TINYBUILD

SOFTWARE & COMPUTER SERVICES

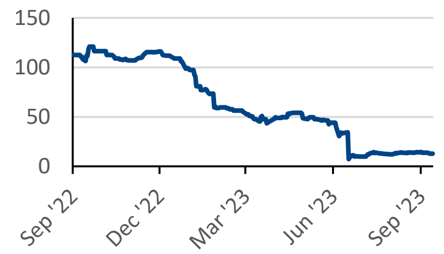
26 September 2023

TBLD.L

12.7p

Market Cap: £25.8m

SHARE PRICE (p)



12m high/low	121.0p/7.3p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (debt)/cash	$14.3m *(at 30/06/23)*
Enterprise value	£14.6m
Index/market	AIM
Next news	FY results, March
Shares in issue (m)	203.9
Chairman	Henrique Olifiers
CEO, Founder	Alex Nichiporchik
CFO	Giasone Salati

COMPANY DESCRIPTION

tinyBuild is a premium AA-rated and indie video games publisher and developer with a focus on multimedia franchises.

www.tinybuild.com

TINYBUILD IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Resilience and operational reset

tinyBuild's results for the six months ended 30 June demonstrated resilient performance during a challenging period, with a key takeaway being management's focus on delivering successful games while maintaining financial stability. Revenue in H1 23 fell 19% to $23.3m (H1 22: $28.8m) and adjusted EBITDA turned negative at -$1.2m (H1 22: $9.9m). However, games sales remained stable, and the company is demonstrating tighter control of spending to steady the business in the short term. A strong games pipeline, combined with continuous monitoring of progress, provides potential for mid- to long-term growth, in our view.

- **Revenue impacted by collapse of platform deals.** Revenue from Development Services fell to $5.2m (H1 22: $11.1m) due to a lower contribution from platform deals, which peaked in 2022 and in H1 23 fell below the FY20 level as a percentage of sales. Mitigating factors such as lower cannibalisation and wider distribution may offset this to some extent, but the benefits are not yet easy to quantify.
- **Management focus on operations and processes.** Management is focused on producing better games, on budget and in a timely manner. CEO Alex Nichiporchik remains close to the production and operations of the games and, supported by recently appointed CFO Giasone (Jaz) Salati, processes are being implemented that provide greater visibility on the revenue potential of titles so that capital is allocated to the most promising games. The full potential of this management team is yet to be seen, but the balance of gaming expertise with tighter financial controls should help to steer the business on the right course, in our view.
- **Diversified and strong games pipeline.** tinyBuild worked on a diverse range of over 50 projects in H1 23, with 20+ projects having an annualised spend of $500k and above. No game accounted for more than 15% of the total development costs and 10%+ invested in new tech, media and platforms. The company is concentrating on 1,000-hour game titles and franchise expansion and creation, and has 12 games in the announced pipeline for release between now and FY25-26.
- **Estimates unchanged.** Despite the challenges faced in H1, the Board is confident that tinyBuild is on track to deliver FY23 results in line with expectations, and we maintain our estimates. Meeting estimates will require a recovery in H2 benefitting from seasonality, strong performance from the H1 and H2 releases, and ongoing cost management.

FYE DEC ($M)	2021	2022	2023E	2024E	2025E
Revenue	52.2	63.3	50.2	53.7	57.5
Adj EBITDA	22.2	24.4	5.2	5.7	7.0
Fully Adj PBT	20.5	19.6	0.5	1.1	2.3
Fully Adj Dil EPS (c)	8.3	7.4	0.2	0.4	0.8
EV/Sales (x)	0.4x	0.3x	0.4x	0.3x	0.3x
EV/EBITDA (x)	0.8x	0.8x	3.6x	3.3x	2.7x
PER (x)	1.9x	2.2x	78.6x	40.5x	19.5x

Source: Company Information and Progressive Equity Research estimates.

Financial Update

Revenue impacted by platform deals, but games sales stable

tinyBuild reported total revenue in H1 23 of $23.3m, a decrease of 19% (H1 22: $28.8m). The Development Services division saw a sharp decline in revenue to $5.2m from $11.1m in H1 22, mainly due to a lower contribution from platform deals. However, revenue from game and merchandise royalties remained flat at $17.5m (H1 22: $17.5m) despite Versus Evil underperforming, with other core titles in the portfolio delivering. The Events division saw recovery in H1 23, with revenue up to £0.6m (H1 22: £0.15m).

Some of the growth from games launches in H1 may flow through into H2 23. Although tinyBuild has a strong games pipeline, any delays to games in H2 will result in revenue being delayed until FY24. So although the mid- to long-term prospects remain positive, we maintain our conservative FY revenue estimates.

One-off impairments hit the balance sheet

tinyBuild reported $27.2m of impairments in H1 23, of which $18.3m was impairments of development costs (mostly of games not yet launched) and $8.9m impairments of intangible assets (Red Cerberus and Not Games). The impairment of development costs and goodwill is reflected in the decrease in intangible assets on the balance sheet, which has reduced from $80.4m in FY22 to $65.2m in H1 23. These substantial non-cash charges are the result of the adjustment of expectations for future revenues of some titles due to industry-wide changes and therefore are not expected to recur.

Negative adjusted EBITDA – potential for recovery in H2

tinyBuild reported negative adjusted EBITDA for H1 23 of -$1.3m (H1 22: $9.9m). This is the result of the drop in revenue combined with a less favourable revenue mix, with a lower proportion of revenues from first party titles, and increased amortisation of development costs, along with an increase in administrative costs.

Management remains confident that the company is on track to meet market expectations. Our FY23E estimate of adjusted EBITDA at $5.2m relies on the ongoing performance of back-catalogue titles, plus revenue from H1 launches coming through in H2 along with sales from H2 releases. H1 23 had a high weight of fixed costs, which should decline in H2, and tinyBuild has identified potential for further efficiencies and savings. We expect that some of the improvements made to financial processes should start to take effect in H2 and into FY24, which will assist operating profitability.

Looking further forward, we expect adjusted EBITDA to remain broadly flat in FY24 due to higher amortisation from increased development costs and the revenue mix, which may see higher royalty payments to developers.

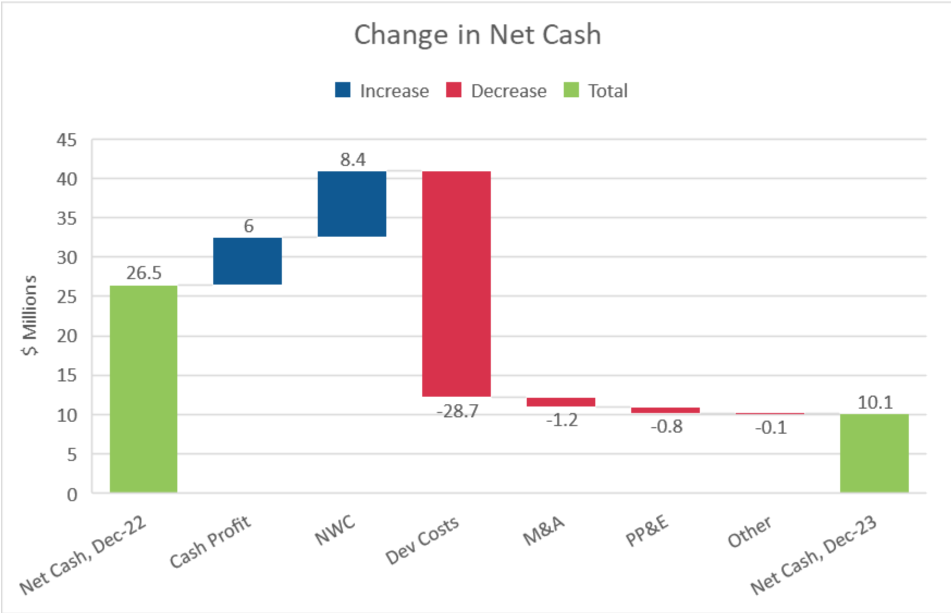
Capex controlled

There was $1.2m of M&A investment in H1 23, and we are pleased to see that the company has paused its M&A activity in the short term while it focuses on cash generation. tinyBuild has continued investment in software development to accelerate growth, albeit at a slower pace. Although investment in software development rose year on year to $16.9m in H1 23 (H1 22: $14.2m), the recent focus on tightening control of costs was evident in a $4.6m reduction from the $21.5m investment in H2 22.

The new measures put in place by CFO Jaz Salati provide greater visibility on which games look the most promising, which means that management can focus on investing in games that deliver a higher return on investment.

Balance Sheet and Cash Flow

Estimated change in net cash



Source: Progressive Equity Research

Net cash as at 30 June 2023 decreased to $14.3m (FY22: $26.5m) as result of lower profit and continued investment in software development. Given the additional detail now available for the H1 period, the cash flow waterfall above might represent a more-likely route to delivery of the end-of-year cash estimate. We maintain our FY23E net cash at $10.1m, at the conservative end of management's $10-20m guidance.

Net cash generated from operations was $6.6m in H1 23, a 26% reduction year on year (H1 22: $$8.8m) due to lower profit offsetting a positive working capital contribution.

Forecasts

Our estimates remain unchanged for FY23E and beyond. We look forward to the full-year numbers, with the hope that there is more visibility around the flow through from the upcoming games pipeline. We will review our estimates at that time.

Challenging market landscape

tinyBuild has faced a challenging year to date because of industry changes, in particular the difficulties surrounding platform deals, which collapsed in H1 23. The market continues to be more competitive than it has been in recent years, with an increased number of high-quality games and elevated discounting levels. This comes against a weaker overall economic backdrop impacted by the higher cost of living, reduced consumer spending, plus higher inflation and interest rates.

Competitor performance has also suffered

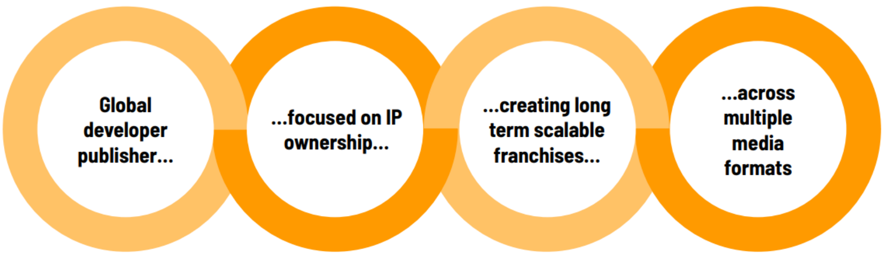
Recent results from tinyBuild's competitors have been mixed. Although Team17 reported strong H1 revenue growth, with performance driven by a diversified games portfolio and strong new release profile, it expects the gaming landscape to remain highly competitive.

Frontier Development's FY23 results, on the other hand, reflected general sales underperformance across the portfolio. The company's acquisition of game development studio Complex Games Inc. is yet to prove profitable. There was general sales underperformance across the portfolio during the Christmas holiday period and there was a lower-than-expected sales contribution from F1 Manager. As a result, the company reported an adjusted EBITDA loss of £4.6m for FY23 (FY22: £6.7m profit).

Devolver Digital's trading update and subsequent half-year results signalled that FY23 performance has been impacted by delays to new title releases, a reduction in revenue from subscription deals and a lower contribution from the back-catalogue. Devolver declined subscription deal proposals that undervalued the titles' value and revenue opportunities in 2023 and 2024, resulting in lower subscription revenues. As a result, the company reported negative normalised adjusted EBITDA of -$3.5m for H1 (H1 22: $6.8m profit) and anticipates FY23 normalised adjusted EBITDA to be at least break-even before a return to growth in FY24. It has delayed high potential titles until 2024 to ensure that they have the time, effort and support to succeed and the business strategy is to maximise the success of new titles by increasing investment in development, quality control and marketing.

Strategy update

Core Strategy



Source: tinyBuild

tinyBuild's core strategy remains unchanged, with management focused on IP ownership, creating long-term scalable franchises across multiple media format. However, there is a strategic repositioning towards the 1,000-hour game, which focuses on emergent gameplay – games that are based on designing systems that work with each other rather than creating levels that users consumer once. In these games, user-generated content and persistent procedurally generated worlds feature, and gameplay can include Player vs Player (PvP), Player vs Environment (PvE), and base building multiplayer. The advantage of the 1,000-hour game is that players return to the game and keep playing, which adds greater value over time.

Own-IP, franchise & games pipeline progress

- **>80 games** in the portfolio
- **Own-IP** reduced slightly to 65% in H1 23 (H1 22: 73%; FY22: 77.1%) as the revenue mix tilted slightly to third-party games, both from back catalogue and new releases.
- **Strong back-catalogue with sales representing 93% of total revenues** as % of gaming revenues in H1 23 (H1 22: 99%; FY22: 80%). This demonstrates the company's ability to extend the life cycle of existing titles to support investment in new games.
- ***Hello Neighbor* franchise** – VR spinoff doing well, *Hello Neighbor 2* rating improvement, key updates coming to consoles and new TV episodes drop on 7 October 2023.
- ***Punch Club* franchise expansion** – record peak concurrent users (CCUs) record + 200k wishlists.
- ***I am Future* franchise creation** – early access launch gets 90% positive reviews. Over $500k in sales +200k wishlists.
- **Pipeline x12 titles announced** – across a variety of genres, budgets and timings. Games will be launched carefully to ensure quality, and timed to maximise revenue generation.

Outlook

Despite a tough year, the company have delivered resilient results with stable games revenue, $6.6m cash from operations and £14.3m net cash at the end of June 2023. tinyBuild remains committed to developing good quality new games, with a focus on the 1,000-hour game, while maintaining financial stability concentrating on cash generation and controlling spending. The cost-control measures being implemented by new CFO Jaz Salati will take time to filter through, as will the revenues from recent and upcoming games launches. As a result, we main cautious on the short-term outlook for the business, while sharing management's confidence that the company is on track to meet full-year expectations. We will revisit our estimates at the FY23 results release, once we have more visibility on the progress made by management initiatives – but we believe tinyBuild is steering a course for potentially healthy long-term growth.

Financial Summary: tinyBuild

Year end: December ($m unless shown)

PROFIT & LOSS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Revenue	52.2	63.3	50.2	53.7	57.5
Adj EBITDA	22.2	24.4	5.2	5.7	7.0
Adj EBIT	20.5	19.6	0.5	1.1	2.3
Reported PBT	12.5	15.9	0.5	1.1	2.3
Fully Adj PBT	20.5	19.6	0.5	1.1	2.3
NOPAT	12.8	11.8	0.3	0.6	1.2
Reported EPS (c)	4.2	5.6	0.2	0.4	0.8
Fully Adj Dil EPS (c)	8.3	7.4	0.2	0.4	0.8
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Operating cash flow	13.3	19.2	23.9	29.2	31.6
Free Cash flow	(24.4)	(21.9)	(16.4)	0.8	0.8
FCF per share (c)	0.0	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	47.0	0.0	0.0	0.0	0.0
Net cash flow	22.5	(22.3)	(16.4)	0.8	0.8
Overdrafts / borrowings	0.0	0.0	0.0	0.0	0.0
Cash & equivalents	48.8	26.5	10.1	10.9	11.7
Net (Debt)/Cash	48.8	26.5	10.1	10.9	11.7
NAV AND RETURNS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Net asset value	96.4	111.6	112.0	112.8	114.4
NAV/share (c)	0.0	0.1	0.1	0.1	0.1
Net Tangible Asset Value	(57.1)	(80.3)	(103.1)	(108.8)	(112.2)
NTAV/share (c)	0.0	0.0	(0.1)	(0.1)	(0.1)
Average equity	67.6	104.0	111.8	112.4	113.6
Post-tax ROE (%)	30.3%	18.9%	0.5%	1.0%	2.0%
METRICS	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Revenue growth		21.4%	(20.7%)	7.0%	7.0%
Adj EBITDA growth		9.5%	(78.6%)	10.3%	21.2%
Adj EBIT growth		(4.2%)	(97.4%)	114.0%	114.0%
Adj PBT growth		(4.1%)	(97.2%)	101.9%	111.6%
Adj EPS growth		(11.0%)	(97.2%)	94.2%	107.2%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		31.0%	1.0%	2.0%	4.0%
VALUATION	**2021**	**2022**	**2023E**	**2024E**	**2025E**
EV/Sales (x)	0.4	0.3	0.4	0.3	0.3
EV/EBITDA (x)	0.8	0.8	3.6	3.3	2.7
EV/NOPAT (x)	1.5	1.6	66.0	32.7	15.5
PER (x)	1.9	2.2	78.6	40.5	19.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	(0.1%)	(0.1%)	0.0%	0.0%	0.0%

Source: Company information and Progressive Equity Research estimates

26 September 2023

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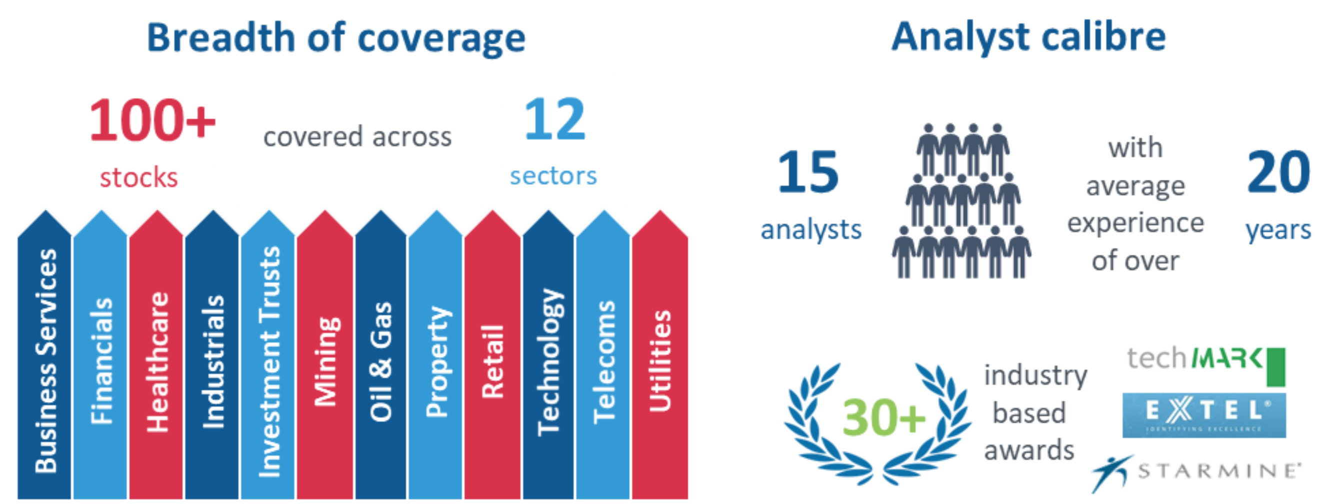

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