

Gameloft

Price EUR7.40

Gameloft's mid-term outlook deserves more than EUR7.2 per share

Fair Value EUR6.7 (-9%)

BUY

Bloomberg	GFT FP
Reuters	GLFT.PA
12-month High / Low (EUR)	7.5 / 3.2
Market Cap (EUR)	636
Ev (BG Estimates) (EUR)	599
Avg. 6m daily volume (000)	371.2
3y EPS CAGR	

	1 M	3 M	6 M	31/12/15
Absolute perf.	10.4%	19.7%	117.6%	22.1%
Softw. & Comp.	2.7%	-1.0%	15.9%	-3.3%
DJ Stoxx 600	2.6%	-4.6%	-1.8%	-7.0%

YEnd Dec. (EURm)	2014	2015e	2016e	2017e
Sales	227.3	256.2	269.0	290.5
% change		12.7%	5.0%	8.0%
EBITDA	13.7	8.0	47.4	59.6
EBIT	-4.2	-1.2	28.0	37.6
% change		71.4%	NS	34.2%
Net income	-5.9	-19.6	19.2	26.6
% change		NS	NS	38.7%

	2014	2015e	2016e	2017e
Operating margin	-1.8	-0.5	10.4	12.9
Net margin	-2.8	-9.4	6.9	9.2
ROE	-4.6	-21.2	14.0	16.7
ROCE	-3.5	-1.1	25.7	30.9
Gearing	-38.6	-32.4	-41.2	-45.4

(EUR)	2014	2015e	2016e	2017e
EPS	-0.07	-0.22	0.22	0.30
% change	-	NS	NS	38.7%
P/E	NS	NS	34.1x	24.6x
FCF yield (%)	NM	NM	3.8%	3.9%
Dividends (EUR)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	2.6x	2.3x	2.2x	1.9x
EV/EBITDA	42.4x	74.9x	12.2x	9.4x
EV/EBIT	NS	NS	20.8x	15.0x



Yesterday, Gameloft provided its mid-term guidance (a three-year plan) for FY18 revenue of over EUR350m, underlying operating profit before SO of over EUR65m and cumulative FCF 2016/18 of more than EUR85m. As a result, FY18 underlying op. profit is 50% above our estimate which was nevertheless the highest in the consensus. After factoring in slightly more cautious advertising revenue forecasts than GFT's targets, we have increased our 2016/18e EPS sequence by 13.8% on average. Regarding speculation surrounding the stock, we cannot exclude a fresh increase in the offer price as 1/ the share is trading above Vivendi's last offer and 2/ Gameloft's 2018 targets are promising. As a reminder, we estimate a fair offer in the range EUR7.2/8.4. We maintain our Buy rating.

ANALYSIS

- Yesterday, during its investor day in London, GFT's management presented its three-year strategic and financial targets. For FY18, management expects to:

- **Grow revenues to over EUR350m**, i.e. a 2015/18 CAGR of over 11% (vs. BG est.: EUR308m, CAGR of +6.3%). This target is based on ~70% in in-app purchases (8-12 new games per year and the resilience of current games: decrease in feature phone games offset by in-app purchases at +5%/year) and ~30% from in-house advertising i.e. EUR100m (2/3 fill rate and 80% coming from programmatic), bearing in mind that the run rate is already at EUR20m/year (vs. EUR5m in FY15).
- **Reach a profitability of 18-20%**, i.e. over EUR65m in underlying op. profit before SO (vs. BG est.: EUR43.3m, i.e. margin of 14.1%). This implies a 2.5X multiplication between 2013 (its historical peak) and 2018. The target is based on the benefit of the 2014-15 streamlining (a reduction of 850 positions i.e. 12.5% of global staff, data center investments completed), the impact of programmatic advertising (high operating leverage: fixed-cost model where all investments have been made), and other elements (increase in gross margin via better revenue mix towards its IPs, and decrease in COGS related to lower feature phone revenues).
- **Generate a cumulative FCF 16/18 of more than EUR85m** (vs. BG. est.: EUR77.1m).

Management intends to reach these objectives through: further concentration (fewer games but with a focus on established franchises and mid-core games), free-to-play monetisation with in-app-purchase (with longer lifetime value) and advertising (with conservative monetisation assumptions: stable DAU and stable revenue per DAU), and secular switch to programmatic mobile advertising (monetising Gameloft's massive mobile audience: GFT has 166m MAU and 21m DAU).

- **Gameloft's FY18 underlying op. profit target was 50% higher than our previous estimate** whereas we were the highest among the consensus. By putting slightly more cautious advertising revenue forecasts than Gameloft's targets into our model, **we have increased our EPS sequence by 13.8% on average over 2016/18e: 0% in 2016e, +7.2% in 2017e and +34.1% in 2018e.**
- **We appreciate GFT's strategy: 1/ Its restructuring plan is now completed.** Indeed this massive reduction in its cost base (closure of 10 development studios between Dec. 2014 and Jan. 2016, resulting in net savings of ~EUR25-27m) should enable the group to return to its past margin levels as of 2016 (BG est.: 11.5%e). **2/ Its internal development strategy in the advertising business** (BG. Est.: EUR18m in 2016) is more than welcome as the in-app purchase business is starting to mature. Thanks to these measures, profitability this year should be close to the 2013 level (11.5%e vs. 12.2%) when the share price was in the EUR5.3-8.2 range. We believe in the margin recovery story, knowing that the stock market usually pays very close attention to GFT's profitability.
- **Speculative appeal unchanged:** the first bid from Vivendi was too low (EUR6), while the latest price is attractive (EUR7.2). However, as Vivendi is seeking to acquire Ubisoft, which has to be a friendly move, it must be generous with Gameloft (the Guillemot family runs both companies). As a result, **we cannot exclude a fresh increase in the offer price as:** 1/ the stock is trading above Vivendi's last offer, and 2/ Gameloft's mid-term financial targets are very promising.

VALUATION

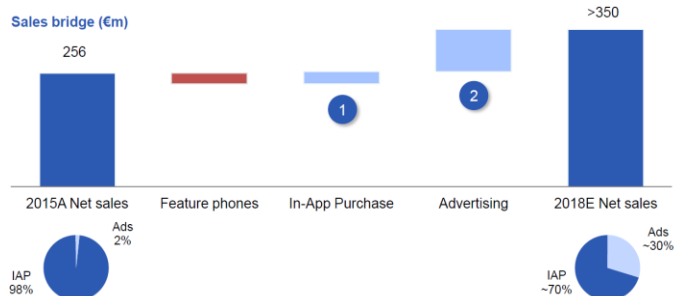
- **We are maintaining our Buy rating and FV of EUR6.7.** Note that if Vivendi pays 2.5x 2016 EV/sales for Gameloft (i.e. same multiple Activision paid for King), this would result in an offer price of EUR8.4. We see this latter as an absolute maximum level that Gameloft does not really deserve

(King is 3x more profitable). As such, a fair offer is probably somewhere in the middle, i.e. EUR7.2-8.4.

NEXT CATALYSTS

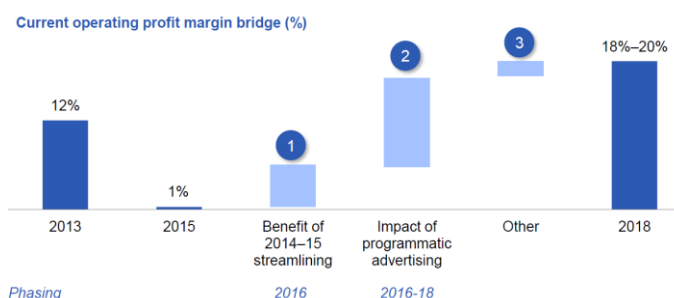
- **Q1 sales:** 28th April (after trading).

Gameloft's 2018 target: top-line growth mainly driven by advertising



Source: Gameloft

Gameloft's 2018 target: to increase its underlying op. margin to 18/20%



Source: Gameloft

Main financial factors for 2013-2018e (old vs. new BG est. over 2017/18)

EURm	2013	2014	2015	BG 2016	Cons. 2016	BG 2017 (old)	BG 2017 (new)	Cons. 2017	BG 2018 (old)	BG 2018 (new)
Sales	233.3	227.3	256.2	269.0	271	287.8	290.5	290	308.0	322.5
Y/Y growth	12.0%	-2.6%	12.7%	5.0%	6%	7.0%	8.0%	7%	7.0%	11.0%
Y/Y organic growth	16.3%	1.1%	5.7%	5.0%	-	7.0%	8.0%	-	7.0%	11.0%
Current EBIT before SO	28.4	-1.1	2.1	31.0	22.6	37.9	40.6	27.2	43.3	57.8
Margin	12.2%	-0.5%	0.8%	11.5%	8.3%	13.2%	14.0%	9.4%	14.1%	17.9%
Current EBIT after SO	24.9	-4.2	-1.2	28.0	-	34.9	37.6	-	40.3	54.8
margin	10.7%	-1.8%	-0.5%	10.4%	-	12.1%	12.9%	-	13.1%	17.0%
EBIT	23.6	-4.9	-11.5	26.0	-	34.9	37.6	-	40.3	54.8
Margin	10.1%	-2.1%	-4.5%	9.7%	-	12.1%	12.9%	-	13.1%	17.0%
Net income	7.5	-6.4	-24.2	18.5	12.3	24.8	26.6	16.1	28.4	38.1
Margin	3.2%	-2.8%	-9.4%	6.9%	4.5%	8.6%	9.2%	5.5%	9.2%	11.8%
Restated net income	8.4	-5.9	-19.6	19.2	-	24.8	26.6	-	28.4	38.1
Margin	3.6%	-2.6%	7.7%	7.1%	-	8.6%	9.2%	-	9.2%	11.8%
Net cash	60.3	52.7	36.9	54.6	44	71.1	72.2	57	90.1	98.0

Sources: Consensus from the company (09/02/16); Bryan Garnier & Co. ests.

Annual game releases from 2012 to 2016e

Number of games	Q1	Q2	Q3	Q4	Full year
2013	2	7	4	3	16
2014	1	3	4	4	12
2015	5	4	2	5	16
2016e	1	3	2	3	9

Source: Bryan, Garnier & Co ests.

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