Jackpotjoy plc

Q118 results

International drives revenue growth

Travel & leisure

Jackpotjoy plc's (JPJ's) Q1 revenues rose 13% to £80.7m, driven primarily by diversification and growth in international markets, with its Vera&John division (26% of revenues) increasing 35%. The earn-out period for the Spanish division has now ended and, given its strong performance, the total contingent consideration increased 20% in the quarter to £72.1m, with £63.8m payable this year. Our headline revenue and profit forecasts remain broadly unchanged and we continue to expect significant deleverage after the final major earn-out payment in June 2018. The stock trades at 7.8x EV/EBITDA and 6.5x P/E for FY19, a meaningful discount to peers.

Year end	Revenue (£m)	EBITDA* (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	269.0	102.2	83.5	112.6	0.0	7.4	0.0
12/17	304.7	108.6	78.2	103.9	0.0	8.0	0.0
12/18e	334.5	113.6	93.7	120.4	0.0	6.8	0.0
12/19e	358.7	116.5	102.0	128.1	40.0	6.5	4.8
12/20e	382.0	122.0	108.5	135.8	45.0	6.1	5.4

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

Headline figures in line with our estimates

JPJ is continuing its steady growth through diversification into new markets, producing consistently strong cash flow across all divisions (90% cash conversion). Q118 revenue growth of 13% was driven by a 35% increase in Vera&John, while the core Jackpotjoy division increased by 7%, indicating mid-single-digit UK growth. As previously discussed, Mandalay has now been consolidated into the Jackpotjoy division and we expect management to focus on cross-sell between brands. Group EBITDA of £27.1m (vs £29.2m in 1Q17) was in line with our estimates and, while the revenue mix is now more skewed to international growth, our headline forecasts remain broadly unchanged.

Spain outperforms: Earn-out payment nudged up

Since FY17, total contingent consideration has risen from £59.6m to £72.1m, indicating a significant uptick in the Spanish Botemania division during the first quarter. The earn-out period for Botemania ended in March 2018 and the final major earn-out payment to Gamesys (c £60m) is due in June 2018. From this point, we anticipate significant deleverage, with adjusted net debt falling from 3.6x at Q118 to 2.8x at end FY18 and 2.1x at end FY19. We forecast dividend payments from 2019.

Valuation: 6.5x P/E and 7.8x EV/EBITDA for FY19

After rising c 40% in 2017, the share price performance has drifted in 2018. At 6.5x P/E, 7.8x EV/EBITDA and 13.4% FCF yield for 2019, JPJ trades at a meaningful discount to peers. This appears unjustified given its growth profile and high cash generation, which should lead to demonstrable debt reduction from mid-2018 (post the Botemania earn-out payment).

15 May 2018

Price	**831p**
Market cap	**£617m**
	£1:€1.13
Unadjusted net debt (£m) at March 2018	292
Shares in issue	74.3m
Free float	95%
Code	JPJ
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	3.9	6.7	46.4
Rel (local)	(1.9)	(0.2)	40.7
52-week high/low		872p	570p

Business description

Jackpotjoy plc is a leading online gaming operator mainly focused on bingo-led gaming targeted towards female audiences. Around 76% of revenues are generated in regulated markets.

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Q118 headline figures meet expectations

- **Revenues: Q118 driven by 35% growth in Vera&John**

Q118 revenues increased 13% y-o-y to £80.7m, driven by 35% growth in Vera&John and 7% growth in the core Jackpotjoy division.

Within Jackpotjoy, the Spanish division has performed extremely well and Jackpotjoy UK appears to have posted mid-single-digit growth. The Mandalay division (which had previously reported revenue declines in FY17) has now been consolidated into Jackpotjoy, which has slightly depressed divisional growth.

At March 2018, average active customers per month grew 7% to 256,699 vs the prior year and average real money gaming revenue per month increased 17% to £24.5m. This equates to monthly real money gaming revenue per average active customer of £95, a y-o-y increase of 9%.

- **EBITDA: Q118 affected by marketing and higher UK gaming taxes**

In line with our estimates, Q118 EBITDA was £27.1m, which represents a margin of 33.6% vs 40.9% in the prior year (£29.2m). Similar to Q417, the UK EBITDA was affected by the introduction of bonuses into the point of consumption tax (POCT 2) and total gaming taxes were 14.0% of total revenues, vs 11.2% in Q117. In addition, margins were affected by continued marketing campaigns across the group. Total marketing costs were 18.0% of revenues vs 13.5% in the prior year. For the full year, we continue to estimate marketing costs of 16.5% of revenues.

- **Increased contingent consideration leads to higher net debt/EBITDA**

The bingo-led business is characterised by high cash conversion and JPJ produced £24.4m of operating cashflow in the quarter, in line with expectations. The company ended the quarter with an unrestricted cash balance of £76.2m and unadjusted net debt of £292m. Including the non-compete payments and contingent consideration, adjusted net debt was £379.9m, which equates to a 3.57x adjusted net debt/EBITDA. This is slightly higher than our expectations, primarily due to the increased contingent consideration, which resulted from a stronger performance in the Spanish division.

- **Outlook and forecast changes**

Management has stated that trading is in line with expectations and our forecasts remain broadly unchanged. The only notable difference is a slight increase in net debt due to the higher than expected earn-out payment in June. Our FY18 unadjusted net debt goes from £286m to £303m.

Jackpotjoy (74% of revenues): Now includes Mandalay

JPJ has now consolidated the Mandalay division into the Jackpotjoy division, with total revenues for the division of £59.5m, representing growth of 7%. Jackpotjoy UK comprised 60% of divisional revenues, indicating a 5% y-o-y growth and we believe Mandalay has continued its revenue decline. To compensate, Starspins and Botemania now comprise approximately 24% of divisional revenues, suggesting 57% growth vs the prior year. This impressive performance is the reason for the increase in contingent consideration.

In terms of profit, divisional EBITDA remains robust, at £26.1m or 43.9% margin. This is despite the rises in UK gaming taxes and the ongoing marketing campaign. Altogether, we have lowered our FY18 revenue forecasts for the whole Jackpotjoy division by c £4m (or 1.6%), although our EBITDA forecast remains broadly unchanged.

Vera&John (26% of revenues): Strong revenues, EBITDA in line

JPJ has continued its impressive growth trajectory in international markets and Vera&John Q118 revenues increased by 35% y-o-y to £21.2m, equating to 31% in constant currency. Q118 adjusted EBITDA of £4.0m represented an EBITDA margin of 18.9% (vs 28% in the prior year), with the decline predominantly due to continued marketing expenses. Increased gaming taxes in regulated markets and additional personnel also contributed to higher expenses.

For 2018, we have raised our revenue growth estimate to 22.7% (vs 17% previously), although our EBITDA estimate remains broadly unchanged.

We summarise our divisional forecasts in Exhibit 1 below.

Exhibit 1: Divisional breakdown

Gaming revenue (£m)	2016*	2017	2018e	2019e	2020e
Jackpotjoy	209.9	231.5	244.7	258.4	271.6
Growth	*47.1%*	*10.3%*	*5.7%*	*5.6%*	*5.1%*
Vera&John	57.0	73.2	89.8	100.3	110.4
Growth	*35.4%*	*28.3%*	*22.7%*	*11.8%*	*10.0%*
Total gaming revenue	**266.9**	**304.7**	**334.5**	**358.7**	**382.0**
Growth	*38.2%*	*14.1%*	*9.8%*	*7.3%*	*6.5%*
EBITDA (£m)					
Jackpotjoy	91.2	102.2	105.1	107.9	110.8
Margin	*43.5%*	*44.2%*	*42.9%*	*41.7%*	*40.8%*
Vera&John	18.0	18.0	21.3	22.6	25.4
Margin	*31.6%*	*24.6%*	*23.8%*	*22.5%*	*23.0%*
Corporate costs	(7.0)	(11.7)	(12.8)	(14.0)	(14.1)
Margin	*(2.6%)*	*(3.8%)*	*(3.8%)*	*(3.9%)*	*(3.7%)*
EBITDA adjusted	**102.2**	**108.6**	**113.6**	**116.5**	**122.0**
EBITDA margin	*38.3%*	*35.6%*	*34.0%*	*32.5%*	*31.9%*

Source: Company accounts, Edison Investment Research. Note: *2016 gaming revenues exclude £2.1m of other revenues from a revenue guarantee and platform migration revenue.

Cash flow and balance sheet

JPJ ended the quarter with an unrestricted cash balance of £76.2m and adjusted net debt of £379.9m. Unadjusted net debt was £292m (excluding contingent consideration and non-compete payments). Cash conversion of 90% produced an operating cash flow of £24m and is in line with our yearly estimates of c £100m.

As discussed above, the total contingent consideration has increased from £59.6m at end FY17 to £72.1m at Q118, of which the current portion is £63.8m. The payment of the Botemania earn-out is due in June 2018. Adjusted net debt/EBITDA ratio was 3.57x at Q118 vs 3.6x at FY17. We forecast unadjusted net debt of £302.5m in 2018, with an adjusted net leverage of 2.8x, reaching the company's target of less than 2.0x during 2019.

Exhibit 2: Changes to estimates

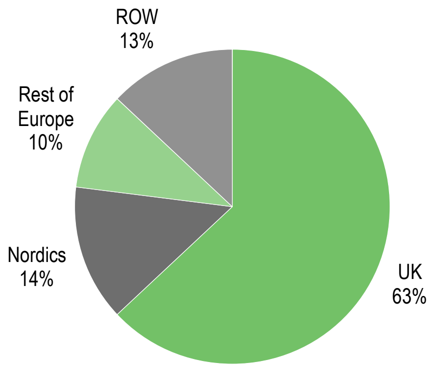
	Revenue (£m)			EBITDA (£m)			EPS (p)		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
2018e	334.0	334.5	0.1	113.6	113.6	0.0	119.7	120.4	0.6
2019e	358.7	358.7	0.0	116.5	116.5	0.0	128.2	128.1	(0.1)
2020e	381.5	382.0	0.1	122.2	122.0	(0.2)	136.1	135.8	(0.2)

Source: Company accounts, Edison Investment Research

Geographic split, gaming taxes and regulation

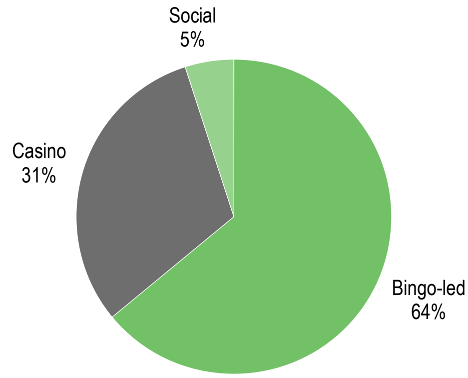
JPJ operates largely in regulated markets (76% of revenue), with bingo-led and casino products comprising 95% of total revenues. In line with the company's goal to diversify geographically, we would expect future growth from additional European markets (eg Italy) as well as Latin America (eg Brazil, Colombia).

Exhibit 3: 2017 geographic revenues



Source: JPJ accounts

Exhibit 4: 2017 product revenues



Source: JPJ accounts

The company pays significant gaming taxes (at 14% of total revenues at Q118), which are expected to rise steadily as new markets regulate. Regulatory changes are a key variable for gaming operators and we highlight the countries of specific interest below:

- **UK**: last year's extension of 15% Point of Consumption Tax (POCT) to include free bets in the UK has been enforced from August 2017, and affects financials from October 2017. Overall, this tax has affected the UK businesses' EBITDA (Mandalay, Starspins and Jackpotjoy UK) by c 3-4%. In addition, there is speculation that the POCT could be raised to 20% to offset the loss of other gaming taxes (specifically from the fixed odds betting terminals). This would have a significant impact on EBITDA (£9.5m or 9% of total EBITDA). .
- **Spain**: the 25% tax on Spanish gross gaming revenues is becoming more relevant as Botemania revenues continue to increase. At FY17, we estimate that Botemania comprised c 11% of the Jackpotjoy division, or 8% of total revenues. Recent proposals for a decrease in Spanish gaming taxes to 20% would be a positive for JPJ (£1.1m EBITDA uplift based on FY17 figures), although at this stage there is little clarity on timing.
- **Sweden**: our forecasts include the expected 18% gaming tax in Sweden from 2019. This will mostly affect the Vera&John division, where we estimate that one-third of revenues are derived from Sweden. With a further estimated c 5% of the Jackpotjoy division coming from Sweden, total Swedish revenues are approximately 9% of group revenues. Our FY19 estimates include a tax hit of c £5.5m on EBITDA (5% of total EBITDA).
- **Norway**: We estimate that approximately 2-3% of revenues are derived from Norway, which is a grey market with no immediate prospects of regulation. Proposals in Norway include domain name system (DNS) blocking (pop-up messages on unregulated gambling sites) as well as measures around the reporting of online gambling payments. At present, most operators believe these proposals would be illegal, but clearly there is some risk to these revenues.

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Exhibit 5: Financial summary

£m	2015	2016	2017	2018e	2019e	2020e
December						
PROFIT & LOSS						
Revenue	194.6	269.0	304.7	334.5	358.7	382.0
Cost of Sales	(101.4)	(130.7)	(147.5)	(167.0)	(187.0)	(200.8)
Gross Profit	93.3	138.3	157.2	167.4	171.7	181.2
EBITDA	70.4	102.2	108.6	113.6	116.5	122.0
Operating Profit (before amort. and except.)	70.1	101.6	108.2	113.1	116.0	121.5
Intangible Amortisation	(50.6)	(55.5)	(62.6)	(61.8)	(61.8)	(61.8)
Exceptional and other items **	(109.7)	(80.3)	(104.9)	(17.0)	2.0	2.0
Share based payments	(2.9)	(2.3)	(1.4)	(2.1)	(2.0)	(2.0)
Operating Profit	(93.1)	(36.5)	(60.8)	32.2	54.2	59.8
Net Interest	(24.0)	(18.1)	(30.0)	(19.4)	(14.0)	(13.0)
Profit Before Tax (norm)	46.1	83.5	78.2	93.7	102.0	108.5
Profit Before Tax (FRS 3)	(114.2)	(36.7)	(65.8)	14.3	40.2	46.8
Tax	(0.5)	0.1	(0.7)	(3.0)	(5.0)	(5.0)
Profit After Tax (norm)	45.5	83.6	77.5	90.7	97.0	103.5
Profit After Tax (FRS 3)	(114.8)	(36.7)	(66.5)	11.3	35.2	41.8
Average Number of Shares Outstanding (m)	61.2	71.2	73.9	74.6	75.0	75.5
EPS - normalised (p)	74.4	117.3	104.9	121.6	129.3	137.1
EPS - normalised and fully diluted (p)	73.1	112.6	103.9	120.4	128.1	135.8
EPS - (IFRS) (p)	(187.6)	(51.5)	(90.0)	15.2	46.9	55.3
Dividend per share (p)	0.0	0.0	0.0	0.0	40.0	45.0
Gross Margin (%)	47.9	51.4	51.6	50.1	47.9	47.4
EBITDA Margin (%)	36.2	38.0	35.6	34.0	32.5	31.9
Operating Margin (before GW and except.) (%)	36.0	37.8	35.5	33.8	32.3	31.8
BALANCE SHEET						
Fixed Assets	674.3	652.3	595.9	537.7	480.4	423.2
Intangible Assets	668.8	648.8	589.0	527.2	465.5	403.7
Tangible Assets	0.2	0.9	1.3	4.8	9.3	13.9
Other long term assets	5.3	2.6	5.6	5.6	5.6	5.6
Current Assets	63.9	139.0	93.2	77.2	93.8	98.4
Stocks	0.0	0.0	0.0	0.0	0.0	0.0
Debtors (incl swaps)	25.6	62.0	26.0	30.0	32.0	34.0
Cash	31.8	68.5	59.0	37.2	50.8	52.4
Player balances	6.5	8.6	8.2	10.0	11.0	12.0
Current Liabilities	(54.3)	(154.9)	(98.5)	(49.3)	(47.3)	(47.3)
Creditors	(23.1)	(41.3)	(46.3)	(45.0)	(45.0)	(45.0)
Short term borrowings	(25.2)	(26.7)	(0.3)	(0.3)	(0.3)	(0.3)
Contingent consideration	(6.0)	(86.9)	(51.9)	(4.0)	(2.0)	(2.0)
Long Term Liabilities	(394.8)	(397.1)	(386.7)	(343.5)	(291.5)	(241.5)
Long term borrowings	(189.3)	(347.4)	(369.5)	(339.5)	(289.5)	(239.5)
Contingent consideration	(203.6)	(33.3)	(7.7)	(2.0)	0.0	0.0
Other long term liabilities	(2.0)	(16.4)	(9.4)	(2.0)	(2.0)	(2.0)
Net Assets	289.0	239.4	204.1	222.2	235.5	232.8
CASH FLOW						
Operating Cash Flow	23.3	84.2	102.0	104.6	107.5	113.0
Net Interest	(24.0)	(17.5)	(30.9)	(19.4)	(14.0)	(13.0)
Tax	(0.5)	(1.2)	(1.0)	(3.0)	(5.0)	(5.0)
Capex	(2.5)	(2.5)	(3.2)	(4.0)	(5.0)	(5.0)
Acquisitions (inc earn-outs)	(355.6)	(156.3)	(94.2)	(70.0)	(5.0)	(5.0)
Financing	203.7	(29.6)	22.2	0.0	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	(14.9)	(33.4)
Net Cash Flow	(155.6)	(122.9)	(5.2)	8.2	63.6	51.6
Opening net debt/(cash)	27.1	182.7	305.6	310.7	302.5	238.9
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	(0.0)	(0.0)
Closing net debt/(cash)	182.7	305.6	310.7	302.5	238.9	187.3
NPV of outstanding earnouts/ other	209.5	140.8	76.6	15.0	5.0	0.0
Currency swaps	(4.7)	(38.2)	0.0	0.0	0.0	0.0
Adjusted net debt	387.5	408.1	387.3	317.5	243.9	187.3

Source: Company accounts, Edison Investment Research