

Gravity Co. (GRVY)

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Disclaimers

- I am not a registered investment advisor and I do not offer any investment advise
- 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)
 - $Z = 1.2T1 + 1.4T2 + 3.3T3 + .6T4 + .999T5 = 0.876 + 0.028 + 0.099 + 1.488 + .43 = 2.921$
 - $T1 = \text{Working Capital (Current Assets - Current Liabilities)} / \text{Total Assets} = (72M - 7M) / 89.5M = 0.73$
 - $T2 = \text{Retained Earnings} / \text{Total Assets} = 2M / 89.5M = 0.02$
 - $T3 = \text{Earnings Before Interest and Taxes} / \text{Total Assets} = 2.6 / 89.5M = 0.03$
 - $T4 = \text{Market Value of Equity} / \text{Book Value of Total Liabilities} = 41M / 16.5M = 2.48$
 - $T5 = \text{Sales} / \text{Total Assets} = 39M / 89.5M = 0.43$