ALIGN
RESEARCH

Gaming Realms

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Licensing led strategy delivering strong growth – shares remain significantly undervalued

Gaming Realms is a creator and licensor of innovative games for mobile, with operations in the UK, U.S. and Canada. Through its unique IP and brands, Gaming Realms brings together media, entertainment and gaming assets in new game formats.

Focus on high margin licensing operations

Following the disposal of its remaining real money gaming (RMG) operations in July 2019 Gaming Realms is now focusing on becoming a leading licensor of games to the global gaming industry. The licensing division focusses on IP brand and content licensing to partners, with the "Slingo Originals" games library being its flagship content. High margins are earned due to there being relatively few direct sales costs associated with such deals in the long-term.

Interims show triple digit growth in licensing revenues

Results for the six months to June 2019 revealed the first set of figures since the RMG business disposal. Numbers for the period showed total group revenues from the continuing operations (excluding real money gaming and affiliates) rising by 18% to £3.2 million. Justifying the decision to focus on Licensing, revenues from this segment soared by 167% to £1.6 million. With new content going live with a number of new partners late in 2019 and into this year, 2020 is expected to see further significant growth

Peer derived valuation suggests upside of 269%

Applying a discounted peer derived multiple to our 2022 forecasts implies an equity valuation of £90.51 million. Discounted back to the end of 2020 at a rate of 12% derives a value of £72.15 million, or a price per share of 25.37p. This implies upside of 269% from the current price of 6.875p. **We update coverage of Gaming Realms with a stance of Conviction Buy.**

Table: Financial overview. Source: Align Research

Year to end Dec	2020E	2021E	2022E
Revenues (£m)	9.69	12.39	14.42
Adjusted EBITDA (£m)	1.49	3.31	5.02
Pre-tax profit (£m)	(2.09)	(0.47)	1.39

** including gain on disposal*

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CONVICTION BUY – PRICE TARGET 25.37p

GAMING REALMS
PLAYING A NEW GAME

Key data

EPIC	GMR
Share price	6.875p
52 week high/low	10.75p/4.05p
Listing	AIM
Shares in issue	284,428,747
Market Cap	£19.55m
Sector	Travel & Leisure

12 month share price chart

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Operations

Following the disposal of its remaining real money gaming (RMG) operations in July 2019 Gaming Realms is now focused on becoming a leading supplier of games to the global gaming industry by following a licensing led strategy. The current operators are as follows:

Licensing/Content Development

The licensing division, established in 2017, focusses on IP brand and content licensing to partners in the US and Europe across a range of gaming sub-sectors including online, lotteries, physical slot machines, social, scratch cards and others. The company has developed a Remote Game Server which allows its flagship "Slingo Originals" games library (www.slingooriginals.com) to be licensed to third party operators as premium content. There are currently over 30 games hosted on the server.

Slingo, a portmanteau of slots and bingo, is a popular online game with a 20 year history which was acquired by Gaming Realms in 2015. The game sees a five reel slot machine display numbers which are then matched to a traditional bingo card. This makes it a quick and fun way of playing, which is well suited to the mobile format due to its speed. The company has ambitions to develop Slingo into a games category in its own right, alongside more established gaming categories such as slots, casino, poker etc.

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 business model sees the company distribute its games by integrating into third party aggregators, typically earning a revenue share, while retaining the IP and avoiding the risks associated with directly operating in the gaming market. **High margins are earned 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.**

A detailed list of branding, distribution and licensing deals signed over recent years can be found in our previous notes. However, relevant for growth in 2020 we highlight the deals with Scientific Games and Relax Gaming, signed in 2019, which will make a full contribution to the numbers this year.

The deal with Scientific Games is a 3-year agreement signed in May 2019 which will see the distribution of the Slingo Originals portfolio via SG Digital's opening gaming system platform. All Slingo games will be distributed to over 200 operators globally via SG Digital's platform, one of the industry's largest content aggregation platforms.

Signed in June 2019 is another a 3-year agreement with Relax Gaming. Gaming Realms will receive a share of the revenue generated from gaming operators adopting its Slingo games via Relax Gaming's distribution platform, which provides access to over 350+ casino brands and has notable access to the Nordic markets.

Social Gaming

This now non-core division 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. With the social business making only modest revenues (via advertising and in game purchases) and requiring high marketing spend to develop it is considered non-core by the company.

Financials & Recent Trading

Interims show triple digit growth in licensing revenues

Results for the six months to June 2019 revealed the first set of figures since the RMG business disposal. Numbers for the period show total group revenues from the continuing operations (excluding real money gaming and affiliates) rising by 18% to £3.2 million. Justifying the decision to focus on Licensing, revenues from this segment soared by 167% to £1.6 million, with the Social operations seeing an expected 29% fall in revenues to £1.5 million.

The adjusted EBITDA loss for the continuing operations reduced to just £6,280 against a loss of £441,133 for the first half of 2018. Including the discontinued Real Money Gaming operations the EBITDA loss was £0.9 million, again justifying the decision to dispose of this business.

Growth in the Licensing business during the period was driven by increased distribution of games across partner sites and an expanded games portfolio. The company saw the 13 partners that went live through 2018 contribute to growth and also went live with tier 1 operator William Hill. It also released four new games into the market and signed worldwide distribution deals with Relax Gaming and Scientific Games.

The Licensing division delivered an adjusted EBITDA profit of £0.723 million for the half for a margin of 44%, a figure we expect to rise as further deals go live with partners and economies of scale are realised. The Licensing division is expected to become cashflow positive by the end of 2020, with the non-core Social business said to be in the latter stages of being rationalised.

On the balance sheet, cash at the period end was £0.28 million but as at the date of the results (26th September) the cash position was said to be c.£4 million. This was following completion of the RMG deal and receipt of funds, settlement of certain liabilities connected to the B2C RMG assets and deal expenses, and further investment in operations.

Following the period end the completion of the RMG disposal allowed Gaming Realms to reduce headcount by 45 and reduce annual costs by £2 million. The Licensing business continued to grow very strongly, with revenues said to have grown by 88% in the 9 weeks since the period end. Also following the period end the company went live with 3 new operators, taking the total to 37, including News International and Betsson which could add up to a further 33 new sites, covering UK and Nordics. Three new games have been released, including Monopoly Slingo, with more releases scheduled for the remainder of the year.

In early October, Gaming Realms launched with another operator, Kindred Group, one of Europe's largest online gambling operators. Kindred has launched Gaming Realms' Slingo Originals content across all 11 Kindred brands including 32Red, Unibet, Maria Casino and Bingo.com, which serve 25 million customers worldwide.

Positive 2019 trading update

Following on from the interims, on 11th February this year Gaming Realms announced a positive trading update covering the full 2019 financial year. The headline news was that revenues for the full year are now expected to be modestly ahead of prior expectations. This was mainly driven by an ongoing good performance in the content licensing business, which added eight new licensing agreements during the year. Combined with a continuing control of costs, the adjusted EBITDA loss for 2019 is expected to be c.£0.5 million.

Into 2020 and the positive momentum is said to have continued, with the company launching its content on the sites of Leo Vegas, the Swedish mobile gaming company, and Buzz Bingo, the online site of one of the UK's largest owners of land-based bingo halls (previously branded as Gala Bingo). In addition, new game "Slingo Centurion" has been launched in partnership with Inspired Entertainment, the global games technology company and developer of the popular "Centurion" game.

Management changes

In other matters, the February trading statement revealed that CEO Patrick Southon had stepped down with immediate effect. The reason given was that Southon is seeking new challenges following the disposal of the B2C real money gaming assets and successful implementation of the B2B focused game development and licensing strategy

As a result, Non-Executive Chairman, Michael Buckley, has become Executive Chairman until a replacement CEO is found, supported by CFO Mark Segal. A replacement CEO is now being sought and a further announcement will be made once they have been appointed. Following the update Michael Buckley bought 250,000 shares in the company at a price of 8p each (£20,000 total) to take his stake in Gaming Realms to 9.58%.

Also joining the board since our last update is Mark Blandford as a Non-Executive Director. Starting in his position in October, Blandford is the founder of Sportingbet.com, the online betting site which listed on AIM in 2001. He stepped down from the Board of Sportingbet in 2007 before its eventual sale in 2013 for £485million. In 2002, he was awarded AIM Entrepreneur of the Year. Since joining he has purchased further shares in the market to take his stake to 3.5%. Also in October, Gaming Realms founder Simon Collins stepped down from his role as a Non-Executive Director.

Forecasts & Valuation

Shares in Gaming Realms have performed well over the past 12 months as investors reacted positively to the changes to the business model and the subsequent positive updates. The shares rose from a floor of just over 4p seen in early 2019 before peaking at 10.75p in early January this year following the post December election rally. However, they have since come back down to 6.875p, a situation we put down to nothing more than the wider market fall caused by coronavirus fears.

With costs reduced significantly following the RMG transaction close and the licensing model having very high margins, we believe that Gaming Realms looks well placed to grow profits significantly in the coming years, especially with the distribution deals with Relax Gaming and Scientific Games providing the opportunity for a marked acceleration of growth this year and beyond.

We have made modest amendments to our forecasts for 2020 – 2022 following our last update, with revenues for the forecast period now expected to be higher as we model for the Social business being retained, although we do note that management continue to seek options for its rationalisation.

For valuation purposes, we retain EBITDA as the most appropriate measure of performance as Gaming Realms' has high non-cash charges associated with amortisation and interest. In 2020 we are looking for a maiden annual EBITDA at the group level of just under £1.5 million. In 2021, as licensing revenues rise and the operational gearing kicks in, this rises to £3.3 million and £5 million in 2022.

Peer derived multiple

To illustrate what kind of valuation Gaming Realms should command if it meets our forecasts then we look to several globally listed games licensing/development companies which provide similar services. Given the higher growth profile of the licensing sector compared to gambling, the sector to which Gaming Realms used to belong, companies can command much higher valuations.

	Market Cap (£m)	Net cash/(debt) (£m)	Historic EBITDA (£m)	EV/EBITDA
NetEnt	522	-188.0	67.0	10.6
Evolution Gaming	5,680	150.2	150	36.9
Activision Blizzard	36,580	2,377	1,718	19.9
Electronic Arts	23,699	4,275	943	20.6
Codemasters	474	24.6	18.7	24.0
			AVERAGE	**22.4**

From our analysis we see that our chosen peers currently trade on an average EV/EBITDA multiple of 22.4 times. Given that Gaming Realms remains in the early stages of its new strategy, and considering a small cap discount, we reduce the multiple by 20% to a figure of 17.9 times. Applying this multiple to our 2022 forecasts for Gaming Realms implies an equity valuation of £90.51 million. **Discounted back to the end of 2020 at a rate of 12% derives a value of £72.15 million, or a price per share of 25.37p. This implies upside of 269% from the current price of 6.875p.**

Conclusion

It is clear from our forecasts that Gaming Realms shares look very cheap should our forecasts be met. Therefore, execution risk remains the principal factor for investors to consider.

One other risk that investors should be aware of in the medium-term is that the company's £3.5 million convertible loan from Jackpotjoy will be due for repayment in December 2022. Under the 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. However, the company may need to pay back the borrowings in cash. In our assumptions, we continue to treat the Jackpotjoy convertible loan as debt given the uncertainty over the eventual conversion price should the note be converted.

Regardless, we point out that our current forecasts could be considered conservative as we assume no further significant distribution deals, in addition to those already announced, are signed over the forecast period. Assuming management continue to deliver on expectations over time, we would expect a further significant re-rating in the shares from current levels. **We update coverage of Gaming Realms with an end 2020 fair value target price of 25.37p and Conviction Buy stance.**

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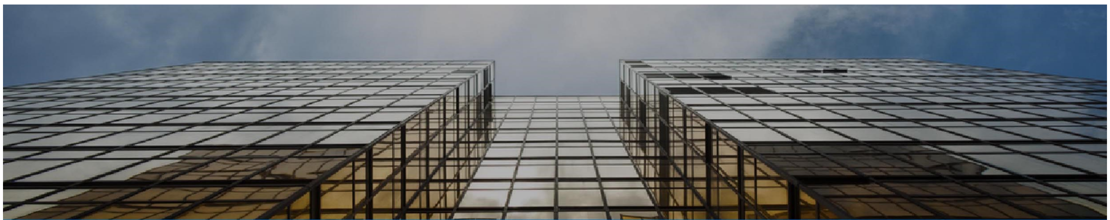

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