

Games Workshop (GAW)

All amounts are in British Pounds

We are long shares of Games Workshop (GAW)

Executive Summary

Games Workshop is the creator of the hobby and brand Warhammer. It is also the market leader for tabletop miniature gaming and related products such as board games, books, and card games. GAW is the owner of the Warhammer intellectual property (IP), where we believe monetization is only in its initial stage; this is where we see the main opportunity. GAW has compounded EPS at 69% in the last three years, has a net cash position, and its ROE is impressive at more than 100%. Royalties (which have more than 90% margins) are coming mostly by licensing its IP to PC and console games developers, with mobile gaming and media (TV series and movies) totally untapped. The recent board appointment of Kate Marsh and explicit messages by management to exploit the IP further, mainly with media initiatives, tell us this is the right time to get long GAW shares. At GBP 42, they currently trade at less than 20 times our estimates of this year's earnings, while enjoying a healthy dividend yield of ~4%, with the potential of a growing profitable stream of royalties going forward, and with one of the most addictive hobbies ever created.

Business Overview:

Games Workshop products, excluding the income from royalties:

GAW makes money by designing, manufacturing and selling fantasy miniatures and related products such as board games, card games, and artwork, among other items. These miniatures and products come from GAW's main brand Warhammer and its products/universes Warhammer 40K and Warhammer Age of Sigmar. These products are "different settings" where characters, stories, and offshoots of other products, like Horus Heresy, are constantly being created.

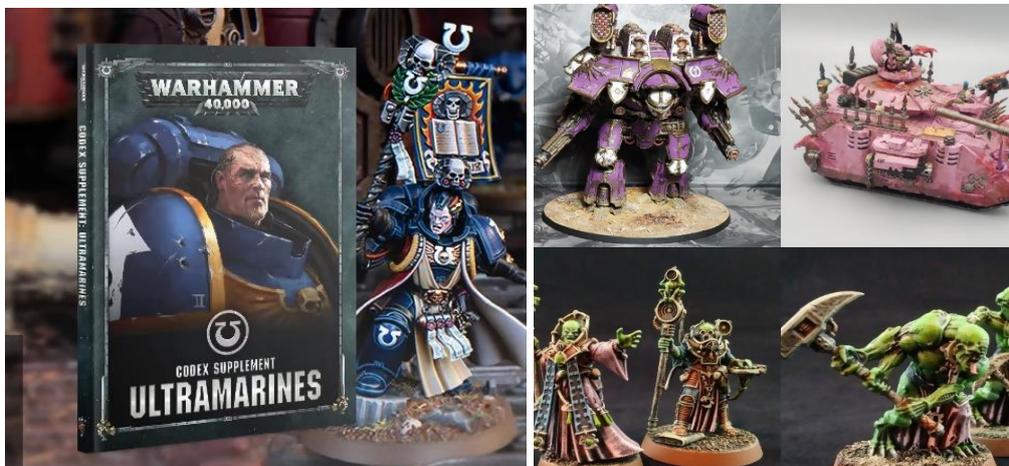
- Warhammer 40k is by far the most popular universe under the GAW's realm of products. Warhammer 40k is a space fantasy setting that takes place in the 41st Millennium.
- Warhammer Age of Sigmar is Warhammer's unique fantasy setting and the second most important.
- Horus Heresy is a setting 10k years before Warhammer 40k (I know this can get really complicated).
- Middle-Earth: GAW also has a licensee with Warner Bros to produce and sell tabletop games and miniatures based on the IP of "The Lord of the Rings" and "The Hobbit."

GAW offers the miniatures and related products to hobbyists that assemble and paint them either as collectors and/or to be used in games played with other hobbyists. The miniatures are accompanied with all sorts of additions, such as books, magazines, board and card games.



<https://www.ricoharena.com/news/warhammer-fans-to-flock-to-ricoh-arena/>

GAW's miniatures carry the Citadel logo (we will explain the Citadel connection further under the company's history) and are mostly made of plastic. GAW also produces miniatures made of resin under the brand Forge World, which represent less than 5% of revenues.



Source: <https://www.games-workshop.com/en-IE/Home>

GAW sells via three channels: Retail, Trade, and Online.

- **Retail:** GAW currently operates 517 of its own stores in 23 countries. Revenues have grown at 21.96% CAGR in the last three years. The company opened 28 net new stores in 2019 and expects to maintain that level of growth with a forecast of 25 net new openings in the current financial year.

Most of the stores are one-man stores, which clearly indicates the focus on profitability by the company. GAW is quick at closing or scaling down non-profitable stores. GAW is also willing to experiment with new concepts and evaluate whether to expand or contract according to results. An example of this is the Warhammer World visitor Centre in Nottingham, which has been very successful. Retail represents 34% of total sales and has the lowest operating margins at 11.2%. It is also the slowest growth channel of the

company; however, it is an essential channel to attract and retain customers/hobbyists as they gather in the stores to paint miniatures and play.

- **Trade:** This channel sells products worldwide to independent retailers, agents, and distributors. It includes the [magazine newsstand business](#) which, to date, has more than 14k subscribers and distributor sales from the Group's publishing business Black Library. It represents 47% of total sales and has healthy operating margins of 36%. The company opened 600 net new accounts in the last financial year reaching a total of 4.7k accounts in 69 countries. Trade has grown sales at an impressive 40% CAGR over the last three years.

Below is a clear explanation by management of the importance of this channel:

"These independent accounts do a great job supporting our customers in parts of the world where we either have not yet opened one of our stores or where it is not commercially viable for us to have one."

Source: Annual Report GAW 2019

- **Online:** This channel sells products through the company's web stores and digital sales through external affiliates. It represents 19% of sales and has the highest operating margins at 62%, while having grown at a 23.52% CAGR in the last three years. It is important to note that the retail stores do not offer the full range of products (they offer around 700 items compared to more than a 1000 available), but they have a web terminal where hobbyists can access and purchase the entire range. The company has invested heavily in its three main websites and has implemented several translations, the most recent and exciting being the launch of the "Warhammer" online store in one of China's e-commerce platforms in February 2019.

Over the last three years, total sales have grown at 29.5% CAGR, gross profit at 31.20%, and **EBIT (excluding royalties) has grown from GBP 11m in 2016 to GBP 71m 2019**. The turnaround is mainly a result of the changes implemented by Kevin Roundtree, who started as CEO in 2015. What we really want to show is the fact that this segment is profitable, healthy, and in great shape. To illustrate the magnitude of the latest results, it is important to mention that 2019 was the first year in GAW's history to beat a year following the release of a new edition of Warhammer 40k. Warhammer 40k first edition happened in 1987 and, on average, there is a new one every four years, the latest having been released in 2017 (financial year 2018). The fact that a non-event year with only minor releases, such as Adeptus Titanicus (based on the Warhammer 40k's Universe) and a new strategy battle game covering the segment Middle-earth, managed to beat the year of the release of the latest edition of Warhammer is extremely encouraging.

An interesting area of growth is China, where the company is just starting to get some traction. The company has six stores in China, launched its online presence in 2019, and doubled the number of trade accounts last year alone. China is the most important market for the gaming industry, and while we do not know whether the company will have the traction it has in its more developed markets, the current growth on sales of 67% is an initial positive sign.

We like the miniatures segment, but where we really see potential is in its IP where, in our view, its monetization is just scratching the surface.

GAW's History and management

GAW was founded in 1975 by three RPG game fanatics, among them Ian Livingstone and Steve Jackson. GAW was a manufacturer of wooden boards initially, and then the company managed to secure the distribution rights of Dungeons and Dragons in the UK. A few years later, GAW provided the funding for Citadel Miniatures, a company that produced the figures used to play RPG games at the time. GAW later acquired Citadel; currently all (with the exception of Forge World) miniatures manufactured by GAW keep the Citadel Logo.

GAW has had a volatile history:

1975-1984

- The company shifts from being exclusively a wooden board manufacturer to producing miniatures with the full acquisition of Citadel.
- The Warhammer brand is created.
- Tom Kirby (future CEO, Chairman and leader of the MBO) joins the company.

1984-1996

- Release of the first edition of Warhammer 40k
- Management buyout in 1991 led by Tom Kirby who becomes a significant shareholder, Chairman, and CEO. He becomes the face of the company; however, he is a strange character and keeps the company's whereabouts very obscure.
- GAW goes public.

1996-2004

- These were the golden years of GAW as sales grew at a 20% CAGR profitably.
- Black Library is launched.
- GAW increases the frequency of its releases.
- GAW expands internationally.

2004-2015

- Tom Kirby loses focus, and hobbyists turn their backs on GAW as they feel the identity of the company is being lost; the result is real reputational damage.
- Kirby stubbornly ignores the monetization of the IP and keeps in total obscurity the strategy of the company.
- The company's results deteriorate, ultimately leading to the departure of Tom Kirby. The company has less revenues in 2016 than it did in 2004.

2015-Present

- Tom Kirby resigns initially as CEO and subsequently as Chairman; he remains a large shareholder, although consistently reducing his stake.

- Kevin Roundtree is appointed CEO.
- Nick Donaldson is appointed Chairman of the board.

The company has been transformed by Kevin Roundtree, and the change cannot be underestimated. Kevin Roundtree, who joined GAW in 1998 and was appointed CEO in 2015, has reinvigorated the company by:

- Understanding, protecting, and exploiting the company's IP. Prior to Kevin's role as CEO, GAW'S revenues from royalties were almost non-existent; today, they are close to GBP 12m.
- Redesigning the marketing approach of the company by aggressively recruiting hobbyists. To illustrate the evolution of the company, under Kirby's leadership back in 2013, the company closed its Facebook page as a result of a customer revolt. In contrast, last year alone, the company's videos on Warhammer content were viewed more than 50 million times across all channels. Its recent website Warhammer.community.com had more than 114 million page views and has 6 million users. Through interaction among the users, the company learns immediately what works, what does not, and why. The engagement with hobbyists that Kevin has managed to achieve is unprecedented, and we think it is only the beginning.
- The creation of more "settings" like Warhammer Age of Sigmar. The company was too dependent on Warhammer 40k until Kevin Roundtree launched Warhammer Age of Sigmar in 2015, which was well received by the community. This launch expands the potential of the IP exponentially as the company has two limitless universes in which to create stories, characters, and fantasy worlds.

It is worth highlighting that the management team is extremely conservative. They prefer to be very careful with their prospects of the business.

Competitive Landscape

GAW does not have a direct competitor as it is not exclusively a toy company nor a digital game company, but is involved in both. To best illustrate the size of the market, we can differentiate the two segments:

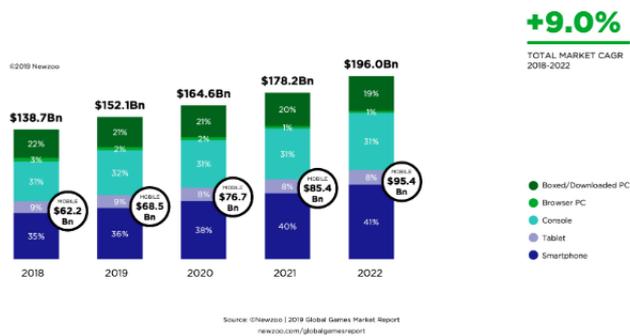
Digital Games: GAW does not produce digital games but licences its IP to developers who then produce games and subsequently pay royalties to GAW. GAW, therefore, is part of this fast-growing market.

According to [newzoo](#), the digital market is worth \$152bn USD, and it is expected to grow 9% CAGR for the next few years.



2018-2022 GLOBAL GAMES MARKET

FORECAST PER SEGMENT TOWARD 2022



Source: <https://newzoo.com/insights/articles/the-global-games-market-will-generate-152-1-billion-in-2019-as-the-u-s-overtakes-china-as-the-biggest-market/>

It is important to highlight that PC and console games make only 50% of the market, and 90% of the royalties received by GAW come from those segments, leaving 50% of the market (tablet and smartphone) ripe to be monetized.

Non-Digital Games: According to Research and Markets, the non-digital games market is worth \$12bn USD and it is expected to grow at a 9% CAGR rate for the next few years. GAW is well positioned to capture at least market growth.

GAW's competitors in the miniatures world are companies such as Privateer Press, Fantasy Light Games, and Wyrd Miniatures.

Boardgames competitors are companies like Z-Man Games and Stonemaier Games.

All of these companies are private; however, Z-Man and Fantasy Flight Games belong to Asmodee, which was acquired by PAI Partners last year in a deal worth \$1.4bn (including debt). Asmodee is just starting to incur in digital games. Its latest reported revenues were 442 million Euros, so the price paid clearly indicated the appetite for this type of company.

Royalties (IP monetization) – The real opportunity

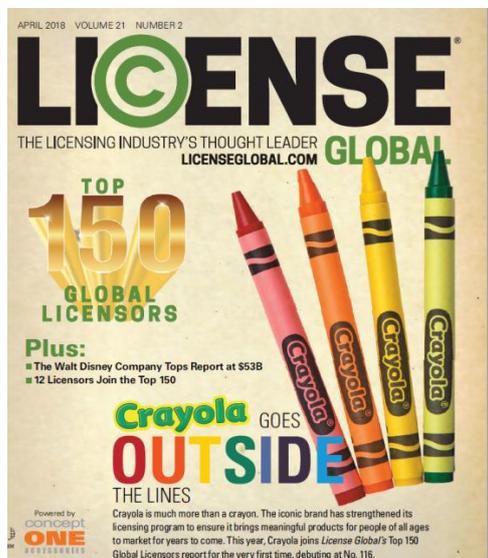
GAW has developed its brands for more than 30 years. It's IP, according to the company, is believed to be "among the best in the world." We do not disagree and think Kevin Roundtree is moving all cylinders to untap its potential.

The Warhammer IP is based on its universes, which constantly create new characters, stories, and, thus, the potential of its IP is not limited to specific characters. This means as long as the new content is of good quality and well received, there is no limit to what GAW can achieve with its IP. We have seen the evolution of the company as follows:

1. The CEO initially set up a group of advisors to understand and protect the IP.
2. The CEO reinvigorated the marketing and, particularly, social media channels.

3. The company started licensing the IP of less important characters to game developers in order to evaluate their performance. If the developers are successful, they build a track record with the company and GAW is able to give them more relevant content related to the IP.
4. The CEO changed the advisor setup with regards to the IP and incorporated it under his main seven business lines. The results dramatically improved with a 10-fold increase in royalties since 2015.
5. The company put in place DAM, which is a business process to organize, store, and retrieve digital assets and any multimedia content. GAW is paranoid with its IP and protects it at all costs.
6. The company committed to exploit the IP with media initiatives, appointed Kate Marsh to the board, and officially committed to develop digital content, particularly animation and TV.

In 2018, GAW made its appearance on the 150 Top Global Licensors of License Global:



What the publication had to say:

137 GAMES WORKSHOP

\$119M (LON: GAW)

WWW.GAMES-WORKSHOP.COM

2017 saw “Warhammer 40,000” and “Warhammer: Age of Sigmar” cement their place at the top of the tabletop wargaming market, with Games Workshop having the biggest year in its 40 year-plus history, says the company. Group sales were up 34 percent and profits up 127 percent over 2016. Games Workshop ended 2017 as the No. 1 gaining stock on the London Stock Exchange (up 269 percent for the year), says the company. This success continued into its licensing business which also had a record year across its key brands.

Fantasy football title “Blood Bowl” also saw success in tabletop and digital formats, and the “Talisman” brand saw a strong re-launch as a board game with support from multiple digital adaptations as well. Key licenses included the PC strategy games “Warhammer 40,000: Dawn of War III” and “Total War: Warhammer II,” the latter winning multiple accolades including PC Gamer’s Strategy Game of the Year. It was also the No. 2 best reviewed licensed video game of the year, says Games Workshop. “Freeblade” on Android and iOS continued to be successful, earning a feature in Apple’s annual keynote for a second year running.

Games Workshop is one of the most prolific licensors in the interactive space, with dozens of titles bearing its various brands available across PC, console and mobile worldwide. “Blood Bowl II,” “Space Hulk: Deathwing” and “Vermintide” are just a few of the additional stand-outs. Games by its licensees consistently appeared on Steam’s top 10 best-sellers, with a number of them spending time at No. 1. The Skulls for the Skull Throne Steam event was a novel promotion in which its various PC game licensees banded together to offer skull-themed content and discounts, causing Games Workshop licensed games to dominate the PC best-sellers list for a week. 2017

We find the below comment by the publication particularly positive to the performance of GAW’s IP. Indeed, just a quick look at the STEAM site can confirm the popularity of titles using GAW’S IP.

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The company climbed four positions in the most recent release of the publication:

133 GAMES WORKSHOP

\$135M (LON:GAW)

WWW.GAMES-WORKSHOP.COM

Games Workshop is the largest and the most successful hobby miniatures company in the world. Its major brands are “Warhammer” and “Warhammer 40,000.” At its core, its business is selling a hobby centered around highly detailed miniatures and collecting, modelling, painting, and playing games with armies of them are activities enjoyed by millions of adherents all across the world.

Top licensed properties in 2018 include “Warhammer 40,000,” “Warhammer Age of Sigmar” and “Talisman.”

Its extensive portfolio of licensed PC games set across various retailers. “Warhammer” universes accounted for more than \$100 million of retail sales in the year.

2019/2020 will see the U.S. continue to participate heavily in the video games market, but its drive for growth will come from a strategic and coordinated approach to entering the consumer products categories.

[Wikipedia keeps a list](#) of all video game releases licenced by GAW. As expected, there has been a huge ramp up in the last two years, which we do not expect to stop. We found the following video to be a great illustration of the strategy at GAW with its IP.

<https://www.youtube.com/watch?v=BtY3Lto IR4>

We have been following GAW’s performance for some time, and, quite frankly, the results have wildly exceeded our expectations. We think the prudent approach the company has established to exploit its IP has placed them in a position where the odds of success for new developments, such as Media, are higher than at any other time in its history.

The recent appointment of Kate Marsh to the board, a media veteran who has led important roles at Sony Pictures Television, Sky, and the BBC, will ensure GAW takes the appropriate steps when negotiating rights for TV series and movies. It has already been announced informally by media channels that the showrunner of the series based on Eisenhorn (a character from Warhammer 40k) is [Frank Spotnitz](#). Frank Spotnitz was the executive producer of *X-Files* and *The Man in the High Castle*; we believe if Mr. Spotnitz is involved, the probable outcome is a successful series.

We think the monetization of the IP is just starting with several other verticals being implemented, such as mobile, tablets, media, and AR/VR realities experiences totally untapped. We also think in the case of a successful media launch, the company can exploit its IP on clothes, attraction parks, and several other verticals. Basically, if the company manages to execute this segment, it can eventually eclipse the current core business, even though management has explicitly mentioned its focus remains the core business. Royalties currently have more than 92% EBIT margins, contribute 13% of the company’s EBIT and, as shown below, have grown at an 58% CARG.

	Royalties	Operating Profit
2014	1,068,000.00	
2015	1,069,000.00	
2016	5,329,000.00	
2017	6,949,000.00	
2018	9,125,000.00	* Warhammer new edition

2019

10,600,000.00

CAGR

58.25%

Financials

GAW's capital allocation policy consists of the distribution of dividends of "truly" excess cash. The company has been explicit that it is not interested in acquisitions nor in disposals of any of its business lines. GAW keeps around GBP 30 million in cash and has an outstanding cash conversion from its earnings. In the most recent year, the company generated GBP 72 million from operations, spent GBP 22.5 million on CAPEX, of which we estimate only GBP 12 million is truly CAPEX. The company is building a new factory and increasing the size of its main operations centre in the US, hence the higher CAPEX figure. Consequently, the company was able to pay GBP 50.3 million in dividends, which corresponds to a 30% Y/Y growth. ROE continues at more than 100% and equity dilution is minimal.

	2016	2017	2018	2019	2020	2021	2023	2024
Revenue	118,069,000.00	158,114,000.00	221,304,000.00	256,574,000.00	282,231,400.00	310,454,540.00	341,499,994.00	375,649,993.40
Cost of Goods Sold	-37,438,000.00	-43,691,000.00	-64,219,000.00	-83,306,000.00	-98,780,990.00	-108,659,089.00	-119,524,997.90	-131,477,497.69
Gross Profit	80,631,000.00	114,423,000.00	157,085,000.00	173,268,000.00	183,450,410.00	201,795,451.00	221,974,996.10	244,172,495.71
Gross Margin	68.29%	72.37%	70.98%	67.53%	65.00%	65.00%	65.00%	65.00%
Selling General & Admin	-69,710,000.00	-83,591,000.00	-92,383,000.00	-103,434,000.00	-110,157,210.00	-117,317,428.65	-124,943,061.51	-133,064,360.51
Royalties	5,939,000.00	7,491,000.00	9,617,000.00	11,365,000.00	12,842,450.00	14,511,968.50	16,398,524.41	18,530,522.58
Operating Income EBIT	16,860,000.00	38,323,000.00	74,319,000.00	81,199,000.00	86,135,650.00	98,989,990.85	113,430,458.99	129,638,467.78
Margin	14.28%	24.24%	33.58%	31.65%	30.52%	31.89%	33.22%	34.51%
Finance Income	93,000.00	87,000.00	90,000.00	102,000.00	102,000.00	102,000.00	102,000.00	102,000.00
Finance Cost	-5,000.00	-7,000.00	-139,000.00	-5,000.00	-5,000.00	-5,000.00	-5,000.00	-5,000.00
Income Before Tax	16,948,000.00	38,403,000.00	74,270,000.00	81,296,000.00	86,232,650.00	99,086,990.85	113,527,458.99	129,735,467.78
Margin	14%	24%	34%	32%	31%	32%	33%	35%
Income Tax	-3,452,000.00	-7,856,000.00	-14,815,000.00	-15,475,000.00	0.00	0.00	0.00	0.00
NET INCOME	13,496,000.00	30,547,000.00	59,455,000.00	65,821,000.00	86,232,650.00	99,086,990.85	113,527,458.99	129,735,467.78
Margin	11%	19%	27%	26%				
Calc:								
Weighted average # of shares	32,116,000.00	32,093,000.00	32,258,000.00	32,438,000.00	32,500,000.00	32,643,000.00	32,786,629.20	32,950,890.37
Diluted number of shares	32,325,000.00	32,150,000.00	32,732,000.00	32,785,000.00	32,800,000.00	32,944,320.00	33,089,275.01	33,234,867.82
EPS Diluted	0.42	0.95	1.82	2.01	2.63	3.01	3.43	3.90
EPS	0.42	0.95	1.84	2.03	2.65	3.04	3.46	3.94
Price			20.70	42.00	42.00	42.00	42.00	42.00
P/E				15.83	15.83	13.84	12.13	10.66
Dividends	0.40	0.74	1.26	1.55	1.55			
EPS CAGR				69.04%	40.74%			

Income Statement: Over the last three years, GAW's core business has grown at an impressive 29% CAGR, while maintaining gross margins (GM) above 65%. The decline on GM is as a result of the rapid growth of the trade channel, which has lower GM but substantially higher EBIT margins.

GM have been compressed as some inventory is written down and the company was paying third party warehousing while the new factory was being built. We are extremely conservative in our estimates of GM in 2020 at 65%; we based them on the shift of the channel mix towards trade.

The company has had an impressive increase in EBIT margins from 14% in 2016 to 32% in 2018, and net margins from 11% to 26%. This is the result of the increase of royalties and higher sales of the core business through its trade channel.

We expect the company to continue the downtrend in its GM to 65% with the continuation of the shift on the channel mix towards trade, which means the continuation of the uptrend in EBIT margins towards 35% in the near term. Contributing to higher EBIT margins will be the increase of royalties as well.

Balance Sheet: GAW has a rock-solid balance sheet, with zero debt and a net cash position of GBP 29.5m.

Cash Flow Statement: The company generated GBP 72m cash from operations (CFO) and spent GBP 22m on CAPEX. The company is building a new factory in the UK and increasing the size of its hub in Memphis. The new factory will double the number of plastic injection machines and the third party warehousing costs incurred should be about to finish. We estimate that true CAPEX is around GBP 12m. The company has also been paying an extraordinary bonus to employees of around GBP 5m and still managed to increase its dividend by 30%. We do not see the company further incurring in major projects. We estimate the cash available to shareholders to keep increasing as a result of lower CAPEX and higher CFO.

CONSOLIDATED AND COMPANY CASH FLOW STATEMENTS

	Notes	Group 52 weeks ended 53 2 June 2019 £000
Cash flows from operating activities		
Cash generated from operations	28	88,776
UK corporation tax paid		(14,217)
Overseas tax paid		(2,079)
Net cash generated from operating activities		72,480
Cash flows from investing activities		
Purchases of property, plant and equipment		(13,651)
Proceeds on disposal of property, plant and equipment		10
Purchases of other intangible assets		(1,875)
Expenditure on product development	14	(6,962)
Interest received		102
Net cash (used in)/generated from investing activities		(22,376)
Cash flows from financing activities		
Proceeds from issue of ordinary share capital	25	718
Interest paid		(5)
Dividends paid to Company shareholders	12	(50,277)
Net cash used in financing activities		(49,564)
Net increase/(decrease) in cash and cash equivalents		540
Opening cash and cash equivalents		28,545
Effects of foreign exchange rates on cash and cash equivalents		286
Closing cash and cash equivalents	20	29,371

Valuation and Conclusion

With 32.5 million shares outstanding and a share price of GBP 42, GAW is trading at an EV of GBP 1.35bn. EBIT is GBP 81.million, meaning the EV/EBIT multiple is 16.42 or 15.51 if we calculated with our conservative forward EBIT of GBP 86.1m, which implies a forward P/E of approximately 19 times.

A way to estimate the implied multiple on the royalties is if we assume royalties will maintain the 13.5% share of EBIT (EBIT of GBP 86.1m), then you are paying an implied multiple for the royalty stream of 28.80 times.

A peer comparison analysis for GAW is difficult; as mentioned before, there are not many listed companies with the same business segments. However, let's quickly take Hasbro numbers and compare it to GAW (Mattel is losing money).

	EV/EBIT	EBIT Margin	P/E
Hasbro	22.5x	14.30%	24.3x
GAW	16.42x	32%	21x

As shown above, GAW's EBIT margins are more than double Hasbro's; however, GAW's EV/EBIT multiple is substantially lower, despite being a company with no debt (Hasbro leverage is substantial), and with a much larger growth potential.

It is worth highlighting that on the 23rd of August, Hasbro [announced](#) the acquisition of Entertainment One (ETO) for 3.3 billion (USD 4bn). ETO is the owner of the cartoon brand Peppa Pig and its main business is the production, distribution, and sales of entertainment content. This is an interesting move by Hasbro to be able to develop and distribute media content based on its brands. The price represented a multiple of 47 times ETON reported EBIT (or 17 times adjusted EBITDA).

We think GAW's current share price is an attractive one to own a business with a rock-solid balance sheet, highly cash generative, growing at impressive rates, although we do not expect the core business to keep growing at the CARG of the last three years. On top of that, we get a business with a royalty stream that almost flows entirely to the bottom line, which has the potential to grow exponentially from the current base, and the company owns, in their words, "one of the best IPs in the world." We truly think the current price and multiples underrate/underappreciate the growth potential of the monetization of the IP.

As an interesting fact, we noted that Soros Asset Management reported on August 21st that it owns 5% of the company. It seems the company is getting more attention.

Risks:

- Management partners with the wrong developers/media producers and the products are a flop, damaging the reputation of the brand.
- Cyclicity. The business has been highly cyclical, and a downturn can harm results, particularly from the core segment.
- Failing to launch successful new releases. If the future editions of Warhammer 40k or Warhammer Age of Sigmar fail to convince hobbyists, results can be affected.

