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Gaming Realms

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Game on for profitable growth in 2017 and beyond

Gaming Realms is a developer, publisher and licensor of mobile and web based real money and social games. The business was set up by the team behind Cashcade Limited, creator of bingo brand Foxy Bingo, which was sold to PartyGaming for just under £96 million in 2009.

Strategy focused on exploiting valuable range of IP

Gaming Realms has developed and acquired a host of popular games, including the flagship "Slingo" brand. The focus is upon exploiting this IP across its real money, social gaming and licensing divisions, with the strategy being to allocate capital towards the more profitable real money gaming and content licensing operations.

Traction seen in trading with 2017 profitability imminent

Following a 60% rise in revenues in the 2016 financial year, followed by positive trading in the first half of 2017, the business is on the cusp of profitability. **Management expect the business to be significantly EBITDA positive for FY2017 and we expect an acceleration in profits after that**.

Fundraise and deferred consideration agreement reduce uncertainty

A recent £1.13 million subscription has provided funds for growth, with several directors taking part. **Crucially, a deferred consideration payment of $4 million previously due in August this year has been deferred to December, with the company currently organising debt facilities to pay the now $4.5 million liability.**

Shares undervalued on a number of metrics

Should Gaming Realms successfully meet our forecasts for 2018 and 2019 the shares would trade on very low multiples of EBITDA and, more importantly, cashflow. **We set an end 2019 target price of 17.8p for the shares and initiate coverage with a Conviction Buy stance.**

Table: Financial overview. Source: Company accounts & Align Research

Year to end Dec	2016A	2017E	2018E	2019E
Revenues (£m)	33.96	33.43	41.62	49.03
Adjusted EBITDA (£m)	(1.02)	2.00	4.02	7.74
Pre-tax profit (£m)	(6.97)	(2.87)	(0.20)	3.61
EPS (p)	(2.55)	(1.03)	(0.07)	1.27

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CONVICTION BUY – PRICE TARGET 17.8P

GAMING REALMS
PLAYING A NEW GAME

Key data

EPIC	GMR
Share price	7.97p
52 week high/low	19.25p/7.95p
Listing	AIM
Shares in issue	284,428,747
Market Cap	£22.67m
Sector	Travel & Leisure

12 month share price chart

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Corporate Background

Gaming Realms (GMR) was founded in 2012 to develop a new generation of social bingo and slot machine gaming concepts. The company was set up by the team behind Cashcade Limited, the creator of well-known online bingo brand Foxy Bingo, which was sold to PartyGaming (now part of GVC Holdings) for just under £96 million in 2009.

The business was listed on AIM in July 2013 following the reverse takeover of Pursuit Dynamics. The transaction involved the acquisition of three online social gaming and gambling businesses, including Gaming Realms Limited along with BeJig Limited and AlchemyBet Limited, together with a placing to raise c.£3.4 million. This set the foundation for the company to take advantage of the rapid growth being seen within these two dynamic markets.

Since then Gaming Realms has been active on the corporate front, completing several acquisitions, disposals and fundraisings, to shape the business into its present form.

In particular, 2015 was a landmark year for the business. August saw the largest deal in the company's history, the $18 million acquisition of certain gaming assets from NASDAQ listed digital media business RealNetworks Inc. This transformational deal brought with it the rights to the established and popular "Slingo" brand and range of games, along with direct entry into North America and a strengthened presence in the mobile and social games market. **The deal also provided a range of new content for the real money gaming business, third-party royalty savings and a large new addressable market for game content.**

Slingo – game changing brand acquisition

Slingo, a portmanteau of slots and bingo, is a popular online game with a 20 year history. Over that time an estimated 55 million Slingo games have been downloaded, with over 5 billion individual games played. The gameplay sees a five reel slot machine display numbers which are then matched to a traditional bingo card (image below). This makes it a quick and fun way of playing, which is well suited to the mobile format due to its speed.

Gaming Realms first licensed the Slingo brand in April 2015 to build its real money gambling game, Slingo Riches. After becoming its most popular game within weeks of launch the company saw the inherent value of the Slingo brand and thus acquired it in its entirety. Since then Gaming Realms has seen Slingo become its most important brand, with a suite of 9 Slingo themed games successfully launched and a range of licensing rights agreed with third-parties for the use of the Slingo name. The popularity of the brand also has the benefit of lowering player acquisition costs.

Move to proprietary platform increases control and improves margins

During 2015 Gaming Realms also realigned its corporate strategy to focus on sites operating on its own proprietary platform, "Grizzly". To further advance this strategy, in 2016 the company sold its third-party platform gaming assets and in-house digital marketing agency Quick Think, allowing management to focus on the suite of core products which it believes will deliver the highest shareholder return.

Going into the second half of 2017, Gaming Realms is now well positioned as a leading developer, publisher and licensor of a number of mobile and desktop real money and social games, with underlying revenues growing quickly and being derived from several different channels. **Having scaled up the business, the expectation is to be profitable for the full 2017 financial year following an adjusted EBITDA profit of £2 million being posted for the second half of 2016.**

Key corporate transactions

Acquisitions

July 2013 – completes the reverse takeover of AIM listed Pursuit Dynamics and the acquisition of three online social gaming and gambling businesses: **Gaming Realms Limited, BeJig Limited** and **AlchemyBet Limited** along with a placing at 13p to raise approximately £3.4 million.

December 2013 – buys specialist marketing agency, **Quick Think Media**, which had particular expertise in online bingo and casino products, for £2.2 million and also completes a placing of £2.4 million at 21p per share.

September 2014 – acquires specialist eGaming marketing company **Blueburra Holdings**, the holding company of Digital Blue, for up to £10.5 million. Raises c.£6 million in a placing at 33p per share to fund the initial consideration.

August 2015 – acquires a range of assets from RealNetworks Inc., including the **Slingo** Brand & Patents along with GameHouse US and Canadian Game studios; Social & Mobile Freemium portfolio games and publishing network; domains including Sudoku.com and Mahjong.com; an intellectual property licence relating to the GameHouse Promotion Network and the entire issued share capital of social app developer Backstage Technologies. The US operations have since been renamed Blastworks Inc. The consideration is $18 million, with $10 million on completion and $4 million paid on the 1 and 2 year anniversaries. A placing of £12.5 million is completed to support the deal at a price of 25p per share.

July 2016 - acquired 62.5% of **Hullabu Inc.** for $0.5 million. Hullabu develops and publishes social games and in conjunction with Blastworks Inc developed, published and marketed the Hidden Artefacts game.

Disposals

April 2015 - enters into a £0.5 million Asset Sale and Purchase Agreement with European Domain Management Ltd. to sell all associated assets in its third-party operated **Bingo Godz** and **Castle Jackpot** brands. This removed £2.1 million of losses associated with these assets in the 12 months to September 2014 and was in line with the strategy to focus resources on its own technology platform.

February 2016 - sold its third-party platform driven website properties, including Iceland Bingo, Cupcake Bingo, Diva Bingo and Lucky Charm Bingo, for a total consideration of £2.9 million to Silverspin Media and Blackspark Limited.

June 2016 - entered into a strategic partnership with digital marketing company **Ayima Limited** in return for assets from digital marketing agency QuickThink Media including certain clients and the Facebook traffic buying team. The partnership sees Ayima provide its marketing services to Gaming Realms, with a focus on promoting games on the its proprietary platform. Gaming Realms also received a 10% stake in Ayima as part of the consideration.

Operations

We discuss Gaming Realms' core operations via its four primary sources of revenues, real money gaming, social publishing, affiliate marketing and licensing.

Real money gaming

The real money gaming operations deliver the largest proportion of Gaming Realms' income, with 63% of total revenues coming from the segment in the last financial year. The range of online and mobile games, which amounts to over 450 fully owned and third-party offerings, include themes such as slots, casino, instant win and Slingo, giving players the chance to win real cash by playing the game.

Slingo themed games are the main focus of this division, with the slingo.com website being the key online gateway for players of the company's real money games. However, mobile is the core avenue for real gaming players, with 87% of funded players using mobile devices in the first half of 2017. **Recognising the progress made within the division, December 2016 saw the company win the Mobile Casino Product of the year award 2016 from trade publication E-Gaming Review.**

Other internally developed brands include **Pocket Fruity** and **Spin Genie**, although these are seeing less marketing spend allocated to them due to the higher traction Slingo has with players. The range of third-party content licensed by Gaming Realms, which, while offering lower margins due to royalty payments being made, provides players with a wide range of content to choose from and increases engagement.

All Gaming Realms' real money gaming players are exclusively in the UK, with subsidiary Bear Group Limited being licensed by the UK Gambling Commission. No revenue is derived from real money gaming in the US. The real money gaming operations are based in Alderney, with Bear Group also being licensed & regulated by the Alderney Gambling Control Commission.

Revenue model

Revenues from this division are reported as "net gaming revenue", that is the difference between the amounts of bets placed less amounts won and after certain bonuses, jackpots and prizes granted to players. Gaming duty of 15% is paid on net gaming revenues. Of the games provided 13 are currently the company's own content and deliver a higher amount of overall net gaming revenue on a per game basis, currently around 36% of total revenues. Further game launches are expected in the coming months. This demonstrates Gaming Realms' current focus on promoting and exploiting its own content, as well as the relative popularity of the games amongst players.

During 2015 Gaming Realms made the decision to migrate games away from third party technology platform Bede onto its own proprietary platform, "Grizzly". This has had the advantage of giving the company full control over its games' development, increasing scalability and higher margins.

Slingo game variants. Source: Company

Third party branded sites advance growth

Since the beginning of 2016 Gaming Realms has signed deals with a range of third-party brand owners to develop dedicated real money gaming sites. Revenues under these deals are typically earned on a revenue share basis, with other advantages coming in the form of the third-parties marketing to their audience base, thus reducing costs for Gaming Realms. Having launched during the course of 2016, these new revenue streams were a key driver of growth within the real money gaming division during the year.

Key deals

In January 2016 a three-year agreement was entered into with **Fremantle Media** to create gaming websites for the X Factor and Britain's Got Talent brands. In April, the BGTGames.com site went live ahead of the popular ITV show's broadcast, including a bespoke Britain's Got Talent branded version of Slingo. Backed by a marketing campaign across TV and digital platforms the site helped to significantly increase real money gaming revenues in 2016. In Q3 2016 thexfactorgames.com was launched, with the creation of a new game based on the long running singing competition.

An agreement was also signed with media producer **Endemol** to develop a new game based on popular gameshow Deal or No Deal brand. Deal or No Deal Slingo launched in Q2 2016 and has since become the highest grossing game within the real money business. **This demonstrates the value which can be created by Gaming Realms collaborating with other brand owners who have relevant content.**

September 2016 saw a three year partnership deal signed with **Express Newspapers** to launch two new online gaming websites, *Star Wins* and *Express Wins.* Express Newspapers, which owns the brands, is marketing the new gaming websites across its media platform, providing a whole new audience access to Gaming Realms' content.

Also in September a three year marketing partnership deal was signed with **Bauer Media UK**. The agreement, which incorporates a revenue share, initially saw Bauer promote the Spin Genie brand across its radio, digital and magazine titles, including Heat and Closer magazines, and on Heat, Kiss, Magic and Absolute radio stations. However, Bauer are currently promoting the X Factor site.

In June this year the company announced an agreement with **ITV Commerce & Ventures** to build and operate new gaming products based on the popular ITV Studios reality dating show, Love Island, made available on dedicated website LoveIslandgames.com. Boding well for the success of the games, the ITV2 broadcast series attracted record breaking audience viewing figures for the channel, with over 2.43 million people watching the series finale.

Social Gaming

The social gaming, or social publishing segment, provides a range of games which are designed for entertainment purposes only and are generally free to play. As no money can be won by the players of these games they are not considered to be gambling from a regulatory point of view. The division nevertheless provides the opportunity to earn a valuable revenue stream from the company's vast content library, supported by its marketing skills.

Gaming Realms' social gaming division was significantly expanded in 2015 via the RealNetworks assets acquisition and portfolio of Slingo IP that came with it. The social games division now operates through the **Blastworks Inc.** subsidiary, which is based in Seattle, US and Victoria, Canada.

Many of the social games are based on traditional gambling themes, such as casino and slots, but Slingo branded games amount to over 80% of the total – the Slingo Arcade app was launched in 2016, with Slingo games repurposed for a social audience. In July 2016 a further dimension was added to the business via the acquisition of a 62.5% stake in Hullabu Inc, a company that in conjunction with Blastworks has produced a number of hidden objects games, including the popular *"Hidden Artefacts".*

The games are made available as mobile and desktop downloadable apps through sites such as the Apple App Store, Google Play and Amazon. **They are also available to play through Facebook, with this providing access to the social media site's large base of potential players in return for a revenue share on both in-game purchases and advertising income.**

Selection of Gaming Realms' social games. Source: Company

Revenue model

Gaming Realms earns income from social games by players buying a range of in-game credits which are used to further advance in the game – a "freemium" model. Otherwise, players who run out of credits have to wait for a certain amount of time to earn additional free gaming time. While only a small proportion of players (around 2-3%) have traditionally spent money on in-game app purchases, this has been growing since the launch of Slingo Arcade. An additional stream of revenue comes to the company from in-game advertisements, with the total split being c.25% from advertising and 75% from credits.

In line with its wider strategy, Gaming Realms is now focusing on the social apps which bring in the highest revenues for the lowest marketing spend.

Affiliate Marketing

Through the Blueburra Holdings subsidiary Gaming Realms provides marketing services for third-party bingo and casino sites in the UK. Via the bingoport.co.uk, freebingohunter.com and freecasinohunter.com sites the company operates an affiliate marketing model, earning fees and ongoing commissions for players who sign up to third-party bingo and casino providers.

The websites attempt to attract new players to third-party client sites using a range of marketing efforts such as blogs and product reviews, along with promotional offers and, in the case of bingoport, a points based system which provides players with rewards for increased activity. Income is typically earned via the third-party paying a fixed fee for each player signed up or a percentage commission being paid on net gaming revenues derived from those players.

Resources and activity focused on these assets have reduced over the past 12 months, reflected in revenues from affiliate marketing falling from £2.1 million to £1.8 million from 2015 to 2016. However, Gaming Realms still enjoys a steady, annuity like stream of revenues given that the players already signed up continue to use the third-party sites and therefore earn ongoing commissions. **With this division not being a major part of the current strategy we see the potential for its disposal should an offer be made at the right price.**

Within the marketing segment, in June 2016 Gaming Realms disposed of certain assets from in-house digital marketing agency QuickThink Digital to the UK, North America and Stockholm based digital marketing agency Ayima Limited. These included certain clients and the Facebook traffic buying team from QuickThink. In line with the focus on promoting its own B2C games, a strategic partnership also was formed which sees Ayima provide its marketing services to Gaming Realms, with a focus on promoting games on the Grizzly platform to new customers.

As consideration for the disposal, Gaming Realms was issued a 10% equity stake in Ayima, which is currently on the balance sheet as available for sale investments valued at £540,000. This transaction removed modest losses associated with the disposed assets from the group and provides the benefit of an enlarged marketing capacity complemented by Ayima's expertise in the area of digital acquisition.

Licensing

This division focusses on IP brand and content licensing to partners in the US and Europe across a range of gaming subsectors including lotteries, online, physical slot machines, social, scratch cards and others. **While the segment derived the lowest amount of revenues on a divisional basis in the last financial year it was by far the most profitable**. In 2016 the segment derived £786,843 of revenues, up 537% from 2015, earning an adjusted EBITDA profit of £443,355 for a margin of 56%. The high margins are due to there being relatively few direct sales costs associated with such deals.

In the 2016 financial year a number of key licensing deals were announced, including with:

- social games developer **Zynga** for a Slingo branded slot game in the social casino market. The deal pays Gaming Realms a royalty on net revenue over a three-year term.

- NASDAQ listed **Scientific Games Corporation**, one of the leading providers of gambling products and services to lottery and gaming organisations, for the exclusive rights to produce and distribute Slingo branded slot machines to casinos and related properties on a worldwide basis. The five year agreement includes a minimum guaranteed royalty stream to Gaming Realms payable within the first two years.

These two agreements generated c. £0.7 million of licensing revenues in 2016, with other deals including:

- a first venture into the US real money online gaming market through a licensing agreement with **Pala Interactive**. Under a transactional waiver granted by the New Jersey Division of Gaming Enforcement, Gaming Realms will deliver its newly developed 90 ball bingo game on PalaBingoUSA.com, the first and only gaming website fully dedicated to this type of Bingo in New Jersey. The company will earn income from a share of the revenues generated from the gaming website.

- **Instant Win Games** – has licensed the Slingo Brand to create and distribute Slingo Branded Instant Win Games on mobile.

Remote Game Server

Given the highly profitable nature of licensing activities Gaming Realms will increase its focus on growing this division, intending to expand the reach of its IP and content into new territories. To that effect, the company has developed a Remote Game Server which allows the Slingo Original games to be licensed to third party operators as premium content.

Gaming Realms is currently live with two partners in New Jersey, one of three US states to offer legal online gambling sites, with others signed and expected to launch shortly. Here, the company is targeting a market worth an estimated $220 million per annum. The first European partnership for the remote game server recently launched was with BetVictor.

Financials

Results for the year to December 2016 were a record for Gaming Realms, reflecting the first full year contribution from the RealNetworks asset acquisition, the range of third-party website deals signed during the year and the increased focus on licensing content.

Revenues

At the top line, group revenues grew by 60% to just under £34 million, although if disposed assets are excluded underlying revenue growth was 106%. Along with the reasons mentioned above, this was driven by new depositing players increasing by 47% to 249,355.

On a divisional basis, **real money gaming** saw revenues up by 100% at £21.5 million. **Social publishing** revenues surged by 227% to £7.9 million, reflecting the full year contribution from the RealNetworks acquisition. But reflecting strong underlying growth, on a daily basis revenues were up by 22% to £21,000 per day. Seeing the strongest growth, albeit from a low base, was **licensing**, with revenues up by 537% at £0.79 million. The **affiliate marketing** business saw revenues slip from c.£2.1 million to c.£1.8 million as marketing efforts were focused on other areas.

EBITDA

Gaming Realms highlights adjusted EBITDA in its financial results, a non-GAAP measure, as a key indicator of its performance. This is calculated as revenues less marketing, operating and administrative expenses, thus ignoring any one-off items and share based payments. We believe that using this measure is appropriate given that Gaming Realms has a large amount of non-cash items in the profit & loss account and in the last financial year delivered a positive net cash inflow from operating activities (discussed further in the forecasts section).

For 2016 the full year adjusted EBITDA loss reduced to £1 million from £4.1 million in 2015. Importantly, there was an improved profitability trend over the year, with the second half seeing a swing to an adjusted EBITDA profit of £2 million from a loss of £1.7 million in H2 2015. Notably, the decision to focus on the Grizzly platform saw content royalties fall by 39%.

On a divisional basis the EBITDA performance makes for interesting reading

	Real money gaming & marketing	**Social gaming**	**Licensing**	**Other**	**TOTAL**
Revenue	25,241,659	7,884,101	786,843	45,515	33,958,118
Marketing expense	-10,847,107	-3,937,053	-	-26,756	-14,810,916
Operating expense	-7,729,060	-1,608,789	-	-	-9,337,849
Administrative	-3,815,567	-4,140,794	-343,488	-2,526,921	-10,826,770
Adjusted EBITDA	2,849,925	-1,802,535	443,355	-2,508,162	-1,017,417

Adjusted EBITDA divisional performance. Data source: Company accounts

The real money and affiliate marketing segment (the two segments are reported together in the accounts) made a healthy EBITDA profit of £2.85 million for the year (we note that £1.93 million of revenues in this segment came from the disposed white label and agency businesses so won't be repeated). Licensing contributed a lower £0.44 million to the bottom line but the 56% EBITDA margin from the licensing segment is notable, reflected in the low marginal and recurring costs associated with licensing deals.

Were it not for the social gaming business making a £1.8 million EBITDA loss (and accounting for the £2.5 million loss in the "other" segment) an EBITDA profit would have been posted for the year. **Reflecting the contribution of the various divisions, a core focus of Gaming Realms' strategy is to now allocate capital towards real money gaming and content licensing.**

Recent Trading

Interims points to full year profitability at the EBITDA level

Results just released for the six months to June 2017 showed that revenues (excluding contributions from disposed businesses) grew by just over 5% to £15.69 million. On a statutory basis revenues were down from £16.63 million, mainly as a result of the contribution in H1 2016 from the sold assets. By geography, 73% of revenues were from the UK & Channel Islands, 18% from the US and the remainder from the "Rest of the World".

More significantly, the adjusted EBITDA loss was cut significantly from £3.08 million to £0.9 million. This was a result of the rising revenues, combined with cost reductions, in particular a 32% fall in marketing expenses and a 9.8% fall in admin expenses. The net loss from continuing operations was down from £5.66 million to £3.76 million.

Operational & divisional highlights

Real money gaming

Revenues in real money gaming grew by 5% to £10.7 million despite a 26% fall in marketing spend to £4.8 million, thus demonstrating the company's ability to attract new players at a lower cost. Three proprietary games were launched on the Grizzly platform during the period, taking the Slingo Originals' portfolio of proprietary games to eleven at the period end, up from eight six months previously. These contributed 36% of gross gaming revenue.

Social gaming

In social publishing, revenues grew by 16% to £4 million, boosted by growth on Slingo Arcade which launched in December 2016. Focus on marketing spend on key apps led to improved returns on investment with marketing spend as a percentage of revenue reducing to 42% from 57% in H1 2016. **Encouragingly, the first EBITDA positive month in the division was seen in June 2017.** A head count reduction of 28 staff through synergies in the division is expected to deliver annualised savings of approximately £2 million, reflecting both improved operational and marketing efficiency.

Licensing

Licensing revenues fell from £322,502 to £228,639 in the first half although this is not a concern giving the timing of such deals can result in one-off payments early on. Four new licensing deals were signed in the period with Resorts Digital Gaming, Rush Street Interactive, Pala Interactive and Caesars Interactive. However, delays in 3rd party integrations of the remote game server to other operators, particularly in New Jersey and the UK in H1, will result in a reduction in anticipated licensing revenue for the year.

Profitability by division at the EBITDA level was not reported in the interims and no analysis of the affiliate marketing division was given.

Balance sheet, funding and cashflow

Gaming Realm's balance sheet looked reasonably solid at the period end, showing net cash of £1.1 million. The main non-current assets consist of £27.25 million of goodwill and intangible assets which have been built up over the years following the numerous acquisitions and investment in development. Net assets were £20.45 million at the period end.

To further support growth, and strengthening the balance sheet, in August Gaming Realms raised £1,132,500 via a subscription at 11p per share, with three directors (Michael Buckley, Patrick Southon and Simon Collins) subscribing a total of £205,000. The net proceeds will be used to increase unique game creation to enhance the game library for both the real money gaming platform and licensing the content on the remote game server.

One other notable balance sheet item is a £3.05 million current liability relating to deferred consideration due to RealNetworks for the Slingo asset acquisition.

Under the terms of the RealNetworks asset purchase in 2015 a final deferred consideration payment of $4 million was due by 10th August 2017. However, the agreement was recently amended to provide for a final payment of $4.5 million to be made by Gaming Realms to RealNetworks by 15th December this year. Gaming Realms is currently negotiating long-term debt financing to settle this sum and to assist with the matter has appointed an adviser who is in discussions with a number of lenders.

Regarding cashflow, Gaming Realms saw a £0.3 million net cash *inflow* from operations in the first half, following on from the £2.22 million inflow in full year 2016. The H1 cashflow performance was mainly driven by the adding back of £2.49 million of amortisation costs, with such expenses traditionally being high given the large amount of intangible assets discussed above. An increase in trade and other payables of £1.37 million and the adding back of £0.37 million of share based payments also boosted operational cashflow.

While being cashflow positive at the operational level, Gaming Realms does have relatively high requirements for investment in intangible assets such as development costs, IP and software. These in effect could be viewed as the company's annual "capex" requirement. In H1 investment in intangible assets amounted to £1.74 million, with the total cash outflow for the period being £1.53 million.

Post period trading positive but some minor issues may affect short-term trading

Into the second half and real money gaming average daily revenue is up by 11% so far in Q3 2017 compared to the same period in Q3 2016. Notably, the social publishing division is now said to be EBITDA positive. **At a group level, "significant" positive EBITDA is expected in the second half of the financial year,** with increased revenues, seasonal marketing costs reduced and a full period of benefits from the integration of the social business expected to combine and deliver a positive EBITDA performance for 2017 as a whole.

One minor negative point was that the licensing issues mentioned above, along with an earlier than previously forecast timing of the new Point of Consumption tax in H2/17, is likely to impact full year EBITDA. **However, management insisted that these are expected to be only short-term timing issues, with profitable growth expected to continue.**

Risks

Regulatory risk

By operating in the real money gaming sector Gaming Realms is subject to various regulatory requirements in the jurisdictions of its operations. The company holds licences from the Alderney Gambling Control Commission, the UK Gambling Commission and has a transactional waiver for New Jersey Division for Gaming Enforcement. It must continue to comply with the requirements of these licences, apply for any new licences which are required and keep up to date with any changes in the regulatory frameworks. The major risk currently comes from changes to regulation and duties in the UK market where all real money revenues are currently generated.

Competition risk

The gaming and gambling markets in which Gaming Realms operates are highly competitive, with many suppliers offering customers many thousands of competing products. This makes marketing an important area for the business, with large budgets and expertise required for marketing campaigns aimed at gaining new customers and encouraging existing customers to continue playing. To maintain a competitive advantage Gaming Realms must also make sure its games are of sufficient quality to sustain customer engagement and develop new games and content on a regular basis.

Financing risk

While Gaming Realms had a positive cash inflow from operations in the last financial year, it remain loss making on a statutory basis. The first half of the current financial year saw losses reduced and positive EBITDA is expected for the full year. However, with the business growing strongly, further funds above the recent subscription may need to be raised to ensure the business has sufficient funds to meet its growth plans.

Reliance on third-parties

Gaming Realms works with a number of providers of non-proprietary third-party games, along with external payment processing and other service providers. Any interruption to the supply of the products or services provided by third-parties may have an adverse effect on the business and its financial performance.

Foreign exchange risks

In the last financial year Gaming Realms derived c.28% of revenues from US customers, along with c.14% from the Rest of the World segment. As such, the accounts and the value given to the shares by the market are exposed to movements in the value of certain foreign currencies against sterling.

Management

Michael Buckley - Executive Chairman

Michael was Executive Chairman of Cashcade, which he founded with Patrick Southon and Simon Collins in 2000. Amongst a number of functions he performed for the company during this period, Michael was responsible for raising the £7 million equity needed for the company's development, creating a number of important commercial relationships for Cashcade and led the sale process which generated an aggregate sale consideration of approximately £96 million for shareholders.

He has invested in and been Executive Chairman of a number of public companies. These include SelecTv plc, a producer of comedy and comedy drama series for television such as Lovejoy, Birds of a Feather and The New Statesman. SelecTv invested in a consortium which in 1991 won the franchise to create Meridian Television, of which Michael was a founder director. He was also Executive Chairman of Pacific Media plc, which invested in a number of internet backbone companies in Asia during the 1990s as well as creating a chain of movie theatres in South East Asia in partnership with United Artists Theatre Circuit Inc.

Patrick Southon - Chief Executive Officer

Patrick has been working within the online gambling sector for the last 13 years. He is particularly focused on marketing, brand building and media buying. Patrick was Managing Director of Cashcade and Managing Partner of NewGame, an investment fund focusing on innovation within the gambling sector. His marketing expertise allowed Cashcade to build a distinctive and prominent brand identity around, among others, its flagship Foxy Bingo brand and turned the company into one of the most effective advertisers on British television.

Simon Collins - Executive Director

Simon co-founded Cashcade in 2000 and was its commercial director with responsibility for acquisitions and third-party relationships. Simon formed a range of profitable business-to-business and affiliate relationships for Cashcade and was an early adopter of both search engine and social network marketing in the monetised digital gaming space. Following the sale of Cashcade, Simon remained at bwin.party until April 2011, where he focused on innovation, research and development as well as the ongoing development of Cashcade's brand in the social networking space. Since leaving bwin.party, Simon joined Patrick Southon in setting up NewGame, an investment fund focusing on innovation within the gambling sector.

Mark Segal - Chief Finance Officer

Mark recently left bwin.party as Finance Director of its bingo division, having been Finance Director of Cashcade until it was acquired by PartyGaming plc in July 2009. Mark was responsible for the full finance function, including commercial negotiations, business intelligence and operational support in the business and took the lead in the sale to PartyGaming plc and acquisition of Independent Technology Ventures in July 2007. Prior to joining Cashcade, in May 2005, Mark spent five years at the accountancy firm Martin Greene Ravden, where he qualified as a Chartered Accountant in 2003.

Stephen Downer - Chief Operating Officer

Stephen has more than 15 years of experience in online gaming. As Director of Gaming at Sky Bet for 10 years, he launched and ran Sky Vegas, Sky Poker and Sky Bingo until 2012. A year later, Stephen led Betfair's online casino launch in New Jersey, and more recently managed Betfair's regulated sports betting and gaming businesses in Spain, Denmark and Bulgaria.

Atul Bali - Non-Executive Director

Atul Bali, president of RealNetworks' games division, joined as a non-executive director of Gaming Realms 12th May 2014. Previously he served as president and chief executive of the Americas division of gaming software supplier Aristocrat Technologies, and has also served as chief executive of XEN Group, since renamed Disruptive Tech Ltd, managing a portfolio of early-stage social data technology, mobile social gaming and ecommerce businesses.

In 1997, Atul joined GTECH, the world's leading regulated lottery and gaming services business. He held a number of senior positions during his career at the company; including President & CEO of GTECH G2, the Group's iGaming, Sports Betting and Server Based Games division, Group Senior Vice-President for Corporate Development & Strategy and led GTECH's Global Business Development team. Atul is a trained Chartered Accountant and worked in the UK for KPMG for four years.

Jim Ryan - Non-Executive Director

Jim recently retired as the Co-CEO of bwin.party digital entertainment plc. He has spent the last 12 years of his career in leadership roles within the online gaming sector and led a number of the industry's largest merger and acquisition transactions, including the merger of PartyGaming plc and Bwin; the acquisitions of Cashcade and the World Poker Tour; and the sale of St. Minver Limited. Jim has held senior management posts at SXC Health Solutions Corp., Procuron Inc., Metcan Information Technologies Inc. and Epson Canada Limited.

His is a Chartered Accountant and Certified Public Accountant, accredited with the Canadian Institute of Chartered Accountants.

Mark Wilson - Non-Executive Director

Mark Wilson is currently Managing Partner (and founder) of NMG, a slot machine distributor and route operator in New Mexico, and parent company to a gaming supply subsidiary in other southwestern US markets. He previously served as executive chairman of Music Choice International, a pan European digital music provider to over 30 cable, satellite, telecommunications and IPTV providers, where he oversaw the turnaround of the business and subsequent sale to Stingray Digital in 2011.

Mark also served as founding president and chief executive officer of Television Games Network (TVG) the leading interactive US horseracing network. TVG was incorporated in 1998 as a Liberty Media-backed company, which was subsequently sold to TV Guide in 2004. He trained as a lawyer after having attended Western Kentucky University and obtaining a Juris Doctorate from the University of Louisville.

Forecasts

In our view, Gaming Realms' strategy is now coming together from all angles, with profitability on an annual basis now looking highly likely commencing in 2017 given the first half performance just reported and management guidance provided in these interims. The focus on producing in-house content on its own proprietary platform produces the twin benefit of higher revenues and lower costs which, combined with a relatively fixed corporate cost base, should see advancement in the bottom line.

We initiate coverage of Gaming Realms with forecasts for the 2017, 2018 and 2019 financial years.

We begin by forecasting revenues on a divisional basis and are looking for real money gaming and licensing to be the fastest growing areas of the business, with social not far behind. In contrast, we are expecting a steady decline in the affiliate marketing business as fewer resources are attributed to the division.

Year to December	**2016**	**2017**	**2018**	**2019**
Real money gaming	21,513,208	23,425,375	29,400,000	34,200,000
Affiliate marketing	1,800,000	1,254,742	960,000	780,000
Social publishing	7,884,101	7,852,923	8,231,377	9,634,268
Licensing	786,843	898,116	3,032,816	4,414,339
Disposed white label and agency business	1,928,451	0	0	0
Other	45,515	0	0	0
TOTAL REVENUES	**33,958,118**	**33,431,155**	**41,624,193**	**49,028,607**

Divisional revenue forecasts. Source: Align Research

For **2017** we are looking for total group revenues to be down slightly on 2017 on a statutory basis at £33.43 million. The small fall is mainly due to the contribution from the disposed white label businesses not being repeated and affiliate marketing revenues being lower, with the second half of the year seeing lower than previously expected licensing revenues.

However, in **2018** we expect the accounts to see the full benefits of the move towards the Grizzly platform, synergies in the social business, and a stream of new licence income contribute to the numbers. **We are looking for total revenue growth of 25% for the full year to £41.62 million, driven by 26% growth in real money gaming and a more than trebling of licensing income.**

In **2019** we expect the positive momentum to continue, albeit with growth rates in real money gaming and licensing being less aggressive. We are looking for 18% total revenue growth for the year, to £49.03 million.

Our summary P&L forecasts are included in the table below

Year to December	**2016**	**2017**	**2018**	**2019**
Revenue	33,958,118	33,431,155	41,624,193	49,028,607
Total expenses	-34,975,535	-31,429,184	-37,607,989	-41,284,850
Adjusted EBITDA	**-1,017,417**	**2,001,971**	**4,016,204**	**7,743,757**
Total exceptional costs	-674,515	-969,500	0	0
EBITDA	**-1,691,932**	**1,032,471**	**4,016,204**	**7,743,757**
Amortisation & depreciation	-4,100,730	-3,903,993	-3,802,995	-3,727,246
EBIT	**-5,792,662**	**-2,871,522**	**213,209**	**4,016,510**
Finance expense	-1,178,154	0	-408,914	-408,914
Finance income	3,022	0	0	0
PRE-TAX LOSS/PROFIT	**-6,967,794**	**-2,871,522**	**-195,704**	**3,607,597**
Tax paid/credit	272,451	0	0	0
NET LOSS/PROFIT	**-6,695,343**	**-2,871,522**	**-195,704**	**3,607,597**
Weighted number of shares	262,432,743	278,082,234	284,428,747	284,428,747
Earnings per share (p)	-2.55	-1.03	-0.07	1.27

In terms of expenses, we forecast this at the group level. Our main assumptions include a fall in marketing expenses as a proportion of revenues as the benefits of the Slingo brand value come through, along with an increased focus on more profitable games and applications. Relatively fixed corporate costs then combine with the growth in revenues to deliver significant growth in the adjusted EBITDA measure. **We expect the group to show a maiden full year adjusted EBITDA for 2017, amounting to just over £2 million. This then rises sharply, to £4.01 million and £7.74 million in 2018 and 2019 respectively.**

We forecast investment in purchase of intangible assets of £3.5 million per annum and amortisation of intangible assets at 25% to obtain our amortisation numbers. For modelling purposes, and given low amounts of capex on tangible assets, we assume no change in fixed assets. Our other key P&L assumption is that the deferred consideration due to RealNetworks is replaced by interest only debt as at 31st December 2017 with interest paid at 12% per annum. This amounts to c.£0.41 million of interest payments for 2018 and 2019. An exchange rate of £1:$1.32 is assumed.

Other important P&L assumptions include no adjustments for changes in exchange rates. With substantial unused tax losses and a 0% tax rate in Alderney, we also assume no corporation tax is paid.

At the bottom line, that results in the first statutory profitable year in 2019, with a £3.61 million net profit and earnings per share of 1.27p.

Balance sheet

Key balance sheet items include the RealNetworks deferred consideration, which we treat as described above. Trade debtors and creditors are assumed to rise in line with revenue growth. More significantly, we are looking for cash to rise to £2.87 million by the end of 2018, rising to £7.52 million by the end of 2019. **Less the assumed deferred consideration related debt, this would equate to net debt of £0.53 million at the end of 2018 and £4.11 million of net cash at the 2019 year end.**

Year to December	2016	2017	2018	2019
ASSETS				
NON CURRENT ASSETS				
Property, plant and equipment	373,307	373,307	373,307	373,307
Goodwill	16,545,864	16,545,864	16,545,864	16,545,864
Available for sale investment	540,000	540,000	540,000	540,000
Intangible assets	12,115,973	11,711,980	11,408,985	11,181,739
Other assets	152,000	152,000	152,000	152,000
TOTAL NON CURRENT ASSETS	**29,727,144**	**29,323,151**	**29,020,156**	**28,792,910**
CURRENT ASSETS				
Trade and other receivables	3,347,595	3,295,647	4,103,318	4,833,245
Cash and cash equivalents	2,616,267	1,868,957	2,871,641	7,515,691
TOTAL CURRENT ASSETS	**5,963,862**	**5,164,604**	**6,974,959**	**12,348,937**
TOTAL ASSETS	**35,691,006**	**34,487,755**	**35,995,115**	**41,141,846**
LIABILITIES				
CURRENT LIABILITIES				
Trade and other payables	7,058,781	6,949,243	8,652,307	10,191,442
RealNetworks deferred consideration/borrowings	3,135,356	3,407,616	3,407,616	3,407,616
TOTAL CURRENT LIABILITIES	**10,194,137**	**10,356,859**	**12,059,923**	**13,599,058**
NON CURRENT LIABILITIES				
Deferred tax liability	1,202,889	1,202,889	1,202,889	1,202,889
Deferred and contingent consideration	0	0	0	0
TOTAL NON CURRENT LIABILITIES	**1,202,889**	**1,202,889**	**1,202,889**	**1,202,889**
TOTAL LIABILITIES	**11,397,026**	**11,559,748**	**13,262,812**	**14,801,947**
NET ASSETS	**24,293,980**	**22,928,007**	**22,732,303**	**26,339,899**
EQUITY				
Share capital	27,413,329	28,442,874	28,442,874	28,442,874
Share premium	87,095,455	87,198,410	87,198,410	87,198,410
Merger reserve	-67,673,657	-67,673,657	-67,673,657	-67,673,657
Foreign exchange reserve	2,408,432	2,408,432	2,408,432	2,408,432
Retained earnings	-25,154,580	-27,653,053	-27,848,757	-24,241,161
Total equity attributable to owners of the parent	**24,088,979**	**22,723,006**	**22,527,302**	**26,134,898**
Non-controlling interest	205,001	205,001	205,001	205,001
TOTAL EQUITY	**24,293,980**	**22,928,007**	**22,732,303**	**26,339,899**

Cash flow

Year to December	2016	2017	2018	2019
CASHFLOW FROM OPERATIONS				
Gain/(Loss) for the year	-6,695,343	-2,871,522	-195,704	3,607,597
ADJUSTMENTS				
Depreciation of property, plant and equipment	120,789	0	0	0
Amortisation of intangible fixed assets	3,979,941	3,903,993	3,802,995	3,727,246
Finance income	-3,022	0	0	0
Finance expense	36,850	0	0	0
Movement in deferred and contingent consideration	1,141,304	272,260	0	0
Unrealised currency translation gains	-191,548	0	0	0
Unwind of deferred tax recognised on acquisitions	-248,941	0	0	0
Loss on disposal of property, plant and equipment	6,531	0	0	0
Profit on disposal	-318,834	0	0	0
Share-based payment expense	993,349	373,049	0	0
Increase/(decrease) in trade and other receivables	643,961	51,948	-807,671	-729,928
Increase in trade and other payables	2,759,244	-109,538	1,703,064	1,539,135
NET CASH FROM OPERATIONS	**2,224,281**	**1,620,190**	**4,502,684**	**8,144,050**
INVESTING				
Acquisition of subsidiary, net of cash acquired	18,759	0	0	0
Purchases of property, plant and equipment	-289,256	0	0	0
Purchase of intangibles	-3,969,611	-3,500,000	-3,500,000	-3,500,000
Proceeds from disposal	1,200,000	0	0	0
Interest received	3,022	0	0	0
NET CASH FROM INVESTING	**-3,037,086**	**-3,500,000**	**-3,500,000**	**-3,500,000**
FINANCING				
Proceeds of Ordinary Share issue	4,025,000	1,132,500	0	0
Issuance cost of shares	-45,000	0	0	0
Payment of deferred consideration	-3,071,447	0	0	0
Interest paid	-36,850	0	0	0
NET CASH FROM FINANCING	**871,703**	**1,132,500**	**0**	**0**
Net increase/(decrease) in cash and cash equivalents	58,898	-747,310	1,002,684	4,644,050
Cash and cash equivalents at beginning of year	**2,516,820**	**2,616,267**	**1,868,957**	**2,871,641**
Exchange gains on cash and cash equivalents	21,747	0	0	0
CASH AT END OF YEAR	**2,616,267**	**1,868,957**	**2,871,641**	**7,515,691**

Valuation

Following the release of the interim results, shares in Gaming Realms slipped to an all-time low of 7.95p before rising modestly to the current 7.97p. That capitalises the business at £22.67 million. We believe that following the results investors focused on the slight expected EBITDA slippage announced by management. **However, given that these were revealed to be short-term issues we prefer to focus on the fact that the company is now on the cusp of profitability, on a strong growth trajectory and hence see a long-term good opportunity at the current share price.**

Valuation matrix

	2016	2017	2018	2019
Price to sales	0.67	0.68	0.54	0.46
EV/EBITDA	N/A	12.1	5.8	2.4
PE	N/A	N/A	N/A	6.3
Price to free cash flow	N/A	N/A	22.6	4.9

The table above shows a selection of current valuation measures for Gaming Realms. Given the cash generative nature of the business and high non-cash charges we prefer to focus on the EV/EBITDA and price to free cash flow measures**. Should the company meet our forecasts the shares currently trade on a very low EV/EBITDA multiple of 5.8 times for 2018, falling to a stupendously cheap 2.4 times in 2019.**

Looked at another way, demonstrating the cash generative potential when the business gets to a certain scale, the price to free cash flow multiple for 2019 is just 4.9 times (we define free cash flow as net operating cash flow less investment in intangible assets). In other words, the free cash flow yield for 2019 is just over 20% at the current stock price. **This gives substantial scope to pay back the deferred consideration related debt and also pay a dividend – something the market we believe has not accounted for whatsoever given the current valuation ascribed to the stock. To be clear however, at present we forecast no distribution to shareholders over our forecast horizon.**

Peer analysis guides target value

While we identify 16 companies in the UK listed Gambling sub-sector most, including the likes of William Hill, Ladbrokes and 888 Holdings, are large entities, at a more mature stage of operation than Gaming Realms and focused on different gaming and gambling activities, such as sports and bingo. In terms of the closest peer by size and operations we identify AIM listed **Stride Gaming (STR),** the multi-branded online soft gaming operator, which runs both real money and social games.

Stride currently trades on a historic EV/EBITDA multiple of 11.24 times, a figure which we believe could be appropriately applied to Gaming Realms, especially given that Gaming Realms arguable has higher growth potential given the stage of its operations. **However, being highly conservative in our valuation we apply a 6 times EV/EBITDA multiple to our 2019 figures, which equates to a market cap for Gaming Realms of £50.6 million, or 17.8p per share.** Should the same multiple be ascribed to Gaming Realms as Stride then a price of just over 32p would result based on 2019 figures and whose visibility will become clearer as we move through the next 12 months.

32Red deal shows blue-sky potential in the sector

In order to reflect the long-term blue-sky potential here we note recent corporate activity in the sector. In February 2017 **32Red (TTR)**, the AIM listed online casino focused gaming operator, agreed to be acquired by online gaming and sports betting specialist Kindred Group for a total of £175.6 million in cash. Making £10.56 million in EBITDA for 2016, and with net cash of £10.12 million at the period end, the takeout price represented an enterprise value/EBITDA multiple of 15.7 times. **Using the same multiple for Gaming Realms and our 2019 numbers would imply a takeout price of c.£125.5 million, or 44.1p per share using the current number of shares in issue.**

While this may be a highly optimistic scenario, we note that if our 2019 numbers are hit Gaming Realms will be not far off the position 32Red was in at the time of its acquisition in terms of profits and cash – see table.

Value	TTR 2016A (£m)	GMR 2019E (£m)
EBITDA	10.56	7.74
Net Cash	10.12	4.11
M. Cap/Takeout Price	175.6	125.5
Multiple	15.67	15.67

TTR 2016 vs GMR 2019: Source Company accounts & Align Research

Conclusion

On our forecasts, Gaming Realms looks dramatically under-valued by a multitude of metrics. The market is seemingly setting a low value for the business given that profitability has not yet been reached and consistent growth beyond that needs to be proven. Whilst there is execution risk in meeting our forecasts, should management deliver, we would expect a significant re-rating in the shares.

With profit trends going in the right direction, management having a clear growth strategy and the recent fundraising supporting the balance sheet, we believe that with the shares trading at near all-time lows (and ignoring a number of positive potential catalysts) that now is an opportune time to take a long-term view on the shares. **We initiate coverage of Gaming Realms with an end 2019 target price of 17.8p and a Conviction Buy stance.**

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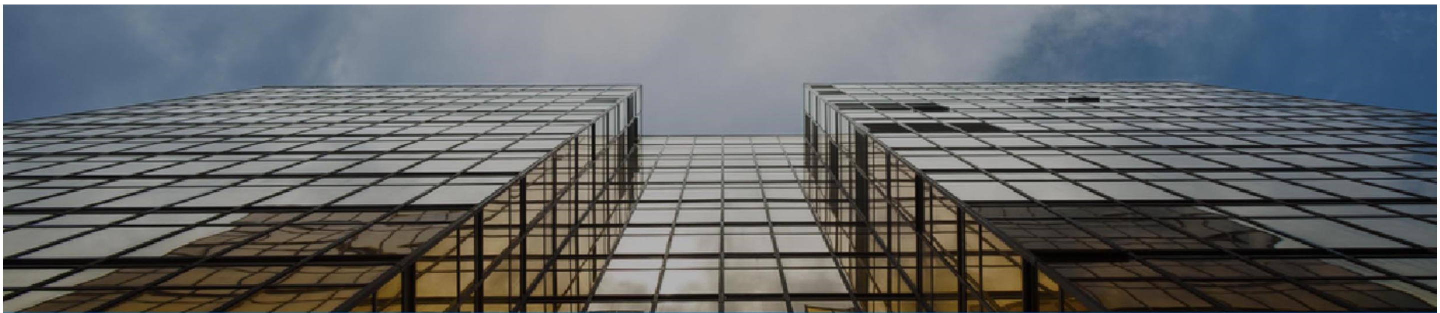

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