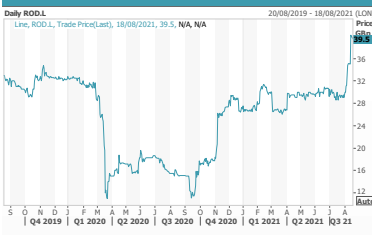




19 August 2021

Casinos & Gaming



Source: Refinitiv

Market data

EPIC/TKR	SPO
Price (p)	40
12m high (p)	41
12m low (p)	11
Shares (m)	188.5
Mkt cap (£m)	75
EV (£m)	33
Free float*	100%
Country of listing	UK
Market	AIM

*As defined by AIM Rule 26

Description

Sportech runs gaming venues in Connecticut under an exclusive licence, and services the lottery in the Dominican Republic. It also has a small, but profitable, online pari-mutuel sports betting business.

Company information

CEO	Richard McGuire
CFO	Tom Hearne
Chairman	Giles Vardey

ir@sportechplc.comwww.sportechplc.com

Key shareholders

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

Diary

Sep'21	Interim results
2H'21	Connecticut decision
Oct'21	Cash returned

Analyst

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SPORTECH PLC

Cash payout

Sportech (SPO) has announced plans to return £36m surplus cash to shareholders by way of a tender offer, at 40p for up to 47% of the issued share capital. Assuming the offer is all taken up, SPO will be left with 100m shares outstanding. The deal requires court approval to create the necessary distributable reserves. SPO also announced that it was in discussions to sell its terrestrial lottery business for ca.\$14m. The potential upside from the newly agreed sports betting deal in Connecticut (CT) remains uncertain but could be significant. We see a range of values from 39p to 46p per share prior to the tender offer.

- ▶ **Tender offer:** Following various disposals, the company was sitting on substantial surplus cash. It is negotiating to sell its terrestrial lottery business in the Dominican Republic for between \$14m and \$15m. The venues in CT, the online lottery business and an online pari-mutuel sports betting business will remain.
- ▶ **Venues in CT:** The big unknown is what happens in CT. SPO revealed that it had agreed a 10-year deal with the CT Lottery Corp. (CLC) to deliver sports betting in its venues and promote CLC's online and mobile channel. We don't know how profitable this will be, but it will certainly be a fillip to the venues business.
- ▶ **Valuation:** An owner of 100 shares thus has 47 shares worth 40p each plus 53 shares worth an estimated 41p to 54p each. Overall, therefore, we estimate the value of SPO's shares to be between 39.3p and 45.9p. The uncertainty around the lottery disposal should be removed by the end of September.
- ▶ **Risks:** There is a risk that the lottery disposal fails to complete, and there is also a very clear risk that the outcome of the CT gaming process is below our lower-end expectations. Once the cash is returned, SPO's equity will be substantially smaller, rendering the shares less liquid.
- ▶ **Investment summary:** SPO is a much-slimmed-down business than the one we first wrote about last November. The remaining venues business should bounce back into profitability in its slimmed-down form. The upside is unknowable and depends on how sports betting pans out in CT, but it could provide significant upside. Plus, there are the two online businesses: a risk-free pari-mutuel online sports gaming business and the online lottery business worth, maybe, £3m.

Financial summary and valuation (continuing businesses only from 2019)

Year-end Dec (£m)	2017	2018	2019	2020	2021E	2022E
Revenue	66	63	34	20	28	30
Underlying EBITDA	6.7	8.0	3.4	-2.0	1.5	3.1
Adjusted EBIT	1.8	0.5	-2.2	-5.4	-0.8	0.8
Reported EBIT	-21.6	-2.9	-8.9	-10.0	-0.8	0.8
Underlying PTP	1.5	0.6	-2.9	-5.9	-0.6	1.0
Statutory PTP	-23.2	-2.7	-9.7	-10.6	-0.6	1.0
Underlying EPS (p)	0.9	-0.8	-4.6	-2.2	-0.3	0.5
Statutory EPS (p)	-12.8	-1.5	-7.7	-6.8	5.7	1.1
Net (debt)/cash	15.9	14.7	13.0	11.4	43.7	46.0
Shares issued	190	186	189	189	189	189
P/E (x)	42.8	n/m	n/m	n/m	n/m	75.5
EV/EBITDA (x)	4.9	4.1	9.6	n/m	21.8	10.5

Source: Hardman & Co Research

Summary

Recent transactions will leave SPO with venues business and two online businesses as well as £46.5m of net cash

In December 2020, SPO, having rebuffed a 28.5p per share takeover approach from US investment firm Standard General, announced the sale of its largest business, Global Tote, to Australian company Betmakers Technology Group, for £30.9m. In February 2021, SPO announced the sale of its Bump 50:50 digital raffle business. The buyer, Canadian Bank Note Company, paid £4.6m upfront, with a further £1.1m due, dependent on performance, in 2022. Also, during 2020, SPO negotiated the sale of a freehold building in New Haven, CT. In the books for £1.2m, it agreed a sale for ca.£4.4m, and also a leaseback for no more than 18 months while it looks for a new premises for its venue.

Combined, these deals produced net cash proceeds of £36.1m (up to £37.2m including the earnout) after deal expenses and tax. Together with the £5.2m of cash on the balance sheet at the year-end (excluding the £6.2m Global Tote deposit), this left SPO with ca.£41m of cash, with a potential further £1m to come.

If the disposal of the terrestrial lottery business in the Dominican Republic goes through – at an estimated \$14m-\$15m – that will add another ca.£10m (net of expenses). SPO is retaining its newly developed online business there.

Offsetting all of this are two liabilities: a possible tax bill of £4.7m plus interest related to a previous disposal and a further £3.9m of outstanding lease liabilities. This will leave SPO with £42.7m net cash, of which it intends to pay out £35.5m in the announced tender offer.

What remains are three businesses – its online lottery business, a pari-mutuel online sports betting business and the CT venues. The impact of the deregulated sports betting market in CT is unknowable, but it must provide enhanced profitability (and indeed viability) to the venues business: it is the scale of that upside that is impossible to calculate. We value the first two businesses at a combined £3m and the venues business, without any sports betting uplift, at ca.£26m. We estimate that the impact of the sports betting will increase the value of the venues business by between 50% and 100%. From this total, we need to subtract capitalised central costs (£8.8m).

We derive a value for the business remaining after the disposals and the tender offer of ca.£28m. To this, we think any sports betting upside might add between £13m and £26m. This equates to a value today of 33.6p per share before the tender offer and before venues upside. With the upside, that comes to a range of between 40.6p and 47.6p.

Venues

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

SPO's venues business 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 11 venues currently operating in the state but a licence to operate up to 24.

All the venues were shut in March 2020, and two leases expired and were not renewed. The venues that have reopened are operating at half capacity to comply with COVID-19 regulations. The company is hopeful that they will be allowed to operate at full capacity come September 2021 and at the start of the NFL season.

Betting is recovering well, but the food and beverage offer is expected to take longer to get back to its previous level.

Venues business – revenue and profits (2019-22E)				
Year-end Dec (£000)	2019	2020	2021E	2022E
Revenue from F&B	4,395	1,472	2,000	2,000
Service revenue	24,431	15,596	22,000	24,000
Total revenue	28,826	17,068	24,000	26,000
Cost of sales	-14,018	-8,624	-12,000	-13,000
Gross profit	14,808	8,444	12,000	13,000
Marketing & distribution	-824	-311	-600	-700
Contribution	13,984	8,133	11,400	12,300
Adj. operating costs	-11,756	-9,218	-9,400	-9,800
Adj. EBITDA	2,228	-1,085	2,000	2,500

Source: Hardman & Co Research

While the venues were shut, the online business, MyWinners.com, came into its own. The CT online handle (value of bets made) increased by 43% in the year, and, overall (i.e. including non-CT retail clients), it rose 72%, making it a third of the total retail handle for the full year. Many customers who have moved to online betting will not move back to betting in the physical outlets.

CT is a small state, both geographically and population-wise, and there is no need to have as many as 24 venues in the current conditions. The optimum number will depend on the final decision regarding the licensing of sports betting.

Sports betting

Outcome of sports betting in CT is unknowable at this stage

We discussed the sports betting situation in CT at length in our report, *Bettor Technology*, published in November 2020. In summary, the State legislature was looking at ways to introduce sports betting in the State, and there were competing parties with differing views on their entitlement to the rights to offer new betting products.

In March 2021, the State announced a proposal to expand gaming, specifically sports wagering and iGaming, in a deal with the Mashantucket Pequot and the Mohegan Tribes and the State Lottery. The proposal includes 15 retail sports betting locations awarded to the State Lottery, with a right to sub-license some of those locations to SPO venues.

This was very much not what SPO was looking for; nor is it what it believed it was entitled to under its exclusive perpetual gaming licence in the State. The company subsequently negotiated an exclusive 10-year deal with the CLC) which, subject to required regulatory consents, provides SPO venues, in conjunction with CLC's sports book provider Rush Street Interactive, an ability to deliver sports betting across its retail estate and promotes CLC's online and mobile channel.

Sports betting is expected to start almost immediately in CT with the all-important NFL season due to start on 9 September. SPO's partners might not be ready for the very beginning of the season but should be shortly afterwards. We have assumed no contribution in 2021.

We have trimmed both our 2021 and 2022 estimates slightly, so that underlying EBITDA becomes £1.5m (from £2.2m) and £3.1m (from £3.3m), respectively. We have not included any uplift from sports betting in either year; we leave that to our valuation scenario, below.

It is important to remember that SPO has to share the upside of the sports betting with a former vendor of the business, Shoreline Star. The detail is explained in our November 2020 report, but the summary is that Shoreline is entitled to an approximate front-loaded one third of the profits.

Valuation

Peer valuation implies 8x 2022E
EV/EBITDA for SPO not unreasonable

The peers (particularly Gaming Innovation Group and Quixant) we used previously in our November 2020 report for valuation purposes were more appropriate for the Global Tote business; nevertheless, they were trading at around 8x 2022E EBITDA. Scientific Games in the US, which is a large lottery player, is trading on 9x 2022E EBITDA. So, 8x 2022E EV/EBITDA for SPO does not seem unreasonable, in our view.

We expect central costs to be reduced to an annual run rate of £1.1m and we have capitalised them at the same multiple.

Valuation scenarios		
	Value (£m)	
Cash	5.2	At FY20 year-end, ex £6.2m deposit
Tote proceeds	30.9	
Bump proceeds	4.6	(ex £1.1m earnout)
Lotteries proceeds	10	
Freehold property	4.4	
Transaction costs	-3.8	
Total disposals	51.3	
Lease liabilities	-3.9	
Tax provision	-4.7	
Settled amounts	42.7	Position prior to payout
Paid out	-35.5	Assuming tender offer taken up 100%
Remaining net cash	7.2	
Lotteries	1.0	Notional amount
PM sports betting	2.0	Generating ca.450k of EBITDA
Transaction costs	-1.0	Various costs in process
Bump earn out	1.1	Assume paid in full
Central costs	-8.8	Capitalised at 8x
ex-venues total	1.5	
Venues 1	24.8	8x FY22E EBITDA
Venues 2	37.2	plus 50%
Venues 3	49.6	plus 100%
Scenario 1	26.3	Value of remaining business
Scenario 2	38.7	After tender offer is complete
Scenario 3	51.1	

Source: Hardman & Co Research

We derive conservative value of 26p with upside from sports betting taking the total to between 39p and 51p for the remaining business

We derive a conservative value of 26.3p (£26m) before the benefit from the impact of the sports betting deal. The upside from a reasonable expectation about how the sports betting pans out, we estimate at between 12.4p and 24.8p per share.

A shareholder today with 100 shares has 47 shares worth 40p each in the tender offer and the remainder worth between 39p and 51p, which equates to £39.30 up to £45.90 for the 100 shares, of which £18.80 is the cash to be returned.

Income statement						
Year-end Dec (£000)	2017	2018	2019	2020	2021E	2022E
Revenue	66,271	63,462	33,571	19,966	27,500	29,500
Cost of sales	-18,562	-17,619	-15,228	-9,432	-12,700	-13,500
Gross profit	47,709	45,843	18,343	10,534	14,800	16,000
Marketing and distribution costs	-2,118	-1,732	-839	-319	-600	-700
Contribution	45,591	44,111	17,504	10,215	14,200	15,300
Ordinary operating costs	-63,289	-43,743	-19,679	-15,647	-15,000	-14,500
Exceptional operating costs	-4,776	-3,453	-6,751	-4,578	0	0
Other income	827	173				
Operating loss/profit	-21,647	-2,912	-8,926	-10,010	-800	800
Finance costs	-212	-290	-787	-568	200	200
Finance income	193	540	52	11		
Joint ventures and associates	-1,484					
Loss before tax from continuing operations	-23,150	-2,662	-9,661	-10,567	-600	1,000
Tax – continuing operations	230	-2,019	-5,793	297		
Loss for the year – continuing operations	-22,920	-4,681	-15,454	-10,270	-600	1,000
Net profit/(loss) from discontinued operations	-1,522	1,822	990	-2,562	11,436	1,100
Loss for the year	-24,442	-2,859	-14,464	-12,832	10,836	2,100
Attributable to:						
Owners of the company	-24,300	-2,859	-14,464	-12,832	10,836	2,100
Non-controlling interests	-142					
No of shares (m)						
Basic	190.135	186.393	188.543	188.751	188.751	188.751
Diluted	190.135	186.393	188.543	188.751	188.751	188.751
EPS (p)						
Basic	-12.8	-1.5	-7.7	-6.8	5.7	1.1
Diluted	-12.8	-1.5	-7.7	-6.8	5.7	1.1
Pre-exceptional EPS (p)						
Basic	-9.5	-0.7	-8.2	-5.4	-0.3	0.5
Diluted	-9.5	-0.7	-8.2	-5.4	-0.3	0.5
Adjusted EPS (p)						
Basic	0.9	-0.8	-4.6	-2.2	-0.3	0.5
Diluted	0.9	-0.8	-4.6	-2.2	-0.3	0.5

Note: the 2019 figures have been restated to strip out the discontinuing businesses; Source: Hardman & Co Research

Balance sheet						
@31 Dec (£000)	2017	2018	2019	2020	2021E	2022E
Assets						
Non-current assets						
Goodwill			604	604	604	604
Intangibles	11,629	13,551	14,935	7,343	7,593	7,843
P, P & E	25,705	26,337	17,676	5,077	3,277	1,477
Right-of-use assets			6,312	1,133	1,133	1,133
Trade receivables	2,443	667	499	156	156	156
Deferred tax assets	6,406	5,979	990	4	4	4
	46,183	46,534	41,016	14,317	12,767	11,217
Current assets						
Trade receivables	10,342	8,169	7,603	1,517	1,517	1,517
Inventories	2,652	2,576	2,616	120	120	120
Current tax receivable				1,442	0	0
Assets held for sale	778			20,164		
Cash	18,757	17,915	15,565	11,821	44,213	46,463
	32,529	28,660	25,784	35,064	45,850	48,100
Total assets	78,712	75,194	66,800	49,381	58,617	59,317
Liabilities						
Current liabilities						
Trade payables	-16,058	-13,169	-12,853	-14,104	-14,104	-14,104
Provisions	-1,103	-977	-579	-321	-321	-321
Financial liabilities	-175		-1,343	-917	-917	-917
Current tax	-7,106	-6,563	-4,969	-4,700	-4,700	-4,700
	-24,442	-20,709	-19,744	-20,042	-20,042	-20,042
Non-current liabilities						
Retirement benefits	-1,537	-902	-1,079	0	0	0
Lease liabilities			-6,881	-3,059	-1,459	-59
Deferred tax			-93			
Provisions	-1,523	-1,434	-1,026	-1,121	-1,121	-1,121
	-3,060	-2,336	-9,079	-4,180	-2,580	-1,180
Total liabilities	-27,502	-23,045	-28,823	-24,222	-22,622	-21,222
Net assets	51,210	52,149	37,977	25,159	35,995	38,095
Equity						
Share capital	37,123	37,350	37,750	37,750	37,750	37,750
Other reserves	22,400	18,435	16,872	16,539	16,539	16,539
Retained earnings	-8,313	-3,636	-16,645	-29,130	-18,294	-16,194
Total equity	51,210	52,149	37,977	25,159	35,995	38,095

Source: Hardman & Co Research

Cashflow						
Year-end Dec (£000)	2017	2018	2019	2020	2021E	2022E
Loss before tax (continuing ops.)	-23,150	-2,662	-8,430	-10,567	-600	1,000
Depreciation and amortisation	4,630	4,777	7,694	8,161	2,300	2,300
JVs	1,484					
Exceptionals (reverse)	23,058	3,453	6,160	5,802		
Net finance (reverse)	19	-250	695	625	-200	-200
Other	645	1,155	1,421	-1,687		
Operating cashflow	6,686	6,473	7,540	2,334	1,500	3,100
Working capital change	-268	-583	-62	1,594		0
Operating cashflow after NWC	6,418	5,890	7,478	3,928	1,500	3,100
Net interest	-235	63	38	-71	200	200
Tax	-15,859	-2,029	-1,356	-1,029	1,442	0
Net cash from ops. pre-exceptionals	-9,676	3,924	6,160	2,828	3,142	3,300
Exceptionals	-11,820	-1,870	-1,731	-484		
Net cash from operations	-21,496	2,054	4,429	2,344	3,142	3,300
Investing						
P, P & E	-6,905	-1,927	-1,169	-753	-500	-500
Buying intangibles	-3,948	-3,106	-2,648	-1,650	-250	-250
JVs	-173	-291	-184			
Acquisitions		-167	-729	-500		
Disposals	88,533	2,686	237	6,180	31,600	1,100
Net cash used in investing (ex-discontinued)	77,507	-2,805	-4,493	3,277	30,850	350
Discontinued	-1,104					
Net cash invested	76,403	-2,805	-4,493	3,277	30,850	350
Financing						
Lease payments			-1,879	-1,655	-1,600	-1,400
Distribution to shareholders	-75,020					
Net cash used in financing	-75,020	0	-1,879	-1,655	-1,600	-1,400
Net change in cash	-20,113	-751	-1,943	3,966	32,392	2,250
FX	-357	-91	-407	-72		
Cash held by assets for sale	-413			-7,638		
Cash at beginning	39,640	18,757	17,915	15,565	11,821	44,213
Cash at end	18,757	17,915	15,565	11,821	44,213	46,463
Customer funds	-2,872	-3,187	-2,580	-465	-465	-465
Corporate cash	15,885	14,728	12,985	11,356	43,748	45,998

Source: Hardman & Co Research

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