Codere

Restructured with new leadership

Initiation of coverage

Travel & leisure

18 July 2019

Codere is an established retail gaming operator in Latin America, Spain and Italy. Following macro and financial difficulties, it completed a successful operational and full debt restructuring in 2016. Q119 net debt/ adjusted LTM EBITDA of 3.1x is comfortably within banking covenants. FY18 revenues declined by 10% due to the 75% devaluation of the Argentine peso, but adjusted EBITDA increased 3.4%, largely due to the new management's performance initiatives. Barriers to entry are very high and future growth should be driven by online, Mexico and Spain. The free float is limited and OTC shares are subject to a restrictive shareholders' agreement. Positive cash flow is expected in FY19 and the stock trades at a deep discount to peers at 3.9x EV/EBITDA and 7.4x P/E for FY20e.

Year end	Revenue (€m)	Adjusted EBITDA** (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/17	1,638.2	273.5	0.01	0.0	N/A	N/A
12/18	1,476.4	282.9	0.48	0.0	7.4	N/A
12/19e***	1,477.4	361.9	0.32	0.0	11.0	N/A
12/20e***	1,609.9	396.7	0.48	0.0	7.4	N/A

Note: *EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Adjusted EBITDA excludes non-recurring items. ***Includes IFRS 16 adjustments – FY19 EBITDA is c €80m higher due to IFRS 16.

Mexico is key market; very high barriers to entry

Codere's key markets are Mexico, Argentina, Italy and Spain and c 80% of EBITDA is from Latin America. Retail slot machines comprise c 78% of revenues, with only a 3% contribution from online. Codere is heavily exposed to both currency and emerging market risk and a 75% devaluation of the Argentine peso contributed to a 10% decline in FY18 revenues (this is now stabilising). In general, the business model benefits from very high barriers to entry and, after meaningful investment, we believe there is significant upside from Mexico and Spain.

Restructured balance sheet, net cash in FY19

After a successful debt restructuring in 2016, Codere reported €1,120m net debt at Q119, which equates to 3.1x net debt/adjusted LTM EBITDA (or €811m net debt and 2.9x ratio pre IFRS 16 adjustments). This is well within banking covenants, although €500/$300m senior notes are due in 2021 and we therefore expect a debt refinancing in the near term. Our forecasts include IFRS 16 adjustments from FY19 and assume a return to normality in Argentina from mid-2019, which leads to flat group revenues in FY19, before returning to 9% growth in FY20.

Valuation: 3.9x EV/EBITDA for FY20e

Codere's share price is languishing at c 85% below its 2015 pre-restructuring highs and it continues to suffer from limited liquidity (a result of the restrictive shareholders' agreement). There is also a potential overhang from credit fund ownership. The stock trades at 3.9x EV/EBITDA and 7.4 P/E for FY20e, a c 42% discount to peers. Catalysts for re-rating include stabilisation in Argentina, growth in Mexico, demonstrable net cash flow, successful debt refinancing and a resolution of the complex shareholders' agreement (which includes a possible share placing).

Price	**€3.52**
Market cap	**€417m**
Net debt post IFRS 16 (€m) at 31 March 2019	1,120
Shares in issue	118.5m
Free float	5%
Code	CDR
Primary exchange	IGBM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	9.8	3.4	(60.3)
Rel (local)	8.0	6.3	(58.5)
52-week high/low		€8.94	€2.86

Business description

Codere is an international gaming company that manages c 57,000 gaming machines, 30,000 bingo seats and 7,600 sports betting terminals across Latin America, Spain and Italy. It was founded in 1980, listed in 2007 and completed a successful debt for equity swap in 2016.

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Investment summary

Expansion, restructuring, new management

Codere was founded in 1980 in Spain and is a market leader in the gaming machine industry. In terms of revenues (LTM to March 2019), its core markets are Mexico (22% revenues), Argentina (25%), Italy (23%) and Spain (13%). At the end of Q119, it operated nearly 57,000 slot machines, 30,000 bingo seats and 7,900 sports betting terminals across various gaming venues, including 148 gaming halls, 1,100 arcades, 10,000 bars, 500 sports betting shops and four racetracks. Approximately 78% of revenues are from slot machines. Online gaming comprises 3% of revenues and is offered in Spain, Mexico and Colombia. The company has c 12,000 employees.

Since inception, growth has been achieved through expanding geographically and selectively acquiring gaming businesses. In all its core markets, gaming regulation is established and Codere focuses on achieving robust market positions to leverage scale and benefit from first-mover advantage. A 2018–21 three-year plan includes further consolidation in core markets (specifically Mexico), as well as expansion into the online market (Spain, Mexico and Colombia). Over the past two years, Codere has been investing heavily in both Mexico and Spain and, once the Argentine currency impact has been lapped, we forecast revenue growth of 9% in FY20 and 8.5% in FY21.

Codere listed in Madrid in 2007 and, including the €200m equity IPO, it has raised c €1.5bn from the capital markets since 2005, which has funded expansion through investments and acquisitions. Following adverse macroeconomic conditions and licence renewals in Argentina, the company completed a full debt restructuring in 2016, whereby equity shareholders were diluted to 2% of the company (NB the founding family subsequently acquired back c 20% of the shares). The publicly listed stock is highly illiquid, and most shares are currently traded OTC (often at a different price to the listed stock). The OTC shares (not the publicly listed stock) are subject to restrictions in the shareholders' agreement.

A new management team has been in place since January 2018 and is instigating numerous efficiency and performance improvement programmes. The board is representative of the shareholder structure and includes representatives of the removed family members, members from the credit funds (specifically Silver Point Capital), as well as two independent members.

Investment considerations and sensitivities

- **High exposure to Latin America:** Mexico and Argentina together comprise 66% of EBITDA (LTM to March 2019), which leaves Codere vulnerable to political and currency fluctuations. In FY18, this was particularly evident in Argentina, where the peso devalued by 75%. Clearly, any further major negative FX changes would negatively affect earnings and could affect the company's ability to service its US dollar- and euro-denominated debt. We estimate that a 10% drop in the Argentine peso affects EBITDA by c 3%.
- **International gaming sector is characterised by regulatory and taxation changes:** Codere has faced numerous tax changes and regulatory burdens across its markets, which is likely to continue, placing inevitable pressure on margins. Recent examples include the tax increases in both Argentina and Italy. We note, however, that Codere benefits from some geographical diversification, which can minimise the impact (eg it is now concentrating more on Mexico and investing less in Italy as a result of the regulatory environment).
- **Scale brings competitive advantages and high barriers to entry**: Codere has invested heavily across its markets and we believe it is competitively well positioned. The industry challenges (higher taxes, stringent regulations) should continue to create barriers to entry,

benefiting established players such as Codere, with the volumes to deploy gaming and CRM technology advantages.

- **A very capital-intensive business:** substantial yearly capex is spent on renewing and buying new slot machines. This limits Codere's ability to generate substantial net cash flow, which might otherwise be used to reduce leverage, although clearly growth capex is to a certain extent discretionary and can be adjusted over time, depending on liquidity needs. In FY18, maintenance capex of €82m and growth capex of €81m together comprised 11% of revenues. For FY19, management has guided to €75–80m maintenance and €20–25m growth capex (total of c 6% of revenues).
- **Ongoing efficiency measures should lead to positive net cash in FY19:** since the restructuring process started in 2013, the company has successfully managed to implement several efficiency measures including a significant and ongoing headcount reduction. A new management team was appointed in January 2018 and it is focused on continued performance improvements, with the aim of generating net cash flow in FY19. Codere achieved growth and operational efficiencies of €49.4m in FY18 and is guiding to a further €41–46m in FY19. This should lead to a sustainably higher EBITDA margin in the future and is an important contributor to net cash flow break-even during FY19.
- **Online beginning to gain traction:** In addition to Codere's meaningful market share in its various retail businesses, its online division is also beginning to gain significant traction (particularly in Spain). In Spain, the company's Real Madrid sponsorship is an important piece of the strategy to gain online awareness. Currently, online comprises 3% of revenues and we forecast it will amount to 5% by FY21. The company is expanding its online business into Mexico and Colombia and has guided to an additional one-off €10–15m marketing spend for FY19 (this is excluded from our adjusted EBITDA).
- **Industry consolidator/acquisition appetite:** a key strategic focus for the company has been to consolidate its markets, as shown by the numerous investments and acquisitions made to date (see Exhibit 4). Although there could be opportunities across many of the markets (eg, consolidating the fragmented Italian market), we believe the company is focused on expansion in Mexico, where it holds a number of unused gaming licences (for greenfield projects) and it has been opening new halls (three in FY18). There is also the possibility of buying the minorities in ICELA (85% subsidiary in Mexico), as well as bolt-on M&A. We note that with the change of government in Mexico, the ability to open new halls by any player might be reduced.
- **Limited free float and shareholder overhang:** as a result of the 98% debt for equity swap in 2016, Codere's share register is dominated by credit investors, who are likely to seek an exit when possible. The free float is very limited and most shares trade OTC. At present, these OTC shares are subject to a complex shareholder agreement and share transfers are restricted. All these restrictions could be automatically lifted upon a €200m+ IPO, or through a strategic merger, as outlined in the shareholders' agreement.
- **High net debt, with €500m and $300m senior notes due in 2021**: at the end of Q119, Codere reported net debt of €1,120m, which equates to a net debt/adjusted LTM EBITDA of 3.1x (or 2.9x before IFRS 16 adjustments). This is well within banking covenants and Codere has sufficient funds to service the debt, with comfortable interest service ratios. Since forecast net cash flow is insufficient to pay down this debt, we would expect the company to refinance the senior notes in the near term. Furthermore, licence renewals are due in Argentina and Italy in the years 2021–24 (c €80m).
- **Litigation**: following the financial restructuring and removal of the founding family from management and chair of the board, the Sampedro family has initiated proceedings against the other shareholders and board members. To date, the proceedings have not been successful, but there is another hearing later in 2019 that could result in a different outcome. The company has guided to €10m litigation costs in FY19, which is excluded from adjusted EBITDA.

Valuation: 42% discount to peers for FY20

Codere's stock is languishing at c 15% of its 2015 pre-restructuring highs. As a result of the restrictive shareholder agreement, the stock is highly illiquid and mostly trades OTC. Trading in the OTC shares is often at a different price, but for our analysis, we are focusing on the publicly listed shares.

The most straightforward way to value the stock is via a peer group comparison and Exhibit 14 compares it to other gaming operators with a retail presence. Codere trades at 3.9x EV/EBITDA and 7.4x P/E for FY20e, which is a c 42% discount to the peer group average.

Clearly, the shares have suffered from a combination of low liquidity and uncertainty regarding the shareholder agreement. In our view, catalysts for a re-rating include stabilisation in Argentina, meaningful growth in Mexico, a successful refinancing of 2021 senior notes, as well as a potential IPO: a €200m placing would remove key shareholder restrictions (although there is a commensurate risk of share overhang, given the credit fund shareholding).

DCF: €8.0 core valuation, c 130% higher than current trading

We have also performed a DCF with a terminal growth rate of 2% and a terminal EBITDA margin of 18% (on a pre-IFRS 16 basis). We assume a terminal capex/sales ratio of 6% (excluding licences) and an effective tax rate of 25% (on EBITDA). Using a WACC of 9% produces a value per share of €8.0. Our core forecasts assume no major FX moves (as witnessed in Argentina in FY18) and no major additional gaming taxes. If we flex the WACC to 10% to account for a higher risk profile, our DCF would be €6.2, which is c 75% above current levels. Please see page 24 for a sensitivity table.

Our core €8.0 per share DCF valuation equates to 5.2x EV/EBITDA and 16.8x P/E for FY20e, which is still lower than the peer group on an EV/EBITDA basis.

Financials: Containing the impact of FX and rising taxes

Revenues affected by Argentine peso; growth from Mexico and Spain

FY18 revenues decreased by 9.9% vs FY17 to €1,476.4m, driven by a 30% decline in Argentine revenues (75% decline in the Argentine peso vs the euro), which was partially offset by a 17% revenue increase in Spain. In constant currency terms, FY18 revenues would have grown by 9.3% vs FY17. As shown by the 6.7% revenue decline in Q119, the impact of the Argentine peso devaluation will still be felt in H119 (until the currency devaluation is lapped) and we therefore forecast flat revenues in FY19. Thereafter, we are forecasting 9.0% growth in FY20 and 8.5% in FY21, driven primarily by Mexico and Spain (where the company has recently made significant investments), as well as a return to normal conditions in Argentina.

EBITDA steady with gaming tax increases offset by cost controls

Despite the FX headwinds in Argentina, FY18 EBITDA increased 3.4% to €282.9m (in line with guidance of €280–285m). Q119 adjusted EBITDA was also 1.3% higher vs the prior period. The improvement was largely due to performance initiatives across the business. Management achieved cost and growth efficiencies of €49.4m in FY18 and is guiding to €41–46m in FY19. The trends for FY19 are therefore similar to FY18, with increased gaming taxes and FX (less extreme in FY19) offset by performance enhancements. Including a positive IFRS 16 contribution of €80m (lower operating costs), our FY19 EBITDA forecast is €361.9m. This excludes €12m of exceptional online marketing costs mainly in Mexico (these are in non-recurring items) and is in line with company guidance of adjusted EBITDA of €280–290m (pre IFRS 16).

Note that Codere has started to report under inflation accounting standards – this is detailed on page 27, and is excluded from our normalised forecasts.

Net cash flow expected in FY19

As we discuss on pages 19–20, Codere successfully completed the restructuring of its balance sheet in 2016 and at Q119, it had net debt of €1,120m (or €811m pre-IFRS 16). Cash was €75.7m at Q119 (€81.8m at FY18), with €153.5m in total liquidity (including the availability under the revolving credit facility). We forecast net cash flow break-even in FY19 (in line with company guidance) and net debt of €1.09bn in FY19. Net cash flow is expected to increase steadily into FY20 and beyond, but we believe this will still be insufficient to refinance the €500m and $300m senior notes due in 2021 and we expect a refinancing in the near term.

IFRS 16 has affected financial figures from FY19

IFRS 16 has a significant impact on the financial figures from FY19. Our forecasts have annualised the data provided at Q119 results, with lower annual operating costs (higher EBITDA) of c €80m, higher depreciation and amortisation of c €40m and higher interest costs of c €45m. Total gross debt also increased by €309m to €1,196m at Q119. Net debt at Q119 of €811m therefore rises to €1,120m post IFRS 16 changes.

Exhibit 1: Income statement

€m	2014	2015	2016	2017	2018	2019e*	2020e*	2021e*
Mexico	341.9	355.3	329.8	339.9	328.4	355.5	383.9	406.9
Argentina	489.0	681.8	534.5	582.4	407.7	326.1	375.0	431.2
Spain	149.9	155.9	170.2	188.0	220.0	208.0	239.2	275.1
Italy	263.8	284.2	321.5	335.8	336.5	341.4	348.2	355.2
Other	141.0	162.3	189.8	192.1	183.8	246.5	263.6	278.7
Revenue	**1,385.6**	**1,639.5**	**1,545.8**	**1,638.2**	**1,476.4**	**1,477.4**	**1,609.9**	**1,747.1**
growth	0%	18.3%	-5.7%	6.0%	-9.9%	0.1%	9.0%	8.5%
Gaming taxes	(468.9)	(571.9)	(550.8)	(597.0)	(528.1)	(530.1)	(589.7)	(642.0)
Gross profit	871.0	1,017.8	946.5	986.4	895.5	894.2	961.4	1,040.9
One-off items	(66.9)	(33.6)	(51.5)	(29.4)	(52.7)	(37.0)	(10.0)	(10.0)
Adjusted EBITDA	**213.2**	**280.1**	**267.7**	**273.5**	**282.9**	**361.9**	**396.7**	**447.7**
margin	15.4%	17.1%	17.3%	16.7%	19.2%	24.5%	24.6%	25.6%
Mexico	75.1	91.5	88.5	92.9	105.9	162.2	169.6	181.4
Argentina	93.4	146.1	131.0	134.2	96.1	73.6	91.0	112.1
Spain	17.6	24.6	29.5	25.1	26.4	49.6	60.7	75.9
Italy	29.4	26.7	26.4	23.6	27.6	28.6	28.6	30.7
Other	18.9	14.2	23.1	28.2	39.9	60.9	61.2	63.1
Corporate costs	(21.2)	(23.0)	(30.9)	(30.4)	(13.0)	(13.0)	(14.5)	(15.5)
Adjusted EBITDA	**213.2**	**280.1**	**267.7**	**273.5**	**282.9**	**361.9**	**396.7**	**447.7**
Normalised operating income (pre inflation adj)	87.7	158.1	159.7	160.5	169.0	197.9	229.7	277.7
Inflation Adjustment	0.0	0.0	0.0	0.0	(19.5)	(4.2)	0.0	0.0
Operating income (post inflation adj)	20.8	124.5	108.2	131.1	96.9	156.7	219.7	267.7
Net finance costs	(129.4)	(131.7)	(128.5)	(64.2)	(67.2)	(111.8)	(113.1)	(108.0)
Associates & joint ventures (post-tax share)	3.0	2.7	(0.2)	(0.1)	(0.1)	(0.4)	(0.4)	(0.5)
One-off items	(61.4)	(71.7)	(1,095.9)	17.2	(32.7)	(18.7)	0.0	0.0
Normalised PBT	**(38.7)**	**29.1**	**31.0**	**96.2**	**101.7**	**85.7**	**116.2**	**169.3**
PBT	(167.0)	(76.2)	(1,116.4)	83.9	(3.1)	25.8	106.2	159.3
Tax	(40.9)	(63.2)	(36.5)	(64.2)	(30.4)	(40.0)	(51.1)	(58.1)
Normalised profit after tax	**(5.5)**	**32.0**	**(5.5)**	**32.0**	**63.3**	**45.7**	**65.2**	**111.2**
Profit after tax	(207.9)	(139.4)	(1,152.9)	19.8	(33.6)	(14.2)	55.2	101.2
Minority Interest	34.9	26.3	31.2	(17.0)	(6.8)	(7.8)	(8.8)	(9.8)
Net income for equity	(173.0)	(113.1)	(1121.7)	2.8	(40.4)	(22.0)	46.4	91.4

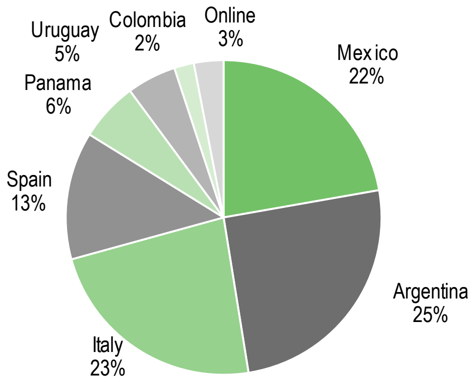
Source: Codere, Edison Investment Research. Note *Includes IFRS 16 adjustments.

Founded in Spain, growth in Latin America

Codere was founded in Spain in 1980 by the Martinez Sampedro family, following the liberalisation of the Spanish gaming industry in 1977. It began amusement with prize (AWP) slot machine operations in 1981 in Madrid and has since steadily expanded both nationally and into Latin America, through selective investments and acquisitions. As a result, it is now a leading international gaming operator with gaming machines, gaming halls, arcades, sports betting, online gaming offering and racetracks in Mexico, Argentina, Spain, Italy, Colombia, Panama and Uruguay.

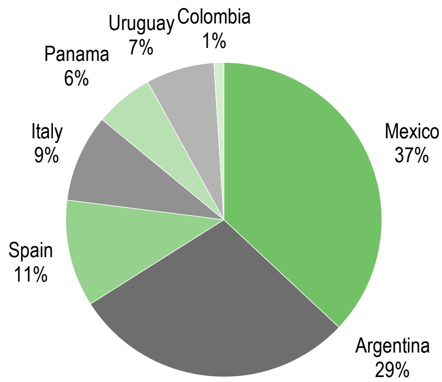
At Q119, the businesses in Mexico, Argentina, Italy and Spain comprised 22%, 25%, 23% and 13% of LTM revenues and 37%, 29%, 9% and 11% of LTM EBITDA. We provide further information on each region in separate sections below.

Exhibit 2: Q119 geographic LTM revenue split



Source: Codere

Exhibit 3: Q119 geographic LTM EBITDA split



Source: Codere

Group strategy: Growth through online and consolidating Mexico

The company's strategy is based on building leadership positions in attractive markets where it can leverage its knowledge, scale and international exposure. In all its core markets, gaming regulation is established and Codere focuses on establishing robust market positions to benefit from first-mover advantage.

Its three-year plan is to implement performance initiatives (witnessed by the €49m cost efficiencies achieved in FY18), consolidate the Mexican market and expand the online business in Spain, Mexico and Colombia. The key growth opportunities are:

- **Roll out unused licences in Mexico:** Codere intends to roll out some of its unused gaming licences in Mexico and expand its product mix available at such gaming halls.
- **Acquisition-led growth:** Codere has been buying minority stakes in subsidiaries (especially in Mexico) and the company should be able to continue integrating small traditional operators. The potential acquisition-led growth is supported by increasingly stringent regulatory requirements, which are often too complex for the smaller players. Although there may be opportunities across many of the markets, we believe Codere is focusing primarily on Mexican growth. Note that due to the recent government change, management believes the pipeline for greenfield locations has stalled; however, we expect this to be a temporary issue.
- **Online growth:** Expansion into online is a key growth driver and online has now been split out as a separate category (rather than incorporated into the country figures). At Q119, LTM online revenues were €50.5m or 3% of the total and we forecast that it will grow to c 5% of the total by FY21. As we discuss below, Codere is investing in this division, particularly in Mexico and Spain, and the company's Real Madrid sponsorship is an important piece of the strategy to gain online awareness.

€1.2bn external funding for investments and acquisitions

Codere listed in 2007 in Madrid and, before a restructuring programme and refinancing in 2016, it had raised c €200m in equity and c €1bn in debt. Further to another refinancing in 2016, Codere has raised a total of c €1.5bn from capital markets (ie not including bank debt). Over the years, the company has used these funds, combined with internally generated cash, to make a number of acquisitions. We highlight some of the more significant transactions in the table below. These figures do not include licence renewals (significantly, in Argentina).

Exhibit 4: Selected acquisitions and investments

Acquisition	Country	Year	Amount
CANOE Bingo Hall Madrid	Spain	2000	€20m
Operiberica (3,500 machines)	Spain	2000	N/A
Royal Group	Argentina	2004	€50m
Operbingo	Italy	2004	€60m
Codere Network	Italy	2006	€20m
MAE Recreational Machines	Spain	2006	€30m
49% of ICELA	Mexico	2007	€225m
Six casinos	Panama	2010	€40m
Caliente (increasing stake)	Mexico	2010	€60m
FG Slot Services, Gap Games, Gaming Re	Italy	2011	€10m
35.8% of ICELA	Mexico	2012	€200m
50% of HRU	Uruguay	2016	€32m
Caliente (consolidating remaining stake)	Mexico	2017	€25m
Carrasco Resort	Uruguay	Total	€80m
Online investments	Spain, Mexico	Ongoing	€25m

Source: Codere, Edison Investment Research

Restructuring: Debt for equity swap and new management

Following financial and macro difficulties, Codere completed a full restructuring in 2016 (more details below), which resulted in a 98% debt for equity swap, such that credit investors are now major shareholders. There is also a complex shareholder agreement in place, which restricts the transfer of the 98% OTC shares (ie not the publicly listed shares, which are freely traded). The company also completed a full refinancing of its post restructuring debt structure in 2016, issuing €500m (6.750%) and $300m (7.625%) senior secured notes due 2021.

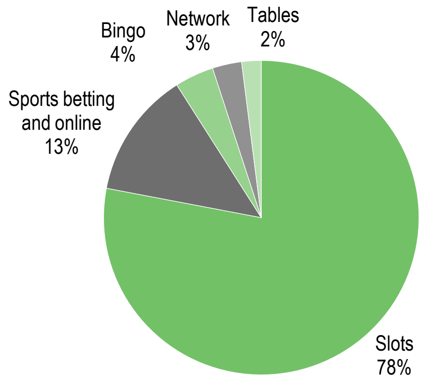
Furthermore, in January 2018, the board removed both members of the Martinez Sampedro family from the executive team and a new chairman and CEO were appointed. This new management team has instigated a thorough review of the business with numerous cost-cutting initiatives now in place.

Products and venues

Codere's operating revenue is derived from a mix of gaming products in different venues. At Q119, slots comprised 78% of GGR, with the remainder from other products such as sports betting, bingo and tables. 59% of revenues is derived from gaming halls, 26% from the slot route business (bars, restaurants and other retail locations), and the rest from other venues such as arcades, network and online platforms, racetracks and sports-betting shops.

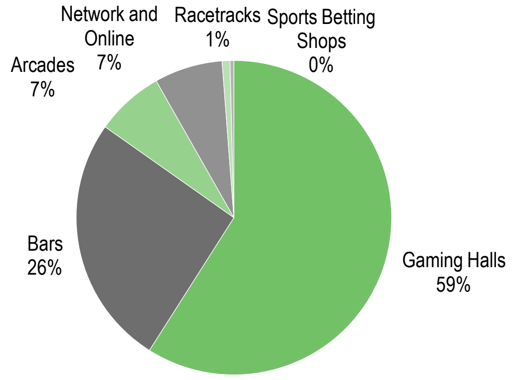
In this section, we highlight the key products and venues that drive revenue and we provide further detail on a country-by-country basis in separate sections.

Exhibit 5: GGR by gaming product Q119



Source: Codere

Exhibit 6: GGR by gaming venue Q119



Source: Codere

Products: Slots are key

Gaming machines (78% of revenues)

Gaming machines (or slot machines) offer cash prizes based on bets made by users. The machines are located in entertainment venues including gaming halls, arcades, bingos, casinos or racetracks as well as non-specialised locations such as bars, restaurants or other hospitality locations.

In terms of gaming capacity, the total number of slots increased 0.3% to 56,764 in Q119 vs the prior year, as shown in Exhibit 7. The change was driven by strong growth in Spain and Mexico, which was partially offset by the reduction of machines in Argentina, Italy and other operations. The reduction of machines in Italy is particularly noteworthy, as this is a direct consequence of more stringent gaming regulation (government decree to reduce installed capacity).

Different machines depending on jurisdiction

The different types of gaming machines are adapted to suit the characteristics of each gaming market and include AWPs, video lottery terminals (VLTs), electronic bingo terminals, casino slots and all other gaming machines that include fully random machines that are not interconnected.

The most important types of machines are AWPs, VLTs and casino slots:

- **AWPs** pay out cash prizes as a percentage of total wagers over a pre-determined cycle of games. AWPs are permitted in Spain (as type-B machines) and in Italy (as Comma 6 or Comma 6A machines). These are legally permitted to be placed in bars, cafes, arcades and bingo halls.
- **VLTs** are server-based prize machines that pay out cash prizes as a percentage of total wagers over a random statistical process, and are permitted in Italy (as Comma 6B machines) to be placed in gaming halls, bingo halls and betting shops only.
- **Casino slots/Class III:** The Latin American countries are predominately focused on operating gaming halls and the most important machines are casino slots within these gaming halls. The majority of Latin American revenues are derived from Class III slot machines (similar to US machines).

Functionally, the main difference between VLTs and AWPs is that VLTs are connected to a central system that provides the machine with a winning number based on a lottery system that makes the machine more random, whereas AWPs are standalone machines that dispense prizes depending on a pre-determined cycle of game.

By regulation, VLTs have a higher prize pay-out than AWPs and higher prizes. In general terms, VLTs have lower taxes than AWPs and are restricted to being placed in gaming halls, bingo halls and betting shops only. Only network operators are able to obtain permits to install VLTs in Italy.

The useful life of a machine varies from 24–40 months in Europe and from 5–12 years in Latin America. The European machines cost c €2,000–4,000 each, whereas Class III machines (in Latin America) typically cost €9,000–15,000. We note that with 75% import tax in Argentina, machine costs are c $25k in Argentina (where there is also very heavy usage and high revenue per machine).

Exhibit 7: Gaming capacity by product Q119 vs Q118

	Gaming Product (Installed Capacity)											
	Slots[2]		Table Seats[3]		Bingo Seats		Sports Betting[4]		Network[5]		Total	
	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019
Region												
Latin America												
Argentina	6,952	6,861	-	-	11,906	11,692	-	-	-	-	18,858	18,553
Mexico	20,160	21,917	1,758	2,178	11,117	11,217	88	90	-	-	33,123	35,402
Panama[6]	3,236	2,940	426	306	-	-	8	8	-	-	3,670	3,254
Colombia	5,132	4,346	246	132	850	500	252	616	-	-	6,480	5,594
Uruguay (CN)	381	403	144	144	-	-	-	-	-	-	525	547
Uruguay (HRU)	1,858	1,875	-	-	-	-	28	28	-	-	1,886	1,903
Brazil	-	-	-	-	-	-	4	-	-	-	4	-
Total	**37,719**	**38,342**	**2,574**	**2,760**	**23,873**	**23,409**	**380**	**742**	**-**	**-**	**64,546**	**65,253**
Europe												
Italy:[7]	9,192	8,124	-	-	5,139	5,139	-	-	18,563	14,231	25,360	20,481
AWP[8]	*8,300*	*7,215*	-	-	-	-	-	-	*17,062*	*12,726*	*18,674*	*13,785*
VLT[9]	*892*	*909*	-	-	-	-	-	-	*1,501*	*1,505*	*1,547*	*1,557*
Spain[10]	9,660	10,298	-	-	1,193	1,064	5,847	7,165	-	-	16,700	18,527
Total	**18,852**	**18,422**	**-**	**-**	**6,332**	**6,203**	**5,847**	**7,165**	**18,563**	**14,231**	**42,060**	**39,008**
Total Group	**56,571**	**56,764**	**2,574**	**2,760**	**30,205**	**29,612**	**6,227**	**7,907**	**18,563**	**14,231**	**106,606**	**104,261**
Gaming Venue												
Gaming Halls	34,867	36,132	2,574	2,760	30,205	29,612	404	769	-	-	68,050	69,273
Arcades	4,589	4,437	-	-	-	-	3,988	5,186	-	-	8,577	9,623
Bars	16,987	16,071	-	-	-	-	1,483	1,541	-	-	18,470	17,612
Sports Betting Shops	128	124	-	-	-	-	352	411	-	-	480	535
Network[11]	-	-	-	-	-	-	-	-	18,563	14,231	11,029	7,218
Total Group	**56,571**	**56,764**	**2,574**	**2,760**	**30,205**	**29,612**	**6,227**	**7,907**	**18,563**	**14,231**	**106,606**	**104,261**

Source: Codere Q119 earnings report. Note: For references, please refer to Codere's Q1 2019 Earnings Results.

Venues: Gaming halls (mostly LatAm) and slot route (Europe)

In terms of venues, 59% of operating revenue is derived from gaming halls, 26% from slot route business (bars, restaurants and other retail locations), and the rest from other venues such as arcades, network and online platforms, racetracks and sports-betting shops.

In Q119, the number of gaming halls was 148, sports-betting shops increased to 478 from 443 and bars decreased from 9,999 to 9,898.

Gaming halls (c 59% of revenues)

Approximately 59% of revenue is derived from the operation of gaming halls, with 14 halls in Europe and 134 halls in Latin America. Gaming halls are entertainment centres where customers bet on various types of gambling for immediate reward, including bingo, sports betting, AWPs and VLTs. Gaming halls typically offer a range of additional services such as restaurants, theatres, hotels and conference rooms and, in some cases, are large leisure centres.

Slot route venues (bars and restaurants) (c 26% of revenues)

The slot route business is based on the operation of slot machines located in bars and restaurants across Spain and Italy. Largely as a result of an Italian government decree to reduce the number of AWP machines, the number of bars with machines declined from 10,293 in FY17 to 9,940 in FY18 and 9,898 in Q119.

Arcades (7% of revenues)

The arcades business is based on the operation of slot machine arcades in Spain and Colombia, where it mainly operates AWPs and self-service terminals (SSTs). At the end of Q119, Codere was present in 1,157 arcades (1,018 in Spain and 139 in Colombia).

Sports betting shops

Sports betting is the activity of predicting results before or during a sports event and placing a wager on the outcome. At the end of Q119, Codere operated 478 sports betting shops in Spain, Mexico, Colombia, Panama and Uruguay.

Racetracks

The company operates under a 'racino' business model that combines horse racing and slot machines in the same venue. Codere operates four racetracks: Racetrack of Las Américas in Mexico and Presidente Remón Racetrack in Panama and, through HRU in Uruguay, it operates the Maroñas and Las Piedras racetracks.

Exhibit 8: Gaming capacity by venue Q119 vs Q118

	Gaming Venues											
	Gaming Halls[2]		Arcades[3]		Bars[4]		Sports Betting Shops[5]		Racetracks		Total	
	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018	2019
Region												
Latin America				Co-located								
Argentina	14	13	-	-	-	-	-	-	-	-	14	13
Mexico[6]	91	95	-	-	-	-	88	90	1	1	92	96
Panama[6,7]	13	11	-	-	-	-	8	8	1	1	14	12
Colombia	10	9	164	139	-	-	252	290	-	-	174	313
Uruguay (CN)	1	1	-	-	-	-	-	-	-	-	1	1
Uruguay (HRU)[8]	5	5	-	-	-	-	28	28	2	2	30	30
Brazil	-	-	-	-	-	-	4	-	-	-	4	-
Total	**134**	**134**	**164**	**139**	**-**	**-**	**380**	**416**	**4**	**4**	**329**	**465**
Europe												
Italy	11	11	-	-	2,349	2,194	-	-	-	-	2,360	2,205
Spain[9]	3	3	817	1,018	7,650	7,704	63	62	-	-	8,533	8,787
Total	**14**	**14**	**817**	**1,018**	**9,999**	**9,898**	**63**	**62**	**-**	**-**	**10,893**	**10,992**
Total Group	**148**	**148**	**981**	**1,157**	**9,999**	**9,898**	**443**	**478**	**4**	**4**	**11,222**	**11,457**
Operator			"Corners"									
Codere	148	148	191	180	-	-	442	313	4	4	432	252
Third Party	-	-	790	977	9,999	9,898	1	165	-	-	10,790	11,040
Total	**148**	**148**	**981**	**1,157**	**9,999**	**9,898**	**443**	**478**	**4**	**4**	**11,222**	**11,292**
Spain												
SSTs Only[10]	-	-	803	980	1,096	1,123	25	21	-	-	1,924	2,124
AWPs & SSTs	3	3	14	38	387	370	38	41	-	-	442	452
Sub-Total	**3**	**3**	**817**	**1,018**	**1,483**	**1,493**	**63**	**62**	**-**	**-**	**2,366**	**2,576**
AWPs Only	-	-	-	-	6,167	6,211	-	-	-	-	6,167	6,211
Total	**3**	**3**	**817**	**1,018**	**7,650**	**7,704**	**63**	**62**	**-**	**-**	**8,533**	**8,787**

Source: Codere Q119 earnings report. Note: For references, please refer to Codere's Q1 2019 Earnings Results.

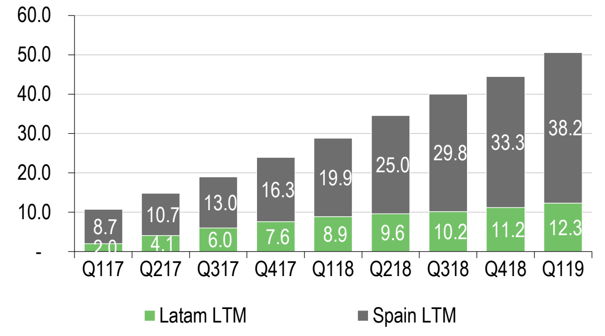
Online gaming (c 3% of operating revenue)

Codere began offering online gaming in 2011 in Spain, with a full commercial launch in November 2016. It also expanded into Mexico in 2016 (multi-channel of current customers) and into Colombia in 2017. In Mexico, the full commercial launch was in Q119.

Online revenues grew from €23.9m at end FY17 to €44.5m in FY18. Q119 LTM revenues were €50.6m, representing c 3% of total operating revenues. While this percentage is significantly below many peers, Codere is actively looking to grow these revenues – as shown by the additional €10–15m marketing spend in Mexico for FY19 and sponsorship of Real Madrid in Spain. As shown in Exhibits 9 and 10 below, at Q119 75% of LTM online revenues were derived from Spain and 70% from the sportsbook. Online gaming EBITDA was €1.2m for Q119, representing a margin of 8%. This compares to a €1.5m EBITDA loss in Q118.

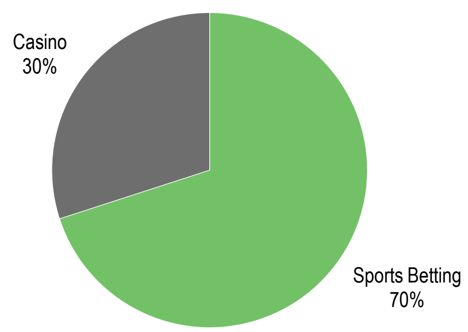
The online business is run from Malta, while the Spanish business is moving to Melilla (Spain) for tax optimisation purposes. Looking ahead, we expect Codere to continue expanding into other regions, as permitted by law. Progress towards regulation is being made in both Argentina (Buenos Aires) and Brazil and Codere would be well positioned if it wins licences in these countries.

Exhibit 9: Online LTM revenue (€m)



Source: Codere

Exhibit 10: Online LTM revenue mix Q119



Source: Codere

Mexico (22% of revenues)

History in Mexico

Codere began operations in Mexico in 1998 through a management services agreement with Grupo Caliente and expanded in 1999 through an agreement with CIE (ICELA). In both instances, Codere participated in the development of halls and offered traditional bingo products through licences owned by both Grupo Caliente and CIE. Over the ensuing years, Codere has progressively achieved a majority shareholding in both operations.

Codere is the largest operator of gaming venues in Mexico, with 95 gaming halls and a racetrack. The company also holds licences to build and operate 40 additional gaming halls in Mexico. In addition, it has a concession for the operation of an entertainment complex in Mexico City that includes the Las Américas racetrack, an amusement park and the largest convention centre in Mexico. At Q119, Codere's Mexican business operated a total of 21,917 slot machines, 11,217 bingo seats, 90 sport betting locations (within the halls) and 2,178 table seats. Most of the halls are open 16 hours a day.

The strategy in Mexico is to continue deploying licences, roll-out new gaming halls, expand into online gaming as well as potentially buying out minorities.

Buying out minorities: Grupo Caliente and ICELA

As part of its ongoing expansion plan, Codere bought into and steadily increased its stake in Grupo Caliente, which is now a 100% subsidiary (since 2017). ICELA is also 84.8% owned by Codere, with CIE holding the remaining stake. We believe Codere could buy out the minorities in the future, depending on cash constraints.

Deploying licences and rolling out new gaming halls

The gaming halls are mainly in large urban areas of Mexico including 20 in Mexico City, five in Guadalajara, four in Puebla and five in Cancun as well as in several other smaller cities. The majority of the gaming halls of ICELA are in Mexico City, the Federal District and in the metropolitan area in the State of Mexico. Legacy Caliente has fewer gaming halls in this area and instead has gaming halls distributed throughout the country.

Codere owns 135 licences in Mexico, of which 95 are operational. The company's strategy is to begin deploying its unused gaming licences, through greenfields or acquisitions of existing operators that do not have the appropriate permits. The company opened three new halls in FY18 and we expect a similar level of hall openings annually.

In Mexico, Codere operates on the basis of an 100% customer identification and entirely cashless system, as Mexican gaming regulation prohibits the use of cash slot machines.

Online: commercially launched in FY18

Online was commercially launched in Q119 and Codere expects to spend an additional €10–15m on marketing to boost the online segment in FY19.

FY18 financial highlights

Revenues: Mexican revenues include the participation in the operating companies of ICELA (85% subsidiary) and in the operating companies of Codere Mexico. Revenues include gaming (subject to gaming tax) as well as other activities such as food and beverage. For FY18, revenue decreased 3.4% to €328m, which equates to a constant currency growth of 2.9%. The growth in local currency was due to a 6.7% increase in average installed capacity (three hall openings in the year), which itself was offset by a 3.7% decrease in unit yields.

Adjusted EBITDA: increased by 14.1% to €105.9m as a result of the cost-cutting initiatives, which offset the decline in revenue. Adjusted EBITDA margin increased from 27.3% in FY17 to 32.3% in FY18 and in constant currency, FY18 adjusted EBITDA in 2018 would have increased 21% to €112.4m. A restructuring programme was initiated in 2013 that involved staff layoffs, reductions in operations and headquarters, reductions in slot product costs and other major procurement costs, which generated substantive cost savings.

Market dynamics

Codere estimates it has c 26% market share of the retail market (which we understand is growing at low single-digit rate) and given the company's consolidation strategy, we believe it will continue to take market share. Hence, revenue growth will come from consolidation rather than market growth.

Regulation and taxes

In Mexico, local and regional authorities have been progressively establishing gaming taxes since 2010 that are only partially deductible, which has slightly increased the total effective gaming tax paid. At FY18, gaming taxes were 10.9% of operating revenues (vs 10.8% in FY17 and 10.4% in FY16).

For the nascent online business (management estimates a market of c €100m gross gaming revenue), we note that Grupo Caliente dominates the market, having enjoyed first mover advantage and operating through a JV with Playtech. Nonetheless, we expect Codere to be able to participate in the growth of the market.

Competition

Until 2004, when the Mexican government enacted regulations granting additional gaming hall licences, Codere estimates that halls operated under Grupo Caliente and CIE's licences constituted the majority of private gaming offered in Mexico. But when the Mexican government granted additional licences in 2005, one-third of these third-party licences were granted to Grupo Televisa, a large Mexican media company, making it a major competitor.

Other competitors include Pringsa with 41 gaming halls, of which 20 are operated by Cirsa, Caliente with 34 bingo halls, Big Bola with 18 bingo halls and Win Pot with 16 gaming halls. In addition, until 2013, there was a proliferation of gaming halls illegally operating without permits. These illegal halls were principally in northern Mexico, particularly in the city of Monterrey, and have progressively been regulated.

Argentina: 25% of revenues

History in Argentina

Codere entered the Argentine gaming market in the early 1990s and is the largest operator of gaming halls in the Province of Buenos Aires. At the end of Q119, the company operated 13 gaming halls, 6,861 slots and 11,692 bingo seats. Most of the halls are located in the surrounding City of Buenos Aires and are open 24 hours a day.

Slot machines

The majority of Argentine revenues are derived from Class III slot machines (similar to US machines). In addition, Argentine gaming halls contain a limited number of non-slot gaming machines, such as electronic roulette-type machines. These machines are regulated in the same way as slot machines.

For its Argentine operations, Codere buys machines from a variety of US and European manufacturers. These are typically financed over 18–36 months, with each machine costing c $25,000 (including duties, taxes and transportation costs). Since 2008, Codere has implemented a ticket-in-ticket-out (TITO) cashless system and almost 100% of the machines run under this system.

FY18 financial highlights

Revenues: Operating revenue in Argentina is principally comprised of revenues from slot machines and from sales of bingo cards after prize pay-outs and revenue from food and beverage. FY18 revenue decreased by 30.0% to €407.7m, due to the significant devaluation of the peso (75.2%), which was more than double the average inflation rate. On a constant currency basis, revenues increased by 18.0%, which was below average inflation of 34.2% and was partly affected by the accounting impact in Q118 of the 0.95% cash-in tax introduced at the end of Q117. Average daily gross win per position in local currency terms increased 18.8% and installed capacity decreased slightly.

Adjusted EBITDA decreased by 28.4% to €96.1m as a result of the devaluation of the Argentine peso and the introduction of the cash-in tax, partially offset by cost efficiencies. The adjusted

EBITDA margin was 23.6% in FY18 vs 23.0% in FY17, due to the ongoing cost-cutting measures. Operating expenses decreased by 30.5% driven by reductions across all cost items, including personnel, rentals and gaming taxes, which benefitted from the FX trend. The effective gaming tax decreased 0.2% to 46.1% (as a percentage of revenues). Note that because all machines operating in Argentina are owned and have very high productivity, there are lower than average rental costs.

Regulation and taxes

Codere is subject to a number of different taxes in Argentina:

- **Tax on gross gaming revenue of 34%:** this is specific to gaming operators.
- **Provincial tax on gross revenue**: from 2017, provincial tax on gross revenue is 15%, having steadily risen from 8% in 2012 and 12% in 2013.
- **Federal tax on bets**: in 2017, an indirect tax is applied on players of electronic games and automated betting machines at a rate of 0.95% of the cash-in.
- **Provincial entry fee:** in 2017, a 20 peso entry fee was announced, per person entering a gaming venue. This fee has yet to be implemented.
- **Cash-out tax on prizes:** a 3% tax on prizes was approved in February 2019, which is payable by the provincial bingo and casino operators. Codere estimates this will impact EBITDA by less than €10m annually.

In total, gaming taxes in FY18 were 46.1% of revenues.

Buenos Aires is currently in the process of regulating online gaming and a number of different operators have applied for licences. To date, Codere is one of the 14 applicants for seven licences in the Province of Buenos Aires and the resolution of the process remains uncertain.

Competition

Under Argentine regulation, the number of bingo halls is restricted to 45 licences, which limits direct competition. The main competitors in the Province of Buenos Aires are AGG, Golden Jack, Grupo Midas and Casino Club, which each have three to four halls.

The remainder of the private gaming market in the Province of Buenos Aires is limited to government-owned casinos and racetracks. Casinos in the Province of Buenos Aires are generally located in tourist areas. There are two racetracks in the Province of Buenos Aires where the installation of slot machines is prohibited. In the City of Buenos Aires, there are two casinos operated by Manuel Lao (former Cirsa chairman) and its local partner, Casino Club. In addition to these casinos, Casino Club also operates, with other partners, the Palermo racetrack and casino in the City of Buenos Aires.

Italy (23% of revenues)

History in Italy

Codere entered the Italian bingo market in 2001, initially providing management services to bingo halls operated by Operbingo, and it entered the AWP machine market in 2004. After a series of acquisitions (see Exhibit 4), the company is now one of the top three operators of gaming halls, with 11 gaming halls and is among the top 10 slot route operators.

Since December 2010 Codere has made numerous acquisitions of slot machine providers and at the end of Q119, it operated a total of 8,124 machines in Italy, which we estimate equates to c 3% market share in terms of number of units. At the end of Q119, it operated 7,215 AWPs, 909 VLTs and 5,139 bingo seats.

The government passed a decree to reduce installed capacity (effective May 2018) and, as a result, Codere's installed capacity reduced by 16.2% at Q119 vs the prior year. To compensate, there was a 24% improvement on AWP unit yields.

Traditional slot route business

The slot route business is the largest revenue component in Italy. In this business, Codere has installation agreements with thousands of bar and restaurant owners across the country. Codere places its AWP machines at specific sites and provides maintenance services, in exchange for a variable fee that is generally equal to 51% of net revenue after deducting gaming taxes and the cost of the network provision.

11 gaming halls

At the end of Q119, Codere owned and operated 11 gaming halls in Italy, offering bingo, AWPs and VLT games. The company has owned bingo halls since the acquisition of Operbingo in 2005 and it has since acquired Bingo Palace, Mortara, Maxibingo and Royal (Caserta). Following the enactment of enabling legislation in 2007 and 2010, the company began installing AWPs and VLTs in its halls. The gaming halls are located in various regions throughout the country such as Rome, Parma, Verona, Bologna and Lecce. Each of these halls are open approximately 11 hours a day.

Network concessionaire

Codere operates a network in Italy as one of 11 network concessionaires for providing machine interconnection and network services. Codere obtained the concession through the purchase of Rete Franco (now Codere Network) in April 2006. The network operator obtains its earnings from two different fees: a canon tax that each machine operator is required to pay to the network, which is approximately €1.0 per machine connected per day; and a fee that varies depending on the contractual arrangements with each machine operator.

At the end of Q119, there were 12,726 AWPs machines and 1,505 VLTs connected to Codere's Italian network. The current concession as network operator in Italy expires in March 2022 and the network renewal licence fee is €22.5m.

FY18 financial highlights

Revenue

FY18 revenue increased by 0.2% to €336.5m. Average daily wins for AWPs and VLTs increased 8.9% and 1.0%, respectively, whereas average installed capacity continues to reflect the reduction decreed by the government (effective in May 2018)**.** Operating revenue in Italy comprises:

- Revenue from network operations, resulting from the interconnection fees for the AWP machines connected to the network as well as from the participation in revenue after prizes and taxes from the totality of the VLTs connected to the network.
- Gaming hall operations, which includes revenue from sales of bingo cards, amounts collected from AWP machines placed in gaming halls and the participation corresponding to the retail location for VLTs placed in the gaming halls (after prize pay-outs in all three cases) as well as revenue from food and beverage sales in gaming venues.
- Gaming machine operations, which includes amounts collected from AWP machines placed in non-specialised locations (such as bars and restaurants) after prize pay-outs and excluding the site owner's share as well as revenue after prize pay-outs for VLTs placed in dedicated gaming halls.

Adjusted EBITDA

Adjusted EBITDA for FY18 increased 17.0% to €27.6m, with the EBITDA margin rising 1.2% to 8.2%. This increase reflects Codere's efforts to optimise the AWP portfolio deployment and cost containment (lower rentals and personnel), despite capacity restrictions and increased taxes.

Gaming tax in Italy

The Italian machine market is heavily taxed (on amounts wagered and winners' prizes) and is characterised by significant regulatory, tax and operational uncertainty. In FY18, taxes represented 64% of revenues and this is expected to continue rising.

We summarise the main tax changes here:

- **Stability law effective 2016:** in 2015, the Italian government passed a new stability law (Legge Stabilità 2016), effective from January 2016. This increased the gaming tax (PREU) for AWPs by 4.5% to 17.5% and for VLTs by 0.5% to 5.5%. The impact to Codere's Italian business was €10.3m in 2016. Although these regulatory changes also allowed for a lower pay-out ratio (winnings to customers) from 74% to 70%, they required other technical upgrades that resulted in further investments in updates or replacements of machines.
- **2017 increase in PREU:** during 2017, the Italian government increased the PREU for AWPs by 1.5% to 19.0% and for VLTs by 0.5% to 6.0%, with no adjustment to pay-outs allowed. The impact on Codere's EBITDA was c €5.0m.
- **2019 budget law**: in December 2018, the Italian Parliament passed the 2019 budget law. Within the law, there were changes to the gaming tax (PREU), as it further increased the tax on AWPs and VLTs by 1.35% and 1.25%, respectively. The law also allowed pay-out reductions from 70% to 68% and from 85% to 84% for AWPs and VLTs, respectively.
- **Further tax increase January 2019**: on top of the 2019 budget law, a further tax increase was approved in January 2019, as shown in Exhibit 11. Altogether, Codere estimates the impact on EBITDA from these increases is expected to remain below €10.0m in 2019 after mitigating actions.

Exhibit 11: Additional gaming tax increases in Italy

Effective date	AWPs	VLTs
1 January 2019	20.60%	7.50%
29 January 2019	21.25%	7.50%
1 May 2019	21.60%	7.90%
1 January 2020	21.68%	7.93%
1 January 2021	21.75%	8.00%
1 January 2023	21.60%	7.85%

Source: Codere

Competition

Competition in the both the gaming hall and slot route market is highly fragmented. For gaming halls, Codere is among the three largest operators. In terms of the AWP slot route market, Codere estimates that the top three operators represent c 14% of the market, measured as number of connected AWPs in the Italian slot route system. The VLT market is more concentrated, as there are only certain networks that have the rights to install VLTs. Competitors include Bplus, Lottomatica, Sisal, Snai group, Gamenet, Admiral, HBG, Global St., Cirsa, NetWin and NTS.

Spain (13% of revenues)

History in Spain

Codere was founded in Spain in 1980 following the liberalisation of the Spanish gaming industry in 1977, initially operating AWPs. The Spanish operations now comprise a slot route business that operates AWP machines, a sports-betting division, including self-service terminals, online gaming, as well as three gaming halls, including the Canoe Gaming Hall in Madrid, in which Codere operates SSTs, slot machines and bingo.

Codere is the second-largest operator of AWPs machines, with 10,298 machines located across bars, restaurants, machine halls and three gaming halls at the end of Q119. It also operates 7,165 sports-betting terminals across its venues, which includes the 62 sports betting shops.

During 2018, Codere completed several acquisitions, including nine arcades and route machines, which collectively operate over 300 machines, for a total consideration of c €10m and at EV/EBITDA multiples between 3.5x and 5.0x.

Slot route business

Codere is a market leader with c 4.7% market share (second largest) by number of machines in the highly fragmented AWPs market in Spain and has a significant presence in most of the regions of Spain, including Madrid, Catalonia and Valencia.

The most important asset in the Spanish AWP business is the relationship with the bar and restaurant owners, where there is typically an installation agreement for about five years. In return, Codere shares the revenue obtained from the machines installed at their location. The AWP business is regulated on a regional level in Spain and the regulations are periodically renewed.

Sports betting

Codere has operated sports betting in Madrid and the Basque region since 2008 and has expanded to all other regions including Catalonia, Valencia, Galicia, Andalucia and the Balearic Islands. These locations include existing gaming venues, sports-betting shops premises, bars, arcades and remotely. Similar to the AWP business, Codere enters into different agreements with bar and gaming hall owners, based on a revenue-sharing agreement.

Gaming halls

Codere also operates the Canoe, Oporto and Leganés gaming halls, which have a number of different devices offering various types of games, including traditional bingo, (similar to the game played in other countries as Mexico, Argentina or Italy), slots and sports betting.

Online gaming

Codere holds licences for online gaming at both the national and regional level in Spain. It launched its online site in 2012, offering sports betting, slots and other games. As discussed above, the sponsorship of Real Madrid is indicative of Codere’s ambitions in online gaming.

FY18 financial highlights

- **Revenue** in 2018 grew by 17.0% to €220m, driven by online and retail sports betting. Revenue in sports betting increased significantly on the back of a 41.5% increase in deployed units. The growing revenue in the slot route business was driven by the 7.3% increase in installed capacity. As detailed on page 11, the Spanish online business reached €33.3m (15% of total Spanish revenues) – from FY19 onwards, online will be reported separately.

- **Adjusted EBITDA** grew 4.9% to €26.4m, while the margin decreased by 1.4% to 12.0%. The decline in margin was due to higher marketing spend in online and sports betting, as well as higher personnel and rental expense associated with the deployment of sports betting points of sale.

Regulation and taxes

In FY18, gaming taxes equated to 32% of operating revenues. Gaming machines in Spain are taxed at a fixed rate of c €3,500 per year per machine (varies per region) and online point of consumption taxes have recently been reduced from 25% to 20%.

Competition

Competition in the AWP operation market in Spain is highly fragmented. Regionally, the competition is from local operators and the national leader is Cirsa. For sports betting, competition varies by region. In the Basque region, the number of operators is limited to licences that are issued by local regulators. In Madrid and other regions, there is no limit to the number of licensees, as long as they comply with regulatory and technological requirements.

The online market (estimated €950m gross gaming revenue) is highly fragmented and Codere therefore remains a small player.

Other markets (17% of revenues)

Other operations include results from Panama, Uruguay, Colombia and Brazil. We have not included information on Brazil, as Codere no longer has any significant operations there.

Panama

Codere entered the Panama gaming market in 2005 and is now the leader in terms of number of gaming halls. At the end of Q119, it operated 11 gaming halls in Panama with 2,940 slot machines, 306 table seats and eight sports-betting locations. Most casinos are open 24 hours a day and the slot machines have TITO operational systems. Codere also owns and operates the Presidente Remon Racetrack in Panama City, which is the only horse racetrack in Central America.

In 2012, gaming taxes increased from 12.5% to 18% of gross revenue from slot machines. There is also a selective excise tax of 5.5% on amounts cashed out (not applicable to the horse races).

Colombia

Codere entered the Colombian slot machine market in 1984 and is now focusing on ownership and operation of gaming machines. At Q119, it operated 4,346 gaming machines located in nine halls and 139 arcades. The casino halls are typically open 16 hours per day, whereas arcades are typically open 14 hours per day. There are also 290 sports betting shops and 616 sports betting machines.

The gaming machines in the Colombian market are generally type-C machines, similar to US Class III machines, which do not have maximum wager and prize limits. The Colombian machine market (excluding machines located in casinos) is highly fragmented. The main competitor in the licensed market is Winner Group, which is affiliated with Cirsa. There is also competition from unlicensed gaming machines in Colombia.

In Colombia, regulation was passed in 2014 introducing the obligation to connect online slots machines and amending existing legislation governing the gaming industry. Accordingly, gaming tax payable on slots connected online would be the higher of a flat tax based on the number of gaming machines or 12% of gross win.

Uruguay

The Uruguayan business operates two horse racetracks and six gaming halls, including five gaming halls under HRU (a fully owned subsidiary since 2016). The sixth hall is the Carrasco Hotel; this is wholly owned by Codere, following a chequered history and financial underperformance. In total, Codere has invested $78.8m into the project, which is now finally break-even.

Given the financial difficulties (particularly with Carrasco), Codere reached an agreement with the gaming authority (Intendencia de Montevideo) to modify the gaming tax structure in 2016. This became effective in 2017. As a result, Codere registered an impairment reversal of €37.7m in FY16.

FY18 financial highlights

Operating revenue includes the both gaming and non-gaming elements (food and beverage and technological services). Operating revenue decreased by 4.3% to €183.8m. The significant changes were:

- Panama decreased 5.8% to €88.8m, due to the devaluation of the US dollar versus the euro and the closing of two underperforming casinos.
- Colombia decreased 5.3% to €23.4m as a result of the closing of an underperforming gaming hall.

Adjusted EBITDA increased by 41.3% to €39.9m, with an EBITDA margin of 21.7% (vs 14.7% in FY17). The main points were:

- Uruguay increased by €3.8m to €18.2m, due to a more efficient HRU operation, as well as favourable FX. Encouragingly, Carrasco continues to perform comfortably above break even.
- Panama's EBITDA increased by €2.5m to €17.3m, due to the local headquarter and operational cost savings.

Restructuring and scheme of arrangement

Restructuring and refinancing in 2016

Following financial difficulties due mainly to imminent licence renewals in Argentina in 2013, the cash acquisition of a stake in ICELA, together with a difficult macroeconomic environment, Codere was unable to service its corporate debt and entered into a financial restructuring process.

The financial restructuring process was completed in April 2016, with highlights detailed below:

- **Legacy notes restructured**: Codere's legacy senior notes, including €760m due in 2015 and $300m due in 2019 plus accrued interest, were exchanged for $164.2m of new second lien senior notes due in 2021, $355.8m of new third lien senior notes due in 2021 and 2,475m new shares.
- **Equity dilution:** as a result of the new share issuance and debt for equity swap, former shareholders were diluted and creditors took a 97.8% equity stake. These new shares are subject to a shareholder agreement, which we discuss below. Note that a subsequent share consolidation in 2018 reduced the outstanding number of shares from 2,254m to 119m.
- **Subsequent refinancing:** in 2016, Codere completed a full refinancing of its post restructuring debt structure, issuing €500m (6.750%) and $300m (7.625%) senior secured notes due 2021.
- **Restructuring costs** in 2016 amounted to €77.1m, which included €3.9m of interest derived from overdue bonds and unpaid bond coupons, €1.4m of default interest to the senior credit

facility agreement recorded as interest expense and €71.8m in extraordinary operating expenses (including €6.5m from refinancing expenses).

- **Now servicing debt from operating cash flow:** since the financial restructuring, Codere has been able to service its debt and operating obligations principally from internally generated and balance sheet cash. Liquidity was improved by putting in place a €95m revolving credit facility, the majority of which remains undrawn.

Shareholder agreement

Subsequent to the financial restructuring and scheme of arrangement, c 98% of shares are subject to a complex shareholder agreement. The pre-existing shares now represent 2.176% of total issued capital and are not party to the shareholder agreement.

Within the shareholder agreement, there are two specific clauses of importance:

- **Transfer restrictions**: the new shares trade OTC and are subject to transfer restrictions, such that an exit for major shareholders is complicated. The trading on these restricted shares is unrelated to the Codere shares traded on the stock exchange.
- **Termination or exit clauses:** the shareholder agreement can be automatically terminated under a few selected scenarios, which specifically includes an IPO of at least €200m. Thus, an IPO would provide an exit route (post IPO) for the credit investors.

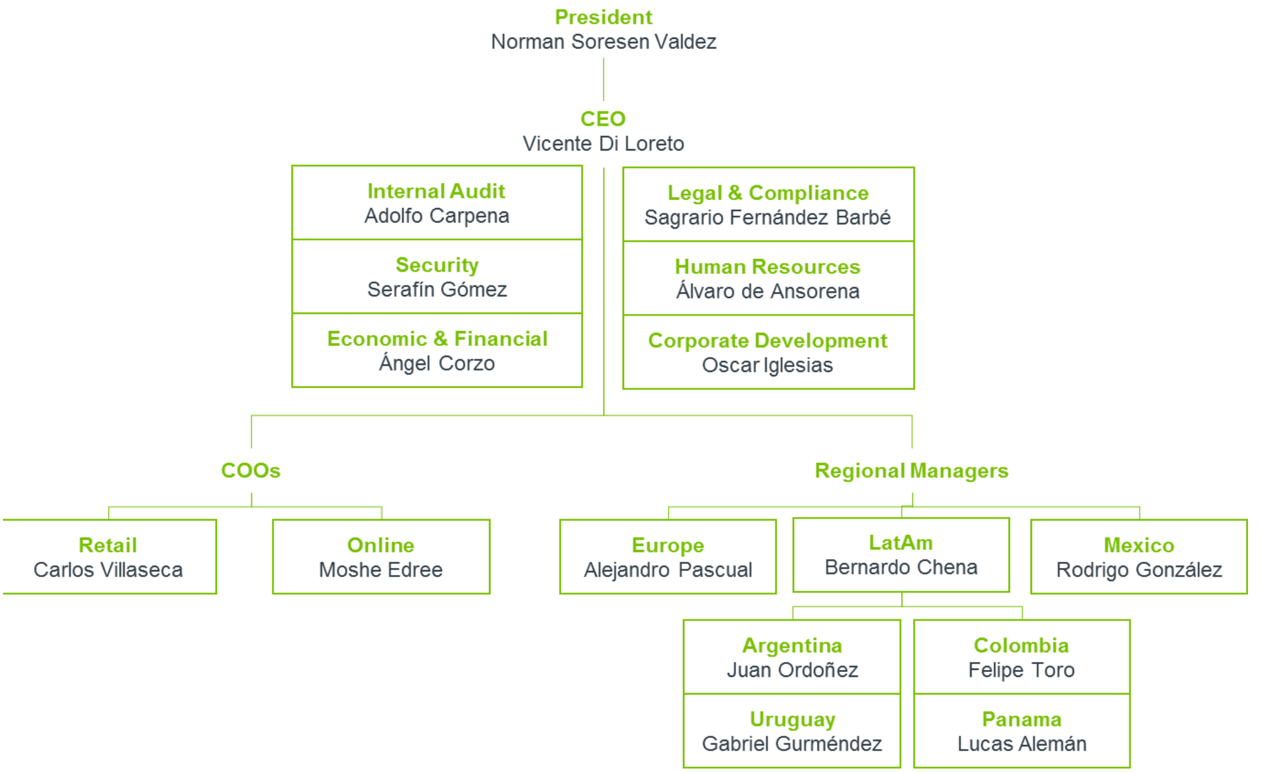
Management and board

In January 2018, the board removed both members of the Martinez Sampedro family from the executive team and a new chairman and CEO were appointed. This new management team has instigated a thorough review of the business with numerous performance improvement initiatives now in place. Exhibit 12 shows the new organisational chart.

The board is representative of the shareholding and includes the Martinez Sampedro brothers' representatives (16% shareholding) as well the credit fund investors from the debt for equity swap (specifically Silver Point Capital) and two independent board members, one of which (Norman Sorensen) is the non-executive president of Codere.

The management team is incentivised with a LTIP plan, based on share price performance.

Exhibit 12: Codere organisational chart



Source: Codere

Exhibit 13: Board and management team

Name	Role	Background
Vicente Di Loreto	CEO	Vicente joined Codere in 2004 as CEO of Codere´s Argentinian operation, which became the company´s most important operation after the acquisition of Grupo Royal in 2005. Afterwards, he was COO for the Latin American operations and in 2011, he moved on to pursue an entrepreneurial project founding gaming consulting company G3M Partners, leveraging his more than 25 years of corporate career in a variety of leadership positions for world-class companies in the entertainment, media, and food industries (Arthur Andersen, Pepsi, Bunge, Molinos, Grupo Clarín). In January 2018, Vicente joined Codere again as CEO.
Angel Corzo	CFO	Ángel Corzo Uceda has been CFO of Codere since July 2013. He was previously a director in the office of the chairman from September 2012 to June 2013 and was controller of Codere from 2007 to August 2012. He participated in multiple projects, including taking interim positions as CFO of the Group. Mr Corzo joined the Group in 2005 as a Monitor Group consultant, where he worked towards the launch of the Italian AWP business. Prior to joining Codere, he acted as manager of the Monitor Group from 2000 to 2006.
Carlos Villaseca	COO Retail	Mr Villaseca joined Codere in 1999 as chief of operations in the Bingo Division (Spain). From 2004 to 2007 he served as CEO of Codere Argentina and in 2008 began his career in Mexico as COO and later on as COO of the North America (Mexico, Panama and Colombia) business unit. In 2019 he was appointed COO for the Group's retail business across all regions. Mr Villaseca started his career in auditing for Arthur Andersen.
Moshee Edree	COO Online	Mr Edree has over 15 years of senior management and investment expertise in the online marketing and internet development industry. His online gaming experience includes working for Netplay, Iglobal media (PartyGaming Plc subsidiary) and Playtech. He is responsible for strengthening the current online structure, incorporating new specialized talent in the management of the online betting and casino business.
Alejandro Pascual	COO Europe	Mr Pascual has been Europe's regional manager since March 2019, having been COO of Europe since November 2014. From 2010 to 2014, he was COO of the Italian business. Previously he was chief operations manager for the Italian AWP and Network Business Unit (2006 to 2010), CFO at Codere Spain (2002 to 2006) and administrative and management control director (2000 to 2002). Before joining Codere, he was director of financial and administrative management at Unión Española de Explosivos (1997 to 2000) and manager at Arthur Andersen (1989 to 1997).
Bernardo Chena	COO South America	Bernardo Chena is the regional manager for markets in Central and South America, in charge of institutional relations and business development in the region. Mr Chena has been COO of South America (Argentina and Uruguay) since 2018, having previously been country manager and executive VP for Argentina since May 2013. Previously he was COO of Codere Panama from December 2011. He joined the group in 2005 and has occupied the positions of CFO of its operations in Panama and Colombia and the position of internal audit manager for Codere America. Before joining the Group, he worked as senior manager in the audit and business adviser branch at Deloitte and Arthur Andersen.
Rodrigo González Calvillo	Regional Manager Mexico	Mr González Calvillo has been the country manager of Codere México since February 2012 and is co-founder and member of the board of Corporacion Interamericana de Entretenimiento (CIE), leader in the out-of-home entertainment industry in Latin America, where he served as MD from 2000 to 2008. Mr Calvillo is also a co-founder of Ticketmaster México and served as MD from 1990 until 1995. He also served as an independent board member of the Mexican Stock Exchange from 2000 to 2005, and board member of Mas Radio Telecomunicaciones and OCESA, the partnership company between CIE and Televisa Entretenimiento.
Norman Sorensen	Chairman of the board	Norman Raul Sorensen has been a member of the board of directors of Codere since April 28, 2016, and chairman since January 2018. He is also a director of Insperity and Encore Capital Group. Previously, he has held positions at Principal International, American International Group and Citigroup. Mr Sorensen Valdez serves as chairman of the audit committee and is a member of the appointments, remuneration and corporate governance committees.

Source: Codere

Sensitivities

Macroeconomic changes: in addition to the risk that negative economic conditions could lower consumer spending, Codere has been particularly affected by fluctuations in currency (see below) and inflation in its core Latin American markets, especially Argentina.

FX risk: Codere is heavily exposed to currency risk, given that its reporting currency is euros, while the majority of business (Latin American subsidiaries) trade in other currencies. During FY18, for example, the Argentine peso devalued by c 75%. We note that the Latin American subsidiaries generally operate in their local currency, providing a natural hedge against foreign currency fluctuations, although there are some costs in US dollars (European and US manufactured machines for example). The company has no FX forward contracts in place and does not hedge any of Latin American currencies.

Gaming regulation and increased taxes: the gaming sector is subject to significant taxation and Codere has experienced a series of tax increases, with the most recent examples being in Argentina and Italy. There is also a risk that governments change the minimum pay-out ratios on the machines or decrease the allowed installed capacity (as in Italy).

Licence renewals: Codere's business is dependent on the granting and timely renewal of the necessary gaming licences. Each region and country has different sanctioning regimes that Codere needs to abide by.

Substantial investment required: to maintain its competitive position, substantial yearly capex is spent on renewing and buying new slot machines, as well as for consolidating the market. This limits Codere's ability to generate net cash flow, which might otherwise be used to reduce leverage. In FY18, maintenance capex of €82m and growth capex of €81m together comprised 11.1% of sales and (in line with guidance) we forecast €95m of total capex in FY19 and FY20 (6% of sales).

High net debt, with €500m/ $300m senior notes due in 2021: at the end of FY18, Codere reported net debt of €781.6m, which equates to a net debt/adjusted EBITDA of 2.9x. Including the impact of IFRS 16, net debt/LTM EBITDA was 3.1x at Q119. This is well within banking covenants and Codere has sufficient funds to service the debt. We expect the company to deliver net cash flow in FY19 but believe future net cash flow is insufficient to pay down debt. We therefore expect the company to refinance these notes in the near term. Furthermore, licence renewals are due in Argentina and Italy in 2021–24 (c €80m).

Litigation: following the financial restructuring and removal of the founding family from management and chair of the board, the Sampedro family has initiated proceedings against the other shareholders and board members. To date, the proceedings have not been successful, but there is another hearing later in 2019 that could result in a different outcome. The company has guided to €10m litigation costs in FY19.

Shareholder structure is very complex: as discussed above, the shareholder structure and agreement are very complex and include share transfer restrictions for shares trading OTC. This naturally limits trading flow but could be resolved by a €200m placing and give mechanisms for debt funds to exit (which also brings the complications of a potential large share overhang).

Valuation: Discount to peers and DCF

Peer group valuation: 42% discount to peers for FY20

Codere's stock is up 8% in the year to date, but still languishing at c 85% below its pre-restructuring highs in 2015. As a result of the restrictive shareholder agreement, the stock is highly illiquid and most shares trade OTC (often at a different price to the listed shares). However, for our analysis we are looking at the listed share price. For FY20e, Codere trades at 3.9x EV/EBITDA and 7.4 P/E.

In our view, catalysts for a re-rating include stabilisation in Argentine revenues, growth in Mexico, a successful refinancing of 2021 senior notes, as well as a potential IPO; a €200m placing would remove key shareholder restrictions (although there is a commensurate risk of share overhang, given the credit fund shareholding).

The most straightforward way to value the stock is via a peer group comparison and Exhibit 14 compares it to many of the listed gaming operators with a retail presence. The limited free float and complicated shareholder agreement have clearly impacted the valuation and Codere trades at the bottom of the range, at a c 42% discount to the peer group average on FY20e EV/EBITDA and P/E.

Exhibit 14: Peer group valuation

Name	Quoted currency	Market cap (m)	EV/EBITDA FY19	EV/EBITDA FY20	P/E FY19	P/E FY20	Dividend yield FY19
Boyd Gaming	US$	3,032	8.3	8.0	15.5	13.5	0.9
Codere	**€**	**417**	**4.2**	**3.9**	**11.0**	**7.4**	**N/A**
Eldorado Resorts	US$	3,607	10.2	9.6	21.5	17.6	N/A
Flutter Entertainment (PPB)	GBp	5,501	15.5	13.7	22.5	19.8	2.7
Gamenet	€	252	4.6	4.1	7.6	5.2	8.4
GVC Holdings	GBp	3,574	8.4	7.2	10.4	8.3	5.8
OPAP	€	3,117	8.7	8.0	16.4	14.6	7.7
Playtech	GBp	1,418	4.5	4.2	9.2	8.2	4.9
Rank Group	GBp	615	5.1	4.9	10.6	10.0	4.9
Red Rock Resorts	US$	2,678	10.6	9.4	19.3	12.6	1.7
William Hill	GBp	1,442	7.2	6.4	16.1	12.2	5.3
Mean			**7.9**	**7.2**	**14.6**	**11.8**	**4.7**

Source: Refinitiv, Edison Investment Research. Note: Priced at 17 July 2019. Includes IFRS 16 adjustments.

DCF: Core valuation is c 130% higher than current share price

We have also performed a DCF with a terminal growth rate of 2% and a terminal (pre-IFRS 16) EBITDA margin of 18%, vs 19% in FY18. We assume a terminal capex/revenue ratio of 6% and an effective tax rate (to EBITDA) of 25%. Using a WACC of 9% produces a value per share of €8.0. Our core forecasts assume no major unforeseen FX moves (as witnessed in Argentina in FY18) and no major additional gaming taxes. If we flex the WACC to 10.0% to account for a higher risk profile, our DCF would be €6.2 per share, which is approximately 75% above the current share price.

Our core €8.0 per share DCF valuation is c 130% higher than the current share price and equates to 5.2x EV/EBITDA and 16.8x P/E for FY20e, which is still lower than the peers on an EV/EBITDA basis.

Exhibit 15: DCF sensitivity table (€/share)

		Terminal growth rate				
		1.0%	**1.5%**	**2.0%**	**2.5%**	**3.0%**
WACC	**11.50%**	3.8	4.0	4.2	4.4	4.7
	11.00%	4.3	4.5	4.8	5.1	5.4
	10.50%	4.9	5.2	5.5	5.8	6.2
	10.00%	5.5	5.9	6.2	6.6	7.1
	9.50%	6.3	6.6	7.0	7.5	8.1
	9.00%	7.1	7.5	8.0	8.6	9.2
	8.50%	8.0	8.5	9.1	9.8	10.6
	8.00%	9.1	9.7	10.4	11.3	12.3
	7.50%	10.3	11.0	11.9	13.0	14.4
	7.00%	11.7	12.6	13.8	15.2	16.9

Source: Edison Investment Research

Financials

Income statement

Revenues: FY18 affected by Argentine peso devaluation

FY18 revenues declined 9.9% vs FY17 to €1,476.4m. This was driven by a 30% decline in Argentine revenues, due to the depreciation of Argentine peso against the euro, which was partially offset by a 17% revenue increase in Spain. In constant currency, revenues were up 9.3% vs the prior year. The impact of the Argentine peso is reflected in our FY19 figures and we forecast flat revenues in FY19, at €1,477.4m. Thereafter, we are forecasting 9.0% growth in FY20 and 8.5% in FY21, particularly driven by Mexico and Spain, as well as a return to normal conditions in Argentina.

Adjusted EBITDA: Cost controls offset the impact of rising taxes and FX

Despite the increase in taxes and FX headwinds in Argentina, FY18 EBITDA increased 3.4% to €282.9m (in line with guidance of €280–285m). The improvement was largely due to performance initiatives across the business; management delivered €49.4m of cost and growth efficiencies in FY18 and expects a further €41–46m in FY19.

In FY19 the trends will be similar, with cost controls offsetting rising taxes and FX headwinds. Our FY19 EBITDA forecast is €361.9m, which is positively affected by c €80m in IFRS 16 adjustments (lower operating costs). Note that the adjusted EBITDA also excludes €12m of exceptional online marketing costs in Mexico. This is in line with company guidance of adjusted EBITDA of €280–290m (pre IFRS 16 adjustments).

We summarise our forecast assumptions in Exhibit 16 below; please see the individual country sections for more details on revenue and EBITDA dynamics.

Mexico: 8% revenue growth, one-off €10–15m marketing costs in FY19

Underlying revenue growth in the Mexican market has historically been around 3%, but we believe this will rise significantly due to ongoing investment and the openings of new halls. For FY19 and FY20, we forecast a c 8% revenue increase to €355.5m and €383.9m, respectively. Management is focusing on cost containment and we forecast a continued strong EBITDA margin of c 45% (note that this now includes an estimated c €38m positive contribution due to IFRS 16 adjustments). For FY19, we forecast additional marketing costs of €12m, but this is included as a non-recurring item.

Argentina: Peso devaluation and tax increases

Given the impact of the devaluation of the peso, we forecast an absolute decline in revenues of 20% in FY19, before returning to 15% growth in FY20 and FY21. This increase is similar to trends from previous periods that followed significant currency devaluations (specifically after 2001), although our forecast revenue of €431.2m in FY21 is still considerably lower than €582.4m revenues achieved in FY17. The impact of the tax increase is estimated at around €10m annually and, together with continued cost controls, we forecast an FY19 EBITDA of €73.6m, rising to €91.0m in FY20. IFRS 16 positively affects EBITDA by an estimated c €7m.

Italy: Stringent gaming regulation affects EBITDA by €10m

Despite the capacity reductions in Italy in FY18, Codere successfully managed to optimise its portfolio with the result that revenues remained flat. Similar to trends in Q119, we forecast a modest 1.4% revenue growth for FY19 and 2% thereafter. This will be accompanied by steadily rising taxes (as detailed above). Codere has guided to a c €10m reduction in EBITDA, as mitigation will offset some of the increase in taxes. We forecast FY19 EBITDA of €28.6m, which includes a positive estimated impact of c €9m from IFRS 16 adjustments.

Spain: Sports betting to drive growth; online reported separately from FY19

With the increased momentum in sports betting and online, FY18 revenue increased by 17% to €220.0m. From FY19, online will no longer be reported within the Spanish division and we forecast Spanish revenues of €208.0m in FY19. Thereafter, we forecast 15% revenue growth in FY20 and FY21 as investment in the sports betting shops steadily translates to revenue. Our EBITDA forecast goes from €26.4m (12% margin) in FY18 to €49.6m (23.8% margin) in FY19, as the lower margin online is excluded and IFRS 16 contributes an estimated c €8m.

Other: Including online from FY19 onwards

In FY18, other operations were affected by FX and by the closure of underperforming halls, and revenues declined by 4.3% to €183.8m. In line with Q119 trends, our FY19 forecasts assume an

8.1% decline in Panama revenues and a 4% decline in Colombia revenues, offset by a 10.6% increase in Uruguay revenues. Following the closure of underperforming halls in Panama and Colombia, we forecast a return to low single-digit growth in those regions for FY20.

For online, we forecast revenues of €64.2m in FY19 and €73.9m in in FY20, as Codere begins to gain traction in Mexico and Spain in particular. We believe these figures are reasonably conservative and suspect there be upside.

Altogether for other operations, we forecast FY19 revenue growth of 34.1% (which importantly now includes online). Online margins were only 8% in Q119 but, given the cost containments across all geographies and an estimated c €17m increase from IFRS 16 adjustments, our total EBITDA margin for other operations goes from 21.7% in FY18 to 24.7% in FY19.

We include a summary table of the country revenue and EBITDA mix here:

Exhibit 16: Geographic revenue and EBITDA split (€m)

Revenue	2014	2015	2016	2017	2018	2019e*	2020e*	2021e*
Mexico	341.9	355.3	329.8	339.9	328.3	355.5	383.9	406.9
growth		3.9%	-7.2%	3.1%	-3.4%	8.3%	8.0%	6.0%
Argentina	489.0	681.8	534.5	582.4	407.7	326.1	375.0	431.2
growth		39.4%	-21.6%	9.0%	-30.0%	-20.0%	15.0%	15.0%
Spain	149.9	155.9	170.2	188.0	220.0	208.0	239.2	275.1
growth		4.0%	9.2%	10.5%	17.0%	-5.4%	15.0%	15.0%
Italy	263.8	284.2	321.5	335.8	336.5	341.4	348.2	355.2
growth		7.7%	13.1%	4.4%	0.2%	1.4%	2.0%	2.0%
Others	141.0	162.3	189.8	192.1	183.8	246.5	263.6	278.7
growth		15.1%	16.9%	1.2%	-4.3%	34.1%	6.9%	5.7%
Total	**1,385.6**	**1,639.5**	**1,545.8**	**1,638.2**	**1,476.4**	**1,477.4**	**1,609.9**	**1,747.1**
growth		18.3%	-5.7%	6.0%	-9.9%	0.1%	9.0%	8.5%
EBITDA	**2014**	**2015**	**2016**	**2017**	**2018**	**2019e**	**2020e**	**2021e**
Mexico	75.1	91.5	88.5	92.9	105.9	162.2	169.6	181.4
margin	22.0%	25.8%	26.8%	27.3%	32.3%	45.6%	44.2%	44.6%
Argentina	93.4	146.1	131.0	134.2	96.1	73.6	91.0	112.1
margin	19.1%	21.4%	24.5%	23.0%	23.6%	22.6%	24.3%	26.0%
Spain	17.6	24.6	29.5	25.1	26.4	49.6	60.7	75.9
margin	11.7%	15.8%	17.3%	13.4%	12.0%	23.8%	25.4%	27.6%
Italy	29.4	26.7	26.4	23.6	27.6	28.6	28.6	30.7
margin	11.1%	9.4%	8.2%	7.0%	8.2%	8.4%	8.2%	8.6%
Others	18.9	14.2	23.1	28.2	39.9	60.9	61.2	63.1
margin	13.4%	8.7%	12.2%	14.7%	21.7%	24.7%	23.2%	22.7%
Corporate costs	(21.2)	(23.0)	(30.9)	(30.4)	(13.0)	(13.0)	(14.5)	(15.5)
Total	**213.2**	**280.1**	**267.7**	**273.5**	**282.9**	**361.9**	**396.7**	**447.7**
margin	15.4%	17.1%	17.3%	16.7%	19.2%	24.5%	24.6%	25.6%

Source: Codere, Edison Investment Research. Note: *Includes IFRS 16 adjustments.

Group expenses

As discussed above, Codere has been facing FX headwinds (particularly in Argentina) and rising taxes in both Argentina and Italy. However, these are expected to be offset by a continued cost-savings programme, with management guiding to €41–46m cost efficiencies for FY19.

Codere’s financial statements are complex and we highlight some of the key income statement items below:

- **Gaming and other taxes**: in FY18 gaming and other taxes were €528.1m, or 35.8% of total revenues. This compares to 36.4% in FY17, with the decline being due to lower absolute taxes from Argentina (due to FX). For FY19, we forecast a total gaming tax rate of 36%.
- **Depreciation and amortisation:** D&A for FY18 was €113.9m, which was flat vs FY17. Largely due to IFRS 16 adjustments, our D&A forecast increases to €164.0m in FY19.
- **Rental costs**: total machine and other rental costs were €110.4m in FY18, which compares to €125.1m in FY17. The decline was due to continued cost containment, portfolio optimisation

and the purchase of machines (rather than rentals). With the implementation of IFRS 16, a large portion of this figure (c €80m) is now capitalised and our rentals forecast for FY19 is €31.1m.

- **Other operating expenses**: as part of the continuing cost-reduction programme (as well as FX in Argentina), personnel costs declined from €298m in FY17 to €252m in FY18 and we forecast Codere to continue focusing on personnel cuts. Total marketing costs were €45.6m in FY18 or 3.1% of revenues. Aside from the additional c €10–15m marketing spend for online expansion in Mexico, we expect this to rise steadily to c 5% of revenues, as online becomes more significant. Note that the pure online companies typically spend 25–30% of revenues on marketing, but clearly do not have many of the retail investment costs.
- **Tax:** Codere's tax position is highly complex, due to M&A, corporate reorganisations, financing structure and international operations. In FY18, the tax provision decreased by €25.8m to €38.4m, primarily due to the devaluation of the Argentine peso together with the positive €7.7m in deferred taxes (non-recurring), which was a result of applying the new regulation in Argentina that allows the revaluation of assets for corporate income tax purposes. The company has guided to a total tax cost of €40m in FY19.
- **Non-controlling interests:** minority interests of €6.8m largely relate to Codere's 85% owned ICELA subsidiary. In the absence of detailed information on ICELA, we assume a similar level going forward.
- **Non-recurring items** in 2018 were €42.7m, which was largely due to the changes in the company leadership in January 2018 and to the operational efficiencies deployed by the new leadership. The breakdown was €13.0m management transition, €19.4m operational and personnel restructuring, €3.5m tax contingencies and €6.8m other. For FY19, the company has guided to non-recurring costs of €25m (€10m for litigation, €10m for restructuring and €5m other) and a further €10–15m in exceptional marketing costs in Mexico. Thereafter we are assuming c €10m per year.

Inflation adjusted accounting and asset revaluation

Given that inflation in Argentina reached more than 100% cumulatively over the last three years, the company started to apply IAS 29 (inflation accounting) in Q318. For FY18, Codere provided the impact of this accounting in four line items:

- Operating profit was affected negatively by €19.5m: €12.2m on EBITDA and €7.3m on other opex.
- Interest income was affected by €1.3m.
- €7.7m lower tax due to the impact on the revaluation of assets for tax purposes.
- An €87.6m increase in shareholders' equity as assets were revalued.

Cash flow statement

Operating cash flow increased 9.1% to €182.8m in FY18, with the decrease in EBITDA fully offset by lower working capital and a decrease in cash tax paid. We summarise some of the key points here, which notably include capex.

Interest expense

In FY18, the cash interest expense was €68.8m: €53.3m for the senior notes, €13.8m for the OpCo debt (including capital leases) and €1.7m for the credit facility. Our cash interest forecast of €67m for FY19 excludes the non-cash IFRS interest expense on the P&L (c €45m annually).

Deferred payments: To affect FY19 and FY20

In FY18, deferred payments increased by €48.2m, consisting of a €2m decrease in authorised deferred gaming taxes in Spain and an increase in deferred payments with capex suppliers of €50.2m, mainly in Mexico and Panama (associated with new supplier financing deals on acquired slot products previously leased). We forecast an associated cash outflow of €20m in FY19, €25m in FY20 and €5m in FY21.

Capex

FY18 capex amounted to €163.4m, of which €82.1m was for maintenance and €81.3m for growth.

- **Growth capex** relates to the expansion of the business, for example obtaining new licences, increasing the number of gaming machines, increasing the number of bingo seats or otherwise expanding the business. For 2018, growth capex was €81.3m (vs €64.2m in 2017), including €51.4m for acquisitions, of which c €39m was incurred in new product agreements mostly in Mexico and Panama.
- **Maintenance capex** relates to maintaining the current capacity, including licence renewals. Maintenance capex in FY18 was €82.1m, due mainly to investment in Mexico of €25.2m (slot renewals and hall refurbishments, €21m in Spain (higher commercial capex offsetting lower product renewals in retail AWP) and €13m in Argentina (slot renewals, halls and casino management) and a €7.6m investment in Uruguay.

Exhibit 17 shows the capex profile, split between maintenance and growth. Codere has guided to c €100m for FY19, roughly split between €20–25m growth and €75–80m maintenance. We forecast a total of €95m and note that the lower capex spend in FY19 will enable the company to achieve its goal of turning net cash flow positive.

Exhibit 17: Capex (€m)

Maintenance capex	2015	2016	2017	2018
Argentina	3.5	7.1	7.4	13.0
Mexico	12.4	21.1	28.9	25.2
Panama	3.2	4.8	13.9	3.2
Colombia	3.3	2.8	1.9	2.1
Uruguay	0.1	9.1	5.2	7.6
Brazil	0.0	0.2	0.1	0.0
Italy	7.1	10.7	6.8	4.7
Spain	16.8	24.2	22.5	21
Other	0.6	0.4	0.4	5.3
Total maintenance capex	**47.0**	**80.4**	**87.1**	**82.1**
% of sales	2.9%	5.2%	5.3%	5.6%
Growth capex				
Argentina	6.5	2.0	0.0	1.9
Mexico	2.1	1.3	28.4	43.4
Panama	0.0	0.0	0.0	5.7
Colombia	0.0	0.6	2.5	2.2
Uruguay	1.2	31	0.0	0.0
Brazil	1.2	0.1	0.1	0.0
Italy	4.9	0.3	6.5	0.2
Spain	3.0	11.7	26.7	27.9
Total growth capex	**18.9**	**47.0**	**64.2**	**81.3**
% of sales			3.9%	5.5%
Total capex	**65.9**	**127.4**	**151.3**	**163.4**

Source: Codere

Balance sheet: Net debt/EBITDA of 3.1x

As we detail on pages 19–20, Codere successfully restructured its balance sheet in 2016 and at the end of FY18, it reported net debt of €781.6m vs €748.6m in FY17. Adjusting for IFRS 16, net debt was €1,120m at Q119, which includes €75.7m cash.

Debt profile: €500m/$300m senior notes due 2021

Codere reported total financial debt of €866.6m at Q119, of which €782.7m was from senior notes (from the 2016 refinancing), as well as €85.7m of debt at the operating company level. Including €309.3m of capitalised operating leases, total adjusted debt was €1.2bn at Q119.

As shown in Exhibit 18 below, this resulted in net debt of €810.9m (pre-IFRS), which leads to a net debt/adjusted EBITDA of 2.9x. Post IFRS 16 adjustments, the net debt/adjusted LTM EBITDA was 3.1x. This is comfortably within all its banking covenants and the credit agency ratings are B2 (Moody's) and B (S&P), both with a stable outlook, suggesting liquidity is regarded as adequate.

Codere expects to generate positive net cash in FY19, which is in line with our forecast of a €5.6m net cash flow in FY19. Assuming no major unforeseen FX changes, we forecast net debt of €1,093m in FY19 and €1,039m in FY20. In terms of cash balance, we assume that the company pays back a net amount of c €20–30m bank debt annually. Note that IFRS 16 has added c €309m to gross debt.

The senior notes are due in 2021 and there are sizeable licence renewals from Argentina and Italy in 2021–24 (c €80m). We therefore expect the company will look to refinance and/or seek an equity issuance before then.

Exhibit 18: Capitalisation (€m) and leverage ratios (x)

Capitalisation table	2018	Q119
Opco Debt	81.4	85.7
Opco Capital Leases	8.6	8.2
Super Senior Revolving Credit Facility	9.9	10.0
Senior Notes	763.5	782.7
Total Financial Debt	**863.4**	**886.6**
Capitalisation of Operating Leases	316.6	309.1
Total Adjusted Debt	1180.0	1195.7
Cash	81.8	75.7
Net Debt	**781.6**	**810.9**
Total adjusted net debt	**1098.2**	**1120.0**
LTM Adjusted EBITDA	282.9	283.0
LTM Adjusted EBITDA (post IFRS 16)	350.9	363.0
Pro-forma Interest Expense	59.9	61.8
Pro-forma Interest Expense (post IFRS 16)	96.9	111.3
Leverage		
Senior Financial Debt/LTM Adjusted EBITDA	0.4x	0.4x
Total Financial Debt/LTM Adjusted EBITDA	3.1x	3.1x
Total Adjusted Net Debt/LTM Adjusted EBITDA (post IFRS 16)	3.1x	3.1x
Total Net Financial Debt/LTM Adjusted EBITDA	**2.8x**	**2.9x**
including inflation accounting	*2.8x*	*2.9x*
Coverage		
LTM Adjusted EBITDA/)Pro-forma Interest Expense	**4.7x**	**4.6x**
including inflation accounting	*4.7x*	*4.6x*

Source: Codere

IFRS 16 adjustments: A summary of changes

Codere is implementing IFRS 16 accounting for operating leases in 2019. The application of IFRS 16 has a significant impact on its financial statements, as it requires that operating leases (except short-term leases and those related to low-value assets) be capitalised to the balance sheet and expensed (as D&A and interest expense) over the term of the lease.

For Q119, Codere provided a breakdown of the IFRS 16 impact and we have annualised this for FY19 as follows: lower operating expenses of c €80m; higher D&A of €40m; higher financial expense of €45m; an increase of €309m on assets and liabilities (capitalisation of operating leases); and lower corporate income tax of €4.5m.

Altogether, our FY19 EBITDA therefore increases by c €80m and total gross debt is €309m higher.

Exhibit 19: Financial summary

€m	2015	2016	2017	2018	2019e*	2020e*	2021e*
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue	1,639.5	1,545.8	1,638.2	1,476.4	1,477.4	1,609.9	1,747.1
Cost of Sales	(621.7)	(599.3)	(651.8)	(580.9)	(583.2)	(648.5)	(706.2)
Gross Profit	1,017.8	946.5	986.4	895.5	894.2	961.4	1,040.9
Adjusted EBITDA	280.1	267.7	273.5	282.9	361.9	396.7	447.7
Normalised operating profit	158.1	159.7	160.5	169.0	197.9	229.7	277.7
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	(33.6)	(51.5)	(29.4)	(72.2)	(41.2)	(10.0)	(10.0)
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	124.5	108.2	131.1	96.9	156.7	219.7	267.7
Net Interest	(131.7)	(128.5)	(64.2)	(67.2)	(111.8)	(113.1)	(108.0)
Joint ventures & associates (post tax)	2.7	(0.2)	(0.1)	(0.1)	(0.4)	(0.4)	(0.5)
Exceptionals	(71.7)	(1,095.9)	17.2	(32.7)	(18.7)	0.0	0.0
Profit Before Tax (norm)	29.1	31.0	96.2	101.7	85.7	116.2	169.3
Profit Before Tax (reported)	(76.2)	(1,116.4)	83.9	(3.1)	25.8	106.2	159.3
Reported tax	(63.2)	(36.5)	(64.2)	(30.4)	(40.0)	(51.1)	(58.1)
Profit After Tax (norm)	(34.1)	(5.5)	32.0	63.3	45.7	65.2	111.2
Profit After Tax (reported)	(139.4)	(1,152.9)	19.8	(33.6)	(14.2)	55.2	101.2
Minority interests	26.3	31.2	(17.0)	(6.8)	(7.8)	(8.8)	(9.8)
Net income (normalised)	(7.8)	25.7	15.0	56.5	37.9	56.4	101.4
Net income (reported)	(113.1)	(1,121.7)	2.8	(40.4)	(22.0)	46.4	91.4
Basic average number of shares outstanding (m)	55	1,879	2,254	119	119	119	119
EPS - basic normalised (€)	(0.14)	0.01	0.01	0.48	0.32	0.48	0.86
EPS - diluted normalised (€)	(0.14)	0.01	0.01	0.48	0.32	0.48	0.86
EPS - basic reported (€)	(2.07)	(0.60)	0.00	(0.34)	(0.19)	0.39	0.77
Dividend (€)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Revenue growth (%)	18.3	(-5.7)	6.0	(-9.9)	0.1	9.0	8.5
Gross Margin (%)	62.1	61.2	60.2	60.7	60.5	59.7	59.6
Adjusted EBITDA Margin (%)	17.1	17.3	16.7	19.2	24.5	24.6	25.6
Normalised Operating Margin	9.6	10.3	9.8	11.4	13.4	14.3	15.9
BALANCE SHEET							
Fixed Assets	1,069.9	1,051.4	988.8	1,137.1	1,382.4	1,310.4	1,244.4
Intangible Assets	606.9	566.8	528.2	613.1	601.0	590.0	580.8
Tangible Assets	385.0	414.4	388.9	453.6	711.0	650.0	593.2
Investments & other	77.9	70.2	71.8	70.4	70.4	70.4	70.4
Current Assets	371.2	428.1	346.8	307.5	307.3	325.8	383.5
Stocks	11.6	11.4	10.0	10.9	11.0	11.0	11.0
Debtors and taxes receivable	188.4	209.3	178.3	163.6	165.9	160.9	155.9
Cash & cash equivalents	110.3	142.1	104.5	81.8	74.4	97.9	160.6
Other	60.9	65.3	54.0	51.2	56.0	56.0	56.0
Current Liabilities	(1,807.3)	(408.7)	(384.2)	(388.4)	(410.0)	(385.0)	(380.0)
Creditors	(338.5)	(160.2)	(158.4)	(169.6)	(149.6)	(124.6)	(119.6)
Tax and social security	(35.6)	(198.7)	(158.7)	(147.9)	(147.9)	(147.9)	(147.9)
Short term borrowings	(1,423.7)	(40.0)	(58.0)	(60.4)	(102.0)	(102.0)	(102.0)
Other	(9.4)	(9.8)	(9.1)	(10.5)	(10.5)	(10.5)	(10.5)
Long Term Liabilities	(249.6)	(997.1)	(946.5)	(964.0)	(1,226.0)	(1,196.0)	(1,146.0)
Long term borrowings	(76.4)	(840.1)	(795.1)	(803.1)	(1,065.1)	(1,035.1)	(985.1)
Other long term liabilities	(173.2)	(157.0)	(151.4)	(160.9)	(160.9)	(160.9)	(160.9)
Net Assets	(615.8)	73.7	5.0	92.2	53.7	55.2	101.9
Minority interests	6.3	24.8	(83.8)	(83.4)	(85.0)	(85.0)	(85.0)
Shareholders' equity	(609.5)	98.5	(78.8)	8.8	(31.3)	(29.8)	16.9
CASH FLOW							
Op Cash Flow before WC and tax	280.1	267.7	273.5	282.9	361.9	396.7	447.7
Working capital	(8.3)	18.9	(13.8)	(4.8)	(25.0)	(30.0)	(10.0)
Exceptional & other (incl IFRS 16 adjustments)	(21.8)	(59.6)	(21.3)	(43.5)	(121.2)	(90.0)	(90.0)
Tax	(43.2)	(48.8)	(70.9)	(51.8)	(40.0)	(51.1)	(58.1)
Net operating cash flow	206.8	178.2	167.5	182.8	175.7	225.7	289.6
Maintenance capex	(47.0)	(80.4)	(87.1)	(82.1)	(75.0)	(75.0)	(75.0)
Growth capex inc acquisitions	(18.9)	(47.0)	(61.6)	(81.2)	(20.0)	(20.0)	(29.0)
Net interest	(31.0)	(77.8)	(67.7)	(67.1)	(66.8)	(68.1)	(63.0)
Equity financing	0.1	0.0	2.1	(0.4)	0.0	0.0	0.0
Dividends	(2.4)	(4.6)	(5.8)	(7.5)	(8.3)	(9.1)	(10.0)
Other	(47.2)	(21.6)	14.4	46.2	0.0	0.0	0.0
Net Cash Flow	60.4	(53.2)	(38.2)	(9.3)	5.6	53.5	112.7
Opening net debt/(cash)	1,305.5	1,389.8	738.1	748.6	781.6	1,092.6	1,039.0
FX (cash balance)	(8.9)	0.0	(10.3)	(8.3)	0.0	0.0	0.0
Other non-cash movements (inc equity swap, FX on debt)	(135.8)	704.9	37.9	(15.4)	(316.6)	0.0	0.0
Closing net debt/(cash)	1,389.8	738.1	748.6	781.6	1,092.6	1,039.0	926.4

Source: Codere accounts, Edison Investment Research. Note: A share consolidation in 2018 reduced the outstanding number of shares from 2,254m to 119m. *Includes IFRS 16 adjustments from FY19.

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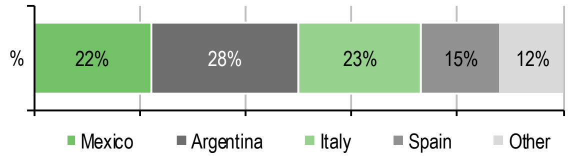
Revenue by geography 2018



Management team

CEO: Vicente Di Loreto

Vicente joined Codere in 2004 as CEO of Codere´s Argentinian operation, which became the company's most important operation after the acquisition of Grupo Royal in 2005. He was then COO for the Latin American operations and in 2011, he moved on to pursue an entrepreneurial project founding gaming consulting company G3M Partners. In January 2018, Vicente joined Codere again as CEO. An Argentina native, he holds an MBA and completed the general management program from Harvard Business School.

CFO: Ángel Corzo

Ángel Corzo has been CFO of Codere since July 2013. He was previously a director in the office of the chairman from 2012 to 2013, and controller of Codere from 2007 to 2012. Mr Corzo joined the group in 2005 as a Monitor Group consultant, where he helped launch of the Italian AWP business. Prior to joining Codere, he acted as manager of the Monitor Group from 2000 to 2006. He holds a degree in aeronautical engineering from the Universidad Politécnica de Madrid and a master's in strategic management from HEC in Paris.

Chairman of the board: Norman Sorensen

Norman Raul Sorensen Valdez has been a member of the board of directors of Codere since 28 April 2016, and chairman since January 2018. He is a director of Insperity and Encore Capital Group. Previously he has held positions at Principal International, American International Group and Citigroup. He received a bachelor's degree in chemistry from the US Air Force Academy in 1971 and a Certificate from Columbia University's Executive Program for International Managers in 1980. Mr Sorensen Valdez serves as chairman of the audit committee and is also a member of the appointments, remuneration and corporate governance committee.

COO Retail: Carlos Villaseca

In 2019, Mr Villaseca was appointed as COO for the group's retail operations across all regions. He joined Codere in 1999 as chief of operations in the Bingo Division (Spain). From 2004 to 2007 he served as CEO of Codere Argentina and in 2008 began his career in Mexico as chief operating officer and is now COO of the North America (Mexico, Panama and Colombia) business unit. Mr Villaseca started his career in auditing for Arthur Andersen.

Principal shareholders (from Codere FY18 annual accounts)	(%)
Silver Point Capital Management	23.2
Martinez Sampedro Family	15.8
M&G Investment Management	21.0
Abrams Capital Management	8.7
Contrarian Capital Management	7.2
Evermore Global Advisors	5.2
Alden Global Capital	3.8

Companies named in this report

Boyd Gaming, Eldorado Resorts, Flutter Entertainment, Gamenet, GVC Holdings, OPAP, Playtech, Rank Group, Red Rock Resorts, William Hill

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