

# Stride Gaming

Scale drives core growth

FY results

Travel & leisure

22 November 2017

**Price** **250.5p**  
**Market cap** **£181m**

Net cash\* (£m) at 31 August 2017 17.4  
 \*Excluding player balances of £2.4m.

Shares in issue 72.1m  
 Free float 34%  
 Code STR  
 Primary exchange AIM  
 Secondary exchange N/A

## Share price performance



	1m	3m	12m
%			
Abs	6.1	12.8	2.0
Rel (local)	7.6	11.4	(7.6)
52-week high/low	259.0p 208.0p		

## 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 and a social gaming mobile app. It was formed in 2012 and only operates in regulated real money gaming markets.

## Next events

AGM February 2018

## Analysts

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Stride reported net gaming revenue (NGR) growth of 18% to £89.9m in FY17, driven by an impressive 39% organic growth in the core real money gaming (RMG). Adjusted EBITDA of £20.2m was slightly above our recently raised estimates. Stride has invested heavily in technology and operational leverage should kick in as acquired customers migrate to the higher-margin proprietary platform. A small investment into the Indian rummy market could also lead to diversified revenue growth. Strong cash flow and £17.4m net cash leaves the company well positioned to pay the final Tarco earnout. The stock trades at CY18e 8.2x EV/EBITDA and 12.0x P/E, slightly below peer group averages. Profitability in the core business should offset potential investment losses and our estimates remain largely unchanged.

Year end	Revenue (£m)	EBITDA* (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/15	27.8	7.3	7.2	14.0	0.0	17.9	N/A
08/16	47.8	12.3	11.3	20.3	2.5	12.3	1.0
08/17	89.9	20.2	18.9	25.8	2.7	9.7	1.1
08/18e	101.0	19.2	17.0	20.2	3.0	12.4	1.2
08/19e	112.8	23.0	20.3	23.9	4.0	10.5	1.6

Note: \*Normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. EPS is fully diluted.

## Third-largest UK online bingo operator

Stride operates over 100 bingo sites and has c 12% share in the UK online bingo market. FY17 pro-forma NGR increased 18% y-o-y to £89.9m with adjusted EBITDA increasing 24% to £20.2m. The highlight was 39% growth in RMG to £48.6m from the in-house proprietary platform. Non-proprietary platform revenues (Tarco and 8Ball) grew 16% to £33.1m and, as expected, social gaming NGR declined 37% to £8.1m. Key RMG operational highlights were a 26% increase in deposits to £147m and a 29% increase in yield per player to £147. Our revenue and EBITDA forecasts remain largely unchanged.

## Strong net cash covers earnouts and investments

Stride reported operating cash flow of £14.3m, with net cash of £17.4m at end August, positioning the company well for further acquisitions and/or investments. An increased contingent consideration (due to better than expected EBITDA) of £17.4m (from £5.6m) for the Tarco assets (51% cash/49% shares) should be comfortably met with internal resources. Additionally, as part of its diversification strategy, Stride has announced a £3m investment for a controlling stake in Passion Gaming, a rummy-focused online gaming business in India. This is included in our RMG forecasts and, importantly, there is no future earnout obligation.

## Valuation: 8.2x CY18e EV/EBITDA

Stride is fully regulated, successfully increasing market share, growing well ahead of the sector average and generating cash, with a progressive dividend policy. However, its 8.2x EV/EBITDA and 12.0x P/E for CY18e remain below the peer averages of c 9x and 13x. In our opinion, demonstrable success in integrating the recent acquisitions, following all the earnouts, is key for any significant re-rating.

## **FY17 results: Slightly above recently raised estimates**

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### **Overview**

Reported NGR grew 88% to £89.9m, equating to a pro-forma NGR growth of 18%. Like-for-like RMG revenues increased 28.7% to £81.7m, driven by the scale of the enlarged group, multi-brand strategy and significant improvements in player engagement and monetisation. As discussed at the interim results in May, there is limited visibility in the social gaming vertical and management has taken a £9.9m impairment against its InfiApps assets. Revenues from this division declined by 37% to £8.1m, with an EBITDA of £0.6m.

For the group, FY17 adjusted EBITDA of £20.2m was slightly above our recently raised forecasts. This represents an EBITDA margin of 22.5% vs the prior year of 21.4%. As the business continues to scale and drive revenues on to the proprietary platform, we expect underlying margin expansion going forward. However, this is expected to be offset by increasing gaming taxes, which specifically include the addition of free bets into the point of consumption tax (effective from August 2017).

Operating cash flow of £14.3m represents a 70% conversion rate and the company ended the year with net cash (excluding player balances) of £17.4m. A final dividend of 1.5p brings the full-year dividend to 2.7p.

In terms of acquisitions and investments, the two notable events were:

- An increased contingent consideration for the Tarco assets of £17.4m from £5.6m, as a result of better than expected performance in the business.
- A £3m investment into Passion Gaming, an Indian online rummy gaming business.

### **RMG: 91% of revenues**

Stride reported strong organic growth in its RMG vertical, with revenues from its proprietary platform increasing 39% to £48.6m. Encouragingly, non-proprietary platform RMG revenues (from acquired assets) grew 16% to £33.3m and we anticipate this growth to accelerate now that the earnout periods are ending.

Deposits increased 26% to £147m and yield per player increased 29% to £147, demonstrating a continued improvement in engagement and monetisation of players. However, RMG-funded players (active players, depositing within the last three months) declined 10% to 146,000, as a result of the group's strategy to focus on high net-value players and reduce the number of players associated with free bets. Mobile and touch devices now represent 66% of the group's total gross gaming revenue vs 56% in the prior year.

### **Impact of 2016 acquisitions**

The acquisitions last year (8Ball, Netboost Media and Tarco) have boosted Stride's market share in the UK online bingo market, from 5% to 12%. The resulting business now has significant scale and liquidity and its multi-brand strategy will enable it to target broader demographics and cross-sell to lapsing players. Stride has taken advantage of opportunities presented by the introduction of the UK POC gaming tax in 2014, which has squeezed smaller operators and left larger multi-product operators focusing more on sports, casino and M&A, rather than bingo. We expect this trend to continue with the extension of POC tax to 'free bets' from August 2017. The impact of the tax on free bets is estimated at 3-4% of RMG EBITDA and will largely be accounted for from 1 October 2017.

Following all the earnouts, Stride believes it can achieve £2.5m of cost synergies and £3m of revenue synergies. Revenue synergies include increasing LTV, yield and cash hold, and cross-selling lapsing Tarco/8Ball players onto its higher-margin proprietary platform.

Stride is already demonstrating synergies within distribution costs, with 8Ball distribution costs having declined from 35% of revenues in H116 to 27% of revenues in H217. As a comparison, Stride's proprietary platform distribution costs are approximately 10%, with total distribution costs at approximately 18% of revenues. Stride's long-term target is to reduce the acquired assets' distribution costs to approximately 15-18%, as more customers migrate to the proprietary platform.

### **Diversification into new products and verticals**

During 2017, Stride has continued its diversification into new product verticals, such as lottery-style games, scratch cards and rummy. It has developed and launched 17 new proprietary slots and instant win games, launched 28 new casino sites with a slots focus and entered the B2B vertical with the launch of Stride Together, which notably includes the B2B JV with Aspers.

### **Diversification into new markets**

As part of its strategy of expanding into new growth markets, Stride has made a £3m controlling investment in Passion Gaming, a rummy-focused Indian online skill gaming company. Management estimates that the Indian skills market will reach c \$3.6bn by 2022 and Stride has the option (but not the obligation) to acquire the remaining 49% of Passion Gaming from the existing shareholders over a three- to five-year period, using a combination of cash and shares. Stride's investment will primarily be directed towards marketing spend, and the company estimates that Passion Gaming will become profitable from the third year. The £3m investment is included in our RMG forecasts and importantly, there is no earnout associated with this investment.

Additionally, Stride owns an Italian remote gaming licence and is in the process of obtaining Spanish and Danish licences, with the intention of launching in Spain and Denmark during FY19.

### **Social gaming: 9% of revenues**

Stride entered the social gaming market with the acquisition of Israel-based InfiApps in July 2015. However, as announced at interim results, market dynamics in this vertical have been very challenging and Stride has recognised a £9.9m impairment for the business, which compares to a total acquisition cost of £19m.

FY17 revenues declined by 37% to £8.1m with an EBITDA of £0.6m. Given the high acquisition costs in social gaming, marketing spend has been reduced and numerous changes to the pricing model have been implemented. The board is currently reviewing its progress in the improvement plans and we anticipate a further announcement in mid-2018.

As detailed in the table below, our forecasts assume a limited contribution to group EBITDA over the next two years.

**Exhibit 1: Divisional forecasts**

Year-end 31 August (£m)	FY15	FY16	FY17e	FY18e	FY19e
RMG	26.7	35.0	81.8	93.6	104.5
Social gaming	1.1	12.8	8.1	7.4	8.3
<b>NGR</b>	<b>27.8</b>	<b>47.8</b>	<b>89.9</b>	<b>101.0</b>	<b>112.8</b>
COS (POC gaming tax)	(2.8)	(5.4)	(11.6)	(16.8)	(19.3)
% of RMG NGR	10.3%	15.4%	14.2%	18.0%	18.5%
Gross profit	25.1	42.4	78.3	84.1	93.5
Marketing cost	(7.0)	(10.9)	(22.6)	(24.9)	(27.8)
Marketing (%)	25.2%	22.8%	25.1%	24.6%	24.6%
Other distribution costs	(2.9)	(7.8)	(16.0)	(18.4)	(20.2)
Other distribution (%)	10.4%	16.2%	17.8%	18.2%	18.2%
Admin costs	(7.8)	(11.4)	(19.4)	(21.6)	(22.5)
Admin (%)	28.2%	23.9%	21.6%	21.4%	19.9%
<b>Adjusted EBITDA</b>	<b>7.3</b>	<b>12.3</b>	<b>20.2</b>	<b>19.2</b>	<b>23.0</b>
RMG EBITDA	7.0	8.2	19.6	18.6	22.0
Social gaming EBITDA	0.3	4.1	0.6	0.6	1.1
Adjusted EBITDA margin	26.3%	25.8%	22.5%	19.0%	20.4%
RMG EBITDA margin (%)	26.4%	23.5%	24.0%	19.9%	21.0%
Social gaming EBITDA margin (%)	24.3%	32.0%	7.1%	8.0%	13.0%

Source: Edison Investment Research

**Exceptional costs**

The 2017 income statement includes a number of meaningful exceptional charges, which we summarise here:

- **Impairment:** a £9.9m impairment charge against the InfiApps assets, as discussed above.
- **Contingent remuneration:** this relates to the earnout payment for the acquisitions of 8Ball (£4.0m cash and £10.1m shares) and InfiApps (£0.9m). Both earnouts were settled in September 2017.
- **Contingent consideration:** this relates to the Tarco earnout liability to the period ending 31 December 2017. The liability has increased during the year due to better than expected EBITDA performance. The fair value of the contingent liability is £17.4m (vs £5.6m in 2016) with the increase of £10.8m and unwinding of interest of £1.0m being recognised in the P&L. The contingent liability will be payable as 51% cash and 49% shares.

**Exhibit 2: Tarco and 8Ball acquisitions**

	Date	Initial consideration	Earnout	Earnout period
Tarco Assets/Netboost	31 August 2016	£18.2m cash + shares	£17.4m (51/49 cash/shares)	12 months to December 2017, EV/EBITDA 7.5x
8Ball	31 August 2016	£12.0m cash	£13.1m (£4.0m cash/ 4.1m shares)	12 months to August 2017

Source: Stride Gaming, Edison Investment Research.

**Estimate changes**

As shown below, our revenue and EBITDA estimates for 2018 and 2019 remain largely unchanged. The 2017 adjusted EPS was 17.8% higher than our estimate, largely due to lower interest and tax charges. This also flows through to 2018 and 2019, offsetting the increase in share count from the Tarco earnout.

**Exhibit 3: Edison estimate changes**

	Revenue (£m)			Adjusted EBITDA (£m)			Adjusted, fully diluted EPS (p)		
	Old	New	% change	Old	New	% change	Old	New	% change
2017	89.5	89.9	0.4	20.0	20.2	1.0	21.9	25.8	17.8
2018e	100.7	101.0	0.3	19.0	19.2	1.0	19.0	20.2	6.3
2019e	112.5	112.8	0.3	23.0	23.0	0.0	23.1	23.9	3.5

Source: Edison Investment Research

**Exhibit 4: Financial summary**

	£m	2014	2015	2016	2017	2018e	2019e
August		UK GAAP	IFRS	IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>							
Revenue		8.5	27.8	47.8	89.9	101.0	112.8
Cost of Sales		0.0	(2.8)	(5.4)	(11.6)	(16.8)	(19.3)
Gross Profit		8.5	25.1	42.4	78.3	84.1	93.5
EBITDA		1.2	7.3	12.3	20.2	19.2	23.0
Operating Profit (norm)		1.2	7.3	12.0	19.4	17.5	20.8
Amortisation of acquired intangibles		(0.3)	(2.5)	(4.2)	(7.8)	(7.8)	(7.8)
Exceptionals		(0.1)	(3.3)	(5.1)	(36.1)	0.0	0.0
Share based payments		0.0	(1.0)	(1.9)	(1.8)	(1.8)	(1.8)
Operating Profit		0.8	0.4	0.8	(26.2)	7.9	11.2
Net Interest		0.0	(0.1)	(0.7)	(0.5)	(0.5)	(0.5)
Profit Before Tax (norm)		1.2	7.2	11.3	18.9	17.0	20.3
Profit Before Tax (FRS 3)		0.8	0.4	0.1	(26.7)	7.4	10.7
Tax (reported)		0.0	0.1	(0.5)	1.1	(0.7)	(0.8)
Profit After Tax (norm)		1.2	6.2	10.9	18.2	16.3	19.5
Profit After Tax (FRS 3)		0.8	0.4	(0.4)	(25.6)	6.7	9.9
Average Number of Shares Outstanding (m)		31.2	43.8	51.5	67.3	74.5	75.5
EPS - normalised (p)		0.0	14.2	21.2	27.1	21.8	25.8
EPS - normalised fully diluted (p)		4.0	14.0	20.3	25.8	20.2	23.9
EPS - (IFRS) (p)		0.0	0.9	(0.8)	(38.1)	9.0	13.1
Dividend per share (p)		0.00	0.00	2.50	2.70	3.00	4.00
Gross Margin (%)		100.0	90.1	88.7	87.1	83.3	82.9
EBITDA Margin (%)		14.6	26.3	25.8	22.5	19.0	20.4
Operating Margin (before GW and except.) (%)		14.6	26.1	25.0	21.6	17.3	18.4
<b>BALANCE SHEET</b>							
Fixed Assets		0.1	37.1	78.7	61.1	53.9	46.1
Intangible Assets		0.0	36.4	73.6	57.8	50.2	42.1
Tangible Assets		0.0	0.2	0.7	0.7	1.0	1.3
Investments		0.1	0.5	4.4	2.7	2.7	2.7
Current Assets		5.7	11.7	27.1	36.5	33.9	49.8
Stocks		0.0	0.0	0.0	0.0	0.0	0.0
Debtors		5.7	4.2	5.8	9.9	7.0	8.0
Cash		0.0	7.4	21.1	26.2	26.4	41.3
Other		0.0	0.0	0.2	0.5	0.5	0.5
Current Liabilities		(1.2)	(7.7)	(26.1)	(35.7)	(15.8)	(17.6)
Creditors		(0.8)	(5.2)	(16.3)	(31.3)	(13.3)	(15.0)
Player balances		(0.4)	(1.4)	(1.8)	(2.4)	(2.5)	(2.6)
Short term borrowings		0.0	(1.1)	(8.0)	(2.0)	0.0	0.0
Long Term Liabilities		0.0	(10.2)	(10.5)	(7.1)	(6.5)	(6.5)
Long term borrowings		0.0	(8.0)	0.0	(4.4)	(4.0)	(4.0)
Other long term liabilities		0.0	(2.2)	(10.5)	(2.6)	(2.5)	(2.5)
Net Assets		4.6	30.8	69.2	54.9	65.4	71.8
<b>CASH FLOW</b>							
Operating Cash Flow		0.0	4.6	14.4	14.3	17.3	20.7
Net Interest		0.0	0.0	(0.6)	(0.6)	(0.5)	(0.5)
Tax		0.0	(0.1)	(0.7)	(1.4)	(0.7)	(0.8)
Capex		0.0	(0.6)	(1.9)	(2.0)	(2.3)	(2.3)
Acquisitions/disposals		0.0	(18.1)	(22.2)	(1.9)	(26.8)	0.0
Financing		0.0	10.4	25.9	(0.5)	17.5	0.0
Dividends		0.0	(3.0)	(0.6)	(1.8)	(1.9)	(2.3)
Net Cash Flow		0.0	(6.6)	14.4	6.1	2.5	14.9
Opening net debt/(cash)		0.0	0.0	3.1	(11.3)	(17.4)	(19.9)
Moving in player balances		0.0	1.0	0.0	0.0	0.0	0.0
Other adjustments		0.0	2.5	0.0	0.0	0.0	0.0
Closing net debt/(cash)		0.0	3.1	(11.3)	(17.4)	(19.9)	(34.7)

Source: Stride Gaming accounts, Edison Investment Research

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