EDISON

GVC Holdings

H118 results

Strong growth amid integration

Travel & leisure

GVC has announced a strong set of H118 results, with pro-forma net gaming revenues (NGR) increasing 8% to £1,717m, driven by an impressive 18% growth in Online. The integration of Ladbrokes Coral is on track, with an additional £30m capex synergies identified. GVC is now a leading player in the global gaming market and is well placed to continue gaining share across all its key territories. M&A are likely to remain a feature and there is significant potential upside from the US, which is not in our estimates. The stock trades appropriately towards the top of its peer group, at 10.3x EV/EBITDA and 13.5x P/E for 2018e.

Year end	Revenue (£m)	EBITDA (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16p	2,998.8	523.4	257.7	N/M	N/M	N/A	N/A
12/17p**	3,291.5	666.5	462.8	N/M	N/M	N/A	N/A
12/18e	3,472.7	734.9	511.0	73.0	32.0	13.5	3.3
12/19e	3,558.5	794.5	560.6	79.8	34.0	12.3	3.5
12/20e	3,318.3	730.0	491.6	69.4	36.0	14.2	3.7

Note: Pro forma results include LCL as if it has been included from 2016. *Normalised and diluted (EPS) excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Continuing operations, excluding Turkey in 2017.

Strong H118 and continued momentum into Q3

Amidst a complex integration, GVC produced an impressive pro-forma H118 NGR growth of 8% to £1,717m, driven by an 18% increase in Online and 29% growth in European Retail. As expected, UK Retail NGR declined by 5% to £665m. Altogether, the FIFA World Cup contributed £35m of NGR in H118 (pre-substitution) and £64m for the whole tournament. Current trading into Q3 is strong, with group NGR up 14% and Online up 30% (18–19% excluding World Cup/ margin benefits). Our headline revenue and EBITDA forecasts remain broadly unchanged, although we have lowered our EPS estimates due to higher forecast depreciation. On the back of a 16p interim dividend, our 2018e dividend forecast goes from 30p to 32p.

Upside potential from US not in estimates

Following the repeal of PAPSA in May 2018, GVC announced a $200m JV with MGM to provide sports betting and online gaming in the US. With access to 15 states, we believe this JV stands GVC in very good stead to benefit from what is likely to be the largest regulated gaming market globally (c $9bn gross gaming revenues, Global Market Advisors). Given the early stage of the regulatory environment and the limited visibility, US revenues are not included in our forecasts, but we believe the upside potential could be significant. In addition, GVC is likely to pursue acquisitions (eg Crystalbet) in high-growth regulated markets.

Valuation: 10.3x EV/EBITDA and 13.5x P/E for FY18e

The LCL acquisition has cemented GVC's leading global position and the £130m+ cost savings are expected to contribute to significant EPS accretion. With net debt/EBITDA peaking at 2.6x in 2018, strong FCF should rapidly drive down leverage. The group trades at 10.3x EV/EBITDA and 13.5x P/E for FY18e, appropriately towards the top end of the peer group.

20 September 2018

Price	**982p**
Market cap	**£5,680m**
	£1:€1.12
Net debt (£m) at June 2018	1,887
Shares in issue	578.4
Free float	99%
Code	GVC
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(9.1)	(2.2)	17.0
Rel (local)	(6.9)	1.1	15.3
52-week high/low		1,170.0p	821.0p

Business description

GVC Holdings is a leading e-gaming operator in both the B2C and B2B markets. Following the acquisition of Ladbrokes Coral in 2018, it now has a market-leading position in UK retail betting. About 90% of revenues are derived from regulated and/or taxed markets.

Next events

Q3 trading update	October 2018

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Edison profile page

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Gaining share across all key markets

H118 results: Strong growth amidst complex integration

Against the backdrop of a complex integration, GVC has produced an impressive set of interim figures. Pro-forma H118 NGR growth of 8% of £1,717m was driven by an 18% increase in Online and 29% growth in European Retail. As expected, UK Retail declined 5% to £665m. Altogether, the FIFA World Cup contributed £35m of NGR in H118 (pre-substitution) and £64m for the whole tournament. Current trading into Q3 is strong, with group NGR up 14% and Online up 30% (18–19% excluding FIFA).

Online (52% of NGR): 18% growth

Online NGR increased 18% to £895m, reflecting market share gains across all key territories, as well as a positive World Cup. For Sports Brands, NGR increased 19%, driven by a 23% increase in the legacy GVC brands, as well as a 36% increase in Eurobet.it. Ladbrokes.com grew 7%, although trading into Q2 and Q3 has been stronger, bringing it more in line with the Coral Brand. The Games Brands NGR increased 13% and was boosted by an impressive 36% increase in Partypoker.

The contribution margin for the Online business declined from 44.7% to 40.7%, largely due to front-ended FIFA World Cup-related marketing spend and the introduction of the point of consumption tax (POCT) on UK gross bets. Total Online marketing spend was 26% of NGR in the period (vs 23.7% in H117). Management anticipates that full-year online contribution margin will be 42–43%, as the impact of front-end marketing costs reverses.

UK Retail (39% of NGR): 5% decline

For the UK Retail division, a good World Cup helped to offset the impact of poor weather in Q118. For H118, OTC wagers declined 8% (-6% l-f-l), the margin remained flat at 17.9% and total NGR declined by 5% to £665m. The contribution margin for the UK Retail division declined from 72.0% to 71.4%.

The total number of shops declined from 3,660 at FY17 to 3,562 at H118 and preparations are underway for c 1000 shop closures once the Fixed Odds Betting Terminal (FOBT) limits are introduced. Alongside the new FOBT rollout, the implementation of the new shop till system, EPOS2, will be completed in 2019.

European Retail (8% of NGR): 29% growth

European Retail NGR increased by 29% to £134m, as a result of strong organic growth in Eurobet Italy, estate growth in Ladbrokes Belgium and an increase in the OTC margin (from 14.8% to 17.8%). The contribution margin increased from 48.4% to 50.0%, with lower payments to franchisees offset by front-ended World Cup marketing costs.

GVC has announced it will seek to grow this business through small bolt-on acquisitions and it believes it is particularly well placed in Italy once an advertising ban on online operators is enforced.

Trading: Strong Q3, FY18 expectations unchanged

Trading remains robust, with group NGR up 14% and Online NGR up 30% (or 18–19% excluding the impact of the World Cup). Management has stated the group remains on track to meet its FY18 expectations and we believe it should comfortably meet consensus figures. Our 2018e EBITDA forecast remains unchanged.

Exhibit 1: Divisional forecasts

P&L	2016	2017	2018e	2019e	2020e
Online	1,296.3	1,602.8	1,838.7	1,968.8	2,157.4
UK Retail	1,431.1	1,391.1	1,318.0	1,254.9	802.0
European Retail	212.0	240.9	268.7	286.6	309.7
Other	59.4	56.7	47.3	48.2	49.2
Total NGR	**2,998.8**	**3,291.5**	**3,472.7**	**3,558.5**	**3,318.3**
growth	0.0%	9.8%	5.5%	2.5%	-6.7%
Online	286.2	406.9	467.5	531.5	592.9
UK Retail	253.3	256.6	246.0	225.9	56.1
European Retail	41.5	48.6	55.0	57.3	65.0
Other	(12.6)	(0.3)	3.8	4.8	4.9
Corporate	(45.0)	(45.3)	(42.0)	(45.0)	(47.0)
Synergies	0.0	0.0	4.5	20.0	58.0
Total EBITDA	**523.4**	**666.5**	**734.9**	**794.5**	**730.0**
EBITDA margin	17.5%	20.2%	21.2%	22.3%	22.0%

Source: Company accounts and Edison Investment Research

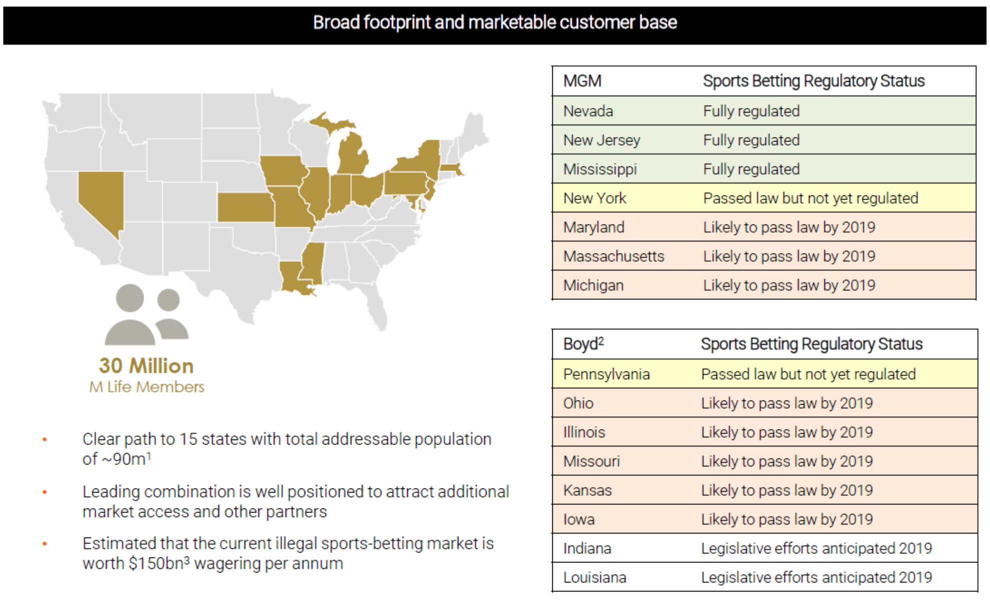
International expansion

MGM JV: Creating a leading player in the US market

In July 2018, GVC and MGM Resorts announced the establishment of a 50/50 JV with a 25-year exclusive agreement. The initial combined contribution is $200m. In essence, this JV should create a leading US sports betting and interactive gaming platform with world-class content, state of the art proprietary technology and broad distribution. As highlighted in Exhibit 2 below, the JV provides access to 15 states and we believe the venture leaves GVC well placed to benefit from what is likely to be the largest regulated gaming market globally.

Global Market Advisors has estimated that the US sports betting market could generate gross gaming revenues of c $9bn, split across the entire country. At this stage, it is difficult to know how much market share GVC might gain within this context, but clearly the opportunities are significant. Given the early stage of the regulatory environment and the limited visibility as to revenue progression, US revenues are not included in our forecasts.

Exhibit 2: JV with MGM



Source: GVC Investor Presentation (September 2018)

Other markets: More bolt-on acquisitions expected

GVC completed the acquisition of 51% of Crystalbet for £36m in April 2018, with an agreement to buy a further 49% for a maximum consideration of £172.5m in 2021 (outside our forecast period). As detailed at the H118 results, Crystalbet's results have already been impressive, with pro-forma H118 NGR increasing by 80% (we estimate c £25m NGR at H118) and over 300 games added via GVC content deals.

Management has stated that it is actively seeking other similar M&A opportunities, with the focus on regulated markets. GVC will also consider retail M&A where there is an opportunity to accelerate online growth.

Integration update

As shown by the strong trading update, the integration of Ladbrokes has started well. All senior management structures are fully in place and the detailed synergy plans have been signed off. GVC remains comfortable with its guidance of £130m synergies by 2021 and it has now guided to an additional £30m capex synergies. We highlight the updated synergy guidance in Exhibit 3 below.

The £44m technology and data synergies are largely dependent on negotiations with Playtech and GVC expects to conclude a mutually beneficial agreement by year end (ie taking more Playtech content in return for migrating away from Playtech's platform).

Exhibit 3: Updated synergy guidance

Financial Year	Cost Synergies		Capex Synergies	Integration Costs
	Cumulative Exit Run Rate	Cumulative Realised In Year	Cumulative Realised In Year	In Year
2018	£7m	£4m-£5m	£0	£17m
2019	£35m	£16m-£26m	£10m-£15m	£39m
2020	£78m	£52m-£62m	£20m-£30m	£43m
2021	£130m	£104m-£114m	£30m	£31m
2022	£130m	£130m	£30m	-

Source: GVC Investor Presentation (September 2018)

Regulatory update

Regulatory decisions are an important feature for all gaming companies. In this section we highlight the key upcoming changes that are likely to meaningfully affect GVC.

- **UK FOBT:** the changes in the maximum B2 stakes (£2 limit) are expected to be enacted in 2018, although the implementation date is still uncertain. We continue to model the impact of the £2 FOBT limit from 2020. GVC anticipates a £120m fully mitigated impact on group EBITDA by the end of the second year of implementation. Please see our June update for further details.
- **UK potential RGD increase:** the government is expected to announce an update on remote gaming duty in the November budget, which is widely expected to be increased from 15% to

20%. This is not in our figures and would have a negative impact of c £20–25m on group EBITDA.

- **Australian POCT:** the majority of states will implement the online POCT on January 2019. The exceptions are Queensland (October 2018) and South Australia (July 2017). The blended rate impact for the group is c 11.5% of gross gaming revenue and this is already in our forecasts.
- **Italy:** all forms of direct marketing on gaming products will be banned from mid-2019. In this context, GVC believes it will be competitively well placed given its 836 shops, where in-store recruitment will be the only viable way of attracting customers online.

Financials and guidance

Following the H118 results and updated guidance on depreciation and capex spend, we have updated our financial forecasts:

- Our revenue and EBITDA forecasts remain broadly unchanged, with c 1% increase in 2018e revenues largely due to slightly higher estimates for the Online and European Retail divisions.
- We have increased our dividend estimate from 30p to 32p, on the back of the 16p announcement, which will be split evenly H1/H2.
- Management has guided to depreciation and amortisation levels of £140m in 2018, £155m in 2019 and £165m in 2020. This compares to our previous estimates of £137m per year and is the main reason for our lowered EPS forecasts.
- We forecast net debt of £1,887m at YE18, which is flat vs H118, and equates to 2.6x net debt/EBITDA. Our net debt/EBITDA ratio falls to 2.2x at the end of 2019.

Exhibit 4: Forecast changes

	Revenue (£m)			EBITDA (£m)			EPS (p)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2018e	3,435	3,473	1.1	735	735	0.0	74.6	73.0	(2.1)
2019e	3,536	3,559	0.7	804	795	(1.1)	84.8	79.8	(5.9)
2020e	3,454	3,318	(0.4)	740	730	(1.4)	76.7	69.4	(9.5)

Source: Edison Investment Research

Exhibit 5: Financial summary

£'m	2016	2017	2018e	2019e	2020e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue (NGR)	2,998.8	3,291.5	3,472.7	3,558.5	3,318.3
Cost of Sales	(1,233.8)	(1,418.7)	(1,581.7)	(1,631.8)	(1,620.4)
Gross Profit	1,765.0	1,872.8	1,890.9	1,926.8	1,698.0
EBITDA	523.4	666.5	734.9	794.5	730.0
Normalised operating profit	376.4	529.5	594.9	639.5	565.0
Amortisation of acquired intangibles	(200.0)	(380.0)	(250.0)	(200.0)	(150.0)
Exceptionals	(534.3)	(59.5)	(142.0)	(39.0)	(103.0)
Share-based payments	(31.8)	(20.7)	(12.5)	(12.5)	(12.5)
Reported operating profit	(389.7)	69.3	190.4	388.0	299.5
Net Interest	(124.6)	(72.0)	(85.0)	(80.2)	(75.0)
Joint ventures & associates (post tax)	5.9	5.3	1.1	1.3	1.6
Profit Before Tax (norm)	257.7	462.8	511.0	560.6	491.6
Profit Before Tax (reported)	(508.5)	2.5	106.5	309.1	226.1
Reported tax	23.6	(9.9)	(66.4)	(72.9)	(63.9)
Profit After Tax (norm)	257.7	462.8	511.0	560.6	491.6
Profit After Tax (reported)	(508.5)	2.5	106.5	309.1	226.1
Minority interests	0.0	0.0	(8.0)	(10.4)	(12.5)
Discontinued operations	28.4	(13.2)	0.0	0.0	0.0
Net income (normalised)	222.1	402.6	436.6	477.3	415.2
Net income (reported)	(456.5)	(20.6)	32.1	225.8	149.7
Basic average number of shares outstanding (m)	NM	NM	578	578	578
EPS - basic normalised (p)	NM	NM	75.48	82.52	71.78
EPS - diluted normalised (p)	NM	NM	72.95	79.76	69.38
EPS - basic reported (p)	NM	NM	5.54	39.04	25.88
Dividend (p)	NM	NM	32.00	34.00	36.00
Revenue growth (%)	NM	10%	6%	2%	-7%
Gross Margin (%)	58.9	56.9	54.5	54.1	51.2
EBITDA Margin (%)	17.5	20.2	21.2	22.3	22.0
Normalised Operating Margin	12.6	16.1	17.1	18.0	17.0
BALANCE SHEET					
Fixed Assets	6,040.7	6,082.0	6,779.8	6,574.8	6,399.8
Intangible Assets	5,605.3	5,607.0	6,224.0	6,054.0	5,926.0
Tangible Assets	245.0	264.4	210.0	175.0	128.0
Investments & other	190.4	210.7	345.8	345.8	345.8
Current Assets	792.0	773.8	785.2	817.2	835.2
Stocks	1.6	2.0	2.0	2.0	2.0
Debtors	342.6	258.7	393.2	413.2	433.2
Cash & cash equivalents	272.2	328.8	175.0	172.0	160.0
Other	175.6	184.3	215.0	230.0	240.0
Current Liabilities	(1,583.1)	(1,121.0)	(1,031.0)	(1,021.0)	(1,011.0)
Creditors	(699.9)	(594.1)	(815.0)	(805.0)	(795.0)
Tax and social security	(67.7)	(253.8)	(40.0)	(40.0)	(40.0)
Short term borrowings	(742.4)	(200.0)	(50.0)	(50.0)	(50.0)
Other	(73.1)	(73.1)	(126.0)	(126.0)	(126.0)
Long Term Liabilities	(1,052.8)	(1,513.9)	(2,622.1)	(2,510.0)	(2,360.0)
Long term borrowings	(749.6)	(1,212.1)	(2,012.1)	(1,900.0)	(1,750.0)
Other long term liabilities	(303.2)	(301.8)	(610.0)	(610.0)	(610.0)
Net Assets	4,196.9	4,220.9	3,911.9	3,861.0	3,864.0
Minority interests	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	4,196.9	4,220.9	3,911.9	3,861.0	3,864.0
CASH FLOW					
Op Cash Flow before WC and tax	558.6	701.2	596.9	794.5	730.0
Working capital	3.8	(29.1)	(50.0)	(25.0)	(25.0)
Exceptional & other	(534.3)	(59.5)	(142.0)	(39.0)	(73.0)
Tax	(6.5)	(14.9)	(60.0)	(72.9)	(63.9)
Net operating cash flow	21.7	597.7	344.9	657.6	568.1
Capex	(58.2)	(205.8)	(177.0)	(150.0)	(140.0)
Acquisitions/disposals	(1,032.4)	(6.0)	(3,157.0)	0.0	0.0
Net interest	(71.1)	(101.3)	(50.0)	(80.2)	(75.0)
Equity financing	158.8	47.0	2,497.0	0.0	0.0
Dividends	(30.4)	(200.1)	(138.5)	(190.7)	(202.3)
Other	109.3	0.0	(123.0)	(127.3)	(12.5)
Net Cash Flow	(902.4)	131.5	(803.6)	109.3	138.3
Opening net debt/(cash)	312.7	1,215.1	1,083.5	1,887.2	1,777.9
FX	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	1,215.1	1,083.5	1,887.2	1,777.9	1,639.6

Source: Company accounts, Edison Investment Research

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