Daily comment

Tuesday 24 March 2015

Optimal Payments, Gaming Realms, Low & Bonar, Billington, Wolseley, S&U, technology - Microsoft Office

Optimal Payments – Skrill: a transformational deal - Analyst: Katherine Thompson
OPAY:LN 528p Mkt cap £861m

Full note available here.

Optimal has announced that it plans to acquire Skrill for €1.1bn. The acquisition will create a business with a comprehensive offering of payment solutions and annualised revenues in excess of $700m. The combined entity will have a more diversified customer base, both geographically and by vertical. The deal is being funded through a combination of a rights issue, equity to the selling shareholders and debt. Management has identified cost synergies and expects the deal to be earnings accretive in its first full year.

Optimal has agreed to acquire Skrill, its main eWallet competitor, for an enterprise value of €1.11bn. Skrill is a payments company with eWallet, payment processing and pre-paid businesses. The company will fund the acquisition through a rights issue (to raise €609m), the issue of equity worth €135m to Skrill shareholders and new debt worth €500m. The rights issue is scheduled to be complete by early May (subject to shareholder approval at a general meeting on 16 April) with the deal scheduled to complete in Q315. Optimal expects the deal to be earnings accretive in the first full year of ownership and has identified significant cost synergies.

Optimal reported FY14 results broadly in line with forecasts at the EBIT level. Revenues grew 44%, with 50% growth in SV and 42% growth in STP, and adjusted EBITDA grew 65% with margin expansion to 23.6%. The low tax rate of 2% resulted in normalised net income 4.5% higher than forecast and growth of 66%. We have revised our forecasts for FY15 (EBITDA down 7% reflecting slightly higher STP processing costs and group operating costs and FX) and introduce FY16 forecasts (revenue growth 8%, EBITDA growth of 13%, 23.0% EBITDA margin).

Optimal is trading on 10.3x FY15e and 9.1x FY16e EV/EBITDA, at a discount to its peer group (on 12.2x and 10.9x respectively) and at a much larger discount to closest peers, Wirecard and SafeCharge (20.0x and 14.7x FY15e respectively). The deal values Skrill at 13.5x its FY14 EBITDA (12 months ended 30/9/14), which is broadly in line with Optimal's historic FY14 EBITDA multiple of 14.1x (based on fully diluted shares of 180.7m). Recognition of the combined entity's scale, growth prospects and strong cash generation should help reduce the discount to peers over time. Optimal will seek a Main Market listing after the acquisition completes.

Gaming Realms – Marketing is paying off – Analyst: Jane Anscombe
GMR:LN 34.5p Mkt cap £67m

Gaming Realms has reported a positive trading update with the *Spin Genie* marketing campaign delivering very encouraging initial results and the new proprietary platform performing well. 2014 was a year of investment but we expect to see the group moving into EBITDA profitability in H215 and our forecasts of strong growth between 2015 and 2017 are unchanged. Even after today's share price rise the 2016e EV/EBITDA is only 8.4x. Investors are backing management's excellent track record and the potential to build a very sizeable UK soft-gaming business.

Gaming Realms has reported revenue of £11.2m for 2014 (15 months) and an EBITDA loss of £8.2m, versus our estimates of £11.8m and £7.2m respectively. However, 2014 was very much a year of investment for the group, both in technology (the new proprietary platform was successfully launched in September) and in new products. Despite this we estimate that year-end net cash was c £3.7m, ahead of our previous forecast, helped by £2.6m of share placings in December.

Gaming Realms began a £1m marketing campaign (including TV) for *Spin Genie* last month and early KPIs are very encouraging. *Spin Genie* is an innovative twist on a standard casino, incorporating social features (eg levels) to encourage players to remain on the site. Gaming Realms reports that March 2015 active daily players are 104% higher than in February and average daily deposits are 183% up (to over £50k or an annualised £18.3m), with 60% of revenues coming from mobile. The average cost per new player (CPA) is below £80 versus a peer average of c £120. Meanwhile Gaming Realms' very successful mobile casino, *Pocket Fruity*, has just migrated to the new platform, while from next month *Spin Genie* will also link to an exclusive real-money version of the long-established *Slingo* social bingo/casino brand.

This positive update underpins our expectations of a move into EBITDA profit during 2015. The next catalyst will be the final results on 22 April. Based on our estimates Gaming Realm's EV/EBITDA falls rapidly over the next three years, yet the 2016e EV/EBITDA of 8.4x stands at a discount to the peer average of c 10.1x.

Low & Bonar – Comments following the AGM – Analyst: Toby Thorrington
LWB:LN 57p Mkt cap £187m

Today's AGM indicates that overall market conditions are broadly unchanged. Volumes are slightly lower than anticipated – but it is unclear whether this is a market, region, segment or company sales development factor – and this will be amplified at the revenue level with softening polymer prices. In the short term this should be beneficial, with some pass through lag working in the company's favour. Consequently, profits are 'in line with' expectations, year to date. There is progress with the Saudi JV where product approvals are coming through; sales will follow but appear to be developing fairly slowly to date (we have a £0.7m share of PAT loss in our FY15 estimate, a small improvement from -£1.1m in FY14). The net effect of currency movements thus far (ie further Euro weakness and USD strength since FY15 results were announced in February) is considered to be neutral.

Overall no new stimulus for LWB's share price here. The consensus rating (2015-2017: P/E 9.5x falling to 8.3x, EV/EBITDA 6.0x falling to 5.4x) is probably more focused on a modest near term growth outlook without giving credit for a pick up beyond the current year. In the meantime, LWB offers a dividend yield approaching 5%. A capital market event in May will be used by the new CEO (Brett Simpson) to refresh company strategy for investors and perhaps, bring prospects beyond the current year into sharper focus.

Billington Holdings BILN LN 216p Mkt Cap £27m Analyst: Toby Thorrington

We also note today's results announcement from **Billington Holdings** (a structural steelwork supplier) with more solid profitability, a first dividend since 2010 and, most importantly, a lengthening order book and prospect list. This underlines our comments yesterday on **Severfield** where we believe UK momentum is very sound and order book development will be the key to re-starting top line growth and driving margins above near term targets.

Wolseley PLC WOS LN 4091p Mkt Cap £10.6bn Analyst: Toby Thorrington

Within **Wolseley's** H1 results, we highlight very strong progress in the USA (now four consecutive quarters of LFL revenue growth in the +9.0-12.4% range and a pickup in the same metric in the UK (+3.4% in Q2). All market segments appear to be developing favourably in the USA whereas UK progress is still being driven by residential new build, with RMI described as subdued. While the latter is unhelpful for **Tyman** (where share gains are expected to outperform in its categories) the USA is its dominant market, so an ongoing favourable backdrop here (as well as a strong USD) remains a positive.

S&U PLC – Results – Analyst: Mark Thomas

SUS LN 2122p Mkt Cap £251m

S&U has been promising excellent growth and in 2014 it delivered even more than was expected. It saw a 48% increase in motor advances and home credit, which has been stable for many years and delivered an 11% increase in advances on an 8% increase in customer numbers. Funding continues to be prudent (gearing 66%) and a deposit licence is being sought. We expect modest consensus upgrades and a good reaction to these results.

Technology – Microsoft – Days of Office – Analyst: Richard Windsor

Office is by far Microsoft's most valuable asset.

Microsoft is systematically removing any reason for the rivals to Office to continue existing. It has announced that it has extended its partnership with Samsung, Pegatron, Dell and 9 others to ensure that its Office apps are installed at the factory on more devices than ever before. Installation at the factory is an important factor when it comes to the success of an app because:

1) Very like being the default option, having the app present in the box ensures that the user does not have to search for, and /or download and install the app from an app store.

Although it is increasingly easy to do this, most users will not bother and studies have shown time and again that usage of apps is much greater when they are pre-installed.

2) Office apps can be quite processor intensive meaning that their performance can be an issue. Agreeing with the manufacturer to preinstall the apps ensures that they are properly tested and that optimisations occur to ensure that performance is as good as it can be.

Consequently, apps that are installed at the factory will often perform better and get used more than those that have to be downloaded.

It is clear that Microsoft's intention is to put its Office apps on every platform that can run them and to ensure that users are strongly incentivised to use them. The basic editing functions on the iOS and Android versions of Office can now be used by any user free of charge. Furthermore, Office 365 is both reasonably priced (at $2 month more than Spotify) and free for students globally. These changes mean that Microsoft has removed all of the reasons to use Google Docs, iWork, Libra Office and so on and as a result we expect that they will cease to exist over time.

The Microsoft Office clones exist because historically either one could not access Office functionality on certain platforms or the software was too expensive. In practice they are a reasonable approximation of the original but using them is painful when most of the rest of the world uses Office. No one has ever been in doubt that Office is superior to anything else out there, it was just a question of accessibility and price. Now that both of these barriers have been removed, I expect that the "Office clones" will wither and die over time. Even people high up in the Linux and Google camps will probably admit behind closed doors that this is likely to be the case.

Office is rapidly becoming Microsoft's most valuable asset and Microsoft is executing the right strategy in using it to bring users back into its ecosystem.

The first step is to ensure that content creators only use Office on whatever platform they choose. The second is to entice them back into the Microsoft ecosystem with a good marriage of Digital Work services and Digital Life services in a single user experience.

Here Microsoft is making slow but steady progress. The one big hurdle that remains is how it markets its wares and tells its story. Marketing remains firmly locked in the old way of doing things and is the only part of Microsoft that has not meaningfully changed over the last year. If Microsoft begins to explain to users properly why they should be living their digital lives with Microsoft, then it has an excellent chance of really fulfilling its potential as the third ecosystem. Until that happens, Microsoft is likely to continue in not making the most of its assets and will remain a hostage to the PC market. Fortunately, none of this is priced into Microsoft's stock, making it safe to live in hope...

Best regards,
Jeremy Silewicz

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