

# Keywords Studios

Acquisition

French audio and localisation consolidation

Software &amp; comp services

The acquisition of four French companies gives Keywords Studios strong capabilities across all major European languages for localisation and voice-over recording. The transactions boost our FY18 EPS by 5%, although some investment in integrating the entities will be required. The expanded offering should also support organic growth, through helping secure more centrally procured, multi-language contacts.

9 August 2017

**Price** **1,190.00p**
**Market cap** **£664m**

€1.10/£

Net cash (€m) as at 31 December 2016 8.7

Shares in issue 55.8m

Free float 69%

Code KWS

Primary exchange AIM

Secondary exchange N/A

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS** (p)	P/E (x)	Yield (%)
12/15	58.0	8.0	12.6	1.2	103.9	0.1
12/16	96.6	14.9	20.3	1.3	64.5	0.1
12/17e	135.1	20.5	28.6	1.5	45.8	0.1
12/18e	158.8	24.3	33.5	1.6	39.1	0.1

Note: \*PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. \*\*DPS in distributable currency.

## Share price performance



%	1m	3m	12m
Abs	57.5	49.7	237.6
Rel (local)	53.4	45.4	202.7

52-week high/low	1,190.0p	337.5p
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## Business description

Keywords Studios provides localisation, testing, artwork, community support and engineering services exclusively to the video games industry. It provides services to 20 of the top 25 games developers and is leading consolidation of this fragmented industry.

## Next events

Interim results	September 2017
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## Consolidating French audio and localisation

Keywords Studios has further consolidated its leadership position in the European localisation and audio service lines through the acquisition of four Paris-based businesses – La Marque Rose (audio), Around the Word (game localisation), Dune Sound and Asrec (both audio recording) – for a total consideration of up to €7.6m (details overleaf). The transaction strengthens the company's French language capability, which had been a relative weakness, and gives the company strong capabilities across all major European languages, which should enable Keywords to win larger and more comprehensive contracts as clients increasingly look to source all voice-over recording work from a single provider. The plan is to integrate the acquired businesses into the company's existing recording studio in Paris, with c €1m expected to be invested in equipment and offices for the combined facilities.

## 5% EPS upgrade, likely more to come

In aggregate, the businesses had revenues of €9.0m and PBT of €0.9m. Aggregate margins (10% at the PBT level) are currently below Keywords' group level (15.4% in FY16), but management expects to bring margins in line with the rest of the group within a couple of years. The acquisitions represent a trailing PBT multiple of 8x, in line with the company's historical norms. This should drop to close to 5x as margins are brought to group level. We upgrade our FY17 and FY18 EPS by 2% and 5%, respectively, with our forecast FY17 year-end net cash dropping back by €7.8m to €6.4m. We believe that there is scope for more organic upgrades, while more earnings-enhancing acquisitions should be expected, with remaining acquisition capital giving the potential to generate EPS of 58-63c exiting FY18 if historical 7-9x current year EV/PBT multiples are maintained.

## Valuation: Premium rating deserved

Keywords' rating of 39x FY18e earnings (vs peer average of 19x) factors in further accretion from acquisitions or organic upgrades. If Keywords were to achieve our notional post-acquisitions EPS of 58-63c, the rating would drop to 20-22x – a modest premium to the sector. We believe a wider premium would almost certainly be maintained.

## Changes in estimates

The transactions involve the acquisitions of La Marque Rose SARL, Asrec SAS, Dune Sound and Around the Word; the latter two were subsidiaries of Dune Media SAS. All are Paris based.

The maximum aggregate consideration is €7.6m, with €6.6m paid on completion and a further €1m over the two years to 31 December 2019 contingent on meeting performance targets. Of the initial €6.6m, €5.7m is being paid in cash with the remainder in shares, 9,534 of which are to be issued on 10 August.

Our estimate changes are shown below. Our FY18 estimates assume that the PBT margin for the acquired businesses expands to 12.3% and therefore FY19 estimates (not yet published) should benefit from further earnings accretion as margins are expanded towards the 15% group level.

<b>Exhibit 1: Estimates changes</b>							
€000s	2016	2017e	2017e	Change	2018e	2018e	Change
	Actual	Old	New		Old	New	
Revenue	96,585	132,136	135,136	2%	148,894	158,794	7%
Cost of sales	(59,907)	(85,815)	(87,825)	2%	(97,486)	(104,347)	7%
Gross profit	36,678	46,322	47,312	2%	51,408	54,447	6%
EBITDA	16,893	22,688	23,006	1%	25,807	27,021	5%
Operating profit (before amort. and except.)	15,090	20,613	20,931	2%	23,525	24,739	5%
Profit before tax (norm)	14,864	20,153	20,471	2%	23,065	24,279	5%
Profit after tax (norm)	11,641	15,921	16,172	2%	18,452	19,424	5%
EPS - normalised fully diluted (c)	20.3	28.1	28.6	2%	32.0	33.5	5%
EPS - (IFRS) (c)	11.2	24.6	25.1	2%	28.6	30.2	6%
Dividend per share (pence)*	1.3	1.5	1.5	0%	1.6	1.6	0%
Closing net debt/(cash)	(8,650)	(14,195)	(6,371)	-55%	(26,333)	(19,171)	-27%

Source: Keywords Studios data, Edison Investment Research. Note: \*DPS in distributable currency.

**Exhibit 2: Financial summary**

	€000s	2014	2015	2016	2017e	2018e
Year end 31 December		IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>						
Revenue		37,293	57,951	96,585	135,136	158,794
Cost of Sales		(24,566)	(36,172)	(59,907)	(87,825)	(104,347)
Gross Profit (inc multimedia tax credits)		12,727	21,779	36,678	47,312	54,447
EBITDA		6,027	9,459	16,893	23,006	27,021
Operating Profit (before amort. and except.)		5,159	8,162	15,090	20,931	24,739
Intangible Amortisation		(468)	(857)	(1,629)	(1,629)	(1,629)
Exceptionals		(1,461)	(1,089)	(1,316)	0	0
Other		(156)	(392)	(686)	(686)	(686)
Operating Profit		3,074	5,824	11,459	18,616	22,424
Net Interest		(106)	(264)	(287)	(460)	(460)
FOREX		467	(474)	(1,737)	0	0
Profit Before Tax (norm)		5,053	8,007	14,864	20,471	24,279
Profit Before Tax (FRS 3)		3,435	5,086	9,435	18,156	21,964
Tax		(1,215)	(1,832)	(3,223)	(4,299)	(4,856)
Profit After Tax (norm)		3,838	6,175	11,641	16,172	19,424
Profit After Tax (FRS 3)		2,220	3,254	6,212	13,857	17,109
Average Number of Shares Outstanding (m)		45.0	48.2	55.9	55.3	56.7
EPS - normalised (c)		8.5	12.8	20.9	29.3	34.3
EPS - normalised fully diluted (c)		8.5	12.6	20.3	28.6	33.5
EPS - (IFRS) (c)		4.9	7.0	11.2	25.1	30.2
Dividend per share (p)		1.10	1.21	1.33	1.46	1.61
Gross Margin (%)		34.1%	37.6%	38.0%	35.0%	34.3%
EBITDA Margin (%)		16.2%	16.3%	17.5%	17.0%	17.0%
Operating Margin (before GW and except.) (%)		13.8%	14.1%	15.6%	15.5%	15.6%
<b>BALANCE SHEET</b>						
Fixed Assets		20,874	32,132	61,873	75,184	78,756
Intangible Assets		17,677	27,675	55,495	66,628	66,349
Tangible Assets		2,761	3,486	5,498	7,676	11,527
Investments		436	971	880	880	880
Current Assets		23,120	34,884	38,677	41,674	57,267
Stocks		0	0	0	0	0
Debtors		6,203	7,519	13,879	17,933	19,726
Cash		11,014	19,018	17,020	14,741	27,541
Other		5,903	8,347	7,778	9,000	10,000
Current Liabilities		(9,746)	(13,128)	(27,830)	(31,534)	(32,862)
Creditors		(9,746)	(11,965)	(19,805)	(23,509)	(24,837)
Short term borrowings		0	(1,163)	(8,025)	(8,025)	(8,025)
Long Term Liabilities		(2,607)	(3,294)	(6,016)	(6,190)	(6,190)
Long term borrowings		0	(571)	(345)	(345)	(345)
Other long term liabilities		(2,607)	(2,723)	(5,671)	(5,845)	(5,845)
Net Assets		31,642	50,594	66,704	79,133	96,971
<b>CASH FLOW</b>						
Operating Cash Flow		2,412	4,768	17,168	22,326	26,677
Net Interest		11	(58)	(58)	(460)	(460)
Tax		(522)	(1,362)	(2,129)	(4,299)	(4,856)
Capex		(1,252)	(1,635)	(2,306)	(4,839)	(6,133)
Acquisitions/disposals		(8,889)	(7,409)	(21,104)	(14,180)	(1,500)
Financing		7,342	14,199	643	0	0
Dividends		(609)	(737)	(825)	(817)	(927)
Net Cash Flow		(4,256)	7,194	(8,611)	(2,268)	12,800
Opening net debt/(cash)		(15,271)	(11,014)	(17,284)	(8,650)	(6,371)
Forex gain on cash		0	0	1	0	0
Other		(1)	(924)	(24)	(11)	0
Closing net debt/(cash)		(11,014)	(17,284)	(8,650)	(6,371)	(19,171)

Source: Keywords Studios accounts, Edison Investment Research. Note: DPS in distributable currency

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