Rank Group

FY results

Digital growth offsets Venues decline

Travel & leisure

Rank Group's FY17 results highlighted the growth potential of its Digital division. Online revenue grew 15.3%, with an impressive operating margin of 20.4% (vs our 14.2% estimate). By contrast, Venues were slightly light, with like-for-like revenues declining by 0.7%, due to fewer customer visits and tighter due diligence. However, Venues' KPIs have improved in H2 over H1 and FY18 has started well. Our headline revenue forecasts are broadly unchanged, although we have lowered our FY18 operating profit by 2.2%, as result of higher employment costs in Mecca. We continue to anticipate a move into net cash in FY18, underpinning Rank's progressive dividend policy. Trading multiples are attractive, with CY18e EV/EBITDA of 6.8x, P/E of 13.7x and free cash flow yield of 8.8%.

Year end	Revenue* (£m)	EBITDA** (£m)	PBT** (£m)	EPS** (p)	DPS (p)	P/E (x)	Yield (%)
06/15	738.3	126.3	74.1	14.6	5.6	15.7	2.4
06/16	753.0	128.2	77.4	15.4	6.5	14.9	2.8
06/17	755.1	128.8	79.3	16.3	7.3	14.1	3.2
06/18e	785.4	131.1	79.6	16.1	8.1	14.3	3.5
06/19e	816.4	137.7	86.7	17.5	8.8	13.1	3.8

Note: *Revenue is before customer incentives. **Normalised, excluding amortisation of acquired intangibles, one-off and exceptional items.

FY17 results: Impressive H217 digital margins

Rank's FY17 revenues were flat at £755.1m (vs our £764.0m), with an operating profit of £83.5m (vs our £80.0m). The key positive was a 15.3% growth in UK Digital revenues, driven by a 43.9% growth in grosvenorcasinos.com. UK Digital operating margins grew from 14.4% to 20.4% (vs our 14.2%), due to an impressive H217 margin of 26.1%. Offsetting digital performance, Venues posted a 0.7% decline in like-for-like revenues, as a result of a 5% and 9% decline in customer visits for Grosvenor and Mecca. However, Venues maintain market share, KPIs improved in H2 over H1 and management has stated that FY18 has started well.

Forecasts: Full impact of minimum wage in FY18

Our headline revenue forecasts remain broadly unchanged, with 4.0% growth in FY18 and FY19. We have adjusted our divisional operating profit forecasts to reflect stronger margins in Digital, further cost savings in Grosvenor Venues, and higher employment costs in Mecca, resulting in 10.6% margin in FY18 (vs 10.8%) and 11.0% in FY19 (vs 11.2%). Our figures suggest that Digital revenues should grow from 14.8% of revenues in FY17 to 18.9% in FY19, contributing 23.8% to operating profit (from 20.5% currently).

Valuation: Calendar 6.8x 2018e EV/EBITDA

Rank's calendar 2018e EV/EBITDA of 6.8x is meaningfully below the peer average. Although it is impacted by more retail challenges than its pure online peers, there is considerably more digital upside. From the current triennial review, Rank faces none of the fixed odds betting terminals (FOBT) risks and might even benefit if it is allowed more machines. An expected move into net cash by CY18 underpins a progressive dividend policy and provides the firepower for potential M&A.

11 September 2017

Price	**229.60p**
Market cap	**£897m**

Net debt (£m) at June 2017	12.4
Shares in issue	390.7m
Free float	29%
Code	RNK
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.1)	4.3	6.4
Rel (local)	0.0	5.1	(1.4)
52-week high/low		243.5p	186.8p

Business description

Rank Group is a gaming-based leisure and entertainment company. Its Grosvenor and Mecca brands are market leaders in UK multi-channel gaming and it also has operations in Spain and Belgium. In FY17 85% of revenues came from its venues and 15% from its digital operations.

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FY17 results and revised estimates

Results overview: Digital is the key positive

FY17 group revenue was flat at £755.1m, slightly lower than our £764.0m estimate. Divisionally, Grosvenor Venues revenue declined 2.7% to £397.2m (vs our £405.0m) and Mecca Venues declined by 3.6% to £213.6m (vs our £217.0m). Enracha revenues were in line with our estimates, at £32.8m. Total Venues like-for-like revenues declined by 0.7% to £642.5m.

The key positive in these results was the impressive performance in the online division. Digital revenues increased 15.3% to £111.5m (vs our £109m), driven by a 43.9% growth in grosvenorcasinos.com to £43.9m. Mecca Digital posted a 4.5% growth in H2, resulting in FY17 growth of 2.1% to £67.6m.

FY17 group operating profit of £83.5m (11.1% margin) was flat vs the prior year and 4.4% above our £80.0m estimate. A shortfall from Grosvenor Venues (£52.1m vs our £55.0m) was fully offset by Digital operating profit of £22.7m (vs our estimate of £15.5m). Notably, Digital operating margin in H217 was 26.1%.

Net debt of £12.4m was lower than our estimate of £23.0m, largely due to lower capex spend in the year (£42.7m vs our £50.0m). Management has guided to £50-55m capex for FY18 and we continue to estimate that the company will deliver net cash during FY18.

Rank has confirmed that trading into FY18 has started well, with encouraging progress in Grosvenor Venues. We anticipate that the key trends in FY18 will be ongoing momentum in Digital, a return to growth in Grosvenor Venues and the continuation of the numerous cost savings programmes. Mitigating the positive, however, we expect margin pressure from the inclusion of 'free play' in the point-of-consumption tax, as well as from rises in the minimum wage, which will have a particular impact on the Mecca division.

Grosvenor Venues (52.6% of revenues): Improving in FY18

Revenues declined by 1% on a like-for-like basis (reported down 2.7%), affected by a slightly below-average win margin. H217 revenues were £195.2m vs our £203.0m estimate. The full year gaming margin was 0.4% lower than the prior year across the entire estate and 6.9% lower for the major players. Tighter customer due diligence checks, venue closures and competitor openings contributed to a 5% decline in customer visits (to 7.73m).

London revenues declined from £150.3m to £140.1m, with an operating margin of 17.6%, and the provinces revenues were flat at £242.1m, with an operating profit margin of 10.7%. Although the market in London remains challenging, Grosvenor Casinos is maintaining market share and trading into FY18 has shown encouraging signs.

In terms of cost base restructuring, Rank is undergoing two separate projects within Grosvenor. Project One (standardisation of contracts) is complete in the provinces, and the major focus is now on London. Project Refocus concentrates on delayering management and aims to achieve a total £6m of savings. For further information, please refer to our capital markets day update note.

We have lowered our FY18 Grosvenor Venues revenue forecast from £409.0m to £403.0m, but have raised our FY18 operating profit estimate from £57.2m to £60.7m, to reflect the ongoing cost savings programme. Our FY19 revenue forecast goes from £417.0m to £410.8m, with an operating profit of £63.0m (vs £60.5m previously).

We do not expect Grosvenor to be affected by the government's current triennial review into stakes and prizes (now estimated for October 2017), but there is more upside than downside, since any restrictions on FOBT betting terminals in betting shops might help the casinos, as would an increase in the number of machines permitted in casinos (which Rank is pushing for and which could be a major positive).

Mecca Venues (28.3% of revenues): Cost pressures ahead

Mecca Venues revenue declined 3.6% to £213.6m vs our £217.0m estimate and like-for-like revenue was down 3% due to a 9% decline in customer visits. Offsetting the industry trend of declining customers, Rank is implementing robust cost control, as well as improved service and better upselling to increase spend per visit, which rose from £19.18 to £20.29.

Operating profit declined from £32.9m to £29.9m, 2.0% below our forecast of £30.5m. With the increase in minimum wage (from April 2017), we expect margins to be further affected going forward and, as a direct result, we have lowered our FY18 Mecca Venues operating profit from £30.0m to £24.0m. Our FY19 operating profit goes from £29.0m to £24.0m.

The first Luda site has now opened (August 2017) in Walsall, with a further two sites opening later this year. Depending on planning permission, management hopes to roll out 10 more sites during 2018. Luda.com will also be launched in FY18. Our forecasts assume that any contribution from Luda will offset the steady decline of the core Mecca customer base.

UK Digital (14.8% of revenues): Impressive margin growth

Grosvenorcasinos.com revenues increased by 43.9% to £43.9m (vs our £41.0m) and H217 revenue was 27.5% higher than H117. During the year, Rank has materially improved the product offering with the launch of its Kambi-powered sportsbook, live casino and an enhanced poker product. Only 3% of Grosvenor Venues' customers play at grosvenorcasinos.com and this is a key cross-sell opportunity. The launch of the single wallet for Grosvenor is still expected during the autumn and we have increased our FY18 grosvenorcasinos.com revenue forecast from £53.3m to £60.1m.

Meccabingo.com revenues increased 2.1% from £66.2m to £67.6m, in line with our estimate of £68.0m, with 4.5% growth in H217 vs H216. As highlighted at the capital markets day, the Bede platform is now performing robustly, with ARPU growth driven by improved platform capabilities and product offerings. Our FY18 meccabingo.com revenue forecast remains broadly unchanged at £72.2m.

The key positive from these results was the impressive operating profit in UK Digital, which increased from £13.9m to £22.7m (vs our £15.5m). This equates to a H2 operating margin of 26.1% and an FY17 operating margin of 20.4%. While these margins are still below many online peers, the improvement is indicative of the success of the divisional restructuring, as well as the benefits of scale.

Although we anticipate continued momentum as the business scales, the extension of the UK gaming duty to 'free play' (with enforcement still expected from 1 August 2017) will have an impact on margins in this division. Our forecasts conservatively include operating margins of 18.9% in FY18 and 19.0% in FY19.

Enracha (4.3% of revenues): Strong margins, helped by FX

Revenues of £32.8m were in line with our estimate of £33.0m, and represent a year-on-year growth of 22.8%. Divisional operating profit of £6.2m exceeded our forecast of £5.5m. We have raised our FY18 operating profit for Enracha from £6.0m to £6.4m, but have otherwise left our forecasts for this division unchanged.

Exhibit 1: Half-yearly results and estimates

Year to June £m	FY15	H116	H216	FY16	H117	H217	FY17	FY18e	FY19e
Grosvenor venues	401.1	205.1	203.0	408.1	202.0	195.2	397.2	403.0	410.8
Mecca venues	224.4	109.8	111.7	221.5	108.0	105.6	213.6	214.0	213.0
grosvenorcasinos.com	22.3	13.9	16.6	30.5	19.3	24.6	43.9	60.1	78.2
meccabingo.com	65.2	33.2	33.0	66.2	33.1	34.5	67.6	72.2	75.8
Digital	87.5	47.1	49.6	96.7	52.4	59.1	111.5	132.4	154.0
Enracha	25.3	12.2	14.5	26.7	16.2	16.6	32.8	36.0	38.6
Revenue*	**738.3**	**374.2**	**378.8**	**753.0**	**378.6**	**376.5**	**755.1**	**785.4**	**816.4**
Grosvenor venues	87.1	43.0	40.8	83.8	38.8	37.8	76.6	86.2	88.5
Mecca venues	41.6	20.8	21.9	42.7	19.2	22.6	41.8	35.0	35.0
Digital	20.2	10.1	8.7	18.8	10.1	17.7	27.8	31.0	35.2
Enracha	4.1	2.2	2.9	5.1	3.7	4.0	7.7	7.9	8.0
Central costs	(26.7)	(13.4)	(8.8)	(22.2)	(12.1)	(13.0)	(25.1)	(29.0)	(29.0)
EBITDA	**126.3**	**62.7**	**65.5**	**128.2**	**59.7**	**69.1**	**128.8**	**131.1**	**137.7**
EBITDA margin %	17.1%	16.8%	17.3%	17.0%	15.8%	18.4%	17.1%	16.7%	16.9%
Depreciation/amortisation	(42.3)	(22.3)	(23.5)	(45.8)	(23.1)	(22.2)	(45.3)	(48.0)	(48.0)
Grosvenor venues	63.4	30.9	30.0	60.9	26.1	26.0	52.1	60.7	63.0
Mecca venues	28.9	14.3	18.6	32.9	13.3	16.6	29.9	24.0	24.0
UK digital	17.2	8.0	5.9	13.9	7.3	15.4	22.7	25.0	29.2
Enracha	2.6	1.4	2.2	3.6	2.9	3.3	6.2	6.4	6.5
Central costs	(28.1)	(14.2)	(14.7)	(28.9)	(13.0)	(14.4)	(27.4)	(33.0)	(33.0)
Operating profit (norm)	**84.0**	**40.4**	**42.0**	**82.4**	**36.6**	**46.9**	**83.5**	**83.1**	**89.7**
Group margin	11.4%	10.8%	11.1%	10.9%	9.7%	12.5%	11.1%	10.6%	11.0%
Net interest	(9.9)	(3.0)	(2.0)	(5.0)	(2.1)	(2.1)	(4.2)	(3.5)	(3.0)
Profit before tax (norm)	**74.1**	**37.4**	**40.0**	**77.4**	**34.5**	**44.8**	**79.3**	**79.6**	**86.7**

Source: Rank Group accounts, Edison Investment Research. Note: *revenue is before customer incentives.

Changes to forecasts

- **Revenues:** our headline revenue forecasts remain largely unchanged, with FY18 revenues of £785.4m (vs £785.0m) and FY19 revenues of £816.4 (vs £813.0m). We have lowered our Grosvenor Venues FY18 and FY19 revenue forecasts by approximately 1% and we have raised our Digital revenues by 5.1% and 5.8% in FY18 and FY19 respectively. Our Mecca and Enracha revenue forecasts remain broadly unchanged.
- **Operating profit**: although we have increased our margin expectations for the Digital division from 14.6% to 18.9% in FY18, we expect further softening in the Mecca Venues division. This is largely due to the increase in the national wage. Altogether, we have lowered our group FY18 operating profit from £85.0m to £83.1m and our FY19 forecast goes from £91.0m to £89.7m.
- **Capex:** FY17 capex of £42.7m was below our forecast of £50m, with the shortfall to be rolled forward into FY18. We have raised our FY18 and FY19 capex estimates to £52m (from £48m and £46m respectively). This includes a c £3m expenditure on Luda sites.
- **Net debt**: the core business remains highly cash-generative. Net debt fell from £41.2m at FY16 to £12.4m in FY17, equating to 0.1x net debt/EBITDA. We continue to expect the group to be cash positive by the end of FY18, in the absence of any material acquisitions.
- **Dividends**: Rank has a progressive dividend policy, with dividends increasing from 6.5p to 7.3p (2.2x cover) and we forecast a 2.0x cover from FY18 onwards.

Exhibit 2: Changes to forecasts

Year end June	Revenue			PBT*			EPS*		
(£m)	Old	New	% change	Old	New	% change	Old	New	% change
2017	764.0	755.1	(1.2)	76.0	79.3	4.3	15.3	16.3	6.5
2018e	785.0	785.4	(0.1)	81.5	79.6	(2.3)	16.4	16.1	(1.8)
2019e	813.0	816.4	0.4	88.0	86.7	(1.5)	17.7	17.5	(1.1)

Source: Edison Investment Research. Note: *Normalised, excluding amortisation of acquired intangibles, one-off and exceptional items.

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Exhibit 3: Financial summary

£'m	2014	2015	2016	2017	2018e	2019e
June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	707.7	738.3	753.0	755.1	785.4	816.4
Cost of Sales	(409.2)	(414.2)	(418.8)	(439.3)	(449.9)	(463.4)
Gross Profit	298.5	324.1	334.2	315.8	335.5	353.0
EBITDA	116.0	126.3	128.2	128.8	131.1	137.7
Operating Profit (before amort. and except.)	72.4	84.0	82.4	83.5	83.1	89.7
Intangible Amortisation	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	(46.5)	2.1	9.3	1.0	0.0	0.0
Operating Profit	25.9	86.1	91.7	84.5	83.1	89.7
Net Interest	(9.9)	(9.9)	(5.0)	(4.2)	(3.5)	(3.0)
Other finance adjustments*	(1.6)	(1.7)	(1.1)	(0.6)	0.0	0.0
Profit Before Tax (norm)	62.5	74.1	77.4	79.3	79.6	86.7
Profit Before Tax (FRS 3)	14.4	74.5	85.6	79.7	79.6	86.7
Tax on norm PBT	(13.9)	(17.0)	(17.4)	(15.6)	(16.7)	(18.2)
Profit After Tax (norm)	48.6	57.1	60.0	63.7	62.9	68.5
Profit After Tax (FRS 3)	0.5	57.5	68.2	64.1	62.9	68.5
Average Number of Shares Outstanding (m)	390.7	390.7	390.7	390.7	390.7	390.7
EPS - normalised (p)	12.4	14.6	15.4	16.3	16.1	17.5
EPS - (IFRS) (p)	5.2	19.1	18.2	16.1	16.1	17.5
Dividend per share (p)	4.5	5.6	6.5	7.3	8.1	8.8
Gross Margin (%)	42.2	43.9	44.4	41.8	42.7	43.2
EBITDA Margin (%)	16.4	17.1	17.0	17.1	16.7	16.9
Operating Margin (before GW and except.) (%)	10.2	11.4	10.9	11.1	10.6	11.0
BALANCE SHEET						
Fixed Assets	613.3	607.2	614.1	606.0	611.4	615.4
Intangible Assets	390.2	395.7	404.3	411.5	412.5	413.5
Tangible Assets	217.5	204.0	202.0	187.9	190.9	193.9
Deferred tax/other	5.6	7.5	7.8	6.6	8.0	8.0
Current Assets	87.9	123.4	100.5	107.4	106.7	106.6
Stocks	3.1	2.8	2.9	2.8	3.2	3.4
Debtors	37.7	31.0	36.6	25.6	30.0	35.0
Cash	47.1	89.6	61.0	79.0	73.5	68.2
Other	0.0	0.0	0.0	0.0	0.0	0.0
Current Liabilities	(168.4)	(309.4)	(173.9)	(186.2)	(184.5)	(189.0)
Creditors (incl provisions)	(164.0)	(184.5)	(159.5)	(151.6)	(170.0)	(174.0)
Short term borrowings	(4.4)	(124.9)	(14.4)	(34.6)	(14.5)	(15.0)
Long Term Liabilities	(290.5)	(126.8)	(188.1)	(136.6)	(130.0)	(90.0)
Long term borrowings	(179.7)	(17.6)	(87.8)	(57.0)	(50.0)	(20.0)
Other long term liabilities	(110.8)	(109.2)	(100.3)	(79.6)	(80.0)	(70.0)
Net Assets	242.3	294.4	352.6	390.6	403.6	443.0
CASH FLOW						
Operating Cash Flow	55.0	146.6	110.2	116.3	125.1	131.7
Net Interest	(8.1)	(7.5)	(5.0)	(3.0)	(3.0)	(2.5)
Tax	(19.1)	(2.2)	(31.1)	(14.7)	(15.9)	(17.3)
Capex	(44.3)	(31.9)	(52.7)	(42.7)	(52.0)	(52.0)
Acquisitions/disposals	0.3	(1.0)	16.2	0.0	0.0	0.0
Financing	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	(16.4)	(18.6)	(22.7)	(26.0)	(30.9)	(33.6)
Net Cash Flow	(32.6)	85.4	14.9	29.9	23.3	26.3
Opening net debt/(cash)	104.1	137.0	52.9	41.2	12.4	(9.0)
HP finance leases initiated	(2.3)	(3.1)	(2.8)	(1.3)	(2.0)	(2.0)
Other	2.0	1.8	(0.4)	0.2	0.0	(0.0)
Closing net debt/(cash)	137.0	52.9	41.2	12.4	(9.0)	(33.2)

Source: Rank Group accounts, Edison Investment Research. Note: *Revenue is before customer incentives.

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