</b>	<b>58.77</b>	<b>98.78</b>	<b>71.40</b>	<b>57.14</b>	<b>89.70</b>
(operating margin)	22.0%	24.5%	25.5%	24.3%	23.1%	21.9%	20.7%	19.5%	18.3%
<b>NOPLAT</b>	<b>38.83</b>	<b>40.29</b>	<b>72.56</b>	<b>61.51</b>	<b>48.60</b>	<b>81.69</b>	<b>59.05</b>	<b>47.26</b>	<b>74.18</b>
+ Depreciation & amortisation	2.99	2.97	5.16	4.59	3.82	6.77	5.17	4.40	7.35
= Net operating cash flow	41.83	43.26	77.72	66.10	52.42	88.46	64.22	51.65	81.53
- Total investments (Capex and WC)	-24.45	-5.09	-46.89	7.06	10.87	-57.67	23.62	9.40	-53.24
Capital expenditure	-7.22	-7.17	-6.86	-6.29	-5.52	-8.47	-6.87	-6.10	-9.05
Working capital	-17.23	2.08	-40.03	13.35	16.39	-49.20	30.50	15.50	-44.19
= Free cash flow (FCF)	17.37	38.17	30.83	73.15	63.29	30.79	87.84	61.06	28.30
<b>PV of FCF's</b>	<b>15.98</b>	<b>31.62</b>	<b>23.01</b>	<b>49.19</b>	<b>38.34</b>	<b>16.80</b>	<b>43.19</b>	<b>27.05</b>	<b>11.29</b>
PV of FCFs in explicit period	256.47								
PV of FCFs in terminal period	361.62								
<b>Enterprise value (EV)</b>	<b>618.09</b>								
+ Net cash / - net debt	0.10								
<b>Shareholder value</b>	<b>618.19</b>								
<b>Number of shares outstanding (m)</b>	<b>94.95</b>								
<b>WACC</b>	<b>11.0%</b>								
Cost of equity	11.0%								
Pre-tax cost of debt	6.0%								
Normal tax rate	17.3%								
After-tax cost of debt	5.0%								
Share of equity	100.0%								
Share of debt	0.0%								
<b>Fair value per share in PLN (today)</b>	<b>6.51</b>								
<b>Fair value per share in PLN (in 12 months)</b>	<b>7.23</b>								

## Terminal EBIT margin

	15.3%	16.3%	17.3%	18.3%	19.3%	20.3%	21.3%
<b>7.0%</b>	13.24	13.91	14.58	15.26	15.93	16.60	17.27
<b>8.0%</b>	10.54	11.04	11.53	12.03	12.52	13.02	13.51
<b>9.0%</b>	8.74	9.12	9.50	9.89	10.27	10.65	11.03
<b>10.0%</b>	7.46	7.76	8.06	8.36	8.66	8.97	9.27
<b>11.0%</b>	6.50	6.74	6.98	<b>7.23</b>	7.47	7.71	7.96
<b>12.0%</b>	5.75	5.95	6.15	6.35	6.55	6.75	6.95
<b>13.0%</b>	5.15	5.32	5.48	5.65	5.82	5.98	6.15

Source: Dr. Kalliwoda Research GmbH

With WACC (Weighted Average Cost of Capital) of 11%, our 12-months DCF-based fair value for CD Projekt RED is **PLN 7.23**.

## Peer Group Analysis

	EV/Sales		EV/EBIT		P/E		EBITDA margin	Net gearing	P/BVPS
Company	2012E	2013E	2012E	2013E	2012E	2013E	Latest	Latest	Latest
Electronic Arts (USD)	0.99x	0.97x	8.17x	6.87x	15.02x	11.65x	-6.27%	-55.50%	2.53
Take-Two Interactive Software (USD)	0.70x	0.96x	4.03x	10.41x	5.64x	13.93x	15.55%	-22.04%	2.21
Activision Blizzard (USD)	2.20x	2.12x	6.89x	6.38x	12.58x	11.31x	37.88%	-33.60%	1.30
Ubisoft Entertainment (EUR)	0.57x	0.55x	8.90x	8.24x	12.96x	12.18x	5.69%	11.65%	0.85
City Interactive (PLN)	1.83x	1.29x	5.53x	4.32x	6.70x	5.25x	33.42%	-23.67%	6.31
Shanda Games (USD)	0.96x	0.87x	3.44x	3.10x	5.47x	4.94x	35.93%	-46.82%	1.59
NCSOFT Corporation (KRW)	7.42x	5.41x	15.79x	13.34x	30.23x	14.75x	27.66%	-35.06%	7.23
<b>Median</b>	<b>0.99x</b>	<b>0.97x</b>	<b>6.89x</b>	<b>6.87x</b>	<b>12.58x</b>	<b>11.65x</b>	<b>27.66%</b>	<b>-33.60%</b>	<b>2.21</b>
CD Projekt RED (PLN)	2.87x	2.89x	13.03x	11.79x	14.65x	14.08x	22.58%	-0.08%	4.52
<b>Premium/Discount</b>	<b>189.2%</b>	<b>198.2%</b>	<b>89.3%</b>	<b>71.5%</b>	<b>16.5%</b>	<b>20.9%</b>			
<b>Fair value CD Projekt RED (PLN)</b>	<b>3.47</b>								

Source: Dr. Kalliwoda Research GmbH, Thomson Reuters Knowledge

Compared to our peers, CD Projekt RED looks expensive on all trading multiples. The high valuation is in our opinion not justified as the company (1) depends on one title “The Witcher” (2) is not yet present in the fast-growing areas of online and mobile games and (3) its “Distribution & Publishing” segment and GOG.com platform will likely face margin pressure in the next years.

Based on our peer group, the fair value of CD Projekt RED is **PLN 3.47**.

### Profit and loss statement

in PLNm	2008	2009	2010	2011	2012E	2013E	2014E	2015E
<b>Revenues</b>	<b>46.92</b>	<b>1.27</b>	<b>50.45</b>	<b>139.95</b>	<b>199.61</b>	<b>198.09</b>	<b>344.07</b>	<b>306.05</b>
Cost of goods sold	-41.93	-0.77	-16.28	-54.73	-76.85	-76.07	-131.78	-116.91
Depreciation	-0.57	-0.37	-1.54	-1.98	-2.99	-2.97	-5.16	-4.59
<b>Gross profit</b>	<b>4.41</b>	<b>0.13</b>	<b>32.63</b>	<b>83.25</b>	<b>119.77</b>	<b>119.05</b>	<b>207.13</b>	<b>184.55</b>
Other operating income	8.57	4.82	1.56	9.06	3.90	4.10	4.30	4.52
Distribution expenses	-4.45	-1.02	-19.60	-37.97	-49.70	-49.13	-84.99	-75.29
Administration costs	-5.36	-4.22	-8.06	-10.98	-15.97	-18.36	-21.12	-24.29
Other operating expenses	-0.68	-1.87	-7.20	-13.73	-14.08	-7.13	-17.59	-15.12
<b>EBIT</b>	<b>2.49</b>	<b>-2.15</b>	<b>-0.68</b>	<b>29.62</b>	<b>43.92</b>	<b>48.53</b>	<b>87.74</b>	<b>74.37</b>
Net financial result	-1.22	-0.18	-0.30	-0.22	0.05	0.20	0.76	1.88
<b>EBT</b>	<b>1.28</b>	<b>-2.33</b>	<b>-0.98</b>	<b>29.41</b>	<b>43.97</b>	<b>48.73</b>	<b>88.50</b>	<b>76.25</b>
Income taxes	0.00	0.00	-1.88	-3.25	-5.09	-8.28	-15.31	-13.19
Net result of acquired entities	0.00	0.00	-0.59	0.00	0.00	0.00	0.00	0.00
<b>Net income / loss</b>	<b>1.28</b>	<b>-2.33</b>	<b>-3.45</b>	<b>26.16</b>	<b>38.88</b>	<b>40.46</b>	<b>73.19</b>	<b>63.06</b>
EBITDA	3.06	-1.78	0.86	31.60	46.91	51.50	92.90	78.96
EPS	0.05	-0.08	-0.06	0.28	0.41	0.43	0.77	0.66
DPS	0.00	0.00	0.00	0.00	0.00	0.00	0.15	0.13

Source: Dr. Kalliwoda Research GmbH, company information

**Balance sheet**

in PLNm	2008	2009	2010	2011	2012E	2013E	2014E	2015E
<b>Current assets</b>	<b>16.82</b>	<b>2.36</b>	<b>77.88</b>	<b>97.74</b>	<b>139.22</b>	<b>171.46</b>	<b>256.29</b>	<b>283.06</b>
Inventories	1.37	0.72	27.74	31.10	41.14	38.22	61.89	51.06
Trade accounts and notes receivables	12.99	1.12	17.87	31.57	43.39	41.43	69.14	58.98
Tax receivables	0.08	0.00	0.63	1.63	2.33	2.31	4.01	3.57
Other receivables	0.06	0.40	1.10	1.23	1.75	1.74	3.01	2.68
Prepaid expenses	0.04	0.10	14.95	18.16	25.90	25.71	44.65	39.72
Liquid funds	2.27	0.03	15.61	14.05	24.70	62.05	73.58	127.05
<b>Non-current assets</b>	<b>6.94</b>	<b>32.87</b>	<b>89.63</b>	<b>90.76</b>	<b>94.46</b>	<b>98.66</b>	<b>100.64</b>	<b>102.26</b>
Property, plant and equipment	6.79	6.44	9.07	9.92	10.15	10.35	10.55	10.75
Investments in subsidiaries	0.07	26.39	0.00	0.00	0.00	0.00	0.00	0.00
Deferred tax assets	0.00	0.00	0.65	0.64	0.00	0.00	0.00	0.00
Other assets	0.02	0.00	0.26	0.27	0.38	0.38	0.66	0.59
Intangible assets	0.06	0.03	72.80	77.92	81.92	85.92	87.42	88.92
Goodwill	0.00	0.00	6.85	2.00	2.00	2.00	2.00	2.00
<b>Total assets</b>	<b>23.75</b>	<b>35.23</b>	<b>167.51</b>	<b>188.50</b>	<b>233.68</b>	<b>270.11</b>	<b>356.92</b>	<b>385.32</b>
<b>Current liabilities</b>	<b>17.81</b>	<b>22.45</b>	<b>73.89</b>	<b>54.88</b>	<b>68.22</b>	<b>64.21</b>	<b>97.44</b>	<b>82.87</b>
Short-term bank debt	0.00	0.25	23.60	13.41	12.41	11.41	10.41	9.41
Short-term leasing	0.00	0.03	0.17	0.20	0.28	0.28	0.49	0.43
Trade payables	14.30	2.02	28.09	33.90	45.08	42.12	68.63	57.05
Tax payables	0.06	0.00	0.05	0.16	0.23	0.23	0.40	0.36
Other payables	0.62	19.33	21.52	6.22	8.86	8.80	15.28	13.59
Deferred revenues	0.00	0.00	0.02	0.09	0.13	0.13	0.22	0.20
Pension provisions	0.00	0.00	0.00	0.21	0.23	0.25	0.28	0.31
Other provisions	2.83	0.82	0.44	0.70	1.00	1.00	1.73	1.54
<b>Long-term liabilities</b>	<b>0.05</b>	<b>9.16</b>	<b>15.96</b>	<b>7.61</b>	<b>0.57</b>	<b>0.57</b>	<b>0.96</b>	<b>0.86</b>
Long-term bank debt	0.00	9.06	9.50	0.00	0.00	0.00	0.00	0.00
Long-term leasing	0.00	0.08	0.00	0.11	0.15	0.15	0.27	0.24
Deferred tax liabilities	0.00	0.01	6.31	6.86	0.00	0.00	0.00	0.00
Deferred revenues	0.00	0.00	0.11	0.34	0.00	0.00	0.00	0.00
Pension provisions	0.02	0.01	0.03	0.03	0.03	0.03	0.03	0.03
Other provisions	0.02	0.00	0.01	0.01	0.01	0.01	0.01	0.01
Other long-term liabilities	0.00	0.00	0.00	0.27	0.38	0.38	0.65	0.58
<b>Shareholder's equity</b>	<b>5.90</b>	<b>3.62</b>	<b>77.67</b>	<b>126.01</b>	<b>164.88</b>	<b>205.34</b>	<b>258.53</b>	<b>301.59</b>
<b>Total shareholder's equity and liabilities</b>	<b>23.75</b>	<b>35.23</b>	<b>167.51</b>	<b>188.50</b>	<b>233.68</b>	<b>270.11</b>	<b>356.92</b>	<b>385.32</b>

Source: Dr. Kalliwoda Research GmbH, company information

**Ratios**

Fiscal year	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Gross margin	9.41%	10.53%	64.68%	59.48%	60.00%	60.10%	60.20%	60.30%
EBITDA margin	6.53%	-140.09%	1.71%	22.58%	23.50%	26.00%	27.00%	25.80%
EBIT margin	5.32%	-169.03%	-1.34%	21.17%	22.00%	24.50%	25.50%	24.30%
Net margin	2.73%	-182.78%	-6.84%	18.69%	19.48%	20.42%	21.27%	20.60%
Return on equity (ROE)	21.68%	-48.85%	-8.49%	25.69%	26.73%	21.86%	31.56%	22.52%
Return on assets (ROA)	10.50%	-7.29%	-3.11%	14.82%	18.39%	15.98%	23.10%	16.49%
Return on capital employed (ROCE)	41.95%	-16.83%	-2.11%	19.72%	23.47%	19.57%	27.96%	20.34%
Net debt (in PLNm)	-2.24	9.40	17.69	-0.10	-11.60	-49.92	-62.11	-116.63
Net gearing	-38.04%	259.56%	22.78%	-0.08%	-7.03%	-24.31%	-24.03%	-38.67%
Equity ratio	24.83%	10.28%	46.36%	66.85%	70.56%	76.02%	72.43%	78.27%
Current ratio	0.94	0.11	1.05	1.78	2.04	2.67	2.63	3.42
Quick ratio	0.86	0.05	0.45	0.83	1.00	1.61	1.46	2.24
Net interest cover	2.05	-12.29	-2.23	137.79	-878.30	-242.67	-114.87	-39.56
Net debt/EBITDA	-0.73	-5.27	20.55	0.00	-0.25	-0.97	-0.67	-1.48
Book value per share	0.23	0.12	1.35	1.33	1.74	2.16	2.72	3.18
CAPEX/Sales	n.a	-0.63%	166.08%	2.22%	3.62%	3.62%	1.99%	2.06%
Working capital/Sales	-0.91%	-1495.20%	24.75%	30.71%	30.16%	29.35%	28.53%	27.71%
EV/Sales	12.14	447.80	11.29	4.07	2.85	2.88	1.66	1.86
EV/EBITDA	185.90	-319.64	661.56	18.02	12.14	11.06	6.13	7.21
EV/EBIT	228.39	-264.93	-843.85	19.23	12.97	11.74	6.49	7.66
P/BVPS	26.02	48.17	4.44	4.52	3.46	2.77	2.20	1.89
P/E	120.00	-75.00	-100.00	21.78	14.65	14.08	7.78	9.03
P/FCF	-54.83	-31.00	55.23	-102.28	49.53	14.86	17.70	7.65

Source: Dr. Kalliwoda Research GmbH, company information



## 4 City Interactive S.A.

### Company description

City Interactive S.A., which was founded in 2002, is a Polish developer, publisher and distributor of proprietary and third-party video games. The company's product portfolio includes logical, adventure and sport games as well as car races, shooters and simulators. Its most popular franchise is the shooter "Sniper – Ghost Warrior", of which it has sold over 2m copies worldwide since June 2010. City Interactive is based in Warsaw/Poland and has additional offices in Germany, UK, Romania, Canada and the US. Currently, it has c. 190 employees (KRe).

### Financials

#### City Interactive S.A.

in PLN	2008	2009	2010	2011	2012E	2013E
EPS	0.03	-1.07	2.13	1.34	4.30	5.48
ROE	1.3%	-57.7%	90.0%	33.6%	68.8%	53.9%
P/E	919.71	-26.86	13.55	21.54	6.70	5.25
P/FCF	-28.44	-78.24	21.09	56.68	15.80	8.03
EV/Sales	11.74	11.85	4.07	4.29	1.76	1.25
EV/EBITDA	75.05	-63.71	8.73	12.84	4.57	3.52
Dividend yield	0.0%	0.0%	0.0%	0.9%	3.0%	3.8%
P/BVPS	11.97	21.68	8.48	6.31	3.62	2.33

Source: Dr. Kalliwoda Research GmbH, company information

### Shareholder structure

Holder Name	Position	% O/S
Marek Tyminski	6,475,794	51.2%
Aviva Investors Poland	683,104	5.4%

Source: Dr. Kalliwoda Research GmbH, company website

## City Interactive S.A.

PC, Console, Online & Mobile

12.03.2012

Reuters: CIAT.WA

Bloomberg: CIA PW

Last price: **PLN 28.31**  
 Market capitalisation: **PLN 358.12m**  
 Free float: **43.4%**

### 12-months chart



### 52 weeks

High: **PLN 37.00**  
 Low: **PLN 16.12**

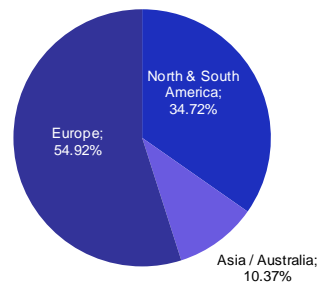
### Stock performance

4 weeks: **-5.32%**  
 1 year: **-2.38%**  
 3 years: **+316.32%**

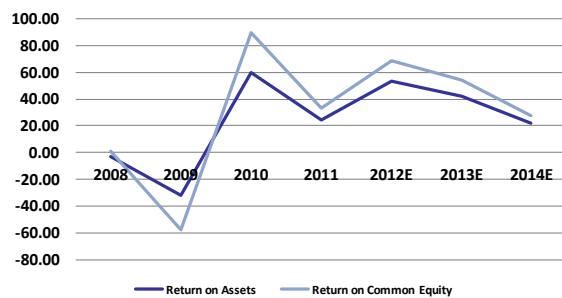
Revenues - yoy growth



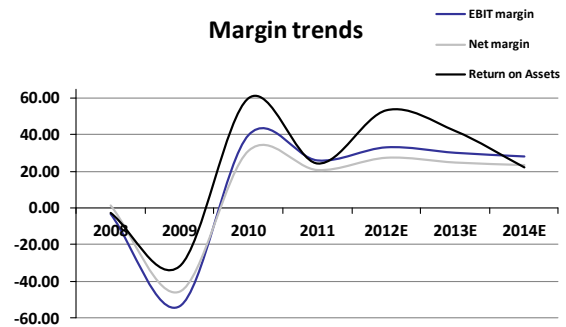
Sales split 2011



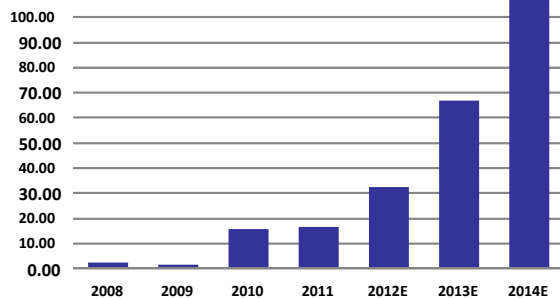
Return development (%)



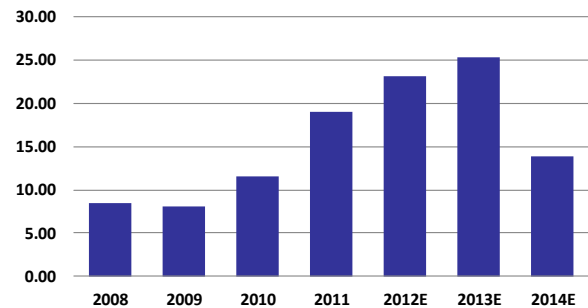
Margin trends



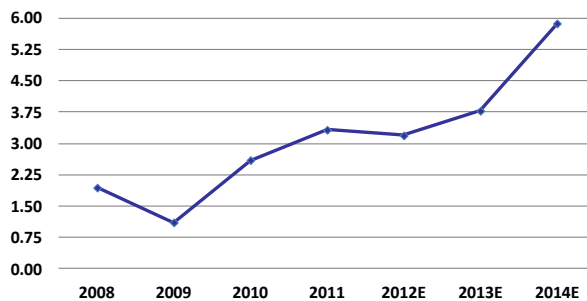
Liquid funds (PLNm)



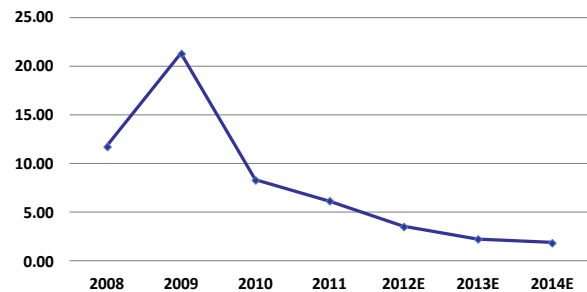
CAPEX (PLNm)



Current ratio



P/BVPS



## SWOT

### Strengths

- With more than 2m copies sold since June 2010, “Sniper – Ghost Warrior” has been a big international success and has strongly increased City Interactive’s (CI) brand recognition worldwide
- Development of “Sniper – Ghost Warrior” only took two years and cost PLN 3m
- International presence through offices in Germany, UK, Romania and North America and distribution co-operations in other regions
- In-house Polish development team costs less than development in Western Europe and ensures control over quality of the games
- Licenses for technologically advanced game engines such as “CryEngine 3” and “Unreal Engine 3”
- Strict cost control
- CEO & founder holds majority of CI’s shares
- Net margin of >25% and strong balance sheet with significant net cash
- Highly qualified and experienced development team with successful product market deliveries (e.g. Stuart Black)

### Weaknesses

- “Sniper” is CI’s by far biggest title in terms of sales
- Reviews of CI’s most other games on gaming websites and magazines have been mediocre
- The release of “Sniper 2” has been postponed twice

### Opportunities

- Promising game pipeline: “Sniper for iPhone/iPad/iPod touch”, “Sniper 2”, “Enemy Front”, “Combat Wings” and “Alien Fear” in 2012; “Sniper 3”, a new RPG and “World of Mercenaries” (online free-to-play first person shooter) in 2013
- Stronger focus on high-quality games, increasing share of console games and expansion into online & mobile games should translate into higher profits
- More diversified product portfolio, thus less risk
- Stronger position with distributors due to the international success of “Sniper – Ghost Warrior” and higher sales from digital distribution should improve gross margins
- Dividend payments possible from 2012 due to high operating cash flows

### Threats

- There is a risk that new games do not meet the expectations of the gaming community
- Most important competitors e.g. Electronic Arts are much stronger financially
- Breach of copyrights and currency risks
- Loss of key personnel
- High investments in the short-term due to several new titles and expansion into online and mobile games

## 2011 financial results and outlook

In 2011, City Interactive (CI) generated total sales of PLN 81.7m (KRe: PLN 77.1m), which corresponded to a decrease of 5.1% y-o-y. On the one hand, revenues were positively impacted by the introduction of “Sniper – Ghost Warrior for PS3” in Europe, North America and Japan and “Sniper Gold Edition”, a version of the game with additional weapons and missions. However, on the other hand CI lowered its prices for “Sniper – Ghost Warrior for PC and Xbox”. In our view, CI sold in total 1.1m copies of “Sniper” between January and December 2011, thereof c. 800k for the Sony PS3 console. Since June 2010, when the PC and Xbox 360 versions were released, the number of units sold has reached over 2m copies.

In July 2011, CI introduced “Sniper” in Japan, the second-biggest gaming market worldwide after the US. As the game has been well-received by Japanese customers, the share of Asia & Australia in CI’s total sales increased from 3.7% in 2010 to 10.4%.

## 2011 financial results vs. our estimates and 2010

in PLNm	2011	2011E	2010	2011 vs 2011E	2011 vs 2010
<b>Net sales</b>	<b>81.72</b>	<b>77.10</b>	<b>86.07</b>	6.0%	-5.1%
<b>EBITDA</b>	<b>27.31</b>	<b>27.48</b>	<b>40.17</b>	-0.6%	-32.0%
<i>EBITDA margin</i>	33.4%	35.6%	46.7%		
<b>EBIT</b>	<b>21.12</b>	<b>21.97</b>	<b>34.19</b>	-3.9%	-38.2%
<i>EBIT margin</i>	25.8%	28.5%	39.7%		
<b>Net income</b>	<b>16.91</b>	<b>17.82</b>	<b>26.89</b>	-5.1%	-37.1%
<i>Net margin</i>	20.7%	23.1%	31.2%		

Source: Dr. Kalliwoda Research GmbH, company information

## Sales split according to segments 2011 vs. 2010

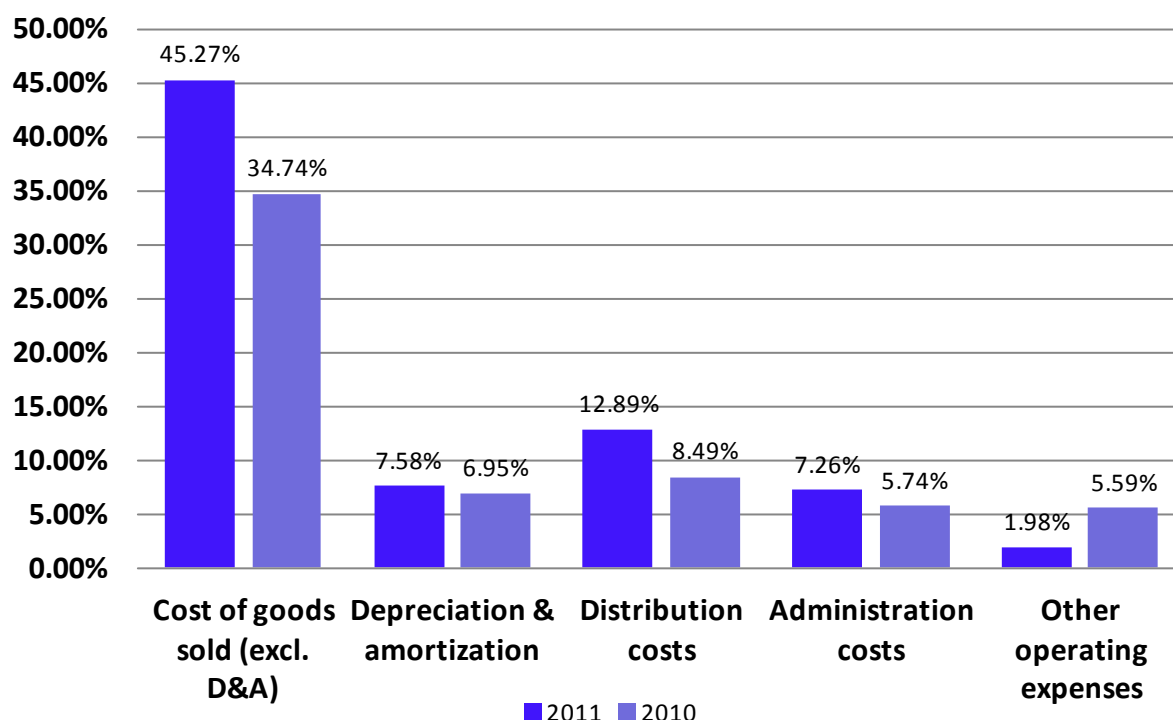
in PLNm	2011	2010
<b>Europe</b>	<b>44.88</b>	<b>43.88</b>
<i>(% of net sales)</i>	54.9%	51.0%
<b>North America</b>	<b>28.37</b>	<b>39.01</b>
<i>(% of net sales)</i>	34.7%	45.3%
<b>Asia &amp; Australia</b>	<b>8.47</b>	<b>3.18</b>
<i>(% of net sales)</i>	10.4%	3.7%
<b>Total net sales</b>	<b>81.72</b>	<b>86.07</b>

Source: Dr. Kalliwoda Research GmbH, company information



In 2011, EBIT went down by 38.2% to PLN 21.1m (25.8% margin) and net income by 37.1% to PLN 16.9m. The profit margins were lower y-o-y due to the following reasons: (1) the share of console games, which cost more due to license fees for console manufacturers, grew from 71% in 2010 to 89% (2) the limited version “Sniper Gold Edition” with additional features was more expensive to produce than normal versions and (3) CI opened a new studio in Bukarest and invested heavily into the development of new games.

#### City Interactive’s cost structure in 2011 and 2010 (as % of net sales)



Source: Dr. Kalliwoda Research GmbH, company information

Despite a cash inflow from a reduction of working capital (PLN 1m vs. PLN -6.4m in 2010), the operating cash flow decreased from PLN 28.8m in 2010 to PLN 25.5m due to lower net income. The cash outflow from investment activity grew from PLN -11.5m to PLN -19.1m as CI heavily invested into several new games in 2011. The cash outflow from financing activities also increased from PLN -2.9m to PLN -5.2m as the company repaid loans, but in contrast to 2010 did not raise new debt. As of 31 December 2011, CI’s cash position amounted to PLN 16.7m and interest-bearing debt to only PLN 3m, which resulted in a net gearing of -23.7%.

## Our forecasts

in PLNm	2012E		2013E		2014E	
	old	new	old	new	old	new
<b>Net sales</b>	<b>154.25</b>	<b>199.50</b>	<b>213.25</b>	<b>281.40</b>	<b>245.24</b>	<b>203.30</b>
<b>EBITDA</b>	<b>58.62</b>	<b>76.81</b>	<b>72.51</b>	<b>99.62</b>	<b>78.48</b>	<b>67.70</b>
<i>EBITDA margin</i>	38.0%	38.5%	34.0%	35.4%	32.0%	33.3%
<b>EBIT</b>	<b>52.45</b>	<b>65.84</b>	<b>63.98</b>	<b>84.42</b>	<b>68.67</b>	<b>56.92</b>
<i>EBIT margin</i>	34.0%	33.0%	30.0%	30.0%	28.0%	28.0%
<b>Net income</b>	<b>42.83</b>	<b>54.70</b>	<b>53.05</b>	<b>69.77</b>	<b>57.92</b>	<b>47.59</b>
<i>Net margin</i>	27.8%	27.4%	24.9%	24.8%	23.6%	23.4%

Source: Dr. Kalliwoda Research GmbH

## Sales model

in PLNm	2012E	2013E	2014E
<b>Sniper 1+2+3 (PC, Xbox, PS3)</b>	<b>108.00</b>	<b>153.00</b>	<b>63.00</b>
<i>Number of units sold (in k)</i>	1,350	1,800	900
<i>(% of net sales)</i>	54.1%	54.4%	31.0%
<b>Enemy Front (PC, Xbox, PS3)</b>	<b>59.50</b>	<b>30.00</b>	<b>88.00</b>
<i>Number of units sold (in k)</i>	700	500	1,100
<i>(% of net sales)</i>	29.8%	10.7%	43.3%
<b>Other core games (Combat Wings, new RPG etc.)</b>	<b>30.00</b>	<b>96.00</b>	<b>49.50</b>
<i>Number of units sold (in k)</i>	400	1,200	900
<i>(% of net sales)</i>	15.0%	34.1%	24.3%
<b>Low-budget titles/iPhone &amp; online games</b>	<b>2.00</b>	<b>2.40</b>	<b>2.80</b>
<i>(% of net sales)</i>	0.6%	0.5%	0.4%
<b>Total net sales</b>	<b>199.50</b>	<b>281.40</b>	<b>203.30</b>

Source: Dr. Kalliwoda Research GmbH

Accounting for CI's 2011 results and recent news flow, we have adjusted our model. In our view, 2012 and 2013 will set a new record for City Interactive. Due to the announced pipeline of new games we have significantly increased our estimates. In Q1/12, CI plans to introduce "Combat Wings – The Great Battles of World War II", a flight simulation, on PC and all console types. Q2/12 and Q3/12 should however be the best quarters of the year due to the planned releases of "Sniper – Ghost Warrior 2" and "Enemy Front" (a World War II-shooter), which both are expected to generate sales of >1m units.

In 2012, CI will also publish its first mobile game "Sniper for iPhone/iPad/iPod touch" and "Alien Fear", a sci-fi shooter, on which CI had initially worked together with an external studio, but terminated the co-operation agreement. All in all, we expect sales of PLN 199.5m in 2012, EBIT of PLN 65.8m (margin of 33%) and a net profit of PLN 54.7m.

In 2013, we expect the release of “World of Mercenaries”, an online shooter game, “Sniper 3” for all platforms and CI’s first role-playing-game (RPG), for which the company hired a former senior producer of CD Projekt RED’ “The Witcher 2” in 2011. In terms of results, we forecast revenues of PLN 281.4m, EBIT of PLN 84.4m (30% margin) and net income of PLN 69.8m. Beyond 2013, we expect that CI will publish a new version of its core titles every two years.

Due to the increase of estimates our 12-months price target for City Interactive, which is now a weighted average of our DCF model (70%) and peer group (30%), goes up from previously **PLN 34.85 to PLN 36.79**. Hence, with an upside of **29.9%** we reiterate our **Buy** recommendation. We favour City Interactive over CD Projekt RED due to the following reasons: (1) strategic focus on console, mobile and online games (2) promising pipeline of titles, which should diversify revenues and reduce dependence on “Sniper” and (3) very low EV/EBIT and P/E multiples.

### DCF model

For our DCF model, we have used the following assumptions:

- Risk-free rate of 5.5% which is the current yield of long-term Polish government bonds
- Beta of 1.30
- Target equity ratio of 100%
- Terminal sales growth rate of 3%
- Effective tax rate of 19%
- Sales assumptions:
  - ➔ 2012E: +144.1% to PLN 199.5m; we believe CI will sell 150k units of “Sniper 1”, 1.2m of “Sniper 2”, which will be released for PC, Xbox and PS3 simultaneously, 700k of “Enemy Front” (PC/Xbox/PS3) as well as 200k of “Combat Wings” and “Alien Fear” respectively
  - ➔ 2013E: +41% to PLN 281.4m; we expect sales of 600k of “Sniper 2”, 1.2m units of “Sniper 3”, 1m units of the new RPG, 500k units of “Enemy Front” and 100k units of “Combat Wings” and “Alien Fear” respectively; from 2014E we forecast that CI will release a new version of its core titles every two years
- EBIT assumption:
  - ➔ 2012E: +211.8% to PLN 65.8m (33% margin); we expect a positive impact from new releases, especially “Sniper 2” and “Enemy Front”; due to the success of “Sniper 1” CI should be able to get better terms from retailers; also, we expect a higher share of digital distribution, which is much more profitable than retail
  - ➔ 2013E: +28.2% to PLN 84.4m (30% margin); main profit drivers will be “Sniper 3” and the announced RPG; from 2014E we think that margins will go down due to (1) high development and marketing costs of new products as customers’ quality requirements increase and (2) intensifying competition

in PLNm	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Total revenues</b>	<b>199.50</b>	<b>281.40</b>	<b>203.30</b>	<b>287.78</b>	<b>207.30</b>	<b>294.22</b>	<b>211.30</b>	<b>309.52</b>	<b>215.30</b>
(y-o-y change)	144.1%	41.1%	-27.8%	41.6%	-28.0%	41.9%	-28.2%	46.5%	-30.4%
<b>EBIT</b>	<b>65.84</b>	<b>84.42</b>	<b>56.92</b>	<b>74.82</b>	<b>49.75</b>	<b>64.73</b>	<b>42.26</b>	<b>55.71</b>	<b>34.45</b>
(operating margin)	33.0%	30.0%	28.0%	26.0%	24.0%	22.0%	20.0%	18.0%	16.0%
<b>NOPLAT</b>	<b>53.68</b>	<b>68.69</b>	<b>46.13</b>	<b>60.61</b>	<b>40.30</b>	<b>52.43</b>	<b>34.23</b>	<b>45.13</b>	<b>27.90</b>
+ Depreciation & amortisation	10.97	15.20	10.77	14.96	10.57	14.71	10.35	14.86	10.12
= Net operating cash flow	64.65	83.89	56.90	75.57	50.87	67.14	44.58	59.98	38.02
- Total investments (Capex and WC)	-44.70	-39.59	1.13	-32.41	1.14	-31.98	1.23	-33.34	2.73
Capital expenditure	-23.12	-25.35	-13.92	-18.11	-13.72	-17.86	-13.50	-18.01	-13.27
Working capital	-21.58	-14.25	15.06	-14.30	14.87	-14.12	14.73	-15.34	16.00
= Free cash flow (FCF)	19.95	44.30	58.04	43.16	52.01	35.16	45.81	26.64	40.75
<b>PV of FCF's</b>	<b>18.20</b>	<b>36.09</b>	<b>42.22</b>	<b>28.03</b>	<b>30.16</b>	<b>18.21</b>	<b>21.18</b>	<b>11.00</b>	<b>15.02</b>
PV of FCFs in explicit period	220.10								
PV of FCFs in terminal period	113.03								
<b>Enterprise value (EV)</b>	<b>333.13</b>								
+ Net cash / - net debt	13.68								
<b>Shareholder value</b>	<b>346.80</b>								
<b>Number of shares outstanding (m)</b>	<b>12.65</b>								
<b>WACC</b>	<b>12.0%</b>								
Cost of equity	12.0%								
Pre-tax cost of debt	6.0%								
Normal tax rate	19.0%								
After-tax cost of debt	4.9%								
Share of equity	100.0%								
Share of debt	0.0%								
<b>Fair value per share in PLN (today)</b>	<b>27.42</b>								
<b>Fair value per share in PLN (in 12 months)</b>	<b>30.71</b>								

## Terminal EBIT margin

	13.0%	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%
<b>8.0%</b>	43.94	45.56	47.17	48.79	50.40	52.02	53.63
<b>9.0%</b>	38.42	39.66	40.90	42.14	43.39	44.63	45.87
<b>10.0%</b>	34.37	35.35	36.34	37.32	38.30	39.28	40.26
<b>11.0%</b>	31.25	32.04	32.84	33.63	34.42	35.21	36.01
<b>12.0%</b>	28.75	29.40	30.05	<b>30.71</b>	31.36	32.01	32.66
<b>13.0%</b>	26.69	27.24	27.78	28.32	28.86	29.40	29.95
<b>14.0%</b>	24.96	25.42	25.88	26.33	26.79	27.24	27.70

Source: Dr. Kalliwoda Research GmbH

With WACC (Weighted Average Cost of Capital) of 12%, our 12-months DCF-based fair value for City Interactive is **PLN 30.71**.

### Peer Group Analysis

Company	EV/Sales		EV/EBIT		P/E		EBITDA margin	Net gearing	P/BVPS
	2012E	2013E	2012E	2013E	2012E	2013E	Latest	Latest	Latest
Electronic Arts (USD)	1.01x	0.98x	8.30x	6.98x	15.20x	11.79x	-6.27%	-55.50%	2.56
Take-Two Interactive Software (USD)	0.68x	0.93x	3.89x	10.06x	5.47x	13.50x	15.55%	-22.04%	2.14
Activision Blizzard (USD)	2.28x	2.20x	7.14x	6.61x	12.91x	11.61x	37.88%	-33.60%	1.33
Ubisoft Entertainment (EUR)	0.60x	0.58x	9.38x	8.68x	13.74x	12.91x	5.69%	11.65%	0.90
CD Projekt RED (PLN)	2.83x	2.85x	12.86x	11.64x	14.46x	13.89x	22.58%	-0.08%	4.46
Shanda Games (USD)	0.82x	0.74x	2.91x	2.62x	4.88x	4.41x	35.93%	-46.82%	1.42
NCSOFT Corporation (KRW)	7.19x	5.24x	15.30x	12.92x	29.33x	14.31x	27.66%	-35.06%	7.02
<b>Median</b>	<b>1.01x</b>	<b>0.98x</b>	<b>8.30x</b>	<b>8.68x</b>	<b>13.74x</b>	<b>12.91x</b>	<b>22.58%</b>	<b>-33.60%</b>	<b>2.14</b>
City Interactive (PLN)	1.76x	1.25x	5.33x	4.15x	6.70x	5.25x	33.42%	-23.67%	6.31
<b>Premium/Discount</b>	<b>74.6%</b>	<b>26.6%</b>	<b>-35.8%</b>	<b>-52.2%</b>	<b>-51.2%</b>	<b>-59.3%</b>			
<b>Fair value City Interactive (PLN)</b>	<b>45.51</b>								

Source: Dr. Kalliwoda Research GmbH, Thomson Reuters Knowledge

Currently, City Interactive looks very cheap on EV/EBIT and P/E multiples. We do not think that this is justified due to its promising game pipeline and excellent profitability compared to the peer group median.

Based on our peer group, the fair value of City Interactive is **PLN 45.51**.

## Profit and loss statement

in PLNm	2008	2009	2010	2011	2012E	2013E	2014E	2015E
<b>Revenues</b>	<b>29.88</b>	<b>29.60</b>	<b>86.07</b>	<b>81.72</b>	<b>199.50</b>	<b>281.40</b>	<b>203.30</b>	<b>287.78</b>
Cost of goods sold	-9.31	-11.64	-29.90	-36.99	-83.79	-116.78	-89.45	-120.87
Depreciation	-5.69	-10.43	-5.98	-6.19	-10.97	-15.20	-10.77	-14.96
<b>Gross profit</b>	<b>14.88</b>	<b>7.53</b>	<b>50.19</b>	<b>38.53</b>	<b>104.74</b>	<b>149.42</b>	<b>103.07</b>	<b>151.95</b>
Other operating income	0.50	0.73	1.06	0.67	0.70	0.74	0.77	0.81
Distribution expenses	-8.61	-10.09	-7.31	-10.54	-24.94	-35.18	-25.41	-35.97
Administration costs	-5.74	-4.66	-4.94	-5.93	-8.90	-11.57	-13.30	-15.30
Other operating expenses	-2.05	-9.43	-4.81	-1.62	-5.77	-19.00	-8.21	-26.67
<b>EBIT</b>	<b>-1.02</b>	<b>-15.93</b>	<b>34.19</b>	<b>21.12</b>	<b>65.84</b>	<b>84.42</b>	<b>56.92</b>	<b>74.82</b>
Net financial result	1.68	-0.66	-1.65	1.19	1.25	1.32	1.80	3.68
<b>EBT</b>	<b>0.66</b>	<b>-16.59</b>	<b>32.54</b>	<b>22.30</b>	<b>67.09</b>	<b>85.74</b>	<b>58.72</b>	<b>78.50</b>
Income taxes	-0.27	3.03	-5.65	-5.39	-12.39	-15.97	-11.14	-14.92
<b>Net income / loss</b>	<b>0.39</b>	<b>-13.56</b>	<b>26.89</b>	<b>16.91</b>	<b>54.70</b>	<b>69.77</b>	<b>47.59</b>	<b>63.59</b>
EBITDA	4.67	-5.50	40.17	27.31	76.81	99.62	67.70	89.79
EPS	0.03	-1.07	2.13	1.34	4.30	5.48	3.74	5.00
DPS	0.00	0.00	0.00	0.27	0.86	1.10	1.12	1.50

Source: Dr. Kalliwoda Research GmbH, company information

## Balance sheet

in PLNm	2008	2009	2010	2011	2012E	2013E	2014E	2015E
<b>Current assets</b>	<b>27.00</b>	<b>20.75</b>	<b>42.83</b>	<b>41.77</b>	<b>91.38</b>	<b>148.03</b>	<b>167.36</b>	<b>218.84</b>
Inventories	3.68	5.52	5.24	4.95	10.97	14.97	11.22	14.83
Prepayments	0.00	0.00	1.25	1.05	2.56	3.62	2.61	3.70
Short-term borrowings	2.14	0.08	0.90	0.41	0.99	1.39	1.01	1.43
Trade accounts and notes receivables	16.50	10.95	17.18	14.53	34.37	46.94	32.80	44.85
Tax receivables	1.87	2.30	2.25	3.04	7.42	10.46	7.56	10.70
Cash & cash equivalents	2.24	1.42	15.52	16.70	32.38	66.86	109.42	139.45
Other current assets	0.56	0.48	0.48	1.10	2.69	3.79	2.74	3.88
<b>Non-current assets</b>	<b>17.75</b>	<b>14.96</b>	<b>16.79</b>	<b>28.90</b>	<b>38.66</b>	<b>48.82</b>	<b>51.97</b>	<b>55.12</b>
Property, plant and equipment	1.42	0.59	0.44	1.39	1.54	1.69	1.84	1.99
Other assets	0.00	0.00	0.00	0.04	0.04	0.04	0.04	0.04
Investments in subsidiaries	0.00	0.00	0.01	0.02	0.02	0.02	0.02	0.02
Deferred tax assets	1.39	4.10	3.22	2.39	0.00	0.00	0.00	0.00
Intangible assets	14.94	10.27	13.11	25.06	37.06	47.06	50.06	53.06
Goodwill	0.01	0.00	0.00	0.01	0.01	0.01	0.01	0.01
<b>Total assets</b>	<b>44.75</b>	<b>35.71</b>	<b>59.62</b>	<b>70.66</b>	<b>130.04</b>	<b>196.85</b>	<b>219.33</b>	<b>273.96</b>
<b>Current liabilities</b>	<b>13.89</b>	<b>18.67</b>	<b>16.45</b>	<b>12.55</b>	<b>28.61</b>	<b>39.12</b>	<b>28.48</b>	<b>38.29</b>
Short-term commercial bond	0.00	5.03	5.02	0.00	0.00	0.00	0.00	0.00
Short-term bank loan	2.66	2.04	0.00	0.00	0.00	0.00	0.00	0.00
Short-term financial lease	0.17	0.18	0.11	2.98	7.28	10.26	7.41	10.49
Tax payables	1.12	0.48	1.09	0.90	2.20	3.10	2.24	3.17
Trade payables	6.12	9.20	9.30	7.55	16.41	21.92	16.05	20.70
Other short-term liabilities	3.82	1.74	0.93	1.12	2.73	3.85	2.78	3.93
<b>Long-term liabilities</b>	<b>0.68</b>	<b>0.24</b>	<b>0.20</b>	<b>0.34</b>	<b>0.09</b>	<b>0.12</b>	<b>0.09</b>	<b>0.12</b>
Pension provision	0.04	0.01	0.01	0.02	0.02	0.02	0.02	0.02
Leasing	0.27	0.09	0.05	0.03	0.07	0.10	0.07	0.10
Deferred tax assets	0.37	0.15	0.13	0.30	0.00	0.00	0.00	0.00
<b>Shareholder's equity</b>	<b>30.18</b>	<b>16.80</b>	<b>42.96</b>	<b>57.77</b>	<b>101.34</b>	<b>157.61</b>	<b>190.76</b>	<b>235.55</b>
<b>Total shareholder's equity and liabilities</b>	<b>44.75</b>	<b>35.71</b>	<b>59.62</b>	<b>70.66</b>	<b>130.04</b>	<b>196.85</b>	<b>219.33</b>	<b>273.96</b>

Source: Dr. Kalliwoda Research GmbH, company information

**Ratios**

Fiscal year	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Gross margin	49.80%	25.43%	58.31%	47.15%	52.50%	53.10%	50.70%	52.80%
EBITDA margin	15.64%	-18.59%	46.67%	33.42%	38.50%	35.40%	33.30%	31.20%
EBIT margin	-3.41%	-53.83%	39.72%	25.84%	33.00%	30.00%	28.00%	26.00%
Net margin	1.31%	-45.82%	31.25%	20.70%	27.42%	24.79%	23.41%	22.10%
Return on equity (ROE)	1.30%	-57.73%	89.99%	33.58%	68.75%	53.88%	27.32%	29.83%
Return on assets (ROA)	-2.88%	-32.08%	59.87%	24.14%	53.26%	41.88%	22.00%	24.29%
Return on capital employed (ROCE)	-1.96%	-76.41%	65.45%	27.55%	52.92%	43.55%	24.17%	25.72%
Net debt (in PLNm)	0.90	5.92	-10.32	-13.68	-25.01	-56.48	-101.92	-128.84
Net gearing	2.97%	35.21%	-24.02%	-23.67%	-24.68%	-35.83%	-53.43%	-54.70%
Equity ratio	67.45%	47.06%	72.06%	81.76%	77.93%	80.07%	86.97%	85.98%
Current ratio	1.94	1.11	2.60	3.33	3.19	3.78	5.88	5.71
Quick ratio	1.35	0.66	1.99	2.49	2.33	2.91	4.99	4.81
Net interest cover	0.61	-24.28	20.78	-17.77	-52.67	-63.95	-31.62	-20.34
Net debt/EBITDA	0.19	-1.08	-0.26	-0.50	-0.33	-0.57	-1.51	-1.43
Book value per share	2.41	1.33	3.40	4.57	7.96	12.39	14.99	18.51
CAPEX/Sales	n.a	16.7%	10.1%	23.4%	11.6%	9.0%	6.8%	6.3%
Working capital/Sales	38.68%	26.45%	17.53%	18.47%	18.38%	18.10%	17.64%	17.43%
EV/Sales	11.53	11.64	4.00	4.22	1.73	1.22	1.69	1.20
EV/EBITDA	73.72	-62.58	8.57	12.61	4.48	3.46	5.09	3.84
EV/EBIT	-337.65	-21.62	10.08	16.31	5.23	4.08	6.05	4.60
P/BVPS	11.76	21.31	8.34	6.20	3.55	2.29	1.89	1.53
P/E	904.06	-26.41	13.32	21.18	6.59	5.16	7.57	5.67
P/FCF	-27.95	-76.91	20.73	55.71	15.53	7.89	6.02	7.76

Source: Dr. Kalliwoda Research GmbH, company information



## 5 Ubisoft Entertainment SA

### Company description

Ubisoft Entertainment SA is a French company that is engaged in the development, publishing and distribution of video games. Its product portfolio includes such titles as "Assassin's Creed", "Just Dance", "Tom Clancy's Rainbow Six", "Rayman", "Tom Clancy's Splinter Cell", "Prince of Persia" and "Driver". Ubisoft Entertainment SA operates through subsidiaries, which are located in 26 countries, such as France, Spain, Germany, United States and China. The company's distribution network covers more than 55 countries around the world. Currently, Ubisoft employs more than 6,700 people worldwide.

### Financials

#### Ubisoft Entertainment SA

in €	FY 08	FY 09	FY 10	FY 11E	FY 12E	FY 13E
EPS	0.74	-0.46	-0.55	0.37	0.46	0.49
ROE	9.2%	-5.8%	-7.1%	4.7%	5.6%	5.8%
P/E	8.23	-13.24	-11.07	16.63	13.37	12.41
P/FCF	-238.25	-5.32	13.77	-5.27	32.99	26.11
EV/Sales	0.58	0.71	0.59	0.58	0.54	0.52
EV/EBITDA	2.66	1.90	1.80	1.66	1.60	1.51
Dividend yield	0.0%	0.0%	0.0%	0.0%	2.2%	2.4%
P/BVPS	0.75	0.76	0.81	0.77	0.74	0.71

Source: Dr. Kalliwoda Research GmbH, company information

### Shareholder structure

Holder Name	Position	% O/S
Fidelity Management & Research Company	10,813,340	11.4%
Guillemot Family	10,635,654	11.2%
Invesco Canada Ltd.	9,554,422	10.1%

## Ubisoft Entertainment SA

### PC, Console & Online Games

12.03.2012

Reuters: **UBIP.PA**

Bloomberg: **UBI FP**

Last price: **€6.09**  
 Market capitalisation: **€578.27m**  
 Free float: **67.3%**

#### 12-month chart

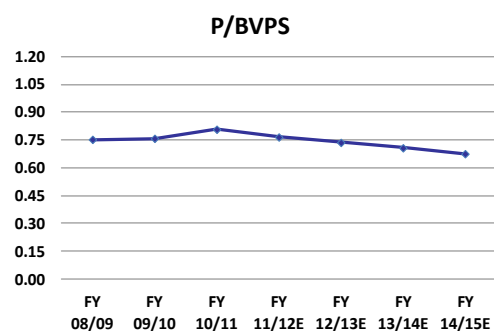
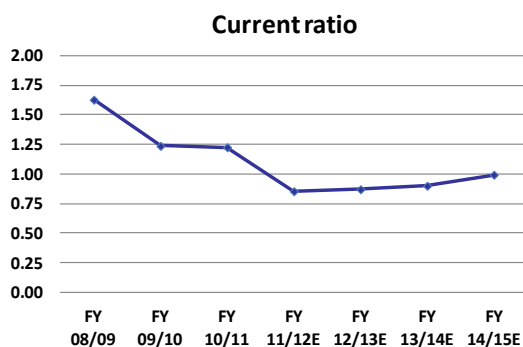
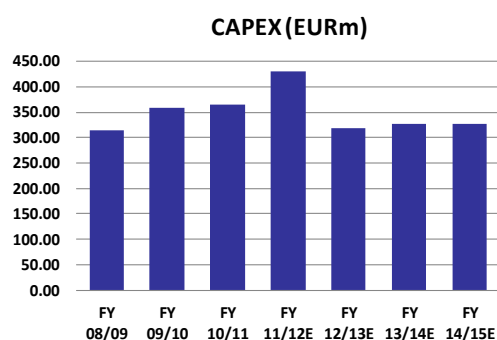
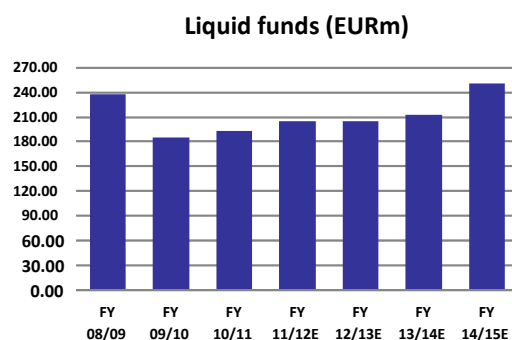
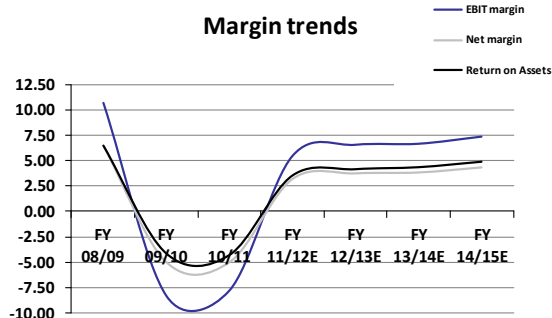
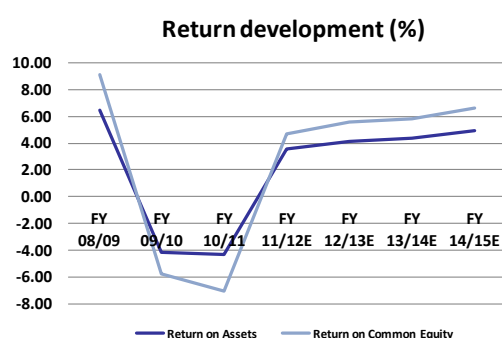
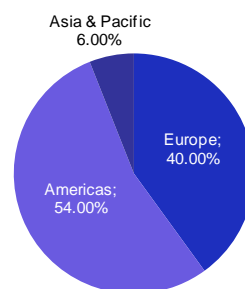


#### 52 weeks

High: **€7.83**  
 Low: **€3.57**

#### Stock performance

4 weeks: **-1.77%**  
 1 year: **-16.80%**  
 3 years: **-49.04%**

**Sales split 2010/11**



## SWOT

### Strengths

- 3<sup>rd</sup> independent publisher of games in the US and Europe
- Ubisoft's "Assassin's Creed" and "Just Dance" franchises are among the most popular worldwide
- "Assassin's Creed" has received excellent rankings on major gaming sites such as IGN.com, Amazon and Gamespot.com
- Strong focus on online games and digital distribution, which are the fastest-growing segments of the video games industry; "The Settlers Online", "Heroes of Might & Magic", "Owlient's Howrse" and "Trackmania 2" are all popular online/social games
- Stock-option program for employees, who consistently overachieve performance goals
- Ubisoft has the second-largest creative force in the industry; its Montreal-based studio was ranked the Top 5 most innovative worldwide
- Truly global company with sales in 55 countries
- Has developed an innovative anti-piracy system for PC games
- Management & founders are among the biggest shareholders
- Stock trades below book value and far below median P/BVPS of peers

### Weaknesses

- High CAPEX of 20-30% of yearly sales due to continuous development of several high-quality core titles; proprietary titles made up 97% of total sales in 9M 2011/12
- High net debt (30/09/11: €101.4m) compared to peers

### Opportunities

- Introduction of new titles e.g. shooters, games for new consoles (e.g. Sony's Playstation Vita)
- Higher margins due to the focus on fewer high-quality titles for consoles and a strongly growing share of the online business
- Further expansion into online and social games with Owlient, Nadeo (development studios), UPlay, ManiaPlanet (online game portals) and Quazal Technologies (technology provider for online games)
- Exploitation of the popularity of e.g. the "Assassin's Creed" franchise through the sale of related books, comics, toys and short movies
- Potential represented by the revamping of strong franchises like FarCry, Ghost Recon, Rainbow Six, Splinter Cell

### Threats

- Risk that games do not meet customer expectations
- Legal risks relating to the violation of intellectual property rights
- Strong competition by larger and financially more potent players such as Electronic Arts or Activision Blizzard
- Currency risks
- Loss of key employees

## H1 2011/12 financial results and outlook

In H1 2011/12, which ended on 30 September 2011, Ubisoft Entertainment generated total sales of €248.5m, which were 4.6% lower y-o-y, but 8% higher on constant exchange rates. Between October and December 2011, revenues amounted to €652m (guidance: €650m, +8.8% y-o-y, +11% on constant exchange rates), which was a consequence of the Christmas season. In the first nine months of fiscal-year 2011, Ubisoft benefitted especially from excellent sales of the Dance titles (c. +30% y-o-y, e.g. “Just Dance 3”, “Michael Jackson The Experience”) and “Assassin’s Creed Revelations” (c. 7m units sold) as well as a 159% growth of the Online segment, which comprises sales from online distribution and games such as “The Smurfs on Facebook”, “The Settlers Online” “Trackmania 2” and “Owlients Howrse”.

## H1/11 financial results vs. our estimates and previous year

in EURm	H1 11/12	H1 11/12E	H1 10/11	H1/11 vs H1/11E	H1/11 vs H1/10
<b>Net sales</b>	<b>248.46</b>	<b>210.00</b>	<b>260.54</b>	18.3%	-4.6%
<b>EBITDA</b>	<b>10.87</b>	-	<b>21.50</b>		-49.4%
<i>EBITDA margin</i>	4.4%	-	8.3%		
<b>EBIT</b>	<b>-54.81</b>	-	<b>-133.75</b>		-59.0%
<i>EBIT margin</i>	-22.1%	-	-51.3%		
<b>Net income</b>	<b>-37.11</b>	<b>-50.00</b>	<b>-89.78</b>	-25.8%	-58.7%
<i>Net margin</i>	-14.9%	-23.8%	-34.5%		

Source: Dr. Kalliwoda Research GmbH, company information

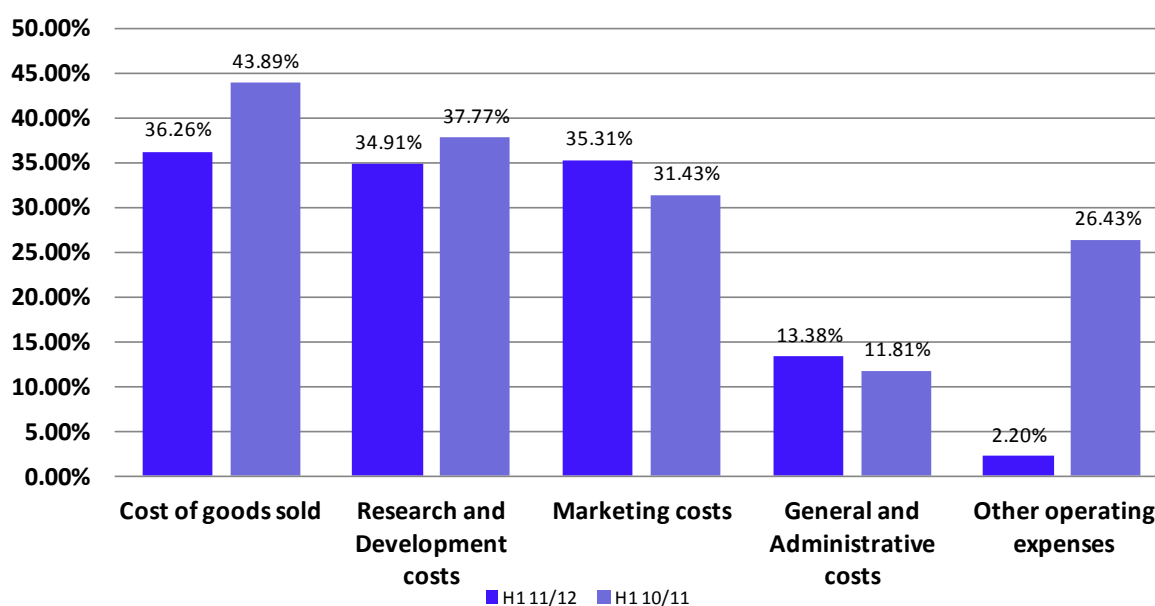
## Sales split according to regions H1/11 vs. H1/10

in EURm	H1 11/12	H1 10/11
<b>Europe</b>	<b>99.38</b>	<b>101.61</b>
<i>(% of net sales)</i>	40.0%	39.0%
<b>North America</b>	<b>121.74</b>	<b>135.48</b>
<i>(% of net sales)</i>	49.0%	52.0%
<b>Rest of the world</b>	<b>27.33</b>	<b>23.45</b>
<i>(% of net sales)</i>	11.0%	9.0%
<b>Total net sales</b>	<b>248.46</b>	<b>260.54</b>

Source: Dr. Kalliwoda Research GmbH, company information

As the share of the Online segment reached 12% and Ubisoft was able to sell its back catalog titles more profitably, the gross margin in H1 2011/12 went up from 56.1% in the previous year to 63.7%. Together with a significantly lower share of other operating expenses (2.2% vs. 26.4% in H1 2010/11), which last year comprised reorganisation expenses of development studios, this reduced the operating loss from €133.8m to €54.8m y-o-y. The net loss went down from €89.8m to €37.1m and was affected by a much lower tax refund y-o-y (€19.5m vs. €45.6m).

### Ubisoft's cost structure in H1 2011/12 and H1 2010/12 (as % of net sales)



Source: Dr. Kalliwoda Research GmbH, company information

Despite the improvement of net income in H1 2011/12, the operating cash flow went down from €51.8m to €1.7m. The main reason were much higher depreciation & amortisation expenses in the previous year (€155.3m vs. €65.7m in H1 2011/12), which were related to reorganisation measures in development studios. Between April and September 2011, Ubisoft invested €10.7m into its working capital, while in H1 2010/11 it reported a cash inflow of €21m from disinvestments.

Together with a cash flow from investing and financing activity of €-197.9m and €-2.2m respectively, Ubisoft generated a total cash outflow of €203.7m. As of 30 September 2011, Ubisoft had net debt of €101.4m as short-term borrowings increased from €92.7m in March 2011 to €236.5m.

### Our forecasts

in EURm	2011/12E				2012/13E		2013/14E	
	H2E	Guidance	old	new	old	new	old	new
<b>Net sales</b>	<b>826.05</b>	<b>1050-1080</b>	<b>1074.50</b>	<b>1074.51</b>	<b>1133.60</b>	<b>1138.78</b>	<b>1191.42</b>	<b>1198.76</b>
<b>EBITDA</b>	<b>360.37</b>	-	<b>450.89</b>	<b>371.24</b>	<b>465.25</b>	<b>386.00</b>	<b>485.74</b>	<b>409.37</b>
<i>EBITDA margin</i>	43.6%	-	42.0%	34.5%	41.0%	33.9%	40.8%	34.1%
<b>EBIT</b>	<b>113.91</b>	<b>45-65</b>	<b>46.20</b>	<b>59.10</b>	<b>74.82</b>	<b>75.16</b>	<b>79.82</b>	<b>80.32</b>
<i>EBIT margin</i>	13.8%	-	4.3%	5.5%	6.6%	6.6%	6.7%	6.7%
<b>Net income</b>	<b>71.60</b>	-	<b>26.76</b>	<b>34.50</b>	<b>45.39</b>	<b>42.89</b>	<b>49.62</b>	<b>46.22</b>
<i>Net margin</i>	8.7%	-	2.5%	3.2%	4.0%	3.8%	4.2%	3.9%

Source: Dr. Kalliwoda Research GmbH

## Sales model

in EURm	2011/12E	2012/13E	2013/14E
<b>Assassin's Creed</b>	<b>225.92</b>	<b>227.84</b>	<b>229.76</b>
Number of units sold (in k)	7,060	7,120	7,180
(% of net sales)	21.0%	20.0%	19.2%
<b>Dance titles</b>	<b>353.70</b>	<b>343.44</b>	<b>324.00</b>
Number of units sold (in k)	13,100	12,720	12,000
(% of net sales)	32.9%	30.2%	27.0%
<b>Other games e.g. Ghost Recon, Splinter Cell</b>	<b>414.89</b>	<b>415.50</b>	<b>417.00</b>
Number of units sold (in k)	16,596	16,620	16,680
(% of net sales)	38.6%	36.5%	34.8%
<b>Online segment</b>	<b>80.00</b>	<b>152.00</b>	<b>228.00</b>
(change y-o-y)	n.a	90.0%	50.0%
(% of net sales)	7.4%	13.3%	19.0%
<b>Total net sales</b>	<b>1,074.51</b>	<b>1,138.78</b>	<b>1,198.76</b>

Source: Dr. Kalliwoda Research GmbH

After strong fiscal Q3 2011/12, when sales were in-line with Ubisoft's increased guidance of €650m, Q4 should be weaker due to lower spending after the Christmas season and fewer new releases than in Q4 2010/11. Ubisoft guides for Q4 sales between €150m and 180m, which should lead to fiscal 2011/12 revenues of €1,050m-1,080m (our estimate is €1,075m). The company's EBIT guidance is €45m-65m vs. our forecast of €59.1m.

For fiscal-year 2012/13, Ubisoft forecasts an improvement of sales and operating profit as well as a positive operating cash flow. This is supposed to be achieved through more releases of core games e.g. Dance titles, shooter games, and dynamic growth of online operations (social/online games and online distribution).

In our model, we have assumed a modest growth of the number of units sold in case of Ubisoft's most important franchise "Assassin's Creed" and other games e.g. "Splinter Cell", however for casual games e.g. Dance titles we have forecast decreasing sales. In our view, the sales growth will be primarily generated by the online segment, which should also have a positive impact on margins. We like Ubisoft's strategy, which consists of offering an online version of all core games as it is in our opinion the right response to market trends.

We have adjusted our estimates for Ubisoft and lowered the WACC, which has increased the company's DCF-based fair value. After taking into account the peer group (30% weight), which shows the company trading at a significant discount to its peers, we have determined a 12-months price target of **€7.79** (previously: **€5.46**). Our new recommendation for the stock is **Buy (Accumulate)** with an upside of **27.9%**.

## DCF model

For our DCF model, we have used the following assumptions:

- Risk-free rate of 3.7%, which is the current yield of long-term French government bonds
- Beta of 1.10
- Target equity ratio of 100%
- Terminal sales growth rate of 2%
- Effective tax rate of 34.4%
- Sales assumptions:
  - ➔ 2011/12E: Our forecast is €1074.5m (+3.4% y-o-y); the company guides for €1050m-1080m; we estimate that sales of “Assassin’s Creed” will reach 7.1m and those of Dance titles 13.1m; the online segment, which comprises online/social games and digital distribution, should reach 7.4% of total sales (€80m)
  - ➔ 2012/13E: +6% to €1138.8m; like Ubisoft we forecast an improvement y-o-y; we believe sales of „Assassin’s Creed“ and other games will slightly increase y-o-y; Dance titles should decrease slightly in terms of the number of units sold; main growth driver should be again the Online segment with sales of €152m (+90% y-o-y, 13.3% share); trend towards Online should remain unchanged beyond 2012/13
- EBIT assumptions:
  - ➔ 2011/12E: €59.1m (5.5% margin) after €-80.5m in 2010/11; Ubisoft guides for €45-65m; main reasons will be in our opinion lower share of R&D and other operating expenses, which last year were impacted by reorganization costs; we also believe that the gross margin will be higher due to dynamic growth of high-margin Online segment;
  - ➔ 2012/13E: +27.2% to €75.2m (6.6% margin); again, main driver will be high-margin Online segment; in the future we expect operating margins of c. 8% as online revenues (digital distribution plus games) continues to grow; on the other hand, we expect high costs associated with development and marketing of core titles as Ubisoft plans to release new versions more often and customers have increasing quality requirements

in EURm	2011/12E	2012/13E	2013/14E	2014/15E	2015/16E	2016/17E	2017/18E	2018/19E	2019/20E
<b>Total revenues</b>	<b>1,074.51</b>	<b>1,138.78</b>	<b>1,198.76</b>	<b>1,263.49</b>	<b>1,329.19</b>	<b>1,395.65</b>	<b>1,458.46</b>	<b>1,516.80</b>	<b>1,562.30</b>
(y-o-y change)	3.4%	6.0%	5.3%	5.4%	5.2%	5.0%	4.5%	4.0%	3.0%
<b>EBIT</b>	<b>59.10</b>	<b>75.16</b>	<b>80.32</b>	<b>93.50</b>	<b>107.66</b>	<b>111.65</b>	<b>115.22</b>	<b>118.31</b>	<b>120.30</b>
(operating margin)	5.5%	6.6%	6.7%	7.4%	8.1%	8.0%	7.9%	7.8%	7.7%
<b>NOPLAT</b>	<b>38.75</b>	<b>49.28</b>	<b>52.66</b>	<b>61.31</b>	<b>70.60</b>	<b>73.21</b>	<b>75.55</b>	<b>77.58</b>	<b>78.88</b>
+ Depreciation & amortisation	284.75	296.08	305.68	315.87	325.65	334.96	342.74	348.86	351.52
= Net operating cash flow	323.50	345.36	358.35	377.18	396.25	408.17	418.29	426.44	430.40
- Total investments (Capex and WC)	-429.93	-321.28	-329.55	-329.98	-339.91	-349.36	-357.53	-364.00	-367.15
Capital expenditure	-430.04	-318.08	-327.68	-327.87	-337.65	-346.96	-354.74	-360.86	-363.52
Working capital	0.10	-3.20	-1.87	-2.11	-2.26	-2.40	-2.79	-3.14	-3.63
= Free cash flow (FCF)	-106.44	24.08	28.80	47.20	56.34	58.81	60.76	62.44	63.25
<b>PV of FCF's</b>	<b>-105.92</b>	<b>21.94</b>	<b>24.02</b>	<b>36.04</b>	<b>39.39</b>	<b>37.64</b>	<b>35.60</b>	<b>33.49</b>	<b>31.06</b>
PV of FCFs in explicit period	181.76								
PV of FCFs in terminal period	452.26								
<b>Enterprise value (EV)</b>	<b>634.02</b>								
+ Net cash / - net debt	-34.27								
<b>Shareholder value</b>	<b>599.75</b>								
<b>Diluted number of shares (m)</b>	<b>95.87</b>								
<b>WACC</b>	<b>9.2%</b>								
Cost of equity	9.2%								
Pre-tax cost of debt	5.0%								
Normal tax rate	34.4%								
After-tax cost of debt	3.3%								
Share of equity	100.0%								
Share of debt	0.0%								
<b>Fair value per share in EUR (today)</b>	<b>6.26</b>								
<b>Fair value per share in EUR (in 12 months)</b>	<b>6.83</b>								

## Terminal EBIT margin

	4.6%	5.6%	6.6%	7.6%	8.6%	9.6%	10.6%
WACC	5.2%	6.2%	7.2%	8.2%	9.2%	10.2%	11.2%
	11.46	8.55	6.73	5.48	4.57	3.87	3.31
	13.83	10.21	7.97	6.44	5.32	4.48	3.81
	16.19	11.87	9.20	7.39	6.08	5.09	4.31
	18.56	13.53	10.43	8.34	6.83	5.70	4.81
	20.93	15.19	11.67	9.29	7.59	6.31	5.32
	23.30	16.85	12.90	10.25	8.34	6.92	5.82
	25.67	18.51	14.14	11.20	9.10	7.53	6.32

Source: Dr. Kalliwoda Research GmbH

With WACC (Weighted Average Cost of Capital) of 9.2%, our 12-months DCF-based fair value for Ubisoft Entertainment is **€6.83**.

## Peer Group Analysis

Company	EV/Sales		EV/EBIT		P/E		EBITDA margin	Net gearing	P/BVPS
	2012E	2013E	2012E	2013E	2012E	2013E	Latest	Latest	Latest
Electronic Arts (USD)	0.99x	0.97x	8.17x	6.87x	15.02x	11.65x	-6.27%	-55.50%	2.53
Take-Two Interactive Software (USD)	0.70x	0.96x	4.03x	10.41x	5.64x	13.93x	15.55%	-22.04%	2.21
Activision Blizzard (USD)	2.20x	2.12x	6.89x	6.38x	12.58x	11.31x	37.88%	-33.60%	1.30
City Interactive (PLN)	1.73x	1.22x	5.23x	4.08x	6.59x	5.16x	33.42%	-23.67%	6.20
CD Projekt RED (PLN)	2.87x	2.89x	13.03x	11.79x	14.65x	14.08x	22.58%	-0.08%	4.52
Shanda Games (USD)	0.96x	0.87x	3.44x	3.10x	5.47x	4.94x	35.93%	-46.82%	1.59
NCSOFT Corporation (KRW)	7.42x	5.41x	15.79x	13.34x	30.23x	14.75x	27.66%	-35.06%	7.23
<b>Median</b>	<b>1.73x</b>	<b>1.22x</b>	<b>6.89x</b>	<b>6.87x</b>	<b>12.58x</b>	<b>11.65x</b>	<b>27.66%</b>	<b>-33.60%</b>	<b>2.53</b>
Ubisoft Entertainment (EUR)	0.59x	0.57x	9.20x	8.52x	12.96x	12.18x	5.69%	14.83%	0.85
<b>Premium/Discount</b>	<b>-65.8%</b>	<b>-53.8%</b>	<b>33.6%</b>	<b>23.9%</b>	<b>3.0%</b>	<b>4.6%</b>			
<b>Fair value Ubisoft (EUR)</b>	<b>9.17</b>								

Source: Dr. Kalliwoda Research GmbH, Thomson Reuters Knowledge

Currently, Ubisoft looks very cheap on sales multiples. In addition, it trades below its book value, while the median P/BVPS of our peers is 2.5x. Despite its relatively low profitability, we do not think that this is justified.

Based on our peer group, the fair value of Ubisoft is **€9.17**.

## Profit and loss statement

in EURm	2008/09	2009/10	2010/11	2011/12E	2012/13E	2013/14E	2014/15E	2015/16E
<b>Revenues</b>	<b>1057.93</b>	<b>870.95</b>	<b>1038.83</b>	<b>1074.51</b>	<b>1138.78</b>	<b>1198.76</b>	<b>1263.49</b>	<b>1329.19</b>
Cost of goods sold	-418.66	-358.12	-365.21	-376.08	-385.42	-393.17	-400.32	-407.20
<b>Gross profit</b>	<b>639.27</b>	<b>512.84</b>	<b>673.62</b>	<b>698.44</b>	<b>753.36</b>	<b>805.59</b>	<b>863.18</b>	<b>922.00</b>
Other operating income	2.35	0.85	0.29	0.30	0.30	0.30	0.30	0.31
R&D costs	-258.54	-311.42	-369.59	-268.63	-283.56	-297.29	-312.08	-326.98
Marketing costs	-205.72	-197.79	-214.54	-197.38	-207.25	-217.61	-228.49	-239.91
Administration costs	-63.12	-75.30	-71.25	-145.06	-152.60	-160.03	-168.04	-176.12
Other operating expenses	-0.78	-1.27	-99.02	-28.57	-35.10	-50.64	-61.37	-71.63
<b>EBIT</b>	<b>113.46</b>	<b>-72.10</b>	<b>-80.49</b>	<b>59.10</b>	<b>75.16</b>	<b>80.32</b>	<b>93.50</b>	<b>107.66</b>
Net financial result	-4.84	4.75	-3.68	-6.49	-9.74	-9.83	-9.61	-8.84
<b>EBT</b>	<b>108.62</b>	<b>-67.35</b>	<b>-84.17</b>	<b>52.61</b>	<b>65.42</b>	<b>70.49</b>	<b>83.89</b>	<b>98.82</b>
Income taxes	-39.79	23.62	32.05	-18.11	-22.52	-24.27	-28.88	-34.02
<b>Net income / loss</b>	<b>68.85</b>	<b>-43.67</b>	<b>-52.12</b>	<b>34.50</b>	<b>42.89</b>	<b>46.22</b>	<b>55.01</b>	<b>64.80</b>
EBITDA	232.73	324.80	343.84	371.24	386.00	409.37	433.32	446.61
EPS	0.74	-0.46	-0.55	0.37	0.46	0.49	0.58	0.69
DPS	0.00	0.00	0.00	0.00	0.14	0.15	0.18	0.21

Source: Dr. Kalliwoda Research GmbH, company information

## Balance sheet

in EURm	2008/09	2009/10	2010/11	2011/12E	2012/13E	2013/14E	2014/15E	2015/16E
<b>Current assets</b>	<b>480.78</b>	<b>449.55</b>	<b>377.00</b>	<b>404.28</b>	<b>414.36</b>	<b>432.13</b>	<b>481.42</b>	<b>540.68</b>
Inventories	62.29	47.97	35.22	48.50	48.50	49.47	50.37	51.24
Trade receivables	69.53	68.75	49.26	56.20	59.56	62.70	66.08	69.52
Other receivables	72.09	89.16	59.48	65.20	69.10	72.74	76.67	80.65
Current financial assets	20.61	33.27	29.11	23.00	25.50	28.00	30.50	33.00
Current tax assets	19.04	25.08	10.57	6.30	6.68	7.03	7.41	7.79
Cash & cash equivalents	237.21	185.32	193.35	205.08	205.02	212.19	250.39	298.47
<b>Non-current assets</b>	<b>652.95</b>	<b>734.57</b>	<b>680.90</b>	<b>849.39</b>	<b>856.84</b>	<b>863.12</b>	<b>856.39</b>	<b>846.30</b>
Property, plant and equipment	27.42	31.80	34.82	36.35	38.35	40.35	42.35	44.35
Investments in subsidiaries	0.34	0.39	0.39	0.32	0.32	0.32	0.32	0.32
Non-current financial assets	3.35	3.61	3.34	3.53	3.74	3.94	4.15	4.37
Deferred tax assets	41.38	65.88	82.53	105.60	90.83	74.92	55.98	33.67
Intangible assets	480.91	526.38	451.70	569.09	589.09	609.09	619.09	629.09
Goodwill	99.55	106.50	108.13	134.51	134.51	134.51	134.51	134.51
<b>Total assets</b>	<b>1,133.73</b>	<b>1,184.12</b>	<b>1,057.90</b>	<b>1,253.67</b>	<b>1,271.20</b>	<b>1,295.25</b>	<b>1,337.81</b>	<b>1,386.98</b>
<b>Current liabilities</b>	<b>295.35</b>	<b>363.25</b>	<b>307.53</b>	<b>473.27</b>	<b>475.71</b>	<b>479.95</b>	<b>484.43</b>	<b>488.85</b>
Short-term borrowings	61.82	121.78	92.73	236.70	234.70	232.70	230.70	228.70
Trade payables	136.66	144.50	110.95	118.20	115.56	115.19	114.54	113.72
Other liabilities	76.87	93.62	96.85	115.95	122.89	129.36	136.34	143.43
Current tax liabilities	19.99	3.35	7.01	2.42	2.56	2.70	2.85	2.99
<b>Long-term liabilities</b>	<b>86.63</b>	<b>59.39</b>	<b>36.38</b>	<b>31.91</b>	<b>17.21</b>	<b>5.03</b>	<b>5.09</b>	<b>5.16</b>
Provisions	1.98	2.22	2.30	2.26	2.40	2.52	2.66	2.80
Employee benefits	1.64	1.71	1.20	1.40	1.43	1.46	1.49	1.52
Long-term borrowings	22.68	22.55	1.90	1.25	1.15	1.05	0.95	0.85
Deferred tax liabilities	60.32	32.92	30.99	27.00	12.23	0.00	0.00	0.00
<b>Shareholder's equity</b>	<b>751.76</b>	<b>761.47</b>	<b>714.00</b>	<b>748.49</b>	<b>778.28</b>	<b>810.28</b>	<b>848.29</b>	<b>892.97</b>
<b>Total shareholder's equity and liabilities</b>	<b>1,133.73</b>	<b>1,184.12</b>	<b>1,057.90</b>	<b>1,253.67</b>	<b>1,271.20</b>	<b>1,295.25</b>	<b>1,337.81</b>	<b>1,386.98</b>

Source: Dr. Kalliwoda Research GmbH, company information



## Ratios

Fiscal year	2008/09	2009/10	2010/11	2011/12E	2012/13E	2013/14E	2014/15E	2015/16E
Gross margin	60.43%	58.88%	64.84%	65.00%	66.15%	67.20%	68.32%	69.37%
EBITDA margin	32.97%	26.72%	31.27%	32.00%	32.60%	32.20%	32.40%	32.60%
EBIT margin	10.73%	-8.28%	-7.75%	5.50%	6.60%	6.70%	7.40%	8.10%
Net margin	6.51%	-5.01%	-5.02%	3.21%	3.77%	3.86%	4.35%	4.87%
Return on equity (ROE)	9.16%	-5.77%	-7.06%	4.72%	5.62%	5.82%	6.63%	7.44%
Return on assets (ROA)	6.50%	-4.18%	-4.32%	3.55%	4.17%	4.37%	4.91%	5.41%
Return on capital employed (ROCE)	8.58%	-5.70%	-6.64%	4.97%	6.20%	6.46%	7.18%	7.86%
Net debt (in EURm)	-151.06	-39.27	-97.53	34.27	32.25	23.02	-17.25	-67.41
Net gearing	-20.09%	-5.16%	-13.66%	4.58%	4.14%	2.84%	-2.03%	-7.55%
Equity ratio	66.31%	64.31%	67.49%	59.70%	61.22%	62.56%	63.41%	64.38%
Current ratio	1.63	1.24	1.23	0.85	0.87	0.90	0.99	1.11
Quick ratio	1.11	0.79	0.88	0.60	0.61	0.63	0.72	0.82
Net interest cover	23.44	15.18	-21.88	9.11	7.71	8.17	9.73	12.18
Net debt/EBITDA	-2.31	-5.93	-3.33	10.03	11.51	16.77	-23.73	-6.43
Book value per share	8.08	8.02	7.53	7.94	8.26	8.60	9.00	9.48
CAPEX/Sales	n.a	41.52%	32.27%	40.02%	27.93%	27.34%	25.95%	25.40%
Working capital/Sales	-1.00%	-1.21%	-5.80%	-5.62%	-5.02%	-4.61%	-4.21%	-3.83%
EV/Sales	0.58	0.71	0.59	0.58	0.54	0.52	0.49	0.46
EV/EBITDA	2.66	1.90	1.80	1.66	1.60	1.51	1.43	1.38
EV/EBIT	5.45	-8.57	-7.68	10.46	8.22	7.69	6.61	5.74
P/BVPS	0.75	0.76	0.81	0.77	0.74	0.71	0.68	0.64
P/E	8.23	-13.24	-11.07	16.63	13.37	12.41	10.43	8.85
P/FCF	-238.25	-5.32	13.77	-5.27	32.99	26.11	14.27	11.55

Source: Dr. Kalliwoda Research GmbH, company information



## 6 Conclusion

In this update, we have given an overview over the current market developments and the companies from our coverage universe: Ubisoft Entertainment from France as well as City Interactive and CD Projekt RED, which both are listed in Warsaw. We maintain our view that the video games industry is highly promising, but on the other hand also risky, as the business is hit-dependent and competitive. Nowadays, the sector provides huge opportunities for smaller developers as online and mobile games, which can be developed at relatively low costs, are increasingly popular. An example are Germany-based Gameforge and Bigpoint or Polish 11bit Studios and Forever Entertainment, which are both listed in the NewConnect segment of the Warsaw Stock Exchange.

After recent results, we have updated our valuation models for our three European coverage companies. This time, we have also used a peer group analysis in order to take into account the current market valuations. Our top pick remains City Interactive, for which we have determined a 12-months price target (70% DCF, 30% peer group) of **PLN 36.79 (upside of 29.9%, Buy rating)**. We prefer the company for the following reasons: (1) promising pipeline of new games, which should benefit from the tremendous global success of “Sniper – Ghost Warrior” and diversify CI’s revenues (2) clear focus on console games and fast-growing online & mobile segment, which generates high margins, and (3) cheap valuation compared to peers, especially on EV/EBIT and P/E multiples.

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