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# City Interactive

Sector: Media & Entertainment  
Fundamental rating: Buy (→)  
Market relative: Overweight (→)  
Price: PLN 27.33  
12M EFV: PLN 41.6 (↓)

Market Cap.: US\$ 108 m  
Reuters code: CIAT.WA  
Av. daily turnover: US\$ 0.20 m  
Free float: 49%  
12M range: PLN 16.50-31.40

**Time to buy.** Following the flow of unimpressive news on delays in key projects the City Interactive's stock has recently seemed to be a little forgotten by investors. With (i) undemanding valuation and (ii) attractive equity story based on a strong project pipeline for 2012/2013, the Company's stock offers a great buying opportunity, in our view. We think that the recent CDR's story of an increase in the share market price prior to a major game release may reiterate itself in the case of City Interactive. With our 12M EFV of PLN 41.6 per share, we see a heavy upside and maintain our LT fundamental Buy recommendation with ST market-relative Overweight bias.

**1Q12 results – not a part of equity story.** The City Interactive's 1Q12 results are not a part of its equity story and are in fact irrelevant as regards the valuation. The Company's preliminary sales figure stands at PLN 11 million which is quite a decent amount, taking into account no new releases, and *Sniper 1* becoming increasingly mature. We expect that lowering of *Sniper's* price allowed for selling approx. 200 ths units in 1Q12, which we consider a good result. All in all, we expect the 1Q12 bottom line to be marginally in the black (see *Figure 2*).

**FY12 estimates trimmed down, given delays in games, but FY13E looks good now.** Because of the significant delay in the release of *Sniper: The Ghost Warrior 2* (from March 2012 to August–September 2012, due to problems with the Crytek engine) and the assumed delay to *Enemy Front* (we tend to think that the game will be published at the end of 3Q12), we have trimmed down our 2012 revenue and net profit forecast (see *Figure 3*).

Every cloud has a silver lining, though – a large part of the anticipated revenue will be shifted to 2013, which should smooth earnings and close a feared gap in the pipeline for next year.

**Sentiment to improve in the coming months?** The heavy delay in *Sniper: The Ghost Warrior 2* (due to problems with the Crytek engine), the slight delay in *Combat Wings* and the uncertain future of *Alien Fear* have resulted in deterioration of the market sentiment to the Company. However, we believe that the approaching game release and associated newsflow should lead to repeating the recent story involving the increase in CDR's market price before the release of *The Witcher 2* for Xbox 360.

**Income from unit game sold.** *Figure 1* presents our assumptions regarding income from a unit game sold (*Sniper: Ghost Warrior 2* and *Enemy Front*).

**Valuation.** We slightly lower (by 7%) our 12M EFV to PLN 41.6 (75%-25% weighted average of DCF and peer-relative approach per share), mainly because of the delays in games that slightly shift expected cash flows.

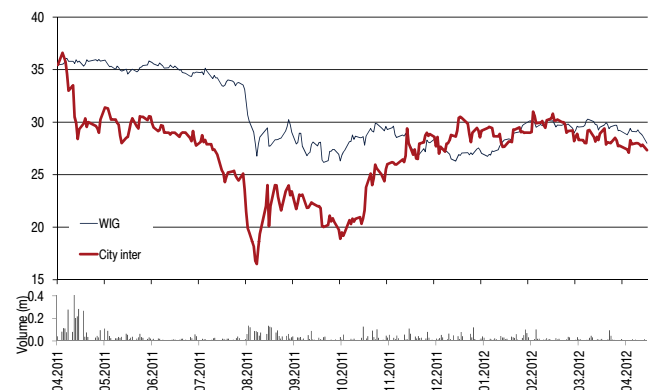
**Guide to adjusted profits**  
No factors necessitating adjustments.

Key data

IFRS consolidated		2011	2012E	2013E	2014E
Sales	PLN m	81.7	161.0	192.4	208.8
EBITDA	PLN m	27.3	61.2	83.8	87.8
EBIT	PLN m	21.1	52.8	65.3	74.1
Net profit	PLN m	16.9	42.9	53.4	61.5
EPS	PLN	1.34	3.39	4.22	4.86
EPS yoy chng	%	-37	154	24	15
Net debt	PLN m	-13.7	-34.1	-71.1	-95.7
P/E	x	20.4	8.1	6.5	5.6
P/CE	x	15.0	6.7	4.8	4.6
EV/EBITDA	x	12.2	5.1	3.3	2.8
EV/EBIT	x	15.7	5.9	4.2	3.4
Gross dividend yield	%	0.0	0.0	6.2	10.8
DPS	PLN	0.00	0.00	1.70	2.96
No. of shares (eop)	m	12.7	12.7	12.7	12.7

Source: Company, DM IDMSA estimates

Stock performance



Source: ISI

## Upcoming events

1. Release of 1Q12 results: May 15, 2012
2. Release of *Combat Wings*: 2Q12 (as declared by the Company)
3. Release of *Sniper: The Ghost Warrior 2*: August 21, 2012
4. Release of 2Q12 results: August 31, 2012
5. Release of 3Q12 results: November 14, 2012
6. Release of *Enemy Front*: 3Q12 (as declared by the Company)

## Catalysts

1. *Sniper: The Ghost Warrior 2* release
2. *Enemy Front* release
3. *Combat Wings* and *Alien Fear* release

## Risk factors

1. Further delays in games release dates

Fig. 1 City Interactive; Calculation of unit revenue for *Sniper 2* and *Enemy Front* (blended)

PLN	
Retail price	130.0
Retail margin	30%
Price for distributor	91.0
Distributor margin (slightly above 20% in Europe, 6-12% in the US)	16%
CI's unit revenue	76.4

Source: Company, DM IDMSA estimates

## BASIC DEFINITIONS

**A/R turnover** (in days) = 365/(sales/average A/R)  
**Inventory turnover** (in days) = 365/(COGS/average inventory)  
**A/P turnover** (in days) = 365/(COGS/average A/P)  
**Current ratio** = ((current assets – ST deferred assets)/current liabilities)  
**Quick ratio** = ((current assets – ST deferred assets – inventory)/current liabilities)  
**Interest coverage** = (pre-tax profit before extraordinary items + interest payable/interest payable)  
**Gross margin** = gross profit on sales/sales  
**EBITDA margin** = EBITDA/sales  
**EBIT margin** = EBIT/sales  
**Pre-tax margin** = pre-tax profit/sales  
**Net margin** = net profit/sales  
**ROE** = net profit/average equity  
**ROA** = (net income + interest payable)/average assets  
**EV** = market capitalization + interest bearing debt – cash and equivalents  
**EPS** = net profit/ no. of shares outstanding  
**CE** = net profit + depreciation  
**Dividend yield** (gross) = pre-tax DPS/stock market price  
**Cash sales** = accrual sales corrected for the change in A/R  
**Cash operating expenses** = accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes

DM IDM S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

## KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:

**Buy** – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;  
**Hold** – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;  
**Sell** – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

**Overweight** – expected to perform better than the benchmark (WIG) over the next quarter in relative terms  
**Neutral** – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms  
**Underweight** – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM IDMSA's recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first. Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

### Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	28	40	8	0	0
Percentage	37%	53%	11%	0%	0%

### Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	31	28	17	0	0
Percentage	41%	37%	22%	0%	0%

## Banks

**Net Interest Margin (NIM)** = net interest income/average assets  
**NIM Adjusted** = (net interest income adjusted for SWAPs)/average assets  
**Non interest income** = fees&commissions + result on financial operations (trading gains) + FX gains  
**Interest Spread** = (interest income/average interest earning assets)/(interest cost/average interest bearing liabilities)  
**Cost/Income** = (general costs + depreciation + other operating costs)/ (profit on banking activity + other operating income)  
**ROE** = net profit/average equity  
**ROA** = net income/average assets  
**Non performing loans (NPL)** = loans in 'substandard', 'doubtful' and 'lost' categories  
**NPL coverage ratio** = loan loss provisions/NPL  
**Net provision charge** = provisions created – provisions released

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Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc.

Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

### Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking

	Buy	Hold	Sell	Suspended	Under revision
Numbers	1	5	0	0	0
Percentage	17%	83%	0%	0%	0%

### Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	2	2	2	0	0
Percentage	33%	33%	33%	0%	0%

**LT fundamental recommendation tracker**

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)	
<b>City Interactive</b>									
Buy	-	11.12.2011	-	Not later than 11.12.2012	-1%	-2%	27.65	44.50	-
-	→	-	01.01.2012	-	-	-	29.00	44.50	→
-	→	-	25.01.2012	-	-	-	28.10	44.50	→
-	→	-	29.02.2012	-	-	-	29.80	44.50	→
-	→	-	20.03.2012	-	-	-	28.15	44.50	→
-	→	-	15.04.2012	-	-	-	27.90	44.50	→
-	→	-	23.04.2012	-	-	-	27.33	41.60	↓

**Market-relative recommendation tracker**

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
<b>City Interactive</b>						
Overweight	-	11.12.2011	-	Not later than 11.12.2012	27.65	-2%
-	→	-	01.01.2012	-	29.00	-
-	→	-	25.01.2012	-	28.10	-
-	→	-	29.02.2012	-	29.80	-
-	→	-	20.03.2012	-	28.15	-
-	→	-	15.04.2012	-	27.90	-
-	→	-	23.04.2012	-	27.33	-



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