



**Holland Views: Games Workshop – Price: £30; MCap: £976m**

## **Niches, Money Trees and Margins of Safety**

We have spent some time looking at the unusual company that is Games Workshop (GAW). We conclude to like much about it from both its exceptional financial metrics (high margins and high returns) and the tailwind that we conclude will likely drive its online profits and IP monetisation in the future. The problem (if there is one) is the Margin of Safety we are offered – or lack of it. Normally we like to find companies that are under-priced and under-earning at the time of purchase. A cursory glance at the profits and share price charts of GAW suggests this is perhaps not the case for this investment. However, two factors stood out in our work that we thought worthy of investor attention. These are:

- The huge boost to margins that is taking place by retail sales becoming online sales
- The fact that the group's Intellectual Property looks substantially under monetised

### **Never has the word 'niche' been so apt**

Late last year we visited Games Workshop at their Head Office and Manufacturing facility in Nottingham (Thank you Client X for kindly organising this). It is a company that for a few years we have been recommended to meet and we only wish we had heeded that advice earlier! From this trip and a studious look at the company's past accounts we have learnt a great deal. Below we offer a few observations.

This is a company with a wonderful global niche product sold to a widespread but dedicated fan base. Games Workshop is a 'miniature wargaming manufacturing company' that is, it sells figurines of mythical characters, fantasy storylines. Its bestselling series being Warhammer.

Suffice to say that it is an unusual product to understand unless you are immersed in that niche (which we doubt many readers of this research will be – but see section later for help). What is striking however is the widespread global following of the product and that it has just grown almost by word of mouth, but done so consistently over the last 30 years. Indeed, when asking the company about why it may open a store in a particular city and the data/research behind such a decision it is clear there is surprisingly little. They just look for geographic areas where they think there might be demand in and crucially try to find store manager for that local business that are/will be passionate about the product. On this point (i.e. the recruitment of the right people) however they are very clear in what they seek. This all suggests long term growth has been disciplined, but perhaps not very dynamic, especially in the online world that we now all live in. We will return to this point.

### Financial metrics to die for

The output of this quirky company making games characters and shipping them globally from Nottingham, are some simple financial metrics e.g.

- RONTA (Return on Net Tangible assets) = 150%,
- Gross margin 70%
- EBIT Margin 33%

In addition, the company has longstanding managers who communicate a great understanding of Intellectual Property protection, innovation and economic value creation. The company also has an excellent record of capital allocation with no acquisitions and a pay-out ratio that ranges from 70%-170% in the last 10 years. They also appear prudent. On our trip we were shown character moulds that the company created 10 years ago that occasionally are re-used for repeat product runs. We note that in the accounts however all moulds are characterised as development costs and are written off at a declining balance rate of 50% over 4 years (so 75% in first 24 months).

The business is also still growing. Store rollouts globally are adding c.+5% pa to the existing estate and most recent sales grew at 14% in 1H 2019 over the same period last year – which had itself seen very strong growth as our Appendix shows. With the shares of the company changing hands for c.17x earnings (and the Balance Sheet sitting on net cash) they appear to be reasonably priced vs. the Rare Bird characteristics that we conclude the company seemingly demonstrates.

If there is a catch, we will come to it shortly, but first we point out the two factors at GAW that excite us even more than the impressive numbers we outlined above.

They are:

## 1. Online sales increase will be a huge driver for profitability

The table below extracted from the group R+A shows the company's sales and profits by different channels. In our model in the Appendix we have laid this and more past period data out to show the remarkable growth that has occurred at this company in recent years. But leaving such growth aside for a moment, another startling point we think can be seen. This being the stark difference in margins it makes between its different routes to market

Sales Sales by segment	53 weeks to	52 weeks to	53 weeks to	52 weeks to	2018 % of total Sales	2017 % of total sales
	3 June 2018 Constant currency	28 May 2017 Constant currency	3 June 2018 Actual rates	28 May 2017 Actual rates		
Trade	£96.2m	£61.3m	£94.3m	£61.3m	43%	39%
Retail	£82.5m	£64.8m	£82.0m	£64.8m	37%	41%
Online	£43.9m	£32.0m	£43.6m	£32.0m	20%	20%
<b>Total sales</b>	<b>£222.6m</b>	<b>£158.1m</b>	<b>£219.9m</b>	<b>£158.1m</b>		

Reported sales grew by 39% to £219.9 million for the year. On a constant currency basis, sales were up by 41% from £158.1 million to £222.6 million.

Operating profit Operating profit by segment	53 weeks to	52 weeks to	53 weeks to	52 weeks to
	3 June 2018 Constant currency	28 May 2017 Constant currency	3 June 2018 Actual rates	28 May 2017 Actual rates
Trade	£33.3m	£18.0m	£32.9m	£18.0m
Retail	£6.7m	£0.5m	£7.2m	£0.5m
Online	£27.9m	£18.8m	£27.9m	£18.8m
Product and supply	£25.1m	£16.3m	£23.9m	£16.3m
Royalties (net of costs)	£9.4m	£6.9m	£9.1m	£6.9m
Other costs	£(26.3)m	£(22.2)m	£(26.4)m	£(22.2)m
<b>Total operating profit</b>	<b>£76.1m</b>	<b>£38.3m</b>	<b>£74.6m</b>	<b>£38.3m</b>

Source:  
Games Workshop Annual Report 2018

The Directors and employees of Holland Advisors may have a beneficial interest in some of the companies mentioned in this report via holdings in a fund that they also act as managers to.

### Contact:

**HollAnd**  
Advisors

Holland Advisors London Limited  
1 Berkeley Street  
London  
W1J 8DJ

Tel: (0)871 222 5521  
Mob: (0)7775 826863  
[www.hollandadvisors.co.uk](http://www.hollandadvisors.co.uk)

**Disclaimer**

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by Financial Conduct Authority). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.