Glu Mobile Research (9/13/19)

Description: Glu Mobile Inc. develops, publishes, and markets a portfolio of free-to-play mobile games for the users of smartphones and tablet devices. The company publishes titles primarily in four genres:

1. Home décor
2. Sports and action
3. Fashion and celebrity
4. Time management.

The company was formerly known as Sorrent, Inc. and changed its name to Glu Mobile Inc. in May 2005. Glu Mobile Inc. was founded in 2001 and is headquartered in San Francisco, California.

Ticker: GLUU
Price: $5.46
Market Cap: $779M
Performance: -32.3% YTD

Analysis

Glu Mobile creates games via two different ways. The first is based on its own brands like that of Blood & Glory, Contract Killer, Cooking Dash, Deer Hunter, Diner Dash, Eternity Warriors, Frontline Commando, Gun Bros, QuizUp, and Tap Sports.

The company also creates games based on third-party licensed brands, such as Kim Kardashian: Hollywood, MLB Tap Sports Baseball, and Restaurant Dash with Gordon Ramsay.

GLUU has been struggling this year, down over 32%. The performance was much worse several weeks ago but the stock has since climbed back from the low $4s to mid $5s.

After researching the stock there were a few things I found that made me quite a bit concerned about the future of GLUU. Much of the reasons are starting to bother investors and that is why I believe the share price has fallen significantly.

These reasons include:

1. Falling active users
2. Slowdown in growth
3. Slowdown in bookings
4. Weakening portfolio

Let's start to break down each issue:

First and foremost, as a gaming company the number one stat you most likely care about are the daily active users and monthly active users.

GLUU has been struggling in this area as both the DAU's and MAU's have been falling quite significantly. MAU's for example came in at 19.1M in Q2 which was flat Q/Q but down from 22.8M in Q2 2018 and down from 24.8M in Q1 2018 – a drop of 23% in 5 quarters.

On the DAU side, the numbers grew Q/Q from 3.1M to 3.2M but are still down from 3.6M last year which is a drop of 11.1%.

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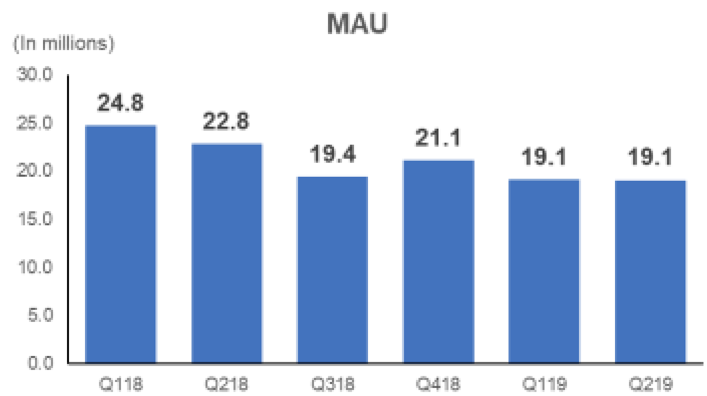
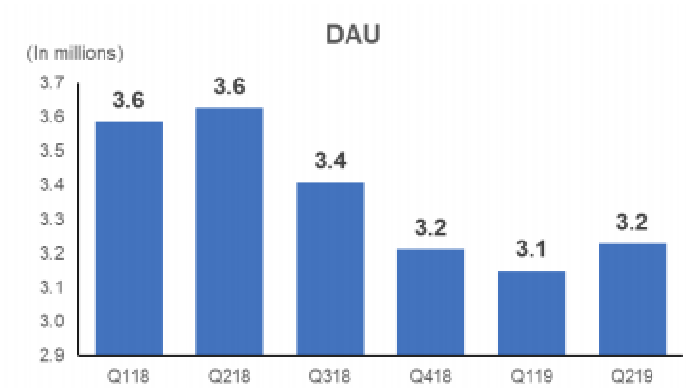




As you can imagine, a slowdown in users tends to correlate to a slowdown in growth and that is what's been happening.

GLUU reported Q2 GAAP EPS of $0.02 beating estimates by $0.02 on revenue of $95.5M (+5.9% Y/Y) missing by $5.43M.

Let's rewind and go over the last several quarters and see what the growth was Y/Y:

Q1 2019: +17.7%

Q4 2018: +19.2%

Q3 2018: +22.4%

Q2 2018: +33.1%

Q1 2018: +43.4%

Q4 2017: +73.2%

As we can see, growth at GLUU has fallen dramatically in less than 2 years from as high as 73% to the most recent quarter's 5.9%.

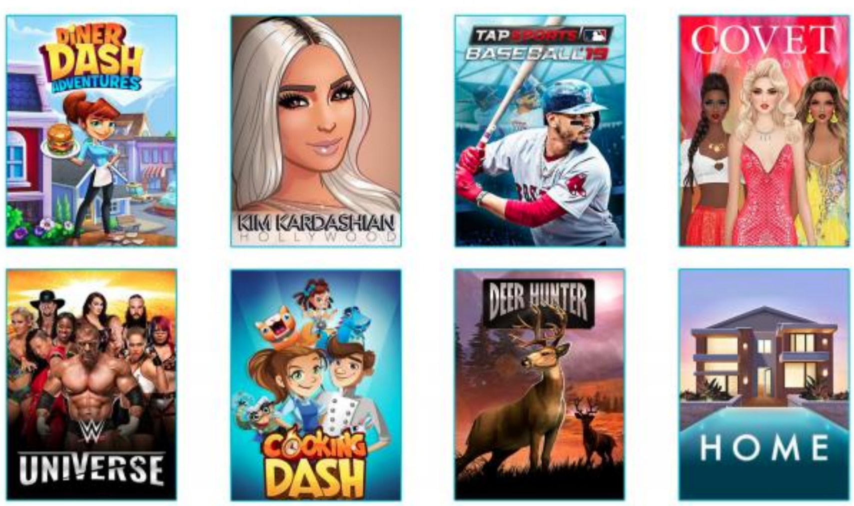
Unfortunately, the same can be said about their growth in bookings. For those that aren't sure what bookings are, they give investors a better idea of future revenues. For example, if GLUU locks down a deal with a company for advertising it may be a 12-month contract they get paid for. GLUU doesn't record the revenues for all of that because revenues are only accounted for in the period in which the service is delivered.

	Actual Q118	Actual Q218	Actual Q318	Actual Q418	Actual Q119	Actual Q219
Total Bookings (in millions)	$86.3	$99.4	$100.7	$98.2	$92.6	$101.9
Total Bookings Growth Q/Q	4%	15%	1%	(2%)	(6%)	10%
Total Bookings Growth Y/Y	25%	20%	18%	18%	7%	3%

While bookings did grow 10% Q/Q and positive for the first time since Q3, they are only up 3% Y/Y and down mightily from last quarter's 7% growth Y/Y, Q4's 18%, and last Q2's 20%.

As for guidance in bookings, it gets even worse. GLUU is guiding Q3 bookings to be $110M-$112M, short of the Street's consensus for $120.4M. For the full year, they're expecting bookings of $406M-$410M, well below expectations for $447.2M.

When looking at the product pipeline, I'm just not sure its compelling enough to make an investment.



Bookings ($m)				
Title	**Category**	**Q218**	**Q219**	**YoY %**
Design Home	Growth	$ 38.2	$ 42.3	10.5%
TSB Franchise	Growth	24.4	28.1	15.3%
Covet Fashion	Growth	13.0	14.4	11.0%
WWE	New 2019	-	1.8	-
Diner DASH Adventures	New 2019	-	1.5	-
Kim Kardashian Hollywood	Catalog	7.8	4.8	(39.0%)
Cooking Dash	Catalog	6.7	4.6	(31.7%)
All Other Bookings	Catalog	9.3	4.4	(51.8%)
Total Bookings		**$ 99.4**	**$ 101.9**	**2.5%**

Total Growth	$ 75.6	$ 84.8	12.2%
Total Catalog	23.8	13.8	(41.9%)
Total Core Games	**99.4**	**98.6**	**(0.8%)**
Total New 2019	-	3.3	-
Total Bookings	**$ 99.4**	**$ 101.9**	**2.5%**

Their licensed games like Kim Kardashian Hollywood is representing a 39% Y/Y drop in bookings, Cooking Dash is down 31.7% Y/Y, and other bookings are down nearly 52% Y/Y. For the most part, the only thing keeping bookings alive are 3 games: Design Home with 10.5% Y/Y growth, TSB Franchise with 15.3% growth, and Covet Fashion with 11.0% growth.

WWE and Diner Dash Adventures are new and based on GLUU's forward looking guidance, it doesn't look like those games are going to be enough to revive bookings growth alone.

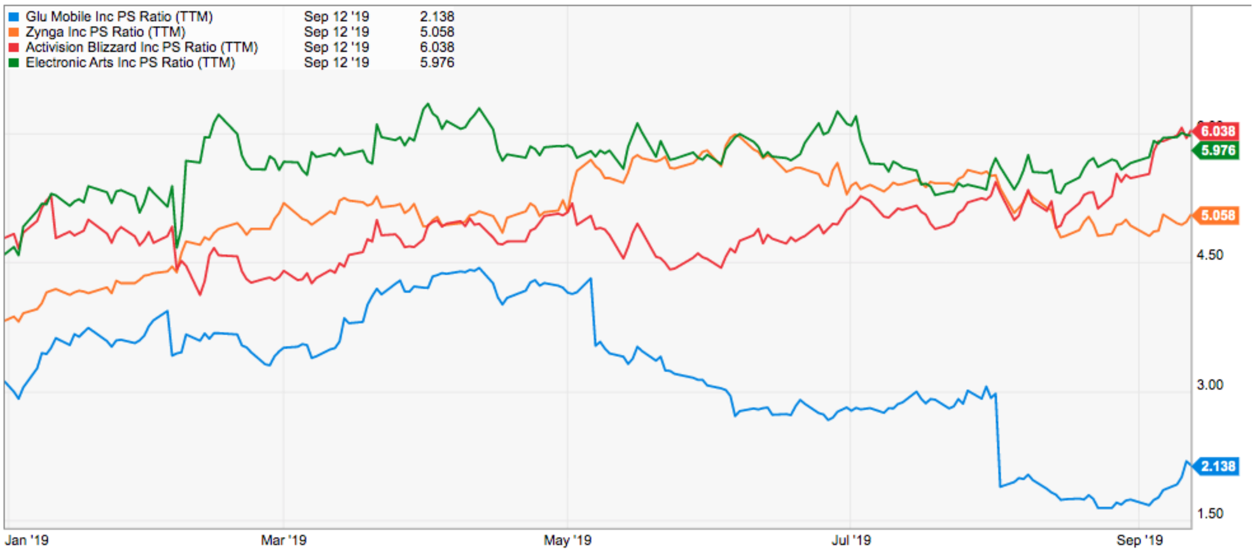
The problem here is two-fold. One, the product portfolio itself isn't that large. Secondly, nearly half the games are falling Y/Y and none of them seem to have the potential to be blockbusters. When you look at a company and competitor like Zynga, they have a portfolio of over 40 games – many of which are blockbusters like Zynga Poker, Words With Friends, Farmville, Draw Something, Game of Throne Slots Casino, and much more.

I'd also go as far as to say that Zynga is also in a much better position to take advantage of mobile betting given their portfolio of games they currently have – when, of course, that opportunity fully opens up.

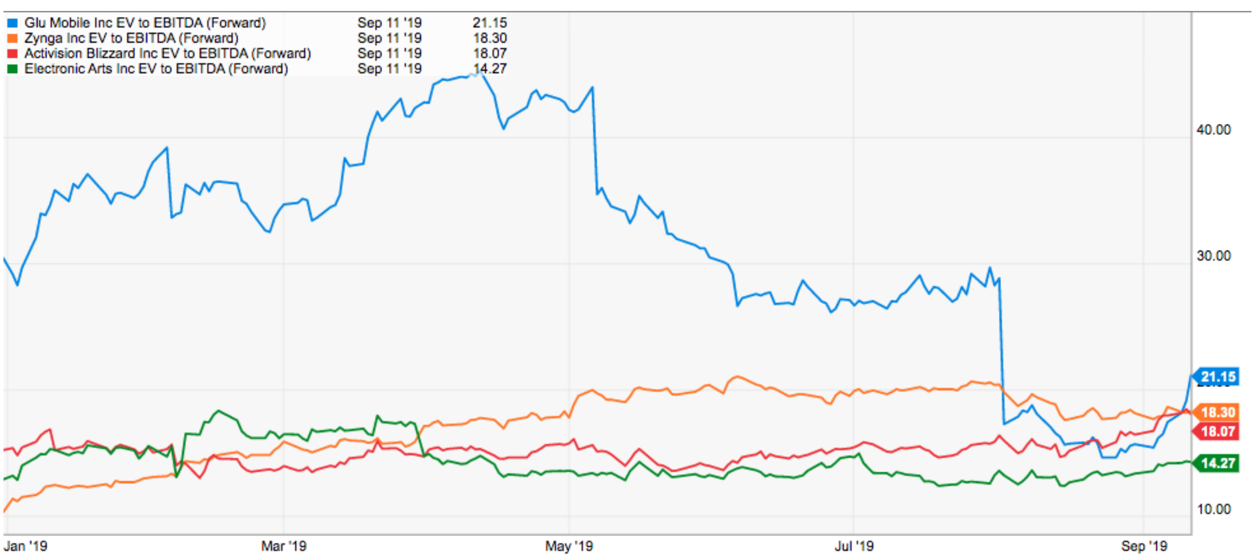
Another competitor we need to think about that many may be overlooking is Apple. Their new Arcade subscription will come with over 100 games for only $4.99/mo and is set to launch next week on September 19th in 150 countries worldwide. While some might say that the games attract two different types of players, I'd say it doesn't matter. What everyone is doing is competing for that little bit of free time you have and Apple launching this service most certainly doesn't make it easier for them.

From a valuation perspective, things are mixed.

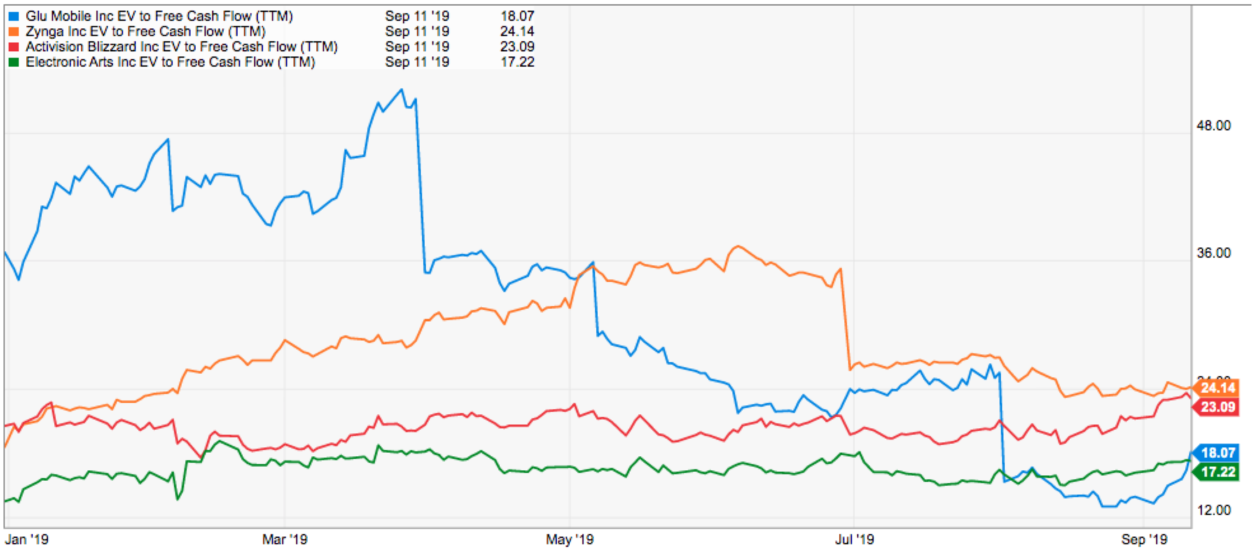
With regard to Price to Sales (P/S), GLUU is cheaper than Zynga, Activision (owns KING), and EA with a 2.13x vs. 5.06x, 6.04x, and 5.98x, respectively.



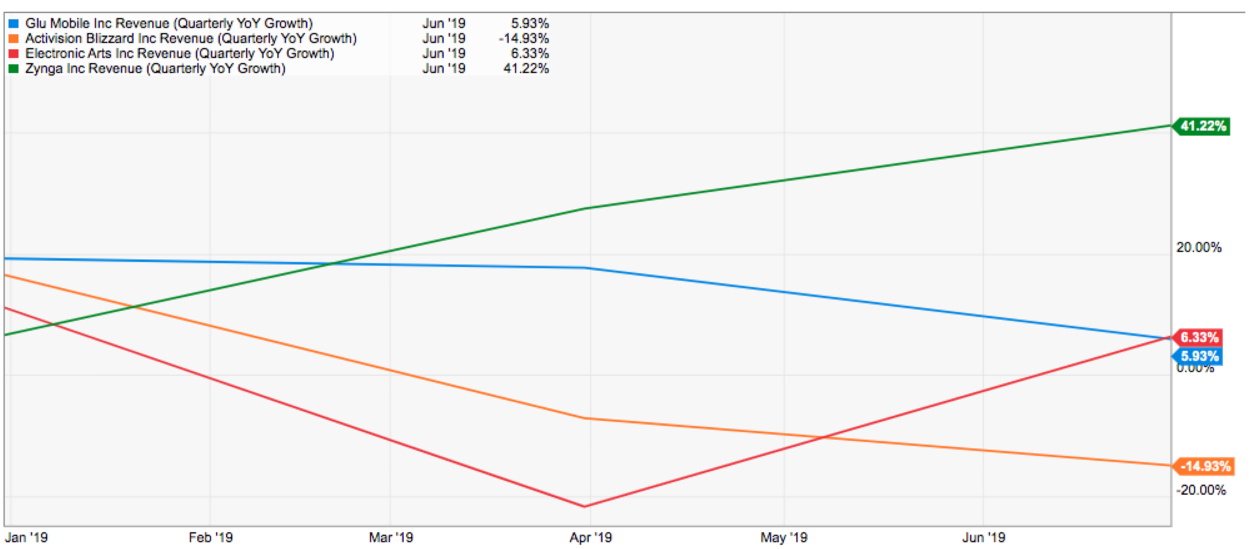
With Enterprise Value to EBITDA, GLUU is actually the most expensive at 21.15x vs. 18.3x, 18.07x, and 14.27x, respectively.



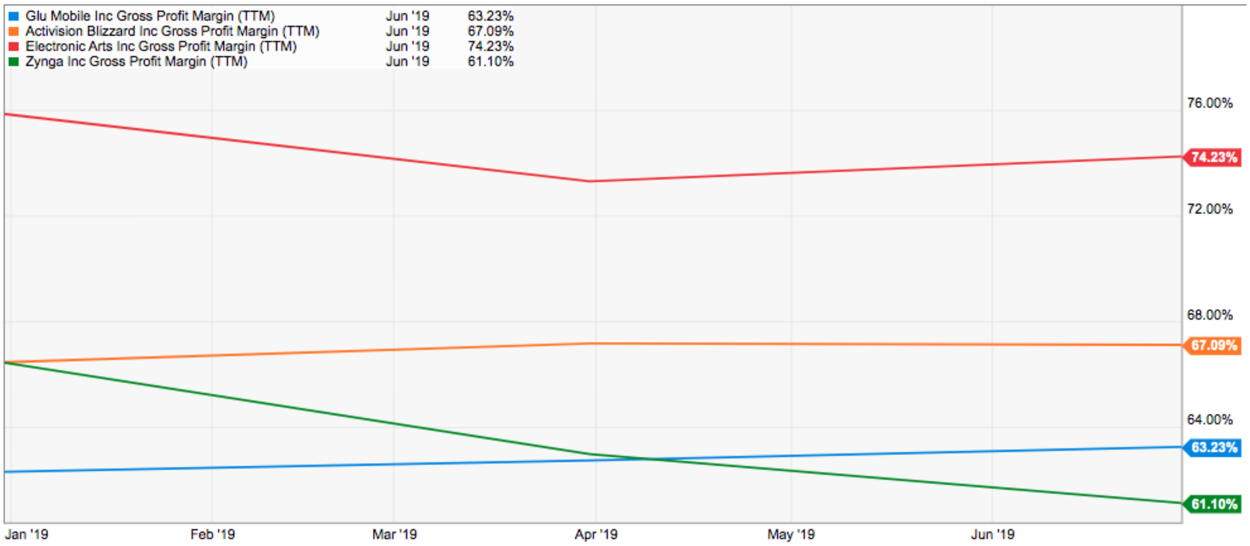
When it comes to EV to Free Cash Flow, GLUU falls in the middle at 18.07x vs. 24.14x, 23.08x, and 17.22x.



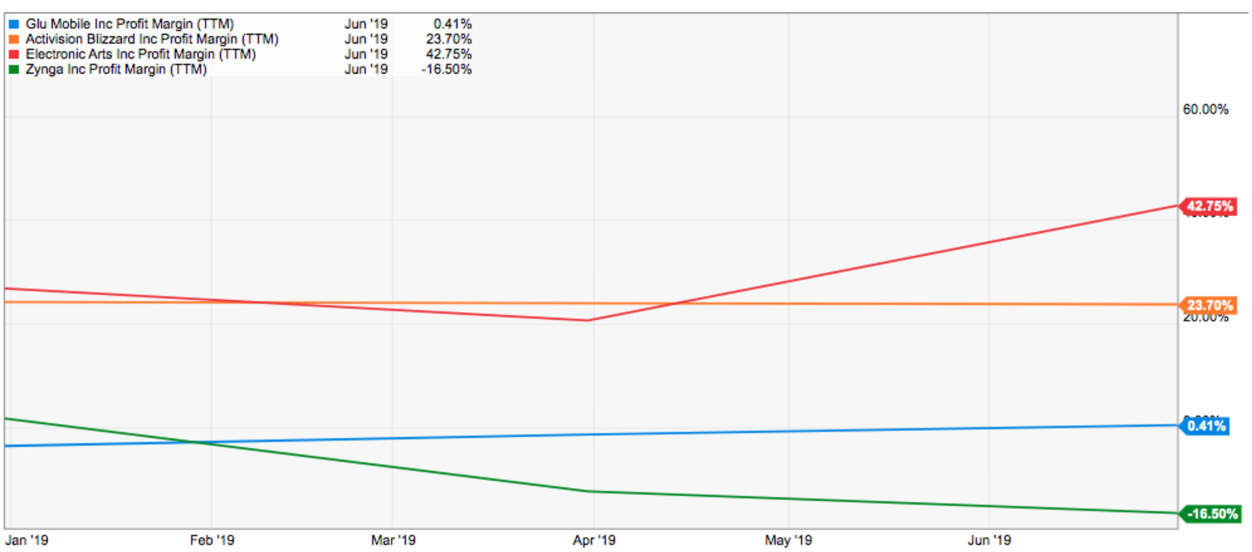
When it comes to valuation though you always have to take the growth into account otherwise it doesn't tell the whole story. Investor are always willing to pay more for growth. As we see, Zynga leads the pack with 41.22% growth Y/Y, ATVI is struggling with revs down nearly 15% Y/Y, EA is growing at 6.33%, while GLUU is growing at 5.93% Y/Y.



How are margins looking? GLUU is towards the bottom here at 63.23% gross margins while EA is at the top with 74.23%.

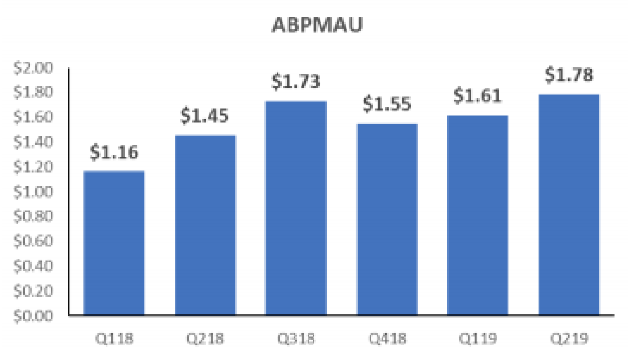


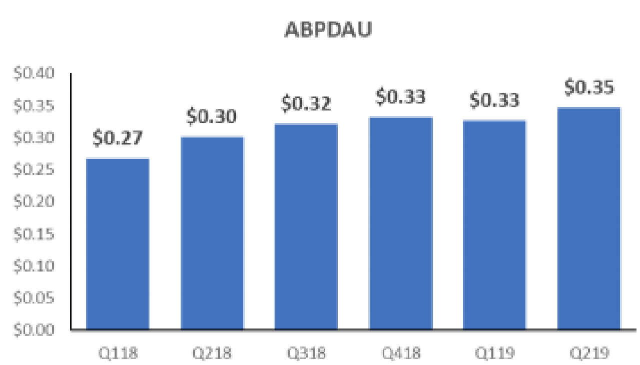
If we work our way down the balance sheet, GLUU is just barely breaking even with a profit margin of 0.41% while ATVI and EA crush the competition at 23.7% and 42.75%, respectively. Zynga, which has been growing the fastest, is not bringing in profits at the moment.



With all of this mind, it's not to say there aren't any bright spots in GLUU. There are a few as seen below.

1. Cash flow positive (free cash flow of $7.6M in latest quarter)
2. Healthy cash balance ($99.5M on hand with $35.1M in total debt)
3. Finally profitable ($0.02 in EPS in last quarter)
4. Growth in revs per active user (image below)





While the company hasn't been growing their users, they've at least been able to get more out of each individual one as seen by the $0.35 in average bookings per daily user and $1.78 in average bookings per monthly user.

With all of this being said, I simply don't see the attractiveness of the investment. With falling DAU's and MAU's, revenue growth tapering heavy, a smaller, less diversified, older portfolio that still isn't turning a solid profit, and competition closing in, I personally don't find the investment that welcoming – even on the pullback from $11 to $5. One can argue that GLUU is an interesting takeout candidate similar to how KING was bought out by Activision but I personally don't see it. When ATVI bought out KING in 2016, KING had over 200 titles, 318M monthly active users (GLUU has 19.1M), and a stellar portfolio that includes one of the hottest games still to this day in Candy Crush. When looking at GLUU's portfolio, nothing of that stature really stands out to me. I personally believe Zynga would get bought out before that of GLUU as they most likely resemble the appeal that KING had.