

Starbreeze

Company report

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Lower valuation improves risk-reward ratio ahead of PAYDAY 3 release

We reiterate Starbreeze's SEK 1.15 target price but increase our recommendation to Accumulate (prev. Reduce) due to the recent decrease in Starbreeze's share price. With the release date of PAYDAY 3 nearing, our confidence in the game's success remains. We are particularly encouraged by the positive feedback the game has received and the positive indicators related to the game released by Starbreeze. The biggest question mark surrounding Starbreeze is the medium to long-term future of the company and what level of confidence to assign to any projections regarding the games after PAYDAY 3. However, with the recent decline in share price, we believe the risk-reward ratio has returned to being modestly positive.

PAYDAY 3 release nearing

PAYDAY 3 is set to be released on 21 September 2023, with early access starting on 18 September. Leading up to the release, Starbreeze has focused on creating the best possible prerequisites for a successful launch. Marketing efforts have included releasing gameplay and live-action trailers, conducted closed and open beta sessions, and inviting gaming journalists/influencers to try out PAYDAY 3. In late August, Starbreeze also showcased PAYDAY 3 at the German gaming convention Gamescom, where PAYDAY 3 was awarded the 'Best PC Game' and 'Most Entertaining Game' awards. Since our last update, PAYDAY 3 has also climbed from number six on Steam's Wishlist to now occupying third place. In addition, Starbreeze announced the post-launch plan for the game, which includes four DLCs (released during late 2023 and 2024), seasonal events, playable characters, and upgrading the game engine to Unreal Engine 5.

Games after PAYDAY 3 and third-party publishing plans

Starbreeze's plan after PAYDAY 3 is to release two new games, one in 2026 (Project BAXTER) and one in 2027/2028. BAXTER is set to be a AAA cooperative multiplayer game based on an iconic licensed brand characterized by collaborative experiences and storytelling in an expansive world. The game will have a budget of USD 45-50 million. Starbreeze will act as both the developer and publisher for BAXTER, but they will also continually evaluate opportunities to add external partners for the project. Starbreeze also plans to expand its publishing division as well as its portfolio of third-party games that today consists of two projects, *The Tribe Must Survive* and *Roboquest*. In addition, Starbreeze also has partnership with LA-based production company Stockholm Syndrome with the goal to develop a PAYDAY story for tv or film.

The risk-reward ratio is modestly adequate at the current valuation

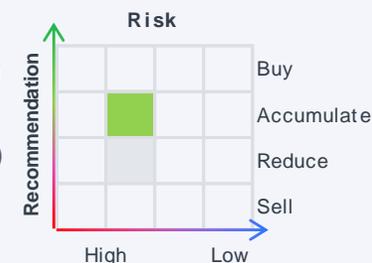
Our estimates assume that PAYDAY 3 will be a commercial success, and so will the next two games, set to be released in 2026 and 2027/2028. Up to 2028, revenues and profits will fluctuate, with higher revenues in years with game releases and lower in the years without. By 2029, we assume that Starbreeze will have reached a "steady state" with revenues growing more steadily. We estimate that EBIT will average SEK 151 million during 2028-2032, resulting in a reasonable EV (23e)/EBIT ratio of 6.0x. However, achieving this EBIT level does require things going according to plan on several fronts. Therefore, we think the risk-reward ratio is adequate but not great at the current valuation. Our DCF valuation comes in at SEK 1.15, which is 21% above the current share price.

Recommendation

Accumulate
(previous Reduce)

1.15 SEK
(previous 1.15 SEK)

Share price:
0.95 SEK



Key indicators

	2022	2023e	2024e	2025e
Revenue	128	679	373	341
growth-%	2 %	432 %	-45 %	-9 %
EBIT adj.	7	434	80	167
EBIT-% adj.	5.3 %	63.9 %	21.3 %	49.1 %
Net Income	-60	447	79	167
EPS (adj.)	-0.08	0.30	0.05	0.11
P/E (adj.)	neg.	3.1	17.7	8.4
P/B	21.6	1.2	1.2	1.0
P/FCF	neg.	8.9	14.1	43.9
EV/EBIT (adj.)	>100	2.0	9.7	4.4
EV/EBITDA	22.6	1.5	2.9	3.2
EV/S	11.7	1.3	2.1	2.2

Source: Inderes

Guidance

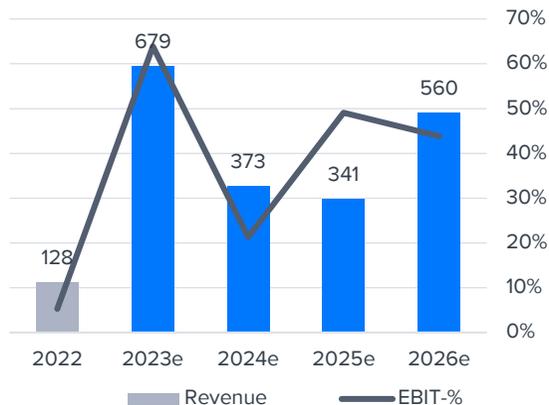
(Starbreeze provides no guidance)

Share price



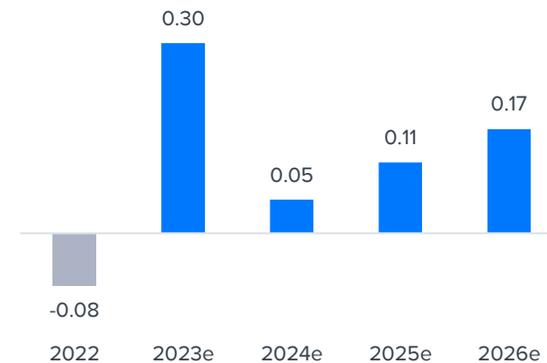
Source: Millistream Market Data AB

Revenue & operating profit-%



Source: Inderes

Earnings per share



Source: Inderes

Value drivers

- *PAYDAY 3* is set to be released 21 September, if successful it will greatly improve the company's outlook
- The company's main asset is their ownership of the *PAYDAY* game franchise
- Starbreeze has built up an organization of 182 employees capable of developing large scale video games
- New game releases after *PAYDAY 3*. One game in production set to be released in 2026
- Future third-party publishing operations

Risk factors

- Undiversified revenue stream with all revenues coming from a single game
- *PAYDAY 3*, being a commercial failure would see Starbreeze take a step back and push their growth story years into the future
- Limited visibility into the games after *PAYDAY 3* makes it hard to assess the company's long-term potential
- Delays in future game projects

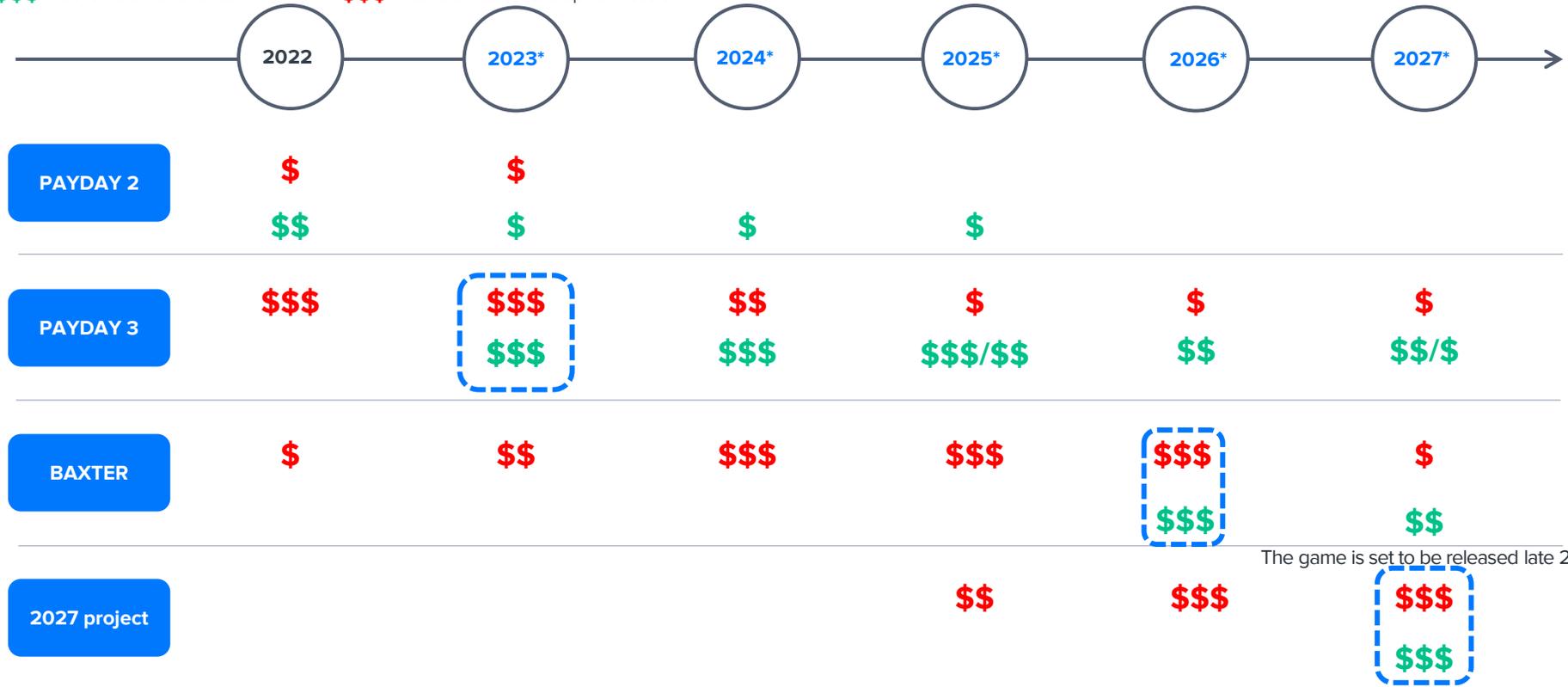
Valuation	2023e	2024e	2025e
Share price	0.95	0.95	0.95
Number of shares, millions	1,477	1,477	1,477
Market cap	1,398	1,398	1,398
EV	871	772	741
P/E (adj.)	3.1	17.7	8.4
P/E	3.1	17.7	8.4
P/FCF	8.9	14.1	43.9
P/B	1.2	1.2	1.0
P/S	2.1	3.7	4.1
EV/Sales	1.3	2.1	2.2
EV/EBITDA	1.5	2.9	3.2
EV/EBIT (adj.)	2.0	9.7	4.4

Source: Inderes

Timeline of game projects

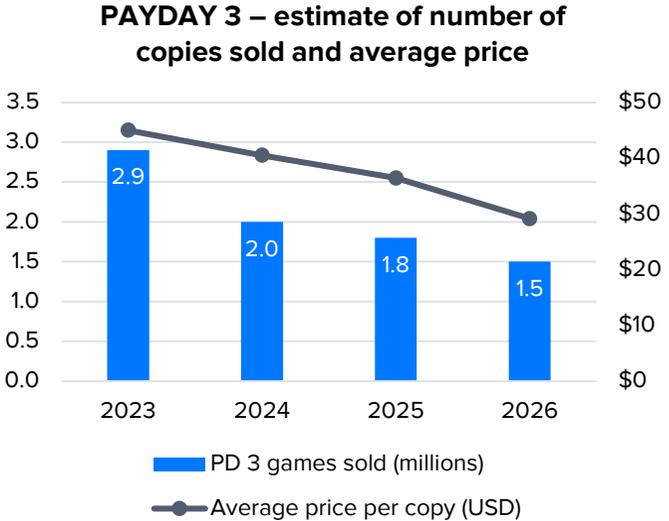
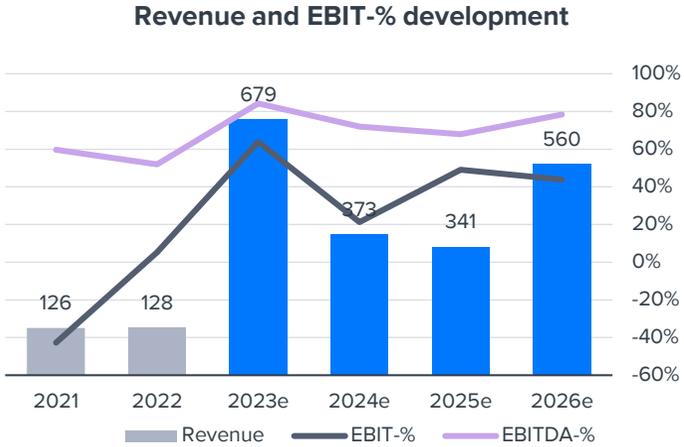
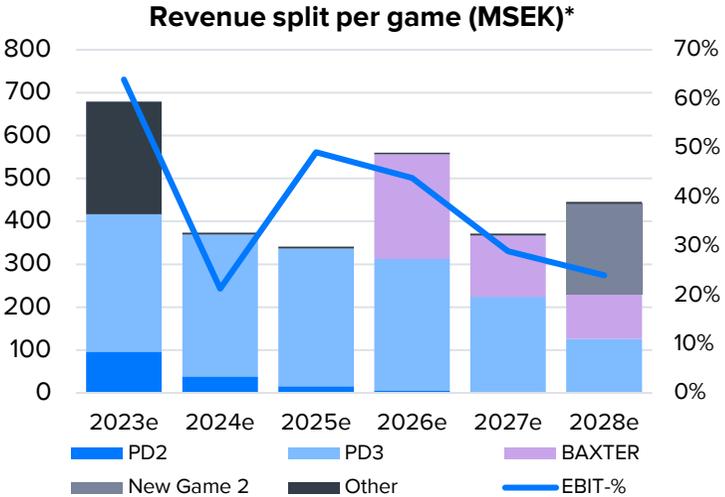
Release year

\$ =low revenue
 \$\$ =medium revenue
 \$\$\$ =considerable revenue
 \$ =low development costs
 \$\$ =medium development costs
 \$\$\$ =considerable development costs



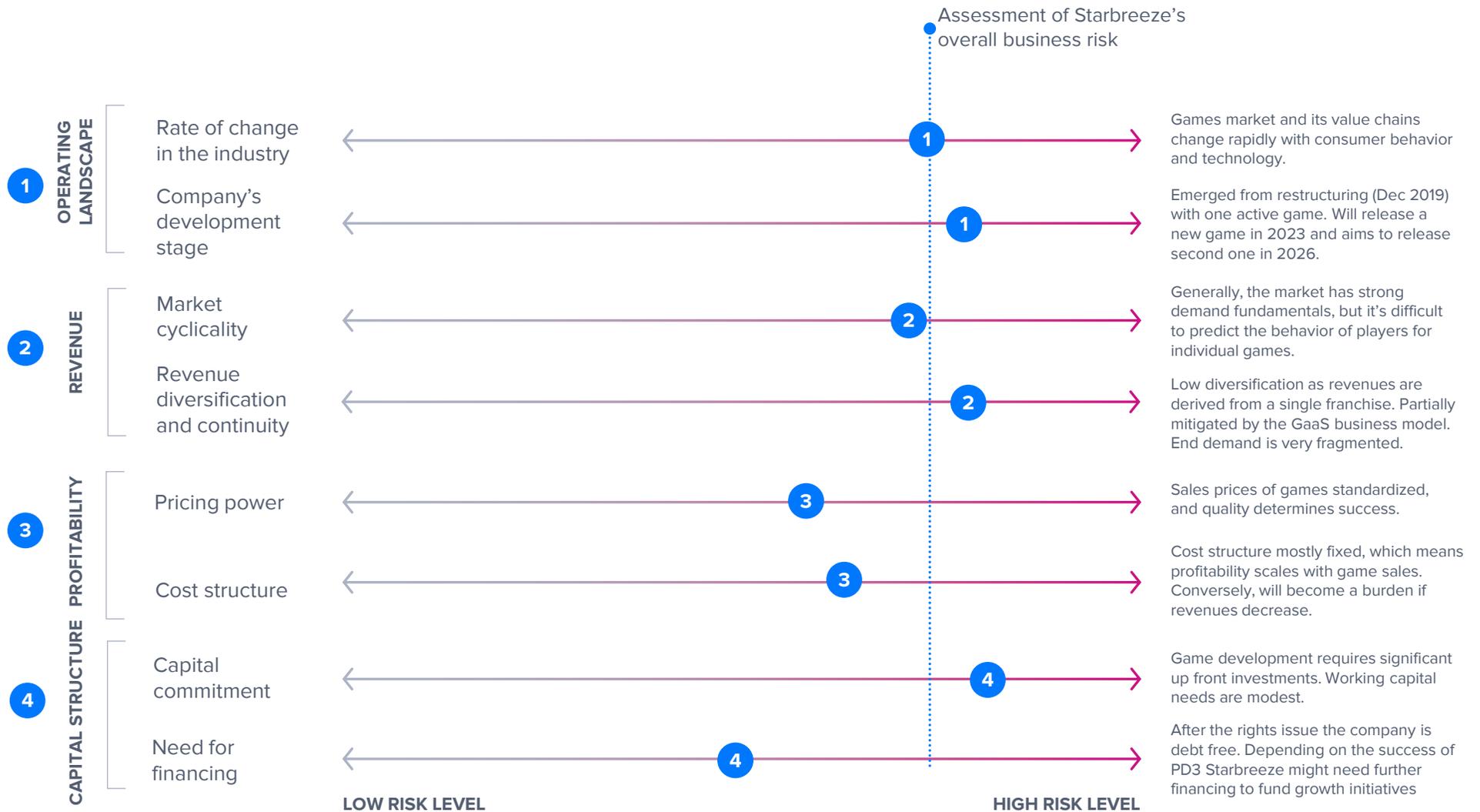
The game is set to be released late 2027

Underlying assumptions for revenue estimates



Source: Inderes, *2023 Other, includes the non-cash game financing income

Risk profile of Starbreeze's business model



Valuation

PAYDAY 3 launch creates excitement but long-term development uncertain

At the current valuation, it is clear that Starbreeze's value is heavily based on the anticipated success of PAYDAY 3. Hence in the short term, we believe that Starbreeze's share price will correlate with the success of PAYDAY 3. The release of PD3 will most likely be an inflection point for the share price, with upwards pressure if the game succeeds and downward pressure if it fails to meet expectations.

After the launch of PD3, we must turn our attention beyond 2023-2024 and assess Starbreeze's potential to generate revenue growth from other game projects. The goal is to mature into a multi-project business model that provides multiple streams of revenues, which would lower the company's risk profile. The key here is to build upon the potential success of PD3 and to reinvest profits into new game projects. Naturally, these games also need to succeed. The current low visibility into these future projects and the lack of a track record in operating a multi-project model creates uncertainty around all long-term projections regarding Starbreeze's financials.

Our target price corresponds to the fair value estimate of our DCF model of SEK 1.16. Our estimates assume that the next three games released by Starbreeze will be commercially successful. With these estimates, we arrive at a valuation somewhat higher than the current market valuation. Indicating that the current valuation is already pricing in a pretty favorable scenario. We, therefore, assess that the risk-to-reward ratio at the current valuation is only modestly attractive. We do concede that any game release has a broad range of outcomes, and a situation may arise where PD3

strongly outperforms or underperforms our estimates, which would naturally increase/decrease Starbreeze's fair value.

Multiple-based valuation suffers from fluctuating financials

Starbreeze's fluctuating revenues and earnings naturally lead to fluctuating multiples. In the near term, Starbreeze also has a couple of larger non-cash charges, such as D&A and the game financing liability, which make the underlying financial figures messy. For 2023, the earnings-based multiples are very low as Starbreeze is set to release a significant game relative to the company's size (P/E 3.1x, EV/EBIT 2.0x). These multiples naturally seem extremely attractive, but one must remember that 2023 will likely be the best year Starbreeze will have in a while. In addition, earnings in 2023 will be amplified due to the game financing liability (non-cash) being credited to the revenues. Free cash flow, meanwhile, will be lower than the earnings, and therefore, the P/FCF multiple will be higher at 8.9x.

In 2024, all three multiples increase as revenues from PAYDAY 3 decrease. The earnings-based multiples are also burdened by high amortization related to PAYDAY 3 in 2024. Consequently, the earnings-based multiples would increase to P/E 17.7x and EV/EBIT 9.7x. The relatively high level of investment will meanwhile burden free cash flow, and consequently, P/FCF increases to 14.1x.

Valuation	2023e	2024e	2025e
Share price	0.95	0.95	0.95
Number of shares, million:	1,477	1,477	1,477
Market cap	1,398	1,398	1,398
EV	871	772	741
P/E (adj.)	3.1	17.7	8.4
P/E	3.1	17.7	8.4
P/FCF	8.9	14.1	43.9
P/B	1.2	1.2	1.0
P/S	2.1	3.7	4.1
EV/Sales	1.3	2.1	2.2
EV/EBITDA	1.5	2.9	3.2
EV/EBIT (adj.)	2.0	9.7	4.4

Source: Inderes

Investment profile

1. Turnaround company with all the eggs in the PAYDAY basket
2. Strong video game franchise in PAYDAY
3. Upcoming release of the new PAYDAY 3 game to PC and console
4. GaaS business model provides longevity, scalability, and reduces risk
5. Large and growing market

Potential



- Successful release of *PAYDAY 3* would generate strong cash flow and set Starbreeze up for the future
- Widening the monetization of the PAYDAY IP through more games and other income streams
- Large PAYDAY community that can be leveraged to promote new games
- Future new game releases
- Potential future publishing operations
- Strong demand outlook on the market

Risks

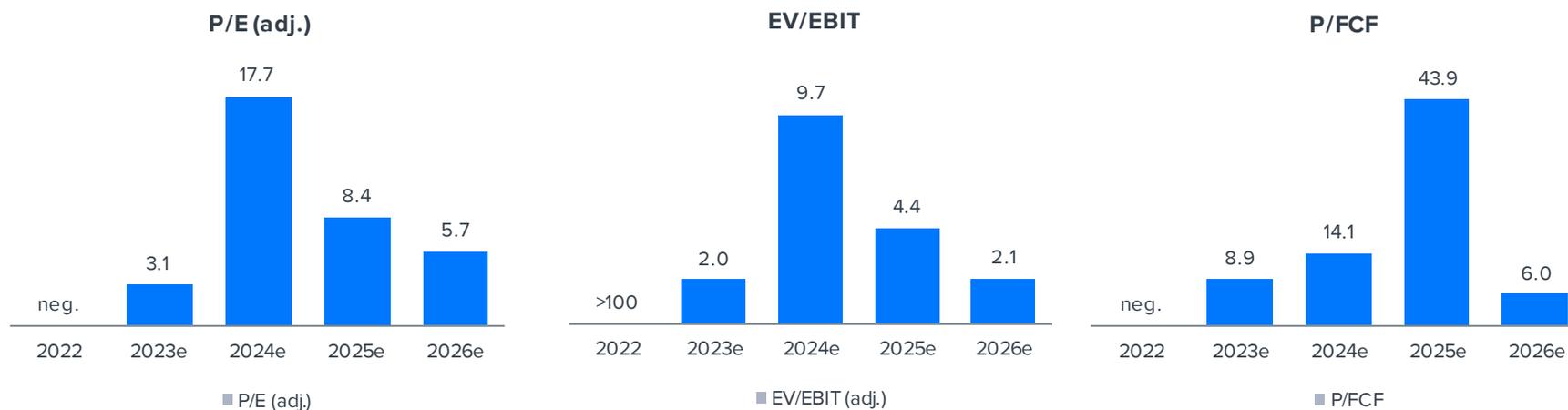


- Starbreeze reliant on a single game for their revenues
- *PAYDAY 3*, being a commercial failure would see the company take a step back and push their growth story a few years back
- Low visibility into future projects after *PAYDAY 3*
- Highly competitive market with many competing products

Valuation table

Valuation	2018	2019	2020	2021	2022	2023e	2024e	2025e	2026e
Share price	0.57	1.30	1.09	1.00	1.69	0.95	0.95	0.95	0.95
Number of shares, millions	318	328	470	725	725	1,477	1,477	1,477	1,477
Market cap	182	427	512	726	1,225	1,398	1,398	1,398	1,398
EV	128	465	647	1,019	1,496	871	772	741	509
P/E (adj.)	neg.	neg.	neg.	neg.	neg.	3.1	17.7	8.4	5.7
P/E	neg.	neg.	neg.	neg.	neg.	3.1	17.7	8.4	5.7
P/FCF	neg.	neg.	neg.	neg.	neg.	8.9	14.1	43.9	6.0
P/B	0.5	69.3	2.2	5.9	21.6	1.2	1.2	1.0	0.9
P/S	0.5	1.5	4.3	5.8	9.6	2.1	3.7	4.1	2.5
EV/Sales	0.4	1.7	5.5	8.1	11.7	1.3	2.1	2.2	0.9
EV/EBITDA	neg.	neg.	13.1	>100	22.6	1.5	2.9	3.2	1.2
EV/EBIT (adj.)	neg.	neg.	59.5	68.2	>100	2.0	9.7	4.4	2.1

Source: Inderes



Peer group valuation

Peer group valuation	EV	EV/EBIT		EV/EBITDA		EV/S		P/E		Dividend yield-%		P/B
Company	MEUR	2023e	2024e	2023e	2024e	2023e	2024e	2023e	2024e	2023e	2024e	2023e
Remedy	289		144.6		35.0	8.4	5.0		793.3	0.4	0.5	4.4
Embracer	4,348	9.1	7.8	5.8	4.9	1.4	1.2	6.7	6.4			0.5
CD Projekt	3,219	35.2	60.0	25.5	36.0	13.7	19.0	43.0	61.8	0.7	0.9	6.5
Paradox Interactive	2,297	26.7	23.6	15.4	12.8	10.6	9.2	34.5	30.9	0.9	0.9	9.7
Tinybuild	9	1.9	1.6	1.2	1.0	0.2	0.2	10.5	9.4			
Enad Global 7	138	4.3	4.3	3.0	3.2	0.8	0.8	6.8	6.8			0.5
11 Bit Studios	351	73.7	8.5	55.9	7.1	14.7	5.0	21.2	8.7			6.1
Playway	538	10.8	9.4	10.7	9.4	6.7	5.9	14.8	12.9	4.8	6.8	5.4
Activision Blizzard	58,745	17.8	16.2	17.0	15.7	6.5	6.4	21.8	20.9	0.9	0.5	3.3
Electronic Arts	30,129	15.7	14.6	13.6	12.5	4.5	4.3	20.2	17.9	0.6	0.6	4.5
Take-Two Interactive	24,320	31.8	33.6	28.3	28.6	5.0	4.7	40.2	43.3			2.5
Ubisoft	4,464		13.2	5.4	4.8	2.3	2.1		18.2			2.1
Starbreeze (Inderes)	84	2.0	9.7	1.5	2.9	1.3	2.1	3.1	17.7	0.0	0.0	1.2
Average		22.7	28.1	16.5	14.3	6.2	5.3	22.0	85.9	1.4	1.7	4.1
Median		16.7	13.9	13.6	10.9	5.7	4.9	20.7	18.0	0.8	0.8	4.4
Diff-% to median		-88 %	-30 %	-89 %	-74 %	-78 %	-57 %	-85 %	-2 %	-100 %	-100 %	-72 %

Source: Refinitiv / Inderes

Income statement

Income statement	2020	2021	Q1'22	Q2'22	Q3'22	Q4'22	2022	Q1'23	Q2'23	Q3'23e	Q4'23e	2023e	2024e	2025e	2026e
Revenue	118	126	24	32	39	34	128	27	43	433	176	679	373	341	560
EBITDA	49	6	5	18	24	19	66	4	14	404	150	572	269	232	439
Depreciation	-38	-60	-14	-15	-15	-15	-60	-16	-17	-53	-53	-138	-189	-64	-193
EBIT (excl. NRI)	11	15	-10	3	9	4	7	-12	-3	351	98	434	80	167	246
EBIT	11	-54	-10	3	9	4	7	-12	-3	351	98	434	80	167	246
Share of profits in assoc. compan.	-2	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net financial items	-139	-52	-14	-14	-17	-17	-61	-13	27	-1	-1	12	-1	-1	-1
PTP	-130	-105	-24	-11	-7	-12	-54	-25	24	350	97	446	79	167	245
Taxes	0	2	0	0	0	-4	-5	0	1	0	0	0	0	0	0
Minority interest	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net earnings	-130	-103	-24	-11	-8	-17	-60	-25	25	350	97	447	79	167	245
EPS (rep.)	-0.28	-0.14	-0.03	-0.02	-0.01	-0.02	-0.08	-0.03	0.03	0.24	0.07	0.30	0.05	0.11	0.17

Key figures	2020	2021	Q1'22	Q2'22	Q3'22	Q4'22	2022	Q1'23	Q2'23	Q3'23e	Q4'23e	2023e	2024e	2025e	2026e
Revenue growth-%	-57.9 %	6.5 %	-15.7 %	-0.8 %	11.4 %	8.3 %	1.5 %	13.3 %	36.1 %	1019.3 %	424.1 %	432.1 %	-45.0 %	-8.7 %	64.3 %
Adjusted EBIT growth-%		37.5 %	-222.0 %	163.2 %	82.3 %	579.7 %	-54.9 %	17.1 %	-188.0 %	3807.8 %	2159.0 %	6331.5 %	-81.7 %	110.5 %	46.8 %
EBITDA-%	41.7 %	5.0 %	19.4 %	57.0 %	63.0 %	57.4 %	52.0 %	15.2 %	32.6 %	93.2 %	85.2 %	84.2 %	71.9 %	68.0 %	78.3 %
Adjusted EBIT-%	9.2 %	11.9 %	-42.1 %	10.6 %	23.2 %	12.9 %	5.3 %	-43.5 %	-6.8 %	81.0 %	55.4 %	63.9 %	21.3 %	49.1 %	43.9 %
Net earnings-%	-110.4 %	-82.3 %	-102.1 %	-35.4 %	-20.1 %	-49.8 %	-46.9 %	-93.5 %	57.2 %	80.9 %	54.9 %	65.8 %	21.1 %	48.9 %	43.7 %

Source: Inderes

Balance sheet

Assets	2021	2022	2023e	2024e	2025e
Non-current assets	499	586	637	637	769
Goodwill	42	48	50	50	50
Intangible assets	405	506	565	569	702
Tangible assets	36	23	14	10	8
Associated companies	1	1	1	1	1
Other investments	0	0	0	0	0
Other non-current assets	9	7	7	7	7
Deferred tax assets	4	0	0	0	0
Current assets	176	160	628	703	739
Inventories	0	0	0	0	0
Other current assets	2	0	0	0	0
Receivables	45	52	102	78	83
Cash and equivalents	129	108	526	625	656
Balance sheet total	674	746	1,265	1,340	1,508

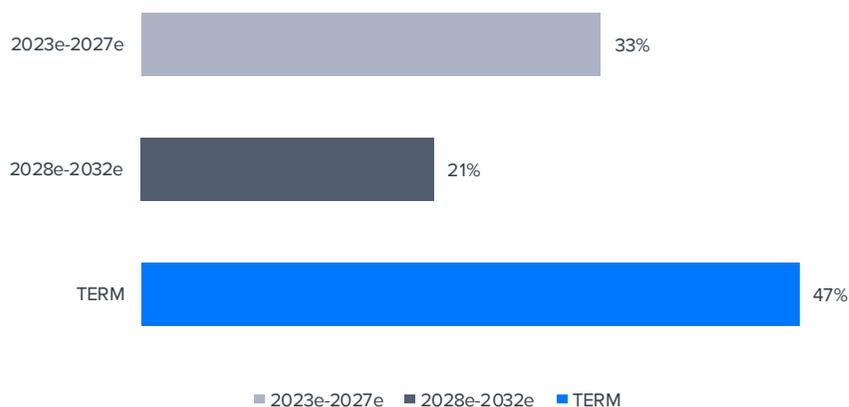
Source: Inderes

Liabilities & equity	2021	2022	2023e	2024e	2025e
Equity	123	57	1,132	1,211	1,378
Share capital	14	14	30	30	30
Retained earnings	-1,890	-1,950	-1,503	-1,424	-1,257
Hybrid bonds	0	0	0	0	0
Revaluation reserve	19	13	10	10	10
Other equity	1,979	1,979	2,596	2,596	2,596
Minorities	0	0	0	0	0
Non-current liabilities	443	386	3	3	3
Deferred tax liabilities	0	1	1	1	1
Provisions	0	0	0	0	0
Long term debt	422	380	0	0	0
Convertibles	0	0	0	0	0
Other long term liabilities	21	5	1	1	1
Current liabilities	109	303	130	127	127
Short term debt	0	0	0	0	0
Payables	91	108	115	112	113
Other current liabilities	18	195	15	15	15
Balance sheet total	674	746	1,265	1,340	1,508

DCF calculation

DCF model	2022	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e	2032e	TERM
Revenue growth-%	1.5 %	432.1 %	-45.0 %	-8.7 %	64.3 %	-33.7 %	19.9 %	-7.8 %	18.0 %	16.0 %	2.5 %	2.5 %
EBIT-%	5.3 %	63.9 %	21.3 %	49.1 %	43.9 %	28.9 %	24.0 %	31.4 %	32.0 %	32.0 %	32.0 %	32.0 %
EBIT (operating profit)	7	434	80	167	246	107	107	129	155	180	184	
+ Depreciation	60	138	189	64	193	137	221	204	207	209	211	
- Paid taxes	0	1	0	0	0	0	0	0	-32	-37	-38	
- Tax, financial expenses	6	0	0	0	0	0	0	0	0	0	0	
+ Tax, financial income	0	0	0	0	0	0	0	0	0	0	0	
- Change in working capital	-8	-222	20	-4	-5	-6	-7	-7	-7	-8	-8	
Operating cash flow	65	350	289	228	434	238	321	326	323	344	349	
+ Change in other long-term liabilities	-16	-4	0	0	0	0	0	0	0	0	0	
- Gross CAPEX	-151	-189	-189	-196	-201	-206	-213	-215	-215	-215	-215	
Free operating cash flow	-102	157	100	32	233	32	108	110	107	129	135	
+/- Other*	0	665	0	0	0	0	0	0	0	0	0	
FCFF	-102	822	100	32	233	32	108	110	107	129	135	0
Discounted FCFF		796	87	25	165	20	62	57	50	54	51	612
Sum of FCFF present value		1,979	1,183	1,096	1,071	906	886	824	767	717	663	612
Enterprise value DCF		1,979										
- Interest bearing debt		-380										
+ Cash and cash equivalents		108										
-Minorities		0										
-Dividend/capital return		0										
Equity value DCF		1,709										
Equity value DCF per share		1.16										
WACC												
Tax-% (WACC)		20.6 %										
Target debt ratio (D/(D+E))		0.0 %										
Cost of debt		8.0 %										
Equity Beta		1.50										
Market risk premium		4.75 %										
Liquidity premium		1.40 %										
Risk free interest rate		2.5 %										
Cost of equity		11.0 %										
Weighted average cost of capital (WACC)		11.0 %										

Cash flow distribution



Source: Inderes

*Other for 2023 is the MSEK 450 from the rights issue + MSEK 215 to compensate for the increase in shares from the convertible loan being converted into shares

Summary

Income statement	2020	2021	2022	2023e	2024e	Per share data	2020	2021	2022	2023e	2024e
Revenue	118	126	128	679	373	EPS (reported)	-0.28	-0.14	-0.08	0.30	0.05
EBITDA	49	6	66	572	269	EPS (adj.)	-0.28	-0.05	-0.08	0.30	0.05
EBIT	11	-54	7	434	80	OCF / share	-0.05	0.12	0.09	0.24	0.20
PTP	-130	-105	-54	446	79	FCF / share	-0.28	-0.06	-0.14	0.11	0.07
Net Income	-130	-103	-60	447	79	Book value / share	0.49	0.17	0.08	0.77	0.82
Extraordinary items	0	-69	0	0	0	Dividend / share	0.00	0.00	0.00	0.00	0.00
Balance sheet	2020	2021	2022	2023e	2024e	Growth and profitability	2020	2021	2022	2023e	2024e
Balance sheet total	709	674	746	1,265	1,340	Revenue growth-%	-58 %	7 %	2 %	432 %	-45 %
Equity capital	228	123	57	1,132	1,211	EBITDA growth-%	-141 %	-87 %	958 %	763 %	-53 %
Goodwill	39	42	48	50	50	EBIT (adj.) growth-%	-102 %	-594 %	-113 %	6331 %	-82 %
Net debt	135	293	271	-526	-625	EPS (adj.) growth-%	-77 %	-83 %	72 %	-467 %	-82 %
Cash flow	2020	2021	2022	2023e	2024e	EBITDA-%	41.7 %	5.0 %	52.0 %	84.2 %	71.9 %
EBITDA	49	6	66	572	269	EBIT (adj.)-%	9.2 %	-42.7 %	5.3 %	63.9 %	21.3 %
Change in working capital	-72	13	-8	-222	20	EBIT-%	9.2 %	-42.7 %	5.3 %	63.9 %	21.3 %
Operating cash flow	-23	87	65	350	289	ROE-%	-111.0 %	-58.9 %	-66.6 %	75.2 %	6.7 %
CAPEX	-89	-112	-151	-189	-189	ROI-%	2.7 %	-10.1 %	1.4 %	55.3 %	6.8 %
Free cash flow	-130	-42	-102	157	100	Equity ratio	32.2 %	18.2 %	7.6 %	89.5 %	90.3 %
						Gearing	59.2 %	238.7 %	478.0 %	-46.5 %	-51.6 %
Valuation multiples	2020	2021	2022	2023e	2024e						
EV/S	5.5	8.1	11.7	1.3	2.1						
EV/EBITDA (adj.)	13.1	>100	22.6	1.5	2.9						
EV/EBIT (adj.)	59.5	68.2	>100	2.0	9.7						
P/E (adj.)	neg.	neg.	neg.	3.1	17.7						
P/B	2.2	5.9	21.6	1.2	1.2						
Dividend-%	0.0 %	0.0 %	0.0 %	0.0 %	0.0 %						

Source: Inderes

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Recommendation history (>12 mo)

Date	Recommendation	Target price	Share price
30.05.2023	Accumulate	1.15 SEK	1.03 SEK
18.08.2023	Reduce	1.15 SEK	1.19 SEK
12.09.2023	Accumulate	1.15 SEK	0.95 SEK



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