
EQUITY RESEARCH REPORT

# LEOVEGAS (LEO)

"The lion is ready to reap the benefits of regulation"

**ANALYSTS:** FILIP ROOS & ROBIN SARDELLA

2018-11-19

# RATING

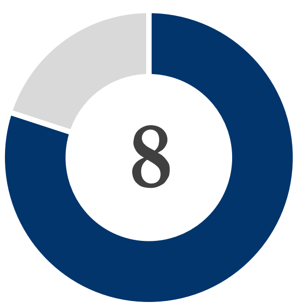
## TABLE OF CONTENTS



## COMPANY DESCRIPTION

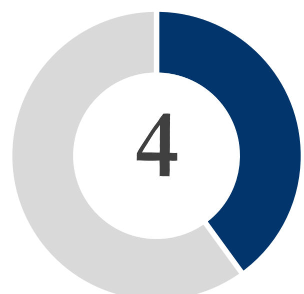
LeoVegas is an online (and mobile) casino currently operating in the Nordics and the UK. They mainly lease games from gambling suppliers like NetEnt and Evolution Gaming. Through LeoVentures they have recently started to compete with gambling suppliers through their ownership of Authentic gaming (Live casino supplier). However, being a gambling operator is their main revenue source. Today LeoVegas is a more mature company and continues to grow faster than the industry, mainly due to acquisitions and a successful marketing strategy.

## VALUE DRIVERS



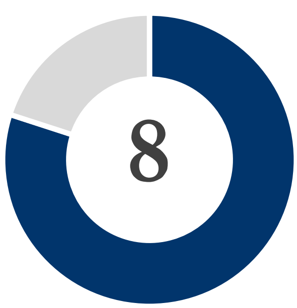

LeoVegas is increasing their profitability by decreasing customer acquisition costs (CAC) and increasing customer value. Last quarter CAC amounted to €199 (€233) while the average customer lifetime value (CLV) amounted to €244 (€267). Although CLV decreased YoY, the long term profitability trend remains strong as costs divided by lifetime value (CLV/CAC) increased to 22% (15%).

## FINANCIAL HISTORY



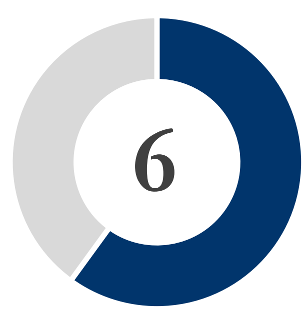

From 2012 to 2016, LeoVegas doubled their revenue YoY. Focus has primarily been on topline growth. In 2015 the EBITDA was negative when marketing cost represented 54% of revenue. Since then the marketing cost has been stable around 43% of their revenue. Debt/EBITDA amounts to 1,19, which compared to peers (0.7-1.4) is about average.

## MANAGEMENT




LeoVegas' founder and CEO Gustaf Hagman have experience as CEO from industry peers like Net Gaming and Eurobet Nordic. He has a solid background in the iGambling industry. Gustaf owns 8% of the stocks in LeoVegas which represents a value of 40 mEUR. Total insider ownership is 10%.

## RISK PROFILE




The iGambling (online gambling) industry is subject to regulatory risks. Governments have incentives to regulate the market in order to put on a gambling tax. The Swedish gambling market is being regulated 1 January 2019. This poses uncertainty to the whole industry.

# LEOVEGAS (LEO)

**LeoVegas** grows through acquiring new depositing customers with the tool of efficient marketing. The underlying market is growing at a 19 % CAGR and LeoVegas's customers are increasing in profitability. Sweden and the UK are showing recent changes in tax-rates, however, regulations shows both risks and opportunities. A base case indicates a 55 SEK share price based on a 12,5 EBITDA-margin 2020E

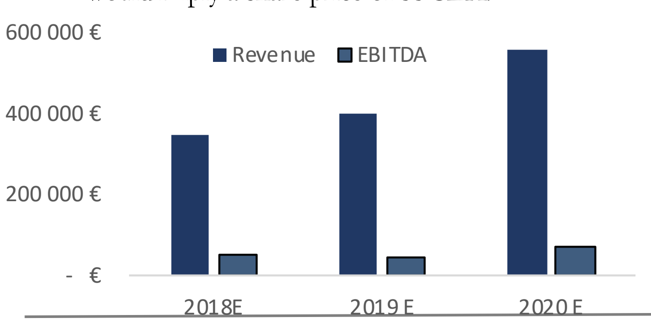
- **Mobile gambling is expected to grow 19 % CAGR 2018-2022.** LeoVegas had 68 % of customer depositions from mobile platforms (2017). Since it's LeoVegas ambition to increase their share of mobile revenue, their strategy are positioned towards the most lucrative part of the gambling market.

- **LeoVegas has a high number of Returning Depositing Customers (RDC).** With a sequential growth of 15% QoQ (75% YoY) LeoVegas are trying to achieve a loyal and sustainable customer base. There remains disputes among investors whether online gambling operators are able to retain customers. With a solid growth of RDC, LeoVegas has shown ability to achieve the contrary. This is a sign of quality.

- **Customer lifetime value (CLV) has a positive upward trend ranging from €220 to €280 implying 27% growth in two years**, although Q3 showed a decrease to €244. In addition to this, reduction in customer acquisitions costs (CAC) are decreasing from €285 to €199 LTM, a decrease of 30%. As this trend continues so does profitability.

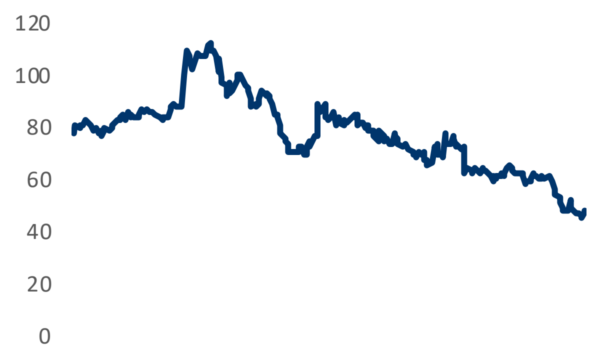
- **Risk related to regulations and Acquisitions.** Since LeoVegas recently acquired two assets in the UK: Royal Panda and Rocket X, they face regulatory risks since the UK are showing stricter regulatory demands for the gambling sector. Sweden will regulate operators from 1 January 2019. Governments can change regulations in the gambling industry unexpected and without warning, this poses a risk to all operators including LeoVegas.

- **Base case** indicates an EBITDA-margin of 12,5% 2020E, below LeoVegas' long term target of 15%. This would imply a share price of 55 SEK.




| LEOVEGAS (LEO) | |
|---|---|
| Current Price (SEK) | 40 |
| 52 v Low/High | 38 / 116 |
| Market Cap (MEUR) | 389 |
| Net Debt (MEUR) | 64,8 |
| Enterprise Value (MEUR) | 453 |
| Sector | Online gambling |
| Exchange | Large Cap |
| Next Report | 2019-02-12 |

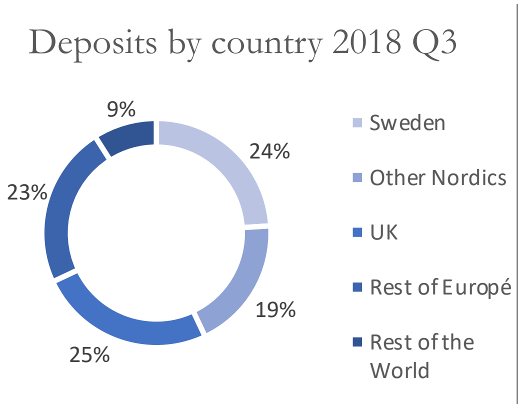
**1 Year Chart**



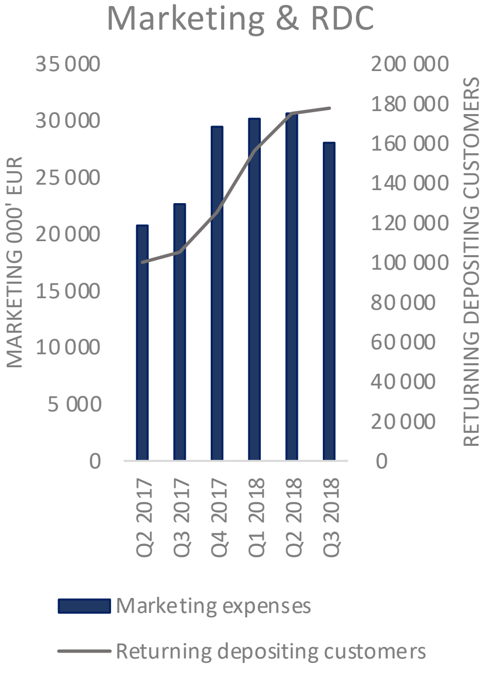

| MEUR | 2018E | 2019E | 2020E |
|---|---|---|---|
| Sales | 344 | 397 | 557 |
| Growth (%) | 59 | 15 | 40 |
| Gross Marg (%) | 72 | 73 | 72 |
| EBITDA | 50 | 42 | 69 |
| EBITDA Marg (%) | 14,5 | 10,6 | 12,5 |
| EV/S | 1,5 | 1,3 | 0,96 |
| EV/EBITDA | 10,6 | 12,7 | 7,7 |

| Ownership | |
|---|---|
| Swedbank Robur fonder | 8,2 % |
| Gustaf Hagman | 8 % |
| Robin Ramm-Ericsson | 6,9 % |
| Handelsbanken fonder | 5,7 % |

# INVESTMENT THESIS








**Gamblers are moving online – long term trend**

The online gambling industry only makes up 20% of the total gambling market. That means that 80% of all gambling in Europe is still made in physical casinos. This is estimated to change in the coming 5-10 years. According to Technavio, it is estimated that the mobile gambling market will grow 19% CAGR 2018-2022. This is the underlying market that LeoVegas operates in, since LeoVegas is mainly a mobile casino. LeoVegas are mainly exposed towards Sweden, other Nordic countries and the UK (these three amounts a total of 68%) which will indicate 50 % regulated revenue from 2019.

**Marketing efficiency and increased CLV**

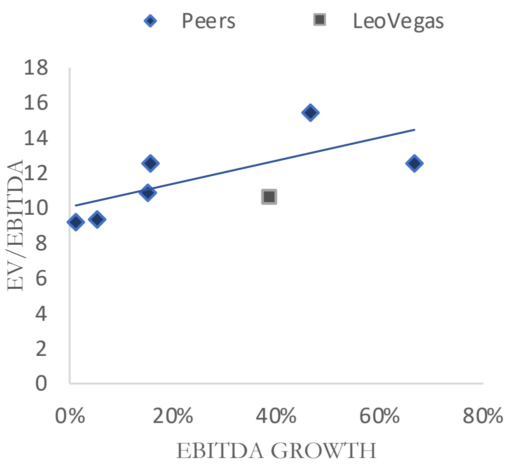
LeoVegas have two main value drivers. (1) high number of new depositing customers (NDC) and returning depositing customers (RDC). (2) increased customer lifetime value (€244) in relation to customer acquisition costs (€199) will increase profitability and give room for additional growth, thus implying margin expansion. In this analysis it is assumed that marketing expenditure have a direct correlation with NDC whereas the RDC is unaffected by the marketing. RDC is a way to measure the loyalty of their customer base. Last quarter LeoVegas experienced an increase in NDC (45%) YoY, however the RDC were showing even stronger growth of 68 % YoY. This is significant since it shows the strength of their customer base and even might imply customer loyalty. It also illustrates how LeoVegas can slow down on marketing expenditures, grow at a slower pace but improve margins significantly. This was exactly what happened Q2 when they communicated a reverse profit warning and an EBITDA-margin of 17,2% (12.4%) due to lower marketing expenditure in relation to revenue. LeoVegas long term EBITDA margin goal is set to 15% where the base case for this analysis imply a 12,5% EBITDA margin 2020E.

**Regulatory risks and opportunities**

LeoVegas largest market Sweden is being regulated 2019-01-01. This is going to affect EBITDA margins short term with about 2-3%. The UK is increasing their tax-rate for gambling from 15% to 21%. The Italian regulators (LeoVegas acquired an operator in Italy) are currently trying to prohibit marketing of casino and betting. Norway did recently approve an IP-block of all unregulated operators. This is how the gambling market works, regulators can quickly change their opinions and increase the tax-rate leading to depressed margins for operators.

**Regulation will also provide potential.** (1) new marketing channels, for instance Facebook and Google adwords which contributes to further strengthening their loyal customer base and market position. (2) Regulation could make smaller operators unable to afford their margins due to regulatory expenses, this is expected to drive the industry towards consolidation. LeoVegas is a fairly large operator that have the resources and capabilities to further continue their acquisition activity. However, they have a large amount of debt already due to previous acquisitions. This may impose short term barriers in their acquisition ability. Currently their debt/EBITDA is 1,19 which compared to Kindred (0,7), Betsson (0,6) and Cherry (1,4) is about average. During 2019 LeoVegas will start paying off their bond (100 mEUR) which was raised in relation to the acquisition of Royal Panda. The 100 mEUR bond are being amortized (straight) of 10 mEUR every quarter. When their debt continues to decrease this may give room to future acquisitions.

# VALUATION




| Peers | EV/EBITDA | EBITDA growth 2018-2020 |
|---|---|---|
| Aspire | 7,3 | 15% |
| Bet-at-home | 9,4 | 2% |
| Catena Media | 15,0 | 47% |
| Cherry | 12,5 | 24% |
| Kindred | 9,3 | 1% |
| NLAB | 11,3 | 60% |

| EBIDTA margin | 2018 E | 2019 E | 2020 E |
|---|---|---|---|
| **Base** | 14.5 % | 10.6 % | 12.5 % |
| **Bear** | 14.5 % | 10.6 % | 6.9 % |
| **Bull** | 14.5 % | 15.3 % | 16.4 % |

| | Upside/ downside | Shareprice |
|---|---|---|
| **Base** | 38 % | 55 kr |
| **Bear** | -34 % | 26 kr |
| **Bull** | 93 % | 77 kr |

**The valuation of LeoVegas has been performed on the basis of a relative evaluation. This is done through an analysis of the peer group using a multiple regression analysis. The multiple used is EV/EBITDA, where the estimated variables are operating margin and EBITDA growth**

**The multiple regression gives a target multiple of 12,5x.** Peers used are: Cherry, Kindred, Nordic leisure, Aspire, Bet-at-home, Catena Media. In January 2019, the Swedish gaming regulation will take effect, negatively hitting the margins of the companies operating in Sweden. All of these peers are in the gaming industry and have thus been regarded as peers to LeoVegas.

**Base case indicates an upside of 38% in 2020E based on the target multiple of 12,5 (EV/EBITDA)**. In the base scenario LeoVegas revenue is expected to grow by 15,3 %. From an estimated 344 mEUR in 2018 to 397 mEUR in 2019E. This is mainly due to the increased marketing capabilities through new channels, after the regulation in 2019. Because the channels are new, it's reasonable to assume that the effectiveness of the marketing will decrease, leading to marketing costs as a percentage of revenue of 39.9% in 2019E, compared to 35.9% in 2018E. The marketing in 2020E is expected to be 31% higher than in 2019E but the marketing cost as a percentage of revenue will decrease as LeoVegas becomes more effective with their marketing. This will lead to an increase in their revenue by 40.3% from 2019E to 2020E. The result will be a slight decrease of the EBIDTA margin from 2018E to 2020E, from 14.5% to 12.5%. This will amount to an estimated EBIDTA growth of 39%. In return, the share price is expected to increase to 55 SEK based on the target multiple of 12,5x EBITDA.

**Bear case indicates a downside of 45% in 2020E.** In the bear case, the new regulation has hit LeoVegas harder and while the expected revenue growth between 2018E and 2019E is still 15.3%, the negative effects will start to show in 2020E. Revenue in 2020E is expected to grow by just 22.7% from 2019E and the main reason for this is the increased competition due to the regulation and an unsatisfying marketing effectiveness. Marketing costs will increase by 46% from 2018E to 2020E and the marketing costs as a percentage of revenue will increase from 35.9% to 37% in 2018E – 2020E. Marketing is LeoVegas' main value driver, the less efficient and higher costing marketing, will lead to a decrease in the EBIDTA margin from 14.5% in 2018E to a low 6.9% in 2020E. The estimated EBITDA is projected to decrease by 33%. The share price has been calculated using the target multiple of 6x and is expected to decrease to 26 SEK

**Bull case indicates an upside of 93% in 2020E.** In the bull case LeoVegas manages to capture the benefits of the regulation in 2019. While assuming revenue and costs are roughly the same as in the base case, their marketing is more effective. This means a successful investments in marketing where, while marketing costs increase by 50% from 2018E to 2020E, the marketing cost as a percentage of revenue decreases from 35.9% to 33.2%. This will in turn result in an EBIDTA margin of 16.4% in 2020E, up from 16.5% in 2018E. This will put the targeted share price to 77 SEK. An 83% EBIDTA growth is projected with a 17,5x EBITDA target price.

# MANAGEMENT

**Gustaf Hagman (8 000 000 shares)**
Group CEO and co-founder

Hagman has over 20 years of experience of entrepreneurship and the online gaming industry, and has been running organizations with over 100 employees. Before founding Leovegas, Hagman was the CEO of Net Gaming AB (publ.) which has given him a lot of valuable insight into the gaming industry. He was also the founder and CEO of Eurobet Nordic AB, working mainly with the company's strategy and management.

**Louise Nylen (382 200 shares)**
Deputy CEO

Nylen is working with strategic questions regarding sustainability and value creating projects. She has been working at LeoVegas since 2013 as Head of Marketing department and Chief Marketing Officer. Her last position was Senior Director at OSM AB as well as and Associate consultant at Bain & Company

**Stefan Nelson**
Group CFO

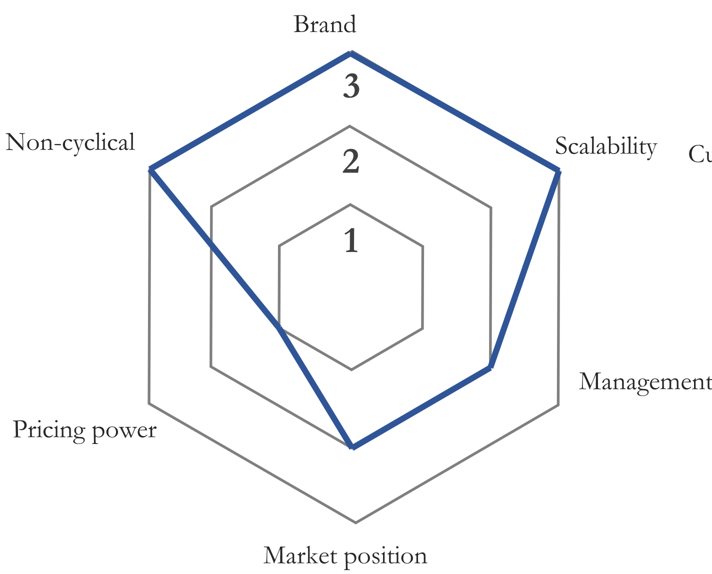
Nelson has over 20 years of experience within the capital market and corporate finance. His last position was a director at SEB Corporate Finance with responsibility over games, media and retail. He has been a top ranked equity analyst in the gaming sector for many years.

**Philip Doftvik (47 000 shares)**
CMO

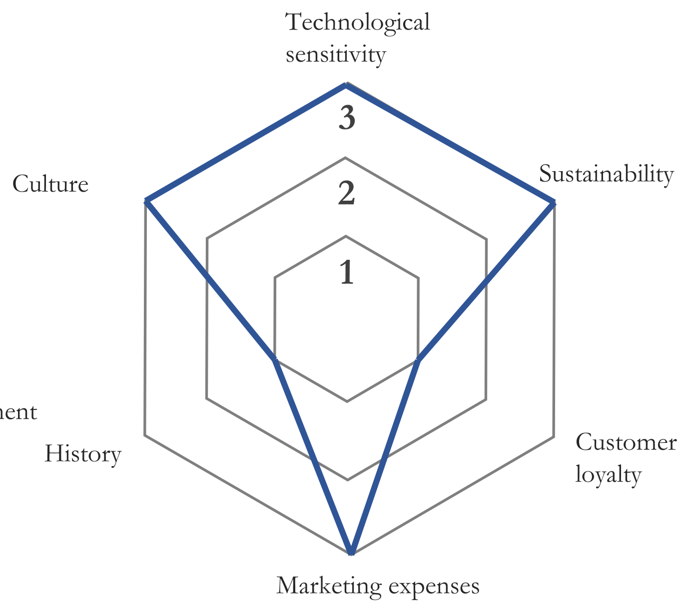
Before LeoVegas, Doftvik as an equity analyst at Carnegie Investment Bank. His last position was at Betsson Group, working in roles such as M&A and Investor relations.

# SWOT-ANALYSIS

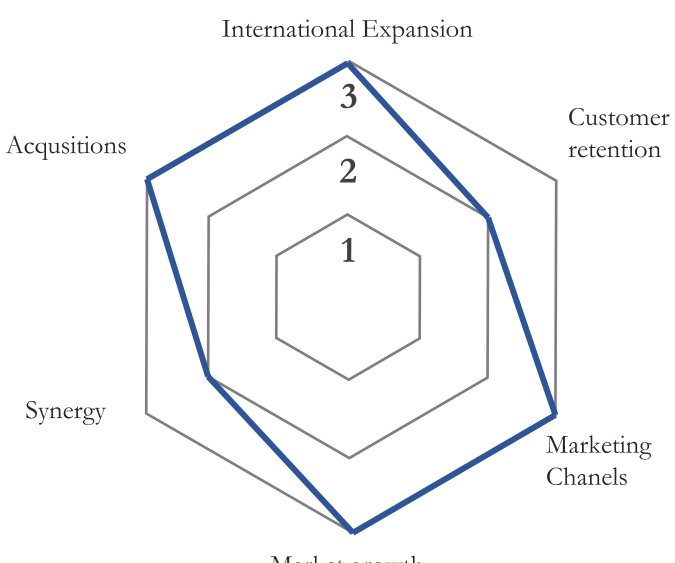
## STRENGTHS



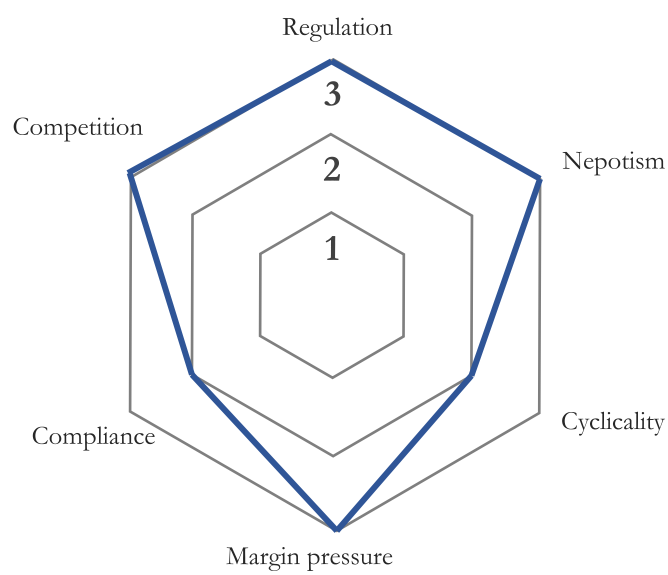

## WEAKNESSES




## OPPORTUNITIES




## THREATS



# APPENDIX I

## Income statement – Base case

| Amounts in EUR 000s | 2015 | 2016 | 2017 | 2019 E | 2020 E |
|---|---|---|---|---|---|
| Revenue | 83 018 | 141 398 | 217 014 | 396 749 | 556 688 |
| Cost of sales | -15 239 | -26 519 | -39 195 | -70 000 | -98 000 |
| Cost of sales as a percentage of revenue | 18,4% | 18,8% | 18,1% | 17,6% | 17,6% |
| Gaming duties | -3 390 | -5 673 | -15 144 | -38 848 | -56 498 |
| Gaming duties as a percentage of revenue | -4,1% | -4,0% | -7,0% | -9,8% | -10,1% |
| Gross profit | 64 390 | 109 206 | 162 675 | 287 901 | 402 190 |
| Gross profit as a percentage of revenue | 77,6% | 77,2% | 75,0% | 72,6% | 72,2% |
| | | | | | |
| Personnel costs | -9 183 | -17 782 | -26 402 | -46 890 | -65 655 |
| Personnel costs as a percentage of revenue | -11,1% | -12,6% | -12,2% | -11,8% | -11,8% |
| | | | | | |
| Other operating expenses | -9776 | -17914 | -22878 | -41000 | -61000 |
| Opertating expenses as a percentage of revenue | -11,8% | -12,7% | -10,5% | -10,3% | -11,0% |
| | | | | | |
| Marketing costs | -45 106 | -60 448 | -91 727 | -158 275 | -207 023 |
| Marketing costs as a percentage of revenue | -54% | -43% | -42% | -40% | -37% |
| Other income and expenses | -565 | 131 | 566 | 500 | 800 |
| Other income and expenses as a percentage of revenue | -0,7% | 0,1% | 0,3% | 0,1% | 0,1% |
| | | | | | |
| EBITDA | -240 | 13 193 | 22 234 | 42 236 | 69 312 |
| EBITDA margin | -0,3% | 9,3% | 10,2% | 10,6% | 12,5% |

# DISCLAIMER

**Ansvarsbegränsning**
Analyser, dokument och all annan information (Vidare ”analys(en)”) som härrör från LINC Research & Analysis (”LINC R&A” (LINC är en ideell organisation (organisationsnummer 845002-2259))) är framställt i informationssyfte och är inte avsett att vara rådgivande. Informationen i analysen ska inte anses vara en köp/säljrekommendation eller på annat sätt utgöra eller uppmana till en investeringsstrategi.

Informationen i analysen är baserad på källor, uppgifter och personer som LINC R&A bedömer som tillförlitliga, men LINC R&A kan aldrig garantera riktigheten i informationen. Den framåtblickande informationen i analysen baseras på subjektiva bedömningar om framtiden, vilka alltid är osäkra och därför bör användas försiktigt. LINC R&A kan aldrig garantera att prognoser och framåtblickande estimat kommer att bli uppfyllda. Om ett investeringsbeslut baseras på information från LINC R&A eller person med koppling till LINC R&A, ska det anses som dessa fattas självständigt av investeraren. LINC R&A frånsäger sig därmed allt ansvar för eventuell förlust eller skada av vad slag det än må vara som grundar sig på användandet av analyser, dokument och all annan information som härrör från LINC R&A.

**Intressekonflikter och opartiskhet**
För att säkerställa LINC R&A:s oberoende har LINC R&A inrättat interna regler. Utöver detta så är alla personer som skriver för LINC R&A skyldiga att redovisa alla eventuella intressekonflikter. Dessa har utformats för att säkerställa att *KOMMISSIONENS DELEGERADE FÖRORDNING (EU) 2016/958 av den 9 mars 2016 om komplettering av Europaparlamentets och rådets förordning (EU) nr 596/2014 vad gäller tekniska standarder för tillsyn för de tekniska villkoren för en objektiv presentation av investeringsrekommendationer eller annan information som rekommenderar eller föreslår en investeringsstrategi och för uppgivande av särskilda intressen och intressekonflikter* efterlevs.
Om skribent har ett innehav där en intressekonflikt kan anses föreligga, redovisas detta i informationsmaterialet.

**Övrigt**
LINC R&A har ej mottagit betalning eller annan ersättning för att göra analysen.

Analysen avses inte att uppdateras.

**Upphovsrätt**