

Keywords Studios

M&A update

Another electrifying M&A deal

Keywords has announced its largest deal of the year so far, the acquisition of High Voltage Software (HVS), a US-based, full-service, work-for-hire, AAA games developer for up to US\$50m, payable two-thirds up front, with one-third after 12 months subject to performance conditions. Keywords will make an initial payment of US\$33.5m, with US\$23.75m in cash. The total consideration represents 5.6x HVS FY21e EBITDA (c US\$9m), within Keywords' target range of 5–7x EBITDA. HVS is Keywords' fifth deal of the year, the third in games development and its third US-based deal. We suspect Keywords was attracted by HVS's close relationship with Epic Games, publisher of Fortnite. We have left our FY20 estimates unchanged, but the deal is 8% EPS enhancing based on our revised FY21 estimates.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (p)	P/E (x)	Yield (%)
12/18	250.8	37.9	45.5	1.61	62.0	0.06
12/19	326.5	40.9	48.8	0.58	57.8	0.02
12/20e	367.0	52.0	58.0	0.00	48.6	0.00
12/21e	454.3	66.8	70.6	1.91	40.0	0.07

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

High Voltage Software: US games developer

HVS is based in Chicago and New Orleans and is Keywords' largest acquisition of the year. HVS has a 27-year history, working on over 100 games across multiple genres and platforms, including franchises such as Fortnite, Saints Row, Mortal Kombat, Hunter the Reckoning, The Conduit and Lego Racers. The HVS team has worked closely with Epic Games on Fortnite, meaning it has expertise with Epic's Unreal Game Engine.

Acquisition multiple of 5.6x FY21e EBITDA

Keywords will make an up-front payment of US\$23.75m in cash and US\$9.75m in shares, together with deferred consideration of up to US\$16.5m (in a mix of cash and shares), based on performance conditions to 31 December 2021. Total consideration represents a multiple of 5.6x HVS FY21 EBITDA (c US\$9m), within management's target acquisition range. Revenues were not disclosed. We have updated our estimates and calculate that the deal is 8% EPS enhancing based on our revised FY21 estimates. Given the deal is so close to the end of the year, we have chosen not to make any changes to our FY20 estimates.

Valuation: HVS 8% earnings enhancing in FY21

Incorporating HVS into our model, Keywords' shares trade on a P/E of 40.0x our updated FY21e estimates, falling to 35.1x in FY22e, in line with its UK games industry peers. With substantial net cash after the deal, together with €100m of undrawn facilities, Keywords remains well placed to complete further deals in FY21 and continue to follow management's proven buy-and-build strategy, with strong organic games industry growth supplemented by M&A.

Software & comp services

16 December 2020

Price **2,564p**
Market cap **€1.90bn**

€1.10/£

Net cash (€m) at 30 June 2020 (excluding lease liabilities) 101.0

Shares in issue 74.0m

Free float 90%

Code KWS

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 23.3 13.3 83.1

Rel (local) 19.5 5.1 104.2

52-week high/low 2,564p 1,232p

Business description

Keywords Studios is the largest and most diverse supplier of outsourced technical and creative services to the games industry. Through regular acquisitions, the company is building its scale, geographic footprint and delivery capability to become the 'go-to' supplier across the industry.

Next event

FY20 trading update January 2021

FY20 results March 2021

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Exhibit 1: Financial summary

	€'000s	2018	2019	2020e	2021e	2022e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		250,805	326,463	367,011	454,304	508,821
Cost of Sales		(154,997)	(206,234)	(228,363)	(281,462)	(314,678)
Gross Profit (inc multimedia tax credits)		95,808	120,229	138,649	172,842	194,143
EBITDA (adjusted)		43,729	57,611	69,910	88,661	99,631
EBITDA (reported)		34,304	43,375	60,198	76,833	86,621
Operating Profit (before amort. and except.)		38,916	42,983	55,521	69,261	78,131
Amortisation of acquired intangibles		(6,872)	(7,318)	(11,324)	(14,148)	(15,846)
Exceptionals		(5,296)	(4,348)	(2,370)	0	0
Other (incl share based payments)		(4,129)	(9,775)	(10,753)	(11,828)	(13,011)
Operating Profit		22,619	21,542	31,074	43,285	49,275
Net Interest		(1,316)	(2,513)	(3,500)	(2,500)	(2,500)
FOREX		791	(1,658)	0	0	0
Profit Before Tax (norm)		37,911	40,913	52,021	66,761	75,631
Profit Before Tax (FRS 3)		22,094	17,371	27,574	40,785	46,775
Tax		(7,191)	(7,462)	(9,488)	(12,176)	(13,794)
Profit After Tax (norm)		30,720	33,451	42,533	54,585	61,837
Profit After Tax (FRS 3)		14,903	9,909	18,086	28,609	32,981
Average Number of Shares Outstanding (m)		64.3	65.1	69.6	74.2	74.5
EPS - normalised (c)		45.5	48.8	58.0	70.6	80.4
EPS - normalised fully diluted (c)		43.7	47.2	55.8	68.4	78.1
EPS - (IFRS) (c)		23.2	15.2	26.0	38.5	44.3
Dividend per share (p)		1.61	0.58	0.00	1.91	2.11
Gross Margin (%)		38.2%	36.8%	37.8%	38.0%	38.2%
EBITDA Margin (%)		13.7%	13.3%	16.4%	16.9%	17.0%
Operating Margin (before GW and except.) (%)		15.5%	13.2%	15.1%	15.2%	15.4%
PBT Margin (%)		15.1%	12.5%	14.2%	14.7%	14.9%
BALANCE SHEET						
Fixed Assets		198,215	223,992	249,339	259,456	261,157
Intangible Assets		180,086	196,769	220,643	222,368	213,981
Tangible Assets		15,002	22,163	23,636	32,028	42,116
Investments		3,127	5,060	5,060	5,060	5,060
Current Assets		100,348	120,483	224,162	261,251	316,745
Stocks		0	0	0	0	0
Debtors		37,019	43,243	46,785	52,399	58,687
Cash		39,870	41,827	139,064	165,941	209,999
Other		23,459	35,413	38,313	42,911	48,060
Current Liabilities		(95,031)	(49,551)	(49,948)	(33,311)	(26,102)
Creditors		(54,960)	(49,471)	(49,868)	(33,231)	(26,022)
Short term borrowings		(40,071)	(80)	(80)	(80)	(80)
Long Term Liabilities		(11,158)	(71,528)	(71,194)	(73,194)	(75,194)
Long term borrowings		(230)	(59,671)	(59,671)	(59,671)	(59,671)
Other long term liabilities		(10,928)	(11,857)	(11,523)	(13,523)	(15,523)
Net Assets		192,374	223,396	352,358	414,202	476,606
CASH FLOW						
Operating Cash Flow		33,954	46,069	66,181	79,833	88,478
Net Interest		(502)	(9,411)	(6,263)	(3,425)	(2,276)
Tax		(6,304)	(13,288)	(9,488)	(12,176)	(13,794)
Capex		(9,440)	(13,145)	(11,083)	(18,293)	(20,488)
Acquisitions/disposals		(25,766)	(27,762)	(39,109)	(17,637)	(8,289)
Financing		0	0	97,000	0	0
Dividends		(1,080)	(1,197)	0	(1,425)	(1,574)
Net Cash Flow		(10,090)	(18,734)	97,238	26,877	43,057
Opening net debt/(cash)		(11,094)	431	17,924	(79,314)	(106,191)
Forex gain on cash		(3)	1,293	0	0	0
Other		(1,432)	(52)	0	0	0
Closing net debt/(cash)		431	17,924	(79,314)	(106,191)	(149,248)

Source: Company accounts, Edison Investment Research

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