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# Stillfront Group AB (SF.SE)

Q2 2022 Earnings Call

## CORPORATE PARTICIPANTS

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### Andreas Uddman

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## OTHER PARTICIPANTS

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### Oscar Erixon

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## MANAGEMENT DISCUSSION SECTION

### Hans Jörgen Larsson

*Chief Executive Officer, Stillfront Group AB*

Welcome to our Stillfront Group Q2 Earnings Call. I will be presenting, along with our CFO, Andreas, today's presentation and there would be a Q&A session afterwards in the ordinary way. So, please, the first slide, the next slide.

Since the last month of last year, we have gained great momentum into Q1, and that has continued into Q2. Our revenues grew in Q2 by 31% and, in total we're at a 1% organic growth. This performance has been primarily driven by the new games that we have launched to the market and the new games that we launched earlier that we have been able to scale up alongside that we have created synergies when it comes to the several areas and collaborations between the different studios that has gained momentum. And also last but not least, we have had a successful live ops, which is a very efficient way of growing our revenues in a cost efficient way.

We also outperformed a strong cash flow, as we have done for several quarters now and the cash flow grew – the LTM cash flow grew by 18% in the quarter. On the right hand side, you can see also the distribution of our revenues, where we have North America still being the largest bulk, but you can see also that Asia is increasing and Asia is almost on par with Europe. You can also see, through the red dots there, that we are a truly global company which is not only looking beautiful on this map, but it's very important because that is the way that we can have the proximity to different markets and that we really can leverage our market reach capabilities to support all our studios worldwide.

Next slide, please. So, just some highlights from the portfolio during the second quarter. So, we had three new games coming into our active portfolio during the quarter. And in total we have had 14 games coming in

organically the last year. So we had a good outcome of the increased soft launch – that we have increased investments that we started some 12, 18 months ago. Also, we have enjoyed a continuous good momentum with Bytro's grand strategy engine-based games. So now we have five games out there from three different studios built upon on the same very successful engine and this is providing us with a strong component in our total organic growth and has been so for some time and we expect it will be going forward as well.

Nanobit also had an exciting quarter, both with – we announced the collaboration with Netflix taking a game to the market in 2023, which is yet another example of how we can get leverage on our existing assets, our existing game engines, in this case in collaboration with Netflix. And it's yet another dimension of the Stillops platform and how we gain access to new distribution forms through, in this case, a good collaboration with Netflix. Also, Nanobit has a very successful scaling up of their new game Winked during the quarter. So, that has really contributed to a good development for Nanobit and for the group. And also, we've seen that BitLife has a very good trajectory in the quarter with a lot of live ops and several feature updates that has been very well received amongst the users. So, Candywriter has been growing 40% year-over-year organically, which of course is a very strong performance. Further, we have a good collaboration between Candywriter that is the publisher and the developer behind BitLife, together with Goodgame, we have made contracts and adopted versions of BitLife in Portuguese and in Spanish. So we have had some good traction in Latin America during the second quarter, and we are enthusiastic what that would bring for the next go-forward basically.

Next slide, please. Looking into our financials, we had, as mentioned, 31% growth in total revenues where around 1% in organic revenue. So the SEK 1,811 million in revenues are built up and developed from last year according to the revenue bridge you can see on the upper right corner of the slide here. So 1% organic growth, just shy of 21% of acquired growth and 10% positive FX effect during the quarter. We have been able to deploy continuously high UA levels without compromising on our profitability targets or the rollouts of less than 180 days. And I'm very pleased to see that we have been able to do this. And very much again, the reason why we can achieve this during a quarter where the market has been a bit mixed, is that we again, leverage the Stillops capabilities and our marketing capabilities the way that we have this data-driven way of marketing our products and rapidly reallocate UA to where it needs the best un-regarded geography and un-regarded product and channel. So, I think that definitely, that is one of the explanations that why we have been able to improve our top line that much in the quarter.

We have slightly lower margins compared to Q1 and Q2 and that is due to that we have several growth initiatives ongoing both, of course, that we invest more in new products that increased the DNA, but also that we have slightly increased the investments and cost taken for improving the Stillops platform further, improving our data capabilities further, as well as the different – other parts of the Stillops platform that is yielding return we think already and we'll do so even more in the future. We also have a different product mix in the quarter with higher degree of mobile revenues, less ad revenues and also that 6waves is consolidated for the first time, the fourth quarter which has a lower gross margin. So that is also something that impacts, but we are convinced that this will be improved in the short to midterm, the different components supporting our margin expansion going forward. And we reiterate that our organic growth will be in the mid-single digit area for the full year this year. Finally, we can also mention that our LTM curve for net revenues is increasing steadily as you can see on the slide here. So, it amounted to SEK 6,243 million the last 12 months now in Q2.

If we can go to the next slide, please. Looking into our total portfolio, we have continued to strengthen and balance further and not at least diversified further our portfolio. This is a pillar in our strategy to have a very strong leader risk reward looking into our portfolio. I think that we have taken a lot of important steps during this quarter as well, just as we have done for this year. So I think that is maybe one of the most important things. So now, with the three new games added to our portfolio, we have 76 products in our active portfolio. And you can also see

how the daily actives and the monthly active users year-on-year has been very, very stable. Whereas our monthly paying users have increased by 8%, showing that our live ops and the traffic that we have acquired contains a higher degree of conversion into paying users, which is, of course, satisfactory. That is also mirroring [indiscernible] (00:08:35) we have had a strong development during the quarter. The share of mobile, as mentioned, increased to being 79% of the total revenues. Ad bookings down in percentage wise of the total revenues to 16%. It's fairly flat in absolute numbers, but it's lower in relative numbers. You can also see the distribution between our different areas and it's pleasing to see that the strategy is, again, increasing to 35%, and we can look into some more details on the next slide for the different product areas.

So, next slide, please. So, we can see that it's a very strong development for our strategy. So, I said it last quarter, I'll say it again, the strategy strikes back, growing some 83% year-over-year, and with a high degree of that coming from organic growth and it's a core strength. You can also see that in our average revenue per daily active users. It's really increasing for strategy, showing that our content and the updates and what we do with our live ops in general are very appreciated in our audience. Of course, also supported by the fact that 6waves are part of our group now for the first full quarter. Also Casual & Mash-up are growing which is satisfactory to see by 24% year-on-year. The only area that is not as product area regarded is growing – it's slightly declining by 3% year-over-year is Simulation, RPG & Action, and that is basically due to the fact that we're not allocating as much UA to that area as we do to the other ones because it's not nearly as much as the other areas in this quarter. But I'm sure that we will see further traction later in this year also in that area.

It's good to see that all three product areas is improving their monetization despite the fact that we have a higher degree of new products which is usually not monetizing as good as a mature product. Whether it's a new product. So still, we are able to cross the board, increase our average revenue per daily active users, not only in strategy. And as mentioned, the number of paying users are significantly improving, not the least in strategy that is contributing in that respect as well.

So, with that, I would like to hand over to Andreas to go deeper into some of the financial aspects. Please, Andreas.

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## Andreas Uddman

*Chief Financial Officer, Stillfront Group AB*

Thank you, Jörgen, and turn to the next slide, please. To start with the cash flow for Q2. We have a continuous strong cash flow development for operations of SEK 477 million, prior to working capital movements. This includes taxes paid of SEK 58 million. In the quarter, we had a negative effect from working capital movements, mainly due to accounts payable being paid, which is a reversal from Q1 with SEK 27 million. So cash flow from operations after net working capital is SEK 450 million. We continue to invest in our products. We spend in total from our investments SEK 829 million in the quarter. SEK 249 million of that is for product development from new products, which is the equivalent of 13.8% of net revenues. We also settled some of the cash components for the earn-outs relating to 2021 and that had a negative effect on investment activities of SEK 523 million. In terms of financing, fairly flat, negative SEK 4 million mainly driven by lease payments of SEK 50 million offset by some slight increase in borrowings for the quarter. We exit Q2 with a cash position of SEK 1.47 billion; so a strong cash flow once again for the quarter.

Looking at our LTM numbers, it's always important to look at how that grows. In the last 12 months, we generated from operations after deducting the IFRS 16 or lease costs at SEK 1.85 billion of free cash flow and this is an increase by SEK 452 million versus last year. We have continued and tactically decided to continue to invest in our products and we spend SEK 832 million, which is an increase from last year of SEK 302 million. In relation to net revenues of the same period, that's 13.3%. It is, however, important to note that we do continue to spend,

grow our operating cash flow more in absolute terms than our investments cash flow. So we are over the period increasing our cash flow after investments of SEK 151 million to just over SEK 1 billion. Cash conversion is SEK 0.45 million in the quarter.

And with that, please, for the next slide. Net debt, that has been fairly stable versus last year, SEK 3.6 billion. It increased with SEK 450 million from Q1, which is mainly due to the settlements of earn-outs where we reduced our free cash that we had at Q1. We had a leverage ratio of 1.4, which is below our target of 1.5. We have a strong cash position of SEK 1.47 billion of cash at hand. Plus we also have SEK 2.3 billion of unutilized credit facility when we exit the quarter. Looking to the right side of this slide, we have a balanced and have maturity profile on our debt, which assures that we can both tackle a market uncertainty and be well-prepared to refinance our existing facilities when we need to.

So then, just to summarize, we continue to have our diversification in revenues. We now have 76 games versus 56 games in Q2 last year. We have continued to invest in our product portfolio and in Stillops platform. This is supported by strong underlying cash flow and also continued healthy margins. This, together with our diversified financing platform, allows us to continue to invest in the business and if we selectively look at M&A opportunities going forward. So, a strong balance sheet position and good cash flow generation from the business in line with previous quarters as well.

And with that, I will hand over to back to Jörgen.

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## Hans Jörgen Larsson

*Chief Executive Officer, Stillfront Group AB*

Thank you, Andreas. We can go into the next slide and some summary, a short summary and an outlook. So, we have returned to organic growth, something that has been our priority and I'm pleased to see that we can go from a minus 7% to a plus 1% of organic growth in just one quarter, and we can do that with a good profitability and a very strong cash generation, as Andreas pointed out. We are entering into the weaker seasonality that we have had, I think, for, if not all, almost all of the 12 years of this company's history. We expect that to be following the quite usual pattern. As for the ones that have followed us for a time, you know that the strategy of the games are more impacted on seasonality usually, than casual games but, all-in-all, we think it would be a quite usual seasonality in Q3. But to finalize, we do reiterate our – we are following our plan to be back on – or reach the mid-single digit organic growth for the full year. So I'm pleased to see that we are on track towards that guidance and that target.

So with that, I would like to open up for questions. Please take it away.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] And our first question comes from Nick Dempsey, Barclays. Please go ahead. Your line is now open.

**Nick Dempsey**

*Analyst, Barclays Capital Securities Ltd.*

Q

Yes. Good morning, guys. I've got three questions. So first of all, with strategy, organic up 29% in the quarter. Simulation, RPG & Action there's no M&A in there, so we can have a decent idea of what organic is. I still get Casual & Mash-up being negative organic growth. And then when I dig into that division can be right at going really well. So, does that mean we're still seeing notable organic year-on-year declines from Super Free and Storm8 combined? And should that start to ease in the second half, if I'm right on that?

And a question, a year on from IDFA change, do you think that with all of the adjustments that you've made internally and the adjustments made by external players you use for marketing that you can now achieve close to the same level of targeting for the same unit of spend as you did before the change or not?

And third question, with the US dollar moving in your favor, should that help margins a bit in the second half as I guess your revenues are a bit more weighted to dollar than your costs, though?

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

Thank you, Nick. I can start on the FX. I think Andreas could take the last question. So when it comes to organic growth from the different areas, you're correct in that we are still not where we are heading and where we would like to be when it comes to organic Casual & Mash-up, but we are definitely in the situation where we have closed the gap on this issue we have with the very uneven performance from Super Free last year, which we have elaborated on. Remind, however, that Super Free did grow top line wise full year 2021 versus full year 2020. So it's not like they were in a crisis situation in any way, but it was a very uneven top line development for Super Free, which make the comp thing very uneven as well, of course. I think that we will see continuous improvements – so we have seen continuous improvement from Super Free since October. And they have for the third consecutive quarter launched successfully a new game that comes into the active portfolio. So they are definitely in a good spot. They have not for the full quarter closed the gap, but they have closed the gap at the end of the quarter. So I hope and think that we will see them contributing to reported organic growth for the rest of the year.

Also, Storm8 has been developing nicely. They had, as you might recall, a tremendous uplift from the pandemic. So they were the ones that grew the most the first quarter being onboard with almost 70% organic growth in one quarter or just actually in a few weeks. So they had been struggling with that comps, but the business is developing positively and they have been successful in several updates in their games, as mentioned in the report. So I'm also optimistic about that when we come out now of the comparison issues from the pandemic, especially for Storm8, they will also contribute later in the year with reported organic growth. So for us, internally, that is not a special topic anymore with Super Free and it hasn't been a special topic in that way for Storm8 as well. But you're right in the fact that we still need some time for it to be contributing organically for the quarter.

Coming to your second question on IDFA, I think that we are definitely post-IDFA. We have been so operationalized for several months now. So I think that what we can see and strengthened by the fact that our

best-performing area is strategy which weren't supposed to be most hit by the IDFA change. And I think that what this has made is that we are – on average, you have a lower LTV on the traffic that we buy since it's not as refined as it was pre-IDFA, but we also pay less so we can have the same relationship between LTV and CPI for a cohort nowadays. But then on our side where we have both the traffic, we refined the traffic. So, basically, we are strengthened from this fact even though it was quite an effort to get to that point. But now, we are refined into traffic and that is one of the reasons why we can be successful in growing strategy that well. So for us, it's not targeting in the same way that was pre-IDFA, but this is part of our industry and the very reason why we have been focusing so much on being data driven and building prediction models because it will always be different changes in different channels.

And that's the reason why we have focused so much on this market reach to mass the many different channels for many different products in many different territories, so we can always optimize which marketing campaigns that needs the best and allocate very dynamic and with a high discipline to where it needs the best. So, I think that is – we then have benefited from that, and we will benefit from that. So IDFA is not a topic for us or issue for us, and along where it hasn't been since the beginning of this year, actually. So I'm pleased with that.

And on your third question, I'll leave to Andreas to talk about the impact from FX.

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**Andreas Uddman**

*Chief Financial Officer, Stillfront Group AB*

A

No. I mean, you're right. It's been a very volatile FX market in the last few months, but even in the last week but in terms of how it impacts, Stillfront is we have a very strong hedge in our portfolio in terms of our P&L, that revenues are very linked to the direct costs. So – and also the – which includes, of course, platform fees and direct costs and also our marketing spend, but also the fact that our cost structure looks very similar to our revenue structure. So, it will, of course, impact the absolute numbers that you report, but it won't impact the margins as such, because we have a nice natural hedge in terms of that in our portfolio. So the cost structure is very similar to our revenue structure.

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**Nick Dempsey**

*Analyst, Barclays Capital Securities Ltd.*

Q

Great. That's helpful. Thank you.

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**Operator:** Thank you. And our next question comes from Oscar Erixon, Carnegie. Please go ahead. Your line is now open.

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**Oscar Erixon**

*Analyst, Carnegie Investment Bank AB*

Q

Thank you and good morning, guys. A couple of questions for me. First of all I'm very glad to see you be back to organic growth. You have some quite comment here on the return on ad spend and also on the sort of mobile gaming markets health in Q2 as opposed to some peers perhaps. Would you say that you have seen any data anomalies on any platforms for Q2? May, for example, looks quite strange from some providers would be useful to hear. Thank you.

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**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

Yes. We have seen some mixed signals [indiscernible] (00:26:10) third-party data. Having said that, I'm sure that the conclusion when this is sorted out or summarized, the second quarter will show a weaker development

against at least what we expected. So I wouldn't be surprised if the sum of the second quarter will be minus 5% in the mobile gaming markets or something like that. So it has been a much higher numbers that has been out there. And it's a bit uncertain about how the market has been developing in second quarter due to some data errors, but also that there is mixed signals in the market and we have seen the different subgenres and different types of products and different market has developed very differently. So, I think that some companies that has a low diversification has been suffering more and either compromising on margins or lowering their spend basically. So, I think that, again, the fact that we have a very diversified portfolio has supported us to grow much faster than the market we think has been growing in Q2.

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**Oscar Erixon**

*Analyst, Carnegie Investment Bank AB*

Q

Understood. And just a follow-up on that. Just curious to hear more about what subgenres have done well and not so well. I mean, Casual & Mash-up was quite strong, for example, for you compared to at least my expectations in Q2.

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**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

Yeah. So it's a multidimensional answer there. So I think we should not go into all aspects, but there are some suggestions that certain type of larger products have had the challenges to grow larger products and with smaller or mid-sized products and fairly large products have had it relatively easier. Strategy has been strong and that has been a bit stronger than I expected not only Q2, but for the first half of this year. Casual & Mash-up has been stable in market-wise I think. We are improving steadily but still some more mileage to walk and some of the Simulation, RPG games has been a bit weaker, RPG maybe. But it's quite not a very unified picture you can get from third-party data besides the fact that the market has been developing slower than most of us expected, I would say.

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**Oscar Erixon**

*Analyst, Carnegie Investment Bank AB*

Q

Understood. Very helpful. And two more questions if I may. One for you, Jörgen, and one for Andreas. So, first of all, I just want to understand the comments on return on ad spend a year a bit better. If the returns – are the returns is better in Q2 versus Q1, any further comments on that? And I mean the spending levels in absolute terms should reasonably logically bode well for Q3 growth, but you mentioned expecting usual seasonality despite this high spending. It would be useful to just hear your reasoning here, please.

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**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

Yeah, so we are pleased to see that we are well within our 180 days [indiscernible] (00:29:46) requirement, which is a very strict one. And the reason we have that is that we force ourselves to utilize the full of our market reach and the different channels that we master in different regions. And the fact that we now have 76 products in our portfolio. I would say that it's on par with Q1 and also Q4. So we have consistently been well within our 180 days. What differs is that we put more into strategy where it's tougher to get the money back within the breakeven within 180 days. So I'm pleased to see that even despite that we are increasing in relative terms in strategy, we can still return well within our 180 days. So, I think we have seen quite similar levels for the last three quarters that is what builds our momentum basically. Then within the second quarter, there are some – you referred to the third quarter data. We have unusual fluctuations within the quarter. So, April and June were stronger than May. So that was a bit unusual, but nothing big in that. But the important thing is that we have been able to deploy 26% in relation to net revenue. So, on a high level with very good returns.



When it comes to the seasonality, usually we are deploying a bit less in relation to topline in Q3, but that is of course – if we can deploy the same level as we do in Q2, that is of course supporting our growth so that we would like to do that, but we will not compromise on profitability and, usually, we cannot deploy that much. So I would expect that it would – it will tick up again in September, as it usually does and then we go into the six months or seven months of strong marketing opportunities following the ordinary pattern, basically. That is what we expect at this point in time.

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**Oscar Erixon**

*Analyst, Carnegie Investment Bank AB*



Fantastic. Thank you, Jörgen. And just one final question – sorry for asking so many questions – but, for Andreas, you talked a little bit about your debt structure. What's your view on refinancing versus not refinancing the debt maturing here, first of all, in 2022? But also, in 2023 more importantly, I mean you have, roughly, I think SEK 1.5 billion in cash but also earn-outs to be paid and quite nice free cash flows, it would be great to hear you elaborating [indiscernible] (00:32:33). Thank you.

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**Andreas Uddman**

*Chief Financial Officer, Stillfront Group AB*



I mean, we have a bond of SEK 600 million maturing in Q4 of this year. Of course, we're following closely the development of the bond markets. And we do have, as noted almost SEK 1.5 billion of cash and SEK 2.3 billion of unutilized facilities. And we have a cash flow generating business. So we are very comfortable that we will be able to deal with that. And then what and when, of course, we have to talk about when we get there. And then we have the next maturity, which is the end of 2023. That's with our banks and we have a good bank relationship or relationship with our banks. But as we always do with financing, we need to consider the market conditions. We need to consider how we work with this both from a strategic perspective, but also from a tactical perspective, but that's why we've been historically and now also conservative in what type of leverage we have and how high it is and also looking as much not just in the absolute value, but also on the maturity profile. So we always when we look at it, should be able to repay debt with existing cash from existing facilities, but as you probably know – you have noticed as well there are obviously various debt markets that are more difficult now but we are in no rush and have a strong balance sheet to sort of go through that period.

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**Oscar Erixon**

*Analyst, Carnegie Investment Bank AB*



Excellent. Thank you very much. That's very helpful.

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**Operator:** Thank you. And our next question comes from Chirag Vadhia, Bank of America. Your line is now open. Please go ahead.

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**Chirag Vadhia**

*Analyst, Bank of America*



Hi. Thanks for taking my questions. First one was just on EBIT margins, which were down this quarter. And you mentioned it was due to investments in growth initiatives and a short-term to mid-term effect in gross margins from the current product mix. Could you call out anything in particular that drove this and if you expect this to continue?

The second question was, how do you view the ad exposure of the group with revenues being cyclical in nature in a recessionary environment, in particular the Casual & Mash-up segment, which has more revenue [indiscernible]

(00:35:05)? And the final question is, what do you think is Apple's new version of SKAdNetwork announced at WWDC and do you think this will affect your user acquisition positively or negatively on iOS in a post-IDFA world? Thanks.

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**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

Thank you, Chirag. I will try to answer these questions. So when it comes to our margin that we see that we – if you look at EBITDA margin, you can see that we are 35%. So compared to the consensus out there, we get 2 percentage points more in D&A, which is the direct effect of that we have increased our investments in product development since 18 months and that has also paid off. So that is one discrepancy towards the consensus going into this is earnings call, this earnings – the Q2 report basically. But I think it's more with – it's as important. But looking into other parts where we see that we short-term to mid-term will improve our margins. Besides the obvious that UA, when that goes down to a more normal level or to a lower level, that directly correlates with our margin. But taking that away, we also have invested some – approximately equal to 1% in margin in our Stillops platform, our data capabilities where we're doing quite heavy investments or taking costs for that and some other parts, marketing capabilities, as I described, we see that that pays off very well. But some of that – approximately 1 percentage point in margin comes from our P&L.

On the gross margin, 6waves is taken into the group for the first full quarter this second quarter. They have third-party publishing today, absolutely dominating, which then provides us with a direct cost in terms of royalties. We have a very clear path that they already started prior to the acquisition. So get in more first-party publishing and second-party publishing. Further, we see a lot of synergy opportunities where they will publish in the Japanese market several of our others Stillfront portfolio games. So, obviously then, that will immediately have a very good, positive impact on gross margins. So I think that we have an opportunity to improve over some time. For a month maybe, we can improve the gross margin just by that, but maybe by 1.5% or so, that's the potential there.

And then the fact that we have increased mobile part of our business; also has an impact. In-game advertising down to 16%. I think we should be – we're not doing good enough, I would say. So I think we should be at the high-teens, even up to 20%. And if it would have been 20%, it's more like 1.5 percentage points improvement in gross margin as well. And as I mentioned earlier, yet another point that supports margin expansion looking, what 12 months ahead is that we then will have a less degree, in relative terms being young products and young products being under upscale, monetized slightly less than mature products. So that will also support our margins going forward. But we have done our decisions to prioritize getting back to organic growth, increasing our investments both in the Stillops platform as well as in our product pipeline. And that is paying off, so I'm pleased with that. So the other products, we have a clear plan on how to get back to the margins the way we were.

Looking at ad revenues, how that will be impacted eCPM [indiscernible] (00:39:08) goes down. I mean, this is, again, something where we – if we have an almost perfect in-built hedge in our business where we have ad revenues, yes, that will obviously go down if the eCPM goes down or the CPIs go down. On the other hand, that will support our marketing further. So this is the dynamic that is so important, strategically important for us to have established which should be higher than 16 in ad revenue so that will balance. We haven't seen any massive movements or large movements in eCPMs so far. They are more volatile but not a structural significant change so far, but it's hard to say what happens in second half of this year.

Your third question about the SKAdnetwork changes, I think it's early to say how that will exactly play out. We haven't received the full understanding – we haven't got the full understanding yet of what that is, but the first view and analysis from our data analysis and marketing people is that it will be unchanged to slight positive when that comes in, but again it's early to say anything more than that, but it will hardly be on the negative side, is our view.

**Chirag Vadhia**

*Analyst, Bank of America*

Thanks so much. Really helpful.

Q

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

Thank you.

A

**Operator:** Thank you. And our next question comes from Edward James, Berenberg Bank. Please go ahead. Your line is now open.

**Edward James**

*Analyst, Joh. Berenberg, Gossler & Co. KG (United Kingdom)*

Right. Thank you for taking my questions. Just a couple for me. So, just firstly on the Nanobit, the Netflix game, can you just discuss how revenue model for those games, are those licenses or upfront payments, are they kind of monetized and like the rest of your portfolio could you see a variety of revenue models for sort of platform partnerships like that?

Q

And second question, just on wages and cost inflation. Is that impacting the margin profile at all? Are you sort of seeing in line or higher or lower cost inflation versus some of your peers and sort of how is that impacting a sort of margin outlook? Thanks.

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

Thank you, Ed. When it comes to the Netflix collaboration, we cannot disclose the commercial terms, but we think it's a very good way for us to leverage our Stillops platform more precisely on our game engines. So, the game engines that Nanobit has developed fits very well with the narrative type of game, fits very well to other IP owners, not only in Netflix, potentially could also be other ones. Then, how do these look like? It's different from one case to another, but we are just as I think I'm convinced that Netflix are pleased with the deal that we did strike. So it has a positive impact for us, but I cannot unfortunately go into any details of that commercial agreement, but I think there is a strategic value. We value that collaboration highly. So we think there are more opportunities potentially in the future as well.

A

When it comes to the wage and cost inflation impact, first of all, a very important thing is to note that we have much lower staff cost in relation to net revenues than traditional game developer. We are at a bit over 16%, correct me if I'm wrong, Andreas. So, that means that if the inflation rate would be 10% across the board which we don't expect to be nearby, then we will have since half of that increase is capitalized, the P&L – immediate P&L effect would only be 0.8% approximately. So we are not that exposed to wage inflation. Having said that, in some areas, in some offices, in some regions, we see some wage inflation. In some other areas, since we are largely distributed globally, there is no or very little impact. So basically, large economies and large hubs, like in California, in San Francisco and, to some extent, in Germany, it's higher, whereas in Eastern Germany, it's lower. But also it will be interesting to see what kind of effect it will have, that some tech – several tech companies are actually lowering their staff in total. So the demand side and the supply side is changing slightly we expect during the second half of this year. Would you like to add something, Andreas, on that?

**Andreas Uddman**

*Chief Financial Officer, Stillfront Group AB*

A

Yes. We have been exposed to what I call the tech inflation for years, and that's what Jörgen was alluding to. Now, we have normal inflation, which we are not blind to, but it might be a offsetting effect between those two waves as such, which is important to keep in mind.

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

All right. Any more questions?

**Operator:** Yes. Our next question comes from Rasmus Engberg, Handelsbanken. Please go ahead. Your line is now open.

**Rasmus Engberg**

*Analyst, Svenska Handelsbanken AB*

Q

Yes. Hi, guys. Hi, Jörgen and Andreas. Just wanted to ask you a bit more longer-term. I mean you've been in the sort of an investment phase now for about a year or more to get back to organic growth and so on. Is this kind of the new Stillfront or are we – or is it kind of like as we go forward, the rate of expansion on new games is unchanged, meaning that the costs and maybe the potential investments are coming down sometime in the beginning of next year when we meet the comps or is it kind of a new Stillfront that we're seeing?

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

Thank you, Rasmus. So that's correct that we took a decision 18 months ago to increase our organic development of products. I think that has really paid off. We have 14 new games organically that has come out to the market and generated revenues on the levels to qualify for our active portfolio. So it has been a very fruitful and the good returns on these investments, but as communicated earlier, we have kept the base of 15 products for six months coming into soft launch. Some of them will fail. Some of them will be very successful and some of – the rest will be in between somewhere. So I think the outcome has been good. That, of course, as we now have 76 games on our portfolio, 15 games in relation to that is a lower number. So what you can expect is that, as we see it now, we will keep approximately this pace in absolute numbers, but in relative numbers, that will go down. That is what I expect now. Then of course, that is something that is evaluated constantly.

If we find good investments and get good traction and could do clever investments with a good risk reward, such as publishing more games [indiscernible] (00:47:20) and it has been exceptional successful for us with a very good risk reward and short time-to-market and good returns. So that we will like to do more of. But to summarize, I would expect us to have lower investments also when it comes to what we do with the Stillops platform. As I mentioned, that is maybe 1 percentage points that go in margins that go into increased cost for expanding our Stillops platform. So we have several very clear identified areas where we think that as our investment pace in relative terms goes down, it will support margin expansion in the next year. Would you like to add something, Andreas?

**Andreas Uddman**

*Chief Financial Officer, Stillfront Group AB*

A

No. I mean, it's just we have a very strong cash flow generating business. So, we can afford to make those tactical decisions. We are generating cash flow and we have decided and taken a decision to use some of that if

not all of it to continue to build Stillfront [indiscernible] (00:48:28) by the company. So that's why we can take that luxury and because we can afford it, just to add.

**Rasmus Engberg**

*Analyst, Svenska Handelsbanken AB*

Q

Yes. Thank you. Thank you very much.

**Operator:** Thank you. And our next question comes from Simon Jonsson of ABG. Please go ahead. Your line is now open.

**Simon Jonsson**

*Analyst, ABG Sundal Collier AB*

Q

Yeah. Hi, all. Two questions from me. So the first one, a question on 6waves. You said it was stable here in the quarter. Could you explain what that means? Does it mean that it maintains the Q3 LTM sales numbers you gave us of SEK 750 million or should we expect slightly declining sales until we see the new releases coming later this year?

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

First, we don't give explicit guidance on each of our studios like that way. But what we mean as stable is its revenue-wise stable, because it's strategy games. And strategy games, you know, we have had strategy games as core on our business for 12 years now. So they are very stable for the very straightforward reason that the loyalty amongst users when you're progressing a strategy game is very, very high. Having said that, it's also the area which is hot and most impacted by seasonality because you don't play the more time-consuming strategy games on average as much during the – when you are on holidays with your family or whatever it might be. And the audience is also a bit older on average than in Casual games. So considering that we not even have a full year with 6waves on board and it's not a perfect symmetry, the LTM before we entered and the February to June that they have been consolidated. So these five months are a bit softer than a full year average, I would say. But KPIs are looking very stable and we are looking forward to grasp the growth opportunities from their existing pipeline and not the least from publishing existing Stillfront games into the world's second largest market for mobile games, which is the Japanese 6waves has a very, very strong knowledge and position.

**Simon Jonsson**

*Analyst, ABG Sundal Collier AB*

Q

Okay. Thank you. And my second one, you commented on the LTV development earlier and how it has been impacted by the IDFA. You don't target the same way as before basically, but could you help us maybe understand how you're as confident in your estimation of LTV and ROIs as before even after privacy change shifts? What are the factors behind that as the visibility should be lower?

**Hans Jörgen Larsson**

*Chief Executive Officer, Stillfront Group AB*

A

The visibility is lower when it comes to looking at the traffic and buying the traffic. So it's less refined. We cannot be buying as precise targeting traffic as we could do pre-IDFA, but that is – again there's – it's a natural part of our industry that you will have changes all the time in the marketing conditions now IDFA was a bigger change because it came from a platform owner that changes in the platform for marketing will be something that we will see in the future as well. What this leads to is that we are doing the refinement of the traffic, so our prediction

models to analyze the traffic, which is not as refined. When we buy it, we do ourselves. So, the prediction model and the prediction rate and the precisioning in our predictions are on par with pre-IDFA, but it's different because we do more. We have refined our models. We have built new models on our side because we cannot get as precise traffic from our partners, the intermediaries where we buy our traffic from. So result is at least as good, which on an otherwise strategy would never be possible to grow as much as we have done. So the outcome is at least as good as pre-IDFA, but it's different, but that's why we are geared the way that we are. So yeah, that's my answer to that question basically.

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**Simon Jonsson***Analyst, ABG Sundal Collier AB*

Q

Okay. That makes sense. But could that also mean that you, as a larger scale player in the market, has an advantage?

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**Hans Jörgen Larsson***Chief Executive Officer, Stillfront Group AB*

A

Absolutely. I mean, if you're dependent on a few channels, I mean, the highway previously were if you were a US player, in particular, you work with primarily a large portion iOS and you work, to a large extent, with the channel on Facebook. That was the main road two years ago. And of course you're much more vulnerable, whereas Facebook entered into the issues with their algorithm as a consequence of IDFA. So I mean, we have very much and accelerating the leverage from the fact that we master many channels. We market many products and in many different territories. So you're absolutely right in that statement and that has accelerated, and it will continue to accelerate. So you benefit from having this diversity, indeed.

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**Simon Jonsson***Analyst, ABG Sundal Collier AB*

Q

All right. Thank you so much, Jörgen and Andreas. That was all from me.

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**Operator:** Thank you. [Operator Instructions] There are no further questions at this time. I hand over to you, speakers, for any closing remarks.

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**Hans Jörgen Larsson***Chief Executive Officer, Stillfront Group AB*

Thank you very much. And thank you, everyone, for dialing in this morning, and also for raising good questions so we have a good discussion and interaction and we are pleased to see you next quarter again, if not earlier.

Thank you, everyone, and have a great day.

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