Hidden Gems Covering Analysis.

Summary

- Management's interests are closely aligned with shareholders as insiders own about 30% of the business.
- Free cash flow has a compounded annual growth rate of 80% over the past 5 years, with a lot of cash and no debt on the balance sheet.
- Industry leader in mobile strategy games, one of the largest growing game categories, and has maintained leading game for over four and a half years.
- Severe competitive pressures and concentration of revenue cause great risk to the company.
- Company's stock has an estimated value of about $2.20-2.48, while trading at only $1.56 today.

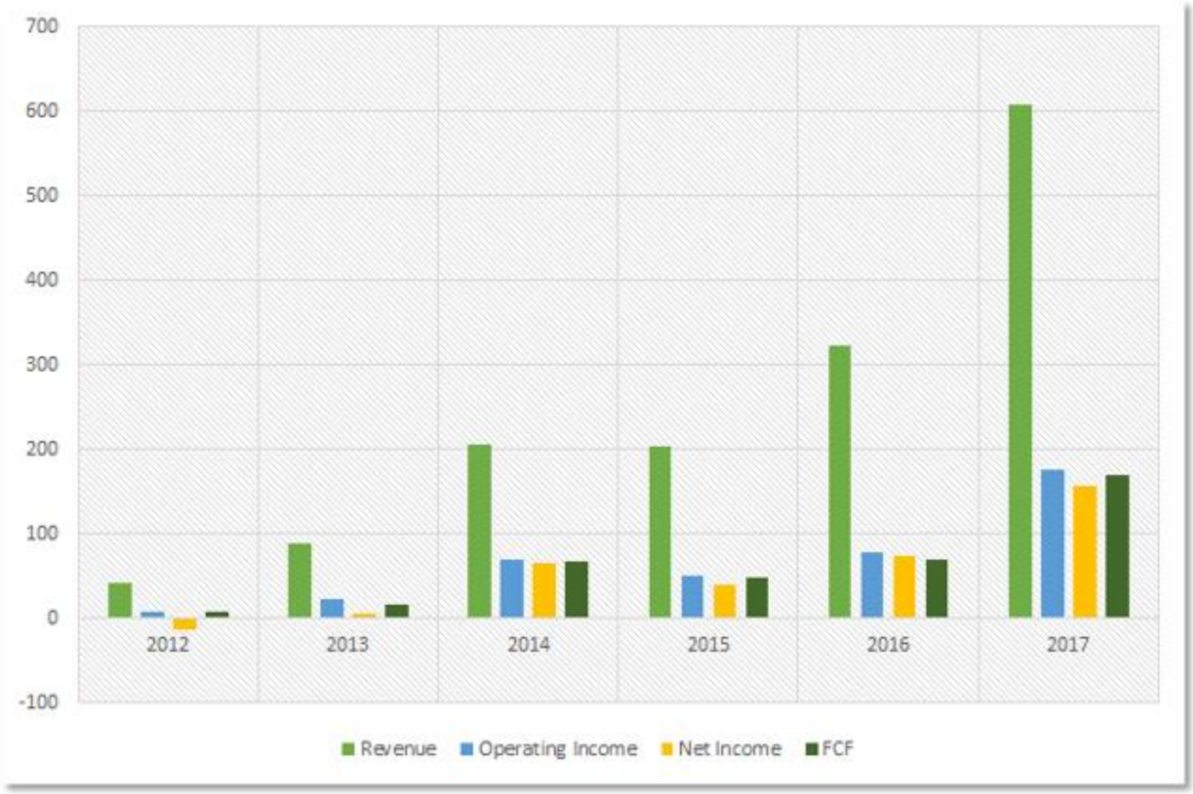
Source: MMOs

IGG (OTCPK:IGGGF) is a small-cap ($2 billion) company headquartered in Singapore that develops and produces mobile games worldwide. The company has regional offices in the United States, Hong Kong, mainland China, Canada, Japan, South Korea, Thailand, Belarus, Philippines, and the United Arab Emirates, with about 480 million registered players from over 200 countries and regions around the globe. Their games are available in 20 different languages and have more than 19 million monthly active users (MAUs). In 2017, 49%, 26%, and 21% of total revenues were from Asia, North America, and Europe, respectively.

They have a recurring revenue business model that focuses on developing and producing industry leading mobile games that are free to play, with revenue generation coming from in-app purchases to enhance the game-playing experience.

2017 Results

This past year was another year of great growth for IGG, with their revenue growing 88.51% year over year from $322 million in 2016, to $607 million in 2017. Operating income, net income, and free cash flow are also up 125.64%, 113.70%, and 146.38%, respectively. Their gross margin is up slightly from last year, but materially unchanged. Their operating margin and net margin are up about 5% and 3%, respectively. IGG also bought back about 1.73% of their shares in 2017, having bought back a total of about 5% of the company's outstanding shares since 2014. Their R&D-to-revenue ratio is down to 8% in 2017 from 11% the previous year, despite still growing revenue.



Source: Data, Morningstar. Graph, self-created.

They continue to maintain and grow a healthy cash position on their balance sheet, with almost $222 million in cash, up 20.55% from 2016. They have no debt on their balance sheet and minimal liabilities - all of which are easily covered by their cash position.

In the third quarter of 2017, the company's most popular game, Lords Mobile, became the top-grossing war-strategy mobile game worldwide and continues to hold that position in 2018. From 26th in January 2017, the company has jumped to 16th by the end of 2017 in terms of global ranking for top grossing apps on the Apple App (AAPL) and Google Play (GOOG) (GOOGL) stores.

One of their other successful games, Castle Clash, is showing unprecedented longevity in the mobile game space by averaging over $11 million in monthly gross billing more than four and a half years after its release.

Their games continued to receive large gaming awards and prestigious rankings, such as the "Android Excellence Game of 2017" from the Google Play Store, and "Top 10 Most Popular Game Overseas" by the China Game Industry Annual Conference. IGG was again listed as one of the "Top 52 Publishers" by App Annie, which they have been since 2015. In 2017, they were ranked 21st, up 13 positions from 34th back in 2015. They were also ranked 19th and 16th by PocketGamer.biz's "Top 50 Mobile Game Developers of 2017" and "BrandZ Top 50 Chinese Global Brand Builders 2018" issued by Google, respectively. IGG was also awarded the "Google: Fastest Growing Mobile Game Brand" and the "2017 Financial Market Listed Companies Award: Best Investment Value on Shenzhen-Hong Kong Stock Connect and Best Investor Relations". Amongst strong competition in the mobile application and mobile gaming industries, these rankings and awards speak to the quality of their game creation.

A table of their 2017 awards is below:

List of awards in 2017

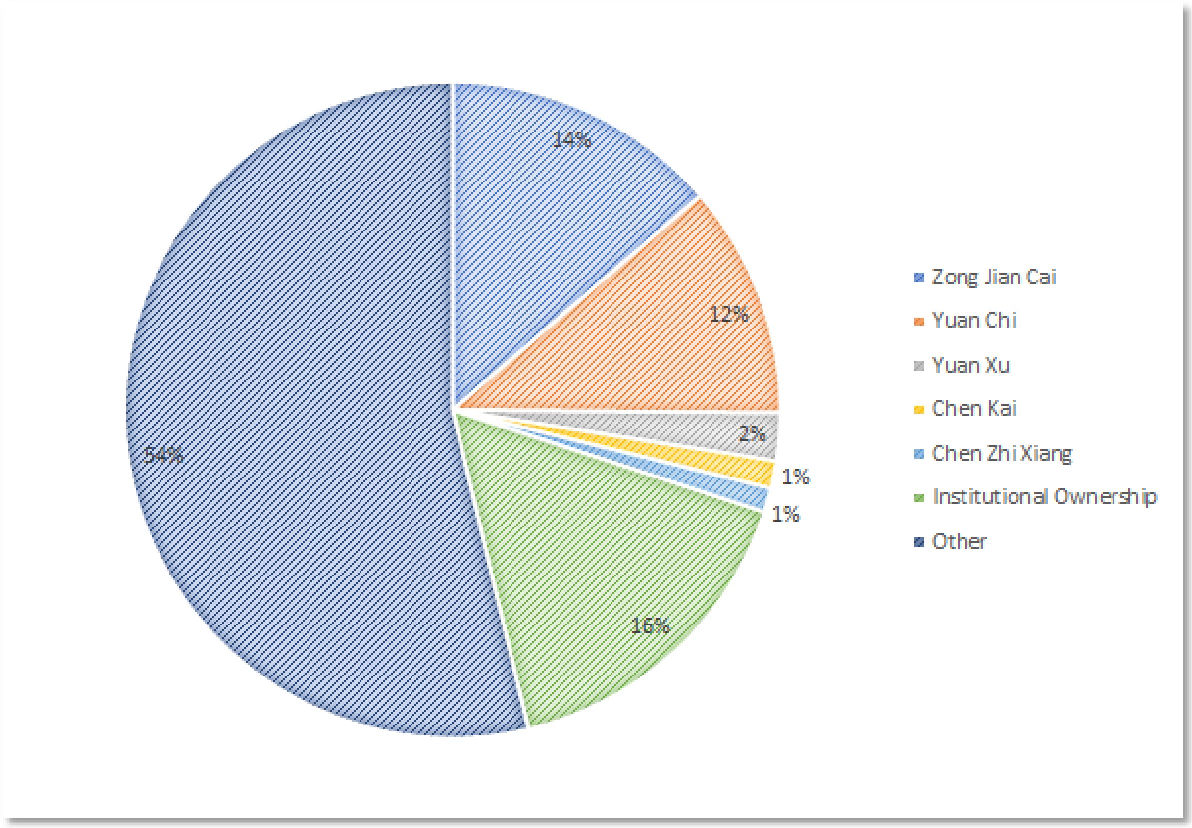
Awards	Awarding Institutions
Awards won by IGG	
21st Place of Top 52 Publishers of 2017	App Annie, a mobile analytic platform
19th Place of Top 50 Mobile Game Developers of 2017	PocketGamer.biz, a well-known mobile game website
Best Overseas Product Operating Enterprise	You Ding Awards, a prestigious prize in the Chinese game sector
Best Game Exporter for 2017	Tian Fu Awards, a prestigious prize in the Chinese game sector
16th Place of BrandZ™ Top 50 Chinese Global Brand Builders 2018, The Fastest Growing Mobile Game Brand	Jointly released by Google Inc. and BrandZ, a brand consulting company under the world's largest advertising communication group, WPP
Awards won by Lords Mobile	
Android Excellence Game of 2017	Google Play
Google Play Awards Best Multi-player Game Nomination	Google I/O Developer Conference
Best International APP for 2017	Xiaomi MIUI Intelligent Ecological Conference
Top 10 Most Popular Game Overseas	The 2017 "Top 10 Games" Ceremony by China Game Industry Association
iChoice Internet Popularity Award 2017 and Most Popular Strategy Mobile Game	Discuss.com, a highly popular discussion forum in Hong Kong
Annual Overseas Market Breakthrough Award	Gamelook, a prestigious game industry medium in China
Hong Kong Golden IT Brand Awards: Best Mobile Game (Strategy)	Hong Kong Golden Discussion Forum, a popular online discussion forum in Hong Kong
Best Popularity for the First half of 2017	"Toutiao", a famous news platform in China
Game Star Top 10 Popular Mobile Games for 2016	"Game Star Award", the most indicative annual award in the game industry of Taiwan

Source: Annual Report

Management

The two co-founders, Zong Jian Cai and Yuan Chi, still own a total of 25.14% (13.65% and 11.49%, respectively) of the business. Zong Jian Cai is not only a co-founder, he is also the Chief Executive Officer and Chairman of the Board. He has over 18 years of experience in the online gaming industry. Yuan Chi acts in a non-executive role as an adviser to the company. The Chief Operating Officer, Yuan Xu, also owns another 2.35% of the business, and also brings over 18 years of experience in the area of project and corporate management. Other insiders, Chen Kai and Chen Zhi Xiang, own 1.34% and 1.20%, respectively. With insiders collectively owning just over 30% of the business, investors can be confident that their interests are aligned with those of shareholders. Management also issues stock options as incentives for employees through their Pre-IPO Share Option Scheme to further align their interests with those of shareholders.

Institutional owners own about 16.25% of the business.



Source: Data, [FactSet](). Graph, self-created.

The management team at IGG also received reasonable salaries in 2017, with the majority of their compensation coming from "discretionary bonuses". Only $1.186 million was paid out in salaries for the top five executive directors. From a value investor's perspective, the IGG management team checks many of the boxes we look for: large insider ownership, ongoing incentives aligned with shareholders' interests, reasonable salaries, and a successful track record.

Catalyst and Competitive Advantage

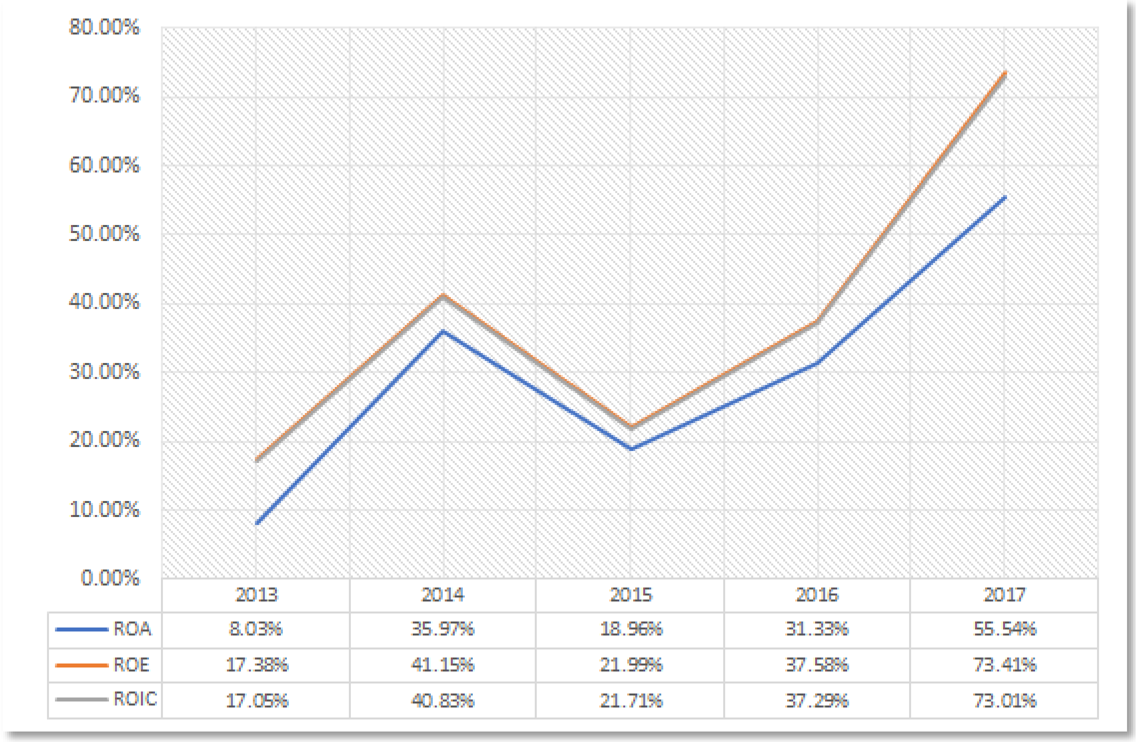
In December 2017, IGG released a new puzzle game, Sweet Maker. It is the first of its kind in the sense that they allow users to design and create their own custom levels within the match-3 game. As of their 2017 annual report, the game was in its infancy, but already began showing strong growth in popularity. Other match-3 type games such as Candy Crush have done incredibly well for King and Activision (ATVI). Over the four proceeding quarters ending with the third quarter of 2017, Candy Crush did over $700 million in revenue (five years after it was released). Candy Crush has been one of the most successful mobile games of all-time, so it is unlikely Sweet Maker will amount to that level of success, but even if they are able to generate a small portion of that revenue, Sweet Maker would prove to be a large catalyst for IGG. With the customization available to players and their history of high quality games, it is certainly possible that Sweet Maker could gain some market share and generate a portion of Candy Crush's revenue figures.

The company's most popular game, Lords Mobile, continues to be an improving catalyst for them and their stock. Monthly revenue climbed to a high of $50 million in 2017, with growth expected to continue into 2018 as it has over 100 million registered users and over 10 million MAUs. The game is also the highest grossing mobile strategy game in the world, and 16th highest monthly grossing app on the combined Apple App Store and Google Play Store charts. In order to continue growing the MAUs, IGG will continue investing in R&D to make further improvements to the game and release new features.

Although not as prominent as it once was, Castle Clash is still averaging over 8 million MAUs for IGG as of December 2017 - more than four and a half years after it was released. Most mobile games would have faded away after nearly five years in the app store, but IGG has been successful in extending Castle Clash's lifespan by continually introducing new game features, building a community around the game, and providing industry-leading customer service.

Customer service is often an overlooked aspect of the mobile gaming space, but IGG attributes a lot of their success to their focus on customer service and customer involvement. It has provided the company with a competitive advantage in an industry that is often difficult to develop a competitive advantage in. In 2017, their customer service center addressed more than 560,000 questions through live chat, more than 550,000 questions via ticket submission, responded to more than 580,000 customer emails, and more than 400 phone call inquiries. The company also promotes customer involvement by hosting offline activities (game tournaments, game shows, trade shows, etc.) for their players throughout the year. Their unmatched level of customer service and their community building efforts have allowed IGG to increase the lifespan of their games. The company will look to use this competitive advantage to maintain their leading role in the mobile strategy game market with Lords Mobile, squeeze a few more profitable years out of Castle Clash, and to gain a sizable market position with Sweet Maker.

Their competitive advantage has allowed IGG to produce very strong Return on Assets, Return on Equity, and Return on Invested Capital. These percentages have been improving significantly over the past five years, with 55.54%, 73.41%, and 73.01%, respectively, in 2017.



Source: Data, MorningStar. Graph, self-created.

IGG has a pipeline of games on the horizon, including sequels to their previously successful games Castle Clash and Clash of Lords, both of which are under development currently. They also have a portfolio of several strategy games, casual games, survival games, and sandbox games, in the pipeline. If the sequel of Castle Clash is even half as successful as the original, it should prove to be a strong catalyst for the stock. Likewise, the success of the other games in the pipeline could prove to be a catalyst for the company moving forward.

The company could also benefit from the large growth in the mobile gaming industry as a whole that is expected according to Statista. The mobile gaming industry is growing rapidly and could improve IGG's results. Within the gaming industry, IGG is looking towards growing trends and plans to take advantage of the increasing popularity in location-based services and augmented reality games.

IGG's stock also has a catalyst from the geographic markets in which they operate. They have a strong presence in markets that are seeing very strong smartphone user growth, and more specifically mobile gaming growth. They have a well-known presence in Asia, the largest mobile gaming location in the world. As the percentage of users of smartphones continues to climb dramatically in many of the less developed countries that IGG operates, they should see an increase in users over the long-term. It is a large trend for the market as a whole, but if smartphone user growth tops 2.87 billion people as it is estimated to by 2020, IGG should see an inflow of new gamers.

Other industry-wide trends IGG stands to benefit from are the increasing popularity of professional gaming and e-sports. The e-sports industry has quickly become a billion dollar industry, with much of its popularity in Asian countries that IGG operates. As this industry-wide trend continues to grow and IGG hosts more gaming competitions and events for their customers, they should see increased growth in users and subsequently revenue.

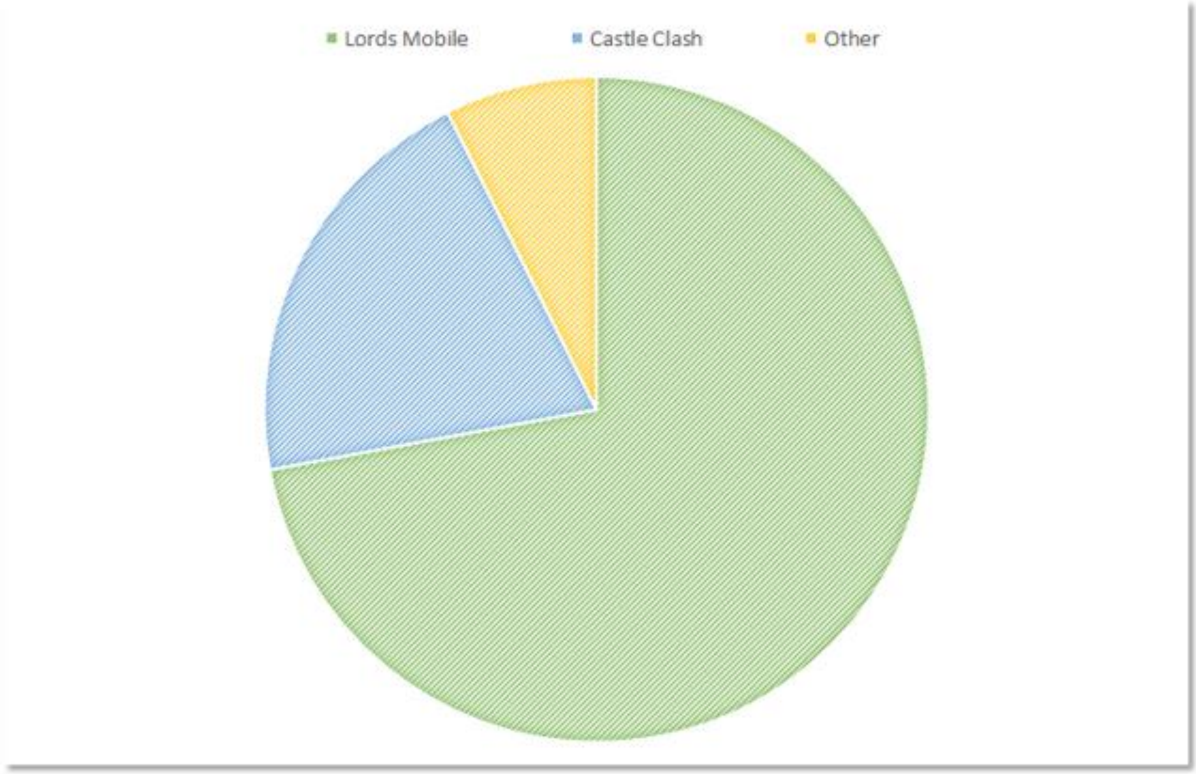
Beginning in 2018, IGG has opened an online store selling physical merchandise related to their intellectual property. Although the future success of this experiment is unknown, other companies have had great success with selling physical items created from their IP portfolios.

Over the short term, the company's profitability stands to improve as one of their subsidiaries, IGG Singapore, has obtained an extension of the Development and Expansion Incentive from the Economic Development Board of Singapore. This incentive cuts the subsidiary's tax rate to 10% on qualifying income until 2019, and 10.5% until 2021.

The company's stock buybacks could also provide a catalyst for the stock over the long-term. In 2017, the company repurchased 37.624 million shares, for a total of $37.7 million. As we will see in the subsequent "Valuation" section below, this is likely a good use of capital as I see the company's stock to be undervalued.

Risks

A large risk facing IGG is their concentration of revenue. 92.6% of revenue comes from just two games; 72.1% and 20.5% for Lords Mobile and Castle Clash, respectively. The concentration puts great risk on their business because, if their main source of revenue falters, their whole business can be at risk. With the Castle Clash game arguably nearing the end of its lifespan, IGG could see a large portion of their business deteriorate significantly, causing them to rely on one major stream of revenue.



Source: Data, Annual Report. Graph, self-created.

Another major risk for the company is competition. Not only does severe competition increase the risk of their revenue concentration, but it makes the company's future far more risky and uncertain as well. Competition makes their revenue concentration more risky because it can erode their largest revenue streams. It also makes the company's future far more risky and uncertain because increased competition reduces the likelihood IGG's future games will be successful. The mobile game and mobile app spaces are incredibly competitive, and the competitive pressures are increasing. IGG has developed successful games in the past, but their new games are going to be up against tough competition. It is possible a competitor releases a similar game and knocks off their games.

I Got Games' stock has very limited market liquidity with only about 4,000 shares traded on average. The company's small-cap size and an illiquid stock can lead to volatile stock prices and potentially inefficient market pricing for substantial periods of time. This lack of liquidity could also lead to an investor being stuck with their shares at a time when they want to exit the position. The stock also is not traded on a formal exchange; it is traded in/on the Over-The-Counter (OTC) market.

With IGG being an international-based entity but listing on a US-based OTC market, there are foreign risks such a political, foreign exchange, different accounting policies, corruption, etc. that an investor must consider. This is not to say that any wrongdoing is happening within the company, but there can be regulatory and political differences between the United States and foreign nations that lead to additional risk in owning a foreign company's stock.

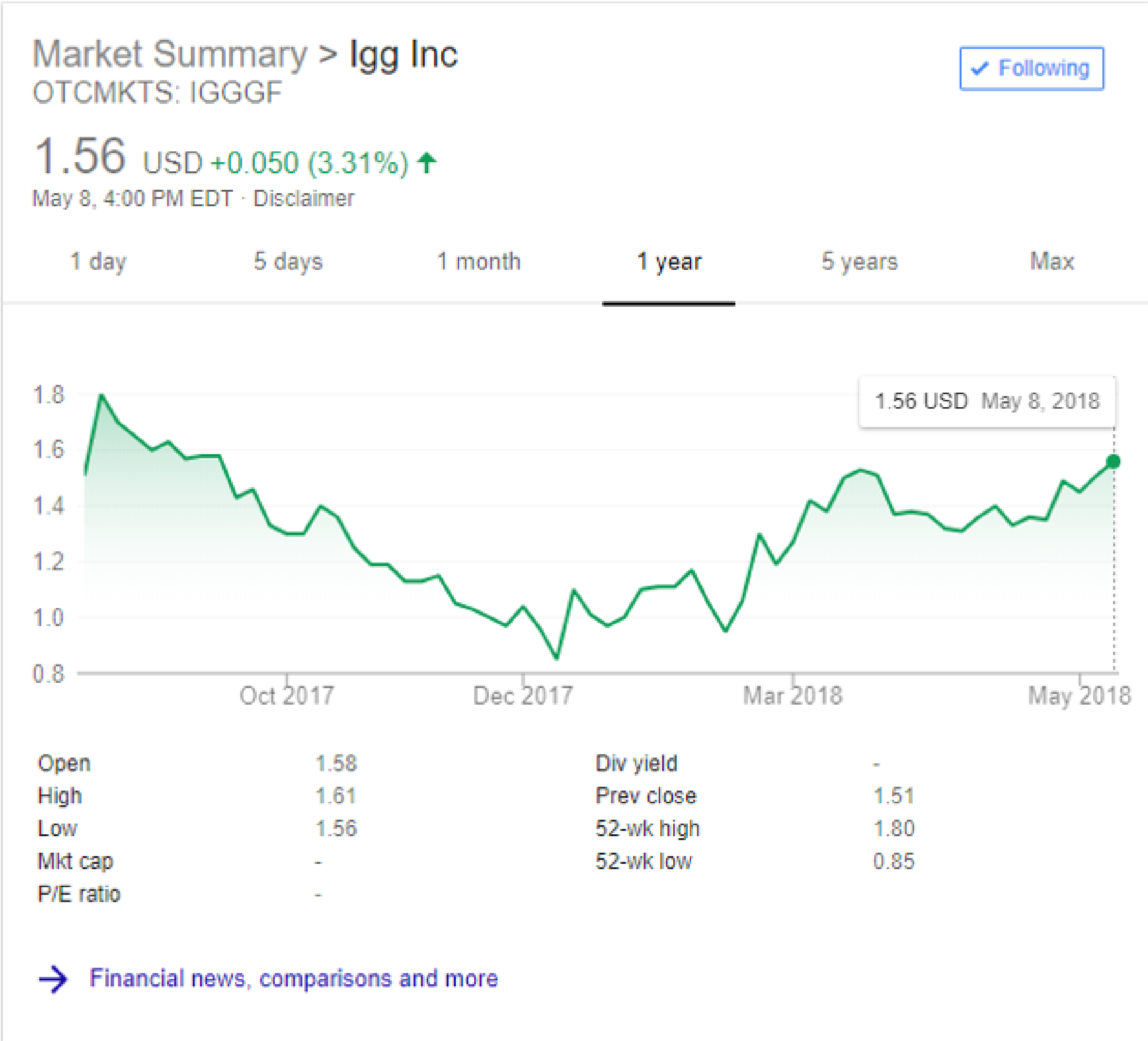
As of late, data breaches and hacks have been becoming more frequent. IGG can be considered at risk for a data breach and/or loss of user data. This could pose as a potential risk to the company as it would diminish the company's user base and likely result in lower revenues.

Simply put, customers could get bored. With hundreds, or even thousands, of game choices thrown at them every day on the various app stores, it is possible they could just get bored with their current game and get "addicted" to a different one. It is somewhat inevitable; they can only play a game so many times or for so long before they get sick of it. In today's world more than ever, people have a shorter attention span, get bored with things more easily, and have more choices than ever at their fingertips. There have been many instances where apps have done well for a short while and then fizzled out. This is entirely possible for IGG's games.

Valuation

An accurate valuation of a high-growth, small-cap, foreign company is not easy, but below I am providing my models and viewpoint on the current value of IGG's stock.

We can use today's price of $1.56 as the base for comparison with the valuations discussed below.



Source: Google

Starting with a relatively conservative DCF analysis, assuming a 15% growth rate for the first five years, a 7.5% growth rate for the following five years, a discount rate of 10%, and a TV multiple of 10x, I value the company's stock at $2.48. I say this is a relatively conservative DCF analysis because the company has grown at a compounded annual growth rate of 80% for the past five years. I recognize an 80% compounded annual growth rate for FCF over the next 10 years is highly unlikely, given the risks discussed in the previous section, so I have decided to use about 1/5 of their 80% compounded annual growth rate for the first five years, and then half of that for the following five years. This gives a middle of the road estimate for the value of the company's stock. An optimistic DCF analysis using a 40% growth rate for the first five years, a 20% growth rate for the following five years, and all else remaining equal values the company's stock at about $7.59. I would not expect these results as it is highly unlikely they're attainable, but they put a plausible upper-bound on the stock's value. A pessimistic DCF analysis using a 3% growth rate for the first five years, a 0% growth rate for the following five years, and all else remaining equal values the company's stock at $1.38. I see this pessimistic valuation as the potential downside. However, I would also assign a low probability to this scenario occurring as well, but it can provide a plausible lower-bound on the stock's value. Based on the three scenarios discussed, the middle of the road DCF analysis seems to be the most probable and realistic, and would provide an adequate return at today's prices. Should these estimations be inaccurate, there is a margin of safety between the calculated value and today's price to allow for some error.

TV @ 10 Years	Conservative, middle of the road		
Years 1-5 growth rate	15.00%	Intrinsic value per share	$2.48
Years 6-10 growth rate	7.50%		
Discount rate	10.00%		
TV multiple	10.00		
No. of shares outstanding	1366.00		

Year	Est. FCF	DF	DFCF
1	172.00	1.10	156.36
2	197.80	1.21	163.47
3	227.47	1.33	170.90
4	261.59	1.46	178.67
5	300.83	1.61	186.79
6	323.39	1.77	182.55
7	347.65	1.95	178.40
8	373.72	2.14	174.34
9	401.75	2.36	170.38
10	431.88	2.59	166.51
TV:	4318.79	2.59	1665.08
		Total:	3393.45

TV @ 10 Years	Optimistic		
Years 1-5 growth rate	40.00%	Intrinsic value per share	$7.59
Years 6-10 growth rate	20.00%		
Discount rate	10.00%		
TV multiple	10.00		
No. of shares outstanding	1366.00		

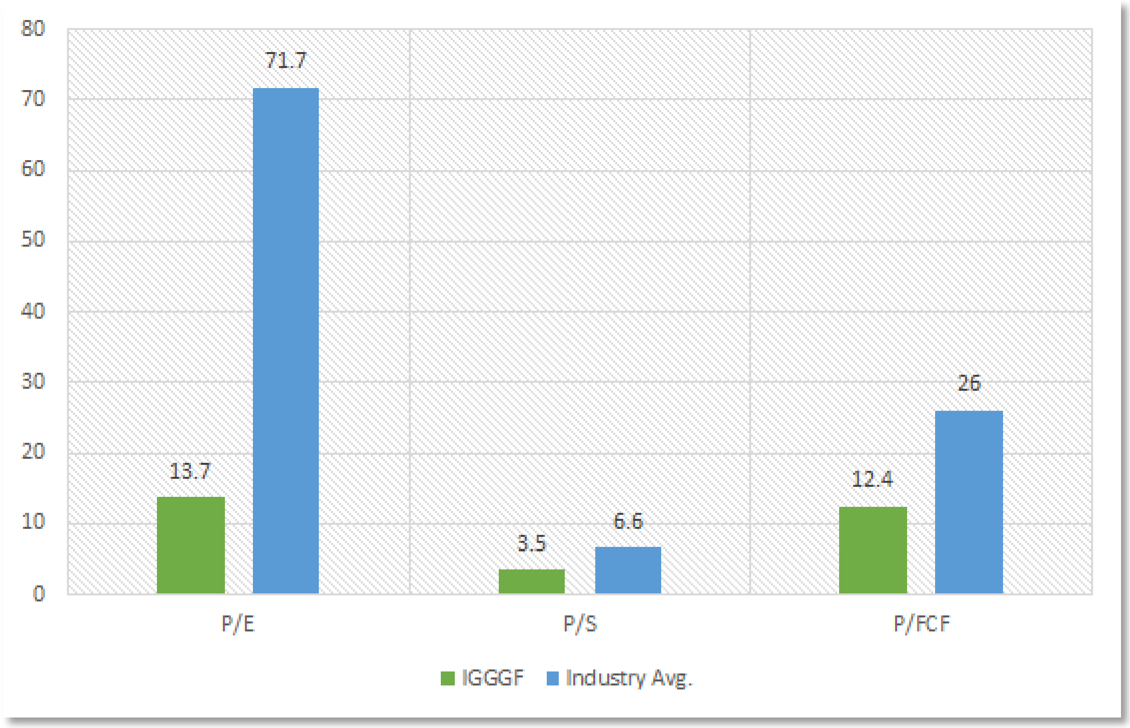
Year	Est. FCF	DF	DFCF
1	172.00	1.10	156.36
2	240.80	1.21	199.01
3	337.12	1.33	253.28
4	471.97	1.46	322.36
5	660.76	1.61	410.28
6	792.91	1.77	447.57
7	951.49	1.95	488.26
8	1141.78	2.14	532.65
9	1370.14	2.36	581.07
10	1644.17	2.59	633.90
TV:	16441.70	2.59	6338.99
		Total:	10363.74

TV @ 10 Years	Pessimistic		
Years 1-5 growth rate	3.00%	Intrinsic value per share	$1.38
Years 6-10 growth rate	0.00%		
Discount rate	10.00%		
TV multiple	10.00		
No. of shares outstanding	1366.00		

Year	Est. FCF	DF	DFCF
1	172.00	1.10	156.36
2	177.16	1.21	146.41
3	182.47	1.33	137.10
4	187.95	1.46	128.37
5	193.59	1.61	120.20
6	193.59	1.77	109.28
7	193.59	1.95	99.34
8	193.59	2.14	90.31
9	193.59	2.36	82.10
10	193.59	2.59	74.64
TV:	1935.88	2.59	746.36
		Total:	1890.47

Source: Self-created

On a relative basis, IGG is trading at lower multiples than the industry average, despite having outstanding operating metrics (as seen above, ROA, ROE, and ROIC). The stock may not be able to demand the same multiples as the industry averages due to the company-specific risks discussed above (lack of liquidity, small-cap, foreign company, etc.), but it should be at least closer to the averages because of their competitive advantage, game pipeline, and very healthy balance sheet. Using multiples slightly lower than the industry average, a P/E multiple of 20x values the company's stock at $2.20, a P/S multiple of 5x (Not only is a P/S multiple of 5x closer to the industry average, but Al Meyer's P/S model shows the company should trade at about 5x sales based on their net margin) values the company's stock at $2.22, and a P/FCF of 18x values the company's stock at $2.24.



Source: Data, Morningstar. Graph, self-created.

Considering the DCF analysis and the relative analysis, the company's stock is worth about $2.20-$2.48.

Summary/Recommendation

There certainly are significant risks facing IGG. The most worrying of the risks is the severe competition in the mobile gaming industry. It is extremely difficult to maintain market share when there are minimal barriers to entry. App development has become quite mainstream, causing IGG to not only compete with other companies but to also compete with individual developers. There are also minimal to no switching costs between games, making it easy for users to change games frequently. The severe competition furthers the issue with IGG's revenue concentration. Competition could easily remove one of IGG's largest revenue streams, which would severely hurt business.

Despite the risks, I recommend a long position in IGGGF. I have been long the company's stock since mid-December 2017 because they have a great management team with significant ownership in the business and their interests are aligned with shareholders, great margins, minimal CAPEX, they have a very healthy balance sheet with a lot of cash, they have been able to develop and maintain a small competitive advantage through their superior customer service, they have shown very strong growth for the past five years, and their future game pipeline looks promising. Even if the competitive natures of the industry hinder the company's growth, it is unlikely that they will lose revenue streams completely. As seen in the DCF analysis above, even with minimal to no growth, there is a small amount of downside risk at today's prices, especially compared to the upside potential. As a long-term investor, I expect to hold my positions for an extended period of time, mitigating the risk from an illiquid stock traded on the OTC market. Ultimately, an investment in IGGGF is an opportunity to own a good business at a fair price, with a great management team, a competitive advantage, and a margin of safety. Given the asymmetric risk-return profile of this investment, I will continue to add to my position in I Got Games.

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TipRanks: Buy IGGGF

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Analyst's Disclosure: I am/we are long IGGGF. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

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About IGGGF

Symbol	Last Price	% Chg
IGGGF	**0.44**	**0.00%**