Gravity Co. (GRVY)

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Disclaimers

• I am not a registered investment advisor and I do not offer any investment advice.

• No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments.
Gravity - business

• Ragnarok – very aged MMO still popular in Japan. 74% revenues in 2009 (US$37M). Cash cow somewhat.
• Ragnarok 2 – forever delayed, not clear if it is any good or if it will be released, but potentially huge catalyst
• Other games – not significant % of revenues, not very popular, may be closed down

• Subsidiary of GungHo Online Entertainment (59.3% shareholder)
Gravity - Misc thoughts

• What can go wrong?
  • Ragnarok 2 killed, other games not successful

• US tax issues due to PFIC status in US
Strategic considerations

• Moat (switching costs, habit, low cost):
  • What are the moats? Game loyalty
  • What does it take to sustain the moats? Not really sustainable, people move on (except for WoW)
  • Bargaining power of suppliers/customers? Not much

• Is it a low risk business? No
• Is there high uncertainty? Yes
• How capital intensive is the business? Medium
• Future growth – unknown
• Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Hopefully understated due to bust before new games pick up
Management

• I don’t usually do management analysis. Included for template completeness
• No dilution
• Can I trust management?
• Management shareholding (> 10%)
• Management incentives?
• Are the salaries too high?
• Is there heavy insider buying?
• Is there heavy insider selling?
• Do I like the management? (Operators, capital allocators, integrity)
• Profitable reinvestment
• What has management done with the cash?
• Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Is it a good business?

• Not really. It’s not a Buffettology pick, it’s a Graham pick
Is it a good business? Cash flow

• Positive cash flow from operations in 2009
Is business cheap? - Graham investment considerations

• .56 P/Book (41M market cap, 73M book value)
• .92 P/net cash (41M market cap, Net cash = 61M Cash + short term investments – 16.5M liabilities = 44.5M)

• Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)
  • Z = 1.2T1 + 1.4T2 + 3.3T3 + .6T4 + .999T5 = 0.876 + 0.028 + 0.099 + 1.488 + .43 = 2.921
  • T1 = Working Capital (Current Assets – Current Liabilities) / Total Assets = (72M – 7M) / 89.5M = 0.73
  • T2 = Retained Earnings / Total Assets = 2M / 89.5M = 0.02
  • T3 = Earnings Before Interest and Taxes / Total Assets = 2.6 / 89.5M = 0.03
  • T4 = Market Value of Equity / Book Value of Total Liabilities = 41M / 16.5M = 2.48
  • T5 = Sales / Total Assets = 39M / 89.5M = 0.43