Casinos & Gaming

Source: Refinitiv

Market data

EPIC/TKR	**SPO**
Price (p)	**18**
12m High (p)	35
12m Low (p)	10
Shares (m)	188.5
Mkt Cap (£m)	34
EV (£m)	30
Free Float*	100%
Market	Main Mkt

**As defined by AIM Rule 26*

Description

Sportech is an international betting technology business serving the world's Tote betting and lottery operators. It also runs gaming venues in Connecticut under an exclusive licence, and offers charitable raffle platforms to sports teams and non-profit organisations.

Company information

CEO	Richard McGuire
CFO	Tom Hearne
Chairman	Giles Vardey

ir@sportechplc.com
www.sportechplc.com

Key shareholders

Directors	0.5%
Lombard Odier	27%
Harwood Capital	18%
Mr Richard Griffiths	8%
Schroders	5%
Artemis 5	4%

Diary

Mar'21	Preliminary results
Aug'21	Interim results

Analyst

Jason Streets 020 7194 7622
js@hardmanandco.com

SPORTECH PLC

Bettor technology

Sportech (SPO) supplies betting systems to over 400 clients in 38 countries, including the world's most widely deployed Tote solution. It has an exclusive licence to operate betting in Connecticut (CT) and is well placed to benefit from eventual legalisation of sports betting in the state. It also has a fast-growing charitable raffle business. The business has been interrupted by COVID-19, but has proved resilient, especially through online channels. There are opportunities to improve margins by transitioning from a mechanical model to a digital one. We would expect these benefits to come through over the next few years.

- **Strategy:** SPO continues to reduce the capital deployed and maintenance costs in its US racing business, as it moves increasingly digital. It is building on, and benefiting from, the growth in international commingling and looks to expand its lottery side. A sports betting licence in CT would prove a valuable extra.
- **COVID-19:** With venues shut and most racing cancelled for a few months, business was inevitably affected, but cash outflows were kept to a minimum, and business is bouncing back. The success of online has demonstrated to many of its more conservative clients where the future lies, and it is a higher-margin one.
- **Valuation:** Our forecasts assume no CT sports licence is awarded and no further major COVID-19 disruption occurs. We value the business on a comparable multiple basis, and derive a central value of ca.33p per share. The start of sports betting in CT raises that to between 45p and 55p.
- **Risks:** The prime risk is that anti-COVID-19 measures are augmented and further disrupt the global racing and sports businesses. The industry has proved resilient and resourceful so far. Gambling is always liable to attract government interest, which can affect profitability of betting customers and their suppliers.
- **Investment summary:** SPO is a business that has underperformed in the past but, in moving away from its industrial model to a more digital one, it should generate significantly higher profits in the future. It sits on nearly £10m of net cash, and has the potential to exploit a new market for sports betting in CT when the State agrees how to implement its new freedoms. There are also further opportunities in lotteries and the growth in international pool betting.

Financial summary and valuation

Year-end Dec (£m)	2017	2018	2019	2020E	2021E	2022E
Revenue	66	63	65	46	58	59
Underlying EBITDA	6.71	7.97	9.31	1.90	8.00	9.50
Adjusted EBIT	1.76	0.54	-0.36	-6.63	0.50	2.40
Reported EBIT	-21.65	-2.91	-7.74	-11.23	0.50	2.40
Underlying PTP	1.55	0.56	-0.81	-7.13	0.00	1.90
Statutory PTP	-23.2	-2.7	-8.4	-12.2	-0.5	1.4
Underlying EPS (p)	0.9	-0.8	-3.6	-3.8	0.0	1.0
Statutory EPS (p)	-12.8	-1.5	-7.7	-6.5	-0.3	0.7
Net (debt)/cash	15.9	14.7	13.0	9.3	11.2	14.1
Shares issued (m)	190	186	189	189	189	189
P/E (x)	19.2	-23.0	-5.0	-4.8	nm	17.9
EV/EBITDA (x)	4.5	3.8	3.2	15.9	3.8	3.2

Source: Hardman & Co Research

Table of contents

Executive summary

A substantial global business supplying gambling technology

SPO is a substantial global business supplying technology to gambling operators, especially those conducting Tote or pari-mutuel pool betting. It has clients in 38 countries and operates across 36 states in the US, where Tote betting is the only legitimate form of gambling on horse racing. The same skills are deployed in offering lottery solutions. In addition to this B2B business, SPO owns and operates a Venues business in CT. It has an exclusive and perpetual licence in the State to take bets on racing (both horses and greyhounds) and Jai alai, which it does through 14 venues across the state and through its online presence: MyWinners.com.

Mature, but growth coming from international initiatives

Global racing betting is a mature business, and revenues are growing only slowly – it is, after all, just about the oldest form of sports betting there is. The industry is encouraging growth through international co-operation. It is creating internationally known horses and jockeys, and encouraging bettors from different jurisdictions to bet on each other's races. A recent invention, the World Pool, where Hong Kong has commingled its betting pools with international pools on races run at Ascot in the UK and Dubai, has seen multifold growth in the size of the pools. This is directly beneficial to SPO, as it is typically remunerated on a percentage of the handle (the total amount wagered).

SPO moving from industrial to digital model, reducing capital and improving margins

In the US business, SPO owns and maintains thousands of betting terminals. This is a capital-intensive business, and the maintenance costs weigh on profit margins. Management is keen to move its racetrack customers to a more digital solution. This would comprise far fewer terminals and bettors using their own phones or computer tablets, or other off-the-shelf hardware supplied by SPO, at a fraction of the cost or acquired directly by the clients. Progress here is slower than anticipated, as both SPO's clients (the racetracks) and the racetracks' customers are very conservative.

COVID-19

Experience of COVID-19 encouraging digital transformation

COVID-19 had a severe impact on SPO's racing business, as most tracks around the world ceased racing altogether for a period of time. As the tracks reopened (often to empty stadia), the betting resumed, and it resumed largely online. This experience may well encourage the racetracks to hasten the switch to a more digital offering, where permitted by law.

Venues

SPO also operates some betting venues, which will benefit when CT allows sports betting

SPO operates off-track betting shops (OTBs) throughout CT. Some of these venues also serve food and drink, which, in some cases, has involved multi-million-dollar investments. Capacity had been increased in anticipation of sports betting being allowed in CT. Since it was permitted in the US, following the repeal of Federal legislation, 19 states have enacted the necessary laws to allow sports betting in their states. CT has not yet agreed how do so, although it is in favour, in principle.

The problem in CT is that there are two tribal casinos, which claim they have an exclusive right to offer sports betting, under existing casino gaming agreements. This is not clear from the law, and has been disputed by the state's Attorney General; however, there is a degree of ambiguity in the agreements that the two casinos have with the state under which they operate their casinos' slot machines. SPO claims that it is entitled to offer sports betting, should the state approve licensing, and that the argument presented by the tribes is misguided. The tribes have threatened to withhold the share of slots revenue that they pay to the state if they are not granted what they want.

It is impossible to call which way it will go, but it seems likely that some sort of compromise will be agreed, as no party wants to end up in lengthy and expensive litigation. In our approach to valuing SPO, we have taken a base case of operating without a sports betting licence, and then added what we estimate a licence might be worth to it.

Current trading

SPO has not performed particularly well over the past few years. Previous management made some poor investments, which have proved costly to extricate from and have resulted in numerous exceptional charges. There had been too much focus on EBITDA, and not enough on cashflow. This is all being addressed, and 2020 had begun well when COVID-19 struck.

SPO successfully conserved cash during COVID-19 lockdown

SPO responded to most of its business shutting down – closed venues, no races and no sports events – by focusing on costs and cash. Consequently, there was a very modest outflow of only £1.4m from the end of February to the half-year-end, when net cash was £9.6m.

There were some key positives in the first half: online retail business grew by nearly half, and the international Tote business grew by 23%, helped by the initiatives mentioned above. Capex was reduced substantially, and the wage bill was slashed, although much of this may return as business returns to normal.

Currently trading on just 3.8x 2021E EV/EBITDA

In our forecasts, we assume no major future disruption from the COVID-19 pandemic, but that remains a clear risk to the business. We have adjusted EBITDA growing back to £8m in 2021E and £9.5m in 2022E, which means SPO trades on an EV/EBITDA of just 3.8x in 2021E, falling to 3.2x in 2022E.

Valuation

Our approach to valuation has been to look at comparable listed European companies operating in the technology sector and servicing the gambling sector. Excluding the expensive outlier, they trade, on average, at 8.1x 2021E EV/EBITDA, falling to 6.3x in 2022E.

We value the core business at ca.33p, and add between 13p and 21p if sports betting finally allowed in CT

In addition to the B2B business, there is CT. We look at two separate scenarios: the first where SPO pays a percentage of revenue (including zero) to the tribes in exchange for them giving up their exclusive claim; in the second, we reverse the position and value what the tribes might pay to SPO for it conceding its position. We derive a central value of 21p for the former scenario and 13p for the latter. These sums can be added to a sector multiple for the rest of the business, which equates to a central 32p-34p, giving a valuation range of 32p through to 55p.

There are many assumptions that have to be made to arrive at these figures, so they can be taken as guide only.

Risks

Further restrictions on international racing are main immediate risk to profitability

Other than the risk that COVID-19 results in further lockdowns of the severity and widespread nature we saw early in 2020, we see the principal risks of investing in SPO centring on the competition in the business and the ever-present possibility of regulatory change. Gambling has also attracted government interest and is endlessly subject to rule changes, which can have an impact on the profitability of the industry and those who supply it. It is also a competitive marketplace.

SPO tends to have very long contracts with its clients, and there is substantial knowledge and skill needed to operate highly complex systems. Nevertheless, there are competitors, and pricing is always under pressure. We found it impressive that SPO continued to win new contracts and extend existing ones, even through the COVID-19 pandemic lockdown.

The business

Introduction

SPO's business reports in two divisions; we look at each separately

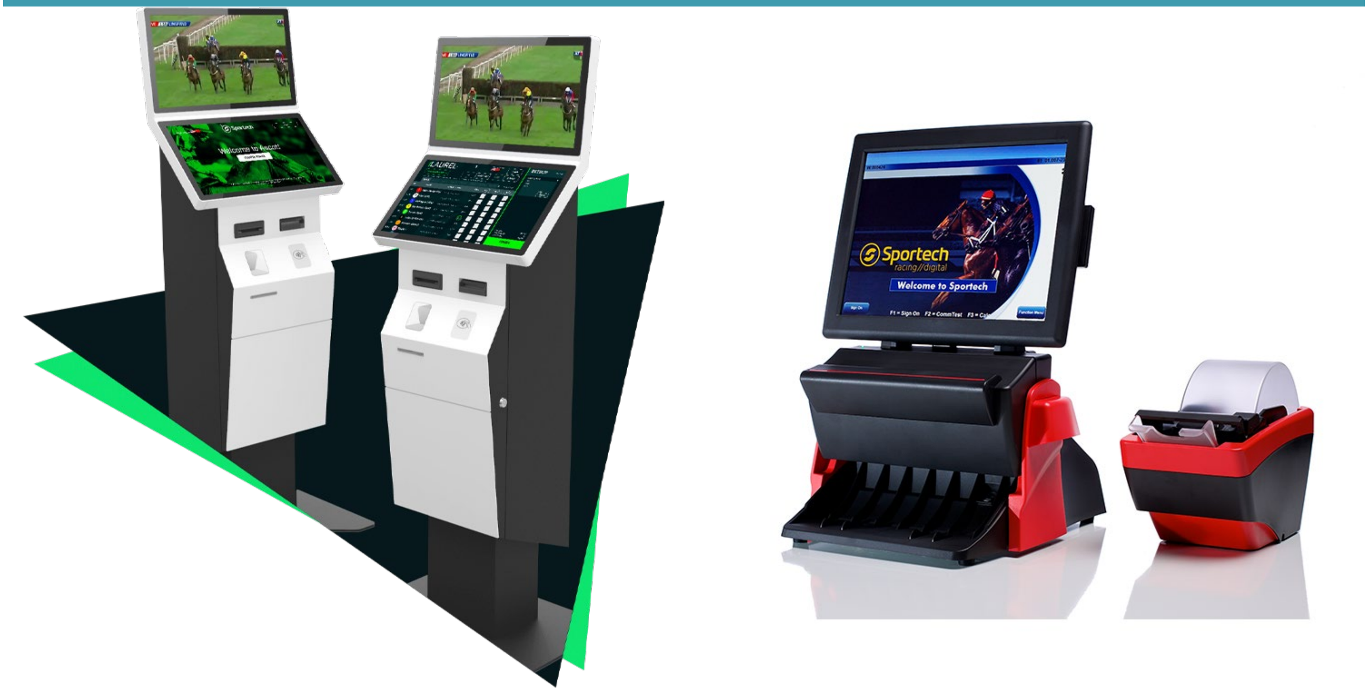
SPO has previously described itself as two divisions: Racing and Digital, and Venues. The former is a B2B business providing services to Tote and lottery operators, and the latter is a B2C business in CT running licensed premises taking pari-mutuel bets, primarily on horseracing. Both have challenges and opportunities. The company sits on a pile of £9m net cash, the legacy of disposing of a profitable football pools business in 2017 and a £97m rebate from the tax authorities over a VAT claim in 2016. The company returned £75m to shareholders, and otherwise paid off its debt.

Previous management teams made various investments in related fields, not all of them successful, and the current team has been clearing up: reducing exceptionals, tidying up outstanding legal claims and onerous lease issues. It has also been beefing up the technology capability of SPO to help it move Racing and Digital into the next phase: the transition of the business from a primarily mechanical offering to a digital one. There is a substantial opportunity to transform the profitability of this business.

The future of the Venues business is largely dependent on the CT legislature and how it decides to implement sports betting in the state. If the decision goes in favour of SPO, this too will have a significant impact on the profitability of the division.

Although the two businesses are linked by gambling, they face completely different issues and, in this report, we look at them separately.

Point-of-sale betting terminals



Source: SPO

Racing and Digital

Business both global and pan-American

SPO provides betting technologies and services to 287 racetrack, off-track betting network, casino, lottery and online pari-mutuel operator customers, plus an additional 147 commingling customers, in 38 countries and 36 US states. Approximately 70% of Racing and Digital revenues are in the Americas – primarily North America but also around the Caribbean and South America. It is a very substantial global business.

It has an estimated 29,000 betting terminals (12,500 in the US), 30 white-label betting websites, and 19 white-label mobile apps deployed worldwide, and systems that annually process $12.3bn in betting handle. The total handle processed has remained fairly consistent over the past seven years or more, until COVID-19.

Betting landscape

Tote betting the most popular form of betting on horse racing through most of world…

Throughout most of the world, gambling on horseracing is done largely through pari-mutuel (or Tote) betting systems. The UK and Ireland are unique among the large horserace gambling nations in that the business is dominated by fixed-odds bookmakers. Australia and New Zealand have sizeable bookmakers but bigger Tote businesses, and most of the rest are either tiny or dominated by a Tote system. The US operates solely on Tote systems.

Global racing betting turnover, 2018 (€m)

Tote	Turnover	Bookmakers	Turnover
Japan	26,692	Great Britain	15,350
Hong Kong	13,917	Australia	7,825
USA	9,841	Ireland	5,116
Australia	9,106	Spain	288
France	8,883	Italy	180
Korea	5,103	New Zealand	121
Sweden	1,300	Mauritius	106
Turkey	938	Germany	26
Canada	876	India	7
Singapore	700	Czech Republic	1
Morocco	639		
Norway	363		
Great Britain	363		
Italy	357		
Chile	254		
New Zealand	239		
South Africa	211		
India	145		
Others	807		
Total	80,736	Total	29,020

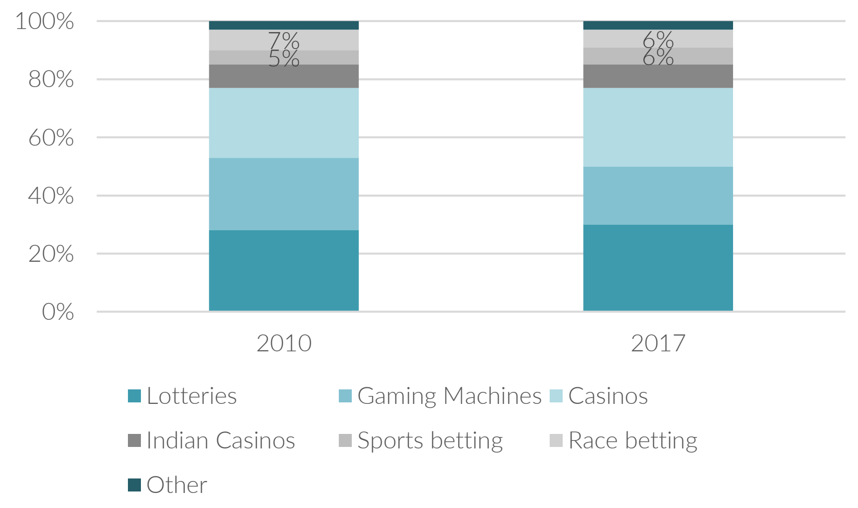
Source: IFHA

…but only 6% of global gambling revenues

Many of the Totes are nationalised industries, and many are monopolies. The system in the US is different from elsewhere. In most international jurisdictions, there is one Tote body that covers all the horseracing in that country; in the US, each racetrack runs its own Tote.

Approximately 6% of gambling yield (i.e. revenue retained by the promoter) worldwide is on racing, with lotteries, casinos and gaming machines being substantially larger. The proportions are fairly stable, with a gentle shift towards casinos (largely in Asia).

Global gross gaming yield – 2017 total $399bn

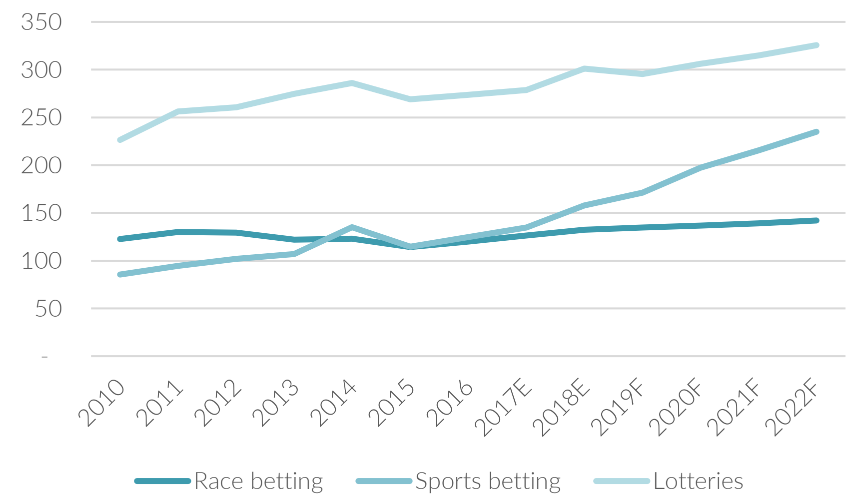


Source: GBGC

Sports betting overtook racing betting in 2014 for first time

In the past 10 years, there has been substantial growth in sports betting, driven by a combination of deregulation and technology. In particular, the ability to gamble while the contest is in play ("in-running") has brought additional excitement and fatter margins for gambling operators. Sports betting first overtook racing betting in turnover (i.e. amounts wagered, rather than revenue retained by operators) in 2014, the year of the Football World Cup in Brazil.

Global betting turnover, 2010-22F ($bn)



Source: GBGC

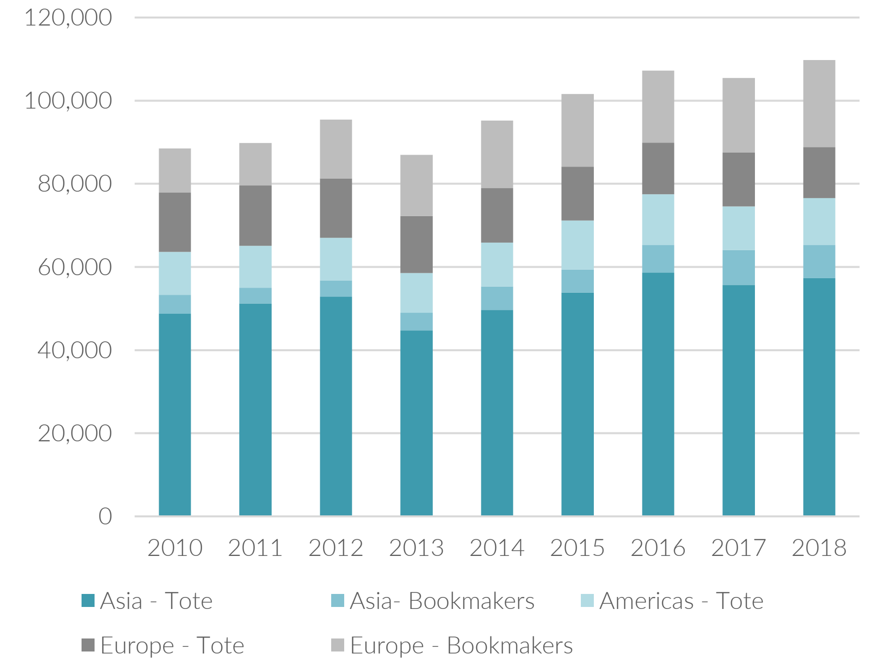
Between 2010 and 2018, sports betting has grown at an estimated 6% p.a., while racing betting has barely grown (1%). Global Betting & Gaming Consultants (GBGC) forecasts the gap will continue to widen, with sports betting growing at 26% p.a. between 2018 and 2022, while racing crawls along at 2%. This growth is driven largely by deregulation in the US, and is clearly only counting legal gambling and ignoring illegal betting, which had been rife in the US prior to the law change in 2018.

Betting on horseracing growing at just 1% p.a.

Racing betting

Betting on horseracing is one of the oldest forms of gambling, and is very well established in most territories where it exists. It is unsurprising that it is not growing as fast as other elements. It is mature. Data from the International Federation of Horseracing Authorities (IFHA) show a marginally different picture than GBGC. It calculates that, in the eight years between 2010 and 2018, overall betting grew by 3% p.a. and, within that, Tote betting grew by just 1% p.a., with bookmaking betting growing at 8% – a similar rate in both Europe and Asia.

Global horserace betting trends ($m)

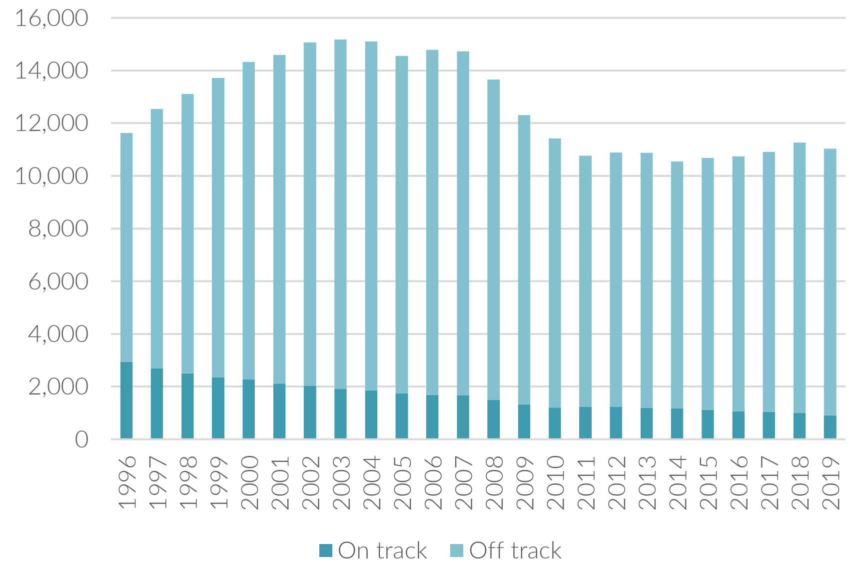


Source: IFHA

Stable in US, after declining between 2003 and 2010

Data from Equibase in the US showed betting down 0.2% p.a. over the same period. Since its peak in 2003, total US horserace betting is down 27%, but it has been fairly stable since 2011, with on-track betting continuing on a steady but gentle decline, and that being offset by a small increase in off-track wagering.

US pari-mutuel (Tote) handle ($m)



Source: Equibase

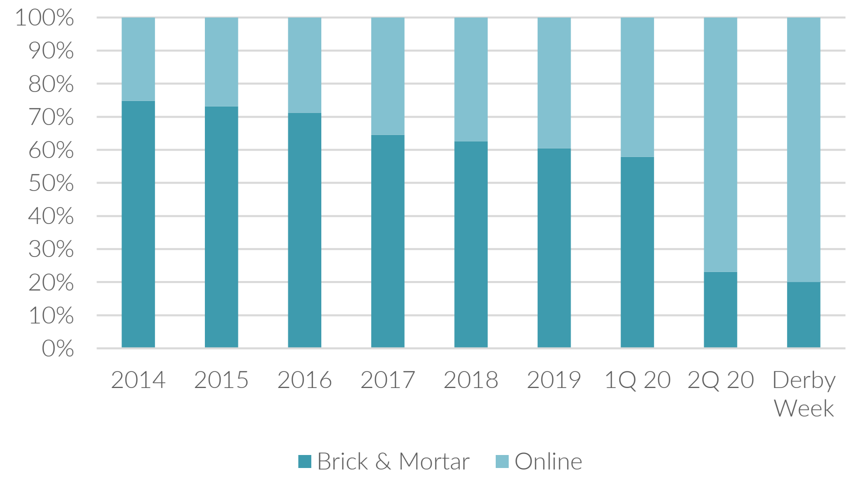
On-track betting is precisely what it says it is: betting placed by gamblers at the racecourse where the horses are running. The off-track betting (OTB), which is 10 times the size of the bets taken on course, comes from two different sources: other racetracks or OTB facilities (like SPO's venues); and digitally. Digital, in this context, means people betting on their phones or computers from wherever they are. The rules regarding what is permissible and what is not vary from state to state.

Digital betting

Digital betting had grown to 40% of racing betting prior to COVID-19

Data from the Oregon Racing Commission – which captures most but not all of the legal digital betting on racing in the US – shows that, in 2019, and the first quarter of 2020, digital betting made up about 40% of the total handle. It has risen steadily from 25% in 2014, but leapt to 77% in 2Q'20, when most racecourses and OTB facilities were closed due to the pandemic, and reached 80% in Kentucky Derby week, which this year was held in September.

US pari-mutuel (Tote) handle split between online and offline ($m)



Source: Equibase, Oregon Racing Commission

Conservative business

Racegoers tend to be on the older side, with average attendees aged around 60. As comes with age, they tend to be conservative: reluctant to embrace change generally and technology in particular. However, there are new racegoers and, with investment in facilities and technology, we do not expect attendance to fall away in normal times. Churchill Downs reported that, for the past nine years, the median age of new players on its TwinSpires digital platform was 40-42. So, the average age may be high, but it is still being topped up by new, younger customers who are more digitally savvy.

Innovation

Since three-quarters of horseracing revenues are derived from gambling, the industry recognises that it needs to innovate in order to thrive. The main area of innovation is in trying to turn racing into a global sport. It is clear that the top-class horses and jockeys draw disproportionate attention (and gambling dollars), so the industry (to the extent that it acts as a single body) is focused on the top performers racing around the world, but also providing betting opportunities globally on wherever the top-class action is. This is not entirely straightforward but has recently produced some big advances.

Stable but low growth

So, the background to SPO's Racing business is stable, but it is not high-growth. Nevertheless, there are two separate areas of opportunity for its core Tote business: one on-track and one online.

Racetrack operations

Thousands of physical terminals provided to SPO's clients

Currently, SPO provides thousands of physical terminals to clients – racecourses and OTB networks – across the US. Each client needs, or feels it needs, sufficient terminals to cater for its biggest day or days of the year. For the rest of the year, many of these machines will be lying idle. The opportunity is to reduce the number of machines to a core minimum, and replace the lost capacity, either with computer tablets owned by SPO (or the client), or, even better, persuading customers to use an app on their own phones. Cutting the number of terminals will not only reduce the capital deployed but also significantly lower maintenance costs.

A typical US racecourse may have 300 or more terminals; each one costing more than $2,000 and each one having to be maintained: currency acceptors, scanners, printers, paper supplies all need to be checked regularly. SPO can have several full-time employees at each racecourse. The numbers could be cut to a core of, for example, 50 machines, with big race days being supplemented by tablets or tablet-like machines. In a normal year, SPO spends not far short of $1m on paper for the machines to dispense as pari-mutuel tickets and vouchers. As customers are moved to online accounts, much of this could be dispensed with. It will be a win-win for both SPO and its clients.

Both customers and racecourses are reluctant to change – it is a very traditional business – but the benefits are too big to ignore. A natural outcome of the COVID-19 crisis is that it may well hasten the move to digital, as racecourses need to make the betting system COVID-secure and reduce costs wherever possible. More importantly, they have seen that, where digital channels are an option, they can take similar amounts of bets using digital systems, when access to the course has been restricted. There is no concern about the practicality of the systems – they work – just the willingness of the courses and their customers to move.

The machines are robust, and last for 12 years or more, so the natural replacement cycle is a slow one. Typically, an SPO client will sign a three- to seven-year deal. A natural moment to introduce change is when a contract is renewed; new terms can be negotiated, which could include lower costs to the client if they are prepared to move with the times. This is not going to be a change that happens overnight, but the benefits will be substantial.

Competition

There are essentially three players providing the Tote services to US racetracks – SPO, AmTote and United Tote. AmTote is part of the private Stronach Group (a large player in US racing, owning racecourses, training facilities, and a major national ADW operation, as well as being a Tote betting system provider). United Tote is part of Churchill Downs, Inc. (a $7bn listed business with racetracks, Tote systems, the largest online horse betting business and casinos).

We estimate that SPO processes more than a third of the US Tote business (ca.$4.7bn out of $12.4bn). Contracts with clients are lengthy (typically three to seven years), and are usually renewed unless the client has changed hands and particularly if it has been acquired by one of SPO's rivals. Nevertheless, there is price competition, limiting the options for raising prices. Changing suppliers creates a disruption for a client as well, so there is limited incentive to change. This is a very stable business.

In the first half of 2020, despite lockdowns around the world, SPO extended and expanded its contracts with a number of key partners, including UK Tote Group, Penn National Gaming (13 racetracks across the US and a national ADW operation), Emerald Downs (Washington State), Macau Jockey Club and Monmouth Park in New Jersey.

Complexity

The waging machines are only the visible part of what SPO does. The added value and skill is in the technology behind them. Pool betting is complex, especially when you have feeds coming in from across the country and internationally. There are exotic bets (multiple horses and/or multiple races), different currencies and many different feeds to manage. The system has to be able to cope with surges of activity just before any race starts, and has to be able to process winning bets almost instantly. The industry has built its own protocol, ITSP, to enable different providers to commingle pools. It is not something in which a new entrant could hope to compete readily.

Contracts

SPO's North American contracts are a mixture of fixed price and percentage of handle terms. Where possible, it negotiates a minimum fee payable. As it reduces the number of terminals at each venue, we would expect to see the revenue fall but the dollar margin to increase. Of its 29,000 terminals in operation worldwide, only 12,500 are in the US, but 70% of the Racing and Digital revenues arise in the Americas (which includes a substantial presence in Latin America and Canada). Outside the US, the business tends to operate differently. The technology is the same, but European and other customers tend to buy Tote systems and terminals outright, or acquire terminals from an alternative supplier and operate them from SPO's Tote system software. They also tend to maintain them themselves (SPO does have some maintenance contracts outside the US, but these are the exception). Without the maintenance (and capital), we would expect the non-US business to be notably more profitable.

It is SPO's stated objective to make its US business look more like its overseas business: capital light, providing software as a service and charging a percentage of the bets flowing through its pipes.

Commingling

"Commingling" – mixing different sources of bets into same pool

Commingling is the term given to mixing different sources of bets into the same pool. The on-track money is commingled with all the bets flowing in from off-track sources. Without commingling, the pools would not be competitive enough – the more liquidity the better. Depending on the size and popularity of the host racecourse, commingled pools in the US from external sources can easily be 10 times the size of the local bets. Many racetracks in the US act as OTBs – they are open even on non-race days, and many also operate digital betting services, for customers to bet on racing around the country and, indeed, the world. As with stock prices, the greater the liquidity, the more accurate the price, and the less impact any individual deal/bet will have on the underlying price/odds.

As communications have improved – in particular latency and consistency – international commingling has become a more substantial part of the business. The deepest and most consistent pools of racing money are in Hong Kong. Serious bettors want access to Hong Kong, and that is provided through Tote operations around the world. It is not a particularly large market in the US, as the time zone makes it very anti-social, but there are large players in Europe who bet into Hong Kong and they do so using (among others) systems managed by SPO. This can be a profitable (if sometimes lumpy) business.

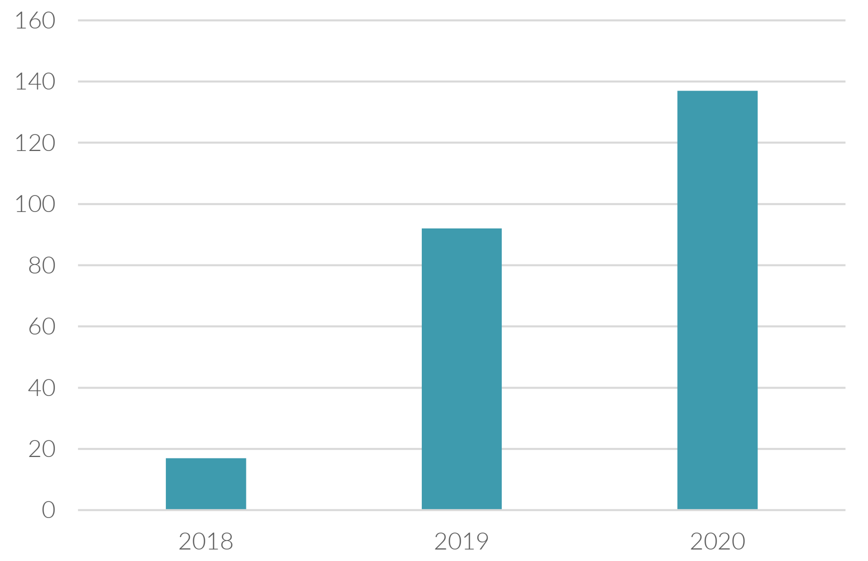
The horseracing industry wants to encourage international commingling, as it sees it (rightly, in our view) as a way of generating additional revenue. Most of the Tote operators in Europe that are not nationalised businesses (like France) are clients of SPO, including the UK Tote, so SPO is a clear beneficiary of this trend.

First-ever World Pool a success

World Pool/Superpool

In 2019, there was the first-ever "World Pool". In partnership with Ascot and Totepool (the UK Tote), the Hong Kong Jockey Club (HKJC) created the first-ever pari-mutuel-based World Pool in which overseas wagers from the UK, Australia, Canada, New Zealand, Europe and the US were commingled into Hong Kong's Royal Ascot pools, directly or via Totepool, to ensure maximum liquidity for a growing international audience. It was a success. The size of the pools increased five times, from £17m in 2018 to £92m in 2019. Only 24 of the 30 races were included due to standardisation issues; in particular, in the UK, "place" bets typically pay out on the top four horses if there are more than 16 runners and the race is handicapped, but elsewhere (and in HK especially), they only pay out on the top three.

UK Tote poll size, Royal Ascot meeting (£m)



Source: Ascot Racecourse

The World Pool was repeated as the Tote Superpool in 2020, albeit behind closed doors, so there was no on-track betting. There were limited field sizes and place bets only paid out on the top three, so that all 36 races were included. The total pool increased by a further 49% to £137m.

Interestingly, the UK Tote claimed that it paid out better odds on the winner than the fixed price bookmakers on 19 of the 36 races. This is an important factor; when the Tote has to compete with bookmakers, it needs to have competitive prices – typically, at odds of less than 8-1, it often pays out less. By introducing massive extra volumes and sometimes a different perspective on the horses' chances, the odds on the more favoured horses can improve. If the Tote can gain a reputation for being a better value, it will attract a larger portion of the business in markets that have fixed-odds betting and that will feed directly to increase SPO's take.

Exotic bets

For the first occasion, the World Pool consisted of just four different markets: Win, Place, Quinella (first two in either order) and Quinella Place (two of the first three in any order.)

More exotic pools, such as the Tierce (or "Trifecta", first three in correct order) and Quartet (first four in correct order), were planned to be offered in the future.

The Quinella Place is called the Swinger at the UK Tote, and is a popular bet. At Ascot, in 2019, there were three exotics: the Swinger, the Exacta (1-2 in correct order) and the Trifecta (1-2-3 in correct order), but only the Swinger was in the World Pool. The table below shows what impact it had on the size of the pool.

Exotic bets at Royal Ascot, 2018 vs. 2019 (£m)

Bet	2018	2019	change
Swinger	0.1	5.5	4007%
Exacta	2.2	2.4	9%
Trifecta	1.5	1.5	1%
Total	3.9	9.4	145%
	UK only	Commingled	

Source: Ascot Racecourse

The swinger pool grew 50 times, while the two exotics – which were not in the World Pool (and perform a perfect "control" for the experiment) – were largely flat.

We would expect to see more World Pools and similar events held in the future. From an SPO perspective, it benefits especially if the racing is held at a course at which it already runs the Tote (e.g. Ascot) but, even if it is held elsewhere (e.g. Dubai), it will still benefit, albeit to a lesser extent, from the bets flowing from its clients into the World Pool.

What is clear is that the racing business is looking at ways to improve the attraction of the sport, especially to sports bettors. That can only be good news for SPO.

Summary

Core business very stable

The core business is very stable, with steady betting domestic revenues and long-term contracts. Its large scale and technological know-how provide a serious barrier to entry. The opportunities are twofold: reducing the number of physical terminals on course will radically improve operating margins (on slightly lower revenues); and increased international commingling could add some significantly higher-margin revenues too.

Bump 50:50

Rapidly growing sports and raffle business…

Included within Racing and Digital reporting, Bump 50:50 is a rapidly growing sports raffle business. Bump 50:50's electronic raffle technology helps foundations maximise their charitable fundraising efforts, with 50/50 raffles offered in-stadia and online, which result in jackpots that are divided equally between the foundation and the drawing winner.

It supplies in-stadia, web and mobile electronic lotteries to some of North America's best-known major league sports teams, collegiate sports organisations, and entertainment venues.

In 2019, Bump 50:50 began to acquire clients from the non-sport philanthropy segment with deployments of its online raffles. At the end of 2019, Bump 50:50 had 100 clients in the US and Canada, across 17 US states and Canadian provinces. An additional 35 new clients were signed in 2020 at the time of the interims, including the NFL® Tennessee Titans and Florida Panthers, and the MLB® Texas Rangers. Of the new clients, 28 are non-profit organisations seeking stable online fundraising opportunities for their worthwhile foundations.

Bump 50:50's strategy includes continued client acquisition activities in the sports charity segment, further expansion into the philanthropic charity segment, and the leveraging of web and mobile platforms to drive organic growth. Innovative products include rollover draws to enhance interest and moving the product online, where state and provincial regulations allow.

Bump is not a large business, but it does make a positive contribution to the bottom line. In 2019, on revenues +33% to £2.0m, it made EBITDA of £300k. This was down on the year before, as some new investment was made and licensing costs increased.

Bump 50:50 record, 2016-19

(£000)	2016	2017	2018	2019
Clients year-end		68	75	100
Revenue	800	1,185	1,502	2,002
EBITDA	200	540	500	300
EBITDA margin	*25%*	*46%*	*33%*	*15%*
Revenue growth		*48%*	*27%*	*33%*

Source: SPO

The business was clearly affected by COVID-19, as most of the sports venues were shut for a period of time. As they reopen, and with the additional clients and online deployments, we would expect revenues and profits to climb again.

The list of clients is truly impressive – it is the hall of fame of American sport. These are powerful allies to have, and Bump's product helps them and their charitable aims. It is not entirely clear to us how these relationships could be further monetised, but there is undoubtedly some unrealised potential there.

Lotteries

...and profitable lottery business

Bump 50:50 is a neat segue into the lotteries business. The Bump 50:50 product is a lottery, as indeed is the Tote, to some extent, with a key difference being that, in pari-mutuel wagering, there is some skill in attempting to pick the winners. Interestingly, the more exotic bets – which combine many individual bets sending the odds skywards – are more similar to straight lotteries with the size of the potential payout (and the likelihood of winning!).

SPO runs a lottery business, which came with the initial acquisition of the US Tote business. Its principal client is the Dominican Republic, where it provides core services to the national lottery (Leidsa). It provides the software, as well as the retail terminals. It has a long contract, and we believe the business is nicely profitable. There is an opportunity to update the digital offering, which could produce a significant uplift in revenues for both Leidsa and SPO.

Lot.to

In February 2019, the group acquired Lot.to Systems Limited ("Lot.to"), a UK-based digital gaming technology business, for £2m, the majority in shares in SPO. The acquisition provided SPO with a digital gaming platform, iLottery, and a specialist team focused on digital-gaming technologies. Importantly, the acquisition also provided SPO with growth opportunities through broadening the suite of gaming services offered by the group.

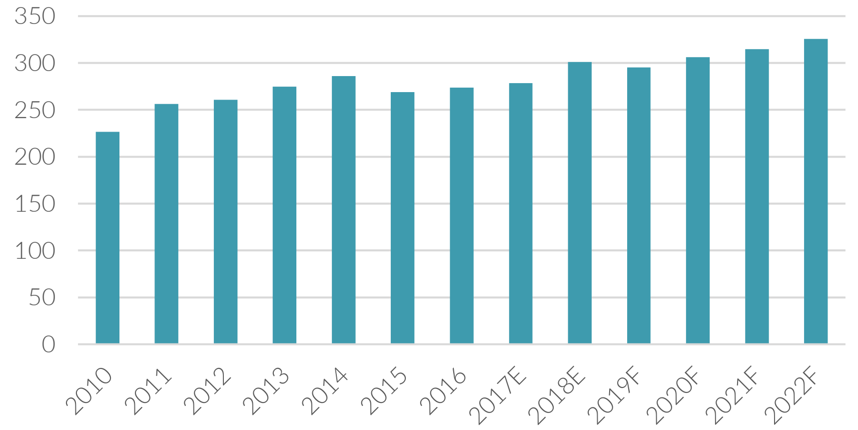
UK-regulated Lot.to was a digital specialist in the lottery sector, which developed turn-key solutions. While its "Rapid Lotto" and lotto betting verticals online had been its core consumer products, its iLottery platform has the capability to operate in any gambling vertical, including self-service POS terminals, and online and through mobiles.

The former Lot.to team originally focused on enhancing SPO's digital contract with the UK Tote. While the SPO Tote team was updating the Tote capability, crucial to being able to manage the World Pool in June 2019, the former Lot.to team was working on providing digital games on the Tote website. Now, its focus as SPO's core Lottery development team is on further enhancing SPO's capabilities and securing further Lottery business.

Future

World lottery revenues are growing steadily: GBGC has them growing at 2% p.a. from 2010 to 2018, and accelerating to 6% p.a. growth from 2018 to 2022.

Global lottery turnover, 2010-22F ($bn)



Source: GBGC

Lottery contracts tend to be lengthy, and the revenues relatively predictable. The business is typically low-capital-intensive, and so the returns are attractive. SPO would clearly like to grow this side of its business, and it has invested in its capabilities in order to improve its chances of doing so.

Conclusion

Racing and Digital a strong core

The Racing and Digital division has a strong core: it is a global business with well-recognised expertise; it has long contracts, and the revenues in normal times are very stable. There is clear potential to improve the profitability of the business as the transition is made from the capital and labour-intensive model to a slimmer digital one. This will take time. However, the only benefit to come from the COVID-19 pandemic is that SPO has been able to demonstrate that the digital systems work and can be just as revenue-productive as the traditional systems. This may hasten the switchover.

The other potential profit improver is the growth in commingling and the global efforts of the horseracing industry to promote World Pools. SPO is a beneficiary of these initiatives, whether it is running the host pool or simply feeding it from one of its many clients.

Lastly, we also see opportunity in the lottery business for SPO to win some more clients, and to grow the business from existing ones.

Venues

Optimum number of venues dependent on final decision regarding licensing of sports betting

SPO Venues offers legal betting on horseracing, greyhound racing and Jai alai (a squash-like game similar to Pelota) through both online and venue-based operations across the state of CT under an exclusive and perpetual licence. It has 14 venues in the state but a licence to operate up to 24.

All the venues were shut in March 2020, and a few remain closed today. Two have leases that mature within six months and that are unlikely to be renewed. The six that reopened in July are operating at half-capacity to comply with COVID-19 regulations. CT is a small state, both geographically and population-wise, and there is no need to have as many as 24 venues in current conditions. The optimum number will depend on the final decision taken regarding the licensing of sports betting.

Sports betting

The legalisation of sports betting in the US had been long anticipated. When SPO acquired the US racing business from Scientific Games in 2010, it came along with a contract with Shoreline Star LLC, a US company. The contract specifies that SPO has to share the profits from any new forms of gaming within CT for 25 years after the commencement of legalised new forms of gaming. The share starts at 50%, and declines to 40% after five years and to 30% after 10 years. The aggregate share will depend on the growth in the business.

In the table below, we show the proportion of the value that SPO retains, depending on the growth rate and the discount rate applied.

Proportion of upside retained by SPO

	growth	0%	2%	4%
Discount rate	12%	60%	63%	66%
	10%	63%	66%	70%
	8%	65%	70%	76%

Source: Hardman & Co Research

We have used a 10% discount rate as our central assumption, and 2% growth from the start all the way through to perpetuity. In practice, it is not that sensitive to the assumptions. On our central estimate, SPO retains two thirds of the value; rising to three-quarters if there is higher growth and a lower discount is applied; and falling to 60% with no growth and a higher discount rate.

This is, of course, a simplified model. If profits were to grow and then fall (due to new competition, say), SPO's share would be reduced. If they started low but grew later, then its share would increase. It is sufficient to say here that it is entitled only to approximately two-thirds of the value created from the new legislation. It is also worth pointing out that it does not have to pay until it has fully recovered any capital invested.

Regulatory position

Currently, 23 states have authorised sports betting, of which 19 operational

Sports betting had long been prohibited across the US (with the exception of Nevada) until the repeal of the Professional and Amateur Sports Protection Act (PAPSA) in May 2018 by the US Supreme Court. The court ruled that each state was free to rule on its own whether to allow sports betting. Each state has adopted its own approach. Currently, 23 states have authorised sports betting, of which 19 are operational. CT has yet to decide what approach to take. There have been Bills put forward in the Connecticut General Assembly, one of which would authorise four existing parties (including SPO) to take sports bets, but there is no consensus as of yet.

The good news from SPO's perspective is that it seems no outsider is likely to be authorised, whatever the outcome. Initially, some large US players argued for free competition, but that has been rejected. The problem arises because of the two tribal casinos in the state.

Tribal issues

The two casinos in CT operate under Memoranda of Understanding (MOUs) with the state. The MOUs grant the tribes exclusive rights to operate casino games in the state in exchange for 25% of the revenues from their slot machines. They pay no tax on any of the other games they operate. They currently pay ca.$250m each year – a substantial contribution to state funds. The tribes agree to continue to make these payments, so long as the state does not pass a law or regulation to allow others to operate any "video facsimile games of chance or commercial casino games" in the state.

It is beyond our competence to argue the legal niceties of the case; however, the essence of disagreement is that the tribes claim that sports betting should come under their exclusive permit and, if any other persons (e.g. SPO) were to be granted a licence that would breach the MOUs, they would no longer be obliged to hand over the 25% cut.

In 2018, Connecticut Attorney General George Jepsen provided written testimony on how sports betting under the proposed legislation could affect the Tribal agreements. He testified that sports betting was not a video facsimile, but whether it was a commercial casino game was an open question, and he was uncertain as to how a court might decide such question. He further stated that he did not believe the tribes are authorised to offer sports betting under existing gaming agreements; thus the tribes need certain state actions before offering sports betting. Finally, the Attorney General wrote that, if the state allowed sports betting and the court found it to be a casino game, then the tribes could cease making payments to the state under the terms of the MOUs. However, if they did stop paying, then the tribes would also no longer be able to operate video facsimile games.

SPO position

In SPO's view, clear solution is for state to break stalemate and license state's existing gaming operators

SPO argues that sports betting is not, nor has it ever been, classified as a "casino game" by the Compacts, by Connecticut State laws, or by the Federal Indian Gaming Regulatory Act, which unequivocally defines and regulates sports betting as something other than a "casino game".

In an independent uncontested testimony submitted in March 2020 to the Public Safety and Security Committee, Attorney Daniel Wallach, a nationally renowned expert on sports wagering and gaming law, testified, "…there are three critical factors distinguishing sports betting from a commercial casino game: (1) they are contests of skill, whereas commercial casino games are considered games of chance; (2) they involve contests taking place – and determined – outside of a casino property, whereas commercial casino games are usually confined to the four walls of a casino; and (3) in most states that allow it, sports betting is not restricted to a casino property."

In SPO's view, the clear solution is for the state to break the stalemate and license the state's existing gaming operators, including SPO, the tribes and the state lottery.

Meanwhile, state losing out on potential tax revenues

Prognosis

The tribes, so far, have taken a "nuclear option" position. They do not want anyone (i.e. SPO or the state lottery) to have a licence, and say they are prepared to jeopardise the whole legal standing of their casinos to stop it. Of course, what is likely to happen is that there would be legal action from whoever were the on the losing side, which could take months, or even years, to resolve. In the meantime, the state is losing out on potential tax revenues, and the citizens of CT are deprived of being allowed to have a legal sports flutter within the state.

The most likely outcome would seem to be some sort of compromise agreement.

Once again, COVID-19 might prove a catalyst: with the state running a substantial budget deficit, there is additional pressure to seek an agreement.

Size of CT sports betting market depends partly on what allowed and not allowed

Size of the CT sports betting market

The size of the future sports betting market in CT will partly depend on what is and is not allowed. Different states have taken different approaches. We summarise some of the approaches in the table below.

Selected US states' approach to deregulation

State	Approach
New Jersey (NJ)	80% online, pre-COVID-19; generally available at casinos and racetracks
Pennsylvania (PA)	Initially retail only at casinos and racinos; then online added in May 2019
Delaware (DE)	Wagering only at three casinos; parlay cards for football betting at lottery retailers; no mobile betting but it is allowed
Mississippi (MS)	Betting at casinos only; mobile only on casino grounds
Nevada (NV)	Been happening for decades
Rhode Island (RI)	State lottery run through two casinos; online allowed but not yet launched
West Virginia (WV)	Early to legislate; but only three venues to bet; online returned in August 2020
New York (NY)	Betting at casinos only; mobile only on casino grounds
Iowa (IA)	Retail and mobile both allowed
Indiana (IN)	Retail and mobile both allowed
Oregon (OR)	Tribes only with state lottery offering its own mobile product (data only for mobile)
New Hampshire (NH)	Launched as online only through Draftkings; retail outlets allowed; lottery will launch sports betting too

Source: Hardman & Co Research

One current legislative proposal in CT would allow betting in SPO's venues, at the two tribal casinos, and in some form of parlay through retail lottery outlets. It would also allow mobile betting by these licensees. In the table below, we show sports betting handle and revenue data for the states where betting has been taking place for more than just a few months.

Selected states, past 12 months to September 2020 gambling revenue ($m)										
State	NJ	PA	DE	MS	NV	WV	IA	IN	OR	NH
Handle	4,893.4	2,914.8	118.8	384.2	4,470.6	351.9	466.5	1,374.6	182.0	177.3
Revenue	332.8	185.4	19.4	44.3	271.2	21.7	29.0	100.7	13.1	12.2
Hold	7%	6%	16%	12%	6%	6%	6%	7%	7%	7%
Population (m)	8.8	12.7	0.9	2.97	2.7	1.85	3.05	6.5	3.8	1.3
Handle/pop ($)	556	230	132	129	1656	190	153	211	48	136
Revenue/pop ($)	38	15	22	15	100	12	10	15	3	9

Source: Legal Sports Report

We think it best to exclude Nevada and New Jersey, where betting has been taking place for decades and where seasoned gamblers travel for vacations. Excluding those two states, where the revenue per head of population is $100 and $38, respectively, the revenue per pop is $13. If we also strip out the bottom two states – New Hampshire, where betting only started in 2020, and Oregon, where the data does not capture the whole picture – the revenue rises to $14.30. If we include all the states that have reported data, even if only for a few months, annualise their latest reported month (usually September) and again strip out NV and NJ, it creeps up to $14.80.

Estimate of CT potential sports betting market ($m)							
State		**Handle**	**Revenue**	**Hold**	**Population (m)**	**Handle/pop ($)**	**Revenue/pop ($)**
New Jersey (NJ)		4,893	333	6.8%	8.8	556	38
Nevada (NV)		4,471	271	6.1%	2.7	1656	100
Pennsylvania (PA)		2,915	185	6.4%	12.7	230	15
Indiana (IN)		1,375	101	7.3%	6.5	211	15
Mississippi (MS)		384	44	11.5%	3.0	129	15
Iowa (IA)		466	29	6.2%	3.1	153	10
West Virginia (WV)		352	22	6.2%	1.9	190	12
Delaware (DE)		119	19	16.3%	0.9	132	22
Oregon (OR)		182	13	7.2%	3.8	48	3
New Hampshire (NH)		177	12	6.9%	1.3	136	9
Total	A	15,334	1,030	6.7%	44.6	344	23.1
Total ex-NV/NJ	B	5,970	426	7.1%	33.1	181	12.9
Total ex-NV/NJ/OR/NH	C	5,611	400	7.1%	28.0	201	14.3
Last month annualised (ex-NV/NJ)	D	15,230	907	6.0%	61.4	248	14.8
Connecticut	A	1,228	82	6.7%	3.57	344	23.1
Connecticut	B	644	46	7.1%	3.57	181	12.9
Connecticut	C	716	51	7.1%	3.57	201	14.3
Connecticut	D	886	53	6.0%	3.57	248	14.8

Source: Hardman & Co Research

If you apply the rates to CT's population of 3.6m, you arrive at revenue of ca.$50m (or $82.5m if you include NV and NJ).

We estimate that these numbers are too low because of the impact of the pandemic. While betting came back strongly in September, momentum was lost, and retail outlets continue to be affected, even though online betting can carry on pretty much unaffected. We would expect the natural level to be about 50% higher, at $75m, or ca.$20 per head.

There are other variables between states as well, including tax rates and relative affluence.

Potential profit opportunity

Three scenarios for profit opportunity:

There are too many unknowns to be able to model accurately what the benefits to SPO might be. Here we look at three scenarios: status quo; SPO pays a tithe to the Tribes; and SPO receives a compensation revenue stream.

No resolution

Status quo;

If the stand-off continues and there is no resolution, then the Venues business continues to survive off pari-mutuel betting only. The estate is too large for that. We would expect it to shrink back to, perhaps, 10 venues, possibly fewer, plus the online operation.

Venues performance, 2016-19

($m)	2016	2017	2018	2019
No. of venues	15	16	16	15
F&B Stanford	0.0	1.9	3.0	2.5
F&B other	3.5	3.3	3.3	3.1
F&B total	3.5	5.2	6.3	5.6
Wagering revenue	36.2	35.8	34.1	31.0
Total revenue	39.7	41.1	40.4	36.6
Cost of goods sold	-20.4	-21.0	-20.6	-18.8
Contribution	19.3	20.1	19.8	17.8
Adj. operating expenses	-16.0	-18.2	-17.9	-14.9
Adjusted EBITDA	3.3	1.9	1.9	2.8

Source: Hardman & Co Research

Of the $37m of revenues, about 15% comes from selling food and drinks (F&B), which achieve around a 70% gross margin, and nearly half of which are served in the Stamford facility. Of the wagering revenue, just under half is swallowed up paying Tote and track fees. In 2017 and 2018, the Venues business made less than $2m of EBITDA, which means it was unlikely to have made a positive net contribution after necessary investment.

In 2019, one small venue was closed, but the EBITDA line is flattered by the introduction of IFRS16, which removed ca.$1.8m of lease expenses from the EBITDA calculation. The reduction in revenue and profits was a function of out-of-state competition. SPO suffered from both illegal activity from out-of-state operators taking bets from CT citizens and also from locals going over state borders to bet on sports, which is legal in neighbouring states.

After vigorous lobbying, the state eventually closed a loophole to clarify and support SPO's exclusive licence to conduct off-track betting through both internet and mobile channels. The law did not take effect until October 2019, though. Subsequently, in 2020, SPO agreed with the CT Legislature to provide a platform for out-of-state operators to source customers in the state, with a fee to be paid to SPO and taxes to be paid to the state.

With the contribution more than halving in the first half of 2020, due to all the venues being closed for more than half the period, the Venues busines reported negative EBITDA of £1.4m. We expect the full year to record an EBITDA loss of £2.3m.

In a full year, with 10 venues operating under the current rules (i.e. no sports betting), and assuming no further lockdowns, we expect revenue to fall to £23m, but remaining EBITDA-positive, at ca.£0.5m.

SPO pays tithe to Tribes;

Sports betting approved

We have assumed, under this heading, that, in order to pave the way for agreement on sports betting, SPO agrees to pay the tribes a percentage of net gaming revenue. Of course, it may be that it has to pay nothing, in which case the additional income would fall straight to the bottom line.

There are numerous assumptions to be made to arrive at what this option might be worth to SPO, in addition to the size of the market. We need to estimate what proportion of the overall revenue opportunity SPO will win and what proportion of it will be online/mobile. We have to make some additional assumptions about marginal extra costs and the tax rate that will be applied to sports betting revenues.

To try to keep the model simple, we have assumed the same number of venues as under the "status quo" option. In practice, SPO is likely to keep more open, but we think the additional profits would be marginal and within our error range.

So, assuming there is $75m of betting revenue, we have deducted 15% gaming tax, and we assume that SPO wins half the business available, with the rest shared between the casinos and the state lottery operator. We have taken the tribes payment at 10%. We have then assumed that 80% of SPO's turnover comes from online business. We have then used Regulus Partners' business model template.

Sports betting P&L – *pro forma* business model

($m)	Land-based	Online
Net revenue	100	100
Taxes	-15	-15
Marketing		-25
Payment costs		-4
Gross profit	85	56
Technology & content	-10	-10
Personnel		-15
Other	-25	-11
Operating profit	50	20

Source: Regulus Partners and Hardman & Co Research

For SPO, we have assumed that there are no extra personnel or property costs in the bricks and mortar share. So, the EBITDA drop-through for online is 20% and for the venues is 50%.

Venues performance, 2016-19

($m)	Main	Alt 1	Alt 2	Alt 3
Total Sports betting revenue	75.0	50.0	75.0	75.0
Sports betting tax	15%	15%	15%	15%
SPO share	50%	50%	80%	50%
Tribes payment	10%	10%	10%	0%
Online percentage	80%	80%	80%	80%
Online net revenue	23	15	33	26
Offline net revenue	6	4	8	6
F&B	4.0	4.0	4.0	4.0
Services	26.0	26.0	26.0	26.0
Sports betting net revenue	28.7	19.1	45.9	31.9
Net revenues	58.7	49.1	75.9	61.9
Venues costs	-29.0	-29.0	-29.0	-29.0
Additional online costs	-18.4	-12.2	-29.4	-20.4
Additional venue costs	-2.9	-1.9	-4.6	-3.2
Total costs	-50.2	-43.2	-63.0	-52.6
EBITDA	**8.5**	**6.0**	**12.9**	**9.3**
EBITDA £ (@1.30)	6.5	4.6	9.9	7.1

Source: Hardman & Co Research

The net result of all these assumptions is an EBITDA of £6.5m, including the underlying £0.5m we are forecasting for the venues on a standalone basis.

There is clearly large scope for error in these numbers. In the table above, we have changed some of the variables (only one at a time). We think the lower bound might be £4.6m and the upper bound could be as high as £10m. Alt 3 is the alternative where the tribes do not receive any payment.

The additional value to SPO, assuming a 10x multiple of EBITDA and remembering that it retains only two thirds of the value, with the balance paid to Shoreline Star, is £40m, or 21p per share.

Tribes pay SPO a percentage.

SPO receives compensation revenue stream

An alternative to SPO paying a tithe to the tribes is the tribes paying SPO a revenue share for their agreement to waive their exclusive right to betting in the state. It is very hard for us to make an assumption about what level this share would be struck. If only the tribes are permitted to take sports bets, we would expect the revenue to be lower, say at $60m. If the tribes were to pay 10% after tax of 15%, that would equate to ca.$5m per year, with no additional effort on SPO's part.

This is a purely illustrative example.

Again, we would put a 10x multiple on SPO's 66% share, which would equate to $33m, or £25m (13p per share).

Forecasts

First reported profit for some years not expected until 2022

Forecasting in the time of COVID-19 is even more difficult than usual. We have assumed revenues to bounce back partially in the second half of 2020 and continue to recover in 2021. Gross margins are static. We have assumed that some costs lost in the first half remain saved and some of the additional costs from dealing with COVID-19 are not repeated. Consequently, the adjusted operating costs (adjusted for non-repeating items, non-cash compensation and excluding depreciation and amortisation) are forecast to come in at £18.5m below 2019's £22.8m. That leaves adjusted 2021E EBITDA at £6.2m.

We estimate 2021 revenue to be most of the way back to 2019 levels, at £58.4m, with costs rising too, but not proportionately, leaving underlying EBITDA at £8.0m. For 2022, we expect steady progress to be made in reducing costs (and seeing some contraction in revenue in the Racing and Digital business), and underlying EBITDA climbing to £9.5m.

Our forecasts assume no change on the sports betting front in CT and no additional clients won in the lottery business, and no net new clients in the Tote business. Steady improvement is seen in Bump 50:50.

By 2022, we see the first reported profit for some years but, all the while, the business is generating cash, as the capex spend (ca.£2.5m) is well below the £7m depreciation and amortisation charge.

Divisional split

Year-end Dec (£000)	2017	2018	2019	2020E	2021E	2022E
Revenue from sale of goods	1,389	1,770	1,420	1,000	1,200	1,200
Bump 50:50	1,185	1,502	2,002	900	2,200	2,600
Service revenue	32,895	30,732	33,103	27,000	32,000	31,000
Total revenue	35,469	34,004	36,525	28,900	35,400	34,800
Cost of sales	-4,335	-3,991	-4,446	-3,757	-4,250	-4,050
Gross profit	31,134	30,013	32,079	25,143	31,150	30,750
Marketing & distribution	-754	-736	-648	-443	-650	-750
Contribution	30,380	29,277	31,431	24,700	30,500	30,000
Adj. operating costs	-22,672	-20,634	-22,845	-18,500	-22,000	-20,000
Adj. EBITDA 2	7,708	8,643	8,586	6,200	8,500	10,000
GP	*88%*	*88%*	*88%*	*87%*	88%	88%
Contribution	*86%*	*86%*	*86%*	*85%*	86%	86%
Adj. EBITDA	*22%*	*25%*	*24%*	*21%*	24%	29%
Revenue	*-2%*	*-4%*	*7%*	*-21%*	22%	-2%
Contribution	*5%*	*-4%*	*7%*	*-21%*	23%	-2%
Adj. EBITDA	*-18%*	*12%*	*-1%*	*-28%*	37%	18%
Venues						
Revenue from F&B		4,724	4,395	2,000	3,000	3,000
Service revenue	31,606	25,399	24,431	15,000	20,000	21,000
Total revenue	31,606	30,123	28,826	17,000	23,000	24,000
Cost of sales	-14,760	-14,241	-14,018	-8,500	-11,500	-12,000
Gross profit	16,846	15,882	14,808	8,500	11,500	12,000
Marketing & distribution	-1,364	-996	-824	-600	-600	-600
Contribution	15,482	14,886	13,984	7,900	10,900	11,400
Adj. operating costs	-13,985	-13,473	-11,756	-10,000	-9,400	-9,800
Adj. EBITDA 1	1,497	1,413	2,228	-2,100	1,500	1,600
Sports investment		-1,428	-1,773	-200	0	0
Adj. EBITDA 2	1,497	-15	455	-2,300	1,500	1,600
Corporate costs	-2,498	-2,088	-1,501	-2,000	-2,000	-2,100
Adj. EBITDA 2	6,707	6,540	7,540	1,900	8,000	9,500
GP	*53%*	*53%*	*51%*	*50%*	50%	50%
Contribution	*49%*	*49%*	*49%*	*50%*	50%	50%
Adj. EBITDA	*5%*	*5%*	*8%*	*-12%*	7%	7%
Revenue	*7%*	*-5%*	*-4%*	*-41%*	35%	4%
Contribution	*7%*	*-4%*	*-6%*	*-44%*	38%	5%
Adj. EBITDA	*-39%*	*-6%*	*58%*	n/a	n/a	7%

Source: Hardman & Co Research

Income statement						
Year-end Dec (£000)	**2017**	**2018**	**2019**	**2020E**	**2021E**	**2022E**
Revenue	66,271	63,462	64,783	45,900	58,400	58,800
Cost of sales	-18,562	-17,619	-17,896	-12,257	-15,750	-16,050
Gross profit	47,709	45,843	46,887	33,643	42,650	42,750
Marketing and distribution costs	-2,118	-1,732	-1,472	-1,043	-1,250	-1,350
Contribution	45,591	44,111	45,415	32,600	41,400	41,400
Ordinary operating costs	-63,289	-43,743	-53,240	-44,047	-40,900	-39,000
Exceptional op. costs	-4,776	-3,453		220	0	0
Other income	827	173	90			
Operating loss/profit	**-21,647**	**-2,912**	**-7,735**	**-11,227**	**500**	**2,400**
Finance costs	-212	-290	-758	-1,000	-1,000	-1,000
Finance income	193	540	63	27		
Joint ventures and associates	-1,484					
Loss before tax from continuing operations	**-23,150**	**-2,662**	**-8,430**	**-12,200**	**-500**	**1,400**
Tax – continuing operations	230	-2,019	-6,034			
Loss for the year – continuing operations	-22,920	-4,681	-14,464	-12,200	-500	1,400
Net profit/(loss) from discontinued operations	-1,522	1,822				
Loss for the year	**-24,442**	**-2,859**	**-14,464**	**-12,200**	**-500**	**1,400**
Attributable to:						
Owners of the company	-24,300	-2,859	-14,464	-12,200	-500	1,400
Non-controlling interests	-142					
No of shares (m)						
Basic	190.135	186.393	188.543	188.543	188.543	188.543
Diluted	190.135	186.393	188.543	188.543	188.543	188.543
EPS (p)						
Basic	-12.8	-1.5	-7.7	-6.5	-0.3	0.7
Diluted	-12.8	-1.5	-7.7	-6.5	-0.3	0.7
Pre-exceptional EPS (p)						
Basic	-9.5	-0.7	-7.7	-6.6	-0.3	0.7
Diluted	-9.5	-0.7	-7.7	-6.6	-0.3	0.7
Adjusted EPS (p)						
Basic	0.9	-0.8	-3.6	-3.8	0.0	1.0
Diluted	0.9	-0.8	-3.6	-3.8	0.0	1.0

Source: Hardman & Co Research

Balance sheet

@31 Dec (£000)	2017	2018	2019	2020E	2021E	2022E
Assets						
Non-current assets						
Goodwill			604	600	600	600
Intangibles	11,629	13,551	14,935	14,500	14500	14500
P, P & E	25,705	26,337	17,676	14,500	14500	14500
Right-of-use assets			6,312	2,000	2000	2000
Trade receivables	2,443	667	499	500	500	500
Deferred tax assets	6,406	5,979	990	1,200	1,200	1,200
	46,183	**46,534**	**41,016**	**33,300**	**33,300**	**33,300**
Current assets						
Trade receivables	10,342	8,169	7,603	6,935	6,535	6,035
Inventories	2,652	2,576	2,616	2,500	2,500	2,500
Assets held for sale	778					
Cash	18,757	17,915	15,565	11,915	13,815	16,715
	32,529	**28,660**	**25,784**	**21,350**	**22,850**	**25,250**
Total assets	**78,712**	**75,194**	**66,800**	**54,650**	**56,150**	**58,550**
Liabilities						
Current liabilities						
Trade payables	-16,058	-13,169	-12,853	-14,500	-16,500	-17,500
Provisions	-1,103	-977	-579	-500	-500	-500
Financial liabilities	-175		-1,343	0	0	0
Current tax	-7,106	-6,563	-4,969	-5,000	-5,000	-5,000
	-24,442	**-20,709**	**-19,744**	**-20,000**	**-22,000**	**-23,000**
Non-current liabilities						
Retirement benefits	-1,537	-902	-1,079	-1,200	-1,200	-1,200
Lease liabilities			-6,881	-4,000	-4,000	-4,000
Deferred tax			-93			
Provisions	-1,523	-1,434	-1,026	-1,200	-1,200	-1,200
	-3,060	**-2,336**	**-9,079**	**-6,400**	**-6,400**	**-6,400**
Total Liabilities	**-27,502**	**-23,045**	**-28,823**	**-26,400**	**-28,400**	**-29,400**
Net assets	**51,210**	**52,149**	**37,977**	**28,250**	**27,750**	**29,150**
Equity						
Share capital	37,123	37,350	37,750	37,750	37,750	37,750
Other reserves	22,400	18,435	16,872	19,500	19,500	19,500
Retained earnings	-8,313	-3,636	-16,645	-29,000	-29,500	-28,100
Total equity	**51,210**	**52,149**	**37,977**	**28,250**	**27,750**	**29,150**

Source: Hardman & Co Research

Cashflow

Year-end Dec (£000)	2017	2018	2019	2020E	2021E	2022E
Loss before tax (continuing ops.)	-23,150	-2,662	-8,430	-12,200	-500	1,400
Depreciation and amortisation	4,630	4,777	7,694	8,100	7,500	7,100
JVs	1,484					
Exceptionals (reverse)	23,058	3,453	6,160	5,000		
Net finance (reverse)	19	-250	695	500	500	500
Other	645	1,155	1,421			
Operating cashflow	6,686	6,473	7,540	1,400	7,500	9,000
Working capital change	-268	-583	-62	0	0	0
Operating cashflow after NWC	**6,418**	**5,890**	**7,478**	**1,400**	**7,500**	**9,000**
Net interest	-235	63	38	-150		
Tax	-15,859	-2,029	-1,356	-1,000	-1,500	-2,000
Net cash from ops. pre-exceptionals	**-9,676**	**3,924**	**6,160**	**250**	**6,000**	**7,000**
Exceptionals	-11,820	-1,870	-1,731	-300		
Net cash from operations	-21,496	2,054	4,429	-50	6,000	7,000
Investing						
P, P & E	-6,905	-1,927	-1,169	-1,000	-1,000	-1,000
Buying intangibles	-3,948	-3,106	-2,648	-1,000	-1,500	-1,500
JVs	-173	-291	-184			
Acquisitions		-167	-729			
Disposals	88,533	2,686	237			
Net cash used in investing (ex-discontinued)	77,507	-2,805	-4,493	-2,000	-2,500	-2,500
Discontinued	-1,104					
Net cash invested	**76,403**	**-2,805**	**-4,493**	**-2,000**	**-2,500**	**-2,500**
Financing						
Lease payments			-1,879	-1,600	-1,600	-1,600
Distribution to shareholders	-75,020					
Net cash used in financing	-75,020	0	-1,879	-1,600	-1,600	-1,600
Net change in cash	**-20,113**	**-751**	**-1,943**	**-3,650**	**1,900**	**2,900**
FX	-357	-91	-407			
Cash held by assets for sale	-413					
Cash at beginning	39,640	18,757	17,915	15,565	11,915	13,815
Cash at end	18,757	17,915	15,565	11,915	13,815	16,715
Customer funds	-2,872	-3,187	-2,580	-2,580	-2,580	-2,580
Corporate cash	**15,885**	**14,728**	**12,985**	**9,335**	**11,235**	**14,135**

Source: Hardman & Co Research

Valuation

We derive valuation of 32p-55p per share

COVID-19 makes valuation particularly difficult – the uncertainty makes investors nervous and forecasting tricky. However, SPO reported a certain amount of reassuring resilience in the first half, with cash outflow restricted to £3m before the impact of FX. Nevertheless, the shares are down 45% year to date, as investors fear that SPO's exposure to leisure spend leaves it vulnerable in the face of further lockdowns.

SPO's depreciation and amortisation charge is substantially higher than its necessary capital expenditure requirement. Management believes that not enough attention was paid to capex historically, and there was wasted spend. The gradual shift of the business away from physical terminals should also reduce capital requirements. We believe investors should focus on EBITDA, or EBITDA less maintenance capex, as the prime valuation metric.

Enterprise value

SPO's enterprise value needs careful calculation. In addition to the usual adjustment for net cash, we need to consider some provisions previously made that may turn into cash payments, the lease liabilities, and also the potential proceeds from the sale of a freehold venue.

Provisions

SPO made a provision of £5m for a potential tax liability relating to the disposal of the Spot-the-ball business and the use of capital losses to offset the gain. The provision is included in the current tax liability. If this is paid, then it will be deducted from cash, so it makes sense to adjust the EV calculation accordingly.

There is also a £1.6m provision against an onerous contract in California, which will also likely convert into cash payments.

Following the introduction of IFRS16, onerous lease provisions are added to lease liabilities. We need to include the lease liabilities in our EV calculation, because the offsetting lease payments are no longer deducted from EBITDA. The lease liabilities recorded on the balance sheet at the interim stage were £5.6m.

Property disposal

SPO was in the process of selling a freehold property in CT when COVID-19 interrupted the sale. It is still likely to go through. The proceeds will be of the order of £5m. Normally, we would have to adjust the lease liabilities to include future rental payments; however, in this case, the venue will not be reopening and, since it does not make a positive contribution to EBITDA, there is no need to adjust the earnings number.

SPO owns another freehold property worth approximately £3m. We have not included this in the EV calculation, but it adds an element of conservatism into the numbers.

Enterprise value calculation (£m)			
Share price (p)	18		
Market cap	33.9		
EV adjustments			
Net cash	-9.3		
Lease liabilities	5.6		
Tax provision	5.0		
Freehold property	-5.0		
Total adj.	-3.7		
Enterprise value	30.2		
	2020E	2021E	2022E
Underlying EBITDA	1.9	8.0	9.5
EV/EBITDA (x)	15.9	3.8	3.2

Source: Hardman & Co Research

The enterprise value at a current share price of 18p equates to £30m. With forecast EBITDA for 2021 of £8m and 2022 of £9.5m, that implies that SPO trades at EV/EBITDA of 3.8x and 3.2x, respectively.

Peer group

There are various gambling technology companies listed in Europe, which seem to provide the best comparison. Of course, none is a perfect comparator, as none has the exposure to the venues business in CT. Before the addition of the value of the sports betting licence in CT, the venues business is not a substantial part of the value, and so is not a major distortion.

Estimate of CT potential sports betting market (US$m)

					EBITDA		EV/EBITDA	
($m)	**Price**	**Currency**	**Mkt. cap.**	**EV**	**2021**	**2022**	**2021**	**2022**
Gaming Innovation Group	0.69	EUR	62	96	22	23	4.4x	4.2x
Global Gaming 555	11.00	SEK	450	362	32	42	11.3x	8.6x
Quixant PLC	115.00	GBP	76	85	10	14	8.5x	6.1x
Kambi Group	29.00	EUR	894	861	52	51	16.6x	16.9x
Average							10.2x	8.9x
Average ex-Kambi							8.1x	6.3x

Source: Refinitiv

Kambi is a bit of an outlier in EV/EBITDA multiples, so we have excluded it and used the average of the other three. Applying this to SPO's forecast EV and then adjusting for the two values we derived for the sports betting licence derives the following value.

Enterprise valuation

(£m)	**2020E**	**2021E**	**2022E**
EBITDA	1.9	8.0	9.5
EV/EBITDA (x)	15.9	3.8	3.2
Peer group multiple (x)	16.5	8.1	6.3
SPO EV	31	65	60
SPO share price (p)	19	34	32
Betting licence potential (p per share)			
Upper		21	21
Lower		13	13
SPO value (p per share)			
Upper		55	53
Lower		47	45

Source: Hardman and Co Research

We derive a valuation of between 32p and 55p per share, with the lower bound assuming no benefit from a sports betting licence in CT.

Risks

COVID-19, regulation, betting competition, client concentration and losses are all risks

In addition to all the normal business risks, SPO faces the following potential threats:

COVID-19

In the initial phases of the lockdown, all venues were closed, as were the racetracks and sports stadiums. With no racing or sporting events taking place, there was no betting or raffles. As things reopened around the world, the value of having online betting and international commingling was very apparent. SPO will suffer again, though, if there is a repeat of lockdown policies. There is also limited mitigation if everything shuts down, but the past year has shown how much can continue remotely, if at all possible. SPO had a net cash outflow between the end of February and the end of June of just £1.4m, so, with net cash at the half-year of just under £10m, it is well positioned to survive another short interruption.

Regulation

Gambling is subject to regulation and taxation the world over. SPO holds numerous licences around the globe, and breaching the terms of these licences could have serious consequences. In particular, the company needs to be on top of data regulation and security. Tax regimes can change, too, making profitable products suddenly untenable. We see no particular risk on this front, but it is ever-present in theory.

The decision of the CT lawmakers about sports betting also has substantial consequences for SPO, as discussed elsewhere in this report.

Betting competition

Horseracing is the most mature of all betting activities, and faces new competition, in particular from other sports betting, notably in the US. Increased sports betting activity can draw customers' dollars away from horseracing, but it can also introduce it to customers who had not bet before, and it can increase the numbers at racetrack and OTB venues around the US. The global horseracing industry is increasing the number of international pool events to encourage greater participation.

Client concentration

SPO notes, in its annual report, that "while the Group has a broad base of business clients and no client accounts for more than 10% of group revenue, there are certain clients within the Group, which if lost, could have a more significant impact on net contributions and Group". It has also suffered leakage in the past – when rival betting organisations have been illegally servicing clients in CT where SPO has an exclusive licence. After intense lobbying, the CT Senate did eventually tighten up the regulation. Subsequently, SPO agreed to let out-of-state operators use its platform in exchange for an ongoing fee and compliance with CT state taxes.

Losses

SPO has reported losses for the past three years, and we expect COVID-19-hit 2020 to add another year. Our forecast has SPO close to breakeven next year, but assuming no benefits of sports betting in CT. At the same time, the business has been substantially EBITDA-positive. There has been a long list of exceptionals and one-off costs. Management has been keen to state that it is focused on reducing the one-offs to a minimum. The company remains significantly net cash-positive.

Directors

Richard McGuire, CEO

Richard has expertise in capital markets and the leisure and gaming industries, and has held a number of non-executive directorships. Prior to joining SPO, Richard was Chairman at Timeweave PLC, the joint owner of TurfTV. He also held the position of non-executive director at Mitchells and Butlers PLC, one of the largest operators of restaurants and bars in the UK.

Tom Hearne, CFO

Tom has extensive experience in the fields of digital technology and sports media, with a long track record of driving growth, increasing profitability, and executing successful M&A transactions. Prior to joining SPO, Tom was CFO for theScore, a sports digital media-focused company, and he has held multiple CFO and Director roles within numerous companies.

Giles Vardy, non-executive chairman

Giles brings more than 35 years of business and boardroom experience, latterly in non-executive roles at public and private companies, including President and CEO of Fidelity Brokerage Services. He also held senior investment banking positions at firms, including Salomon Brothers, County NatWest and Swiss Bank Corporation. His gaming industry experience includes the role of Non-Executive Chairman of Trident Gaming Limited from 2005 to 2008.

Chris Rigg, non-executive director

Chris has considerable business and boardroom experience in executive roles at public and private companies. He has previously held both non-executive and executive directorships at quoted companies, including Clinigen Group PLC and Quantum Pharma PLC. During his time at Quantum Pharma, Chris held a number of senior positions, including Group Strategic Director, Chief Financial Officer, and Chief Executive Officer. Chris has now been appointed as Chief Executive Officer for Mandata.

Ben Warn, non-executive director

Ben is a digital specialist bringing over 20 years' experience in senior commercial, business development and marketing roles within the betting and gaming industry. His passion is combining sports content with technology to create new products, drive revenue and increase user engagement. Ben has held Senior Executive positions with Ukbetting PLC, Rank Interactive, and Sky Betting and Gaming, the most recent being at the Perform Group, where he was CEO of its Gaming division.

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(Disclaimer Version 8 – Effective from August 2018)

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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