ALIGN
RESEARCH

Gaming Realms

16th October 2018

Refocusing into highly profitable licensing model and disposal of assets create significant value creation opportunities

Gaming Realms is a developer, publisher and licensor of real money and social games with operations in the UK, U.S. and Canada. The business was set up by the team behind Cashcade Ltd, 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 gaming, social gaming and licensing divisions, with the strategy being to allocate capital towards the more profitable real money gaming and content licensing operations.

Disposal of B2C brands provides significant cash inflow

Gaming Realms has recently sold a 70% stake in certain UK online casino B2C businesses to River UK Casino Limited (RUKC) for a total value of up to £23.1 million. **The minimum payment is £8.4 million, along with a further maximum cash earn-out payment of £14.7 million.** Providing significant further potential, the retained 30% stake is subject to a mutual put & call option based on an uncapped valuation of 5.5 times RUKC's 2020 EBIT.

Valuation suggests 148% upside

Our sum-of-the-parts based valuation of 14.55p per share implies 148% upside from the current price of 5.875p. However, we use what we consider to be very conservative assumptions for each part of the valuation and as such believe there could be significant further upside potential. **Conviction Buy.**

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

Year to end Dec	2018E	2019E	2020E	2021E
Revenues (£m)	20.87	16.90	21.20	24.60
Adjusted EBITDA (£m)	(0.31)	0.82	4.10	7.50
Pre-tax profit (£m)	(2.55)	(4.61)	(1.43)	1.85
EPS (p)	(0.09)	(1.62)	(0.50)	0.65

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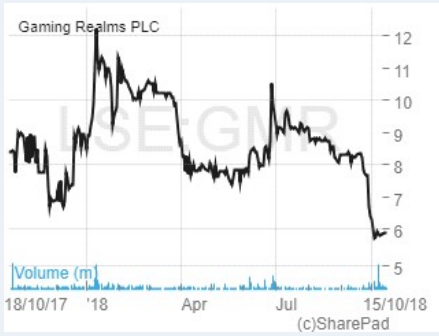
CONVICTION BUY – PRICE TARGET 14.55p

GAMING REALMS
PLAYING A NEW GAME

Key data

EPIC	GMR
Share price	5.875p
52 week high/low	12.25p/5.75p
Listing	AIM
Shares in issue	284,428,746
Market Cap	£16.7m
Sector	Travel & Leisure

12 month share price chart



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Corporate Background

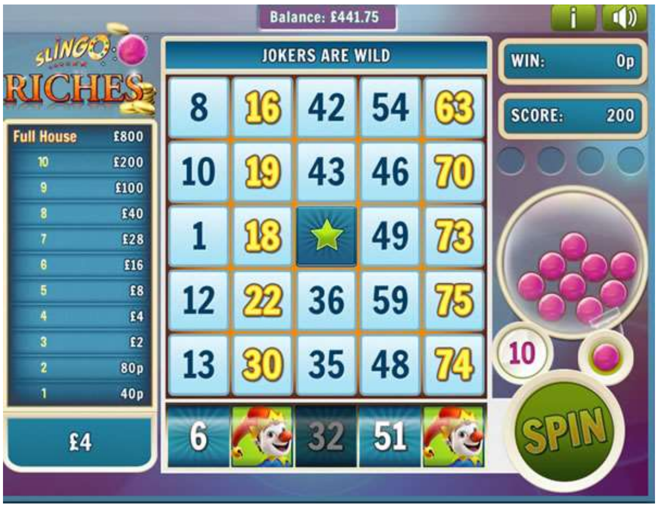
Gaming Realms (GMR) was founded in 2012 to develop a new generation of social bingo and slot machine gaming concepts. The company was set up by the team behind Cashcade Limited, the creator of well-known online bingo brand Foxy Bingo, which was sold to PartyGaming (now part of GVC Holdings) for just 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 together with a placing to raise c.£3.4 million. This set the foundation for the company to take advantage of opportunities in these large markets. According to the Gambling Commission, the gross gambling yield across the whole of the remote (online) sector in Great Britain amounted to £4.9 billion the year to September 2017, with £2.7 billion of this coming from casino games.

Since listing, Gaming Realms has been active on the corporate front, completing a number of acquisitions, disposals and fundraisings, to shape the business into its present form – see our initiation note of September 2017 for a comprehensive list of deals.

Arguably the most important acquisition was completed in August 2015 when Gaming Realms completed the $18 million acquisition of certain gaming assets from NASDAQ listed digital media business RealNetworks Inc. This 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.

Slingo, a portmanteau of slots and bingo, is a popular online game with a 20 year history which 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. In line with its current strategy, Gaming Realms has developed the "Slingo Originals" portfolio of games which it licenses to third parties.



Slingo Riches. Source: Company

Since our initiation of coverage note on 19th September 2017 Gaming Realms has repositioned the business model following a number of disposals. In March 2018 the company sold its affiliate portals, bingoport and freebingohunter, for £2.4 million to 1ST Leads Ltd. However, the most significant deal, completed in August 2018, saw the company sell a 70% stake in most of its UK online casino B2C business to River UK Casino Limited for a total cash consideration of up to £23.1 million. **This was in line with the company's new strategy to focus on the highly profitable area of content development and licensing.**

Operations

Gaming Realms' current operations consist of three main business lines:

Real Money Gaming

For the past few years Gaming Realms' primary source of revenues has come from the Real Money Gaming division. The business offers a range of online and mobile games, which amounted to 683 fully owned and third-party offerings at the end of the last financial year. These 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 84% of gross gaming revenue coming from mobile in 2017.

During 2015 Gaming Realms realigned its corporate strategy to focus on sites operating on its own proprietary platform, "Grizzly". At the end of 2017 the library had grown to 19 proprietary games. 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 wider 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. 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. 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.

Real Money B2B

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 division during the year. Key white label agreements include clients such as ITV, Endemol and Bauer Media.

River Casino deal

On 27th June 2018 the make up of the Real Money Gaming division was transformed after Gaming Realms announced that it had entered into a proposed deal to sell a 70% stake in most of its UK online casino B2C businesses to River UK Casino Limited, a subsidiary of Oslo Bors listed River iGaming, for a total cash consideration of up to £23.1 million. The brands sold were Pocket Fruity, Spin Genie, Britain's Got Talent Games, X Factor Games and associated business, with Gaming Realms retaining the Slingo.com website and the Slingo brands.

Consideration for the deal is a minimum payment of £8.4 million (£4.2 million on completion and £4.2 million payable with the earn-out), along with a further maximum cash payment of £14.7 million on an earn-out basis. The earn-out is payable no later than 31st August 2019 and will be based on 70% of 5.5 times River UK Casino's EBIT for the 12 months to 30th June 2019 minus the £8.4 million minimum payment – the maximum earn-out will be paid out on EBIT of £6 million being achieved.

For the year ended 31st December 2017 the businesses being sold delivered £14.1 million of net gaming revenue (out of a total of £22.7 million from the division) and an adjusted profit before tax and interest (but after central costs) of £2.2 million**. While not being quantified, management have said these figures are expected to be "significantly higher" for the 12 months to 30th June 2019.**

Providing material further upside potential, Gaming Realms' retained 30% interest in River UK Casino is subject to a mutual put and call option arrangement which can be exercised no later than 31st October 2020 based on an *uncapped* valuation of 5.5 times River UK Casino's EBIT for the 12 months to 30th June 2020.

The deal also sees River iGaming and Gaming Realms jointly provide a working capital loan facility of £3 million to River UK Casino to fund investment in marketing until at least 30th June 2019, repayable no later than 30th June 2020. The current management team of the business will run River UK Casino until at least 30th June 2020. In addition, River UK Casino has entered into a five year white label B2B platform and content agreement with Gaming Realms on normal commercial terms, which is expected to generate approximately £1 million of annual revenue for the company.

The sale is in line with Gaming Realms' strategy of focusing its resources on its higher margin international licensing and content development business (see below), with the revenue generated from River UK Casino becoming a significant source of income for the B2B platform.

The first £4.2 million of the sale proceeds are intended to be used for the continued development of new gaming content and platform enhancements, as well as providing a loan of £0.9 million to fund River UK Casino's marketing budget. Gaming Realms will be reviewing options for the balance of the proceeds above the first £4.2 million, including a potential return of cash to shareholders. On 16th August 2018 the company announced that the sale had completed, with the initial consideration payment of £4.2 million having been received.

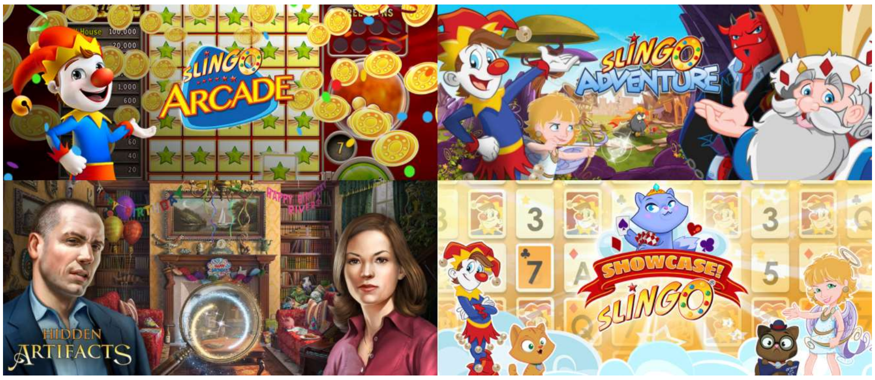
Following completion of the sale, the strategy for the remaining real money games will be focused on marketing Slingo, optimising customer acquisition costs and growing the white label B2B business, with a number of new deals going live in 2018 expected to contribute to growing revenues this year and beyond.

Social Gaming

The second largest division by revenues in the last financial year, making up 22% of the total, is social gaming, or social publishing. The business 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 social games division operates through the Blastworks Inc. subsidiary, which is based in Victoria, Canada.

Many of the social games are based on traditional gambling themes, such as casino and slots, with Slingo branded games making up c.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. Only a small proportion of players (around 2-3%) have traditionally spent money on in-game app purchases, with additional stream of revenue coming from in-game advertisements.

In the last financial year the social business saw revenues slip by 13% to £6.9 million but following a significant cost cutting exercise the EBITDA loss was reduced by 97% to £0.1 million. **The business moved into profitability in the second half of the year and is now profitable on a monthly basis**.

As the company focusses on the real money gaming and licensing sides of the business we expect the social division to becoming increasingly "non-core" over the next few years, with marketing and other costs being minimised and aligned with only the best performing games. We note that management recently commented, it *"…will continue to evaluate strategic opportunities for our non-core activities such as the social publishing business."*

Licensing/Content Development

The licensing division focusses on IP brand and content licensing to partners in the US and Europe across a range of gaming subsectors including online, lotteries, physical slot machines, social, scratch cards and others. The company has developed a Remote Game Server which allows the Slingo Original games library (www.slingooriginals.com) to be licensed to third party operators as premium content.

Given the highly profitable nature of licensing activities Gaming Realms is increasing its focus on growing this division, intending to expand the reach of its IP and content into new territories. The high margins are due to there being relatively few direct sales costs associated with such deals in the long-term, with the more significant costs seen in the early months as deals are set up.

Recent licensing deals

Reflecting the focus on new licensing, and the creativity of the content, a number of new deals have been signed so far in 2018.

Jan 2018 – a three-year licensing and revenue share agreement was signed with 888 Holdings Plc (888), to distribute new Slingo Originals content. Under the deal, 888 will host new Slingo games on its "Dragonfish" B2B platform, distributing across 200+ bingo sites.

Also in January, a two-year licensing and revenue share agreement was agreed with New Jersey based online casino, GoldenNuggetCasino.com, to launch Slingo Originals content. In 2017, Golden Nugget Casino held a 30% share of the New Jersey online gaming market, making it the largest operator in New Jersey.

Feb 2018 - a multi-show game licensing agreement was agreed with ITV, initially based around the television shows Dancing on Ice, The Only Way is Essex and Hell's Kitchen. The new games are hosted on Gaming Realms' proprietary platform under the umbrella brand tellygames.com and come after an agreement in 2017 to launch loveislandgames.com.

May 2018 - a three-year licensing deal was announced with Sony Pictures Television for Gaming Realms to create and host the new gaming website millionairegames.com on its proprietary platform following the return of 'Who Wants To Be A Millionaire?' in the UK for its 20th anniversary. The site went live in tandem with the return of the show on ITV in May, with a Slingo game format of 'Who Wants To Be A Millionaire?' also created.

June 2018 - a two-year licensing and revenue share agreement was signed with GVC Holdings, one of the world's largest sports betting and gaming groups, to roll out Slingo Originals content worldwide. GVC will distribute the content across all of its sites and had a six-week exclusive period of hosting Gaming Realms' new 'BlackJack X-Change' casino game. This follows an agreement made in July 2017 for GVC to distribute Slingo Originals in New Jersey.

To further grow the licensing business Gaming Realms is looking to develop around 12 games per annum and go live with between 12 to 15 new client integrations per annum. Further large clients in UK and Europe will be targeted, as well as in the US as the trend for states to regulate gambling activities continues.

Financials

The 2017 financial year was a landmark one for Gaming Realms, with the company delivering a maiden profit at the adjusted EBITDA level for the first time. Adjusted EBITDA is calculated as revenues less marketing, operating and administrative expenses, ignoring any one-off items and share based payments. While reporting such a figure to investors as an indication of profits is often controversial, we believe that using this measure is appropriate given that Gaming Realms has historically had a large amount of non-cash items in the profit & loss account and has also demonstrated it can be cash flow positive.

At the top line, total revenues for the year (to 31st December) fell by 7% to £31.6 million but excluding disposed non-core assets revenue was down by just 1%. Adjusted EBITDA for the period was £0.8 million following a £2 million loss in 2016. This came as costs were cut across the business, most notably marketing (down by 30% to £10.3 million as spending was directed to the most profitable games) and headcount in the social business. The statutory net loss for the period was up by 23% at £8.23 million after £0.9 million of restructuring costs, £4.9 million of (non-cash) amortisation expenses, £0.75 million of finance expenses and a £6.0 million loss from continued operations.

Across the divisions, **Real Money Gaming** saw revenues grow by 5% to £22.7 million with adjusted EBITDA up from £1.26 million to £2.67 million. This was despite a 15% rise in operating costs, including a rise in point of consumption tax. In **Social Gaming**, revenues fell by 13% to £6.9 million. However, after a 45% cut in marketing costs and reduction in headcount from 53 in June 2016 to 19 by the year end, adjusted EBITDA losses were reduced by 97%, from £1.8 million to £57,195 and the business was profitable in the second half.

In **Licensing** revenues grew by 6.7% to £0.84 million but a loss of £0.22 million was posted as initial set up costs were booked in. The now disposed of **Affiliate Marketing** business saw revenues fall from £3.7 million to £1.32 million after several operations were sold, with adjusted EBITDA down from £1.59 million to £0.89 million.

Cash flow and balance sheet

Gaming Realms saw a £1.04 million net cash inflow from operations during the year as the large amortisation costs were added back, along with other significant items including £3.13 million of impairment costs and a £1.17 million rise in trade and other payables. However, net cash decreased by £1.3 million over the year to £1.32 million as £3.2 million was spent on development costs, offset by £1.13 million of proceeds from an equity subscription in August completed at 10p per share.

Net assets totalled £16.2 million at the period end, with the major item being £20.46 million of intangibles. A £3.14 million liability due to RealNetworks as deferred consideration for the Slingo acquisition was removed during the year following a deal with Jackpotjoy (discussed below).

Jackpotjoy deal eliminates balance sheet liability and increases income

One of the most significant developments of 2017 came in December, with the company entering into a 10 year framework services agreement with the Jackpotjoy Group (JPJ), the largest online bingo-led operator in the world, for the supply of various real money services on favoured terms, including Slingo Originals content. As services are requested by the Jackpotjoy Group, the parties will negotiate and enter into relevant call-off contracts.

Further advancing its strategy to build branded sites for third parties, Gaming Realms also entered into a separate agreement for the provision of JackpotHappy.com, a white label site on the Gaming Realms proprietary platform. **With Jackpotjoy having an average 259,861 active customers per month in the 12 months to June 2018, this provides a significant opportunity for Gaming Realms to further grow revenues.**

Secondly, the two companies also entered into an agreement under which Jackpotjoy provided a five year, £3.5 million convertible loan to Gaming Realms, with interest charged at attractive terms of 3 month LIBOR plus 5.5%. The loan will be secured over the company's Slingo assets and business. Following receipt of the proceeds, Gaming Realms paid off the outstanding sum of $4.5 million (£3.14 million) due to RealNetworks Inc. as the final tranche of the Asset Purchase Agreement signed on 10th August 2015 and which was due on 15th December 2017.

Under the other terms of the loan, Jackpotjoy may elect to convert all or part of the principal amount into ordinary Gaming Realms shares at any time after the first year. Such shares will be issued at a discount of 20% to the share price prevailing at the time of conversion. However, if the conversion price is lower than the nominal value of 10p then the shares can be converted at this nominal value and the difference paid in cash. Under this arrangement, the maximum dilution to Gaming Realms shareholders will be approximately 12%, assuming the loan is converted in full.

Recent Trading

Interims

Results for the six months to 30th June 2018 showed a continuation of trends seen during the previous full financial year. Total revenues for the period were down by 27% at £11 million. The main reason for the fall was a 43% decline in revenues from the B2C brands sold post period end to £4.1 million, along with a 48% fall in social gaming revenues to £2.1 million. These were offset by a 28% rise in ongoing real money and licensing revenues to £4.8 million. This came despite a 31% fall in marketing spend in this business, reflecting customer loyalty and game quality.

Licensing revenue increased by 175% to £628,215 in the half, and by 88% in the 9 weeks after the period end. In the nine weeks since the period end revenues excluding the sold brands have risen by 10%.

Despite the revenue fall, adjusted EBITDA before share based payments came in at £0.4 million for the period, compared to a loss of £1.1 million in H1 2017. This came as total marketing costs were cut significantly across the business, from £6.44 million to £2.78 million, and administration expenses fell from £5.47 million to £3.8 million. All divisions were profitable at the adjusted EBITDA level for the half.

After accounting for £2.46 million of amortisation costs and £0.51 million of finance expenses the statutory net loss for the year was £2.62 million, down from £3.76 million. Total cash at the period end stood at £0.43 million, down from £1.32 million, with the balance sheet being strengthened during the period by a £1.85 million payment for the disposal of the affiliate marketing business. **Since the period end, the position has been further enhanced by the £4.2 million initial payment from River UK Casino.**

Operational highlights

In addition to the deals discussed on page 7, in January Slingo Originals content was launched on a number of Ladbrokes Coral gaming sites. These were launched through aggregator platform, Gameiom, with whom Gaming Realms has a third-party distribution contract. Under the deal Gaming Realms will receive a share of the gaming revenues generated by the Slingo games featuring on Ladbrokes Coral gaming sites.

Also in January, a partnership agreement was signed with the Health Lottery, a company owned by media giant Northern & Shell, which has hundreds of thousands of weekly customers both online and in retail. Gaming Realms is an instant game partner to the Health Lottery and has launched 'Health Games', (www.healthgames.co.uk/) a B2C gaming site which will be based on Gaming Realms' proprietary gaming platform. The long-term partnership is based on a revenue share.

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. Following the government's recent decision to reduce the maximum allowed stake on Fixed Odds Terminals in betting shops to £2 from £100, it is expected that Remote Gaming Duty may be raised at the next Budget in November 2018 from 15% (to an expected 20% or higher) in order to make up lost tax revenues.

As noted in the valuation section below, we model for a 20% RGD rate from mid-2019. Should the rate instead be raised to 25% our 2021 adjusted EBITDA forecast, upon which our valuation is based, would fall from £8.49 million to £6.93 million. Combined with the effect on net cash, this would reduce our target price from 14.55p to 13.26p.

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.

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 first half of the current financial year Gaming Realms derived c.21% of revenues from US customers, along with c.3.5% 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 – Non-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, 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 16 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 was previously Finance Director of the bingo division of bwin.party, 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.

Jim Ryan - Non-Executive Director

Jim recently retired as the Co-CEO of bwin.party digital entertainment plc. He has spent the last 14 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

While Gaming Realms' strategy has changed somewhat over the past few years, we believe that the company is now the best position it has been in since IPO in terms of profit growth potential. Management have already shaped the business to be profitable on an EBITDA basis and with the new higher margin focused strategy we expect significant progress over the next three years.

We re-initiate coverage of Gaming Realms with forecasts for the 2018, 2019, 2020 and 2021 financial years.

We begin by forecasting revenues on a divisional basis. Real money gaming revenues are expected to fall from 2018 to 2019 due to the removal of the sold B2C assets from the accounts. In social, activity levels are expected to drop in line with its position as a non-core division, with revenues tailing off to zero in 2021. In contrast, licensing is expected to be the fastest growing division.

Year to December	**2017**	**2018**	**2019**	**2020**	**2021**
Real money gaming	22,727,729	13,878,737	8,492,548	11,110,838	13,842,792
Social publishing	6,878,760	4,000,000	2,500,000	1,500,000	0
Licensing	839,541	2,142,262	5,251,756	7,879,632	9,980,883
Other	179,315	848,601	655,696	709,530	776,325
TOTAL REVENUES	**30,625,345**	**20,869,599**	**16,900,000**	**21,200,000**	**24,600,000**

Divisional revenue forecasts. Source: Align Research

For **2018** we expect total group revenues to fall by around 32% as the disposed of real money gaming business are removed from the accounts. Social publishing revenues are expected to fall due to decreasing activity in the division. However, licensing revenues should grow rapidly as the range of deals recently announced begin to make maiden contributions.

In **2019** and beyond were looking for steady growth in real money gaming as further white label deals start to make a contribution, with licensing continuing to grow quickly as efforts are concentrated in this area of the business. Revenues from social continue to fall, but with an associated fall in costs.

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

Year to December	**2018**	**2019**	**2020**	**2021**
Revenue	20,869,599	16,900,000	21,200,000	24,600,000
Total expenses	-21,177,220	-16,080,000	-17,100,000	-17,100,000
Adjusted EBITDA	**-307,621**	**820,000**	**4,100,000**	**7,500,000**
Total exceptional costs	3,327,598	-21,964	0	0
EBITDA	**3,019,976**	**798,036**	**4,100,000**	**7,500,000**
Amortisation & depreciation	-5,088,006	-5,202,000	-5,306,040	-5,412,161
EBIT	**-2,068,030**	**-4,403,964**	**-1,206,040**	**2,087,839**
Finance expense	-479,779	-209,368	-222,559	-236,580
Finance income	0	0	0	0
PRE-TAX LOSS/PROFIT	**-2,547,809**	**-4,613,332**	**-1,428,599**	**1,851,259**
Tax paid/credit	0	0	0	0
NET LOSS/PROFIT	**-2,547,809**	**-4,613,332**	**-1,428,599**	**1,851,259**
Weighted number of shares	284,428,746	284,428,746	284,428,746	284,428,746
Earnings per share (p)	-0.90	-1.62	-0.50	0.65

We forecast costs at the group level, expecting a rise in gaming duty in line with real money gaming growth, a stabilisation of marketing expenses as white label partners market to their own customer base and a steady rise in admin and operational expenses to support the expanded operations. Remote gaming duty is assumed to be 15% of real money gaming revenues in 2018, rising to a blended rate of 19% in 2019 to account for a forecast mid-year increase to 20%, followed by 20% in 2020 and 2021.

In 2018 Gaming Realms will see a hit to adjusted EBITDA following the removal of the disposed real money gaming operations. **From 2019 the figure should begin to rise sharply as the benefits of the highly profitable licensing deals come through**. We expect the group to show a return to an adjusted EBITDA profit for 2019, amounting to £0.82 million, rising to £4.1 million in 2020 and £7.5 million in 2021.

Our other assumptions include a £4.2 million profit on disposal in 2018 following the sale to River iGaming. Investment in intangibles is forecast at £2.35 million per annum over the forecast period, with a £0.15 million investment in capex, in line with management's recent comments regarding investment in game and platform development. Amortisation is expected at around £5 million per annum, with modest depreciation costs. With substantial unused tax losses and a 0% tax rate in Alderney, we assume no corporation tax is paid.

Balance sheet

Key balance sheet items include the Jackpotjoy convertible loan which is accounted for under non-current liabilities. To simplify the treatment of the loan note we assume it accrues interest at 6.3% per annum (5.5% plus current 3 month LIBOR of 0.8%), with interest payments rolled over and added to the liability. Working capital movements are expected to be in line with total revenue growth. **More significantly, we are looking for total cash (including overdraft) to rise to £2.61 million by the end of 2020, rising to £8.22 million by the end of 2021 (excluding any funds due from River UK Casino).**

Year to December	2018	2019	2020	2021
NON CURRENT ASSETS				
Intangible assets	17,888,190	15,219,790	12,451,022	9,579,879
Equity investments	747,222	747,222	747,222	747,222
Property, plant and equipment	251,042	217,442	180,170	139,153
Other assets	163,865	163,865	163,865	163,865
TOTAL NON CURRENT ASSETS	**19,050,320**	**16,348,320**	**13,542,280**	**10,630,119**
CURRENT ASSETS				
Trade and other receivables	2,561,861	2,074,570	2,602,420	3,019,789
Cash and cash equivalents	3,095,157	238,203	2,611,885	8,223,634
Assets classified as held for sale	0	0	0	0
TOTAL CURRENT ASSETS	**5,657,018**	**2,312,773**	**5,214,305**	**11,243,423**
TOTAL ASSETS	**24,707,338**	**18,661,093**	**18,756,585**	**21,873,542**
CURRENT LIABILITIES				
Trade and other payables	6,316,846	5,115,321	6,416,852	7,445,970
TOTAL CURRENT LIABILITIES	**6,316,846**	**5,115,321**	**6,416,852**	**7,445,970**
NON CURRENT LIABILITIES				
Deferred tax liability	440,756	0	0	0
Other Creditors	3,323,308	3,532,677	3,755,235	3,991,815
Derivative liabilities	600,000	600,000	600,000	600,000
TOTAL NON CURRENT LIABILITIES	**4,364,064**	**4,132,677**	**4,355,235**	**4,591,815**
TOTAL LIABILITIES	**10,680,910**	**9,247,998**	**10,772,088**	**12,037,785**
NET ASSETS	**14,026,428**	**9,413,095**	**7,984,497**	**9,835,756**
EQUITY				
Share capital	28,442,874	28,442,874	28,442,874	28,442,874
Share premium	87,198,410	87,198,410	87,198,410	87,198,410
Merger reserve	-67,673,657	-67,673,657	-67,673,657	-67,673,657
Available for sale reserve	207,222	207,222	207,222	207,222
Foreign exchange reserve	1,614,909	1,614,909	1,614,909	1,614,909
Shares to be issued	145,000	145,000	145,000	145,000
Retained earnings	-36,078,154	-40,691,487	-42,120,085	-40,268,826
Total equity attributable to owners of the parent	**13,856,604**	**9,243,271**	**7,814,673**	**9,665,932**
Non-controlling interest	169,824	169,824	169,824	169,824
TOTAL EQUITY	**14,026,428**	**9,413,095**	**7,984,497**	**9,835,756**

Cash flow

Year to December	2018	2019	2020	2021
CASH FROM OPERATIONS				
Net loss	-2,547,809	-4,613,332	-1,428,599	1,851,259
Add back				
Depreciation	162,027	183,600	187,272	191,017
Amortisation	4,925,980	5,018,400	5,118,768	5,221,143
Finance expense	479,779	209,368	222,559	236,580
Movement in deferred tax	-440,756	-440,756	0	0
Loss on disposal of property, plant and equipment	443,748	0	0	0
Profit on disposal of assets	-4,200,000	0	0	0
(Increase)/decrease in trade and other receivables	1,197,573	487,291	-527,849	-417,369
Increase (decrease) in trade and other payables	-2,952,886	-1,201,525	1,301,531	1,029,118
NET CASH FROM OPERATIONS	**-2,932,345**	**-356,954**	**4,873,682**	**8,111,749**
CASH FROM INVESTING				
Purchases of property, plant and equipment	-150,000	-150,000	-150,000	-150,000
Purchase of intangibles	-2,350,000	-2,350,000	-2,350,000	- 2,350,000
Proceeds from disposal of assets	1,849,133	0	0	0
Proceeds from River UK Casino	4,200,000	0	0	0
NET CASH FROM INVESTING	**3,549,133**	**-2,500,000**	**-2,500,000**	**- 2,500,000**
CASH FROM FINANCING				
NET CASH FROM FINANCING	**0**	**0**	**0**	**0**
CASH INCREASE/(DECREASE)	**616,788**	**-2,856,954**	**2,373,682**	**5,611,749**
OPENING CASH	1,319,098	2,130,953	-726,001	1,647,681
Exchange gains/(losses)	195,067	0	0	0
CLOSING CASH	**2,130,953**	**-726,001**	**1,647,681**	**7,259,430**

Valuation

Shares in Gaming Realms currently trade at a near all-time low of 5.875p, to capitalise the company at just £16.7 million. As an initial reflection of the value on offer here, the current market cap is less than the maximum £18.9 million additional consideration due from River iGaming for the River UK Casino deal should all profit targets be met. **That means, should the maximum consideration be paid, the market is effectively valuing the company's residual 30% stake in River UK Casino and the remaining Gaming Realms business at less than nothing.**

Valuation matrix

	2018	2019	2020	2021
Price to sales	0.80	0.99	0.79	0.68
EV/EBITDA	N/A	26	4.73	1.87
PE	N/A	N/A	N/A	9.0
Price to free cash flow	N/A	N/A	7.04	2.98

The table above shows a selection of current valuation metrics for Gaming Realms. Given the high non-cash charges we prefer to focus on the EV/EBITDA and price to free cash flow measures. Note that in this valuation section we treat the Jackpotjoy convertible loan as debt given the uncertainty over the eventual conversion price should the note be converted.

If Gaming Realms meets our forecasts the shares will trade on a very low EV/EBITDA multiple of 4.73 times for 2020, falling to 1.87 times in 2021. Demonstrating the cash generative potential when the business gets to a certain scale, the price to free cash flow multiple for 2021 is just under 3 times, with free cash flow defined as net operating cash flow less investment in intangible assets and capex. **In other words, the free cash flow yield for 2021 is c.33%.**

Peer analysis

While we identify 15 companies in the UK listed Gambling sub-sector, we consider the closest peer by size and operations to be AIM listed **Stride Gaming (STR),** the multi-branded online soft gaming operator, which runs both real money and social games. While **Nektan (NKTN),** the international B2B and white label gaming software and services provider, also has similarities to Gaming Realms, we do not consider the company in this analysis it has been historically loss making. Based on management forecasts for adjusted EBITDA of £16 million for the year to 31st August 2018, and net cash of £22.4 million as at 28th February 2018, **Stride Gaming currently trades on a historic EV/EBITDA multiple of just 3.2 times.**

We should point out that the valuation has fallen from 11.24 times at the time of our initiation note, with Stride shares having lost just over half their value over the past year. This was in reaction to a flat profit performance at the interim stage, concerns over the expected rise in remote gaming duty and an announcement that a subsidiary of the company received notice from the Gambling Commission regarding the imposition of a "significant financial penalty" over compliance failures. A £4 million provision has been set aside for the penalty and the final decision is expected by the end of the year.

We consider Stride Gaming's valuation to be artificially low due to the penalty uncertainty, and believe that an EV/EBITDA multiple of 5 times our 2021 forecasts for Gaming Realms to be both conservative & appropriate. This would equate to a market cap for Gaming Realms of £40.19 million, or 14.1p per share.

32Red deal shows blue-sky potential

As discussed in our initiation note, in February 2017 **32Red (TTR)**, the AIM listed online casino focused gaming operator, was 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 15.67 times. **Applying the same multiple to our 2021 numbers for Gaming Realms would imply a takeout price of £120.2 million, or 42.26p per share excluding the earn-out consideration.**

While this is very much a blue-sky scenario, we note that if our 2021 numbers are delivered Gaming Realms will not be far off the position 32Red was in at the time of its acquisition in terms of profits - as per the table below

Value	TTR 2016A (£m)	GMR 2021E (£m)
EBITDA	10.56	7.50
Net Cash	10.12	2.69
M. Cap/Takeout Price	175.6	120.2
Multiple	15.67	15.67

TTR 2016 vs GMR 2021: Source Company accounts & Align Research

Conclusion

We use a sum-of-the-parts approach to set an end 2018 target price for Gaming Realms:

- Peer based valuation – as per, what we believe to be, an artificially depressed price for Stride Gaming at this point we discount the implied end-2021 price of 17.5p back to end 2018 at a discount rate of 12% = **10.06p per share.**

- **Earn-out consideration** – we conservatively assume only half of the remaining maximum £18.9 million consideration is received from River iGaming at the end of August 2019. Therefore, £9.45 million discounted back at 12% to end-2018 = £8.75 million or an additional **3.08p per share**.

- **Remaining River UK Casino stake** - the balance 30% holding in River Casino can be bought by River iGaming after 31st October 2020 based on a value that is 5.5 times June 2020's EBIT. Assuming EBIT of £3 million for that year (half the £6 million figure needed to deliver the maximum earn-out in 2019) this equates to £16.5 million. Multiplied by the 30% GMR interest = £4.95 million and discounted back from end-October 2020 at 12% = £4.02 million or an additional **1.41p per share.**

Our sum-of-the-parts valuation is therefore 14.55p per share, implying 148% upside from the current price of 5.875p. However, we again point out the conservative assumptions for each step of this derived valuation as detailed above and as such we believe that there could be significant further upside potential.

It is clear from our forecasts that Gaming Realms shares look very cheap on a number of metrics should those forecasts be met. Therefore execution risk is a major factor to consider. Assuming management deliver on expectations over time, we would expect a significant re-rating in the shares from the current woeful valuation.

We re-initiate coverage of Gaming Realms with a target price of 14.55p and Conviction Buy stance.

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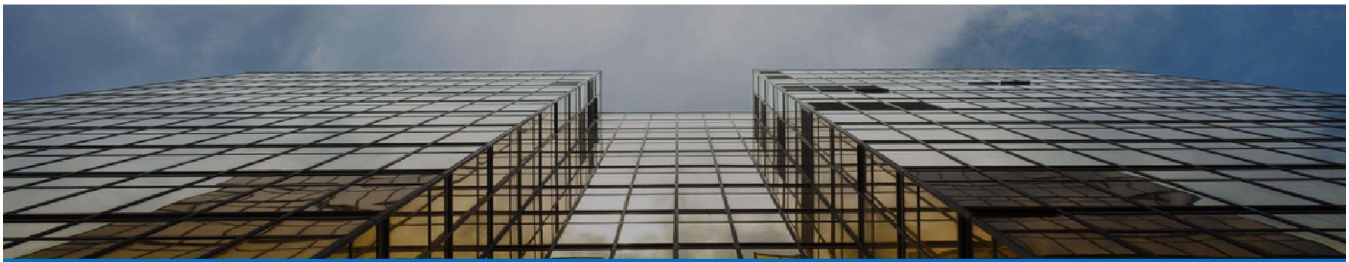

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