HUUUGE

Santander Biuro Maklerskie

Bloomberg: HUG WA, Reuters: HUG.WA

CEE Equity Research

Gaming, Poland

14 February 2023, 08:25 CET

Hu(uu)ge decision time coming

Maintaining Outperform, TP up at PLN36

It's been almost 6 months since HUG started strategic options review with the aim to maximize value for shareholders through attracting a new strategic investor. It seems to us that the investment community is slowly losing confidence potential new investor might appear. We would not be surprised if new investor were not coming.

But we tend to believe HUG already created more value than potential investor could offer to shareholders. First, HUG significantly improved results through cost cutting. Secondly, HUG invests for the future through publishing agreements avoiding risky M&As. Thirdly, HUG invests in new technology to drive future results (WebShop, metaverse, AI).

We expect either new investor on one hand or significant dividend / buyback on the other hand as HUG has almost 50% of mcap in cash. We reiterate Outperform rating with TP increased to PLN36.

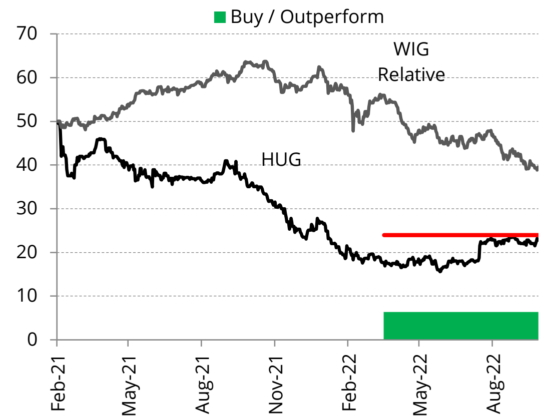
Improved results. HUG's user acquisition costs decreased from USD 40m in 1Q21 to around USD 12 in 4Q22 (on our estimates). Should we assume such low UAC for the whole 2023, we tend to believe HUG could still surprise with the upside in terms of EBITDA generation as revenues do not fall to the extent of costs decrease. On our numbers HUG is traded at FCF yield of above 12%.

Investments for the future. HUG acquired Traffic Puzzle in 2021 and burnt cash on this M&A. Investors are afraid the company might make the same mistake potentially in the future but HUG has signalled a potential change in course and has invested in future growth through two publishing deals that do not tie significant amount of cash.

Investments in technology. HUG is also active on technology field. The company is aware of potential metaverse impact on gaming segment. HUG has started WebShop for its most important clients that should improve gross margins in the future. Also testing new AI solutions to optimize costs is also of interest for HUG (though costs optimization on AI are hard to be calculated for the moment).

Valuation and risks. We set our target price for HUG at PLN36 and reiterate Outperform rating. The risks to our investment view include volumes of micro transactions or potential value destructive M&As.

Recommendation	Outperform
Target Price (Dec 2023, PLN)	36
Price (PLN, 13 February 2023)	23.7
Market cap (PLNbn)	2.0
Free float	70%
Number of shares (mn)	84.2



The chart measures performance against the WIG index.

Main shareholders	% of votes
Anton Gauffin	30.7%
Raine Group	12.9%
NN Pension Fund	8.3%
Huuuge	6.7%

Source: Company data

Company description

Huuuge is the largest FTP (free-to-play) developer listed on WSE. Two social casino games are most important products of Huuuge.

HUG: Financial summary and ratios (year to December)

PLNmn	2019	2020	2021	2022E	2023E	2024E
Revenues	259.4	332.7	373.7	319.7	293.5	294.4
EBITDA Adj.	16.2	53.5	52.6	81.8	85.4	82.3
EBIT	14.2	50.2	44.6	71.8	73.4	70.3
Net profit	4.3	-82.6	-9.7	56.7	58.0	55.6
P/E (x)	227.3	-11.7	-60.2	8.7	8.6	9.3
EV/ EBITDA Adj. (x)	22.7	5.6	3.6	3.1	2.3	1.9
FCF Yield	3.2%	17.2%	3.5%	7.5%	12.7%	12.5%
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, Santander Brokerage Poland estimates
Historical 2019-21 valuation ratios based on historical average prices

Analyst

Piotr Zielonka, CFA, *Equity Analyst*

+48 22 534 16 10 piotr.zielonka@santander.pl

Valuation

Our target price for HUG is derived from DCF model and goes up to PLN 36. Our valuation is 100% DCF based, not taking peer comparison into account as gaming companies results are dependent on timing of new games releases and thus not effectively comparable.

Fig. 1. HUG: Valuation summary

Method	Value (PLN)	Weight
DCF	36.0	100%
Peer comparison	42.0	0%
Target price* (PLN)	**36.0**	

*Source: Santander Brokerage Poland estimates *100% DCF, NOTE: rounded to the nearest integer*

DCF

We value HUG using DCF at PLN 36/share. We use WACC of 8.0% based on Capital Asset Pricing Model with RFR of 5.0%, ERP of 3.0% and beta of 1.0x. For terminal assumption we use -3% (negative 3%) growth rate to calculate EBIT for HUG.

Fig. 2. HUG: DCF summary

PLNmn	2022E	2023E	2024E	LT
Revenues	320	294	294	286
EBIT	72	73	70	68
Tax rate	*21%*	*21%*	*21%*	*21%*
NOPAT	57	58	56	54
D&A	10	12	12	10
Capex	-28	-3	-3	-10
Change in WC	0	0	0	0
FCF	39	67	65	54

Source: Santander Brokerage Poland estimates

Peer comparison

Fig. 3. HUG: Peer comparison (prices as of 11 February 2023).

Company name	Curr	Price	MCAP	P/E (x)			EV/EBITDA (x)		
			PLNmn	2022E	2023E	2024E	2022E	2023E	2024E
CD PROJEKT	PLN	138.6	9,115	41.0	27.3	53.2	28.2	20.4	41.1
11BIT	PLN	586.0	1,250	61.4	155.1	8.8	57.2	159.8	7.0
PLAYWAY	PLN	395.0	1,610	18.7	16.1	15.6	13.8	11.5	11.0
MEDIAN				**41.0**	**27.3**	**15.6**	**28.2**	**20.4**	**11.0**

Source: Bloomberg consensus estimates, Santander Brokerage Poland estimates

Fig. 4. HUG: Assumptions, forecasts and ratios

Key ratios	2018	2019	2020	2021	2022E	2023E	2024E
EPS (PLN)	0.15	0.22	-4.26	-0.50	2.89	2.92	2.68
DPS (PLN)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
BVPS (PLN)	-0.11	-0.24	-1.14	2.68	3.32	3.95	4.40
No of shares (mn)	84.2	84.2	84.2	84.2	85.2	86.2	90.0
MCAP (PLN mn)	4,212	4,212	4,212	2,527	2,131	2,156	2,250
EV (PLN mn)	4,061	4,098	3,804	1,640	1,084	832	643
P/E (x)	328.7	227.3	-11.7	-60.2	8.7	8.6	9.3
P/BV (x)	43.3	24.1	11.8	7.0	4.3	4.1	4.9
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
FCF yield (x)	0.5%	3.2%	17.2%	3.5%	7.5%	12.7%	12.5%
EV/Sales (x)	4.0	3.6	2.6	1.0	0.8	0.7	0.5
EV/EBITDA Adj. (x)	98.8	22.7	5.6	3.6	3.1	2.3	1.9

Income statement	2018	2019	2020	2021	2022E	2023E	2024E
Revenues	236	259	333	374	320	294	294
EBITDA Adj.	8	16	54	53	82	85	82
D&A	1	2	3	8	10	12	12
EBIT	8	14	50	45	72	73	70
Net financial costs	-3	-5	-126	-46	0	0	0
Pre-tax profit	5	9	-76	-1	72	73	70
Tax	2	5	6	9	15	15	15
Minorities	0	0	0	0	0	0	0
Net profit	3	4	-83	-10	57	58	56
Adj. EBITDA margin	3.5%	6.3%	16.1%	14.1%	25.6%	29.1%	28.0%
EBIT margin	3.2%	5.5%	15.1%	11.9%	22.5%	25.0%	23.9%
Net margin	1.3%	1.6%	-24.8%	-2.6%	17.7%	19.8%	18.9%

Balance sheet	2018	2019	2020	2021	2022E	2023E	2024E
PPE	1	1	3	4	22	13	4
Goodwill	0	0	0	0	0	0	0
Intangibles	0	0	0	0	0	0	0
Other non-current assets	1	3	15	64	64	64	64
Cash	35	26	94	204	241	305	370
Other current assets	17	22	30	28	25	23	23
Total Assets	54	53	142	300	352	404	461
Equity	-9	-20	-96	226	283	341	396
Minorities	0	0	0	0	0	0	0
Short and Long term Debt	0	0	0	0	0	0	0
Other liabilities	63	73	238	74	69	63	64
Total Equity and Liabilities	54	53	142	300	352	404	461
Net debt	-35	-26	-94	-204	-241	-305	-370
Net debt to EBITDA Adj. (x)	-4.3	-1.6	-1.8	-3.9	-3.0	-3.6	-4.5

Cash flow statement	2018	2019	2020	2021	2022E	2023E	2024E
Operating CF	4	13	73	30	65	67	68
Investing CF	-1	-1	-5	-16	-28	-3	-3
FCF pre dividends	4	12	68	14	37	64	65
Dividends paid	0	0	0	0	0	0	0

*Source: Company data, Santander Brokerage Poland estimates *NOTE: solely Santander Brokerage Poland estimates*

Investment thesis

- HUG is one of the biggest game developers in Poland with two core franchises in online casino gaming segment.
- HUG's strategy is to maintain the highest possible cash flow from the core games while investing in new gaming projects. To minimize risk the company decided to invest in new games through publishing rather than via M&A.

Valuation

- Our target price of PLN36 is based on DCF model. We use DCF as the only valuation tool as HUG's results in 2022E-24E are not comparable to other developers due to differences in business models
- HUG is trading at FCF yield of 12.0% for 2022E-24E.

Risks

- Lower than expected volumes in future games.
- Higher than expected development costs.

Santander Brokerage Poland

Jana Pawla II Avenue 17
00-854 Warszawa
fax. (+48) 22 586 81 09

Equity Research

Kamil Stolarski, PhD, CFA, *Head of Equity Research* *Banks, Insurers, Strategy*	tel. (+48) 22 586 81 00	kamil.stolarski@santander.pl
Paweł Puchalski, CFA, *Equity Analyst* *Telecommunications, Metals & Mining, Power*	tel. (+48) 22 586 80 95	pawel.puchalski@santander.pl
Tomasz Krukowski, CFA, *Equity Analyst* *Oil&Gas, Pharma & Biotech, CEE Non-Financials*	tel. (+48) 22 586 81 55	tomasz.krukowski@santander.pl
Adrian Kyrcz, *Equity Analyst* *Construction, Real Estate, IT*	tel. (+48) 22 586 81 59	adrian.kyrcz@santander.pl
Tomasz Sokołowski, *Equity Analyst* *Consumer, E-commerce*	tel. (+48) 22 586 82 36	tomasz.sokolowski@santander.pl
Michał Sopiel, *Equity Analyst* *Industrials, Chemicals, Quantitative Analysis*	tel. (+48) 22 586 82 33	michal.sopiel@santander.pl
Piotr Zielonka, CFA, *Equity Analyst* *Gaming, Strategy*	tel. (+48) 22 534 16 10	piotr.zielonka@santander.pl
Marcin Działek, *Analyst* *Technical Analysis*	tel. (+48) 22 782 93 09	marcin.dzialek@santander.pl

Sales & Trading

Kamil Kalemba, *Head of Institutional Equities*	tel. (+48) 22 586 80 84	kamil.kalemba@santander.pl
Mateusz Choromański, CFA, Head of Sales *Securities Broker, Investment Advisor*	tel. (+48) 22 586 80 82	mateusz.choromanski@santander.pl
Alex Kamiński	tel. (+48) 22 586 80 63	alex.kaminski@santander.pl
Błażej Leśków, *Securities Broker*	tel. (+48) 22 586 80 83	blazej.leskow@santander.pl
Michał Stępkowski, *Securities Broker*	tel. (+48) 22 586 85 15	michal.stepkowski@santander.pl
Marek Wardzyński, *Securities Broker*	tel. (+48) 22 586 80 87	marek.wardzynski@santander.pl
Adam Mizera, *ACCA, CFA, Securities Broker* adam.mizera@santander.pl	tel. (+48) 22 586 85 14	

DISCLOSURES

All of the views expressed in this report accurately reflect the personal views of the Analyst of Equity Research Team in Santander Brokerage Poland which is a separate organizational unit of Santander Bank Polska S.A. ("Santander Bank Polska"), who is the author of this report.
Santander Brokerage Poland emphasizes that this document is going to be updated at least once a year.

Santander Brokerage Poland acts as a market maker / liquidity provider, on principles specified in the Regulations of the Warsaw Stock Exchange (WSE), for the shares of **Huuuge SA** and therefore holds financial instruments issued by this issuer / these issuers.

The issuer / issuers this report relates to, may hold shares of Santander Bank Polska in the amount of less than 5% of the total issued capital.
Santander Bank Polska Group, its affiliates, representatives or employees may occasionally undertake transactions or may be interested in acquiring securities of companies directly or indirectly related to those being analysed.
Santander Bank Polska or its affiliates may, from time to time, to the extent permitted by law, participate or invest in financing transactions with issuer / issuers this report relates to, perform services for or solicit business from such issuers and/or have a position or effect transactions in the financial instruments issued by these issuers(especially in relation to the services provided by PTE Santander Allianz SA), ad as a result Santander Bank Polska may be indirectly connected with these issuers.
Santander Bank Polska does not rule out that in the period of preparing this report any Affiliate of Santander Bank Polska might purchase shares of the Issuer or any financial instruments being the subject of this report which may cause reaching at least 0,5% of the share capital.
Subject to the above, the Issuer is not bound by any contractual relationship with Santander Bank Polska, which might influence the objectivity of the recommendations contained in this report.
However, it cannot be ruled out that, in the period in which this report is in force, Santander Bank Polska will submit an offer to provide services for the issuer / issuers this report relates to, or will purchase or dispose of financial instruments issued by these issuers or whose value depends on the value of financial instruments issued by these issuers.
With the exception of remuneration from the Santander Brokerage Poland Analysts do not receive any other form of compensation for recommendations made. Remuneration received by the persons who prepare this report may be dependent, in an indirect way, from financial results gained from investment banking transactions, related to financial instruments issued by the Issuer, made by Santander Brokerage Poland or its Affiliates.

Global statistics presenting the rating of the covered companies and the share of companies provided with investment banking in the past 12M are available at: https://www.santander.pl/inwestor/global-statistics
A list of all recommendations on any financial instrument or issuer that were disseminated by Santander Brokerage Poland during the preceding 12 month period can be found on: http://centruminformacji.santander.pl/_fileserver/item/1501616

LIMITATION OF LIABILITY

This report was produced by Santander Brokerage Poland which is a separate organizational unit of Santander Bank Polska S.A. (Santander Bank Polska) with its registered office in Warsaw. Santander Brokerage Poland and brokerage activity conducted by Santander Brokerage Poland is subject to the supervision of the Financial Supervision Commission with its headquarters in Warsaw.
Santander Brokerage Poland is subject to the regulations of the Act on Trading in Financial Instruments dated July 29th 2005 (Journal of Laws of 2018, item 2286 - consolidated text, further amended), Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies dated July 29th 2005 (Journal of Laws of 2019 item 623 - consolidated text, further amended), Act on Capital Market Supervision dated July 29th 2005 (Journal of Laws of 2019, item 1871 – consolidated text, further amended). This report is addressed to qualified investors and professional clients as defined under the above indicated regulations and to Clients of Santander Brokerage Poland entitled to gain research reports based on the brokerage services agreements.
Santander Brokerage Poland may not have taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. The investments and services contained or referred to in this report may not be suitable for particular investor and it is recommended to consult an independent investment advisor in case of doubts about such investments or investment services. Nothing in this report constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to investor's individual circumstances, or otherwise constitutes a personal recommendation to particular investor.
Affiliates of Santander Bank Polska may, from time to time, to the extent permitted by law, participate or invest in financing transactions with the issuer / issuers this report relates to, perform services for or solicit business from such issuers and/or have a position or effect transactions in the financial instruments issued by these issuers. Santander Brokerage Poland may, to the extent permitted by applicable Polish law, UK law and other applicable law or regulation, effect transactions in the Financial instruments before this report is published to recipients.
Santander Brokerage Poland may have issued, and may in the future issue, other research reports that may be inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them and Santander Brokerage Poland is under no obligation to ensure that such other reports are brought to the attention of any recipient of this report.
Santander Brokerage Poland informs that success in past recommendations is not a guarantee of success in future ones.
Information and opinions contained herein have been compiled or gathered, with due care and diligence, by Santander Brokerage Poland from sources believed to be reliable, however Santander Brokerage Poland cannot ensure their accuracy or completeness. Investor shall be responsible for conducting their own investigation and analysis of the information contained or referred to in this report and of evaluating the merits and risks involved in the Financial instruments forming the subject matter of this report. The information and opinions contained herein are subject to change without any notice.
Santander Brokerage Poland is not responsible for any losses incurred by Investors which were result of investment decisions based on recommendations issued by Santander Brokerage Poland, on condition that they were prepared with due care and diligence.
This report does not constitute an offer or invitation to subscribe for or purchase or carry out transactions in any financial instruments and shall not be considered as an offer to sell or to buy any securities. This report is furnished and presented to you solely for your information and shall not be reproduced or redistributed to any other person. This report nor any copy hereof shall not be disseminated, published or distributed directly or indirectly in the United States of America, Canada, Australia or Japan. Disseminating, publishing or distributing of this report directly or indirectly in the above countries or to any citizen or resident of these countries may be considered breach of the law or regulations related to the financial instruments in force in these countries. Dissemination, publishing or distribution of this report may be restricted by law in other countries. Persons who distribute this report shall make themselves aware of and adhere to any such restrictions. This report may be distributed in the United Kingdom to persons who have professional knowledge about investing in accordance with relevant regulations.
Opinions in this report must not be relied upon as having been authorised or approved by issuer. Santander Brokerage Poland informs that investing assets in financial instruments implies the risk of losing part or all the invested assets.
Santander Brokerage Poland indicates that the price of the financial instruments is influenced by lots of different factors, which are not or cannot be dependent from issuer and its business results. These are factors such as changing economical, law, political or tax condition. More information on financial instruments and risk connected with them can be found on www.santander.pl/inwestor section disclaimers and risk.
The decision to purchase any of the financial instruments should be made only on the basis of the prospectus, offering circular or other documents and materials which are published on general release on the basis of polish law.

Ratings definitions:

Outperform – Total return 10% above benchmark. Upside of approximately ≥15%.
Neutral - Total return 0%-10% above benchmark. Upside of approximately 5%-15%.
Underperform - Total return below benchmark. Upside of approximately <5%.
NOTE: The relevant benchmark for European Equities (including CEE Equities) is the 1Y German Bund rate +ERP (5.5%).
The definition of ratings are indicative. Recommendations may differ from these guidelines when justified due to the market factors, industry trends, company specific event, etc. In such cases, a pertinent clarification for the discrepancy is included in the report.

Target prices set from January to June are for December 31st of the current year. Target prices set from July to December are for December 31st of the following year.
Periodicity: our recommendations/ target prices for each issuer are going to be reviewed at least once a year and whenever market events so warrant.

In the Technical Analysis reports (TA reports), Santander Brokerage Poland does not apply direct investment ratings, and all opinions and elements of analysts' assessment are included in a descriptive form in the study itself.
The period of validity of the TA report is a maximum of 30 days, while the publication of a new TA report for a given financial instrument means that the previously published study is no longer valid.
Due to the short time horizon of the Technical Analysis reports, Santander Brokerage Poland is not going to update them on a regular basis.

In preparing this report Santander Brokerage Poland applied at least one of the following valuation methods: discounted cash flows (DCF), comparative, mid-cycle, dividend discount model (DDM), residual income, warranted equity method (WEV), SOTP valuation, liquidation value.
The discounted cash flows (DCF) valuation method is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The comparative valuation method is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.
The mid-cycle multiple valuation is based on long-term average valuation multiples of a sector or a peer group. The methodology aims to calculate a fair, through the cycle value of the company. Among its shortfalls is that at peaks and/or troughs of the cycle, the implied fair value may deviate substantially from the market's value of an analysed stock as well as the methods' reliance on the quality of external data (we usually use Bloomberg or Damodaran databases).
Simplicity and average through-cycle value allowing to capture over- as well as under-valuation of a given stock are the main advantages of this methodology.
The dividend discount model (DDM) valuation is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.
Residual income method is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The warranted equity method (WEV) is based on the formula P/BV = (two year forward ROE less sustainable growth rate)/(Cost of equity less sustainable growth rate) which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.
SOTP valuation - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.
Liquidation value method – liquidation value is the estimated amount of money that an asset or company could be quickly sold for, such as if it were to go out of business. Then, the estimated assets value is adjusted for liabilities and liquidation expenses. One advantage of this valuation method is its simplicity. This method does not account for intangible assets as goodwill, which is the main disadvantage.

In the opinion of Santander Brokerage Poland, this report has been prepared with all due diligence and excludes any conflict of interests which could influence its content. In Santander Bank Polska there are implemented internal regulations, which are designed to prevent conflicts of interest concerning recommendations. Physical and logic barriers are established, and the principles of documentation adequate to the type of Santander Bank Polska operations are implemented. Additionally, Santander Bank Polska introduced a number of obligations and restrictions relating to the protection of confidential information flow between organizational units.
The date and time on the first page of this report indicates the date of the production of the recommendation, and the dissemination of the recommendation takes place on the same day before the start of the session.

ANY PERSON WHO ACCEPTS THIS REPORT AGREES TO BE BOUND BY THE FOREGOING DISCLAIMER AND LIMITATIONS.