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Guillemot: it may not quite double, but it should get close

JULY 21, 2020 / PUPPYEH / EDIT

I'm going down the market cap curve again, because once again I'm finding value that simply doesn't exist in the larger names in the US at this stage of the bull market. (Note: *in the interests of time given the imminent catalyst, this will be a shorter report than normal; I am happy to answer any follow-up questions you may have*).

Guillemot (Paris: GUI) is by no means the world's greatest company. In many respects it compares quite unfavorably with one of my favorite investments, **Endor AG**: it has a lower-priced, entry-level product in sim racing that appears to be losing share; it has struggled to consistently grow revenues and earnings in recent years; it is controlled by the seemingly disinterested Guillemot family, already sitting pretty with their Ubisoft wealth; and it has failed to shut-down the money-losing Hercules business despite many years of losses. That's the bad news.

The good news, you ask? GUI is, quite simply, far too cheap, both in absolute and relative terms. In spite of its lumpy history, it is still sitting in the right place at the right time – that is, a purveyor of Sim racing wheels; joysticks; and gamepads, in the middle of a secular explosion in interest both in sim racing and in gaming/esports in general. Every other direct competitor worth mentioning (Endor, Logitech, Turtle Beach) has seen near-term revenues explode, and GUI is likely to report a similar inflection in its numbers in just a few days (2Q revenues are due on July 23), and throughout 2H this year. Whilst GUI stock has rallied a bit, it is still massively underperforming peers, and

<https://rapercapital.com/2020/07/21/french-small-cap-it-may-not-quite-double-but-it-should-get-close/>

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there appears plenty of room to go. Most of its relevant competitors trade at or through multi-year, if not all-time, highs. Take a look at **Logitech**:



Or Endor:



Or Turtle Beach (only not at all-time highs because of the especial Fortnite effect on its business a couple of years ago, but well on the way to getting close again):



Meanwhile here is **Guillemot**:



BRL.AX BMWX **CLMT** CNE.LN

CVN.AX DXLG E2N eml.ax **EVO.AX**

FAR.AX GAN hdg.na **HRBR**

IDA.AX INTL KAR.AX **LMN** MBR MET.NZ

MFD.AX NIO NLOP **PAC.AX**

PBIT.TO PTEC.LN RE4.SI **SAVE** SF3.DE

SHVA.TA **SMR.AX** SNEX SQZ.LN tnk.ax **TRQ**

TWTR UNTC **URF.AX** wow WRKS.LN

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February 2024 (11)

January 2024 (11)

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In fact, the charts barely tell half the story, as on the simplest of valuation measures – EV/sales – **GUI today trades at <0.4x CY EV/sales, versus Logitech at 3.6x, Turtle Beach at 1.1x, and Endor at 3.3x** (on my numbers). Of course not all revenues are created equal, and there are structural impediments at GUI – but in my view this disparity is beyond excessive and won't last.

Essentially, then, this is a very simple 'catch-up' trade. The current inexorable trend in both Sim racing gear and gaming accessories is the rising tide lifting all boats, even the laggards like GUI, and the upcoming 2Q sales report (to be followed by likely more bullish 3Q and 4Q reports in the next 6months) should be the positive catalysts that inflect the stock back to or through multi-year highs. Of course, this is a French small-cap; and it is ILLIQUID (in capitals since it really only trades ~\$200k a day); and historical execution has undoubtedly been poor. So it really cannot be a large position, and is one I put in the more speculative/trading-type camp.

Nevertheless, I still feel risk reward is compelling here, not least because at 3.4 EUR, the implied market cap is only 52mm EUR, whilst the implied value of GUI's shareholding in Ubisoft (Paris: UBI), is ~31mm EUR – in other words, on a pre-tax basis, *60% of the current stock price is 'covered'* by this very high quality video game developer (which has itself been discounted lately, perhaps for **non-fundamental reasons**). Whilst longer-term I do have problems with so much capital being tied up in this UBI investment, it certainly protects the downside value as simply put, we are not paying much at all for the operating business at GUI. More on this later.

Quick Guillemot overview

Guillemot is a small, family-controlled French company that has two predominant brands:

- **Thrustmaster**: a diversified manufacturer of gaming accessories, including Sim Racing wheels; headsets; joysticks (for flight simulators); and gamepads (for console gaming). This segment constitutes ~90%+ of revenue and more than 100% of operating earnings on a multi-year basis;
- **Hercules**: a problem child business that theses days produces DJ equipment, but has historically done everything from speakers, to other accessories and peripherals. Hercules is a major drag on the PnL, generating 2-3mm EUR in operating losses a year, mostly due to insufficient scale (4-5mm EUR revenues today) and no brand recognition. I will spend zero time discussing this business.

As mentioned above, GUI also has a very large stake in Ubisoft – a legacy of the origins of the company (the five Guillemot brothers founded both Ubisoft, in 1986, and Guillemot, in 1997). Of course, UBI today is one of the world's largest video game developers, whilst GUI is merely an also-ran small-cap, and an insignificant part of the Guillemot family's fortune. This is unlikely to change near-term, and limits liquidity in the underlying GUI shares (since the Guillemot family still owns 75% of the company).

You can see some of key Thrustmaster products here. Notice the Ferrari branding on both the racing wheels and the headsets – this is the key OEM relationship that

November 2023 (14)

October 2023 (11)

September 2023 (9)

August 2023 (10)

July 2023 (12)

June 2023 (11)

May 2023 (12)

April 2023 (9)

March 2023 (14)

February 2023 (13)

January 2023 (11)

December 2022 (6)

November 2022 (9)

October 2022 (7)

September 2022 (7)

August 2022 (10)

July 2022 (8)

June 2022 (8)

May 2022 (10)

April 2022 (7)

March 2022 (7)

February 2022 (7)

January 2022 (7)

December 2021 (5)

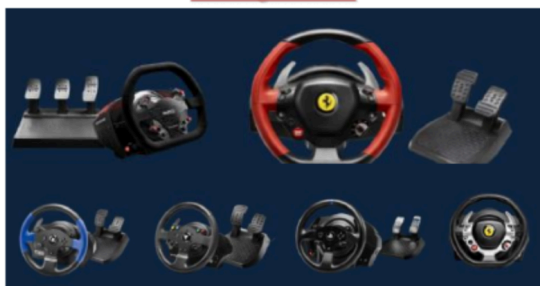
November 2021 (8)

October 2021 (7)

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Thrustmaster has enjoyed for >10 years, and perhaps the single relationship that continues to allow Thrustmaster to compete in some products with Endor's Fanatec:

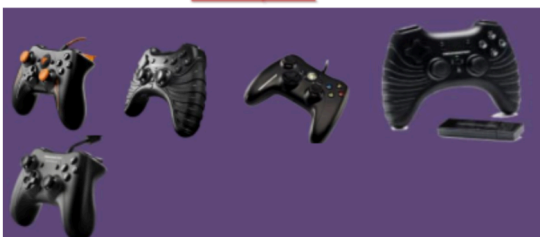
Racing wheels



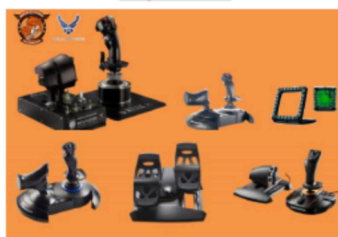
Gaming headsets



Gamepads



Joysticks



The market positioning and strength of Thrustmaster's position varies considerably by product. Thrustmaster is the overwhelming market leader in joysticks, for example, with an 80%+ share (according to NPD data as cited in GUI's 2018 annual report). On the other hand, the market share position in headsets and gamepads is very small (perhaps single digits %), though the market size is very large (since around 25 million gamepads were shipped in the US in 2018). The positioning in racing wheels is more complicated: Thrustmaster has a very high share – over 60% – of the market, and more or less dominates entry-level wheels (the average ASP of their product last year was ~140 EUR/wheel), but clearly this is not where most of the profits are made. Fanatec, on the other hand, has a much higher share (perhaps 80%) of the higher-end products (over 500 EUR/wheel), and enjoys a premium brand position, meaning Thrustmaster is invariably stuck competing with Logitech at the entry-level for the casual gamer. Of course, GUI does not disclose what product-level margins look like. Further complicating matters, keep in mind also that GUI does not disclose how much revenue comes from each product group – but I estimate Sim racing wheels are at least 30-35% of total GUI consolidated revenues today (and likely higher this year given the growth of the market). In any case GUI today is a hodge-podge: a partial bet on sim racing; a partial bet on gaming accessories in general; and an implicit bet on UBI stock price as well, of course.

Segment disclosures aside, historical performance has been fairly lumpy. GUI has alternated between profits and losses, and revenue growth has been hit and miss. The below chart summarizes the last few years of revenues, gross margins, and EBIT margins (note that this all ignores below-the-line financial gains/losses from the UBI stake and other items):

August 2021 (7)

July 2021 (7)

June 2021 (7)

May 2021 (9)

April 2021 (8)

March 2021 (7)

February 2021 (8)

January 2021 (5)

December 2020 (7)

November 2020 (7)

October 2020 (6)

September 2020 (7)

August 2020 (10)

July 2020 (7)

June 2020 (6)

May 2020 (7)

April 2020 (5)

March 2020 (4)

February 2020 (4)

January 2020 (4)

December 2019 (2)

November 2019 (1)

October 2019 (1)

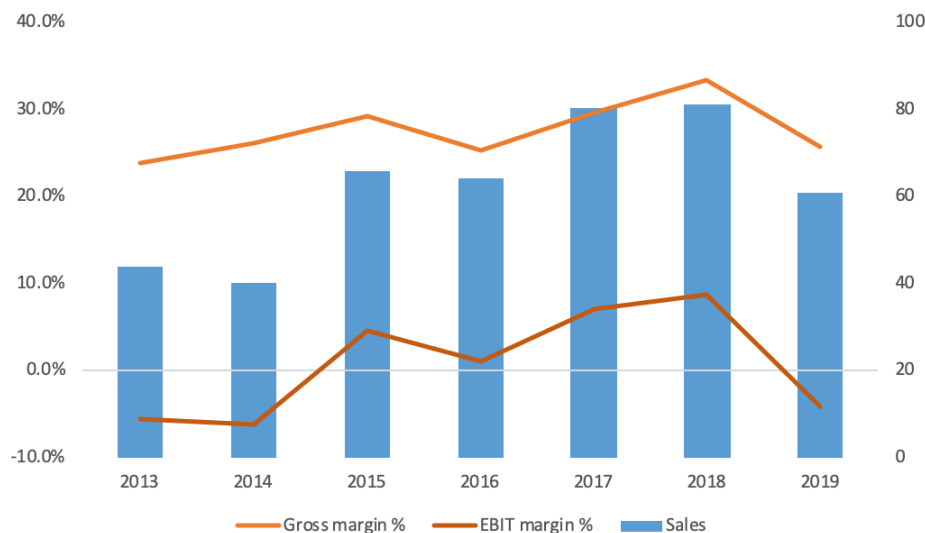
August 2019 (2)

July 2019 (3)

April 2019 (1)

March 2019 (3)

GUI Revenues, Gross Margins, EBIT Margins, 2013-19



The problems appear partially to do with brand and positioning – that is, Thrustmaster has steadily lost share at the high end of the market – but also to do with the company’s model. As it stands, Thrustmaster relies on retailers to sell the vast majority of their product in-store – unlike Fanatec that is essentially an online-only direct seller. In other words, Thrustmaster is subject to the vagaries of the sell-in/sell-through cycle, which can be difficult to manage and subject to large inventory swings (a good comp for this business model and its difficulties is Turtle Beach, the US headset manufacturer, which has exhibited similar PnL volatility in the past).

These issues came to a head in 2019. Whilst the overall sim racing market continued to grow aggressively (looking at Endor’s revenues), Thrustmaster saw revenues fall >20% YoY, due to inventory destocking at key retailers in the US after outsized growth in 2018. These errors were compounded in 1Q, where revenues barely grew despite the late benefit of COVID spiking demand in March, because the situation flipped and suddenly retailers didn’t have enough inventory to meet demand. GUI was further unable to satisfy rush orders since their manufacturing partners (mostly in China) were offline for COVID, thus leading to some delayed (and presumably lost) orders. Thus, I am in no way arguing GUI is a well-managed business, nor executed well in the recent past.

Where we go from here

Of course what’s past is past, and we simply care about what happens next. In this regard, I am much more positive the wind is now firmly at GUI’s sails. Firstly, there is an inherent filip in 2Q this year from a very easy comp (last year’s 2Q was quite weak, driven by some of the destocking already mentioned). Secondly, the 1Q sales report already presaged that demand at the end of 1Q was intense:

Thrustmaster developments

During this period of enforced staying at home, both Thrustmaster’s website and online shop have been experiencing record numbers of visits on a daily basis. Internet users have also come up with inventive online challenges, featuring Thrustmaster’s accessories. Home confinement has had a particularly stimulating effect in terms of online e-Sports competitions: since real-world Formula One races have been put on hold, virtual races in which famous championship drivers compete have been taking place.

Moreover, NPD data for both **May** and **June** suggest accessory demand was incredibly strong:

July 2016 (1)

March 2016 (1)

February 2016 (2)

December 2015 (1)

October 2015 (1)

September 2015 (2)

August 2015 (3)

July 2015 (1)

June 2015 (1)

May 2015 (2)

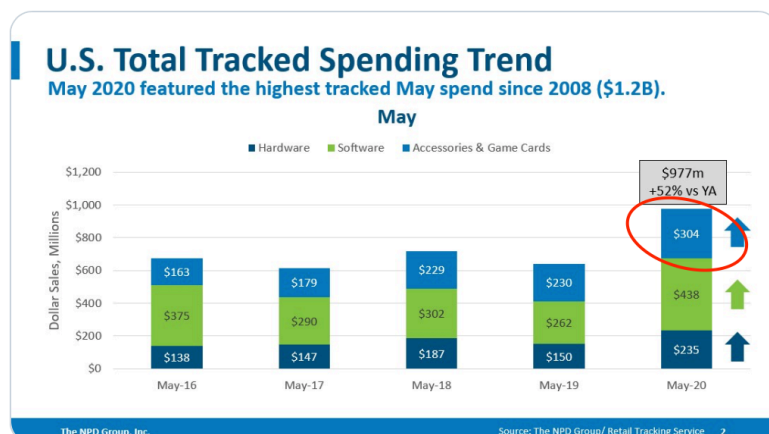
April 2015 (4)

March 2015 (6)



Mat Piscatella @MatPiscatella · Jun 12

MAY 2020 US NPD THREAD - May 2020 tracked spending across Video Game Hardware, Software, Accessories and Game Cards totaled \$977 million, 52 percent higher when compared to a year ago. This is the highest tracked spend for a May month since the \$1.2 billion achieved in May 2008.



6

38

82

2



Mat Piscatella

@MatPiscatella

US NPD ACC & GC - New dollar sales records for a June month were set across a number of Accessories categories including Gamepads, Headsets/Headphones, Steering Wheels and Controller Enhancements.

1:56 PM · Jul 17, 2020 · [Twitter Web App](#)

2 Retweets and comments 19 Likes

Direct competitors like Turtle Beach and Logitech have also already presaged extremely strong 2Q results, far ahead of analyst expectations. This Turtle Beach commentary in particular is quite important, since Thrustmaster shares the same sales model (retail/distribution-led) and many of the key retailers overlap (like Gamestop, and Walmart, etc):

Turtle Beach +45% on raising Q2 sales outlook

Jun. 16, 2020 6:47 AM ET | About: [Turtle Beach Corporation \(HEAR\)](#) | By: [Niloofer Shaikh](#), SA News Editor

- Turtle Beach Corporation (NASDAQ:[HEAR](#)), video-game headset maker [long favored](#) by Fortnite players, has [increased](#) its Q2 sales outlook to [\\$74M - \\$77M vs. prior guidance of \\$42M - \\$47M and consensus of \\$43.8M](#), driven by continued strong demand and significant additional increases in product supply.
- Juergen Stark, CEO of Turtle Beach, said, "Looking toward the balance of the year, while it remains unclear the extent to which the current sales surge represents a pull-forward of sales that might otherwise have occurred later in the year, we anticipate being able to reflect all or most of the increased second quarter revenue when we provide updated full-year guidance as part of our next quarterly earnings report. [We expect to enter July with channel inventories still needing significant replenishment.](#) We also expect the higher revenues to drive higher adjusted EBITDA for the quarter and the year, partially offset by higher expediting costs incurred to achieve the incremental sales."

Meanwhile Logitech, in results after the bell yesterday, spoke to ongoing and sustainable strength in the broad 'x-from-home' categories, with gaming especially a standout, growing 38% YoY (the most relevant vertical clearly for GUI's business):

UNDERLYING SECULAR "xFH" TRENDS ACCELERATED

	Q1'21	Q1'20	Y/Y	Y/Y (CC)
Pointing Devices	120	122	(1%)	1% ¹
Keyboards & Combs	145	129	13%	15%
PC Webcams	61	28	116%	121%
Tablet & Accessories	46	38	20%	22%
Video Collaboration	130	73	77%	81%
Mobile Speakers	29	50	(42%)	(42%)
Audio & Wearables	71	59	22%	23%
Gaming	182	135	35%	38%
Smart Home	7	10	(31%)	(30%)
Net sales	\$792	\$644	23%	25%

Beginning in March, secular "xFH" (work-from-home, learn-from-home, and play-from-home) trends have accelerated

PC Peripherals +19% (CC), due to content creation/streaming and demand for personal workspace in the home

Gaming +38% (CC), as people entertain and socialize with friends and fellow players through online gaming

Video Collaboration +81% (CC), led by increasing demand for video everywhere

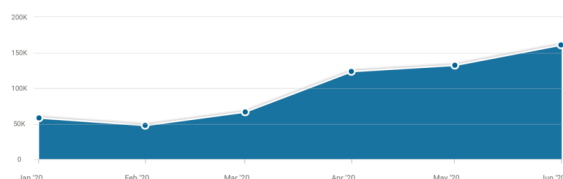
Blue Microphone sales (+50%) offset

Finally, online traffic tracking sites like Similarweb suggest Thrustmaster's online portal continues to see record levels of interest:

Total Visits to shop.thrustmaster.com

Growth & total visits to shop.thrustmaster.com over time

On desktop & mobile web, in the last 6 months



Engagement

Total Visits

160.70K

▲21.68%

Avg. Visit Duration

00:01:51

Pages per Visit

4.32

Bounce Rate

42.92%

It stands to reason, then, that at least the upcoming 2Q print, if not 3Q as well, should be a massive improvement over 1Q levels and of course versus year-ago levels as well – personally I would not be surprised to see 50%+, or even higher, YoY revenue growth reported for both 2Q and 3Q.

Valuation discussion – how cheap is too cheap?

In modeling the company, I looked closely at the recent PnL and also at competitor Turtle Beach. These businesses have an overwhelmingly fixed-cost model, where the majority of opex is personnel/marketing/licensing and a bit of D&A, and, because adjusted gross margins are not high (around 30%), underlying profitability can really swing around. With comps reporting 50-100% growth in 2Q revenues and likely ongoing strength into year end as new consoles are launched by both Sony and Xbox, I don't think its unrealistic to think GUI revenues could get back up to 2018 levels, or close, implying around 80mm EUR of revenues and perhaps 4-5mm of clean EBIT. Similarly I don't think its a stretch to see the ongoing boom in Sim racing, new consoles, and new racing games bleed over into 2021 and see a bit more growth, along with margin expansion off a high fixed cost base:

	2013	2014	2015	2016	2017	2018	2019	2020E	2021E
Sales	43.7	40.3	65.8	64.2	80.4	81.2	60.9	78.0	87.0
COGS	20.5	17.8	42.8	27	41.6	57.1	28.8	24.2	27.8
Changes in inventories	3	2.2	-10.7	6.4	0.1	-18.7	3.2	14.6	15.3
External expenses	9.8	9.8	14.5	14.5	14.9	15.7	13.2	15.0	16.0
Gross Profit	10.4	10.5	19.2	16.3	23.8	27.1	15.7	24.2	27.8
Personnel expenses	7	7.1	7.1	8.3	8.3	9.4	9.8	9.5	10.0
D&A	2.2	2.7	2.6	2.6	3.2	3.1	3.4	3.4	3.5
Provisions allowance	0.9	0.7	1.5	1.4	2.9	1.6	1.1	1.2	1.0
Taxes & duties	0.3	0.3	0.3	0.3	0.4	0.4	0.3	0.4	0.4
Other operating items, net	2.4	2.2	4.7	3	3.3	5.6	3.6	5.0	5.5
EBIT	-2.4	-2.5	3	0.7	5.7	7	-2.5	4.7	7.4
Gross margin %	23.8%	26.1%	29.2%	25.4%	29.6%	33.4%	25.8%	31.0%	32.0%
EBIT margin %	-5.5%	-6.2%	4.6%	1.1%	7.1%	8.6%	-4.1%	6.0%	8.6%
Personnel % revs	16.0%	17.6%	10.8%	12.9%	10.3%	11.6%	16.1%	12.2%	11.5%
D&A % revs	5.0%	6.7%	4.0%	4.0%	4.0%	3.8%	5.6%	4.4%	4.0%
Other op items, % revs	5.5%	5.5%	7.1%	4.7%	4.1%	6.9%	5.9%	6.4%	6.3%
Total opex % revs	29.3%	32.3%	24.6%	24.3%	22.5%	24.8%	29.9%	25.0%	23.4%
Shares out	15.3	15.7	15.7	15.2	15.2	15.2	15.2	15.2	15.2
Stock price	0.9	0.9	1.5	1.4	5	4	2.5	3.4	3.4
Market cap	13.8	14.1	23.6	21.3	76.0	60.8	38.0	51.7	51.7
Net debt	7.2	7.2	6.1	9.1	1.2	7.9	10.2	8	8
Value of shareholdings	5	7	12.3	15	28.5	31.3	27.3	30.4	30.4
Adjusted EV (EUR mm)	16.0	14.3	17.4	15.4	48.7	37.4	20.9	29.3	29.3
EV taxing UBI stake at 50%	18.5	17.8	23.5	22.9	63.0	53.1	34.6	44.5	44.5
EV/EBIT (x)	-6.7x	-5.7x	5.8x	22.0x	8.5x	5.3x	-8.4x	6.3x	3.9x
EV/EBIT (x) w/ 50% credit for Ubi	-7.7x	-7.1x	7.8x	32.7x	11.0x	7.6x	-13.8x	9.5x	6.0x
EV/revenues (x)	0.37x	0.36x	0.26x	0.24x	0.61x	0.46x	0.34x	0.38x	0.34x
EV/revs (x) w/ 50% credit for Ubi	0.42x	0.44x	0.36x	0.36x	0.78x	0.65x	0.57x	0.57x	0.51x

No doubt this is somewhat speculative with regards to 2021. But here is the kicker: we are paying an incredibly low multiple for the core business here, **barely 0.4x EV/revenues and perhaps 6x EV/EBIT** (or 4x EV/EBIT if you indulge me my 2021 numbers) for a business still with high market share in small but rapidly growing niches, and still favorably exposed to the eSports mega-trend. And even if we HEAVILY discount the Ubisoft stake – I use a punitive 50% discount, to account for tax and the market not fully valuing the stake as it may never be realized – we are still only paying 0.6x EV/revenues, and <10x operating earnings, for the business. Keep in mind also that because GUI still has ~33mm EUR in NOLs, they will not be a cash tax payer for at least 3 more years – meaning IF they can actually print 5-8mm in EBIT, there is a good chance most of it turns into net income (there is -0.3/0.4mm per year drag in interest expense). Thus, completely irrespective of the Ubisoft stake, **this business could well be trading on 7-8x net income, and returning to growth, if things break their way over the next year.**

I admit, this is a bit 'pie in the sky' and not as scientific as I usually prefer to be. But keep in mind Turtle Beach trades today at 1.1x EV/sales; is also a small-cap, exposed to many of the same trends as GUI; but is also slightly levered and without the UBI stake safety net. Logitech, of course, trades in the relative stratosphere at 3.6x EV/sales (it is a large cap, though, and far more diversified, to be fair). But why can't GUI trade at 1x EV/sales? That's hardly a demanding valuation – indeed, Turtle Beach paid >1x sales to

acquire ROCCAT last year, an (in my view) inferior, low/no growth peripherals maker that did <\$15mm in revenues:

Note 2. Acquisitions

ROCCAT

On May 31, 2019, the Company completed its acquisition of the business and assets of **ROCCAT**, a provider of gaming keyboards, mice and other accessories for a purchase price of approximately \$12.7 million and up to \$3.4 million in potential earn-outs based on revenues for the years ending December 31, 2019 and 2020, as provided in the asset purchase agreement. The purchase price was paid in cash at closing and was funded by the Company's cash reserves and additional borrowings under its credit facility. In addition, business transaction costs incurred in connection with the acquisition of \$3.5 million for the year ended December 31, 2019 were recorded as a component of "General and administrative" expenses in the Condensed Consolidated Statements of Operations.

For the year ended December 31, 2019, **ROCCAT** had revenue of **\$14.4 million**. The Company is unable to provide the results of operations attributable to **ROCCAT** as those operations were substantially integrated into our legacy business.

1x EV/sales on my current year numbers is **6.5 EUR/share – or almost a double** from where we are today. This is according GUI full value for their UBI stake, but even at just 50%, the implied valuation is still around 5.7 EUR/share – **~68% upside from current**. And I don't think its too aggressive to roll these numbers forward to 2021 and assume some growth, meaning it is one of the rare COVID beneficiaries I have been able to find that could still reasonably almost double and not look anywhere near expensive, to me.

Keep in mind too that the low float cuts both ways: with the Guillemot brothers owning 75% of the float and thus the free float constituting ~12-13mm EUR today, this is certainly not a trade for large funds, but it really only takes a handful of institutional buyers to want to own this – or (and I'm really dreaming now!) for the Guillemot brothers to want to take out the minorities – for the stock to get back to 6 EUR in a hurry.

Either way, with the ongoing secular and idiosyncratic COVID-related demand at its back, and the valuation unreasonably cheap, GUI makes a lot of sense to me here for a small position. I expect both the 2Q and 3Q sales prints to be extremely positive on a YoY basis, and that to serve as the near-term catalyst to get the stock back up near its highs (or through!) from a couple of years ago.

Disclosure: long GUI PA

 Uncategorized

GUI

← Checking in on the aircraft leasing sector Guillemot: scrubbing the numbers post blowout
2Q, still >50% upside →

5 thoughts on “Guillemot: it may not quite double, but it should get close”