

Game Digital

Year end on track, the journey continues

Pre-close update

Game Digital (GMD) is ending FY17 on revised expectations after demand for the Nintendo Switch caused a short-term hiatus, which we believe masks positive market developments. Refining its medium-term transition strategy, GMD is to exit its B2B web hosting operation. The market values GMD's business at less than zero, but we keep our 83p share valuation.

| Year end | Revenue (£m) | EBITDA (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | EV/EBITDA (x) | Yield (%) |
|----------|--------------|-------------|-----------|----------|---------|---------|---------------|-----------|
| 07/15 | 866.6 | 46.9 | 38.0 | 18.5 | 14.7 | 1.3 | N/A | 59.8 |
| 07/16 | 822.5 | 28.0 | 16.4 | 8.8 | 3.4 | 2.8 | 7.9 | 13.9 |
| 07/17e | 780.3 | 8.0 | (4.0) | (1.8) | 1.0 | N/A | N/A | 4.1 |
| 07/18e | 789.9 | 13.4 | 0.9 | 0.4 | 0.0 | 64.2 | N/A | N/A |

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

Year finishes in line with revised expectations

On 30 June 2017, GMD advised the market that as a result of supply shortages of the successful Nintendo Switch, launched in March, second-half trading would be below expectations. Six weeks later, trading is in line with revised expectations. Cost savings of £5m have been realised, although costs are slightly higher than our forecast, which we reduce by £0.4m for FY17 only. Cash generation has been strong, with year-end net cash of £47m beating our forecast of £45m.

Switch success positive for the market

With global sales forecast by Nintendo of c 10m units in its first year, the Switch is approaching the market significance of the Xbox One. That raises the market profile of Nintendo, which is traditionally No. 3 to Microsoft and Sony. An intensification of competition should be positive for the UK games market and GMD in particular.

Strategy of cycle independence is intact...

In our April [initiation](#) we set out GMD's strategy of transitioning from an exclusively high street retailer to independence from the traditional gaming cycle. This involves developing relationships with its interest group, including experiential services such as BELONG gaming arenas and the Insomnia gaming conference with over 50,000 attendees. Execution of the strategy will take until FY20 and necessarily carries significant execution risks which we reflect in our valuation.

...with review of options for Multiplay Digital

In line with its strategic focus, GMD has decided to maximise shareholder value for its game server hosting business, Multiplay Digital, which provides capacity-related solutions for games developers and publishers. We comment further overleaf.

Valuation: Market valuation less than zero

We note that GMD's current market capitalisation of £42m is below net cash of £47m (27p per share), ascribing a negative value to the business. Our valuation is a blend of three metrics: DCF, peer comparison, and sum-of-the-parts. We are not materially changing forecasts, with no change to our valuation of 83p per share.

Retail

23 August 2017

Price 24.6p
Market cap £42m

| | |
|--------------------------------|--------|
| Net cash (£m) at end July 2017 | 47 |
| Shares in issue | 170.9m |
| Free float | 55% |
| Code | GMD |
| Primary exchange | LSE |
| Secondary exchange | N/A |

Share price performance



| % | 1m | 3m | 12m |
|------------------|-------|--------|--------|
| Abs | (7.9) | (43.6) | (64.7) |
| Rel (local) | (7.2) | (42.8) | (67.5) |
| 52-week high/low | | 77p | 19p |

Business description

Game Digital is the leading omni-channel specialist retailer of video games in the UK and Spain, with 311 stores in the UK, 270 stores in Spain and over 30% market share.

Next events

| | |
|---------------|--------------|
| Final results | October 2017 |
|---------------|--------------|

Analysts

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Server hosting business: Review of strategic options

In the light of the early success of GMD's esports activities, including the first 18 BELONG retail concepts, management has made the decision to maximise shareholder value in respect of Multiplay's Digital division.

Multiplay, which was acquired in March 2015, comprises the Digital division with its multiplayer game server-hosting technology, and the Events and Esports activities which include major gaming and esports events and the BELONG concept. While the Digital business is relatively small from a revenue perspective, given it is a tech business delivering c 100% revenue growth in a growth market, its potential value should not be understated. By way of reference, GMD paid a total consideration of £20m for Multiplay in 2015, which was c 4 times its total sales of c £4.5m, split approximately equally between the two divisions. In FY17, Multiplay will deliver total sales of £11.6m, of which £4.5m is from Digital.

Exhibit 1: Financial summary

| Accounts: IFRS, Yr end: July, GBP: Millions | 2015A | 2016A | 2017E | 2018E | 2019E | 2020E |
|---------------------------------------------|---------|---------|---------|---------|---------|---------|
| Profit and Loss statement | | | | | | |
| Total revenues | 866.6 | 822.5 | 780.3 | 789.9 | 800.9 | 1,007.1 |
| Cost of sales | (652.9) | (612.7) | (582.4) | (586.6) | (589.0) | (763.6) |
| Other income/(expense) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Exceptionals and adjustments | (12.2) | (11.5) | (4.7) | (9.1) | (9.1) | (9.1) |
| Depreciation and amortisation | (8.5) | (10.5) | (11.0) | (11.9) | (13.0) | (15.1) |
| Reported EBIT | 29.9 | 8.4 | (12.1) | (7.7) | (2.4) | 22.4 |
| Finance income/(expense) | (0.4) | (1.1) | (1.0) | (0.6) | (0.6) | (0.8) |
| Exceptionals and adjustments | (3.7) | (2.4) | 4.4 | 0.0 | 0.0 | 0.0 |
| Reported PBT | 29.5 | 7.3 | (13.1) | (8.2) | (3.0) | 21.6 |
| Income tax expense (includes exceptionals) | (4.4) | (1.3) | 1.0 | (0.2) | (1.3) | (6.8) |
| Reported net income | 25.1 | 6.0 | (12.1) | (8.4) | (4.3) | 14.9 |
| Basic average number of shares, m | 168.3 | 168.9 | 170.9 | 170.9 | 170.9 | 170.9 |
| Basic EPS, p | 12.7 | 3.3 | (5.1) | (5.0) | (3.3) | 4.8 |
| Dividend per share, p | 14.7 | 3.4 | 1.0 | 0.0 | 0.0 | 4.0 |
| Adjusted EBITDA | | | | | | |
| Adjusted EBITDA | 46.9 | 28.0 | 8.0 | 13.4 | 19.7 | 46.6 |
| Adjusted EBIT | 38.4 | 17.5 | (3.0) | 1.4 | 6.7 | 31.5 |
| Adjusted PBT | 38.0 | 16.4 | (4.0) | 0.9 | 6.1 | 30.7 |
| Adjusted diluted EPS, p | 18.5 | 8.8 | (1.8) | 0.4 | 2.8 | 13.8 |
| Balance sheet | | | | | | |
| Goodwill | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Intangible assets | 61.0 | 56.7 | 43.0 | 29.3 | 15.6 | 1.9 |
| Other non-current assets | 0.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Total non-current assets | 80.4 | 75.7 | 68.0 | 63.0 | 57.5 | 50.2 |
| Cash and equivalents | 63.1 | 48.8 | 57.3 | 54.3 | 56.6 | 69.0 |
| Inventories | 66.8 | 76.1 | 73.1 | 73.7 | 74.0 | 95.9 |
| Trade and other receivables | 17.8 | 20.4 | 19.6 | 19.8 | 20.1 | 25.3 |
| Other current assets | 0.9 | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Total current assets | 148.6 | 153.1 | 150.7 | 148.4 | 151.4 | 190.9 |
| Non-current loans and borrowings | 0.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 |
| Other non-current liabilities | 5.7 | 4.4 | 1.9 | 1.9 | 1.9 | 1.9 |
| Total non-current liabilities | 5.8 | 7.5 | 5.0 | 5.0 | 5.0 | 5.0 |
| Trade and other payables | 93.8 | 85.9 | 82.5 | 83.1 | 83.5 | 108.2 |
| Current loans and borrowings | 0.0 | 7.2 | 7.2 | 7.2 | 7.2 | 7.2 |
| Other current liabilities | 3.2 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| Total current liabilities | 97.0 | 94.4 | 91.0 | 91.6 | 92.0 | 116.7 |
| Non-controlling interest | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Cashflow statement | | | | | | |
| Cash from operations (CFO) | 44.1 | 6.2 | 13.3 | 13.5 | 19.6 | 33.6 |
| Capex | (11.3) | (13.3) | (12.4) | (16.0) | (16.6) | (16.9) |
| Acquisitions & disposals net | (12.4) | (1.5) | 13.3 | 0.0 | 0.0 | 0.0 |
| Other investing activities | (0.2) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Cash used in investing activities (CFIA) | (23.9) | (14.8) | 0.9 | (16.0) | (16.6) | (16.9) |
| Net proceeds from issue of shares | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Movements in debt | (1.5) | 1.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other financing activities | (37.8) | (13.9) | (5.7) | (0.6) | (0.6) | (4.2) |
| Cash from financing activities (CFF) | (39.3) | (12.4) | (5.7) | (0.6) | (0.6) | (4.2) |
| Increase/(decrease) in cash and equivalents | (19.1) | (21.0) | 8.5 | (3.0) | 2.4 | 12.4 |
| Currency translation differences and other | (3.1) | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Cash and equivalents at end of period | 63.1 | 43.1 | 51.6 | 48.6 | 50.9 | 63.3 |
| Net (debt) cash | 63.0 | 38.5 | 47.0 | 44.0 | 46.3 | 58.7 |
| Movement in net (debt) cash over period | 63.0 | (24.5) | 8.5 | (3.0) | 2.4 | 12.4 |

Source: GMD accounts, Edison Investment Research

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