16-Feb-2022

Stillfront Group AB (SF.SE)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

Good morning, everyone, and welcome to Stillfront's Q4 and Year-End Report. I'm here today with Andreas, our CFO, and we will make a presentation and then open up for Q&A.

Initially, on next slide, I would like just to update you on how Stillfront looks today. We are, as always, expanding and growing. So, now we are not less than 22 studios [ph] where over 21 (00:00:27) were consolidated and part of the Q4 number that we are reporting. We are working very systematically with building a larger and larger game portfolio – we will go further into that – that are typically characterized by attracting users over long time and also be long-life-cycle games. We are currently – or we currently have entertained 64 million unique users in the fourth quarter globally, and we are one – we were 1,381, to be precise, by the year-end, the professionals. And these professionals are located on the red dots, the offices that we have, on the map. And you can also see the distribution of our revenues generated from the 64 million users that we have. So, 49% of our revenue are generated in North America, 30% in Europe, and 15% in Asia. So, that is how Stillfront currently looks like or by the year-end.

Go into next slide, I will give you an update on some of the developments that we've had in our product portfolio. First of all, and very importantly, is that from the 15 products that entered into soft launch in the latter part of the year, already eight of them have been – have qualified to get into our active portfolio, which we think is a good outcome. And then how far we can scale them this year is obviously yet to be seen, but that is an outcome that we are very pleased with; also the fact that these come – these are representing all the three product areas is something which is very good. So, we continue to diversify and balance our portfolio in a way that is very satisfactory. So, in total, we now have 64 games in our active portfolio with a strong pipeline for new games coming into soft launch, namely 15, at least 15 during the first half of this year and then more games in the second half of the year.

I would like also to highlight and make it as a good example on how we work with BitLife. With the – on the BitLife engine, Candywriter, in collaboration with Goodgame and others in our group, utilizing and leveraging the Stillops platform that we have developed to really see that we get more than just one game on that engine, we do much more on that engine to leverage that engine. So, we have made a German version, the first international version of BitLife, and also we have made a spin-off called DogLife so that we make more games on the same engine, both [ph] characterize (00:03:24) them and adopt them for new territories but also making sister games, so to speak, on the same engine. So, that's a grand example of the leverage that we can create and have created and will create on the business platform and the way that we operate.

We also – I would like to say that we see good traction in Jawaker, the acquisition that was consolidated in – from the 1st of October, and they also have launched a number of games and have leveraged the fact that they have this very successful ecosystem one-app approach. So, they have several games even more now in their only app, which make it possible to cross-promote and get players to play and stay for a longer time.

Moving on to next slide. A bit about our revenue development and our UAC development. So, we grew by 33% year-over-year in the fourth quarter, which is a solid growth, we think. Out of this, then SEK 1,442 million that we have in revenues in the quarter, 26% of that were spent correspondingly in UA, for user acquisition. And that's a high and solid number; in absolute numbers, the highest spend we've ever had, SEK 378 million. And the good thing is that we have been able to deploy that much in a constantly improving environment for our products and our marketing with that – with continuous very good return on marketing spend well within our 180 days requirement on return on ad spend. So, we are very pleased with that, both on existing products as well as new products. So, that is yet another example of how we have managed to continue with our marketing post-IDFA. So, we really feel that we are in a post-IDFA situation which is the new normal, and we can deploy that kind of marketing.

Also for the full year, we had – we record revenues of approximately SEK 5.5 billion which is our also all-time high, just as the quarter was all-time high in revenues. And the organic growth for the quarter was, in total, minus 4.9%. So, we are gradually improving and getting out of the comparison thing from the pandemic period that we have been talking a lot about. And what is very satisfactory is that we both have a sequential growth organically, reported organically, from Q3 to Q4. But also that we, from late November through December, have had organic growth, reported organic growth. And also we have had a very strong January. So, we have the good momentum that we expected. We also can see and record.

Then it's very important and a bit – this reported organic is a bit special because 1st of February, Super Free becomes organic, so to speak. We have three new studios becoming organic in Q1. And since we have had an isolated problem during the second half, especially with Super Free with lower top line, when they become organic, when they had good traction, they will contribute significantly to lowering our reported organic growth, which is only some three-fourths of our total business. But the reported organic growth will be negative in Q1. But we are also confident that and expect that for the full year 2022, we would be back on organic growth. And as you easily can calculate, including Q1. So, as you easily then can calculate is that from Q1 and onwards, we will be on good territory, both driven from new products, existing products, and generally very good traction. Turning to next slide, please.

So, a few words about our profitability. So, we have an operational profitability or adjusted EBIT, which we primarily measure, of 32% in Q4 and, for the full year, 33%. So, we can continue to deliver high – consistent high margins which is very satisfactory despite the fact that we have increased our marketing spend significantly. And as I said, they are on record-high levels. And obviously, the reason why we can combine high UA with high margins is obviously that we have the strong return we have on the marketing with this good momentum that I touched upon. So, we are pleased with that. Of course, if you compare with Q4 last year, when we were not able to deploy that much UA, the margins are lower, but that is also both explained by basically lower UA last Q4, but also that we came out of the pandemic effects looking at the full year. But all in all, solid and consistently high margins even though that our [indiscernible] (00:09:08) has increased, and that is something that is very, very important for us and very satisfactory.

If we go to next slide, looking to our – into our portfolio, we – as I said, we now have 64 games in our active portfolio. We are striving to get to the 100, 100, 100, 100 vision that I spoke about on Capital Markets Day. So, we aim for getting up to 100 products within not too long time, and we are taking a significant step in Q4 by adding a product up to 64, and, again, several products – many products on its way out as well. 75% of our revenues were mobile in the quarter; 19% of our revenues are ad revenues, which is something that we aimed for on the Capital Markets Day back in 2019 that we had an ambition – had a target to be on high teens when it comes to ad revenues. And now we have had 19%, 18%, and 19% again the last three quarters. So, that is important. It's further diversification and an inbuilt hedge towards fluctuations in ad costs – ad revenues. So, that's a very important thing.

In the quarter, we have 47% of our revenues generated within Casual & Mash-up. We strive to keep a good balance between the three product areas, which is clearly you can see here with Casual & Mash-up being a big portion of our total revenues, adding 6waves now consolidated from the 1st of February now just a couple of weeks ago, which is [ph] fewer Strategy (00:10:55), more or less, will significantly add further diversification and further balance in our portfolio. So, that and the geographical presence in Japan that they represent really add to strengthen Stillfront's market position indeed.

You can see here also that the DAU and MAU are increasing both year-over-year, which is a mix – consequence of the product mix and studio mix that we have. But if you look sequentially, you can see that we are increasing both DAU and MAU, which is satisfactory. You can also see that our average revenue per daily active users is increasing, and that is mainly due to that we have been most successful in monetizing on our – within Casual & Mash-up, which is important and satisfactory. But I would like to point out the thing that is maybe not very clear here but very important is that we combine this improved monetization through ad revenues, but also you can see that we are recording all-time high in the number of monthly paying users, unique paying users, so we are at SEK 1.44 million which is the highest ever. So, both more in-app purchases or players that pay for our [ph] brand statement (00:12:15) but also generating more ad revenues is the proof that our business model are developing as we had hoped for.

Also, and finally on this slide, I would like to also point out that we have SEK 78 million coming from outside the active portfolio, and that's a good number because that shows primarily what comes from products that are in the launch phases but not yet have passed the threshold to come into the active portfolio. So, that's a very strong indicator that we have games that very, very likely will come into the active portfolio now in Q1 on top of the eight that already made it, so to speak. So, all in all, the product are – we continue to evolve and strengthen our product. Diversification is stronger than ever, and we also have things coming on – coming in here in Q1. So, I'm very pleased with how the portfolio had performed during the quarter and the year.

Go into the next slide, please. So, looking at more in detail on the different areas, we shouldn't go through all the numbers here during the presentation, but I will – I'm very pleased just to conclude that Strategy had a very good quarter. So, we grew 10% sequentially which is a very good number, and we have been able to deploy significant

UA with very good returns in Strategy. And as you probably recall that we have discussed many times is that IDFA was supposed to be a challenge for target marketing, which you primarily use for Strategy. So, the fact that we can deploy as much UA and grow as much as we do post-IDFA is yet another confirmation that we are performing well in the post-IDFA world and that the market conditions have really improved step-by-step throughout the year. So, we are optimistic on how that will continue in the coming year or years I would say. And also, that is not due to one or two products; it's actually many products in our Strategy portfolio that are performing very well.

Simulation, RPG is basically flat, so not so much more to talk about there. Casual & Mash-up are growing both through obviously that Jawaker is consolidated but also Candywriter have had a really, really strong quarter and contributing to organic growth indeed.

So – and also, as I touched upon, if you look at the ARPDAU, you can see that we increased, as mentioned, in Casual & Mash-up and you can see a decrease in Strategy, which is the perfect normal and the way it should look like. Because in Strategy, when you take in new users, the spending curve is completely different to Casual & Mash-up. You take in users and they start to spend in a slower way in the more complex Strategy games. But that spend will – we know will come and will be there for a very, very long time.

So, adding and be and be successful in marketing for Strategy has a very high value for a long time, but it has the technical effects. As you can see, that the first period then the average revenue goes down because a larger portion of the users have not yet started to spend, so to speak. But all in all, this is yet another sign of strength and that our portfolio and our performance are very healthy.

So, with that, I would like to hand over to Andreas. Please, Andreas.

Andreas Uddman

Chief Financial Officer, Stillfront Group AB

Thank you, Jörgen. Please go to slide number 9, and this is just summarizing some of the highlights for the – for Q4. We have a revenue growth of 33% with an adjusted EBIT margin of 32%. We continue to generate strong cash flows and we have the SEK 442 million from operations in Q4. We were at a strong financial position by year end with a cash balance of over SEK 1.1 billion and an undrawn credit facility of almost SEK 1.3 billion (sic) [SEK 2.3 billion] (00:16:59).

We are at our – around our financial targets in terms of leverage at 1.56 and following the acquisition of primarily Jawaker. So, we had a strong underlying financial performance, we have a more diversified financing platform and this, of course, creates the flexibility to support our M&A agenda and our business agenda going forward.

Moving into slide 10 then, looking a bit around our income statement for Q4, Jörgen touched upon the revenue growth of 33% which is both through acquired, which grew 38%, impacted by a negative organic growth of 4.9% and a small FX effect on that as well. But I think the key thing and I think the key one is that we grew SEK 362 million on revenues. The dynamics that we've been talking about why we want ad revenues, which was 90% of our net revenues, you can see – really see coming through in the gross profit.

The gross profit increased with SEK 347 million, so 44%, because of – the platform fees only increased in absolute term SEK 15 million and only 5% versus last year. So that's what's you see coming through and that is in – results in an improved gross profit of 6 percentage points. And that 6% is probably we can then deploy and have deployed by spending more UA, which was at the record level of SEK 378 million or 26% of net revenues.

In terms of other external expenses and – staff costs have grown from last year, but it has grown in terms of the trend we've seen during 2020. So, that's with the additions of new students. In terms of relationship between – with net revenues, it's still – is in line with what we've seen in previous years but as in previous quarters. We had, of course, more depreciation of – and amortization excluding PPA items of SEK 96 million, and that gives then an adjusted EBIT margin of SEK 460 million of – 32%, which is a 15% increase versus Q4 2020.

We have some items affecting comparability of SEK 24 million, mainly driven by the Jawaker – sorry, the 6waves acquisition and then some IFRS, too, non-cash costs as well included in that. Looking at then our financial items, we had underlying costs on – in the financial items of SEK 45 million of interest costs, then we have SEK 20 million negative of non-cash interest from earnout consideration. And we had SEK 5 million negative as well, which is net effect of FX and revaluation of earnouts for the quarter.

In the quarter, we recorded a smaller tax cost of SEK 11 million or 6%. I think it's important to look at the full year where we actually had 25%. It's – you tend to adjustments and we – look at your tax positions in Q4, so the full year was 25%.

So, moving to the next slide then, slide 11, in terms of our cash flow, as previously mentioned, SEK 442 million operative cash flow even if we, in that, paid SEK 85 million of tax, which was slightly offset by a positive net working capital of SEK 37 million in the quarter. So, we continue to grow our cash flow generation. We did investments of SEK 1.5 billion, primarily Jawaker which – and also The Firstborn acquisition, and we did spend SEK 185 million on product development which is, in relation to revenues, approximately 12.8%. Slightly higher for the quarter isolated but in line with what we have seen. We also launched a significant amount of products.

We did utilize – in terms of our financing cash flow, we did utilize our credit facilities which – to pay for the Jawaker acquisition on October, and we got some cash in for the second tranche of that equity raise early October as well. So – but still, cash flow, it's an isolated quarter, I think the trend is very important, and looking at the 12 months, we generated almost SEK 1.6 billion on cash flow from operations after deducting lease payment costs. And we continue to invest heavily in our portfolio.

We invest in, for the full-year 2021, SEK 621 million. That's an increase from the SEK 444 million the year before. However, it's important, in terms of relation to net revenues, that relationship remains around 11.4%, which is the same for 2020. So, we continue to grow our cash flows in absolute terms, but we also continue to invest in our operations.

But as important, we don't invest all the money, so our absolute cash flows between the years after that continued investment is SEK 953 million or a growth of SEK 180 million. And this is, of course, critical for how we operate our business, the strength of the business, that we continue to see strong cash flows from the business because that supports both further business initiatives but also M&A initiatives. And we had for the quarter – for the full year a cash conversion rate of 0.47.

Our net debt, around our financial target of 1.56, as expected, so – and we have been striving to be around that. We obviously work tactically with our financing and we have a pending equity raise ongoing as well, but we are striving to be around 1.50 – 1.5. And we have a good maturity profile in terms of our debt portfolio where we, earlier in 2021, issued another bond of SEK 1.5 billion.

So just to summarize a bit, for the full year, we have continued as – with our revenue diversification. We had 64 games in the active portfolio as of Q4 2021 versus 42 as of the same period 2020. We also have increased our diversification, a bit more exposures towards Asia or 15% of our revenues came from Asia in Q4 versus the 11%

in the same period in 2020. That would, of course, increase with 6waves coming on and being consolidated, but that furthers increases our diversification.

Same with ad revenues, in total for the full year, we had approximately 17.4% of our ad revenues, it's almost SEK 1 billion going into our revenues, creating this natural hedge that we've been talking about. And that's a significant increase from the year before where that relationship was only approximately 6% full year.

In terms of our cost positions, we continue to have cost – our costs under control for the full year. They are developing in line with how our revenues are developing even if there are, of course, effects between quarters, et cetera, but that is still a cost that we focus on but we also keep under control. And we continue to invest in our product portfolio.

So, with that said, strong financial performance for the full year on all metricses, and with that, I will hand over to Jörgen for some concluding remarks.

Hans Jörgen Larsson

Chief Executive Officer, Stillfront Group AB

Thank you, Andreas. We go to slide 13, please. So we think we have had a very solid 2021. We have had some known and some unknown challenges as we have been talking about, but I think considering that we still delivered 37% year-over-year growth and also our EBIT has grown by 21%, and our cash flow, as Andreas pointed out, has developed very strongly.

We have nearly SEK 1 billion in free cash flow after record investments in products which, obviously, also pays off, with now – adding eight products in the quarter and in the year, we have added more than 20 products. So I think we have developed our portfolio in a very good way.

Also very important is that we have, as – it's a really, really strategic important thing, that we add geographies constantly because one of the main competitive advantages that we have and we will constantly and have constantly worked hard to develop is our market reach. So we have more products to market in more regions than ever through more channels than ever. And that is the reason why we can be consistent in returning ad spend on a very high level which, obviously, drives growth and high profitability in combination.

I'm very happy to conclude that on our list of geographies that we – that really were white spots, more or less, the Indian subcontinent and Japan, we now have arranged and managed to get into to our business. Obviously, 6waves not in Q4 but coming in – signed and coming from the 1st of February, and we are strengthening our position with the unique capabilities and the unique portfolio of Jawaker in the MENA region.

Also, it's very important for us to describe the positive momentum we have in our business that we have had operational-wise since late November through December, and we have had a very strong momentum in January as well. So, despite that we have reported – we will have a reported negative organic growth due to the fact that the isolated problem, Super Free that will be consolidated, makes it look different, but that is – we have a significant business that is not reporting organic growth.

And very important is that we feel confident that we have managed to turn around the issues that we had in Super Free from, say, April to November in a very good way, and they are working together with the group in general and achieving a lot of new results and new products coming out. So, that isolated problem we see is history, basically. So, we are, therefore, confident, besides the fact that our general portfolio is developing in a very good way, that we will grow organically full-year 2022 compared to full-year 2021.

So, basically, we – Stillfront is in a good shape. We have good momentum. We have 6waves coming in, further improving our competitiveness and how – our competitive capability significantly. So, 2022 will be exciting year and we leave the pandemic and IDFA behind us, so that is all good.

And with that, I would like to open up for the Q&A session, please.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And the first question comes from Simon Jonsson, ABG. Please go ahead, your line is now open.

Simon Jonsson
Analyst, ABG Sundal Collier AB

Q

Hi and thanks for taking my questions. So, first, you stated that you saw conditions improving on your marketing efforts. Was that a sequential improvement during the quarter? And also, how has that improvement translated into Q1?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Yeah. So, we have constantly, since both in Q3 and further in Q4, to answer your question, seen improvements and – but important is that I often get the question, is it more expensive or tricky to market? But we – you could have tackled the IDFA thing, we're just pouring in money, marketing and accept low rate on the marketing. We have not done that. We have constantly, through the year where we have had record spending, throughout the year without compromising on return on ad spend.

Then it works differently compared to pre-IDFA, but the important thing is that we can conduct marketing on high level, and we continue to do that and improve that into Q4 and we have good traction in Q1 as well. As you probably know, Q1 is usually the best quarter of the year for marketing, and so far, we are pleased with how much we have been able to deploy.

And as you can see, also last year, we have – we spend usually more in Q1 because it's better market conditions, so I see no reason at all that, that shouldn't be the case this year as well. So we feel comfortable and operational-wise, we have very good traction in our marketing operations.

Simon Jonsson
Analyst, ABG Sundal Collier AB

Q

Okay, thanks. And as a follow-up on that, could you explain the development of UA spending by segment? It seems like the UA spending was lifted somewhat by Strategy. Could you maybe add some flavor on the dynamics of the UA spend in Casual & Mash-up which seems to have decreased Q-over-Q in relation to bookings?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Yeah. So, very important and a cornerstone in our strategy is not to say that we should have a – whatever predetermined distribution of our marketing spend between the three different product areas or different studios or individual products. The key strength of ours is that we are really strong in – dynamically allocate the capital to where it returns the best.

We don't care whether that is a Mash-up product or whether it's a Strategy product. That – that's not an aim in itself, that it's spent on a certain product or a certain area. The key thing is that we are very, very disciplined in always reallocating the capital to where it returns the best. And that is what we have done through the year.

And that means that some quarters, one studio will get – will – they deserve to have more marketing money because their products are performing better. But if that is not the case, next day, next weeks, next month, next quarter, they will not have the right to spend that money. And that is the very reason why we are really one of market leaders when it comes to return on market spend. And also that drives, obviously, our consistent high margins.

So there is a very hard work going on every single hour, literally. We have constantly concurrent more than 1,000 campaigns, 1,200 campaigns running and we shift them on a daily basis because the ones that are not performing good is out, and we deploy or find new channels and constantly do [ph] A/B (00:34:08) testing and reallocating the capital. And our professionals are really, really good in this, supported by our data analysts.

Then we did get good traction in – as you commented on, with Strategy because we have strong products. We find good traction with new channels and existing channels. But it's not like we decide that [ph] our pre-orders (00:34:35), so to say – so to speak.

Simon Jonsson
Analyst, ABG Sundal Collier AB

Q

Okay, thanks. And my last question, on the 6waves acquisition call, you mentioned that asset acquisitions are included in organic growth. Could you clarify the thinking behind this? And as a follow-up, are those investments included in your definition of the free cash flow, and if not, why?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

The cash flow, Andreas could – you can fill in later, Andreas. But just to start with the principle here, just as in publishing business, when you buy the rights to publish a game that someone else has developed, this is very similar, but we buy also the software. And this is a – this is how, I would say, the general treatment in the market is, that if you have publishing deals, if you have second-party publishing, third-party publishing, or if you buy the actual software, all these are treated as organic growth.

And the reason is that you don't get them an operational business, a going concern. What we have to do is we have to – we have usually migration projects going on for typically three, four months in order to get these products running by our own staff, and it's the organic entities that take care of this. And we also take costs for [ph] add, personnel add (00:36:04), server costs, we move them through our servers and stuff like that.

So, it is very much as a publishing business and that is why that is by us and I would say all – I would guess most, if not all, of our peers, when you acquire a product or an asset as we call it. So, that is not a business we acquired, it's a component that we then deploy with our own staff. On the cash flow topic or if you would like to fill in on anything, Andreas, please.

Andreas Uddman
Chief Financial Officer, Stillfront Group AB

A

No, and as you said, it's the actual underlying cost but it's also the amortization related to that sort of part that is also not adjusted away as the PPA items. So, that's just something to add to that. We – [ph] we'd have to consolidate (00:36:53). But is it – it's not a business combination on – for us. It's actually – it's – you don't buy an operation, it's just an asset.

But it in terms of the cash flow, yeah, it's – I mean we – it's part of the intangible assets. We have, for transparency, chosen to add in another line in our quarterly reports that you see the actual cash flows going out in terms of the acquisition, if that was the question. But there, we're very transparent in terms of the difference between product development and this asset acquisition, but they are not part of the acquisitions of studios.

Simon Jonsson
Analyst, ABG Sundal Collier AB

Q

Okay. But in terms of your definition of free cash flow, do we have to adjust that number for those investments?

Andreas Uddman
Chief Financial Officer, Stillfront Group AB

A

I mean we look at free cash flow like – no, in that number, that – in the SEK 621 million, the cost of that business is not part of it.

Simon Jonsson
Analyst, ABG Sundal Collier AB

Q

Okay. Thank you for clarifying and thanks for taking my questions. I'll return to the queue.

Operator: And the next question comes from Martin Arnell, DNB. Your line is now open.

Martin Arnell
Analyst, DNB Markets

Q

Hi, Jörgen and Andreas. I want to start off asking you on those comments on very strong start to Q1. You said you had a very strong start to January, so does that mean that the organic growth in December continued in the first months?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Well, we are not reporting Q1 now. We just state that we have a good quarter so – and the reason why we're not growing organically is that we had to add Super Free, so I think you can draw the conclusion yourself.

Martin Arnell
Analyst, DNB Markets

Q

Yeah, sure. But you add Super Free from 1st February, right...

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Exactly, that's why I'm saying that...

Martin Arnell
Analyst, DNB Markets
Q

...and the question was about January.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB
A

...with good traction continuing in January, I think you can draw the conclusions since the negative organic growth comes from 1st of February.

Martin Arnell
Analyst, DNB Markets
Q

Okay. Thank you. And on Super Free, how long do you think it will take to turn it around? And you said you had improvements in the latter half of Q4, could you just exemplify a bit further what was driving those improvements? Thank you.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB
A

Yeah. So, we are – we have seen a significant improvement so – but then it's a bit catching up time because they started off on a very high level the first couple of months last year, which makes this – I mean it's like comparing apples with, I don't know, oranges or whatever. So, when you look at – what is organic in Q4 is not what is organic in Q1.

But we have definitely gained traction with Super Free because there were both some product-related issues but also marketing channel issues where they have to – they have benefited now in a more clear way from being part of the group and using the Stillops platform in several ways to improve their performance.

So – and Nick and the – and his team in – at Super Free are now – have made a really good job since late November as well. So without [ph] giving (00:40:35) individual studios forecast, we don't give forecast, as you know, we are very comfortable that they will contribute to organic growth latter part of the year, or second half...

Martin Arnell
Analyst, DNB Markets
Q

Okay, thanks. And...

[indiscernible] (00:40:47)

Martin Arnell
Analyst, DNB Markets
Q

Yeah, okay. And on your UA spend, 26% of the revenue in the quarter, and looking at the outlook for UA and taking your organic growth for the full year into account, do you see anything in – on the cost side that should change your margin profile this year in addition to acquisitions?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB
A

I think that what is important here is that we not – we do not compromise on the return on the UA spend, and that is the big moving part here. So I hope and think that we will be able to deploy more than 26% in Q1. But, obviously, we are not – we're not reporting Q1 and we're only halfway through. So honestly, I don't know, but what is steering that is the return.

It's not like we budget and say that whatever the return is, we should spend X or Y million. So I hope and think that we follow the pattern that we had, if not since I founded this company 11 years ago, at least most of these years, we have been spending more in, say, January to April or something depend – from year-to-year, it depends a bit in Q2 how long you have this very favorable marketing conditions.

But typically, we have a lower margin in Q1 because we deploy more. And since we never deploy if we don't get back it in two quarters, we will get back that in the full year. So – then of course how much we will deploy in Q4 this year, it's very hard to have a firm view on. But I hope and think that we will be at margins, what we can see now, 30%, 32%, because – it's not because other costs are increasing, it is because we can deploy UA with high profitability and grow organically.

And you can easily do the math. If we have a negative growth in – organic reported growth, that is, in Q1, then we – then Q2 to Q4 needs to be significantly better on average to reach this, and we think we can do that with keeping margins on 30% or above. So I think our business model is very solid and we are able to do that. But to give a – we don't give that exact forecast but we are confident that we can combine high margins with good organic growth, which we will prove this year.

Andreas Uddman
Chief Financial Officer, Stillfront Group AB
A

And just...

[indiscernible] (00:43:34)

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB
A

Also next year.

Andreas Uddman
Chief Financial Officer, Stillfront Group AB
A

...in addition, I mean we did disclose a bit the dynamics, having 6waves as well where we did the acquisition. I mean on an absolute – on the EBIT margin perspective, it doesn't, but it's of course between the gross profit and UA, there's different type of profile. So, that's just something to have in mind. That's why we were transparent around that, the P&L structure both in the – of 6waves.

Martin Arnell
Analyst, DNB Markets
Q

Perfect. That's very helpful that you clarify. And just on this, you mentioned it's very important to add geographies and that's a key strength of your model. I'm thinking about the M&A pipeline going forward. Should it be more tilted to Asian markets when we think about that context?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB
A

As the market conditions is a bit more difficult for financing than it were a couple of years ago, and also that we are – we think we are valued on low multiples, but now the – as you saw in the 6waves, we can still do – and

Jawaker, by the way, we can still do acquisitions with a decent arbitrage, so to speak, even though the big value is not the arbitrage, the big value is that what we, operational-wise, will develop over time.

But I think that there is – we are more selective because the markets and the financing is a bit more challenging. So we are more selective, but now with the proposed raise on the equity that we are conducting now, we also have firepower beyond 6waves. So I think that we – as long as the market and the multiples are where they are, we think we will be – continue selective.

But you shouldn't forget that approximately 300 companies where more than 100 are potentially very interesting and fitting for us, they are still there, so we have a pipeline. Then, of course, the pace of acquisitions of the smaller entities has gone down in general in the market to adjust. Where the acquisitions will happen or what is the rationale and what we are looking for is to add strategic components rather than do more of the same when we are selective.

And, of course, getting very – getting a stronghold in Japan is very, very important for us. But, obviously, as you indicate in your question, that is not covering the full Far East. So that is still interesting for us. And we think that just the fact that we have the guys from 6waves, Arthur, Rex and their team which is very experienced and has been around for a long time, has a very extensive network, open up for further acquisitions there.

But we also have still some white spots on some [ph] stronger (00:46:47) levels in our map, so we have a very clear view on what we would like to add but, obviously, we don't disclose that in the public. But more selective, adding strategic components like geographies, like white spots in our product catalog is what we're looking for.

Martin Arnell
Analyst, DNB Markets

Q

Thank you very much, Jörgen and Andreas. That's all for me.

Operator: And the next question comes from Oscar Erixon, Carnegie. Your line is now open.

Oscar Erixon
Analyst, Carnegie Investment Bank AB

Q

Thank you, and good morning, Jörgen and Andreas. A couple questions from me starting with the organic growth here. Again, around minus 5% [ph] you expect (00:47:35) in Q1, [ph] but I mean (00:47:37) clearly strong underlying momentum, and Super Free, clearly a mechanical effect. Could you share any more details on some sort of underlying growth metric, for example, sequential growth for the entities and group in Q4 or organic growth year-on-year excluding Super Free? Just some more sort of input there would be helpful to understand the underlying momentum. Thank you.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Well, we try to avoid to report each of them. That will make your job even more tough, Oscar and others, if we would report every 22 – each of the 22 studios and all of our 64 products. And it varies, again, how we allocate the capital, so that's also – it's not try to be secret. It's just that it's often misleading. But as mentioned, we have a sequential growth that we are pleased with and as we expected from Q3 to Q4. And I think that we can also add to the picture that we think that there's a – during Q2, Super Free will add to our organic growth, but we cannot say if it's April or May or something like that, but then I think we will cross that very important line.

And then on our other studios, I would say that we have, in general, good traction all over across the line, more or less. Then of course, one individual studio, it varies, of course, depending on when they release new products and get traction and so on. But in general, very broad and more even momentum that we have between the different studios with – including Super Free from November. But obviously still [ph] not capped (00:49:33). They haven't closed the gap to what they had last year. But we expect they will do that in April, May or so.

Oscar Erixon
Analyst, Carnegie Investment Bank AB

Q

Understood. That's helpful. And then you mentioned the strong return on ad spend in Q4 and, as I take it, continued good traction here in Q1. But could you shed some more detail on how that is developing in Q1? Do you expect any change here due to COVID restrictions easing, or would you say that the good conditions here are more related to your products and possibly supply chain issues for product company, your competitors?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

We don't see that we have had any COVID effects at all basically neither in engagement from users because our games are not the types of games that are affected whether you are in lockdown or not in lockdown. And mobile, you bring your mobile when you're on the beach or whatever, go skiing or whatever. So, that is no effect and the low-paced games we have. The marketing conditions have not been changed in either direction since June 2020. So, we are very neutral to how COVID develops, I would say, so that we don't see – we really don't see any – very low or no probability at all that that will have an impact.

It's basically that we have many products, new and also existing products, within our brand Strategy portfolio, for instance, that have been developing really, really strong. We have also, as mentioned, Candywriter and the spin-offs that were made from the BitLife engine and BitLife in itself. Stronger performance, Jawaker. So, it's a very – it's a combination of having many products that can grow. But again, I can – I repeat myself when I say that the key reason that we can continue with this good, very strong return on marketing spend is that we have such a strong market reach.

We have more channels than ever that we master in more territories, and we market more strong products than ever. Of course, we, having that and continue to build that, improved the chances for us to have a solid and strong marketing for not only one or two quarters, for not only one or two years, but for one or two or more decades. That is the thing that we constantly work on to improve. So, it's not one or two individual products or so that is behind this traction.

Oscar Erixon
Analyst, Carnegie Investment Bank AB

Q

Great. Two more questions for from me. Obviously, there's been a lot of changes in the marketing ecosystem in 2021. Can you talk a little bit about how your key marketing channels and your marketing mix have changed in Q4 from sort of year-on-year perspective? I suppose Facebook, less important; TikTok, growing and so on. Some more flavor there would be interesting to hear. Thank you.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Yeah. We work with, I would say, between 50 and 100 channels in parallel. And, again, the key competitive advantage is the rapid and disciplined reallocation. So, it looks different from literally day to day, hour to hour. But, in general, we are doing less on Facebook. In general, we're doing more on other channels like TikTok, AppLovin, ironSource but also through Apple directly. So, that's the general trends. But what is very important to note is that changes in channels is something that is completely natural in our business and has been for 11 years now. So, then, of course, IDFA was a much larger change because it came from a platform owner, but the ones that are hit is not the content owners and the publishers, it is the intermediaries like Facebook. So, I think we will see that continue throughout the year. But that is what I can say on the trends. So, they have continued like they shifted in – during the summer that has continued more or less. Then you can find pockets or certain products that performs well on Facebook as well from time to time.

Oscar Erixon
Analyst, Carnegie Investment Bank AB

Q

Great. That's very interesting. Thank you. And just finally then for me, the 6waves acquisition, can you talk a little bit about the momentum here? I think you disclosed Q3 LTM figures, sales of SEK 750 million, roughly. What growth can we expect compared to that number here in 2022? Anything you can add would be helpful there. Thank you.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Again, we don't give individual forecasts in that way. But I think that what is very attractive – it's many things that is attractive. As you have heard us of saying, we're very enthusiastic by after three years of discussions, maybe actually manage to get the transaction done. It's a really high-quality studio. What is very good in there, in the dynamics of their businesses that they have now for existing Strategy games with large communities, extremely loyal users, which has a very high stability and predictability, we have our legacy in Strategy games, so we know that – very well how that works. Then they have a pipeline of not less than five games that they target to get out during this year. They will not contribute that much in the first half of the year. But we hope and think that they could contribute significantly during the – as a game traction during the second half of the year. And they have a very strong track record of launching new products.

So, I would be very surprised if not one, two, or three of these products would be performing very well and scale up during the latter part of the year. So, also looking back now, that is no guarantee for the future that they have a very impressive track record of growing more than double digit year-over-year CAGR for a long time, but of course, not exactly the same number per quarter. But you must look at longer perspective than that. So, I think that we will see them grow by double-digit number for a long time. Not every quarter. Some quarters, maybe 20%, depending on launches, but the first half, you will not see so much differences or growth. But on the second half, we expect the growth to take off driven by the new products that comes up.

Oscar Erixon
Analyst, Carnegie Investment Bank AB

Q

Excellent. Thanks, Jörgen.

Operator: And the next question comes from Nick Dempsey, Barclays. Please go ahead. Your line is now open.

Nick Dempsey
Analyst, Barclays Capital Securities Ltd.

Q

Yeah. Good morning, guys. I've got two questions left. So, on margins, adjusted EBIT margins, you mentioned that you'd hope to keep a high adjusted EBIT margin of at least 30%. I mean, you've just done 33% for 2021, 32% for the fourth quarter. I don't want to jump on top of your numbers, but if we were to reduce to 30% in 2022, that would be a notable step-down. So, are you signaling that that should come down, or are you just giving a more big-picture comment on margins there? I just want to clarify that.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

It's the...

Nick Dempsey
Analyst, Barclays Capital Securities Ltd.

Q

The second question – okay, sorry. Go ahead.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

So, it's definitely a big-picture comment, and that is basically that, short term, the lower margin, the better because we don't compromise with – it goes in the UA. We get the money back in less than 180 days. So, then we build a stronger company over time. But, I mean, we have our target still there of 35% margin and have a plan to get there in 2023, so – but it's more the big-picture thing. We are ready to go to 30% margin if we can deploy that marketing rather than giving you a forecast. But looking at the full picture, and since it's that much focused on organic growth, we choose to go out with that. We're comfortable to be delivering organic growth for the full year despite that it will be negative in Q1 because it's an isolated problem behind that. And it's not because we are completely lowering our margins and compromising with profitability and just pouring in UA. We are very, very disciplined. So, it's more the big-picture thing rather than giving a forecast but – yeah.

Nick Dempsey
Analyst, Barclays Capital Securities Ltd.

Q

And there's no change to that 35% then...

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

No.

Nick Dempsey
Analyst, Barclays Capital Securities Ltd.

Q

...even including acquisitions you made, etcetera?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

No.

Nick Dempsey
Analyst, Barclays Capital Securities Ltd.

Q

Okay. And then my second question, I was going to have another go with the Super Free organic. I know there have been a couple of questions on that, but you're saying they'll face easier comps from April than you would hope that it would start to add to your organic growth from then. Is that because you're seeing sequential positive organic growth in Super Free already and, therefore, it just needs to continue at that rate for it to contribute positively from April, or do you need to show an improvement – if there are hope involved in an improvement – in Super Free sequential performance for it to contribute positively to group organic from April?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

They have improved significantly from late October, early November and constantly, so I think that, already on this level, we are in a good spot. But of course, it's a fast-moving product, so it could easily go faster, it could easily go a bit slower. So – and we will not spend money again if it's not returning. If it doesn't make sense, we will not throw good money after bad, so to speak. So – but I think they are on a level where we will see them contributing to organic growth without any significant changes in the development that we've seen already and the levels that they are on already. So, that makes us confident. It could also grow a bit faster. It could take a month or so more. That is very hard to say, but they will contribute, I'm convinced.

Nick Dempsey
Analyst, Barclays Capital Securities Ltd.

Q

Okay. Thank you. That's clear.

Operator: And the next question comes from Rasmus Engberg, Handelsbanken. Please go ahead. Your line is now open.

Rasmus Engberg
Analyst, Svenska Handelsbanken AB

Q

Yes. Hi. Good morning. Just two quick questions. If you were to talk about your sort of two most significant releases this year of new products, which would they be and when are they planned to the extent that you have already communicated them, of course?

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

My team love to ask me that question, and I've been consistently wrong for 10 years. So – and that's the whole point why we are data-driven. We don't hope and think. We measure and act. So, we look at the – that's why we have this soft-launch approach. Make a minimum viable product, take it out to the market, and it's not the CEO or the CFO that should guess or, whatever, hope. It's the consumers that should show that these products is very attractive. We like them. We'd like to spend time. We'd like to spend money on them. And then we develop these products further. And it's very hard to guess, and we are not built upon – I mean, hope is not a strategy. So, instead, data, collect it, then analyze data, and put them on a way that gives the best effect.

So, to be bluntly honest, I haven't a clue. Then I might have more hope on some products than others. But again, we – you also have to see what kind of investments [ph] it's in (01:02:36). So, we're very ROI-driven. When we make a spin-off, for instance, DogLife, the investment needed to take DogLife out using the full engine that was already developed for BitLife is very limited, but it's a sophisticated game. So, even if that game doesn't come up to be one of our top-grossing games, it's a fantastic ROI. So, you have to look obviously both on the investment side as well as the return side, so – and I think we have improved our capabilities on getting out more for the same money in terms of investments. So, we are better reusing engines. We're better on collaborations between the different studio through our Stillops platform that is really creating synergies on a higher, completely different level than compared to two years ago.

So, which individual products will take us the longest way, it's hard to say. But as we have seen now, usually 20% fails of new products accounts into soft launch, 20% becomes better than we expected, and the rest is in between where we, in most cases, at least get our money back. But in some cases, they become really strong for a decade or so. So, I think that approach is completely opposite to what you usually have in traditional console game development where you invest in three years and cross your fingers and hope to recoup 50% or 300% of your investment. Here, it's more an incremental investment as the product lives, first gain initial traction, then we continue to invest in the product for decades. And that's a much better risk/reward in our view.

Rasmus Engberg
Analyst, Svenska Handelsbanken AB

Q

The reason for asking was obviously that you commented that 6waves had significant expansion plans in the second half of the year. But never mind. Just a final question. In terms of the target for this year, the report says mid-single-digit organic growth. I don't think you mentioned it at all in this presentation, but that is still your sort of ambition or your – what you look forward to for this year.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

That is correct. Mid-single digits.

Rasmus Engberg
Analyst, Svenska Handelsbanken AB

Q

Right. Excellent. No further question. Thanks.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

A

Just a comment on the – I must just comment on what you said would be – we expect because of the track record that 6waves would be successful. But I don't know if it's game number one, two, three, four, or five, or typically two or three of them, as I said, will be successful. But you asked me which of them, and that I don't know. But I'm sure they will be successful. It's a numbers game.

Rasmus Engberg
Analyst, Svenska Handelsbanken AB

Q

Thanks.

Operator: And we haven't received further questions at this point. I will hand back to the speakers.

Hans Jörgen Larsson
Chief Executive Officer, Stillfront Group AB

So, thank you, all, for dialing in and listening, and also issuing good and relevant questions. And I just would like to conclude that we are very optimistic about the momentum that we have, and we are really looking forward to 2022 organically, as well as through the acquisitions that we have made. Jawaker has started off very well. We are very happy to have 6waves onboard and what we can deliver jointly. So, looking forward to talk to you, report in the coming quarters. Thank you very much for dialing in.