

# Stride Gaming

Robust growth in real money gaming

Interim results

Travel & leisure

Stride Gaming's H117 pro forma net gaming revenues (NGR) grew 21% to £44.0m, driven by strong organic growth in the real money gaming (RMG) vertical. In a continuation of previous trends, the social gaming vertical has weakened, with a 24% decline in revenues to £4.7m, and Stride has recognised a £10.2m impairment on its InfiApps assets. However, the core RMG business is gaining market share, trading has been robust in Q317 and management has reiterated its FY17 outlook. Our headline FY17 revenue and EBITDA figures remain unchanged. Stride trades at 7.5x calendar 2017e EV/EBITDA, a meaningful discount to its peers.

| Year end | Revenue (£m) | EBITDA* (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|----------|--------------|--------------|-----------|----------|---------|---------|-----------|
| 08/15    | 27.8         | 7.3          | 7.2       | 14.0     | 0.0     | 16.3    | N/A       |
| 08/16    | 47.8         | 12.3         | 11.3      | 20.3     | 2.5     | 11.2    | 1.1       |
| 08/17e   | 88.8         | 19.5         | 17.5      | 21.4     | 2.8     | 10.7    | 1.2       |
| 08/18e   | 100.7        | 18.5         | 16.3      | 19.7     | 3.0     | 11.6    | 1.3       |
| 08/19e   | 112.5        | 22.7         | 20.0      | 24.0     | 4.0     | 9.5     | 1.8       |

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

## Core RMG business gains market share

A 21% increase in like-for-like H117 revenues was driven by organic growth and market share gains in the core RMG business. Revenues from the proprietary platform rose 55% to £23.8m, reflecting a highly analytic data-driven approach and multi-brand strategy. Non-proprietary platform RMG revenues (acquired assets) grew 4% to £15.5m and we anticipate further growth once the earnout period ends. Despite the decline in social gaming revenues, management has reiterated its FY17 outlook and our headline FY17 revenue and EBITDA remain unchanged. FY18 financials are expected to be affected by higher taxes, further investment into the proprietary platform, as well as a lower contribution from social gaming, and we have lowered our FY18e EBITDA by 11.9%. We also introduce FY19 figures.

## Challenging social gaming, but positive B2B news

As previously highlighted, the social gaming market has proved challenging and H117 revenues declined 24% to £4.7m. As a result, Stride has recognised a £10.2m impairment on its social gaming assets vs a total acquisition price of c £19m. Once the earnout period ends in July 2017, Stride will gain greater control and it will undertake a full strategic review of the business. Our estimates now assume a minimal contribution to EBITDA going forward. In addition, we have not included any potential upside from the recently announced B2B licensing vertical, and JV with Aspers. We expect a fuller update on both these verticals at FY results.

## Valuation: 7.5x 2017e EV/EBITDA

Stride is fully regulated, successfully increasing market share, growing well ahead of the sector average and generating cash, with a progressive dividend policy. However, its 7.5x calendar 2017e EV/EBITDA is below the peer group average. In our opinion, a demonstrable success in integrating the recent acquisitions, post all the earnouts (December 2017), is key for a re-rating.

30 May 2017

**Price** 228p  
**Market cap** £154m

Net cash\* (£m) at 28 February 2017 9.5  
\*Excluding player balances of £1.8m

Shares in issue 67.4m

Free float 34%

Code STR

Primary exchange AIM

Secondary exchange N/A

### Share price performance



% 1m 3m 12m

Abs (0.4) 2.0 (13.3)

Rel (local) (3.4) (2.3) (27.4)

52-week high/low 288p 216p

### Business description

Stride Gaming is an online soft gaming operator in the bingo-led and social gaming markets. It uses its proprietary and purchased software to provide online bingo and slot gaming and a social gaming mobile app. It was formed in 2012 and only operates in regulated real money gaming markets.

### Next events

Pre-close trading update September 2017

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## H117: RMG drives growth

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### Interims overview

Following the acquisitions of 8Ball, Netboost Media and the Tarco assets in August 2016, reported net gaming revenues grew 104% to £44m. This represents a pro forma NGR growth of 21%. Like-for-like real money gaming revenues increased 30% to £39.3m, driven by the scale of the enlarged group, multi-brand strategy and significant improvements in player engagement and monetisation.

Offsetting the positive trends in RMG, social gaming has continued to weaken, with a 24% decline in revenues and, as a result of the limited visibility, management has taken a £10.2m impairment against its InfiApps assets.

In line with our forecasts, adjusted EBITDA increased by 20% to £9.6m vs a pro forma £8.0m, representing a constant 22% EBITDA margin. We expect underlying margin expansion going forward, although this will be offset by expected increases in the point of consumption (POC) tax.

Post period, management has established Stride Together, a new B2B vertical to license its proprietary platform to gaming operators, media partners and retailers in the UK and abroad. Its first JV with Aspers Group is due to launch in Q417. At this stage, we have not included any potential upside into our forecasts and we expect a full update at the FY results.

Q317 trading in RMG has been robust and management has reiterated its outlook for the full year.

### Real money gaming: 89% of revenues

Stride reported strong organic growth in its RMG vertical, with revenues from its proprietary platform increasing 55% to £23.8m. Non-proprietary platform RMG revenues (from acquired assets) grew 4% to £15.5m and we anticipate further growth once the earnout period ends.

RMG-funded players (active players, depositing within the last three months) were up 21% to 162,000 (vs a pro forma 2016 134,000) and yield per player was up 8.5% to £127, demonstrating a continued improvement in engagement and monetisation of players. Mobile and touch devices now represent 58% of the group's total gross gaming revenue.

The acquisitions last year (8Ball, Netboost Media and Tarco) have doubled Stride's market share in the UK online bingo market, from 5% to 10%. The resulting business now has significant scale and liquidity and its multi-brand strategy will enable it to target broader demographics and cross-sell to lapsing players. Stride has taken advantage of opportunities presented by the introduction of the UK POC gaming tax in 2014, which has squeezed smaller operators and left larger multi-product operators focusing more on sports, casino and M&A, rather than bingo. We expect this trend to continue with the expected extension of POC tax to "free bets" from August 2017.

The earnout periods end in August 2017 (8Ball) and December 2017 (Tarco) and, post earnout, Stride believes it can achieve £2.5m of cost synergies and £3m of revenue synergies. Revenue synergies include increasing LTV, yield and cash hold, and cross-selling lapsing Tarco/8Ball players onto its higher-margin proprietary platform.

### Social gaming: 11% of revenues

Stride entered the social gaming market with the acquisition of Israel-based InfiApps in July 2015. Founded in 2012, InfiApps diversified Stride both by product and geography, with approximately 65% of revenues derived from the US. Management has previously discussed the challenges of the social gaming market and trading in H117 has continued to be disappointing. H117 revenues from this vertical declined by 24% to £4.7m, as management has focused more on profitability than

revenues. Given the high acquisition costs in social gaming, marketing spend has been diverted to higher-margin RMG for the short term.

As a result of the uncertain outlook for this vertical, Stride has prudently recognised an impairment of £10.2m for the business. This compares to a total acquisition cost of c £19m.

We anticipate that Stride will take greater control over the social gaming vertical at the end of the earnout period and the board will undertake a review of this business in due course. As detailed in the table below, our forecasts assume a limited contribution to group EBITDA over the next two years.

#### Exhibit 1: Summary divisional forecasts

| Year end 31 August (£m)         | FY15        | FY16        | FY17e       | FY18e        | FY19e        |
|---------------------------------|-------------|-------------|-------------|--------------|--------------|
| Real money gaming (RMG)         | 26.7        | 35.0        | 80.8        | 90.5         | 101.1        |
| Social gaming                   | 1.1         | 12.8        | 8.0         | 10.2         | 11.4         |
| <b>Net gaming revenue (NGR)</b> | <b>27.8</b> | <b>47.8</b> | <b>88.8</b> | <b>100.7</b> | <b>112.5</b> |
| COS (POC gaming tax)            | (2.8)       | (5.4)       | (11.5)      | (16.3)       | (18.7)       |
| % of RMG NGR                    | 10.3%       | 15.4%       | 14.2%       | 18.0%        | 18.5%        |
| <b>Gross profit</b>             | <b>25.1</b> | <b>42.4</b> | <b>77.3</b> | <b>84.4</b>  | <b>93.8</b>  |
| Marketing cost                  | (7.0)       | (10.9)      | (21.8)      | (24.7)       | (27.6)       |
| Marketing %                     | 25.2%       | 22.8%       | 24.5%       | 24.5%        | 24.5%        |
| Other distribution costs        | (2.9)       | (7.8)       | (16.9)      | (19.5)       | (21.0)       |
| Other distribution %            | 10.4%       | 16.2%       | 19.1%       | 19.3%        | 18.7%        |
| Admin costs                     | (7.8)       | (11.4)      | (19.1)      | (21.7)       | (22.5)       |
| Admin %                         | 28.2%       | 23.9%       | 21.5%       | 21.6%        | 20.0%        |
| <b>Adjusted EBITDA</b>          | <b>7.3</b>  | <b>12.3</b> | <b>19.5</b> | <b>18.5</b>  | <b>22.7</b>  |
| RMG EBITDA                      | 7.0         | 8.2         | 19.0        | 17.8         | 21.0         |
| Social gaming EBITDA            | 0.3         | 4.1         | 0.5         | 0.7          | 1.7          |
| Adjusted EBITDA margin          | 26.3%       | 25.8%       | 21.9%       | 18.4%        | 20.2%        |
| RMG EBITDA margin %             | 26.4%       | 23.5%       | 23.5%       | 19.7%        | 20.8%        |
| Social gaming EBITDA margin %   | 24.3%       | 32.0%       | 6.0%        | 7.0%         | 15.0%        |

Source: Stride Gaming accounts, Edison Investment Research.

#### Forecast changes

The strength in RMG has offset the weakness in social gaming and our 2017e headline revenue and EBITDA figures are unchanged. Our 2017e PBT forecast is lowered from £18.3m to £17.5m, due to slightly higher amortisation and finance expenses in H1. Our 2017e RMG revenues increase from £78.3m to £80.8m and social gaming revenues decline from £10.5m to £8.0m.

Given the uncertainty for the social gaming market, we have forecast limited EBITDA contribution from this vertical and our group 2018 EBITDA declines from £21.0m to £18.5m. For 2018, the underlying margin expansion in RMG is offset by the expected increase in gaming tax.

We introduce 2019 forecasts, which continue the trend of double-digit revenue growth in RMG and underlying margin expansion, as the business keeps scaling.

Operating cash flow in H117 was £4.2m vs £4.8m in the previous year. While the business should revert to an underlying cash conversion rate of c 90%, the H1 cash flow was affected by one-off working capital movements from the acquisitions in August 2016. Our forecasts include cash earnout payments of £5m for 2017 (relating to InfiApps) and £18.4m in FY18 (relating to Tarco and 8Ball). We estimate a net cash position of £13.1m in 2017 and £16.5m in 2018.

#### Exhibit 2: Edison estimate changes

|        | Revenue (£m) |       |        | EBITDA (£m) |      |        | EPS (p) |      |        |
|--------|--------------|-------|--------|-------------|------|--------|---------|------|--------|
|        | Old          | New   | % chg. | Old         | New  | % chg. | Old     | New  | % chg. |
| 08/17e | 88.8         | 88.8  | 0.0    | 19.5        | 19.5 | 0.0    | 22.5    | 21.4 | (4.9)  |
| 08/18e | 103.3        | 100.7 | (2.5)  | 21.0        | 18.5 | (11.9) | 23.6    | 19.7 | (16.5) |

Source: Edison Investment Research

**Exhibit 3: Financial summary**

|  | £m | 2014    | 2015   | 2016   | 2017e  | 2018e  | 2019e  |
|--|----|---------|--------|--------|--------|--------|--------|
| August                                       |    | UK GAAP | IFRS   | IFRS   | IFRS   | IFRS   | IFRS   |
| <b>PROFIT &amp; LOSS</b>                     |    |         |        |        |        |        |        |
| Revenue                                      |    | 8.5     | 27.8   | 47.8   | 88.8   | 100.7  | 112.5  |
| Cost of Sales                                |    | 0.0     | (2.8)  | (5.4)  | (11.5) | (16.3) | (18.7) |
| Gross Profit                                 |    | 8.5     | 25.1   | 42.4   | 77.3   | 84.4   | 93.8   |
| EBITDA                                       |    | 1.2     | 7.3    | 12.3   | 19.5   | 18.5   | 22.7   |
| Operating Profit (norm)                      |    | 1.2     | 7.3    | 12.0   | 18.0   | 16.8   | 20.5   |
| Amortisation of acquired intangibles         |    | (0.3)   | (2.5)  | (4.2)  | (5.1)  | (5.0)  | (5.0)  |
| Exceptionals                                 |    | (0.1)   | (3.3)  | (5.1)  | (19.6) | 0.0    | 0.0    |
| Share based payments                         |    | 0.0     | (1.0)  | (1.9)  | (1.3)  | (1.3)  | (1.3)  |
| Operating Profit                             |    | 0.8     | 0.4    | 0.8    | (7.9)  | 10.5   | 14.2   |
| Net Interest                                 |    | 0.0     | (0.1)  | (0.7)  | (0.6)  | (0.5)  | (0.5)  |
| Profit Before Tax (norm)                     |    | 1.2     | 7.2    | 11.3   | 17.5   | 16.3   | 20.0   |
| Profit Before Tax (FRS 3)                    |    | 0.8     | 0.4    | 0.1    | (8.5)  | 10.0   | 13.7   |
| Tax (reported)                               |    | 0.0     | 0.1    | (0.5)  | 0.1    | (1.3)  | (1.6)  |
| Profit After Tax (norm)                      |    | 1.2     | 6.2    | 10.9   | 16.2   | 15.0   | 18.4   |
| Profit After Tax (FRS 3)                     |    | 0.8     | 0.4    | (0.4)  | (8.4)  | 8.7    | 12.1   |
| Average Number of Shares Outstanding (m)     |    | 31.2    | 43.8   | 51.5   | 67.4   | 70.0   | 71.5   |
| EPS - normalised (p)                         |    | 0.0     | 14.2   | 21.2   | 24.1   | 21.4   | 25.7   |
| EPS - normalised fully diluted (p)           |    | 4.0     | 14.0   | 20.3   | 21.4   | 19.7   | 24.0   |
| EPS - (IFRS) (p)                             |    | 0.0     | 0.9    | (0.8)  | (12.4) | 12.5   | 16.9   |
| Dividend per share (p)                       |    | 0.00    | 0.00   | 2.50   | 2.80   | 3.00   | 4.00   |
| Gross Margin (%)                             |    | 100.0   | 90.1   | 88.7   | 87.1   | 83.8   | 83.4   |
| EBITDA Margin (%)                            |    | 14.6    | 26.3   | 25.8   | 21.9   | 18.4   | 20.2   |
| Operating Margin (before GW and except.) (%) |    | 14.6    | 26.1   | 25.0   | 20.3   | 16.7   | 18.2   |
| <b>BALANCE SHEET</b>                         |    |         |        |        |        |        |        |
| Fixed Assets                                 |    | 0.1     | 37.1   | 78.7   | 64.0   | 59.7   | 54.7   |
| Intangible Assets                            |    | 0.0     | 36.4   | 73.6   | 58.6   | 53.9   | 48.6   |
| Tangible Assets                              |    | 0.0     | 0.2    | 0.7    | 0.9    | 1.3    | 1.6    |
| Investments                                  |    | 0.1     | 0.5    | 4.4    | 4.4    | 4.5    | 4.5    |
| Current Assets                               |    | 5.7     | 11.7   | 27.1   | 29.5   | 33.7   | 49.6   |
| Stocks                                       |    | 0.0     | 0.0    | 0.0    | 0.0    | 0.0    | 0.0    |
| Debtors                                      |    | 5.7     | 4.2    | 5.8    | 6.4    | 7.0    | 7.0    |
| Cash   |    | 0.0     | 7.4    | 21.1   | 23.1   | 26.7   | 42.6   |
| Other  |    | 0.0     | 0.0    | 0.2    | 0.0    | 0.0    | 0.0    |
| Current Liabilities                          |    | (1.2)   | (7.7)  | (26.1) | (20.6) | (19.7) | (19.7) |
| Creditors                                    |    | (0.8)   | (5.2)  | (16.3) | (18.6) | (17.5) | (17.5) |
| Player balances                              |    | (0.4)   | (1.4)  | (1.8)  | (2.0)  | (2.2)  | (2.2)  |
| Short term borrowings                        |    | 0.0     | (1.1)  | (8.0)  | 0.0    | 0.0    | 0.0    |
| Long Term Liabilities                        |    | 0.0     | (10.2) | (10.5) | (14.0) | (10.5) | (10.5) |
| Long term borrowings                         |    | 0.0     | (8.0)  | 0.0    | (8.0)  | (8.0)  | (8.0)  |
| Other long term liabilities                  |    | 0.0     | (2.2)  | (10.5) | (6.0)  | (2.5)  | (2.5)  |
| Net Assets                                   |    | 4.6     | 30.8   | 69.2   | 58.8   | 63.2   | 74.1   |
| <b>CASH FLOW</b>                             |    |         |        |        |        |        |        |
| Operating Cash Flow                          |    | 0.0     | 4.6    | 14.4   | 11.5   | 17.7   | 21.8   |
| Net Interest                                 |    | 0.0     | 0.0    | (0.6)  | (0.3)  | (0.3)  | (0.3)  |
| Tax  |    | 0.0     | (0.1)  | (0.7)  | (0.5)  | (1.3)  | (1.6)  |
| Capex  |    | 0.0     | (0.6)  | (1.9)  | (2.1)  | (2.3)  | (2.3)  |
| Acquisitions/disposals                       |    | 0.0     | (18.1) | (22.2) | (5.0)  | (18.4) | 0.0    |
| Financing                                    |    | 0.0     | 10.4   | 25.9   | 0.0    | 10.0   | (0.0)  |
| Dividends                                    |    | 0.0     | (3.0)  | (0.6)  | (1.8)  | (2.0)  | (2.1)  |
| Net Cash Flow                                |    | 0.0     | (6.6)  | 14.4   | 1.8    | 3.4    | 15.4   |
| Opening net debt/(cash)                      |    | 0.0     | 0.0    | 3.1    | (11.3) | (13.1) | (16.5) |
| Moving in player balances                    |    | 0.0     | 1.0    | 0.0    | 0.0    | 0.0    | 0.0    |
| Other adjustments                            |    | 0.0     | 2.5    | 0.0    | 0.0    | (0.0)  | (0.0)  |
| Closing net debt/(cash)                      |    | 0.0     | 3.1    | (11.3) | (13.1) | (16.5) | (31.9) |

Source: Stride Gaming accounts, Edison Investment Research

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