

# Keywords Studios

Sparkling growth, improving margins

FY19 trading update

Software & comp services

Although we expected strong growth in H219, FY19 revenue of €326m, reflecting 30% overall growth and 15% organic growth, represents a sparkling performance. EBITDA and PBT were ahead of forecast at €49.5m and €41.0m, respectively. Given the higher revenue base, we are revising our FY20 revenue estimate up by 4%, but prudently holding operating profit and PBT at previous levels as margins normalise through FY20. We retain our view that Keywords remains strongly positioned as the only games service provider at a global scale. The company's P/E rating (25.0x FY20e) reflects its leading market position, track record and potential, and should fall further as Keywords continues its buy-and-build strategy.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (p)	P/E (x)	Yield (%)
12/17	151.4	23.1	30.0	1.46	53.9	0.11
12/18	250.8	37.9	40.1	1.61	40.3	0.12
12/19e	326.0	41.0	46.0	1.77	35.2	0.13
12/20e	374.9	52.4	64.8	1.95	25.0	0.14

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

## Market leader in a growth industry

As management emphasised at the Montreal capital markets day (CMD), as well as strong industry growth (Newzoo forecasts 8.4% growth 2019–22), Keywords benefits from the growth of outsourcing and increasing market share as a market leader in a fragmented global industry. Growth is further boosted by M&A through Keywords' successful buy-and-build strategy. With the next console transition in Q420, the medium-term growth outlook remains robust and next week's London CMD will provide further insight into the opportunities for each of Keywords' business lines.

## Robust performance leading to forecast revisions

Although we expected strong growth, FY19 revenues of €326m (FY18: €250.8m), reflecting 30% overall growth and 15% organic growth, represents a sparkling performance. EBITDA and PBT were accordingly ahead of forecast at €49.5m and €41.0m, respectively (Edison: €48.8m, €40.2m), while management expects FY19 net debt of €18m (H119: €9m). Given the higher revenue base, we are revising our FY20 estimates (revenues +4%) but prudently holding operating profit and PBT at previous levels, reflecting caution on the normalisation of margins in FY20 (operating margins of 14.2% vs 14.9% previously), together with a more conservative stance on cash conversion (see below).

## Valuation: Rating undemanding, likely to fall further

Keywords remains well placed with strong industry growth and a healthy acquisition pipeline focused around game development and marketing services. Keywords has delivered an adjusted EPS CAGR of 40% from 2014–19, and we believe looks set to maintain double-digit revenue growth for the foreseeable future. In this context, we believe that a 25.0x FY20e P/E is not overly demanding and fairly reflects Keywords' leading market position, track record and potential. This rating should fall further as Keywords successfully continues to execute its buy-and-build strategy.

30 January 2020

**Price** 1,370p

**Market cap** £894m

€1.18/£

Expected net debt (€m) at 31 December 2019 18.0

Shares in issue 65.27m

Free float 89%

Code KWS

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (10.0) 20.9 28.8

Rel (local) (8.0) 17.0 16.0

52-week high/low 1,838p 900p

### Business description

Keywords Studios is 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

London CMD 5 February 2020

Final results 31 March 2020

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## Revised estimates

Our estimate revisions are shown in Exhibit 1.

In summary, we have revised FY20 revenue growth (+4% to €375m) given Keywords' robust performance in FY19, as well as management's reassuring comments from the trading update on the medium-term outlook. However, we have taken the opportunity to be slightly more cautious on margin expectations, largely holding our FY20 operating profit (€53.4m) and PBT (€52.4m) forecasts at previous levels. This reflects a more prudent assumption on margin progression through FY20, although management restated its expectations that operating profit margins will normalise (which we take as 15%) incrementally in FY20 as Keywords' leverages its investment (in facilities, recruitment, training, IT, security and HR) over its growing revenue base.

Management has estimated FY19 year-end net debt to be higher than anticipated at €18m (Edison: €10.2m), leading to a reduction in our expectations for net cash in FY20 to €7.6m. However, with the expectation of further M&A to be financed by the company's new €100m three-year banking facility (extendable to €140m over five years), the net cash/debt position is likely to continue to change significantly.

**Exhibit 1: Estimate changes**

€000s	2018	2019e	2019e		2020e	2020e	
Year end 31 December	Actual	Old	New	Change	Old	New	Change
Revenue	250,805	319,720	326,004	2.0%	360,157	374,913	4.1%
Cost of sales	(154,997)	(200,771)	(205,021)	2.1%	(224,903)	(234,889)	4.4%
Gross profit (inc multimedia tax credits)	95,808	118,949	120,982	1.7%	135,253	140,024	3.5%
Gross margin (%)	38.2%	37.2%	37.1%		37.6%	37.3%	
EBITDA	44,232	48,845	49,500	1.3%	60,965	61,192	0.4%
Operating profit (before amort. and except.)	38,916	42,216	42,741	1.2%	53,498	53,419	-0.1%
Operating margin	15.5%	13.2%	13.1%		14.9%	14.2%	
Profit before tax (norm)	37,911	40,216	41,001	2.0%	52,498	52,419	-0.2%
Profit after tax (norm)	30,720	32,776	33,416	2.0%	43,048	42,983	-0.2%
EPS - normalised (c)	40.1	45.0	46.0	2.1%	64.8	64.8	-0.2%
Dividend per share (p)	1.61	1.77	1.77		1.95	1.95	
Closing net debt/(cash)	423	10,188	18,000	76.7%	(24,745)	(7,647)	-69.1%

Source: Keywords Studios accounts, Edison Investment Research

**Exhibit 2: Financial summary**

	€000s	2016	2017	2018	2019e	2020e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue		96,525	151,430	250,805	326,004	374,913
Cost of Sales		(59,907)	(96,345)	(154,997)	(205,021)	(234,889)
Gross Profit (inc multimedia tax credits)		36,618	55,085	95,808	120,982	140,024
EBITDA		16,833	26,645	44,232	49,500	61,192
Operating Profit (before amort. and except.)		15,030	23,915	38,916	42,741	53,419
Intangible Amortisation		(1,629)	(3,038)	(6,872)	(7,559)	(8,315)
Exceptionals		(1,316)	(3,016)	(5,607)	(2,981)	0
Other		(686)	(1,426)	(4,129)	(6,000)	(6,600)
Operating Profit		11,399	16,435	22,308	26,201	38,504
Net Interest		(287)	(818)	(1,005)	(1,740)	(1,000)
FOREX		(1,737)	(3,623)	791	(1,159)	0
Profit Before Tax (norm)		14,804	23,097	37,911	41,001	52,419
Profit Before Tax (FRS 3)		9,375	11,994	22,094	23,302	37,504
Tax		(3,223)	(4,731)	(7,191)	(7,585)	(9,435)
Profit After Tax (norm)		11,581	18,366	30,720	33,416	42,983
Profit After Tax (FRS 3)		6,152	7,263	14,903	15,717	28,068
Average Number of Shares Outstanding (m)		55.9	58.7	64.3	65.3	65.4
EPS (c)		20.8	31.3	41.8	46.8	65.8
EPS - normalised (c)		20.2	30.0	40.1	46.0	64.8
EPS - (IFRS) (c)		11.0	12.4	23.2	24.1	42.9
Dividend per share (p)		1.33	1.46	1.61	1.77	1.95
Gross Margin (%)		37.9%	36.4%	38.2%	37.1%	37.3%
EBITDA Margin (%)		17.4%	17.6%	17.6%	15.2%	16.3%
Operating Margin (before GW and except.) (%)		15.6%	15.8%	15.5%	13.1%	14.2%
<b>BALANCE SHEET</b>						
Fixed Assets		61,873	142,927	198,215	223,669	222,865
Intangible Assets		55,495	131,610	180,086	197,727	189,696
Tangible Assets		5,498	10,111	15,002	22,975	30,202
Investments		880	1,206	3,127	2,967	2,967
Current Assets		38,677	80,182	100,349	107,916	145,357
Stocks		0	0	0	0	0
Debtors		13,879	27,473	37,019	48,125	55,343
Cash		17,020	30,374	39,871	29,295	54,942
Other		7,778	22,335	23,459	30,497	35,071
Current Liabilities		(27,830)	(51,677)	(95,031)	(83,595)	(84,279)
Creditors		(19,805)	(32,734)	(54,960)	(36,523)	(37,207)
Short term borrowings		(8,025)	(18,943)	(40,071)	(47,072)	(47,072)
Long Term Liabilities		(6,016)	(10,420)	(11,158)	(11,703)	(10,718)
Long term borrowings		(345)	(337)	(230)	(230)	(230)
Other long term liabilities		(5,671)	(10,083)	(10,928)	(11,473)	(10,488)
Net Assets		66,704	161,012	192,375	236,288	273,225
<b>CASH FLOW</b>						
Operating Cash Flow		17,108	21,389	38,481	41,278	58,069
Net Interest		(58)	(253)	(502)	(7,542)	(6,394)
Tax		(2,129)	(4,731)	(6,304)	(7,585)	(9,435)
Capex		(2,306)	(3,803)	(9,440)	(14,572)	(15,000)
Acquisitions/disposals		(21,104)	(90,090)	(30,296)	(28,000)	(316)
Financing		643	82,936	174	0	0
Dividends		(825)	(867)	(1,080)	(1,155)	(1,276)
Net Cash Flow		(8,671)	4,581	(9,919)	(17,577)	25,647
Opening net debt/(cash)		(17,284)	(8,650)	(11,094)	423	18,000
Forex gain on cash		1	(891)	(3)	0	0
Other		36	(1,246)	(1,596)	0	0
Closing net debt/(cash)		(8,650)	(11,094)	423	18,000	(7,647)

Source: Keywords Studios data, Edison Investment Research

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