EDISON

Jackpotjoy plc

An attractive deleveraging bet

Outlook and Q3 results

Travel & leisure

Jackpotjoy plc (JPJ) is the clear leader in the c £800m UK bingo-led market, with exceptionally high EBITDA margins and strong cash flow. The group's balance sheet is simplifying following a major earnout payment and we expect it to reach 2.0x net debt/EBITDA in 2019. With four sets of strong quarterly figures under its belt, JPJ's shares have risen 42% since the January listing in London. Nonetheless, at 7.9x P/E, 8.2x EV/EBITDA and 11.7% free cash flow yield for 2018e, the stock still trades at a significant discount to peers and we believe the re-rating will continue as value steadily transfers from debt to equity.

Year end	Revenue (£m)	EBITDA* (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)
12/16	269.0	102.2	65.6	88.4	0.0	9.7
12/17e	298.2	107.4	65.2	86.4	0.0	9.9
12/18e	326.0	113.8	83.9	108.3	0.0	7.9
12/19e	349.4	116.4	92.5	117.0	0.0	7.3

Note: *EBITDA, PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. EPS is fully diluted.

Market dominance and high free cash flow

JPJ has a 23% market share in the c £800m UK bingo-led market, with additional growth in other markets, including Spain and Sweden. We forecast 9% revenue CAGR for 2016-19, which is broadly in line with industry growth estimates, and offsets an estimated 600bp drop in EBITDA margin, from the impact of rising gaming taxes. During 2017, JPJ paid a £94.2m earnout to Gamesys and has made significant progress in simplifying its balance sheet. Although the group remains relatively indebted (3.3x FY17e adjusted net debt/EBITDA), it currently generates c £100m operating cash flow per year and is comfortably positioned to cover the £44m earnout payment in June 2018. Leverage should then reduce rapidly.

Nudging up 2017 revenue and EBITDA

Q317 revenue grew by 14% to £75.4m vs Q316, with 21% growth in Vera&John. Growth of 12% in the core Jackpotjoy division was driven by Starspins and Botemania (Spain). Mandalay's revenues declined by 8%; we believe it will be incorporated into Jackpotjoy in due course. As expected, marketing costs increased in the quarter and adjusted Q317 EBITDA margin was 35.4% vs 39.9% in Q217. We raise our FY17 revenue estimate from £294.8m to £298.2m and our FY17 EBITDA from £105.7m to £107.4m. Our 2018 and 2019 EBITDA estimates are unchanged.

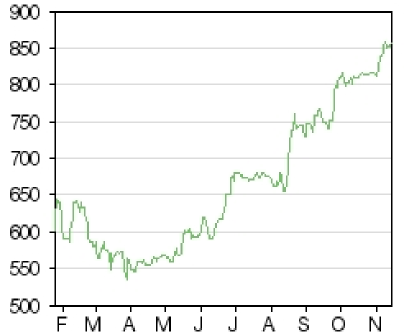
Valuation: Up 42% year to date, but still below peers

JPJ has produced four sets of robust quarterly reports since relisting in London and the stock has risen 42% this year. Nonetheless, JPJ continues to trade at a meaningful discount to peers (7.9x P/E, 8.2x EV/EBITDA for 2018e), reflecting legacy concerns about the Gamesys relationship, high leverage, the lack of dividend and low liquidity. However, cash generation should lead to demonstrable debt reduction from 2018 and we would expect a continued re-rating of the shares as value steadily transfers to equity.

14 November 2017

Price	**857.50p**
Market cap	**£635m**
	€1.12/£
Net debt (£m) at September 2017	298
Shares in issue	74.1m
Free float	95%
Code	JPJ
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	6.0	30.9	N/A
Rel (local)	7.8	29.1	N/A
52-week high/low		859.0p	534.0p

Business description

Jackpotjoy plc (JPJ) (formerly The Intertain Group) is a leading online gaming operator mainly focused on bingo-led gaming targeted towards female audiences. About 77% of revenues are generated in regulated markets. It moved its listing from the TSX to the LSE in January 2017.

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Jackpotjoy plc is a research client of Edison Investment Research Limited

Investment summary: An established UK player

Brief history: Leading regulated online gaming business

Jackpotjoy plc (JPJ) is the world's biggest online bingo-led operator and also offers online casino and social gaming. After its listing in London in January 2017, JPJ became the holding company for The Intertain Group, which de-listed from the Toronto Stock Exchange (TSX) at the same time. Intertain listed on the TSX in February 2014 (TSX:IT) and grew rapidly, with four acquisitions in 2014 and 2015 including Jackpotjoy (April 2015), which was acquired for £436m plus a c £300m earnout from Gamesys, which remains its platform provider. JPJ has already paid £250m of the earnout (see page 5 for more detail). After a strategic review in H116, new UK management was appointed (Neil Goulden and Andrew McIver) and the decision was made to list in London as Jackpotjoy plc (JPJ), pursuing an organic growth strategy. With the successful completion of the listing, Andrew McIver is stepping down as group CEO. Simon Wykes has joined as group MD, having formerly worked as CEO of Gala Leisure and MD at Gala Coral Group.

Financials: High margins, simplifying balance sheet

JPJ has grown very rapidly since 2014, via both acquisitions and strong organic growth. We expect revenue to grow by 10.8% in 2017 to £298.2m and 9.3% in 2018 to £326.0m. Our forecast 2017 EBITDA margin of 36.0% is significantly above industry averages, helped by lower than average marketing spend. As a result of the 2015 acquisition of Jackpotjoy from Gamesys, leverage remains relatively high (3.3x 2017e adjusted net debt/EBITDA). Following the £94.2m earnout payment to Gamesys in June 2017, the Q317 unrestricted cash balance was £39m and net debt was £298m. The most significant remaining obligation is a £44m earnout payment in June 2018 (for Botemania, which is the Spanish business within the Jackpotjoy division). Underlying cash conversion is approximately 100% and JPJ currently generates c £100m operating cash flow per year. We forecast net debt of £274m in 2018 and an adjusted net leverage of 2.5x, reaching 2.0x in 2019.

Valuation: Low rating presents an opportunity

Since listing in London in January, the stock has risen by 42%. However, it is still rated at a material (39%) discount to the sector on a FY18e P/E basis, although the EV/EBITDA discount (8%) is narrower due to its capital structure and leverage. A 10x 2018e P/E, which is still at a discount to peers to allow for the relatively high leverage, would imply a share price of 1,080p and a 9.7x 2018e EV/EBITDA, which is in line with 888 Holdings. Our DCF comes in marginally higher at 1,132p/share (range of 1,031-1,391p at 9-11% WACC).

Sensitivities: Regulation, operational and economic

77% of JPJ's business is regulated, but licensed markets may still change tax rates or conditions (eg UK remote gaming duty is being applied to gross rather than net revenues from August 2017), and other markets may introduce licensing regimes with new taxes or product requirements (eg expected regulation in Sweden from 2019). JPJ is dependent on Gamesys for the operation of its largest segment, the 'Jackpotjoy' division, but the relationship is good, the operating agreements have considerable protections in place and JPJ now has much more control over strategy and budgets since March 2017 (the end of the main earnout period). Gamesys' service fees will rise by 25% from April 2020 (currently supplied at cost) and we allow for this in our DCF. Other sensitivities include competition, including any pressure to spend more on marketing, which is currently far lower than industry averages (we estimate 16.5% marketing/revenues vs industry averages of 20-30%).

Investment considerations

JPJ has a market-leading UK position, high-growth businesses in Europe (mainly the Nordics and Spain) and opportunities for expansion into new territories such as Latin America. It mainly targets the female demographic (age 35-50), which differentiates it from most sportsbook and pure casino brands, which are male (18-35) focused. The group was built by acquisition but has now moved into an organic growth phase. Following the acquisition of Jackpotjoy from Gamesys, the group remains relatively indebted (2017e adjusted net debt/EBITDA of 3.3x) but strong underlying cash flows mean that the remaining Gamesys earnout (the Spanish part of Jackpotjoy – estimated at £44m in cash in June 2018) should easily be covered. Thereafter leverage should reduce rapidly.

- **JPJ is the market leader in the UK, with a 23% share of the bingo-led market**
  - JPJ owns a leading portfolio of online gaming brands.
  - Strong brand name and high customer retention enables lower than average marketing spend. Combined with robust revenue growth, this leads to a high-margin, cash-generative business model.
- **JPJ is operating in a growth market, driven by mobile gambling**
  - Estimates from the Gambling Commission and H2 Gambling Capital (H2GC) indicate that UK online gross gaming yield (GGY) will increase at a c 7% CAGR in 2016-21.This compares to our JPJ revenue CAGR forecast of 9% from 2016-19.
  - H2GC estimates that the UK bingo-led market (gross gaming revenue) generated c £787m in 2016. We estimate that this equates to net gaming revenues of c £600-650m.
- **Regulation will continue to have a negative impact on margins**
  - The inclusion of free bets in the UK Point of Consumption Tax (POCT) is estimated to affect UK margins by 3-4% (Jackpotjoy UK, Starspins and Mandalay).
  - Sweden's gaming regulation is expected in 2019, with an anticipated 18% tax.
- **Management team – incoming group MD has a strong operational background**
  - The management team has been further strengthened during 2017, with the appointment of Simon Wykes (former CEO at Gala Leisure) as group MD, as well as new divisional heads for both Jackpotjoy and Vera&John.
- **Leveraged but simplifying balance sheet**
  - Following the payment of a £94.2m earnout to Gamesys in June 2017, adjusted net debt/EBITDA was 3.35x in Q317 (from 3.6x at June 2017).
  - There is a residual contingent consideration of c £47.5m (time-weighted, probability-adjusted). In addition, there remains £15m in non-compete payments (accounted for in debt), being paid at £0.67m per month from April 2017.
  - Yearly operating cash flow of c £100m means that the company can satisfy its obligations internally and we expect deleveraging from mid-2018.
- **JPJ is dependent on Gamesys for the operation of Jackpotjoy**
  - JPJ owns the brands, exclusive content, intellectual property, customer data and liquidity. Gamesys provides the content, hosts the platform and is responsible for marketing and customer support.
  - Service fees paid to Gamesys will increase by 25% in April 2020 (for staff who have not been internalised by JPJ before then).
  - There is a potential risk when the non-compete clause expires in April 2019. However, the relationship between the two companies is good and several operating agreements have considerable protections in place for the longer term.

The world's largest bingo-led operator

JPJ provides online gaming to a global customer base, with its main focus being online 'bingo-led' real money gaming in the UK and Europe. It is the number one bingo-led operator globally and bingo-led gaming accounted for c 65% of revenue in the past 12 months (LTM) to September 2017, casino 28% and social gaming 6%. 77% of revenues are derived from regulated markets, which compares to Paddy Power Betfair (95%), 888 (71%), GVC (75%) and Stride Gaming (100%).

Exhibit 1: Divisional revenue mix*

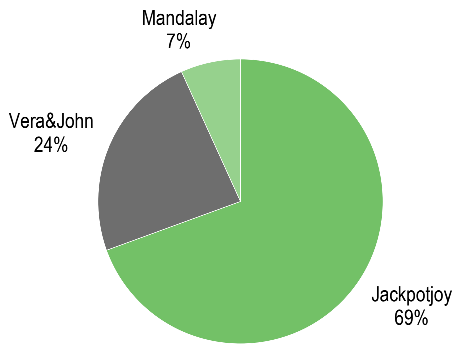
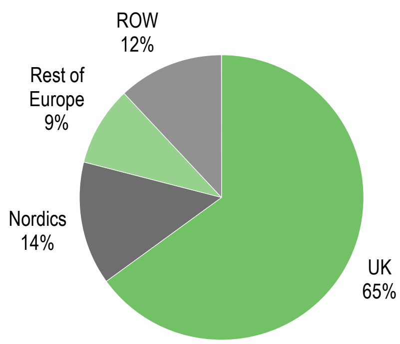


Exhibit 2: Geographic revenue mix*



Source: JPJ, Edison Investment Research. Note: *LTM to September 2017

JPJ is organised into three divisions, of which the 'Jackpotjoy' division is the largest, accounting for 69% of revenues and 77% of EBITDA in Q317. JPJ operates its Vera&John casino brands on its own proprietary platform. The operation of its Jackpotjoy brands is fully outsourced to Gamesys, while Mandalay's bingo-led brands are hosted by Dragonfish (888 Holdings).

Jackpotjoy division (69% of revenues)

JPJ's flagship brand is *Jackpotjoy*. The Jackpotjoy division also includes the *Starspins* and *Botemania* real money gaming (RMG) brands. Jackpotjoy and Starspins also offer social games. The UK is the biggest market, accounting for c 77% of revenue, with Sweden at c 6%, Spain c 10% and the US 6% (social gaming only).

Exhibit 3: Jackpotjoy brand overview

	Jackpotjoy	Starspins	Botemania	Social
Online B2C products	Bingo, casino, slots	Slots	Bingo, casino, slots	Social slots
Main markets	UK/Sweden	UK	Spain	US
Launch date	UK 2002, Sweden 2012	2013	2007	2011
Market position	#1 UK online bingo-led	Leading UK online slots site	#1 Spain online bingo-led	3.8m downloads
Monthly actives	120,000	25,000	20,000	500,000

Source: Jackpotjoy Investor Presentation September 2016, Edison Investment Research estimates

Jackpotjoy UK was launched in 2002 by Gamesys and grew rapidly to become the UK's leading online bingo-led brand, with over 1.6 million registered players on its database. It has won many awards and enjoys very strong brand recognition, helped by high-profile television campaigns, such as the current promotion with brand ambassador Paddy McGuinness. Jackpotjoy has a loyal customer base and, in 2016, 90% of revenues came from players who joined in 2015 or earlier, much higher than the industry average. The Jackpotjoy brand was launched in Sweden in 2012, where slots are the most popular product offering. Starspins was launched in the UK in 2013 to complement Jackpotjoy with a pure slots offering. Botemania was launched in Spain in 2007 and regulatory changes allowed it to reintroduce slots in June 2015. In Q317, Botemania and Starspins comprised approximately 23% of divisional revenues, from 21% in Q217.

Jackpotjoy has steadily improved the monetisation of players through mobile, with mobile comprising 62% of Jackpotjoy revenues in Q3, vs 61% in Q2, 57% in Q1 and 55% in Q416. Mobile average revenue per user (ARPU) is now greater than desktop ARPU.

Mandalay (7% of revenue)

Mandalay mainly operates UK online bingo-led sites on the Dragonfish (888) platform and has over 30,000 monthly active customers. Its key brands include C*osta Bingo*, which was launched in 2009, and *Sing Bingo,* which was launched in 2010. With its multi-brand strategy, it differs from the Jackpotjoy division in the sense that customers typically have lower ticket prices with a more value-driven proposition. After the termination of the Jackpotjoy earnout period, JPJ is now able to cross-sell Mandalay brands to lapsing Jackpotjoy and Starspins players, although a meaningful impact is only anticipated from 2018. In addition, JPJ has stated that it is considering merging Mandalay with its other bingo assets, particularly given the focus on cross-selling between all the bingo brands as well as the relative size of Mandalay.

Vera&John (24% of revenue)

Vera&John was launched in 2011 and is a global online casino operator. It offers over 800 games (slots, table games, live casino, etc), both proprietary and from third-party suppliers such as NetEnt and Microgaming. It aims to offer a differentiated casino experience and many of its RMG games also have social variants that are played on a freemium basis. Its main RMG brands are *Vera&John* and *Vera&Juan* and it has over 30,000 monthly active players. It operates in over 10 countries and while the bulk of its revenues come from northern Europe, notably Sweden, we estimate that c 30% comes from Asia (mainly Japan).

Vera&John has a proprietary platform, which it is leveraging through a B2B white-label offering for white-label customers.

Relationship with Gamesys

Gamesys is a long-established private operator, having been formed in 2001. Its headquarters are in Piccadilly, London, and it has c 1,000 employees worldwide, including c 269 dedicated to Jackpotjoy. Other B2B customers include Virgin Games, Virgin Casino (New Jersey, US) and Heart Radio Bingo. Intertain acquired Jackpotjoy from Gamesys in April 2015 for £436m plus an earnout of approximately £300m, of which £250m has already been paid.

JPJ owns the brands, exclusive content, intellectual property, customer data and liquidity. Gamesys provides the content and hosts the platform, but it is more than just a platform provider, as it is also responsible for marketing and customer support. Coinciding with the end of the Jackpotjoy UK earnout period, Jackpotjoy gained control over its strategic plan and budget in April 2017.

The table below summarises the key points of the relationship, and a fuller discussion can be found in our February 2017 outlook note. The most salient points are a 25% rise in service and platform fee costs from 2020 (included in our DCF) as well as the ending of the non-compete clause in April 2019. Management has consistently provided reassurance that the relationship between Gamesys and Jackpotjoy is very strong and, given the operating agreements in place, we do not believe the ending of the non-compete clause will result in a change of platform provider.

Exhibit 4: Gamesys agreement with Jackpotjoy

Scope/ operation of:	■ Real Money Gaming (Jackpotjoy UK, Jackpotjoy Sweden, Starspins, Botemania) ■ Social Gaming (Jackpotjoy Social Slots, Starspins Social Slots)
Services	■ Platform and content ■ Marketing and customer support
Terms	■ Operating agreement until 2030 ■ Content agreement until 2040 ■ Non-compete until 2019
JPJ fees	■ Service costs: at cost and then at cost +25% from April 2020

Source: Jackpotjoy plc

History and development

JPJ started life as Aumento Capital II in Canada in 2011, a special purpose acquisition vehicle. It acquired InterCasino in February 2014, changed its name to The Intertain Group and listed on the TSX (TSX:IT). The business grew very rapidly on the back of three further acquisitions (see Exhibit 5), which took 2015 revenue to C$385m (2014: C$41m).

Exhibit 5: Acquisition record

	Date	Initial consideration		Costs	Earnout	Remaining	Vendor
InterCasino	Feb-14	£39m	Cash	£1m	0	0	Amaya Inc (AYA:TX)
Mandalay	Jul-14	£45m	Cash	£4m	£14m	0	Founders
Vera&John	Dec-14	£70m	50/50 cash/shares	£6m	£6m	0	Founders
Jackpotjoy	Apr-15	£436m	85/15 cash/shares	£29m	c £300	£47.5m	Gamesys Ltd

Source: JPJ prospectus, Edison Investment Research

On 17 December 2015, Intertain was targeted by a 120-page short-seller report, which was the catalyst for a formal strategic review. The review culminated in a relisting in London, as well as the formation of a new management team. With a focus on deleveraging, the strategy is on organic growth rather than pursuing further acquisitions.

Management and board

To coincide with the January 2017 relisting in London, JPJ's board and management team was restructured, with representation from an array of highly experienced British and Canadian members.

- JPJ's executive chairman Neil Goulden was formerly group MD, CEO and chairman of one of the UK's leading gambling groups, Gala Coral, from 2001-14.
- CFO Keith Laslop joined Intertain in February 2014 and provides considerable executive and financial continuity.
- In October 2017, the company announced that Andrew McIver would be stepping down as group CEO, and the appointment of Simon Wykes as group managing director reflects the group's focus on operational momentum, rather than the practicalities surrounding the relisting.
- Since listing, new heads have been appointed for the Jackpotjoy and Vera&John divisions.
- The non-executive directors provide a broad range of industry and financial experience. Full biographies are provided in JPJ's listing prospectus.
- Noel Hayden is a special adviser to JPJ. Noel founded Gamesys and remains its chairman and major shareholder. He was a director of Intertain until September 2016 and is a 3% shareholder in JPJ. His role should maintain the strong relationship between the two groups.

Exhibit 6: Management and board

	Position	Tenure*	Comment
Neil Goulden	Executive chairman	Aug 16	Former CEO and chairman of Gala Coral 2001-14, leading industry roles
Simon Wykes	Group managing director	Nov 17	Former CEO Gala Leisure, MD Gala Coral Group, MD Rank Group
Keith Laslop	CFO/director	2014	CFO of Intertain since 2014, previously principal of Newcourt Capital (private equity)
Irina Cornides	CEO Jackpotjoy division	Jun 17	Former chief revenue officer of Intertain Bahamas
David Flynn	CEO V&J	Sep 17	Former chief commercial officer at NYX, previously CEO and COO of NYX Interactive AB
David Danziger	Independent non-exec	2011	Senior VP of assurance services at chartered accountants MNP LLP
Paul Pathak	Independent non-exec	2011	Partner, Chitiz Pathak LLP Toronto law firm since 1996
Jim Ryan	Independent non-exec	Mar 16	CEO of Pala Interactive since 2013, former co-CEO bwin/CEO partygaming
Colin Sturgeon	Independent non-exec	Jan 17	Senior positions at RBC Capital Markets 1981-2005
Nigel Brewster	Independent non-exec	Jan 17	Senior roles in private-equity backed UK leisure companies

Source: Jackpotjoy prospectus, Edison Investment Research. Note: *Date of original appointment to Intertain or JPJ boards rather than the technical date of appointment to the JPJ board.

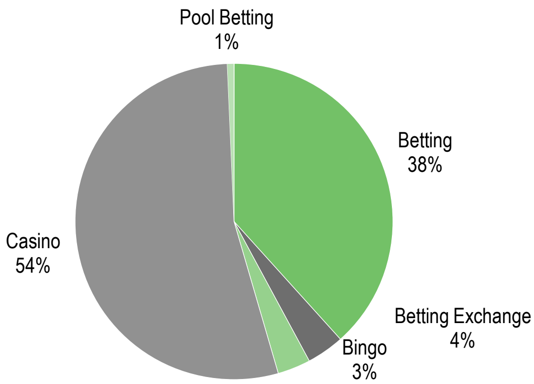
Dominance in a growing market

UK online gaming market

The UK comprises approximately 65% of JPJ's revenues and we provide a snapshot of the UK online market below. For a fuller analysis of the UK gaming industry, please see our October 2017 UK gaming sector report.

The Gambling Commission estimates that, at September 2016, there were 540 remote casino, betting and bingo licences held by 333 operators. From October 2015 to September 2016, UK digital revenues amounted to £4.46bn (vs £4.23bn in the year to March 2016). Similar to H2GC global online growth forecasts, estimates from the Gambling Commission and H2GC indicate that UK online GGY will increase at a c 7% CAGR in 2016-21. While still impressive, this represents a significant slowdown compared to the 15% CAGR between 2008 and 2015 (source: H2GC).

Exhibit 7: UK remote gaming sector – £4.46bn (October 2015 to September 2016)

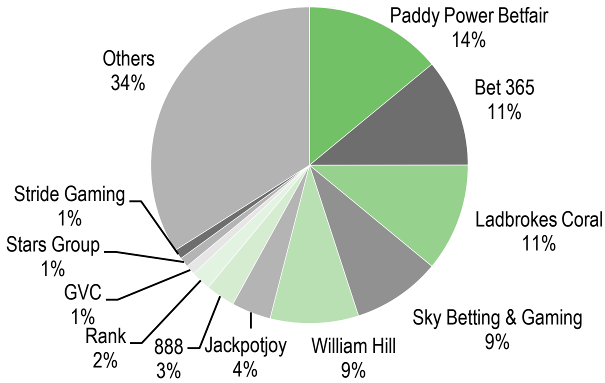


Source: Gambling Commission

Results from the sportsbooks players (PPB, Ladbrokes) appear to indicate that online sports betting could be outpacing online casino growth, although this may also be operator specific. In addition, evidence from Jackpotjoy plc and Stride Gaming suggests that the market-leading, low-stakes soft gaming operators are achieving the greatest momentum.

There are no precise figures for market share in the UK online gaming market, as there is no obligation for operators to split revenues by geography. Furthermore, reporting lines can be blurred with, for example, most operators including bingo-led items (slots) in their bingo division. Looking at overall net gaming revenue per operator, however, it is clear that the online market is dominated by the sports operators, who have successfully cross-sold into real-money gaming.

Exhibit 8: Estimated UK online market share, 2016



Source: Company data, Gambling Commission, Edison Investment Research estimates

Online bingo

The UK is the world's largest online, real-money bingo market, with 437 bingo sites in 2016. The UK Gambling Commission reports that online bingo generated £149m of gross gaming revenue (GGR) in the year to September 2016. This is the pure bingo figure (excluding slots). H2GC's most recent estimates indicate that the UK bingo-led segment generated £787m GGR in 2016. These new figures imply that casino games (mainly slots) account for approximately 80% of the bingo-led market. Deducting the impact of free bets, we estimate that the UK bingo-led market generated approximately £600-650m in net gaming revenues (NGR) in 2016.

The UK bingo-led market is highly competitive and estimated market share has changed in the two years since remote gaming duty (RGD or POCT) was introduced. Key players are Jackpotjoy plc, Stride Gaming, Mecca, Tombola, 888, Gala Bingo and Foxy Bingo (GVC).

Gaming taxes and regulation

JPJ operates largely in regulated markets and pays significant gaming taxes (at 11.6% of total revenues in Q317), which are expected to rise steadily. Notable increases include:

- **UK Point of Consumption Tax (POCT)**: The extension of POCT to include free bets in the UK is being retrospectively enforced from August 2017. Our forecasts indicate a c 3-4% impact (annualised) to the UK businesses' EBITDA (Mandalay, Starspins and Jackpotjoy UK). Across the group, this equates to approximately 2-3% of total EBITDA margin.
- **Spain:** The 25% tax on Spanish gross gaming revenues will become more relevant as the Botemania revenues grow. We estimate that Botemania comprises c 11% of the Jackpotjoy division.
- **Sweden**: Our forecasts include the expected 18% gaming tax in Sweden from 2019. This will mostly affect the Vera&John division, but we estimate that c 5% of the Jackpotjoy division is also derived from Sweden.

Sensitivities

Regulation: JPJ holds licences in Malta, the UK and Denmark, while services provided by Gamesys and 888 are covered by their Gibraltar, UK and (in the case of Gamesys) Spanish licences. Licence conditions and tax rates can and do change in regulated markets (as above). In addition, JPJ operates in Japan, which is an unregulated 'grey' market with no gaming licensing, and there could be a risk of sanctions.

Relationship with Gamesys: As noted above, JPJ is dependent on Gamesys for the operation of its largest segment. Its service fees will increase by 25% in April 2020 (for staff who have not been internalised by JPJ before then). While the earnout period is over for Jackpotjoy and Starspins, it runs to 31 March 2020 for Botemania. There is potential risk when the non-compete clause expires in 2019. However, the relationship between the two companies is good and several operating agreements have considerable protections in place for the longer term.

Technology and platform risks: Aside from Gamesys, JPJ is also dependent on 888 (Dragonfish) and other third-party suppliers such as payment processors. It is also exposed to the usual internet-related risks and the need to adapt to technological change.

Competition: JPJ operates in highly competitive markets. Some of its competitors are bigger, with greater financial resources, but JPJ is the largest bingo-led operator, with the highest liquidity and the UK gaming tax is a barrier to entry for smaller operators.

Marketing: JPJ's marketing spend is below the industry average due to the strength of the Jackpotjoy brand (at c 16.5% of revenue versus an average of 20-30%) and our forecasts are sensitive to assumptions about future spend ratios. Given the strong brand name and customer retention, we believe JPJ's marketing will not rise substantially from current levels, but clearly any rise in marketing expense would correspondingly reduce EBITDA.

Economy: Gambling has historically proved resistant to economic slowdowns, but not immune, although the structural growth in online gambling outweighed economic pressures in the last major slowdown of 2007-08. For example, a slowdown related to Brexit could have an effect on the group's customers or markets.

Indebtedness and earnout liabilities: JPJ reported net debt of £298m at 30 September 2017, with a further £47.5m earnout still to be paid. However, the company generates c £100m operating cash flow per annum, and is well placed to fund its remaining obligations, as well as begin to pay down debt. We estimate that adjusted net debt/EBITDA will fall from 3.3x at 2017 to less than 2.0x in 2019.

Q3 overview and changes to estimates

Q317 revenue increased by 14% to £75.4m, driven by a 21% growth in Vera&John, as well as 12% growth in the core Jackpotjoy division. At September 2017, average active customers grew 13% to 251,186 in LTM (the past 12 months) and average real money gaming (RMG) revenue per month grew 16% to £22.6m, equating to £90 per customer. The company reported an adjusted Q317 EBITDA margin of 35.4% (£26.7m) vs 38.5% (£25.6m) in the prior year. As expected and typical in H2, higher marketing spend in the quarter had an impact on EBITDA.

Including a one-off working capital inflow, Q3 cash conversion was over 100% and resulted in a quarterly operating cash flow of £32.6m. JPJ ended the quarter with an unrestricted cash balance of £39m and adjusted net debt of £298m.

Jackpotjoy (69% of revenues)

Jackpotjoy's revenues increased 12% y-o-y to £52.2m and were sequentially flat vs Q217. Jackpotjoy UK revenues declined sequentially by c 3% and comprised approximately 65% of divisional revenues, vs 70% in the prior year and 67% in Q217. Starspins and Botemania continued to show robust growth and now comprise 23% of divisional revenues, vs 21% in Q217.

With the increased marketing costs in H217, Jackpotjoy's Q317 adjusted EBITDA margin of 44.5% compares to 48.2% in the prior year and 47.6% in Q217. This continues to be significantly above industry averages of 20-30%. We forecast 2017 and 2018 revenues of £207.0m and £224.8m, respectively. With the impact of the tax on free bets (starting in Q417), our divisional EBITDA margin falls from 44.9% in 2016 to 44.6% in 2017 and 42.0% in 2018.

Vera&John (24% of revenues)

Q317 gaming revenue from Vera&John increased 28% to £18.4m vs the prior year, driven by growth in Sweden, Asia and other new jurisdictions. In constant currency, growth was 21%. Adjusted EBITDA of £4.9m represents a margin of 26.6%. We forecast continued strong growth in this division, with revenues of £70.9m in 2017 and £80.9m in 2018.

Mandalay (7% of revenues)

Q317 revenues declined by 8% to £4.9m vs the prior year. With the impact of lower marketing spend, however, EBITDA increased from £1.4m to £1.9m. As discussed at previous results, management has focused on changing promotional spend to improve operational margins and deposit hold in future periods. We forecast FY17 revenues of £20.2m to remain flat, with EBITDA margin declining from 36.8% in 2017 to 35.1% in 2018, largely due to the POCT on free bets.

Exhibit 9: Summary divisional forecasts

Gaming revenue £m	2016	2017e	2018e	2019e
Jackpotjoy	188.2	207.0	224.8	238.4
growth	*55.3%*	*10.0%*	*8.6%*	*6.1%*
Vera&John	57.0	70.9	80.9	90.6
growth	*35.4%*	*24.4%*	*14.0%*	*12.0%*
Mandalay	21.7	20.2	20.3	20.4
growth	*1.2%*	*-7.0%*	*0.5%*	*0.5%*
Total gaming revenue	**266.9**	**298.2**	**326.0**	**349.4**
growth	*38.2%*	*11.7%*	*9.3%*	*7.2%*
EBITDA				
Jackpotjoy	84.6	92.2	94.4	98.5
margin	*44.9%*	*44.6%*	*42.0%*	*41.3%*
Vera&John	18.0	19.5	24.2	23.5
margin	*31.6%*	*27.5%*	*29.9%*	*26.0%*
Mandalay	6.6	7.4	7.1	7.1
margin	*30.4%*	*36.8%*	*35.1%*	*34.7%*
Corporate Costs	-7.0	-11.9	-11.9	-12.7
margin	*-2.6%*	*-4.0%*	*-3.6%*	*-3.6%*
EBITDA adjusted	**102.2**	**107.4**	**113.8**	**116.4**
EBITDA margin	*38.3%*	*36.0%*	*34.9%*	*33.3%*

Source: Jackpotjoy accounts, Edison Investment Research. Note: Excludes other non-gaming income of £2.1m in 2016 (revenue guarantee and platform migration).

Estimate changes

Following Q317 results, we have nudged up our FY17 revenue and EBITDA estimates by 1.2% and 1.6%, respectively. Our 2018 and 2019 revenue forecasts also increase by c 1%, but we have kept our EBITDA forecasts unchanged, to allow for the impact of rising gaming taxes.

We have included accretion (for the payment of future earnouts) into our interest costs, raising our estimate for interest expense in 2017 from £32.0m to £40.3m and our amortisation estimate is raised from £55.0m to £61.2m. As a result, our 2017 fully diluted EPS estimate falls 8% to 86.4p.

Exhibit 10: Estimate changes

	Revenue (£m)			EBITDA (£m)			EPS (p)		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2017e	294.8	298.2	1.2	105.7	107.4	1.6	93.8	86.4	(7.9)
2018e	322.3	326.0	1.1	113.8	113.8	0.0	109.2	108.3	(0.8)
2019e	345.3	349.4	1.2	116.4	116.4	0.0	118.0	117.0	(0.8)

Source: Edison Investment Research

Cash flow and balance sheet

JPJ ended the quarter with an unrestricted cash balance of £39m and net debt of £298m. Including the contingent consideration, adjusted net debt/EBITDA was 3.35x in Q317, from 3.6x in Q217 and 4.0x in Q117.

Following the £94.2m earnout payment in June, the adjusted net debt calculation includes:

- A contingent consideration of c £47.5m, which comprises the Botemania earnout and the three milestone payments that may be earned should the Jackpotjoy division reach certain EBIT thresholds in each of the three years to March 2020. The balance sheet figure of £47.5m is time weighted and probability adjusted. We estimate cash outflows of £49m in June 2018 (£44m for Botemania and a £5m milestone) with £5m outflows in June 2019 and June 2020 for the milestone payments.
- A further c £15m of non-compete payments is already included in the debt figures.

Including a one-off working capital inflow, cash conversion in Q317 was over 100% and JPJ currently generates approximately £100m operating cash flow per year. The company is therefore comfortably positioned to meet its future earnout obligations. We forecast net debt of £273.8m in 2018, with an adjusted net leverage of 2.5x, reaching 2.0x during 2019.

Under the terms of its covenants, the group is permitted to pay dividends once leverage reaches 2.75x, and the company has stated that it intends to begin paying dividends once the balance sheet is closer to sector average gearing. We have not included dividends in our forecasts, as the company will still be quite leveraged by sector standards in 2019. But given the strong cash flow generation, and assuming the company does not participate in further M&A, it is possible that dividends could begin as early as 2019.

Valuation

Online gambling companies are generally valued on a P/E and EV/EBITDA basis, although we have also performed a DCF. Exhibit 11 shows the main UK-listed peers, of which we consider the closest to be 888 Holdings and GVC, both of which have sizeable online bingo and gaming operations, and the smaller Stride Gaming. Paddy Power Betfair is also a comparator, and highly rated. Ladbrokes, William Hill and Rank have large, low-growth, land-based estates as well as online operations; Playtech is mainly software/B2B. Internationally, B2C operators Betsson and Kindred are the closest peers.

The stock has risen 42% since listing, but remains at a discount to the sector. JPJ's 2018e P/E of 7.9x compares to the UK sector average of 12.9x and the EV/EBITDA of 8.2x stands at a 8% discount. The group is demonstrating a lengthening track record as a 77% regulated, cash-generative gaming operator in a growing and consolidating marketplace. To allow for the above-average leverage, a conservative 10x 2018e P/E, which is still at a discount to peers, would imply a share price of 1,080p and a 9.7x 2018e EV/EBITDA, which is in line with 888.

Exhibit 11: Sector peer group multiples

Name	Quoted Currency	Market cap (m)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	PE 1FY (x)	PE 2FY (x)	CAGR EPS Growth FY1-3	Div yield 1FY (x)
GVC HOLDINGS PLC	GBp	2,669	11.4	10.8	16.3	14.4	4.2%	3.4
LADBROKES CORAL GROUP PLC	GBp	2,561	8.0	6.7	11.5	8.6	3.5%	3.0
PADDY POWER BETFAIR PLC	GBp	7,289	16.0	14.1	22.6	19.9	4.5%	2.2
PLAYTECH PLC	GBp	2,621	8.7	8.0	12.5	11.4	4.0%	3.9
WILLIAM HILL PLC	GBp	2,304	7.9	7.5	11.5	10.6	1.3%	4.8
JACKPOTJOY PLC	**GBp**	**633**	**8.7**	**8.2**	**9.9**	**7.9**	**16.3%**	**0.0**
888 HOLDINGS PLC	GBp	895	12.3	9.8	20.7	16.1	3.3%	4.6
RANK GROUP PLC*	GBp	921	7.2	6.9	14.5	14.0	3.8%**	3.3
STRIDE GAMING PLC*	GBp	189	8.6	8.3	12.1	12.9	NA	1.1
STARS GROUP INC/THE	CAD	4,046	9.4	8.9	9.6	8.9	NA	NA
BETSSON AB	SEK	8,872	8.9	8.1	10.9	9.7	-1.9%	4.7
BET-AT-HOME.COM AG	EUR	724	17.3	14.7	21.3	18.7	5.1%	5.5
KINDRED GROUP PLC	SEK	24,393	14.8	12.5	19.5	16.5	-1.3%	3.3
Mean			10.7	9.6	14.8	13.0	3.9%	3.3
Median			8.9	8.3	12.5	12.9	3.8%	3.3
UK mean			**9.9**	**8.9**	**14.5**	**12.9**	**4.9%**	**3.0**

Source: Source: Bloomberg consensus, Edison Investment Research estimates. Prices as at 13 November 2017. Note: *Calendar year; **1 year EPS growth.

DCF: For our DCF we have run forecasts through to 2023 with revenue growth moderating to 4.0% by 2023 and a terminal growth rate of 2.0%. Our forecast EBITDA margin for 2019 is 33.3% (2018e: 34.9%) and we assume this falls to 28% by 2023 (due to the Gamesys fee increase and a slight rise in the marketing ratio), with a terminal margin of 26%. With a WACC of 10%, our DCF value is 1,132p/share. Flexing the terminal margin between 25% and 27% produces a range of 1,092-1,171p, while a 9-11% WACC range (and 26% terminal EBITDA margin) gives 1,031-1,391p.

Exhibit 12: Financial summary

£m	2015	2016	2017e	2018e	2019e
Year end 31 December					
PROFIT & LOSS					
Revenue	194.6	269.0	298.2	326.0	349.4
Cost of Sales	(101.4)	(130.7)	(144.3)	(162.1)	(179.7)
Gross Profit	93.3	138.3	153.9	163.9	169.8
EBITDA	70.4	102.2	107.4	113.8	116.4
Operating Profit (before amort. and except.)	70.1	101.6	105.4	111.9	114.5
Intangible Amortisation	(50.6)	(55.5)	(61.2)	(61.2)	(61.2)
Exceptional and other items **	(109.7)	(52.5)	(33.5)	1.0	0.4
Share based payments	(2.9)	(2.3)	(1.5)	(2.0)	(2.0)
Operating Profit	(93.1)	(8.7)	9.2	49.7	51.7
Net Interest	(24.0)	(35.9)	(40.3)	(28.0)	(22.0)
Profit Before Tax (norm)	46.1	65.6	65.2	83.9	92.5
Profit Before Tax (FRS 3)	(114.2)	(40.7)	(30.1)	22.2	30.5
Tax	(0.5)	0.1	(0.7)	(2.5)	(4.5)
Profit After Tax (norm)	45.5	65.7	64.5	81.4	88.0
Profit After Tax (FRS 3)	(114.8)	(40.6)	(30.8)	19.7	26.0
Average Number of Shares Outstanding (m)	61.2	71.2	74.1	74.5	74.5
EPS - normalised (p)	74.4	92.2	87.0	109.3	118.1
EPS - normalised and fully diluted (p)	73.0	88.4	86.4	108.3	117.0
EPS - (IFRS) (p)	(187.5)	(57.1)	(41.5)	26.5	34.8
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	47.9	51.4	51.6	50.3	48.6
EBITDA Margin (%)	36.2	38.0	36.0	34.9	33.3
Operating Margin (before GW and except.) (%)	36.0	37.8	35.4	34.3	32.8
BALANCE SHEET					
Fixed Assets	674.3	652.3	593.2	534.0	475.9
Intangible Assets	668.8	648.8	587.6	526.4	465.2
Tangible Assets	0.2	0.9	2.9	5.0	8.1
Other long term assets	5.3	2.6	2.6	2.6	2.6
Current Assets	63.9	139.0	71.7	72.1	99.9
Stocks	0.0	0.0	0.0	0.0	0.0
Debtors (incl swaps)	25.6	62.0	28.0	32.0	34.0
Cash	31.8	68.5	34.7	30.1	54.9
Player balances	6.5	8.6	9.0	10.0	11.0
Current Liabilities	(54.3)	(154.9)	(106.5)	(68.5)	(66.5)
Creditors	(23.1)	(41.3)	(40.0)	(40.0)	(40.0)
Short term borrowings	(25.2)	(26.7)	(24.5)	(24.5)	(24.5)
Contingent consideration	(6.0)	(86.9)	(42.0)	(4.0)	(2.0)
Long Term Liabilities	(394.8)	(397.1)	(331.8)	(283.4)	(231.4)
Long term borrowings	(189.3)	(347.4)	(309.4)	(279.4)	(229.4)
Contingent consideration	(203.6)	(33.3)	(6.5)	(2.0)	0.0
Other long term liabilities	(2.0)	(16.4)	(16.0)	(2.0)	(2.0)
Net Assets	289.0	239.4	226.5	254.2	278.0
CASH FLOW					
Operating Cash Flow	23.3	83.0	102.4	108.8	111.4
Net Interest	(24.0)	(35.9)	(32.0)	(28.0)	(22.0)
Tax	(0.5)	(1.2)	(2.5)	(2.5)	(4.5)
Capex	(2.5)	(2.5)	(4.0)	(4.0)	(5.0)
Acquisitions (inc earnouts)	(355.6)	(156.3)	(94.2)	(49.0)	(5.0)
Financing	203.7	(10.0)	36.7	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Net Cash Flow	(155.6)	(122.9)	6.4	25.3	74.9
Opening net debt/(cash)	27.1	182.7	305.6	299.2	273.8
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Closing net debt/(cash)	182.7	305.6	299.2	273.8	198.9
NPV of outstanding earnouts/ other	209.5	140.7	55.5	6.0	2.0
Currency swaps	(4.7)	(38.2)	0.0	0.0	0.0
Adjusted net debt	387.5	408.1	354.6	279.8	200.9

Source: Jackpotjoy accounts, Edison Investment Research

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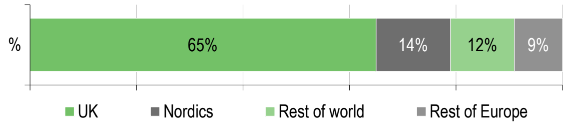
Revenue by geography (12 months to September 2017)



Management team

Executive Chairman: Neil Goulden

Neil was group MD, CEO and chairman of Gala Coral Group from 2001 to 2014. He has spent over 25 years at board level in leisure businesses including Ladbrokes, Compass, Allied Leisure and Gala Coral and he is currently senior independent director at Marston's. He has held a number of industry and ministerial appointments and currently advises the government as a member of the Horserace Levy Board.

Group Managing Director: Simon Wykes

Simon Wykes was appointed as group managing director, effective 1 November 2017, having recently completed an external consultancy role with Ladbrokes Coral on their merger integration plans. He was previously CEO at Gala Leisure and MD at Gala Coral Group, where he oversaw the execution of a successful strategic turnaround plan of its bingo division. He also served as MD of Rank Group for over four years. He is also a non-executive director for both Leisure Electronics Ltd and Wexel Gaming.

CFO: Keith Laslop

Keith joined Intertain as CFO at the time of the qualifying transaction in February 2014. Prior to that, he served as principal of Newcourt Capital, a private equity group. From 2004-08 he was CFO and then president of Prolexic Technologies (a DDoS mitigation provider) and from 2001-04 he was CFO and business development director of London-based Elixir Studios (a video-gaming software developer). Other previous roles include being a director (2008-11) and COO (June-September 2010) of Gerova Financial.

Outgoing CEO: Andrew McIver

Andrew was CEO of Sportingbet from 2006-13 (when it was acquired by GVC) having previously been group finance director. He qualified as a chartered accountant with Arthur Andersen and held senior finance positions with Signet Group, Ladbrokes and House of Fraser before joining Sportingbet in 2001. Andrew will remain at JPJ until January 2018, to ensure a smooth transition.

Principal shareholders	(%)
Intertain Jerseyco Ltd	16.0%
UBS	7.7%
HG Vora Capital Management	7.1%
Goldman Sachs	6.4%
Canacord Genuity	5.5%
Odey Asset Management	4.2%
Capita Financial Mgrs Ireland	3.8%

Companies named in this report

888 (888: LN); bet-at-home (ACX: ETR); Betsson (BETS-B: STO); GVC Holdings (GVC: LN); Kindred Group (KIND-SDB: STO); Ladbrokes Coral Group (LCL: LN); Paddy Power Betfair (PPB: LN); Playtech (PTEC: LN): Rank Group (RNK: LN); The Stars Group (TSGI: TSE); Stride Gaming (STR: LN); William Hill (WMH: LN)