

Stride Gaming

Focusing on synergies and strategic growth

FY18 trading update

Travel & leisure

26 September 2018

Price 97.5p
Market cap £74m

Net cash (£m) at April 2018 19.8
Shares in issue 75.8m
Free float 35%
Code STR
Primary exchange AIM
Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	(10.1)	(34.6)	(58.2)
Rel (local)	(9.3)	(34.4)	(59.5)
52-week high/low	259.0p		83.5p

Business description

Stride Gaming is a leading online gaming operator in the UK. It uses its proprietary and purchased software to provide online bingo and slot gaming. It was formed in 2012 and only operates in regulated real money gaming markets.

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Analysts

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Stride's FY18 trading update confirms the widely reported headwinds facing the UK bingo-led market, with a c 3% decline in real money gaming (RMG) in H218. More positively, FY18 RMG EBITDA appears to be in line (or slightly better) than our recently reduced estimate. Importantly, Stride's high-margin proprietary platform is a key differentiator and the company remains well placed to gain market share. The balance sheet is strong and we expect strong cash flow through synergies and strategic growth. The stock has fallen 60% this year on the back of downgrades and a UKGC fine (which appears to be c £4m) and now trades at depressed levels of 5.8x P/E and 3.3x EV/EBITDA for CY19e.

Year end	Revenue* (£m)	EBITDA (£m)	PBT** (£m)	EPS** (p)	DPS (p)	P/E (x)	Yield (%)
08/16	47.8	12.3	11.3	20.3	2.5	4.8	2.6
08/17	89.9	20.2	18.9	25.8	2.7	3.8	2.8
08/18e	89.0	16.1	14.2	13.9	2.9	7.0	3.0
08/19e	85.0	16.2	13.9	16.1	3.0	6.1	3.1
08/20e	93.5	17.5	15.8	18.5	3.1	5.3	3.2

Note: *Adjusted revenue excludes social from FY18, and includes Stride's share of Stride Together (inc Aspers JV). **PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

RMG EBITDA slightly above expectations

Stride's FY18 net gaming revenues (excluding social) increased by c 4% to at least £85m, which reflects a c 3% decline in H218 and confirms the continued stagnation of the overall online bingo-led market. However, due to tight cost controls, FY18 EBITDA is in line with our recently reduced expectations, with core RMG EBITDA estimated at 5% ahead. As highlighted in our [May update](#), the market is expecting a further increase in remote gaming duty after November's budget (from 15% to 20%). This is now included in our forecasts from April 2019 and, as a consequence, we have lowered our FY19 and FY20 EBITDA by 1.2% and 13.4%.

Technology drives synergies and strategic growth

Stride's proprietary platform is a key differentiator in the online gaming market, enabling better KPIs and cost controls compared to peers. In addition to extracting synergies from its recent acquisitions, the technology is being deployed for organic expansion in UK gaming (B2C and B2B casino), as well as cost-effective international B2B. We estimate that the Stride Together B2B division contributed £3.5m to FY18 adjusted net revenue. The balance sheet is robust and we note that Stride will make a provision of £4m (c 20% of end April net cash) for the recently announced fine from the UKGC (August 2018).

Valuation: 5.8x P/E and 3.3x EV/EBITDA for CY19e

The stock has fallen 60% year to date and trades at depressed multiples of 3.3x EV/EBITDA and 5.8x P/E for CY19e. Given the company's superior technology, high net cash and continued strong cash generation (despite the regulatory environment), this seems unjustified in our view. For a meaningful re-rating, we expect investors to focus on synergies, cost controls and ultimately an uptick in EBITDA.

Streamlining UK real money gaming

Headline figures reflect challenging market

In its FY18 trading update, Stride reported net gaming revenues of at least £85m, which compares to FY17 real money gaming revenues of £81.8m. As reported at H118 results, the online bingo-led market is facing a number of headwinds, in the form of stagnating industry growth and innumerable regulatory burdens, which was reflected in our estimated c 3% decline in real money gaming revenue in H218.

With the benefit of ongoing operational efficiencies, however, FY18 EBITDA of 'not less than' £16.0m suggests the actual result was slightly above our recently lowered estimate of £16.0m. We believe this includes a better than expected result from the core UK RMG, offset by Indian rummy investment (which is fully consolidated). As a consequence, we have now slightly raised our FY18 EBITDA forecast to £16.1m.

Extracting synergies from acquisitions

Stride has invested heavily into its proprietary platform, which is a key differentiator in the online gaming market, enabling better KPIs and cost controls compared to peers. While still investing in technology, IP and compliance, Stride has now begun to realise synergies from its recent acquisitions and, in light of the more challenging market, we expect a greater focus on synergies and operational efficiencies in future (feeding mostly into lower admin costs).

Strategic growth: UK casino and B2B

In terms of strategic growth, Stride's proprietary technology is being leveraged to expand further into UK B2C casino, where the company has less than 1% market share. The company's B2B division was launched last year (Stride Together), and we estimate that this division contributed c £3.5m to adjusted net revenue for FY18. The B2B offering also provides a cost-effective channel for international expansion.

Estimate changes reflect previously highlighted tax increase

As UK's third-largest online bingo-led operator, Stride remains well positioned, but we now believe that the overall bingo-led market may be shrinking. Although we expect the company to organically grow its market share in the wider UK gaming market (ie casino), as well as expand through B2B, we have conservatively lowered our adjusted net gaming revenue forecasts by 17.5% and 18.9% for FY19 and FY20.

As we have previously highlighted, there is a strong possibility that the government will raise the remote gaming duty from 15% to 20% after the Budget in November. Industry speculation is that the tax will be effective from April 2019 and we now include this impact in our figures (which equates to five months impact in FY19 and a full year impact in FY20).

Our FY19 EBITDA goes from £16.4m to £16.2m and our FY20 EBITDA goes from £20.2m to £17.5m. Within this figure, we estimate core RMG of £16.6m in FY19 and £17.6m in FY20. We note that, excluding this tax increase, our underlying FY19 EBITDA would have actually increased to c £17m and our FY20 EBITDA would have grown to c £21m. The reason for the underlying uplift is that we now expect the company to focus almost entirely on synergies and UK growth, rather than international expansion (other than low-cost B2B).

The balance sheet remains robust and we note that Stride will make a provision of £4.0m for the announced fine by the UKGC (August 2018), which equates to c 20% of estimated net cash.

We summarise our divisional forecasts and headline forecast changes in the tables below. We expect further information at the FY18 results in November.

Exhibit 1: Divisional summary						
Year end 31 August (£m)	FY15	FY16	FY17	FY18e	FY19e	FY20e
Real money gaming (RMG)	26.7	35.0	81.8	85.3	79.5	85.0
Social gaming/ Rummy	1.1	12.8	8.1	0.3	0.5	1.0
Net gaming revenue (NGR)	27.8	47.8	89.9	85.5	80.0	86.0
Stride Together (including Aspers JV)	0.0	0.0	0.0	3.5	5.0	7.5
Adjusted net revenue	27.8	47.8	89.9	89.0	85.0	93.5
COS (POC gaming tax)	(2.8)	(5.4)	(11.6)	(15.4)	(16.0)	(19.1)
% of RMG NGR	10.3%	15.4%	14.2%	18.1%	20.0%	22.5%
Gross profit	25.1	42.4	78.3	70.1	64.0	66.9
Marketing cost	(7.0)	(10.9)	(22.6)	(22.2)	(20.0)	(21.5)
Marketing %	25.2%	22.8%	25.1%	26.0%	25.0%	25.0%
Other distribution costs	(2.9)	(7.8)	(16.0)	(12.8)	(11.2)	(11.9)
Other distribution %	10.4%	16.2%	17.8%	15.0%	14.0%	13.8%
Admin costs	(7.8)	(11.4)	(19.4)	(19.0)	(16.6)	(16.0)
Admin %	28.2%	23.9%	21.6%	22.2%	20.8%	18.6%
Adjusted EBITDA	7.3	12.3	20.2	16.1	16.2	17.5
Adjusted EBITDA margin	26.3%	25.8%	22.5%	18.8%	20.2%	20.4%
RMG EBITDA	7.0	8.2	19.7	16.8	16.6	17.6
Social Gaming/ Rummy EBITDA	0.3	4.1	0.6	(0.7)	(0.4)	(0.1)
Adjusted EBITDA	7.3	12.3	20.2	16.1	16.2	17.5

Source: Company accounts, Edison Investment Research

Exhibit 2: Estimate changes									
	Adjusted revenue*			EBITDA			EPS**		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2018e	91.4	89.0	(2.6)	16.0	16.1	(0.6)	14.3	13.9	(2.9)
2019e	103.1	85.0	(17.5)	16.4	16.2	(1.2)	16.6	16.1	(3.0)
2020e	115.4	93.5	(18.9)	20.2	17.5	(13.4)	21.7	18.5	(14.7)

Source: *Adjusted revenue excludes social from FY18, and includes Stride's share of the Aspers JV. **EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Exhibit 3: Financial summary

	£m	2015	2016	2017	2018e	2019e	2020e
August		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
NGR		27.8	47.8	89.9	85.5	80.0	86.0
Adjusted Revenue (inc Stride Together)		27.8	47.8	89.9	89.0	85.0	93.5
Cost of Sales		(2.8)	(5.4)	(11.6)	(15.4)	(16.0)	(19.1)
Gross Profit		25.1	42.4	78.3	70.1	64.0	66.9
EBITDA		7.3	12.3	20.2	16.1	16.2	17.5
Operating Profit (norm)		7.3	12.0	19.4	15.0	13.9	15.3
Amortisation of acquired intangibles		(2.5)	(4.2)	(7.8)	(7.0)	(7.0)	(7.0)
Exceptionals		(3.3)	(5.1)	(36.1)	(3.7)	0.0	0.0
Share based payments		(1.0)	(1.9)	(1.8)	(1.4)	(1.4)	(1.4)
Operating Profit		0.4	0.8	(26.2)	3.0	5.5	6.9
Net Interest		(0.1)	(0.7)	(0.5)	(0.9)	(0.5)	(0.5)
Contribution from jvs/assocs.		0.0	0.0	0.0	0.1	0.5	1.0
Profit Before Tax (norm)		7.2	11.3	18.9	14.2	13.9	15.8
Profit Before Tax (FRS 3)		0.4	0.1	(26.7)	2.1	5.0	6.4
Tax (reported)		0.1	(0.5)	1.1	(0.6)	(0.6)	(0.6)
Profit After Tax (norm)		6.2	10.9	18.2	13.8	13.3	15.1
Profit After Tax (FRS 3)		0.4	(0.4)	(25.6)	1.6	4.5	5.8
Average Number of Shares Outstanding (m)		43.8	51.5	67.3	74.5	76.0	76.0
EPS - normalised (p)		14.2	21.2	27.1	15.0	17.3	19.9
EPS - normalised fully diluted (p)		14.0	20.3	25.8	13.9	16.1	18.5
EPS - (IFRS) (p)		0.9	(0.8)	(38.1)	1.6	5.6	7.5
Dividend per share (p)		0.00	2.50	2.70	2.90	3.00	3.10
Gross Margin (%)		90.1	88.7	87.1	82.0	80.0	77.8
EBITDA Margin (%)		26.3	25.8	22.5	18.8	20.2	20.4
Operating Margin (before GW and except.) (%)		26.1	25.0	21.6	17.6	17.4	17.8
BALANCE SHEET							
Fixed Assets		37.1	78.7	61.1	62.1	54.8	47.6
Intangible Assets		36.4	73.6	57.8	51.5	44.0	36.5
Tangible Assets		0.2	0.7	0.7	0.9	1.1	1.3
Investments		0.5	4.4	2.7	2.7	2.7	2.7
Assets Available for sale/other		0.0	0.0	0.0	7.0	7.0	7.0
Current Assets		11.7	27.1	36.5	34.1	40.9	52.2
Stocks		0.0	0.0	0.0	0.0	0.0	0.0
Debtors		4.2	5.8	9.9	7.0	8.0	8.0
Cash		7.4	21.1	26.2	26.6	32.4	43.7
Assets Available for sale/other		0.0	0.2	0.5	0.5	0.5	0.5
Current Liabilities		(7.7)	(26.1)	(35.7)	(19.8)	(17.6)	(17.6)
Creditors		(5.2)	(16.3)	(31.3)	(17.3)	(15.0)	(15.0)
Player balances		(1.4)	(1.8)	(2.4)	(2.5)	(2.6)	(2.6)
Short term borrowings		(1.1)	(8.0)	(2.0)	0.0	0.0	0.0
Long Term Liabilities		(10.2)	(10.5)	(7.1)	(6.5)	(6.5)	(6.5)
Long term borrowings		(8.0)	0.0	(4.4)	(4.0)	(4.0)	(4.0)
Other long term liabilities		(2.2)	(10.5)	(2.6)	(2.5)	(2.5)	(2.5)
Net Assets		30.8	69.2	54.9	69.9	71.6	75.6
CASH FLOW							
Operating Cash Flow		4.6	14.4	14.3	14.5	14.5	15.8
Net Interest		0.0	(0.6)	(0.6)	(0.9)	(0.5)	(0.5)
Tax		(0.1)	(0.7)	(1.4)	(0.6)	(0.6)	(0.6)
Capex		(0.6)	(1.9)	(2.0)	(2.0)	(2.0)	(2.0)
Acquisitions/disposals		(18.1)	(22.2)	(1.9)	(22.5)	0.0	0.0
Financing/other		10.4	25.9	(0.5)	16.2	(3.5)	1.0
Dividends		(3.0)	(0.6)	(1.8)	(2.1)	(2.2)	(2.3)
Net Cash Flow		(6.6)	14.4	6.1	2.7	5.7	11.3
Opening net debt/(cash)		0.0	3.1	(11.3)	(17.4)	(20.1)	(25.8)
Moving in player balances		1.0	0.0	0.0	0.0	0.0	0.0
Other adjustments		2.5	0.0	0.0	0.0	0.0	(0.0)
Closing net debt/(cash)		3.1	(11.3)	(17.4)	(20.1)	(25.8)	(37.1)

Source: Company accounts, Edison Investment Research

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