

Ubisoft

Price EUR29.03

No profit warning – quite the opposite, even by taking additional security

Fair Value EUR35 (+21%)

BUY

Bloomberg	UBI.FP
Reuters	UBIP.PA
12-month High / Low (EUR)	38.3 / 19.0
Market Cap (EUR)	3,296
Ev (BG Estimates) (EUR)	3,308
Avg. 6m daily volume (000)	250.9
3y EPS CAGR	34.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-15.5%	-18.9%	9.9%	8.8%
Softw. & Comp.	-7.7%	-1.9%	6.1%	0.4%
DJ Stoxx 600	-3.4%	-1.2%	-1.2%	-9.4%

YEnd Mar. (EURm)	03/16	03/17e	03/18e	03/19e
Sales	1,394	1,638	1,878	2,124
% change		17.5%	14.7%	13.1%
EBITDA	600	688	876	1,060
EBIT	156.1	200.0	313.0	423.0
% change		28.1%	56.5%	35.1%
Net income	116.0	131.1	214.2	294.1
% change		13.0%	63.4%	37.3%

	03/16	03/17e	03/18e	03/19e
Operating margin	11.2	12.2	16.7	19.9
Net margin	6.7	7.7	11.4	13.8
ROE	9.2	11.0	15.8	17.8
ROCE	11.0	11.3	18.9	26.1
Gearing	4.3	1.1	-16.0	-31.9

(EUR)	03/16	03/17e	03/18e	03/19e
EPS	1.02	1.11	1.82	2.49
% change	-	9.3%	63.4%	37.3%
P/E	28.6x	26.1x	16.0x	11.6x
FCF yield (%)	NM	2.5%	6.7%	9.0%
Dividends (EUR)	0.00	0.00	0.00	0.00
Div yield (%)	NM	NM	NM	NM
EV/Sales	2.4x	2.0x	1.6x	1.3x
EV/EBITDA	5.6x	4.8x	3.5x	2.6x
EV/EBIT	21.4x	16.5x	9.8x	6.5x



UBI has posted better-than expected H1 earnings (much more revenue and much lower losses than last year). And even by taking more cautious assumptions for the fiscal H2 titles (and in particular *Watch Dogs 2*), the group has finally upgraded its non-IFRS operating income for the FY (from ~EUR230m to EUR230m-EUR250m; the consensus was at EUR236.4m and we were at EUR240m) thanks to very robust momentum for the digital segment and back-catalogue combined with tight cost control. While investors expected a profit warning (the stock was down 17% from September to date), we believe this reliable guidance should reassure the market on the current FY and UBI's mid-term plan (2018-19). We revised hardly anything on the operational level. Buy and FV maintained.

ANALYSIS

- Better-than-expected fiscal Q2 sales:** Revenue came out at EUR142.2m (+28.5% Y/Y, +28.8% at cc), i.e. well above our EUR106m figure (no consensus; guidance of ~EUR100m). We expected the group to beat our expectations (given the cautious guidance) but not by this magnitude.
- Fiscal H1 earnings pack:** Sales reached EUR281.4m (+35.7% Y/Y, +37.1% at cc), i.e. much higher than our EUR245m estimate (guidance of ~EUR239m), with a gross margin of 80.5% vs. 74.4% last year (positive digital impact). Note that there were no major game releases, i.e. the same configuration as last year. However, the non-IFRS operating loss was much lower than last year at -EUR61.8m vs. our -EUR90m, thanks to a strong back-catalogue (EUR256.4m, +45.5%) and more digital revenues (EUR202.6m i.e. 72.0% of total sales, +102.6% Y/Y: incl. higher recurring player investment of EUR95.4m, +132.1% Y/Y) coming from *The Division* and *Rainbow Six Siege*. After EUR24.9m of stock options (incl. -EUR13m from free share plans) and EUR3.6m of non-current charges (brand depreciations), the loss was of -EUR90.3m i.e. lower than our -EUR102.5m. Non-IFRS net loss reached -EUR35.9m vs. our -EUR67.0m, and IFRS net loss -EUR66.1m vs our -EUR79.5m. The FCF was negative but less than expected at -EUR17.7m (-EUR358.9m in H1 2015-16) and the group finally posted a net cash position of EUR37.7m.
- Management's guidance:** UBI has revised downwards its sales over the FY from ~EUR1,700m to EUR1,610m-EUR1,670m (more conservatism on projections for H2 games and negative forex impact), but upgraded its non-IFRS operating income target from ~EUR230m to EUR230m-EUR250m i.e. a margin from 13.5% to ~15% (better-than-expected H1, very robust momentum for the digital segment and back-catalog combined with tight costs control). It expects a positive FCF generation (and a "strong FCF" before change in WCR). Note that it now sees digital sales representing 40% of its FY sales (vs. over 35% before) and back-catalog 35% (vs. 30% before).
- A reassuring message:** As H1 is not representative in this industry and as UBI will release five AAA games in fiscal H2 (two of which in Q3), it was essential to pay close attention to Q3 guidance, and to the Q4 release slate. 1) Management said it expects ~EUR560m in fiscal Q3, stable Y/Y (vs. our EUR650m), which includes mainly more conservatism on *Watch Dogs 2*. It is a wise decision given the current low pre-orders on this game in the US, even if the quality of the game is a much better indicator for final sales cf. *Far Cry 3* (in that respect, pre-tests are really positive on *WD2*). 2) The group confirmed all games for the last quarter which was very reassuring (*For Honor*, *South Park and Ghost Recon: Wildlands*; this latter title received excellent feedbacks) meaning it expects sales of ~EUR768m-EUR829m in fiscal Q4 (in line with our EUR800m). Whereas investors expected a profit warning (the stock has lost 17% since the beginning of September), the updated guidance should reassure the market. Indeed, we consider it as very consistent and achievable (the FY will be less back-end loaded, and with a stronger-than-expected profitability thanks to higher extra content and back-catalog sales), and it even demonstrates that the group is accelerating towards its 20% op. margin objective in FY 2018-19 (i.e. EUR440m).

Ubisoft's line-up on fiscal year 2016-17

Games	Launch date	Target audience	Our impression at E3
<i>Watch Dogs 2</i>	15/11/16	Core gamers	✓✓✓
<i>Steep</i>	Dec. 2016	Mostly core gamers	✓
<i>For Honor</i>	14/02/17	Mostly core gamers	✓✓
<i>Ghost Recon: Wildlands</i>	07/03/17	Core gamers	✓✓✓
<i>South Park: The Fractured But Whole</i>	Calendar Q1 17, i.e. fiscal Q4	Core/casual gamers	✓✓

Source: Bryan, Garnier & Co (✓ Weak; ✓✓ Good; ✓✓✓ Excellent).

- Note that during the critical Christmas quarter, **the two AAA games from Ubisoft won't directly compete with Titanfall 2 (EA), Battlefield 1 (EA) and Call of Duty Infinite Warfare (Activision Blizzard)**. Indeed, *Watch Dogs 2* is an adventure/action game and *Steep* an extreme-sports game.
- **Our forecasts:** we now see FY 2016-17 sales of EUR1,637.9m i.e. +17% Y/Y lfl (vs. EUR1,718.8m before) but we maintain our non-IFRS operating income of EUR240.0m (margin of 14.7%, +260bp). **Note that we have revised our EPS sequence over the next three fiscal years by -6.7% on average (-10.8%, -4.9% and -4.5% respectively) but hardly anything on the operational level** (it's mainly stock-based compensation, number of fully diluted shares...).
- **Speculation surrounding UBI stock remains intact** (we do not see it before April 2017 at the earliest). Bear in mind that the Guillemot family holds 13.22% of UBI's share capital and 19.16% of the voting rights. This compares to Vivendi's 22.8% and 20.2% respectively. We consider this latter as the most motivated player since the acquisition of Gameloft). **As Vivendi has currently no entry into UBI's board, it will have to make a formal and correct takeover bid if it really wants to take the control of the company.**

VALUATION

- **We maintain our Buy recommendation and FV of EUR35** (only based on fundamentals). The UBI share has lost 17% since the beginning of September and 24% since its peak in July. **As investors expected a profit warning, we believe the upgraded non-IFRS operating income target of EUR230m-EUR250m for FY 2016-17** (vs. around EUR230m before) **should reassure the market and make even more credible UBI's mid-term plan** (FY 2018-19 targets).
- **In the event of a takeover bid, we estimate a valuation between EUR41** (the very minimum, and EUR46 if Vivendi wants to avoid counterbids as far as possible) **and EUR51** (maximum).

NEXT CATALYSTS

- **Q3 sales:** February 2017.

BG estimates for the next two fiscal years

EURm	Sales	Y/Y growth	Non-IFRS op. income	Non-IFRS op. margin	Non-IFRS net income	IFRS net income	Non-IFRS EPS	IFRS EPS	Fully diluted shares
2016/17e	1,637.9	17.5%	240.0	14.7%	171.1	125.9	1.45	1.07	118.0
2017/18e	1,878.0	13.9%	340.0	18.1%	241.2	214.2	2.04	1.82	118.0

Source: Bryan, Garnier & Co ests.

For 2016-17e, the last consensus from the company (13/09/16) was at EUR236.4m.

For 2017-18e, the last consensus from the company (13/09/16) was at EUR304.8m.

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