

Online gambling sector

February 2005

A new way to win

Investment opportunities in online betting and gaming



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Key conclusions

Online gambling should grow at 20%+ per annum for several years

Online gambling is already a significant new industry with 2004 revenues (amounts lost by gamblers) worldwide exceeding \$8bn or 37% higher than in 2003. However, they still represent little more than 2% of the world gambling market. There is enormous scope for continued growth as existing gamblers are tempted to play online and as new users are attracted to the medium.

The internet is expanding the gambling market

Online gambling appeals to a wider audience than traditional gambling – in particular to younger, more affluent computer literate customers and to women. The latter represent 30-40% of players in Europe versus 5% in offline casinos. Playing at home is not just convenient, it can also be much less intimidating than visiting a casino or betting shop.

Poker is currently the main driver of growth...

Online poker was virtually non-existent in 2000 – now the gross rake (operator commission) is running at \$4.5m a day. Poker is one of the world's most popular card games, played by 50-80m people in the US alone and attracting big television audiences. From the operator's point of view, poker is a risk free business where 'big is best' – players gravitate towards popular poker sites where they know other people will be playing.

...but other drivers will start to take over

There is little sign that the explosion in online poker is abating but already operators are looking for the next big growth segment. Bingo is a possibility, as too are skill games, which have the advantage of being legal in parts of the US. Gambling over mobile phones (mgaming) has considerable potential and software operators are beginning to launch a wide array of new games. Longer-term, gambling over iTV (interactive television) may also take off once the technology improves.

Online operators are becoming increasingly attractive for investors

Consolidation amongst operators is accelerating, for example Sportingbet's acquisition of Paradise Poker. This drives economies of scale and builds brands – thus introducing barriers to entry which historically have been weak.

Infrastructure providers are another way to play the sector

Software suppliers, such as CryptoLogic and Fun Technologies, and payment processors such as NETeller are prospering from market growth and because of US restrictions on the use of credit cards. Future growth is attractive, for example NETeller's revenues are forecast to increase by 36% during 2005.

The regulatory environment favours the UK

There were a number of positive regulatory moves in 2004, notably the WTO's ruling in favour of Antigua. There are some US risks, for example anti-gambling measures are combined within anti-terrorism legislation, but we expect these to fail. The delay keeps potential US competitors out of the market. The long awaited UK Gambling Bill, if finally passed, would mean the UK becoming a major regulated jurisdiction for online gambling operators.

Risks... outweighed by opportunities

The early stage nature of the industry means there will be casualties along the way. The profit warning from BETonSPORTS demonstrates the business risks which exist for some. Wider operational risks come from hackers and systems failures, together with customer default or fraud. These are modest when compared to the high returns on capital (NETeller is likely to have a ROIC of 185% in 2004) and strong positive cash flows (Gaming VC's cash conversion exceeds 100%) of operators and infrastructure providers.

The UK is home to the global quoted industry

The imminent arrival of Party Poker will confirm the UK's leading position for international online gambling stocks. There are at least 11 UK listed online gambling stocks and many others are either coming to market or dual listing in London.

We continue to see value in the sector

Online gambling share prices have increased by 63% on average over the last 12 months. Many of the smaller players are loss-making. Of the profitable larger firms, BETonSPORTS (20x), Gaming VC (11x), NETeller (38x) and Sportingbet (28x) trade on mean PEs of 24x. We expect upgrades, particularly for NETeller and Sportingbet, during the year.

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1. The online gambling market

Gambling is an enormous worldwide industry, with estimated operating revenues of \$433bn¹ in 2003 (amounts staked, less winnings returned to punters in the case of casino games and machines). Around 98% of gambling still takes place in traditional 'bricks and mortar' locations such as casinos, betting shops and bingo clubs. However, a small but rapidly growing proportion is taking place online, mainly over the internet but also on mobile phones and through digital interactive television (iTV). Drivers for growth include rising internet penetration, more consumer confidence in online payment systems and new and more attractive online sites and games.

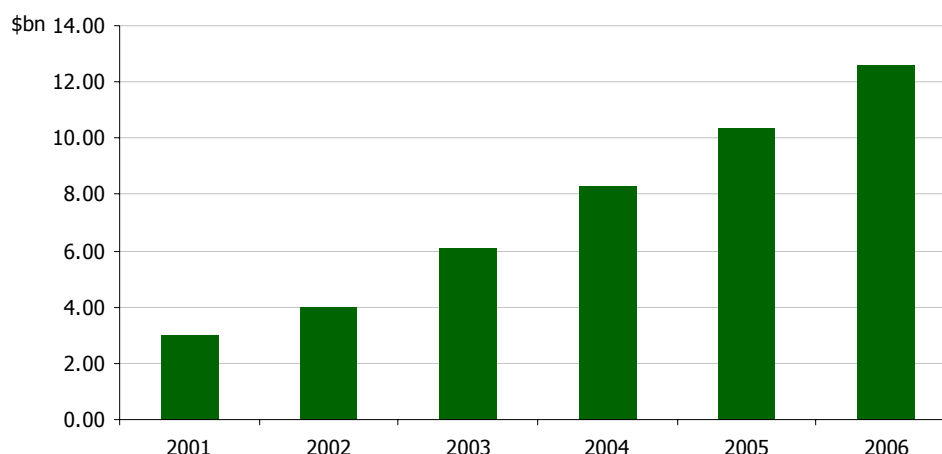
Online gambling appeals to a wide audience

Online gambling has a number of attractions for players. It is convenient and easily accessible at any time of day or night, and it protects player anonymity. Casino sites provide a huge array of games, including free-play games that encourage players to 'have a go'. Sites for online sports betting provide odds checking as well as comprehensive results services and live streaming of major events. Betting exchanges have sprung up which allow player-to-player betting, matching people with opposing views. The broad demographic appeal of online gambling means that bet sizes tend to be relatively low. Although there are exceptions (some casino games and betting exchanges), much of the business is entertainment-led rather than high roller gambling.

Worldwide market for online gambling

Industry statistics for online gambling need to be treated with caution. The industry is new and many operators (particularly US-facing sites) are private companies, so data is limited. However, the general consensus is that the worldwide market for online gambling has grown from nothing in 1995 to \$6bn in 2003 and over \$8bn in 2004. Forecasters expect the market to grow by 20-25% in both 2005 and 2006 and to rise as much as tenfold over the next ten years.

Figure 1. Estimated worldwide online gambling revenues (\$bn)



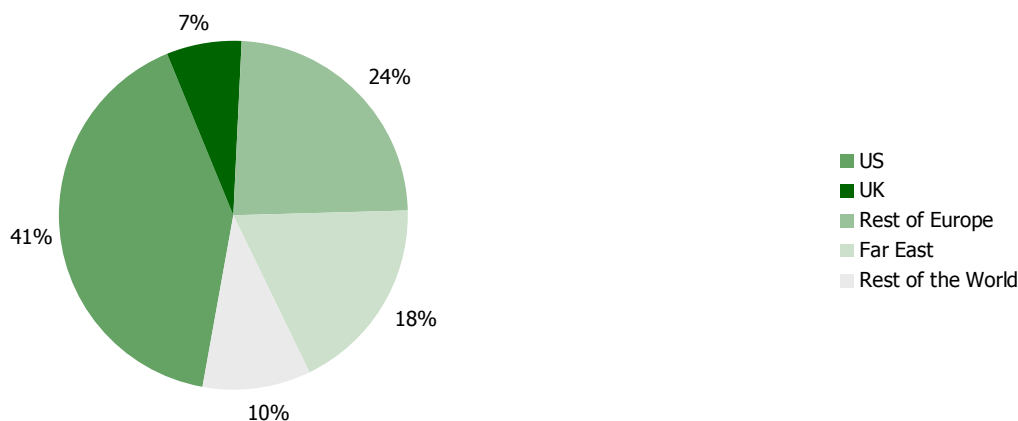
Source: Christiansen Capital Advisors. LLC

¹ Source: The Economist Sep 2004, Global Betting and Gaming Consultants.

Online gambling revenues by country

The US is the largest single online gambling market, despite attempts by the US Department of Justice to curtail it (see Regulation section). As a result US-facing sites are located offshore, mainly in the Caribbean. The US is believed to account for more than 40% of the total world market for online gambling and 60-70% of the market for poker. Within the Far East, Japan is easily the biggest market driven by casino games.

Figure 2. Estimated split of online gambling revenues by country



Source: iGlobalMedia, December 2004

Looking forward, we expect the fastest growing markets to be Asia Pacific (estimated to be growing at almost 50% per year) and Europe (35-40% per year). However, Far East markets present their own challenges for western operators (cultural, linguistic, payment systems, etc.) and thus we believe that online gambling operators will increasingly invest in Europe. The UK could become the first major country with a fully legal and regulated online gambling industry when the Gambling Act becomes law. The Euro-zone countries are also attractive, with increasing internet connectivity, high disposable incomes, and generally (although not uniformly) favourable regulatory environments.

The US market is maturing slightly but still expected to achieve double-digit growth. It is likely to grow very dramatically again when and if online gambling is eventually legalised and the major US casino operators enter the market, but we do not expect this to happen for some years to come.

Macro-economic influences

Gambling is a leisure pursuit and total expenditure is affected by changes in consumer income and confidence. At present the online industry is showing very strong growth and is too new for any statistics to be available on the effect of an economic downturn. In the past, most areas of gambling have proved very defensive in an economic downturn (although not completely immune) as they provide low cost entertainment (bingo, for example). We believe that there might be some effect on average stake size, but the key drivers behind the industry's growth - more people playing online - remain intact. If anything, this inexpensive form of home-based entertainment could benefit if people cut back on other forms of recreation.

New media for gambling - mobile and iTV

At present most online gambling takes place over the internet (indeed it is probably one of the most profitable internet businesses). However, operators are taking an increasing interest in the opportunities for delivering gambling products via mobile phone or interactive digital television (iDTV).

Mobile (mgaming)

At present the market is small, but is starting to take off as 3G and Java-enabled handsets have become more widespread. Consultants Alexander Resources forecast worldwide revenues for betting via mobile phones to reach £9bn by 2008.

Many of the larger software suppliers are now starting to offer mobile gambling products. These include casino-style games, soft/ fixed odds games, sports betting and lotteries. For example, Paddy Power launched mobile sports betting last June, followed by virtual horseracing and bingo, and Ladbrokes has launched a full suite of Microgaming powered casino games. Stream Group's 'GO! 82020' brand offers a wide array of content from ringtones to movie clips and betting applications.

Mobile gambling is not far removed from mobile multi-player gaming, which is already popular in Japan. There are still a number of technical issues to be resolved, such as age verification and payment processing, security, roaming, and jurisdiction. However, with a rapidly growing penetration of mobile phones worldwide, the medium-term opportunity is significant.

iTV (interactive television)

In 2000 Open TV launched Bluesquare's sports betting service and Ladbrokes introduced pool betting on cable. However, the market is still very small and has been slow to take off, partly because of the relative unsophistication of iTV technology compared with the internet, and the slowness of the return path.

Sky is probably the only business currently making a significant amount of money out of iTV gambling. It offers sports betting under its Sky Bet and Sky Bet Vegas brands and has an interactive gambling TV channel. William Hill also runs an interactive gambling TV channel and Littlewoods launched its Gaming ITVi service (a partnership between Sportech and ITV) in June 2004.

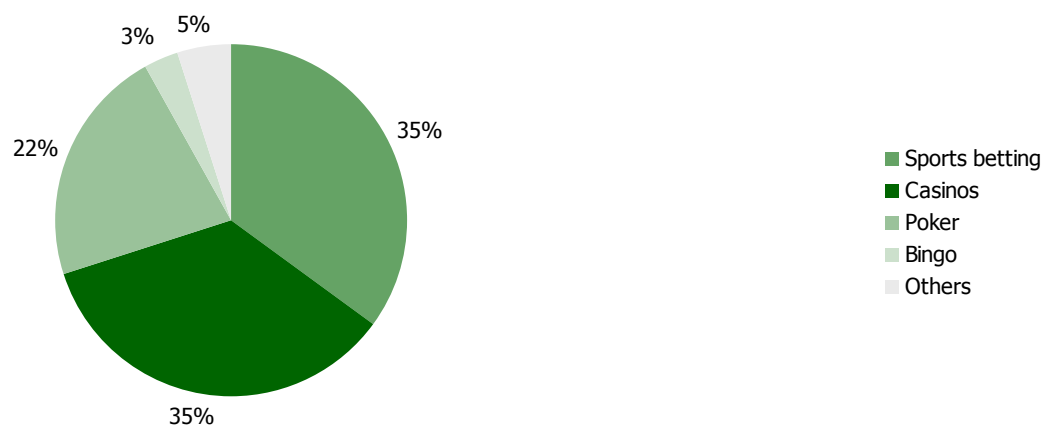
In the US, skill games and interactive games with prizes (not legally counted as gambling) are becoming popular. Zone4Play (listed on NASDAQ) distributes play-for-fun and skill games on cable and satellite TV while SkillJam (owned by Fun Technologies plc) recently announced an agreement to provide pay-for-play games to GSN, The Network For Games (jointly owned by Sony and Liberty Media).

2. Online gambling products

The chart below shows an approximate breakdown of the worldwide online gambling market by product. We estimate that more than half (around 55%) comes from casino games plus poker, with poker being the fastest growing single segment (around 20% currently compared with perhaps 12% in 2003). About 35% comes from sports betting and the balance mainly comes from bingo, skill games, and lotteries.

These are very rough estimates as little hard data is available. Also, the proportions vary in different markets: for example, poker represents a much greater percentage in the US than in Europe, while sports betting (horse racing) is the dominant category in Australia.

Figure 3. Online gambling products



Source: Edison Investment Research, industry estimates

It has been estimated that there could be as many as 31,000 internet gambling sites worldwide (of all languages and types).² However, our main interest is in sites run by the main UK and US-facing operators. One of the longer established gambling portals is Casino City, which ranks 2,300 websites by product and popularity at its website www.online.casinocity.com. This includes 1,140 online casinos, 608 sports books, 257 online poker sites, 146 bingo sites, 19 sites for skill games, and 16 lotteries.

Sports betting

Sports and sports betting are immensely popular around the world yet only a handful of countries – about half a dozen including the UK – have fully licensed retail betting shops. In the 1980s and 1990s a large global market for sports betting developed using telephone betting. But the internet has enormous advantages over the telephone. It provides visibility of prices, comprehensive results services, and live video streaming of major events. Punters can bet on a wide range of sporting events worldwide at any time of day or night. Typically the most popular sports are American football and basketball, European football and horseracing.

² Source: National Audit Office Report on Gambling Duties January 2005.

There are two principal groups of sports betting operators: fixed odds operators and betting exchanges.

Fixed odds sports betting

This is the traditional sports betting model whereby the operator sets the odds for each event and players then back a potential winner or outcome. There are many different ways in which odds are set and players may bet, but in general the bookmaker's skill lies in odds setting and risk management, so as to achieve an 'overround' or profit margin.

Table 1 shows the current top four US-facing sites (as far as one can estimate). Other larger US-facing sportsbook operators include PlayersOnly, Bet365, Intertops, Pinnacle, Millennium Sports and BetWWTS. All of the main UK bookmakers now also offer online sports betting:

Table 1. Popular fixed-odds sports betting websites

US-facing sites	Notes
Sportsbook.com	Sportingbet, UK listed. Jurisdiction: Antigua and Barbuda
BoDog	Owned by BoDog.com (private). Jurisdiction: Costa Rica
Sports Interaction	Private. Jurisdiction: Kahnawake, Canada
BETonSPORTS	UK listed. Jurisdiction: Antigua and Barbuda
UK sites	Notes
William Hill Online	UK listed
Ladbrokes.com	UK listed
Bet365	Owned by Bet365 Group, private
Blue Square	Owned by Rank Group, UK listed
Coral	Owned by Coral Eurobet (private)
Sporting Odds /Sportingbet.com	Sportingbet, UK listed

Source: Hitwise, December 2004, industry estimates

The online sports betting industry has grown extremely rapidly but it is also highly competitive. It is much easier to compare odds online than by walking around different betting shops and a number of websites have sprung up that do just that, such as www.oddschecker.com. The UK industry also faces pressure on margins from betting exchanges. Nevertheless it still represents a tiny proportion of total sports bets placed and the major brands are likely to continue to attract sports fans and recreational gamblers.

Most of the major sports betting operators are now capitalising on their brand strength to offer casino games and poker. The type of person that enjoys sports betting also tends to enjoy other types of online gaming and may, for example, be tempted to play casino games while waiting for the outcome of a sporting event. This logic partly explains Sportingbet's acquisition of Paradise Poker last November. As well as adding a high growth and low risk new income stream, Paradise provided considerable cross-selling opportunities. Conversely, casino and poker operators have not tended to enter the sportsbook market because they do not have the required experience as principal risk-takers.

Betting exchanges

Betting exchanges, led by Betfair, represent a new forum for gambling and have only sprung up over the last five years. They have been described as the *eBay* of the betting industry as they allow individuals to place bets with each other online (i.e., 'person-to-person' betting). The exchange does not set the odds but simply acts as an intermediary between people with opposing views and takes a commission. As with conventional betting, one person will 'back' his selection (team, horse, etc.) to win. The other person 'lays' his selection, offering odds against it winning (as the traditional bookmaker does). Players are able to choose the odds they want to play at and can bet while the game is in play if they wish.

To date, betting exchanges have mainly attracted serious gamblers and high rollers (who might wager around £80,000 a week). They are increasingly used by bookmakers who wish to lay-off bets. They usually provide better odds than high street bookmakers (because they do not themselves take any risk) and this, together with the ability to lay bets, is attracting an increasing number of retail gamblers.

MECN (Media and Entertainment Consulting Network) has suggested that by 2008 betting exchanges will match bets worth \$159bn, compared with a 2004 volume of \$16bn. This represents a CAGR of almost 80%. Betfair's commission revenues in the year to April 2004 reached £67m (and its operating profit was £11.9m).

There are about 25 different betting exchanges but Betfair is clearly the market leader with 75-80% of the total market and perhaps as much as 85-90% in the UK. We believe the only other exchange of any size is BETDAQ (owned by the Global Betting Exchange and also licensed in the UK). Other exchanges include AllSports Market, Betmate UK, Betbull (part owned by Fun Technologies plc), Betsson, Parbet, and Trade Sports.

Betting exchanges need plenty of liquidity (i.e., people with opposing views to bet against one another). In November 2003 the third biggest UK exchange, Sporting Options, went into administration amid allegations that client funds had been misappropriated to grow the business. Betfair provided a rescue package for its client, helping the reputation of the industry while adding to its own client base.

Going forward, although initial barriers to entry are low, only a few new exchanges are likely to succeed, as scale is critical.

Online casinos

There are still far more casino sites on the internet than any other category. However, the market is maturing and consolidating and the number of sites has fallen from over 1,800 to under 1,200 in the last two years. In the early days one could almost launch a new casino site from a back bedroom but now barriers to entry have risen. Operators need a trusted brand, a broad product range and an effective payment system. New entrants are now more likely to be well-funded, perhaps land-based gaming companies looking to add an online product, and to acquire turnkey casino systems from the major software suppliers.

Table 2 lists some of the most popular US online casinos, alphabetically after 888.com and Golden Palace which come top in most surveys. In Europe the list would include the casino sites of operators such as Ladbrokes, Littlewoods and Gaming Corporation (casino.co.uk) in the UK and Casino-club.com (owned by Gaming VC) in Germany and Austria.

Table 2. Popular US online casinos

Website	Owner	Licence jurisdiction	Software provider
Casino-on-Net (888.com)	Cassava Enterprises (private)	Gibraltar	Proprietary
Golden Palace	Private	Kahnawake, Canada	Playtech
All Slots Casino	Jackpot Factory (private)	Kahnawake, Canada	Microgaming
Intercasino	Private	Netherlands Antilles	WagerLogic
Lucky Nugget	Belle Rock Gaming (private)	Gibraltar	Microgaming
River Belle	Belle Rock Gaming (private)	Gibraltar	Microgaming
Starluck Casino	PartyGaming (private):	Gibraltar	iGlobalMedia

Source: Casino City Online, Hitwise, industry estimates

Online casinos offer a wide range of games including all those found in land-based casinos such as blackjack, roulette, and slots. They offer players 24/7 play from the comfort of their homes, and offer high returns for operators as they do not require glitzy bricks and mortar and can be based in tax-free jurisdictions. Thus they can afford much higher payouts, typically 96-98% compared with 88-90% at land-based casinos. In practice this typically means that players play for longer before they reach a psychological losing threshold, so returns on capital can still be very high for online casinos.

The online casino market is competitive as payout ratios can easily be compared on websites such as winneronline.com/bestpayouts. Players often switch accounts or have accounts with a number of casinos. The operators aim to improve player 'stickiness' by offering newer or better games, sign-up bonuses and bigger jackpots. In practice it is very hard to differentiate casino sites. The long-term winners are likely to be those operators who already have strong brands, either in entertainment (Virgin recently caused a stir by re-entering this segment) or in other areas of online gaming such as poker or sports betting.

Poker

In the last five years poker has exploded to become online gambling's most interesting segment. The key driver has been the growing popularity of the offline poker card game, especially in the US which has 50-75m poker players and makes up about 75% of the world market. Televised tournaments such as the World Poker Tour (WPT) on the Travel Channel and the World Series of Poker (WSOP) by ESPN have brought in a substantial number of new poker players, as have celebrity programmes.

Online poker sites provide a forum for players in real time, with convenient 24 hour access to active tables for general play, known as 'ring games'. New players can learn quickly on 'play money' tables, while the sites offer a wide variety of games and stakes. Poker sites also offer tournament play on both a single-table and multi-table basis, with major online tournaments offering prizes of \$100,000 or more. The latest trend is for players to play satellite tournaments online and win seats into big offline championship events such as the WPT Championship and WSOP. The resulting publicity can be enormous. In the 2004 WSOP, for example, the winner Greg Raymer beat 2,576 other players to win the title and \$5m. His buy-in stake was \$10,000, which he had won on an online poker site for an original stake of \$40!

The online poker market has grown from nothing to more than \$1.5bn in less than a decade, but is still a tiny fraction of the total poker market (perhaps around 2%). PokerPulse.com estimates that there were almost 1.8m active real money poker players online in January 2005, and that global gross rake is running at about \$4.5m a day. There are about 250 online poker sites globally but the market leader PartyPoker.com (owned by PartyGaming) has an estimated 50% share, and the top five operators have 80%. As well as individual sites there are also about 20 poker networks (of which Prima Poker, owned by Microgaming, is the largest and fastest growing) which bring together dozens of card rooms to create one unified body of players. In Europe, Ladbrokes has the biggest site despite, or perhaps because of, the fact that it does not allow US players.

Table 3. Popular online poker rooms

Website	Owner	Licence jurisdiction	Software provider
Party Poker	PartyGaming (formely iGlobalMedia)	Kahnawake, Canada	iGlobalMedia
Poker Stars	Private	Costa Rica	Proprietary
Paradise Poker	Sportingbet	Kahnawake, Canada	Proprietary
Pacific Poker at 888.com	Cassava Enterprises (private)	Gibraltar	Random Logic
Ultimate Bet	eWorld Holdings	Kahnawake, Canada	Proprietary

Source: PokerPulse (January 2005), Casino City Online

Although US players presently dominate the market there is plenty of scope for growth in Europe. British players currently make up about 80% of the European market and, interestingly, it has been estimated that 30-40% are women compared with only 5% offline. Only a few operators, such as Ladbrokes and Empire, provide many local language sites but poker is already popular in Scandinavia, Germany, Austria and a number of Eastern European countries. New players are being attracted to the offline tournaments that the large online operators are promoting in 2005. Ladbroke is running its Poker Million 2005 televised tournament, with the final in July, \$855,000 in the prize pool and \$400,000 bonuses to online qualifiers. Poker Stars is staging a televised pan-European Poker Tour (EPT) with events in Barcelona, London, Paris, Vienna and Dublin, the final in the Monte Carlo Casino, and over €2m in the prize pool.

The online poker operator makes money by hosting games on his site. In ring games they take a small percentage of the winner's pot (typically about 3%) which is known as the rake. In tournaments, players pay an entry fee and there is a single jackpot for the winner. Thus the business is low risk as the operator merely acts as a host (unlike sports betting, which requires active risk management).

Bingo, skill games, and lotteries

After poker, the likely next growth segments for operators will probably be bingo and skill games.

Bingo

Casino City already lists 147 bingo sites and some industry estimates suggest that 5m people already play online bingo. The game is particularly attractive to women, a growing segment of the online gambling population. Some sites offer free play, notably Canadian based Bingo.com Inc (OTCBB: BGR) which claims to have more than 1m registered users; it relies on advertising revenue for its income but to date has been heavily loss-making. However, pay to play sites are growing in number.

Table 4. Popular online bingo websites

Website	Owner	Licence jurisdiction	Software provider
Bingo Room	Savinet Enterprises (private)	Cyprus	ProWager
Think Bingo	Private	Kahnawake, Canada	GlobalCom
Ruby Bingo	Intercontinental Casinos (private)	Antigua & Barbuda	Playtech
Party Bingo	PartyGaming (iGlobalMedia, private)	Kahnawake, Canada	iGlobalMedia
Zany Bingo	Intercontinental Casinos (private)	Antigua & Barbuda	Playtech
Only Bingo	Private	Kahnawake, Canada	Playtech

Source: Casino City Online, January 2005

In the UK the most popular bingo site is the privately owned Jackpotjoy.com

Skill games

Skill-based games are defined as those in which the outcome is predominantly determined by the respective skill levels of a game's individual players. This distinguishes skill games from casino games (which for this purpose include poker), which are defined as games of chance. The distinction is very important in the US where skill games are not legally defined as gambling (despite the fact that cash skill games do involve players wagering against each other). There is still some uncertainty in cases where skill games also involve an element of chance. Around a dozen US states (including Arizona, Delaware and Florida) either ban or restrict cash skill games in which case operators can decline to accept players from those states. In other states, such as California, online skill games may be legally advertised in a way that is forbidden for online gambling.

The non-casino skill game online market is expected to grow rapidly and DFC Intelligence has estimated that it could reach \$5bn in wagers by 2006. They are particularly attractive to casinos that are looking to expand their product ranges and to market to customers who might not initially be attracted to an online casino.

Many different skill games are available including trivia quizzes and solitaire variations. One of the leaders in this market is SkillJam, owned by London-listed Fun Technologies (formerly CES Software). It has over 5m registered users and provides cash skill games to major online casinos such as Golden Palace and Casino-On-Net. Most of SkillJam's competitors are private companies, including Worldwinner.com, Game Trust, Game Account, and Midas Player.

Lotteries

Most state lotteries allow customers to buy tickets over the internet and such sites could account for 2% of the online gambling market. Most lotteries operate as monopolies, either national, as in the UK, or state, as in the US. The websites tend to be very popular and often occupy high slots in online site popularity rankings in the US, as much for results checking as actual betting. However, pay-out ratios are poor and their success often comes because they are able to attract people who are not regular casino gamblers or who believe they are subscribing to the state's 'good causes'.

Spread betting

Spread betting is a small niche segment of the gambling industry, conducted over the telephone and internet. Most spread betting is financial, betting on the movement of indices, currencies, commodities, and so on. However, some operators offer odds on sporting events (notably Sporting Index, which claims 60% of that sub-sector) as well as major political, economic or topical events. Spread betters do not quote odds; instead they quote for the price of a market at some date in the future. This type of betting is high risk, as punters can lose more than their initial stake if the market moves too far in the opposite direction. Conversely, the potential gains are also considerable, and are tax-free in the UK, (i.e., are free of UK capital gains and income tax).

Spread betting is mainly popular in the major financial centres (London, New York, Paris and so on). The main operators are all private companies: IG Index (UK), Sporting Index (UK), Binexx (owned by InterCapital, UK), BetonMarkets (Malta) and InTrade (Dublin). It has recently been reported (*Sunday Times* 30 January 2005) that IG Index is considering a return to the UK stockmarket two years after it was taken private in a £143m buyout backed by CVC Capital Partners. IG Index's EBITDA for the year to May 2004 was £23m compared with £15m in the previous year and a float would undoubtedly further increase interest in the sector.

3. Online gambling industry structure

There are three main types of business involved in the online gambling industry.

- **Operators** - the largest and most visible group who market and run websites offering online gambling products.
- **Software and systems providers** - who not only develop new game software but also in many cases provide full platform hosting services.
- **Payment processors** - services to facilitate quick and secure payment mechanisms.

Operators

There are estimated to be some 400 different companies operating online gambling sites, both online specialists and traditional 'offline' gaming companies. The industry is global, with many operators offering multilingual and multi-currency sites but US companies are not allowed to compete in this market because of anti-gambling laws. This has allowed British companies to lead the industry, along with a raft of private companies – many now quite sizeable – based in the Caribbean and other licensed gambling jurisdictions.

Operators need good software, popular games, effective payment systems, and good marketing. Some use their own proprietary software, such as Sportingbet and PartyGaming (iGlobalMedia, for poker and bingo). Most license their software from specialist companies. It is often hard for online casinos to differentiate their product, so much rests on their marketing skills. In addition, they need to establish player trust, which favours the larger, better known names. Finally, operators also bear some regulatory risk if they sell into markets where the legality of online gambling is unclear (as in the US). Thus most operators are located in properly licensed and regulated offshore jurisdictions (see Regulation section).

All online gambling operators share the same advantages of low capital requirements and the ability to achieve high returns on capital. There are significant economies of scale (e.g., Sportingbet's cost per sports bet was only £1.93 in the three months to October 2004 compared with £3.19 in the same period in 2002). Thus it makes sense for the bigger operators to offer a range of products, to introduce players to new types of gambling and to improve player loyalty and 'stickiness'.

Many operators have increased the size of their networks and accelerated their rates of growth with affiliate programmes and white label agreements, particularly for international expansion. Affiliates are marketing partners who earn commission by referring players to the leading site. They may be paid a fee for each new sign-up or take a share of the winnings or deposits. Under white label agreements, other gaming companies outsource their operations to the lead brand, which normally takes a percentage of revenues. As an example, PartyGaming (iGlobalMedia) has several thousand marketing partners and white labels poker sites such as Coral and Empire.

Major online gambling operators

In August 2004 eGaming Review published its Power 25 guide to the 'most powerful players in the egaming industry'. Their ranking is based on four criteria: scale, reach, diversity, and influence. The authors admit that it is not an exact science and that the rankings are likely to change as the industry develops. For example, PartyGaming may be ranked higher given its sheer size. Nevertheless, we have not found a better guide and thus reproduce the top ranking dozen below:

Table 5. Top gaming operators from the 'Power 25'

Operator	Notes
Sportingbet	Leading sports betting operator, No. 3 in poker (Paradise Poker), plus casinos. One of the biggest and most international operators with 30 websites, 19 languages and over 2m registered customers in the US, Europe and Australasia.
Ladbrokes	Leading operator despite not accepting US customers. Strong in Europe, with links to Asia, a top 10 poker site, casino, iTV presence, and internationally recognised brand.
William Hill	Largest pure UK betting company. Over 1,600 betting shops; Online operations (sportsbook, casino and poker) made £24m operating profit in the first 6 months of 2004.
Cassava Enterprises	Owns 888.com - Casino-on-Net, the biggest online casino, and Pacific Poker, a top 5 poker site. EBITDA reportedly \$80-100m.
PartyGaming	Owns Party Poker, with more than 50% of online poker market, plus Party Bingo and Starluck Casinos. EBITDA reportedly \$350m rising to a possible \$600m in 2005.
Betfair	Invented the betting exchange, still hold 80% of this new, rapidly-growing, segment.
BETonSPORTS	A leading US-facing sportsbook, listed on AIM (but had a profit warning in H2 2004)
Victor Chandler	Smaller than William Hill or Ladbroke but still leading UK online betting industry with broad international reach through VC Bet and white label programme.
Carmen Media Group	Parent of the Belle Rock Gaming group, close to Microgaming and influential in the online casino sector.
BetWWTS	Leading Antigua based US-facing sportsbook (behind Sportingbet and BETonSPORTS).
InterCasino	One of the original and best online casinos, now expanding in Europe.
Skybet	Owned by BSkyB (which bought out Surrey Sports in 2000), pole position in fledgling UK iTV online gaming market.

Source: eGAMING REVIEW 'Power 25' August 2004

For reference, the rest of the top 25 consists of: BetandWin, Poker Stars, BoDog, VIP Management, Pinnacle Sports, Tropical Paradise, Interwetten, Rank Group, Coral Eurobet, Gamebookers, Bet365, Virgin Games, and Unibet.

Software and systems providers

Most online gambling operators source their software from specialist companies, which is more effective than employing teams of developers and programmers in house. Over time the software companies have expanded their range of services to include customer support, back office systems, payment processing and platform hosting. They can even provide complete off the shelf online gambling systems, supporting different products and channels. Thus it is now relatively easy for established offline gambling brands to migrate to the internet.

Most software developers, such as Microgaming and CryptoLogic, originally specialised in casino games. Barriers to entry for casino operators are much lower than for sports betting and almost 2,000 online casino sites sprang up in a relatively short space of time. However a few have specialised in sports betting, such as World Gaming and Orbis. Most have now also added poker, bingo, skill games, and lotteries as their customers have looked to diversify their product offerings.

Software providers develop standard gambling engines that can be customised to give each operator a distinctive user interface. They seek to compete by developing new games and game variants but in practise there are few truly original game concepts. Thus competition has begun to focus more on back office functions, service and support. Operators want to attract, retain, and re-activate players and to do this they need detailed customer information to plan cost effective promotional campaigns, as well as multi-currency and multilingual support, secure high volume transaction systems and effective payment systems. They often offer their own e-payment systems together with links to popular e-wallets such as NETeller and FirePay.

Some service providers such as Boss Media and Orbis provide complete gambling platforms. These are particularly attractive for operators who have traditionally specialised in one product but are now looking to develop a whole suite of products across a range of end channels (internet, mobile, etc.). They are usually designed with an open architecture to link in with the operators' existing systems and allow customers single end-user accounts across all products and channels.

Software companies derive recurring revenues from licensing their software and support. There are additional revenues from customisation, payment processing, and other services that are partly fixed but are mainly calculated as a percentage of each licensee's level of activity. These revenues are typically seasonally weaker in the summer months when players spend less time at their computers.

Boss Media estimates that there are about 100 competing suppliers of gaming software and systems worldwide. However, larger companies dominate the market, particularly in casinos (most casino portals such as Casino City list the software powering each site).

Table 6. Major software and systems providers

Company	Business
Microgaming Systems (UK)	Private (S.Africa). Developed first online casino system in 1994, offers 250 products, mainly casino and poker. Supports 117 sites including many US-facing casino sites.
CryptoLogic (Canada)	Public, listed in Toronto, NASDAQ & London. Offers casino, bingo and poker through WagerLogic, plus Ecash. 32 sites including William Hill & Littlewoods.
Boss Media (Sweden)	Public, listed in Stockholm. Offers complete gaming systems. Supports 44 sites including SBM (Monaco), William Hill, Norsk Tipping and Sportingbet.
RealTime Gaming (US)	Private, founded in 1998. Supports 73 sites including BoDog casino.
Playtech (Cyprus)	Private, founded in 1999, offers a unified platform with casino, poker and bingo. Supports 72 sites.
iGlobalMedia (Gibraltar)	Private (PartyGaming), poker, bingo and casino software plus turnkey packages. Supports 85 sites.
Chartwell Tech. (Canada)	Public, listed in Toronto, founded in 1998, offers gaming systems. Supports 30 sites.
Fun Technologies (UK)	Public (formerly CES Software), listed in London. A leading provider of skill gaming and exchange betting technology and turnkey solutions.
IQ-Ludorum	Public, listed in London, supports 45 sites including BETonSPORTS.
World Gaming (UK)	Public, listed on NASDAQ, partnership with Sportingbet plus about 20 licensees.
Orbis (UK)	Private, established 1995, offers complete gaming systems, customers include Littlewoods, Blue Square and Ladbrokes

Source: Casino City, Boss Media

Payment processors

Effective payment systems are essential for the online gambling industry. Customers need to be able to deposit money to gamble and they need to have enough trust in the system to believe that their winnings will be paid out. Credit cards are one obvious mechanism, but since December 2001 an increasing number of US financial institutions have stopped accepting online gambling transactions (identified by the code 7995). There is no actual law prohibiting such lending, but anti-gambling government factions led by New York attorney general Eliot Spitzer, have successfully lobbied banks.

In any case, some credit card companies have been nervous about accepting gambling transactions after a well publicised case in California in 1998, where a woman who accumulated more than \$100,000 in online gambling debts successfully argued in court that gambling debts were not enforceable. Furthermore, credit cards were not really designed for regular two-way transfers of money, and there are also problems with bad debts and fraud.

Thus online casinos have encouraged the development of European-based payment processing systems. Some, such as Paybox, are direct debit solutions that protect the player from having to reveal his bank account details to the casino.³ More popular, however, are electronic wallets or e-wallets that are already familiar and accepted by a wide range of retailers. In the US the act of purchasing electronic cash in the form of an e-wallet is not illegal, so the US citizen is then free to use this for whatever purpose they choose.

³ The player uses his mobile phone number as his casino identity code and Paybox, a trusted third-party, authorises a BACS direct debit transfer.

Until recently PayPal was probably the leading e-wallet for online casinos but since its acquisition by eBay it no longer accepts gaming transactions. UK-quoted NETeller is now a leader in this market place and popular with operators because of its simple integration into online casino payment systems. It offers players swift and secure facilities to deposit, transfer and withdraw money (free except for InstaCash which transfers money instantaneously). The casinos pay fees on monies transferred into their accounts. A key part of NETeller's (and other e-wallet companies) operation is stringent identity verification, to reduce the risk of fraud, bad debts and money laundering.

Apart from NETeller, other popular payment processors for online casinos are FirePay and MoneyBookers. FirePay is owned by Optimal Payments (listed on Nasdaq, OPMR) which also acquired Canadian-listed Terra Payments in 2004. Moneybookers is based in the UK and privately owned by Gatcombe Park Ventures. Additionally, many of the online gambling software companies include payment systems in their products, such as CryptoLogic with Ecash.

4. Regulation

Online gambling tends to fall outside existing regulatory frameworks, which have typically been in force for many years. Furthermore, online gambling is in practise hard to regulate, given the nature of the internet. Hence many countries are grappling, in different ways, with how to regulate the online gambling industry.

US

In the US, land-based gambling is legal everywhere except Utah and Hawaii but the legal status of online gambling is uncertain. The Justice department maintains that online gambling is banned under the 1961 Wire Act, which prohibits interstate gambling over a 'wire communication facility'. Not all the courts and states agree, for example, a US Court of Appeal ruled that it might apply to sports betting but not to skill-based casino games. Over the past nine years there have been various attempts at the federal level to ban online gambling in the US, but so far each has failed.

While the legal debate goes on the number of Americans gambling on-line has grown rapidly. Online casinos and gambling websites are located offshore in countries, such as Costa Rica and Antigua, where online betting is legal. In practice, it is difficult for US regulatory authorities to take action against casinos that are operating legally in other countries. Instead, federal prohibitionists have tried to stop US companies 'aiding and abetting', notably by seeking to ban the use of credit cards and other financial instruments. Such a bill (H.R. 2143) was passed by the House of Representatives in June 2003, but in the US legislation must pass through both houses in the same format within a two-year period if it is to become law. The companion bill in the Senate, the Internet Gambling Prohibition Act, S 627 (sponsored by Senator John Kyl) was not passed before the end of the 108th Congress last November.

Congressman Oxley (who supported H.R. 2143) is expected to try to attach an online gambling funding prohibition to anti-terrorist/ anti-money laundering legislation in 2005, as he tried to do with the 9/11 Response bill at the end of 2004.

At the same time, the Department of Justice (DoJ) has taken a strong line against US media companies who have carried advertisements for internet gambling services. In September 2004 three St Louis based sports radio stations agreed to forfeit \$158,000 of income from advertising offshore gambling companies, and other media channels have also stopped accepting such advertisements. However, Casino City, which provides informational services including a directory of internet and land-based casinos, is seeking a declaratory judgement from a Louisiana federal court that the DoJ's ban violates the First Amendment.

Despite all the above, we believe that the prohibition efforts will ultimately fail and that there will be slow moves towards licensing and regulation over the next few years. During 2004, the World Trade Organisation (WTO) ruled in favour of Antigua, which had argued that efforts to prohibit Americans from using credit cards to gamble on the internet violated trade agreements that require the US to permit foreign internet companies to offer their services to Americans. The US is appealing on the grounds that it has the right to regulate betting and gambling.

Much of the impetus for legalisation will probably come from individual states, which have historically tended to be responsible for gambling. The increasing scale of the tax revenues foregone is in itself a powerful argument. When widespread legalisation finally happens the big land-based casinos will undoubtedly go online, dramatically increasing the likely scale of the industry. This will increase competition for US-facing sites such as Sportingbet, but equally it may mean that established online gambling brands become attractive acquisition targets.

UK

The UK betting industry is regulated by the Betting, Gaming and Lotteries Act 1963. This allows bookmakers and football pools operators to accept bets by post or telephone, and thus it is also legal to offer betting over the internet so long as the operator has a bookmakers permit. However, the Gaming Act of 1968 prohibits UK-based online gambling sites since it states that casino, bingo and machine gaming can only take place on licensed premises with the gambler present in person. It is not, however, illegal for British residents to gamble online or for overseas operators to offer online gambling to them. Thus UK gaming sites are currently required to have their servers located offshore.

In 1999 the Government set up the Budd commission to review and reform UK gambling policy. Its report, in 2001, forms the basis for the long awaited Gambling Bill that was proposed on 18 October 2004. The Bill passed its Third Reading in the Commons on 24 January 2005 and is now due for its second reading in the Lords on 22 February.

Much of the recent debate and media focus has been on the Bill's proposals for new large Las Vegas style super-casinos. There has been less attention on the important recommendations for what has been defined as 'remote' (internet, mobile, iTV) gambling. The Bill provides a regulatory framework for remote gambling, allowing operators to base sites in the UK. There will be a specific 'remote' licence which operators will be required to hold in addition to any operating licenses for non-remote services. The licence will be subject to conditions, particularly for measures that exclude children from internet gambling.

The Bill could still be held up in the Lords before the general election. However, the Bill has broad cross-party support for it and it seems likely that it will succeed with concessions, possibly further cuts in the number of super-casinos. Licences could then be issued within the next 12–18 months. The UK should then become a major jurisdiction for online gambling operators. This should give the industry much greater credibility as well as providing a regulatory example for other countries, especially the US.

Continental Europe

Continental Europe has a range of different regulations governing gambling. As in the US, the arrival of the internet has thrown up questions about cross-border gambling. At the heart of the issue is the right of member states to block gambling sites based in other member states versus the European Commission's desire for a Europe-wide policy.

Gambelli was the first test case where criminal proceedings were brought against more than 100 people running data centres taking bets in Italy on behalf of English bookmakers Stanley International. The Italian state argued that such activities were the preserve of the state. The European Court of Justice (ECJ) ruled, in November 2003, that member states could block foreign gambling services if they were deemed socially hazardous, but not if they desired to protect their own monopoly. Gambling companies hailed this as a victory – although the ECJ cannot itself change Italian law, its recommendations clearly steered the local courts to favour open market competition. But the state monopolies were also encouraged by the fact that the ECJ did not state categorically that Italian law, which favours state monopolies, ran contrary to EU laws.

Since the *Gambelli* verdict some countries, such as Germany, have taken the ruling to define legislation that opens up EU markets to suppliers in other countries. Others are still trying to protect their domestic industries. Sportingbet, Ladbrokes, Betfair and others are taking cases through the courts, notably in the Netherlands but also in Denmark, France and Hungary.

Eventually it is hoped that the European Commission will implement a European wide services directive, but anti-gambling factions are lobbying to have the gambling provisions removed from it. In any case, it is unlikely to take effect before 2010.

5. Taxation

Most online gambling companies currently pay little or no tax as their licence jurisdictions are tax havens: Antigua, Alderney, Isle of Man, and so on. The main exception is online betting for companies licensed in the UK, which are subject to general UK betting duty. This is levied at 15% of gross profits, (i.e., the amount staked less winnings paid out). At present UK betting exchanges pay duty at 15% of commission receipts but the Government announced in the 2004 Budget that this would be reviewed; UK bookmakers argue that the duty should be levied on a figure closer to a gross profits measure.

In January 2005 the UK National Audit Office published a report on gambling duties, noting that 'reports by representative groups have made it clear that many e-gaming businesses would welcome regulation in the UK and would be prepared to pay for it'. The key issue is how much of a premium they might be prepared to pay. Some commentators have argued that it should be as much as the 15% Gross Profit Tax paid by offline operators, but others have argued for 5% or even 2%. Furthermore, there is an issue over whether operators who locate some of their operations in the UK should have to locate all their UK facing businesses here. If tax levels are set too high, nearby jurisdictions such as the Isle of Man and Malta will continue to compete to attract operators. The UK Treasury is due to publish a report into the tax implications of the new Gambling Bill later this year.

6. Risks

Legislative and regulatory risks

The most significant regulatory risk relates to US-facing companies, who admit they are operating in a legal grey area. So far, legal advice has indicated that the US cannot take action against companies that are not incorporated in the US and do not have any physical presence there. However, there have been and are likely to continue to be attempts to pass laws which restrict US-facing companies' ability to provide services to US customers.

Most online gambling operators are located in offshore jurisdictions and, while some have quite tight licence requirements, others are very lax. As the industry gets bigger problems such as gambling addiction and under-age gambling will increase.

Systems failure and hacking

The online gambling industry relies on interactive electronic delivery systems, principally the internet, and thus businesses are vulnerable to any breakdowns, whether from power loss, natural disasters, accident or sabotage. The main problem in the last year or so has come from hackers who have regularly launched distributed denial of service (DDoS) attacks, particularly during peak betting times such as the American Super Bowl Sunday. There have been reports of betting sites being shut down for some hours and even reports of a few sites giving in to extortionist's demands. Payment processors as well as operators have been attacked. There are some DDoS protection systems available from security companies but they are also expensive.

Market transparency and competitive risks

The internet allows users to switch between websites globally within seconds, which means that it is extremely easy to compare relative product offerings. Online casinos, for example, compete fiercely with sign-up bonuses, jackpots and 98%+ payouts. Sporting odds need to be close and competition from betting exchanges puts further pressure on margins. Poker rooms need scale and it is easy for players to see where the biggest card rooms are, but there is less pressure on the rake percentage because the market is dominated by a few large operators. Barriers to entry are still low and it is hard to build brand loyalty.

Intellectual property

Many of the most successful internet operators rely on their brand names and brand image. The global nature of the internet means that it can be difficult to police the use of property rights and the misappropriation of proprietary information.

Betting and gambling risks

Gambling operators take risks as part of many of the products they offer. Sports betting operators set odds which, on average, result in them making a gross margin. They may, however, lose on a particular outcome or series of outcomes. This is similarly the case in online casinos where the house 'edge' may be negative in the short-term.

Risks from default and fraud

Poker and betting exchange operators take a 'rake' or commission that is effectively risk-free. However, all operators face the risk of customer fraud or default, as do payment processors. Regulators tend also to be concerned with the risk of money-laundering through online gambling; operators do not usually accept cash deposits although some payment processors do.

7. UK quoted and unquoted sector

Table 7 lists UK quoted companies whose business is entirely (or nearly entirely) focused on online gambling.

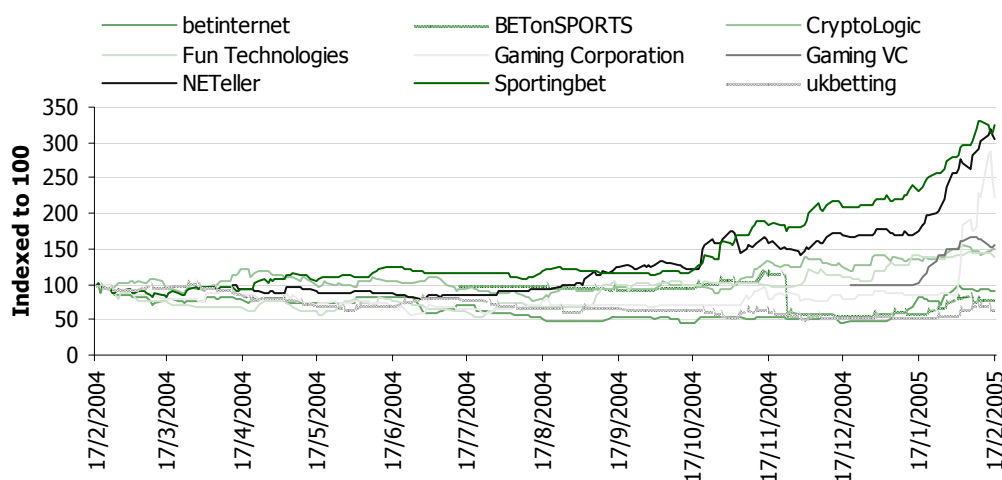
Table 7. 'Pure' UK quoted online gambling companies (ranked by market capitalisation)

Company	Price	Mkt. cap.	Description
Sportingbet (SBT)	289p	£949m	Leading UK quoted online gambling portal with over 2m registered customers. Main businesses are sports betting, poker (acquired Paradise Poker Nov. 2004) and casino games. 2004/5 turnover to June (est.) £1.24bn, normalised pre-tax £41.0m. www.sportingbet.com
NETeller (NLR)	598p	£717m	A leader in online payment systems, NETeller operates a secure online money transfer service. It has over 1m members and 1,400 registered merchants, most in the eGambling industry. Turnover to Dec 2004 (est.) \$83m, pre-tax profit \$52m. www.neteller.com
Gaming VC (GVC)	709p	£221m	Gaming VC owns Casino-Club (acquired Nov. 2004), a leading European online casino operator with most of its customers in German speaking countries. It also owns two gambling related magazines. Turnover to Dec 2004 (est.) £48m, pre-tax profit £28m. www.gamingvc.com
CryptoLogic (CRP)	1450p	£178m	Cryptologic is based in Canada and is the world's largest public online gaming software developer.
BETonSPORTS (BSS)	120p	£97m	One of the world's leading online and telephone sportsbook and casino operator. Turnover to Jan 2005 (est.) £556m, pre-tax profit £7m. www.betonsports.com
Fun Technologies (FUN)	198p	£78m	Formerly CES Software, Fun Technologies is based in Canada and provides person to person skill gaming and exchange betting technology. In 2004 it entered the regulated US market with the acquisition of www.skilljam.com . Turnover to Dec 2004 (est.) £1.3m, EBIT loss £2.5m.
ukbetting (UKB)	48p	£46m	The UK's leading online gaming and sport content operator whose websites provide in depth information on sports and games and offer fixed odds sports betting. Turnover to Dec 2004 (est.) £88m, loss £0.6m. www.ukbetting.com
betinternet (BET)	9p	£14m	Licensed sports bookmaker providing a worldwide telephone and internet service. Turnover to May 2005 (est.) £83m, loss £1.3m. www.betinternet.com
The Trading Exchange(TES)	32p	£11m	Development and exploitation of fixed odds p2p (person to person) betting software application. Turnover to Dec 2004 £3.6m, breakeven. www.tradingsports.com
Gaming Corporation (GMC)	8p	£11m	Online casino, gaming and advertising. Turnover to Sep 2004 £13m, pre-tax loss £0.95m. www.gamingcorp.net
Interactive Gaming Holdings (IGH)	11p	£3m	Control over a network of gaming related portals, advertising traffic referral sites and operational casino and bingo white label sites. www.igamingholdings.com

Source: Consensus Estimates

On average, online gambling share prices have risen by 63% over the last 12 months.

Figure 4. Internet betting companies' share price performance



Source: Datastream

The four leading quoted online gambling stocks, BETonSPORTS, Gaming VC, NETeller and Sportingbet trade on mean PEs of 24x. As one would expect, those with the highest earnings' growth rates have the better valuations (Table 8).

Table 8. Valuation of online gambling

	PBT growth rate 2005-6	PE 2005	Yield 2005
	%	x	%
BETonSPORTs	+27%	19.8x	5.5%
Fun Technologies	+200%	36.6x	-
Gaming VC	+3%	10.9x	7%
NETeller	+93%	22.0x	3%
Sportingbet	+34%	29.0x	0.3%

Source: Consensus estimates & Durlacher

Other UK quoted gambling companies

In addition to the above, most of the major UK quoted gambling companies have sizeable online operations. These include: Hilton Group (Ladbrokes) (HG.); William Hill (WMH); Rank Group (RNK); Paddy Power (PLS), Stanley Leisure (SLY) and Sportech (Littlewoods) (SPO). The online gambling software provider, Boss Media, is located and listed in Sweden (BOSS.ST).

Unquoted online gambling companies

Finally there are many large privately owned online gambling companies, especially online casino and poker operators. Many of these have already been mentioned in the appropriate sections of this report. The largest is believed to be PartyGaming (based in Gibraltar and formerly known as iGlobalMedia) which owns PartyPoker, Starluck Casino and PartyBingo. Cassava Enterprises (Gibraltar) owns 888.com, Casino-on-Net and Pacific Poker. Intercasino owns the Intercasino site plus bingo and poker sites and Carmen Media Group (Gibraltar) owns a number of casinos, poker rooms and an online sportsbook.

In Europe, Coral Eurobet (owned by Charterhouse Development Capital) has online betting, casino and poker, and Betfair is the largest online betting exchange. Smaller unquoted UK online sports betting companies include Victor Chandler (VCbet) and bet365 Group Ltd.

Sportingbet

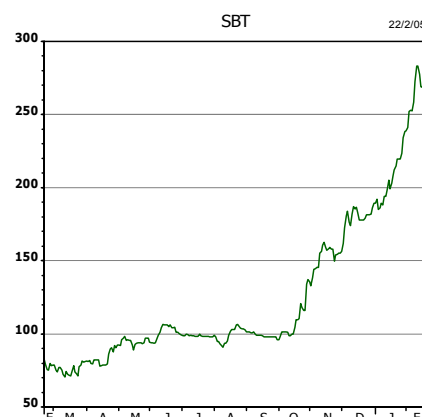
290p

Year end	Turnover £m	PBT* £m	EPS (fd)* p	P/E x	Yield %
03/03a	979	12.4	4.1	71	-
07/04a	1,432	20.1	6.8	43	-
07/05e	1,235	41.0	10.0	29	0.3%
07/06e	1,385	55.0	12.2	24	4.5%

* PBT & EPS are normalised (pre-goodwill and exceptionals)

Business description

Sportingbet is a leading online gaming and entertainment portal with over 2m registered customers. Its main businesses are sports betting, poker (following the acquisition of Paradise Poker in November 2004), and casino games.



Source: DATASTREAM

Sportingbet plc is a research client of Edison Investment Research Ltd

Company details

Market cap	£954m
Ticker	SBT
Listing	AIM
Shares in issue	329.0m

Deputy chairman	Mark Blandford
Chief executive officer	Nigel Payne
Financial director	Andrew Mclver

Major shareholders

Paradise Vendors	17%
Fidelity	10%
Merrill Lynch AM	9%
DBS Advisors	9%
M&P Blandford	5 %

6th Floor
Transworld House
82-100 City Road
London
EC1Y 2BJ
Tel: 020 7251 7260

www.sportingbet.com

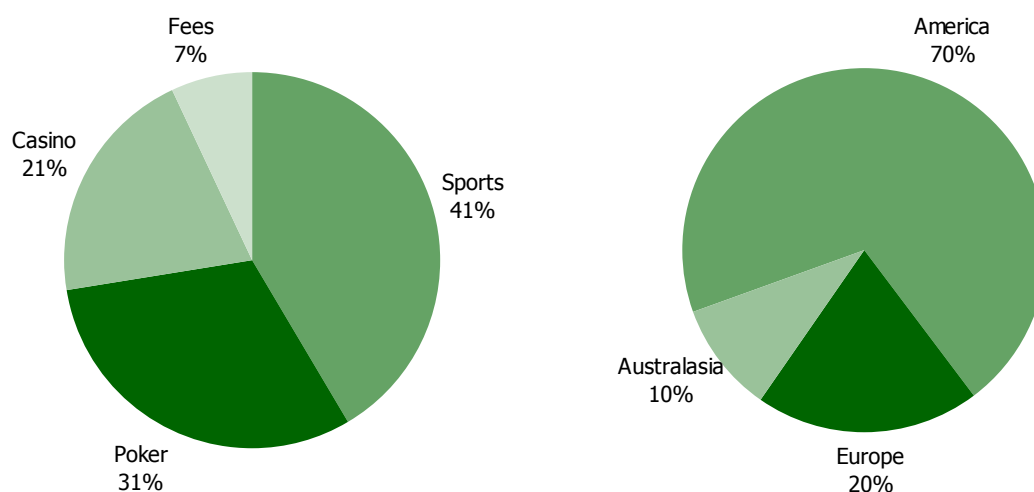
- **Sportingbet's key strengths** are its size, broad product range and brand names. It took an early lead in online sports betting and now, with Paradise Poker, has enormous scope to cross-sell its sports, casino and poker products. This well timed acquisition, for an initial £169m or less than 7x expected 2004 operating profits, demonstrates management's astuteness.
 - **'Topline' entertainment:** Sportingbet's products appeal to a wide range of recreational gamblers rather than high-roller punters. About 70% of profits come from its US-facing business, so there is some regulatory risk, but recent developments have been generally positive. It is also strong in Europe and Australia and has considerable scope to develop Paradise Poker internationally.
 - **Strong EPS growth and cash generation:** online gambling benefits from economies of scale; as the number of bets placed rise the costs per bet falls and profits increase. Furthermore, capital requirements are very low and the business is strongly cash generative. We expect the £90m debt post the Paradise acquisition to be eliminated within two years.
 - **Forecasts:** Sportingbet reported interim results for the six months ended 31 January 2005 on February 22. Revenues were £825.2 million vs. £637.2 million in the same period in 2004, with operating profit (pre-goodwill and amortisation) of £26.0 million vs. £14.0 million in 2004.
- Sportingbet completed its acquisition of Paradise Poker for \$297.5 million during the period in November 2004. Paradise Poker contributed £12.5 million to Sportingbet's reported turnover and £8.0 million to operating profit.

Sportingbet recent results and estimates

£m	2003a Yr to Mar	2004a 16 mth to Jul	2005e Yr to Jul	2006e Yr to Jul
Profit & loss				
Turnover	979	1,432	1,235	1,385
EBITDA	14.7	18.9	46.0	62.0
Operating profit	14.6	21.7	46.3	60.0
Pre-tax profit*	12.4	20.1	41.0	55.0
Profit after tax *	12.4	20.0	39.5	52.5
Balance sheet				
Net assets	88.4	101.0	245.0	285.0
Gross debt	15.4	33.8	75.0	35.0
Gearing %	17.4	33.5	30.6	12.3
Interest cover x	6.6	10.8	10.5	12.0

* PBT & EPS are normalised (pre-goodwill and exceptionals)

Estimated mix of gross profit



Source: Edison Investment Research, industry estimates

Sportingbet history

Date	Event
1998	Mark Blandford founded Sportingbet
2000-2	Organic growth supplemented by successful acquisitions, including SportsBook.com
2002-3	US bank processing difficulties, Sportingbet introduces new payment channels
2003	SportsBook meets earn-out targets early, liabilities successfully renegotiated
2003-4	European operations reach critical mass and move into profit
Nov 2004	Sportingbet acquires Paradise Poker for initial \$297.5m (£169m) cash and shares plus deferred consideration dependent on profitability of up to \$50m (£27m) in cash and shares and bonus of up to \$25m (£13.6m) cash.

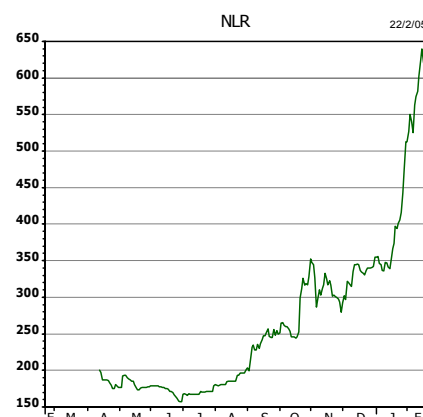
NETeller

598p

Year end	Turnover \$m	PBT \$m	EPS Cents	P/E x	Yield %
12/03a	24.6	23.1	0.2	-	-
12/04e	83.1	51.8	29.9	38x	-
12/05e	113.4	73.3	52.2	22x	-
12/06e	210.9	141.0	102.0	11x	-

Business description

NETeller is a leader in the e-wallet marketplace and secure online money transfer service and has been providing secure transactions since 1999. It has over 1.2m members, 1500 online merchants and processes over \$2 billion in year in funds transfers.



Source: DATASTREAM

Durlacher is joint broker for NETeller

Company details

Market cap	£717m
Ticker	NLR
Listing	AIM
Shares in issue	119.8m

President & CEO	Gordon Herman
Chairman	Stephen Lawrence

Major shareholders

Corvina Int. Limited	36%
Alberta Limited	14%
Gordon Herman	4%

Grosvenor House
66/67 Athol Street
Douglas
Isle Of Man
IM99 2BJ
Tel: 01624698700

www.neteller.com

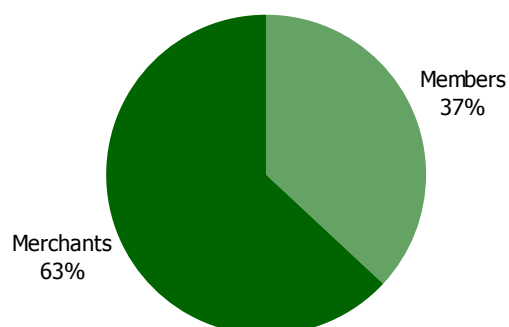
- **NETeller's key strengths** are its established leadership position covering 80% of global online gambling sites and the economies of scale that flow from this. NETeller's 'know your clients' systems ensures bad debts remain extremely low. Gambling sites have been keen to adopt the system as it virtually eliminates the problems of repudiated credit card transactions.
- **Solid growth:** NETeller currently has over 1,500 merchants who offer payment by one or more of NETeller's services. The number of merchants is growing and constitutes an indirect and highly cost effective distribution network for offering NETeller's e-wallet services to individual members. NETeller is adding some 1,500 new members a day and already has over 1.2 million members.
- **Intelligent revenue generation:** Revenue is derived from merchants as well as individual members on the movement of funds. No fee is charged to members for normal electronic funds transfer but a fee is charged for Instacash, which offers the ability to transfer money instantaneously. Merchants pay fees on monies transferred
- **Healthy profitability:** With revenues being driven by increasing numbers of merchants and members, low fraud and operating costs, profitability is extremely healthy (>60% op. margins) and cash generation remains strong.
- **Forecasts:** Preliminary results announcement is expected in March. We expect revenue growth of around 238% and adjusted PBT growth of around 124%.

NETeller recent results and estimates

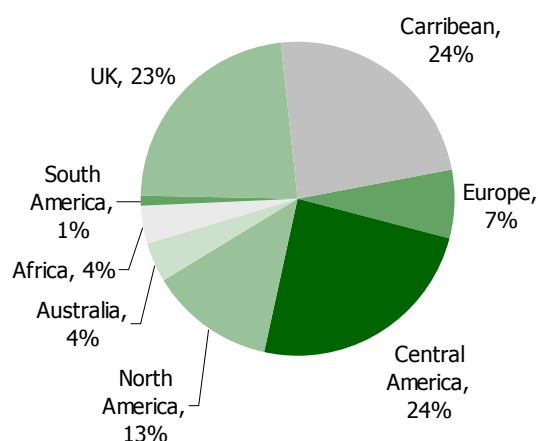
\$m	2003a 16months to Dec	2004e Yr to Dec	2005e Yr to Dec	2006e Yr to Dec
Profit & loss				
Turnover	41.0	83.1	113.4	210.9
EBITDA	23.2	50.4	68.8	135.1
Operating profit	2.6	46.9	66.4	132.9
Pre-tax profit*	23.1	20.1	41.0	55.0
Profit after tax *	23.1	51.8	73.3	140.9
Balance sheet				
Net assets	0.2	150.9	281.5	530.7
Gross debt	-	-	-	-
Gearing %	0	0	0	0
Interest cover x	n/a	29	14	22

* PBT & EPS are normalised (pre-goodwill and exceptionals)

Revenue mix by customer



Distribution by merchant



Source: Durlacher, industry estimates

NETeller history

Date	Event
1999	Founder and major shareholder Stephen Lawrence developed the idea of an e-wallet
2000	\$200,000 in private funds were raised to establish the NETeller Group
1999-2004	Growth until April 2004 was financed solely by internally generated cash flow
2004	April 2004, Shares of NETeller plc commenced trading on AIM. £30m was raised for the company and £5m for existing shareholders.
2004	15m new shares were placed at the issue at a price of £2 raising £30m for the company. In addition 2.5m existing ordinary shares were sold by shareholders raising £5m.

Gaming VC

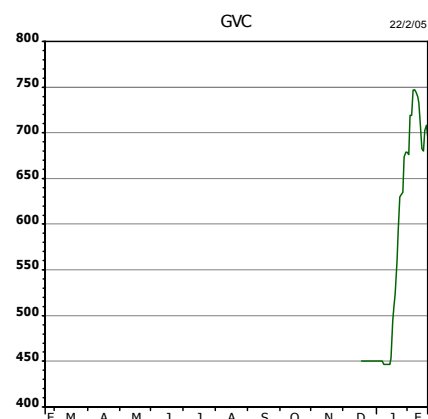
709p

Year end	Turnover €m	PBT €m	EPS Cents	P/E x	Yield %
12/05e	47.7	34.0	90.8	11x	7%
12/06e	49.4	35.0	94.0	11x	7%

Consensus estimates

Business description

Gaming VC is the leading player in the German and Austrian online gambling markets. The company has an active customer base of 58,000 and more than 100,000 registered users and an excellent record of customer acquisition and retention.



Source: DATASTREAM

Company details

Market cap	£221m
Ticker	GVC
Listing	Main
Shares in issue	31.1m

Chief executive	Steven Barlow
Chief operating officer	Scott Miller

Gaming VC Holdings S.A.
73 Cote d'Eich
1450 Luxembourg

www.gamingvc.com

- **Casino-club, Gaming VC's core business:** Formed from a tie up between a successful specialist roulette magazine and Boss Media, the gaming service provider. The magazine has a subscriber base of 170,000 which is clearly benefiting Casino-club. Average customer retention is 300 days which far exceeds competitors where, on average, 80% of customers are lost in a month. Gaming VC has now bought the software and gambling license from Boss Media.
- **Germanic tailoring:** Casino-club's success can also be attributed to the tailoring of the software to the German market, linguistically and stylistically. Retention is also aided by exploiting the magazine customer base, the acquisition of a customer database from a previous business, the use of heavy newspaper advertising, and direct marketing. Casino-club has seventeen different games and is also available in English, Spanish, French and Italian.
- **Healthy profitability and cash generation:** Operating margins are 86% for existing markets and 60% for new markets, and net margins are around 40%. The business is extremely cash generative both from its margins and because customers tend to reinvest winnings instead of withdrawing funds. This also increases incremental revenue per customer over time.
- **Growth:** Growth is expected to be flat for existing markets but high for new markets such as Russia, Spain and Italy.

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