

# Keywords Studios

Trading update

Making hay while the sun shines

Keywords has delivered exceptional growth in H121, reflecting continued strong demand from video games developers driven by gamers desperate for new content. Expected revenues of €238m are up c 37% y-o-y, with organic growth of 23% as all service lines performed well against a weak H120 comparator (initial impact of COVID-19). Margins were also elevated, with adjusted PBT of €40m, an 80% y-o-y increase and a margin of 16.8%, continuing the uplift in margins seen in H220. With costs expected to start to normalise towards the end of the year, we have raised our FY21 adjusted PBT margin to 16%, but have left our FY22 and FY23 margins at 15%. Keywords trades on a P/E of 39.4x our updated FY21 estimates, falling to 37.1x in FY22. However, we expect that further M&A will lower Keywords' rating.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (p)	P/E (x)	Yield (%)
12/19	326.5	40.9	48.8	0.58	68.1	0.02
12/20	373.5	55.0	60.9	0.00	54.5	0.00
12/21e	491.5	78.8	84.3	1.91	39.4	0.07
12/22e	563.9	84.8	89.6	2.11	37.1	0.07

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

## H121: Strong organic growth, elevated margins

Keywords' trading update shows a strong H121, with revenues of €238m (H120: €173.5m), up c 37% y-o-y, and organic growth of 23% (H220: 15.0%, FY20: 11.7%) with all service lines performing well against a weak H120 (initial impact of COVID-19). Adjusted PBT is expected to be c €40m, a more than 80% increase year-on-year (H120: €21.7m), a margin of 16.8% (H120: 12.5%, H220: 16.6%) and a continuation of the strong margins seen in H220. The group ended H121 with net cash of €84m (FY20: €102.9m), having spent €45m on M&A in the period (Tantalus, Climax and €5m of deferred consideration). With strong positive cash flow, Keywords will restart its progressive dividend policy in 2021.

## FY21 estimates revised upwards

Given the combination of strong organic growth (H121: 23%) and elevated adjusted PBT margins (H121: 16.8%) versus long-term guidance of 15%, we feel it appropriate to raise our FY21 estimates. Conservatively, we are leaving revenues unchanged, but increasing our adjusted PBT margins to 16% to reflect the super-normal margins in H121. However, with the assumption that costs will start to normalise towards the end of the year, we have increased our margin assumptions for FY22 and FY23 only incrementally to 15%, in line with long-term guidance.

## Valuation: Keywords justifies a premium valuation

In our opinion, Keywords' shares warrant a premium valuation, trading on a P/E of 39.4x our updated FY21 estimates, falling to 37.1x in FY22. With high growth driven by substantial underlying demand for its services, the group remains capacity constrained. However, with net cash of €84m, as well as €100m of undrawn facilities, the group retains substantial financial firepower and we expect to see further M&A in the coming periods, which should lower Keywords' rating.

Software & comp services

5 August 2021

**Price** **2,816p**

**Market cap** **£2.13bn**

€1.18/£

Net cash (€m) at 30 June 2021 (excluding lease liabilities) 84.0

Shares in issue 75.57m

Free float 90%

Code KWS

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs 7.9 10.5 41.2

Rel (local) 7.4 7.0 16.0

52-week high/low 2,996p 2,056p

### Business description

Keywords Studios is the largest and most diverse supplier of outsourced technical and creative services to the games industry. Through regular acquisitions, the company is building its scale, geographic footprint and delivery capability to become the 'go-to' supplier across the industry.

### Next event

H121 results 15 September 2021

FY21 trading update January 2022

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## FY21 revised upwards, FY22/23 largely unchanged

We had expected Keywords' business to bounce back in FY21, supported by pent-up demand from its core client base and underpinned by strong consumer demand for games across all platforms and geographies. This bounce-back in demand is now visible in Keywords' H121 trading update, constrained only by resource capacity and the company's ability to meet increased demand.

**Revenues:** despite 23% organic growth in H121, well above the company's guidance of 10–15% long-term organic growth, we have conservatively decided not to increase our FY21 revenue estimate. We also leave our assumptions for 12% organic growth in FY22 and 10% in FY23 unchanged. However, we see no reason why growth should slow materially in H221, save that the company appears to be resource constrained, with more demand than it can meet at present. This points to the likelihood of further acquisitions in the coming periods, which we do not factor into our estimates.

**Margins:** the adjusted PBT margin in H121 was 16.8% (H120: 12.5%, H220: 16.6%), a continuation of the elevated margins seen in H220. Despite a trend of strengthening margins, we see this level of margin as unlikely to be sustained as costs start to normalise towards the end of the year. In particular, we anticipate more normal levels of capex, marketing spend and travel in FY22. Accordingly, we have raised our adjusted PBT margin for FY21e to 16%, implying PBT of €78.8m, but have only nudged our margin estimates for FY22 and FY23 up to 15%, the group's long-term margin guidance.

Other assumptions remain unchanged.

### Exhibit 1: Revised estimates

€'000s	2020	2021e			2022e			2023e		
Year end 31 December	Actual	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	373,538	491,544	491,544	-	563,935	563,935	-	620,328	620,328	-
Gross profit (incl. multimedia tax credits)	141,772	186,735	192,634	3.2%	213,425	215,117	0.8%	234,768	236,008	0.5%
Gross margin (%)	38.0%	38.0%	39.2%		37.8%	38.1%		37.8%	38.0%	
EBITDA (adjusted)	74,177	94,659	100,557	6.2%	106,078	107,770	1.6%	115,893	117,134	1.1%
Operating profit (pre amort. and except.)	57,259	74,909	80,807	7.9%	85,130	86,822	2.0%	93,643	94,884	1.3%
Operating margin	15.3%	15.2%	16.4%		15.1%	15.4%		15.1%	15.3%	
Profit before tax (norm)	54,954	72,909	78,807	8.1%	83,130	84,822	2.0%	91,643	92,884	1.4%
PBT (norm) margin	14.7%	14.8%	16.0%		14.7%	15.0%		14.8%	15.0%	
Profit after tax (norm)	43,927	58,327	63,046	8.1%	66,504	67,857	2.0%	73,314	74,307	1.4%
EPS – normalised (c)	60.9	78.1	84.3	7.9%	88.1	89.6	1.7%	96.8	97.8	1.0%
Dividend per share (p)	0.00	1.91	1.91	-	2.11	2.11	-	2.32	2.32	-

Source: Keywords Studios accounts, Edison Investment Research

**Exhibit 2: Financial summary**

€'000s	2019	2020	2021e	2022e	2023e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
Revenue	326,463	373,538	491,544	563,935	620,328
Cost of Sales	(206,234)	(231,766)	(298,911)	(348,818)	(384,320)
Gross Profit (incl. multimedia tax credits)	120,229	141,772	192,634	215,117	236,008
Investment income	-	1,437	-	-	-
EBITDA (adjusted)	57,611	74,177	100,557	107,770	117,134
EBITDA (reported)	43,375	66,760	100,557	107,770	117,134
Operating Profit (before amort. and except.)	42,983	57,259	80,807	86,822	94,884
Amortisation of acquired intangibles	(7,318)	(8,808)	(11,317)	(14,051)	(15,456)
Exceptionals	(4,348)	(2,650)	-	-	-
Other (incl. share-based payments)	(9,775)	(15,350)	-	-	-
Operating Profit	21,542	41,119	69,490	72,771	79,428
Net Interest	(2,513)	(2,522)	(2,000)	(2,000)	(2,000)
FOREX	(1,658)	(6,103)	-	-	-
Profit Before Tax (norm)	40,913	54,954	78,807	84,822	92,884
Profit Before Tax (FRS 3)	17,371	32,494	67,490	70,771	77,428
Tax	(7,462)	(11,027)	(15,761)	(16,964)	(18,577)
Profit After Tax (norm)	33,451	43,927	63,046	67,857	74,307
Profit After Tax (FRS 3)	9,909	21,467	51,729	53,807	58,851
Average Number of Shares Outstanding (m)	65.1	70.8	74.8	75.7	76.0
EPS - normalised (c)	48.8	60.9	84.3	89.6	97.8
EPS - normalised fully diluted (c)	47.2	57.7	81.6	87.1	95.4
EPS - (IFRS) (c)	15.2	30.3	69.1	71.1	77.4
Dividend per share (p)	0.58	0.00	1.91	2.11	2.32
Gross Margin (%)	36.8%	38.0%	39.2%	38.1%	38.0%
EBITDA Margin (%)	13.3%	17.9%	20.5%	19.1%	18.9%
Operating Margin (before GW and except.) (%)	13.2%	15.3%	16.4%	15.4%	15.3%
PBT Margin (%)	12.5%	14.7%	16.0%	15.0%	15.0%
<b>BALANCE SHEET</b>					
Fixed Assets	245,461	309,685	355,464	379,024	397,717
Intangible Assets	196,769	240,810	280,783	294,036	300,652
Tangible Assets	22,163	26,419	32,225	42,532	54,609
Right of use assets	21,469	27,807	27,807	27,807	27,807
Investments	5,060	14,649	14,649	14,649	14,649
Current Assets	120,483	189,567	195,070	244,729	306,069
Stocks	-	-	-	-	-
Debtors	43,243	47,832	57,457	64,352	70,787
Cash	41,827	103,070	91,167	128,357	178,060
Other	35,413	38,665	46,446	52,019	57,221
Current Liabilities	(57,292)	(91,130)	(97,153)	(99,356)	(101,969)
Creditors	(49,471)	(83,696)	(89,719)	(91,922)	(94,535)
Short term borrowings	(80)	(73)	(73)	(73)	(73)
Lease liabilities	(7,741)	(7,361)	(7,361)	(7,361)	(7,361)
Long Term Liabilities	(85,694)	(36,887)	(36,887)	(36,887)	(36,887)
Long term borrowings	(59,671)	(122)	(122)	(122)	(122)
Lease liabilities	(14,166)	(21,503)	(21,503)	(21,503)	(21,503)
Other long-term liabilities	(11,857)	(15,262)	(15,262)	(15,262)	(15,262)
Net Assets	222,958	371,235	416,493	487,509	564,930
<b>CASH FLOW</b>					
Operating Cash Flow	46,069	80,879	91,508	104,364	112,658
Net Interest	(9,411)	(9,816)	(9,047)	(9,047)	(9,047)
Tax	(13,288)	(4,459)	(15,761)	(16,964)	(18,577)
Capex	(13,145)	(13,908)	(19,792)	(22,707)	(24,977)
Acquisitions/disposals	(27,762)	(39,936)	(57,104)	(16,567)	(8,269)
Financing	-	111,698	-	-	-
Dividends	(1,197)	-	(1,707)	(1,889)	(2,084)
Net Cash Flow	(18,734)	124,458	(11,903)	37,190	49,703
Opening net debt/(cash)	430	17,924	(102,875)	(90,972)	(128,162)
Forex gain on cash	1,293	(3,426)	-	-	-
Other	(53)	(233)	-	-	-
Closing net debt/(cash) (excluding lease liabilities)	17,924	(102,875)	(90,972)	(128,162)	(177,865)

Source: Company accounts, Edison Investment Research

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