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RESEARCH

Gaming Realms

6th October 2020

Interims ahead of expectations and further strong growth expected in H2 2020 and beyond. Forecasts and target price updated.

Gaming Realms is a creator and licensor of innovative games for mobile, with operations in the UK, U.S. and Canada. Flagship brand Slingo® is a highly popular and unique game genre which combines elements of slot, bingo and table gameplay. These games are licensed by some of the biggest online gaming operators in the world, including DraftKings, Sky Betting & Gaming and GVC, and distributed directly to operators or via global partners such as Scientific Games & Relax Gaming using the company's proprietary Remote Game Server platform.

Interims show revenue growth of 66% and a substantial EBITDA profit

Results for the six months to 30th June 2020 showed revenues up by 66% to £5.2 million. The company benefitted from the effects of the COVID-19 inspired lockdown, along with growth from partners signed up over the past 12 months. Adjusted EBITDA went from a loss of £0.1 million in H1 2019 to a profit of £1.24 million, demonstrating the company's strong operational leverage.

Licensing drives growth, with Social Publishing also on the up

The numbers were again driven by the core Licensing division, with revenues up by 104% to £3.4 million due to an increase in distribution and an expanded games portfolio. The Social Publishing division, previously considered as non-core, put in a good performance by growing revenues by 29% to £1.8 million. Strong growth has continued since the period end, with Licensing revenues up by 140% in July and August and Social revenues up by 56%,

U.S. offers further growth opportunities as states regulate gambling

In H1, 56% of sales came from the U.S., with the market expected to grow at a compound rate of 17% from 2020 to 2025, rising to a value of $6.1 billion by 2025. In New Jersey, where the company already has an operating licence, revenues grew by 94.7% year-on-year. Subject to regulatory approvals, Gaming Realms expects to be licensing its games in Pennsylvania by the start of 2021 followed by Michigan and further states thereafter as and when they regulate.

Peer derived multiple gives a target price 67% ahead of current levels

Our chosen peers trade on an average historic EV/EBITDA multiple of 30.8 times. Adding a small cap discount of 20% and applying this multiple to our 2022 forecasts implies an equity valuation of £141.4 million for Gaming Realms. **Discounted back to the end of 2020 at a rate of 12% derives a price per share of 39.4p, implying upside of 67% from the current price. We update coverage and retain our stance of Conviction Buy.**

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CONVICTION BUY

Price target – 39.4p

GAMING REALMS
PLAYING A NEW GAME

Key data

EPIC	GMR
Share price	23.6p
52 week high/low	24p/4.45p
Listing	AIM
Shares in issue	285,967,207
Market Cap	£67.1m
Sector	Travel & Leisure

12 month share price chart

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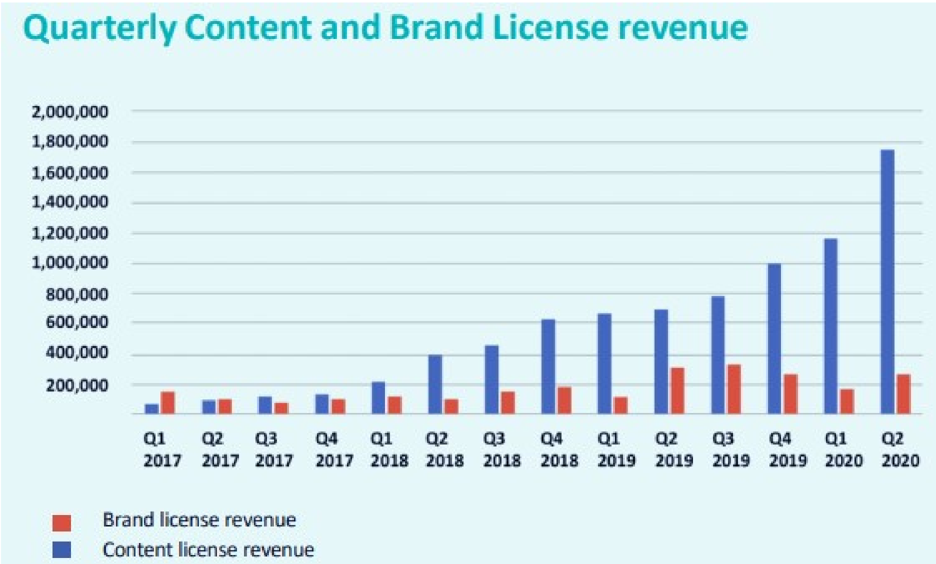
Interims

On 8th September 2020 Gaming Realms announced its results for the six months to 30th June 2020. These were the first set of interim numbers following the sale of the company's remaining real money gaming (RMG) operations in July 2019. They also came on the back of two positive trading updates, released in early June and mid-August, both of which confirmed that trading was ahead of market expectations for the full year.

P&L

At the top line, revenues grew by 66% to £5.2 million in the period. As flagged in the company's August trading update, revenue growth benefitted from the effects of the COVID-19 inspired lockdown, as players spent more time indoors in front of their screens. Encouragingly, similar levels of growth are said to have been maintained post period-end, a time when most of the harshest lockdown restrictions were relaxed around the world. As discussed further below, this is a trend being seen elsewhere in the online gaming industry as consumers shift their offline habits online.

Again, the numbers were driven by an excellent performance from the core **Licensing** division, which grew revenues by 104% to £3.4 million due to an increase in distribution and an expanded games portfolio. Of this growth, £0.8 million came from existing partners, benefitting from the 14 partners that went live through 2019. Remaining growth of £0.9 million came from partner integrations that went live after 30th June 2019. Adjusted EBITDA soared from £0.73 million to £1.73, million for a margin of 42%. According to the company's interim results presentation, the Content Licensing segment has now seen quarterly compound revenue growth of 26% since Q1 2018, further justifying last year's strategic decision to focus on this fast growing division.



Source: Company

Meanwhile, the **Social Publishing** division, previously considered as non-core, put in a good performance by growing revenues by 29% to £1.8 million. This was due to an increase in new Slingo content being produced and also improved player management and new player engagement features. The division delivered an impressive adjusted EBITDA of £0.8 million, up from £0.4 million in H1 2020, despite marketing spend being reduced to a negligible £30,000 from £100,000.

At the group level, adjusted EBITDA went from a loss of £0.1 million in H1 2019 to a profit of £1.24 million. This demonstrates the company's strong operational leverage, with combined operating and admin expenses rising by only 15% to just over £4 million. The statutory net loss for the year from continuing operations was reduced from £2.4 million to £0.63 million, largely due to the higher profits but also due to lower non-cash amortisation and finance charges.

Balance sheet and cash flow

Gaming Realms ended the period with cash of £0.85 million but as at 31st August this had increased to £1.9 million following a reversal of working capital outflow seen in the first half. The major liability remains the company's convertible loan due to Gamesys Group (previously Jackpotjoy) in December 2022, which is on the balance sheet at just under £3.5 million.

The net cash flow performance for the period was affected by the working capital outflows mentioned above, with the H1 2019 net operating outflow of £0.35 million rising to £0.55 million. Offsetting the lower losses, trade receivables rose by £1.15 million, compared to a fall of £1.32 million in H1 2019, but this is understandable given the large rise in revenues. Trade payables fell by £0.29 million and within investing activities Gaming Realms capitalised £1.1 million of development costs. Overall, the total cash outflow for the half was £1.86 million, up from £1.82 million.

Despite the outflow seen in H1, Gaming Realms expects that FY2020 as a whole will be cash flow positive as a result of high margin growth offsetting development costs, with deferred consideration of £1.5 million also due by the year end from the sale of the B2C real money gaming assets.

Operational highlights

Growth in the period was driven by the further expansion of the company's international distribution partners and the release of new Slingo games, which are said to have had increased take up by consumers. During the period Gaming Realms went live with five tier-1 operators: Gamesys, Sky Betting & Gaming, 888 Casino in the UK, DraftKings in New Jersey and Caliente in Mexico, securing a wider distribution base for its games. It also released four new games into the market, including Slingo Centurion in partnership with Inspired Entertainment, with the portfolio containing 40 games at the period end.

Post period end trading and outlook

Strong growth has continued since the period end, with Licensing revenues up by 140% in July and August and Social revenues up by 56%, with growth rates in both divisions being materially higher than in the first half. Overall, the company is currently performing in line with market expectations and at this point in time expects to meet (the recently increased) market forecasts for the full year.

Also in the second half the company has; gone live with three further new operators, Jumpman Gaming, White Hat Gaming and MrQ; signed a distribution deal with major European games distributor Oryx Gaming; and agreed a direct integration and expanded deal in U.S. with Rush Street Interactive (RSI). A number of new commercial developments are said to be in the pipeline. Two new Slingo games have also been released, Slingo Xing Yun Xian and Slingo Advance (below), with additional new content expected to be released in H2.

Slingo Advance - a retro computer-style game that transports you to outer space. Source: Company

International Expansion Opportunities

Alongside its strategy to add new distributers, operators and IP licensees, together with expanding its games portfolio, Gaming Realms is now making a concerted effort to expand internationally. According to the company, the international online casino market has grown at a compound rate of 11% over the last five years and today is worth $17.2 billion. From the interim results we note in particular the excellent performance being seen in the fast growing U.S. markets, which are steadily being opened up to regulated online gambling activities.

Gambling laws are complex in the U.S. But to summarise, each state is free to regulate (or prohibit) individual types of gambling (sports, casino, poker etc.) and whether they can be carried out online or not. New Jersey in particular has been a pioneer of liberalising online gambling regulations, with online casinos opening for business in the state in 2013. Several other states have now legalised online casino gambling, including Delaware, Pennsylvania, West Virginia and Michigan. In contrast, Hawaii and Utah permit no form of gambling whatsoever, but the U.S. market as a whole is seeing more states opening up to legalised online gambling activities.

Driving the expansion is the attractive tax receipts that online gambling can generate. This major benefit was highlighted during the recent pandemic lockdown in the U.S. In Pennsylvania for example, land based casinos brought in no tax dollars in April and May as they were forced to close. In contrast, May saw $23.25 million of taxes collected from online casinos, up from just $8 million in March, pre-lockdown (*Source: https://www.playpennsylvania.com/revenue/*).

Gaming Realms generated 56% of its sales from the U.S. in the first half of this year and flagged that the market is expected to grow at a compound rate of 17% from 2020 to 2025, rising to a value of $6.1 billion by 2025. In New Jersey, where the company already has an operating licence, revenues grew by 94.7% year-on-year, with market share maintained at 3.5% of total gross gaming revenues. Subject to regulatory approvals, Gaming Realms expects to be licensing its games in Pennsylvania by the start of 2021 (after it filed for a game content supplier licence during the first half), followed by Michigan and further states thereafter as and when they regulate.

Driving the company’s growth in the U.S. will be the recently expanded deal with Rush Street Interactive (RSI), an online casino and sports betting specialist which recently announced it intends to list on the New York Stock Exchange via a merger with shell company dMY Technology Group. The new deal sees the Slingo Originals portfolio extended from its current distribution in New Jersey to add the Pennsylvania market, which is RSI’s largest territory. Also, the Slingo Originals content will now be directly integrated into RSI's platform, thus eliminating the need for a distribution partner and enhancing margins.

Rush is another big player to add to Gaming Realm’s portfolio of partners, with Rush’s recent IPO investor presentation showing it is the market leader in online casino in the U.S., having a 16.7% market share in May 2020. Encouragingly for Gaming Realms, the presentation further suggested that the types of online casino games which it offers are “pandemic resistant”, with RSI seeing online casino revenues grow from $12.2 million in March to $18.6 million in April and to $23.4 million in May, before slipping back to $21.7 million in June as real world restrictions eased. Meanwhile, NetEnt recently reported gross gaming revenue growth in New Jersey at 148% Y/Y and in Pennsylvania at +100% Q/Q for its quarter to June.

Elsewhere, the three-year licensing and distribution agreement with Oryx Gaming gives Oryx access to the entire Slingo Originals portfolio which will be distributed via the Ory x Hub platform. As part of the agreement, Oryx will also be able to license the Slingo content to over 100 operators worldwide, through existing partnerships.

Forecasts & Valuation Update

Following the recent positive trading updates and interim results, shares in Gaming Realms reached a near 5 year high of 24p at the start of September. They have since slipped back to 23.6p but are still well above lows of 4.45p seen in March this year at the nadir of the coronavirus inspired sell off.

We last issued forecasts on the company in March this year, at the time looking for maiden annual EBITDA at the group level of just under £1.5 million for FY 2020. But with over 80% of this already achieved in the first half we are now updating our numbers having worked with management and considered other company and industry data. 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.

For FY2020 we are looking for c.80% growth in overall licensing revenues, with 27% growth in Social, leading to total revenues of just under £11 million. After total costs of c.£8.5 million we are conservatively looking for adjusted EBITDA of £2.47 million. For FY2021 and FY2022 we, again conservatively, assume respective 35% and 20% revenue growth in Licensing and flat growth of 5% in Social. That leads to total revenues rising to £13.8 million in 2021 and to £16 million in 2022. Our adjusted EBITDA forecasts for the two years are £4 million, rising to £5.8 million.

Peer derived valuation multiple

To illustrate what kind of valuation Gaming Realms should command if it meets our forecasts then we again 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 before the disposal of its B2C assets, companies can command much higher valuations.

All five companies in our peer group have significantly increased in value since our last update note, benefitting from growth in the U.S. along with consumers shifting their gambling habits online due to global COVID-19 restrictions. We also note, reflecting the high corporate activity in the sector, that in June the live-casino software provider Evolution Gaming made an all-share offer to acquire rival NetEnt at a valuation of c.£1.7 billion, with the deal recommended by NetEnt and expected to complete in October. Accelerating its presence in the fast growing U.S. markets was given by Evolution as one of the reasons behind the deal.

	Market Cap (£m)	Net cash (£m)	Historic EBITDA (£m)	EV/EBITDA
NetEnt	1,819	-188.1	75.1	26.7
Evolution Gaming	10,503	192.3	165.9	62.2
Activision Blizzard	47,077	2,810	1,730	25.6
Electronic Arts	28,750	3,816	2,334	10.7
Codemasters	549	24.8	18.2	28.8
			AVERAGE	**30.8**

Gaming Realms peer analysis – share prices and exchange rates as at close on 5th October 2020. Data sources: Sharepad, xe.com and individual company accounts

From our analysis we see that our chosen peers currently trade on an average historic EV/EBITDA multiple of 30.8 times, up from 22.4 times at the time of our last note in March. Given that Gaming Realms remains in the relatively early stages of its new licensing focused strategy, and considering its size, we apply a small cap discount of 20% to the multiple, giving a figure of 24.6 times. Applying this multiple to our 2022 forecasts for Gaming Realms, and using current net debt figures, implies an equity valuation of £141.4 million. **Discounted back to the end of 2020 at a rate of 12% derives a value of £112.74 million, or a price per share of 39.4p. We set this as our new target price, implying upside of 67% from the current price of 23.7p.**

Conclusion

Gaming Realms is now showing that its content licensing focused strategy is consistently delivering strong growth and high margins. We have also seen the Social publishing division growing revenues at a steady rate and maintaining high margins, an added bonus giving that the company previously considered this business non-core and was looking at divesting it. With the shares having risen fivefold since their recent March lows, the markets are now starting to realise the company's potential. However, combined with a relatively stable fixed cost based and a steady stream of new partnership deals coming through, we believe Gaming Realms is well positioned to continue strong growth throughout the rest of 2020 and beyond.

Again, investors have to consider that the £3.5 million convertible loan due to Gamesys Group will be due for repayment in December 2022. Under the terms of the loan, Gamesys may elect to convert all or part of the principal amount into ordinary Gaming Realms shares at any time after the first year at a discount of 20% to the share price prevailing at the time of conversion. However, Gaming Realms may need to pay back part of the borrowings in cash if the price per share at conversion is lower than the nominal value of 10p, with the cash payment equal to the shortfall on the nominal value payable. But with the shares currently trading well above the nominal value a cash payment is looking increasingly unlikely. The maximum dilution to shareholders under the loan terms will be c.11% assuming the loan is converted in full, which would effectively reduce our target price to 35p, still 48% above the current share price.

We point out that our current forecasts could be considered conservative given that our revenue growth assumptions are well behind those delivered in H1 2020. Assuming management continue to deliver on expectations over time, we would expect the shares to move closer to our target price. Speculating somewhat, given the growth being seen in the U.S. markets, and considering high levels of corporate activity being seen, we believe Gaming Realms could be on the radar as a potential target for a larger player looking to expand its games portfolio and improve margins. Alternatively, a move to the NASDAQ market, as recently undertaken by former AIM listed and U.S. focused gambling software developer GAN (GAN), could see a higher valuation being awarded.

We update coverage of Gaming Realms with an end 2020 fair value target price of 39.4p and Conviction Buy stance.

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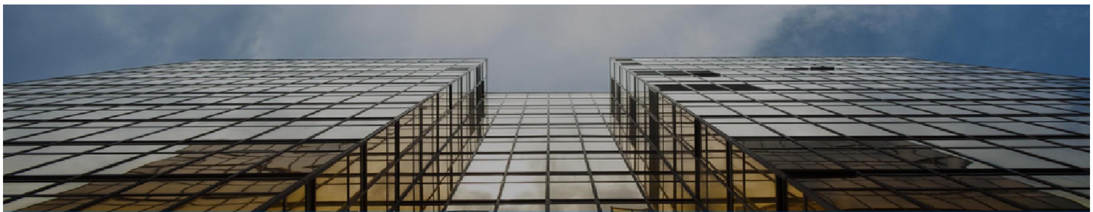

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