

Keywords Studios

Gobo strengthens engineering operations

Keywords' acquisition of Studio Gobo and Electric Square for up to £26m meaningfully strengthens the company's engineering service line, while enhancing our FY19 earnings by 6% based on conservative assumptions. In paying a maximum of 7.6x historic EBITDA for the business, the company looks to be buying a good asset in a high value-add service line at a very reasonable multiple.

Year end	Revenue (£m)	PBT* (£m)	EPS* (c)	DPS (p)	P/E (x)	Yield (%)
12/16	96.6	14.9	20.3	1.3	109.4	0.07
12/17	151.4	23.0	29.9	1.5	74.2	0.08
12/18e	257.6	37.8	48.6	1.6	45.7	0.08
12/19e	299.2	45.5	56.0	1.8	39.6	0.09

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

Strengthening the engineering service line

Studio Gobo and Electric Square are two Brighton, UK-based games engineering studios co-founded and led by games industry veteran, Tony Beckwith. Studio Gobo has a core strength in high-end console games development, providing full development (entire games, a new capability for Keywords) or co-development (parts of games) for a range of tier one clients including Ubisoft (For Honor), Microsoft (Miami Street) and Disney Infinity (Marvel Super Heroes, Guardians of the Galaxy). Electric Square has core strengths in live ops development (developing new features and downloadable content to keep gamers engaged) and free-to-play and racing games. The addition of the 170 Brighton-based engineers in the combined group (Gobo) brings Keywords' engineering team to 610 people. While the business does have some risk from Brexit and a relatively high customer concentration, the acquisition by Keywords will help mitigate these.

FY19 EPS upgraded by 6%

Gobo's revenues for the 12 months to 31 July are estimated at £11.6m, up strongly from £6.2m for the year to 30 September 2017. EBITDA of £3.6m represents a healthy 31% margin, vs Keywords 17% for FY18e. The consideration was £15m up front (a mix of £10.5m cash and 255k shares), with a further £11m contingent on achieving strong EBITDA growth in the first year following completion. This equates to a maximum of 7.6x historic EBITDA, which is well within Keywords' norms for acquisitions. Assuming a c 15% revenue growth rate for Gobo, the deal enhances our FY19 EPS by 6%.

Valuation: Sustained execution should deliver returns

The c 40x FY19e P/E (c 22x EBITDA) clearly prices in continued strong progress, but further acquisitions and organic upside could bring this down substantially. We have highlighted the company's ability to continue to make good acquisitions at attractive multiples as a key sensitivity to the investment case, especially as it expands into higher value-added services, and we see this acquisition as encouraging in this regard. We believe sustained execution should continue to deliver returns.

Engineering acquisition

Software & comp services

28 August 2018

Price 2,000p

Market cap £1,272m

£/€1.11

Net cash (£m) at 31 December 2017 11.1

Shares in issue 63.6m

Free float 83%

Code KWS

Primary exchange AIM

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 4.3 12.1 47.8

Rel (local) 6.5 15.7 47.1

52-week high/low 2,065p 1,185p

Business description

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

Next events

Interim results September 2018

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Estimate changes

Our estimate changes in Exhibit 1 incorporate the acquisition of Gobo; we also include July's small acquisitions of Snowed In and Yokozuna for the first time.

In aggregate, FY19 EPS is upgraded by 6%, which is almost entirely due to the Gobo acquisition. For Gobo our forecast FY19 revenues of €14.8m (c £13.3m) with €4.2m EBITDA implies a c 15% revenue growth rate compared to respective figures of £11.6m and £3.6m for the year to 31 July 2018. The EBITDA contribution of €1.0m for the remainder of FY18 is more modest due to investment into the business, with a pick-up expected in H119 supported by the timing of projects already in the pipeline.

Similar to other companies providing full and co-development services (eg Sumo), Gobo's customer base is relatively concentrated but these customers are sticky and Keywords' broad customer network should help diversify this. The company also benefits from UK Video Games tax credits, which will be accounted for in the same way as the company's multi-media tax credits, as a credit to cost of goods sold.

Snowed In and Yokozuna together add €2.5m to FY19 revenues but nothing to PBT on our forecasts, with forecast losses (€0.4m) from Yokozuna (currently pre-revenue) offsetting the positive contribution from Snowed In.

Our underlying P&L estimates are unchanged. However, factoring in the weaker dollar, the organic growth required to reach our full year number is now c 11% versus 7.5% were the USD dollar/euro rate to remain unchanged. Give the company's recent positive trading update, we feel this forecast remains well supported.

Exhibit 1: Estimate changes incorporating acquisitions of Gobo, Yokozuna and Snowed In

	€000s	2017	2018e			2019e		
31-December		Actual	Old	New	Change	Old	New	Change
PROFIT & LOSS								
Revenue		151,430	252,254	257,610	2	283,276	299,177	6
Cost of Sales		(96,345)	(161,749)	(165,311)	2	(181,812)	(192,355)	6
Gross Profit		55,085	90,505	92,300	2	101,464	106,823	5
EBITDA		26,645	43,249	44,210	2	49,134	53,545	9
Operating Profit (before amort. and except.)		23,915	38,389	39,246	2	43,676	47,780	9
Profit Before Tax (norm)		23,043	37,342	37,849	1	42,504	45,509	7
Profit After Tax (norm)		18,312	29,948	30,355	1	34,428	36,862	7
EPS - normalised fully diluted (c)		29.9	47.7	48.6	2	52.8	56.0	6
EPS - (IFRS) (c)		12.4	34.2	33.1	(3)	43.2	44.9	4
Dividend per share (pence)		1.5	1.6	1.6	0	1.8	1.8	0
Closing net debt/(cash)		(11,094)	(19,155)	(4,840)	(75)	(38,957)	(14,823)	(62)

Source: Company data, Edison Investment Research

Exhibit 2: Financial summary

	€000s	2016	2017	2018e	2019e
31-December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		96,585	151,430	257,610	299,177
Cost of Sales		(59,907)	(96,345)	(165,311)	(192,355)
Gross Profit (inc multimedia tax credits)		36,678	55,085	92,300	106,823
EBITDA		16,893	26,645	44,210	53,545
Operating Profit (before amort. and except.)		15,090	23,915	39,246	47,780
Intangible Amortisation		(1,629)	(3,038)	(5,000)	(5,500)
Exceptionals		(1,316)	(3,016)	(2,784)	0
Other		(686)	(1,426)	(1,854)	(2,410)
Operating Profit		11,459	16,435	29,609	39,870
Net Interest		(287)	(872)	(1,397)	(2,271)
FOREX		(1,737)	(3,569)	0	0
Profit Before Tax (norm)		14,864	23,043	37,849	45,509
Profit Before Tax (FRS 3)		9,435	11,994	28,212	37,599
Tax		(3,223)	(4,731)	(7,494)	(8,647)
Profit After Tax (norm)		11,641	18,312	30,355	36,862
Profit After Tax (FRS 3)		6,212	7,263	20,717	28,952
Average Number of Shares Outstanding (m)		55.9	58.7	62.5	64.5
EPS		20.9	31.2	48.5	57.2
EPS - normalised (c)		20.3	29.9	48.6	56.0
EPS - (IFRS) (c)		11.2	12.4	33.1	44.9
Dividend per share (p)		1.33	1.46	1.61	1.77
Gross Margin (%)		38.0%	36.4%	35.8%	35.7%
EBITDA Margin (%)		17.5%	17.6%	17.2%	17.9%
Operating Margin (before GW and except.) (%)		15.6%	15.8%	15.2%	16.0%
BALANCE SHEET					
Fixed Assets		61,873	143,872	165,226	174,962
Intangible Assets		55,495	132,555	152,307	161,445
Tangible Assets		5,498	10,111	11,713	12,311
Investments		880	1,206	1,206	1,206
Current Assets		38,677	80,182	84,533	98,322
Stocks		0	0	0	0
Debtors		13,879	27,473	38,077	41,885
Cash		17,020	30,374	24,120	34,103
Other		7,778	22,335	22,335	22,335
Current Liabilities		(27,830)	(52,503)	(48,005)	(44,222)
Creditors		(19,805)	(33,560)	(29,062)	(25,279)
Short term borrowings		(8,025)	(18,943)	(18,943)	(18,943)
Long Term Liabilities		(6,016)	(10,420)	(10,365)	(10,365)
Long term borrowings		(345)	(337)	(337)	(337)
Other long term liabilities		(5,671)	(10,083)	(10,028)	(10,028)
Net Assets		66,704	161,131	191,389	218,697
CASH FLOW					
Operating Cash Flow		17,168	18,373	38,095	44,675
Net Interest		(58)	(253)	(1,397)	(2,271)
Tax		(2,129)	(4,731)	(7,494)	(8,647)
Capex		(2,306)	(3,803)	(6,121)	(6,363)
Acquisitions/disposals		(21,104)	(87,074)	(27,502)	(16,264)
Financing		643	82,936	0	0
Dividends		(825)	(867)	(1,034)	(1,148)
Net Cash Flow		(8,611)	4,581	(5,453)	9,982
Opening net debt/(cash)		(17,284)	(8,650)	(11,094)	(4,840)
Forex gain on cash		1	(891)	(500)	0
Other		(24)	(1,246)	(301)	0
Closing net debt/(cash)		(8,650)	(11,094)	(4,840)	(14,823)

Source: Company data, Edison Investment Research

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