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Gaming (Citi)
Western Europe

UK Online Gambling

Mitigating The UK Point Of Consumption Tax

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- **Mitigating the point of consumption tax** – We factored the planned 15% UK online POC tax into our FY15 forecasts 18 months ago – but assumed no mitigation. We are increasingly confident of some offsetting actions and now factor in a first slice of cost cuts which should offset up to c30% of the cost hit. However, we think operators may be able to mitigate 70-80% of the gross tax hit, through additional cost cuts and market share gains suggesting there is scope for further mid-single digit upgrades to our forecasts beyond FY15.
- **First wave of cuts assumed** – We now assume 3% online costs cuts and 0.5% other group cost cuts in FY15. In practice we expect Staff costs and Other admin costs are held constant against a growing market – which will likely necessitate that many directly variable costs (e.g. marketing) will continue to grow.
- **Further cuts possible** – We see upside to our cost reduction assumptions and think that up to 5% of online costs and 1% of other group costs could be cut by also trimming growth in marketing budgets, addressing underperforming shops and reviewing content and other supplier costs.
- **UK market share gains likely** – We think that c15% of the UK market could be left with very low or negative profits post the tax and may exit. Assuming that 50% of this market share migrated to the top players it could give each a 7-11% uplift in sales potentially mitigating another c20% of the tax hit.
- **New avenues for growth** – The UK represents 10-80% of online revenues for our coverage universe – significant potential remains elsewhere. William Hill and Paddy Power are growing in Italy (and Spain for WMH) and Australia. We expect Betfair to flex its commission structure. Ladbrokes still looks too focused on Retail.
- **Winners** – Of the quoted players William Hill looks well placed to mitigate the impact and we upgrade FY15 EPS by 5%. We cut our Ladbrokes FY13-FY15 forecasts c10% after weak H1 results despite assuming similar mitigation. PAP forecasts are also trimmed 1-3% to reflect the weak Australian dollar. Our forecasts for Betfair and bwin.party already assume cost savings so we make no changes. Ahead of H1 results next week we make PAP Most Preferred and bwin.party Least Preferred.

		Rating		Target Price		Current Year Earnings Estimates	
Company	Ticker	Old	New	Old	New	Old	New
Betfair	BETF.L	1	1	£9.75	£9.75	p53.4	p53.4
Bwin.Party	BPTY.L	2	2	£1.30	£1.30	EU¢11	EU¢11
Ladbrokes	LAD.L	2	2	£1.90	£1.90	p16.0	p14.4
Paddy Power	PAP.L	1	1	€75.00	€75.00	€2.87	€2.80
William Hill	WMH.L	1	1	£5.00	£5.15	p28.9	p28.9

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Contents

Point of consumption

The UK government has announced that it plans to introduce a Point of Consumption gaming tax in December 2014. The government has indicated that the tax will be set at 15% of gross gaming profits (stakes less prizes) from UK domiciled customers. Last week's *Summary of Consultation Responses* from HM Treasury and HM Revenue & Customs emphasised the government's commitment to pushing this through. Although the industry is lobbying for a lower rate and is threatening legal action, we see this as a red herring.

We factored this tax in to our FY15 and beyond forecasts some time ago

We factored this tax in to our FY15 and beyond forecasts some time ago but we are increasingly confident that the stronger operators will be able to mitigate the impact to some degree. We see three sources of mitigation:

- UK market share gains;
- Group cost savings;
- Growth from new markets.

In this note we factor in a first wave of mitigation from initial cost savings and amend our forecasts as follows:

Figure 1. EPS forecast changes

EPS forecast changes	Year end	FY 1E new	FY 1E previous	% change	FY 2E new	FY 2E previous	% change	FY 3E new	FY 3E previous	% change
Betfair(p)	Apr	53.4	53.4	0.0%	55.9	55.9	0.0%	47.4	47.4	0.0%
bwin.party (€cents)	Dec	10.7	10.7	0.0%	11.5	11.5	0.0%	8.1	8.1	0.0%
Ladbrokes (p)	Dec	14.4	16.0	-9.9%	16.9	18.9	-10.6%	16.0	17.7	-9.5%
Paddy Power (€)	Dec	2.80	2.87	-2.5%	3.29	3.42	-3.9%	3.20	3.24	-1.2%
William Hill (p)	Dec	28.9	28.9	0.0%	31.1	31.1	0.0%	29.9	28.6	4.5%

Source: Citi Research

Figure 2. Citi vs Reuters consensus

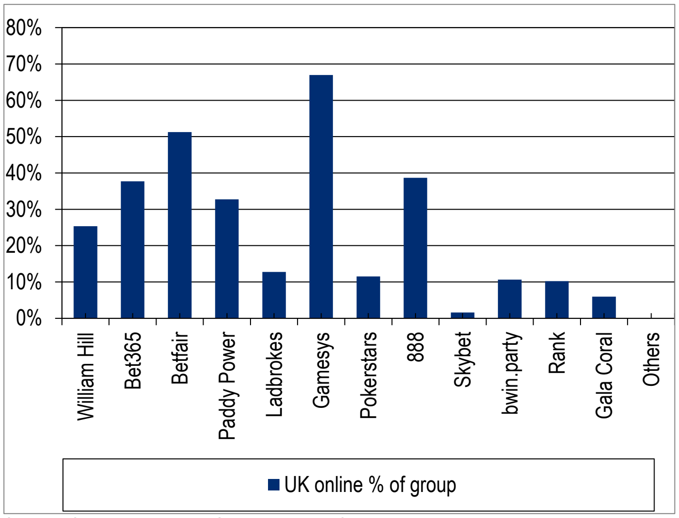
EPS forecasts vs consensus	Year end	FY 1E new	FY 1E consensus	Diff from cons	FY 2E new	FY 2E consensus	Diff from cons	FY 3E new	FY 3E consensus	Diff from cons
Betfair(p)	Apr	53.4	46.0	16.1%	55.9	47.4	18.0%	47.4	42.2	12.3%
bwin.party (€cents)	Dec	10.7	12.3	-13.0%	11.5	13.8	-16.7%	8.1	14	-41.9%
Ladbrokes (p)	Dec	14.4	15.0	-3.9%	16.9	17.2	-1.8%	16.0	16.8	-4.6%
Paddy Power (€)	Dec	2.80	2.83	-1.2%	3.29	3.27	0.5%	3.20	3.16	1.3%
William Hill (p)	Dec	28.9	29.3	-1.2%	31.1	31.7	-2.0%	29.9	30.4	-1.7%

Source: Reuters, Citi Research

The presence of Betfair as a peer-to-peer betting exchange and the fact that Bet365 is already onshore and paying tax is likely to keep the market competitive

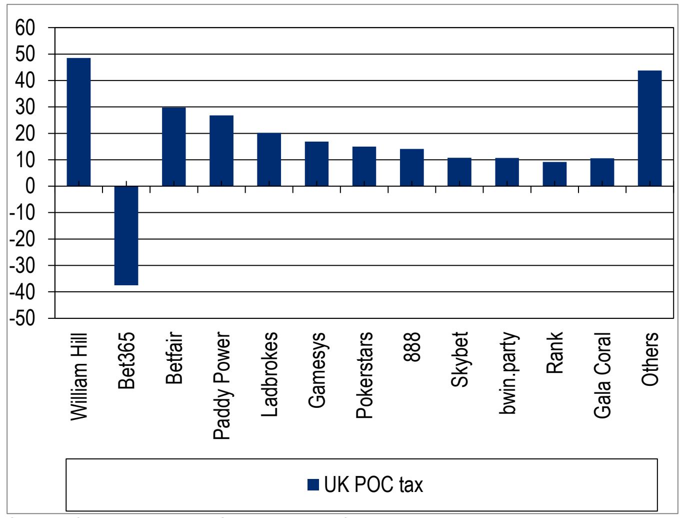
One area we do not see as a likely source of mitigation is a worsening of odds to favour the bookmaker. The presence of Betfair as a peer-to-peer betting exchange and the fact that Bet365 is already onshore and paying tax is likely to keep the market competitive. Given its likely lower tax bill, we cannot rule out a more aggressive push from Bet365 to improve odds to the customer as a tool for market share gains – although the company has not commented on this. However, this could be a dangerous approach as it would likely cause other major players to follow suit and could leave margins permanently reduced. Ramping up marketing spend to drive market share gains is probably a more flexible approach.

Figure 3. UK online revenues as a % of group revenues (2012)



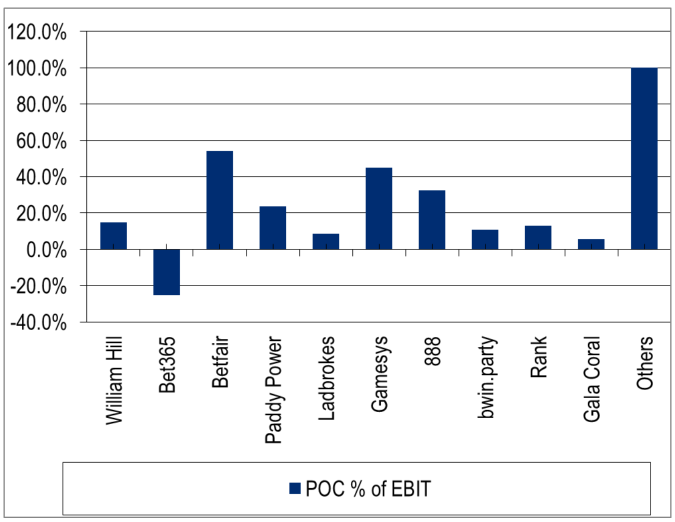
Source: Company reports, Gambling data, Citi Research

Figure 4. Implied UK Point of Consumption tax bill (at 15%) based on 2012 revenues, £m



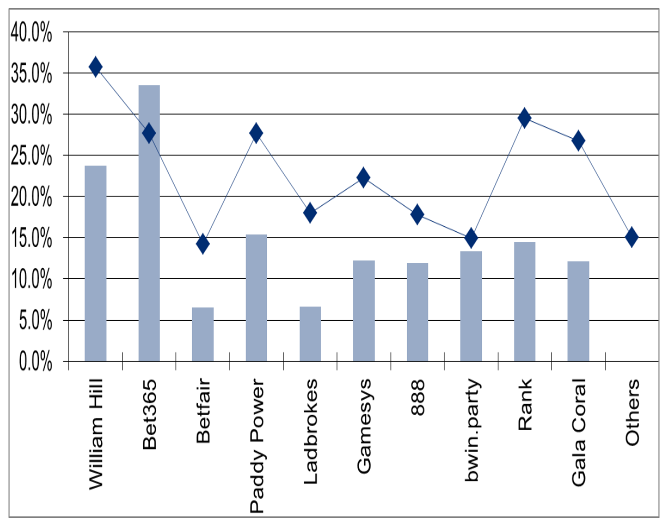
Source: Company reports, Gambling data, Citi Research

Figure 5. Implied Point of Consumption tax bill as % of group 2012 EBIT (for Betfair we assume £20m of announced cost cuts are added to FY13 reported EBIT)



Source: Company reports, Gambling data, Citi Research

Figure 6. Implied Online EBIT margin pre/post POC tax – based on 2012 data (pre-mitigation) (for Betfair we assume £20m of announced cost cuts are added to FY13 reported EBIT)



Source: Company reports, Gambling data, Citi Research

Base case – Cost savings

Our base case now assumes a first wave of cost savings as follows.

- 3% cost reduction for online operations;
- 0.5% cost reduction for offline operations.

In practice we expect these cost savings to be achieved by holding staff and other admin costs stable. Against a market growing at c10% pa this should be sufficient to achieve a c3% real saving in online costs. We assume that directly variable costs and marketing costs continue to track sales growth.

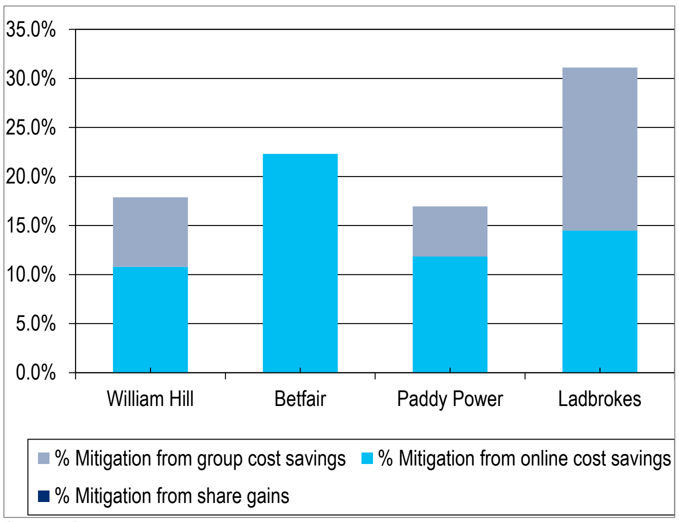
Upside case – Further cost savings

We think additional cost reductions may be possible – notably through controlling marketing spend and taking a tougher line on other group costs. Ultimately we think the following total cost savings may be achievable.

- 5% cost reduction for online operations;
- 1% cost reduction for offline operations.

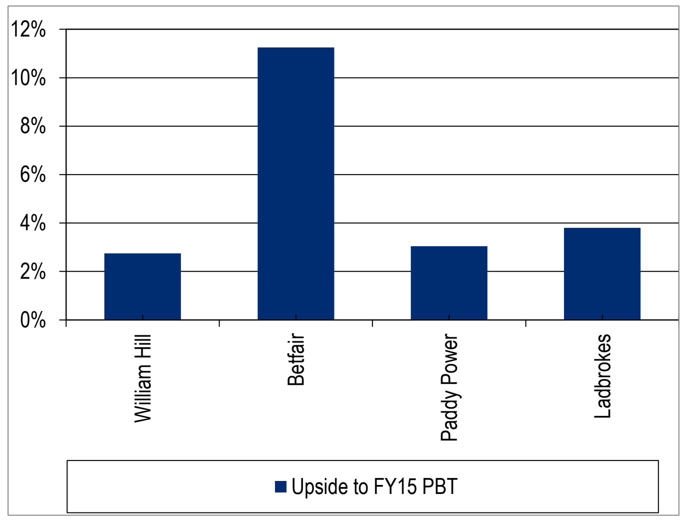
We illustrate below the potential impact of these incremental cost savings

Figure 7. % Mitigation from cost savings



Source: Citi Research

Figure 8. Potential upside to FY15 PBT

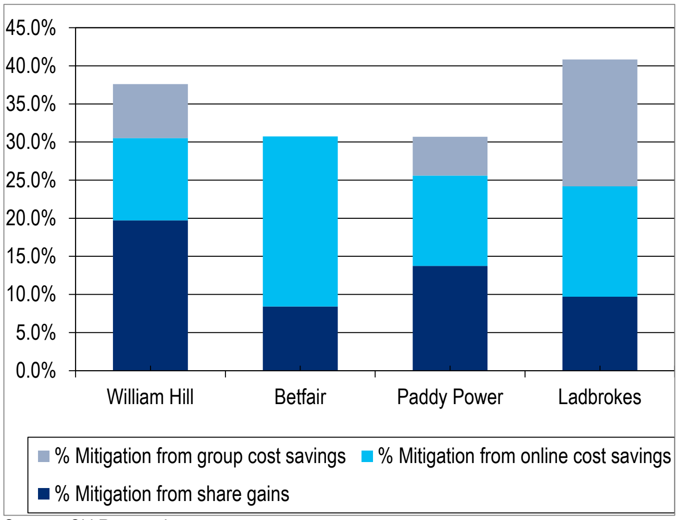


Source: Citi Research

Bull case – Market share gains

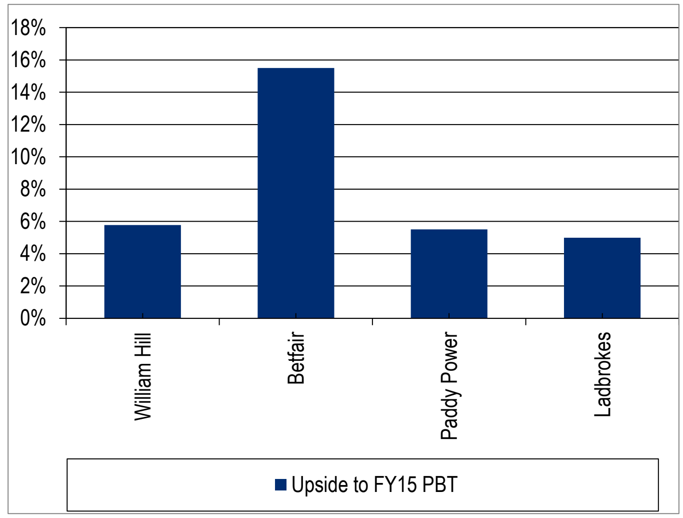
We think that operators accounting for up to 15% of the market could become close to breakeven or unprofitable once the tax is implemented. This may cause these operators to exit the market, operate illegally or wind down marketing spend. Any of these options are likely to drive a loss of market share from these smaller players. Our Bull case assumes that 50% of this market share (i.e. 7.5%) shifts to the top-12 operators in proportion to their current market share. We assume incremental margins on these share gains are c10% points above expected post-tax EBIT margins.

Figure 9. % Mitigation from cost savings and market share gains



Source: Citi Research

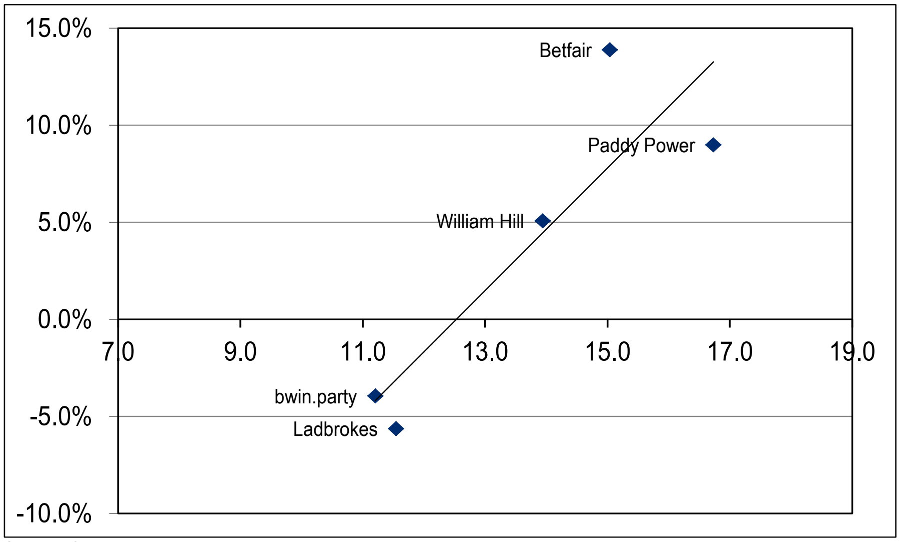
Figure 10. Potential upside to FY15 PBT



Source: Citi Research

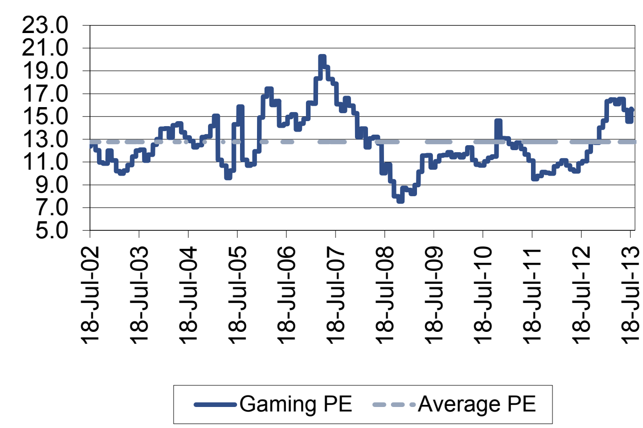
Recommendations and valuation

Figure 11. FY14 PE vs 4 year EPS CAGR



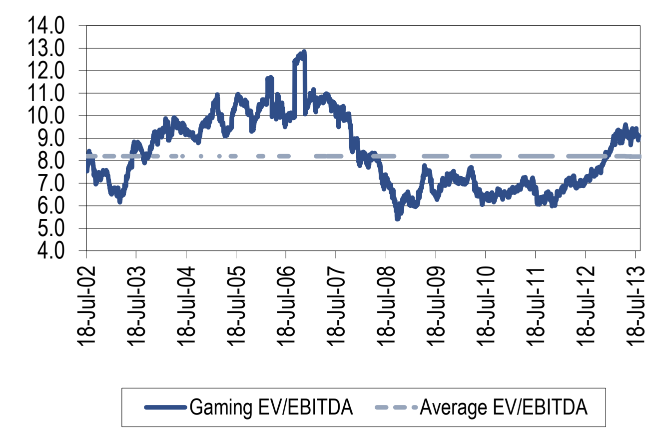
Source: Citi Research

Figure 12. Gaming sector PE history



Source: Datastream, Citi Research

Figure 13. Gaming sector EV/EBITDA history



Source: Datastream, Citi Research

- **Betfair – Buy.** We have previously flagged the significant potential from commission increases and cash returns (*Betfair (BETF.L) - Upgrade to Buy – commission increases and cash returns to drive value*, 10 June). We think changes in in pricing could fully offset the PoC tax (we assume a 15% revenue rise) and if so Betfair would face less pressure to cut costs to protect margins. We expect a further £10m of cost-cutting (on top of the £20m announced by management) irrespective of the PoC tax, as the new CEO completes his shake-up of the business. Nevertheless the group's low margins relative to peers suggest more could be done.
- **Bwin.party – Neutral.** Only around 10% of bwin.party's revenues come from the UK and we expect its exposure to the online POC tax is of a similar magnitude. However, this is one tax of many that we expect bwin.party to have to incur and we assume no special mitigation for the UK POC tax. As a result we leave our

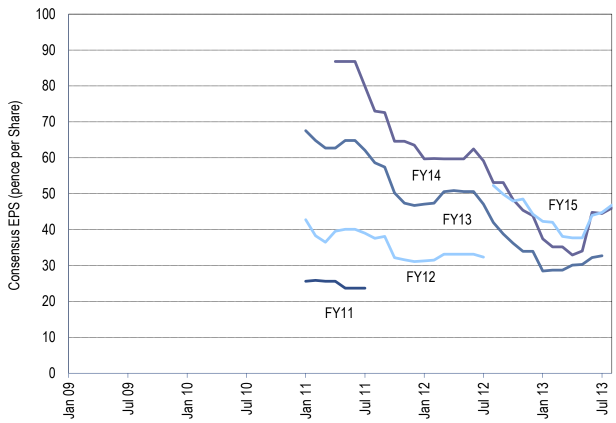
forecasts unchanged ahead of H1 results on 30 August. We expect results to be disappointing and we make bwin.party our Least Preferred stock ahead of this.

- **Paddy Power – Buy.** Paddy Power's share price has lagged in the last six months as the weak Australian $ has been a drag on earnings and director share sales have weighed on sentiment. We trim our FY13/14/15 EPS by 2.5%/3.9%/ 1.2% to reflect recent FX moves and likely lower-than-expected interest income. This is netted off against c4% POC tax mitigation in FY15. Nevertheless, we expect good H1 results to reassure investors and retain our Buy recommendation and €75 target. We make PAP Most Preferred ahead of these results.

- **Ladbrokes – Neutral.** With only c12% of group revenues from UK online customers LAD has the least exposure of this peer group – with the potential tax liability representing c8.5% of EBIT. However, this reflects the historical weaknesses in its online business which lacks scale compared to peers. Our forecasts assume only 15% of group EBIT comes from online in FY15 and we remain to be convinced that the group can close the gap to peers given its lack of marketing scale and persistent technology delays.

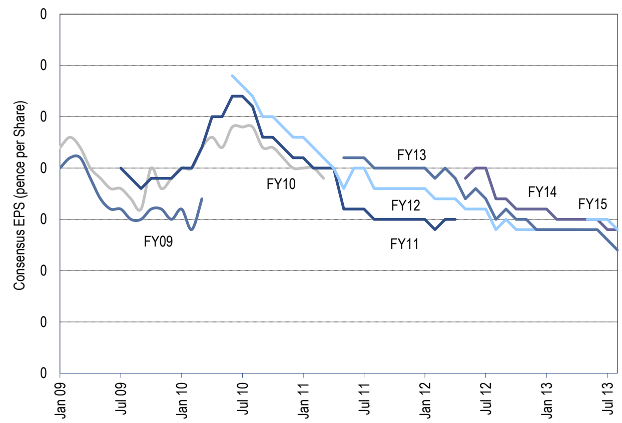
- **William Hill – Buy.** With c16% of the UK online market WMH has a leadership position. With this scale online and in retail comes substantial marketing firepower. We expect the group to use its scale to drive growth. We upgrade FY15 EPS by c5% to reflect some initial cost cuts but we see scope for further mitigation, potentially delivering another c5% upside to forecasts. We see three other sources of longer term potential not included in our analysis.

Figure 14. Betfair EPS momentum



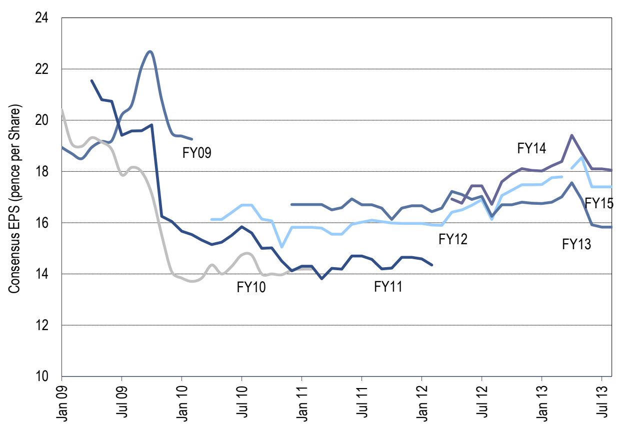
Source: DataStream

Figure 15. bwin.party EPS momentum



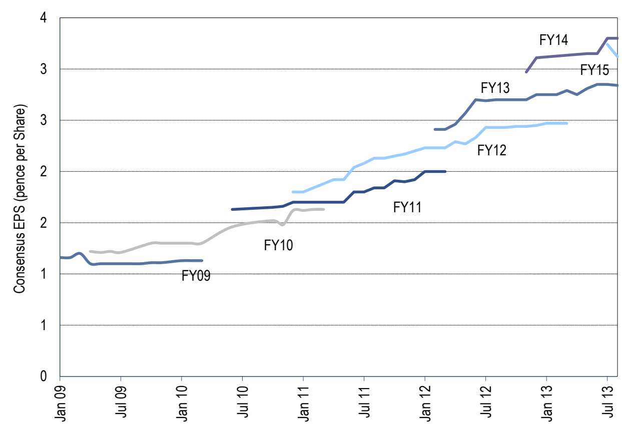
Source: DataStream

Figure 16. Ladbrokes EPS momentum



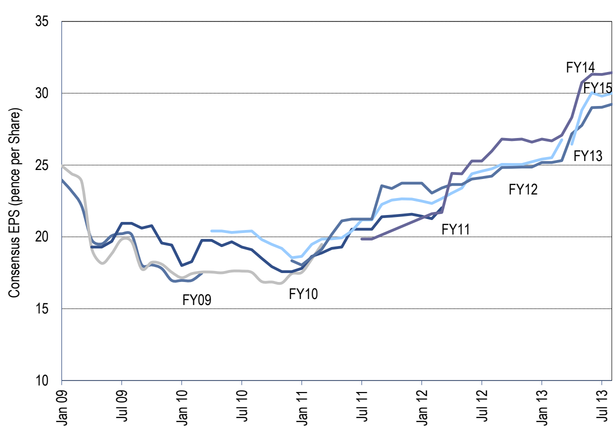
Source: DataStream

Figure 17. Paddy Power EPS momentum



Source: DataStream

Figure 18. William Hill EPS momentum



Source: DataStream

Figure 19. Annualised valuation metrics

	Betfair	Bwin.Party	Ladbrokes	GTECH	OPAP SA	Paddy Power	William Hill	Average
RIC Code	BETF.L	BPTY.L	LAD.L	GTCH.MI	OPAr.AT	PAP.L	WMH.L	
Rating	Buy	Neutral	Neutral	Buy	Neutral/High Risk	Buy	Buy	
Fiscal Year End ^	Apr	Dec	Dec	Dec	Dec	Dec	Dec	
Currency	GBP	GBP	GBP	EUR	EUR	EUR	GBP	
Price	9.87	1.33	1.98	21.81	7.17	61.00	4.32	
Target Price	9.75	1.30	1.90	25.50	6.70	75.00	5.15	
Market Capitalisation	1,033	1,084	1,813	3,789	2,287	2,997	3,740	
Enterprise Value	872	1,006	2,145	7,167	2,377	2,797	4,222	
Analyst	Josh Lipman	Josh Lipman	James Ainley	Mauro Baragiola	Josh Lipman	James Ainley	James Ainley	
Valuation								
Price/Earnings (x)								
2012E	26.9	11.3	9.3	13.1	4.5	24.6	15.9	15.1
2013E	21.5	14.5	13.7	12.9	15.5	21.8	14.9	16.4
2014E	17.9	13.5	11.7	12.1	19.3	18.6	13.9	15.3
2015E	19.7	19.1	12.3	11.3	10.9	19.1	14.5	15.3
EV/EBITDA (x)								
2012E	11.3	7.8	7.3	7.1	3.5	17.1	11.0	9.3
2013E	9.2	9.0	9.3	6.7	10.7	14.8	10.7	10.1
2014E	8.1	7.9	8.3	6.3	8.5	12.5	10.2	8.8
2015E	8.5	9.0	8.4	6.0	5.4	12.2	10.4	8.6
EV/EBIT (x)								
2012E	22.0	9.4	9.0	11.5	3.8	21.2	12.4	12.8
2013E	16.0	11.5	12.3	10.9	13.8	18.4	12.3	13.6
2014E	12.9	10.0	10.7	10.1	14.8	15.3	11.6	12.2
2015E	13.9	12.7	11.2	9.6	7.9	15.3	11.9	11.8
FCF Yield (Pre-growth capex)								
2012E	5.7%	-2.6%	11.4%	17.4%	23.3%	6.3%	7.0%	9.8%
2013E	5.4%	7.9%	5.8%	11.7%	-3.1%	6.0%	6.3%	5.7%
2014E	5.7%	6.6%	9.3%	16.6%	10.3%	6.6%	7.6%	9.0%
2015E	4.9%	4.4%	9.5%	6.5%	16.9%	6.5%	7.3%	8.0%
Dividend Yield								
2012E	1.2%	2.2%	4.5%	3.7%	7.9%	2.0%	2.4%	3.4%
2013E	1.5%	2.4%	4.5%	3.8%	1.7%	2.3%	2.6%	2.7%
2014E	1.9%	2.6%	4.5%	3.8%	2.6%	2.6%	2.9%	3.0%
2015E	2.1%	2.7%	4.5%	3.8%	7.8%	2.7%	2.9%	3.8%
Margins								
EBIT Margin								
2012E	10.3%	14.9%	22.4%	20.7%	48.4%	20.8%	26.0%	23.4%
2013E	13.6%	14.2%	15.3%	20.5%	15.5%	20.3%	23.2%	17.5%
2014E	15.5%	14.5%	16.4%	21.1%	11.2%	21.7%	24.0%	17.8%
2015E	13.7%	9.8%	14.9%	21.6%	13.7%	19.0%	21.3%	16.3%
Growth								
EPS Growth								
2012E	-15.1%	-29.9%	39.9%	26.3%	-6.6%	16.9%	23.9%	7.9%
2013E	25.1%	-21.9%	-32.1%	1.1%	-70.9%	12.7%	6.7%	-11.3%
2014E	19.8%	7.4%	17.2%	7.0%	-19.7%	17.5%	7.3%	8.1%
2015E	-8.9%	-29.2%	-5.2%	6.6%	77.0%	-2.6%	-3.8%	4.8%
CAGR: 2012 - 2015	11.0%	-16.0%	-9.0%	4.9%	-25.5%	8.8%	3.3%	-3.2%
Balance Sheet								
Net Debt/EBITDA								
2012E	-2.0	-0.9	1.3	2.4	-0.2	-1.0	0.7	0.0
2013E	-2.0	-1.6	1.7	2.3	0.6	-1.2	1.6	0.2
2014E	-2.0	-1.9	1.2	2.0	-0.2	-1.4	1.2	-0.2
2015E	-2.3	-2.4	1.0	2.0	-1.0	-1.8	1.0	-0.5
Interest Cover								
2012E	-18.8	16.6	7.9	4.0	-61.9	-43.1	10.1	-12.2
2013E	-35.7	27.5	7.1	4.3	-19.3	-49.2	7.4	-8.3
2014E	-38.5	29.9	8.9	4.7	34.5	-41.8	8.1	0.8
2015E	-33.3	22.8	10.7	5.1	-26.6	-30.1	9.3	-6.0

Source: dataCentral, Citi Research

Cost savings

We see two sources of cost reduction:

- Online costs – We see scope for up to 5% of costs to be cut;
- Other group costs – We see scope for up to 1% of group costs to be cut.

Our forecasts now assume that 3% of online costs are cut and 0.5% of other group costs are cut, which we see as a halfway house towards the full potential savings.

Figure 20. Expected cost savings in FY15 (£m)

	Online cost saving	% Mitigation from online cost savings	Group cost saving	% Mitigation from group cost savings	Net impact of POC	% of gross impact
William Hill	8	16.2%	3	7.1%	-37	-76.7%
Betfair	10	33.5%	0	0.0%	-20	-66.5%
Paddy Power	5	17.8%	1	5.1%	-21	-77.1%
Ladbrokes	4	21.7%	3	16.6%	-12	-61.6%

Source: Citi Research

Longer term we think incremental savings could take the total to 5% of online costs and 1% of other group costs.

Figure 21. Potential Incremental cost savings in FY15 and beyond (£m)

	Online cost saving	% Mitigation from online cost savings	Group cost saving	% Mitigation from group cost savings
William Hill	5	10.8%	3	7.1%
Betfair	7	22.3%	0	0.0%
Paddy Power	3	11.8%	1	5.1%
Ladbrokes	3	14.5%	3	16.6%

Source: Citi Research

Online costs

We think that those with the highest cost base and which have grown costs fastest will be best placed to cut costs

The last few years have been characterised by operators building their businesses aggressively to try and build market share. We think that this will have led to some inefficiency and duplication of costs. The imposition of the point of consumption tax will force operators to take costs out to compensate. We think that those with the highest cost base and which have grown costs fastest will be best placed to cut costs. Ladbrokes' lack of online growth relative to peers suggests it may have least room to cut.

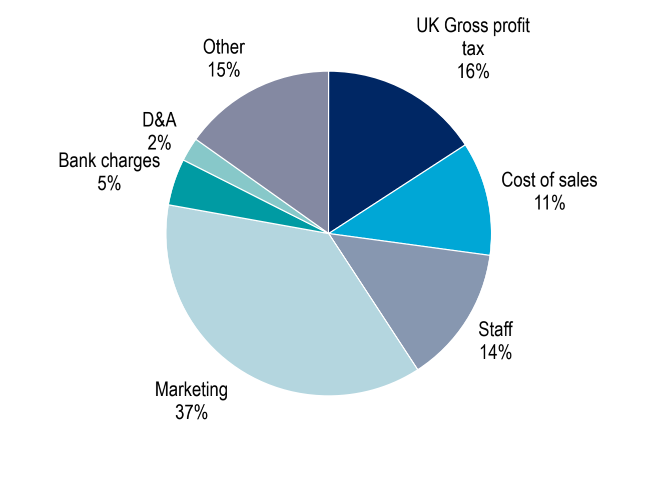
- William Hill's online costs have grown around 4.5x in from £50m in FY08 to £225m FY12;
- Ladbroke's online costs have grown c30% from £108m in FY08 to £145m in FY12;
- Betfair's core costs have grown c30% from £216m in FY09 to £278m in FY13;
- Paddy Power's European online costs have grown c3x from €46m in FY08 to €144m in FY12.

We show below a breakdown of William Hill's expected FY15 online costs as a guide to the key cost areas. Many of the costs will be directly variable to revenues (e.g. UK gross profits tax, cost of sales, bank charges) so we would expect cost reductions will come from staff costs and other administrative costs (eg content costs). There appears to be scope for all industry players to cut marketing costs

(especially affiliate costs – which may fall mechanically) but we expect management teams to be sensitive to reductions here given a likely fight for market share. As a result we don't see this as likely in the first instance.

Management teams should have flexibility as long as the market continues to grow. Holding certain costs flat in absolute terms will effectively reduce costs relative to top-line growth. If we assume 10% revenue growth and assume that staff costs and other costs are held flat and that marketing costs only increase 5%, then this implies that overall costs will grow only 5% – a 5% cost saving in real terms.

Figure 22. William Hill's FY15E cost split



Source: Citi Research

Figure 23. Industry cost inflation scenario based on WMH cost split

	Year 1	Year2	Comment
Revenue	100.0	110.0	10% revenue growth
UK Gross profit tax	-12.0	-13.2	Hold % of sales
Cost of sales	-8.6	-9.5	Hold % of sales
Staff	-10.3	-10.3	Hold flat
Marketing	-28.1	-29.5	Assume 5% growth
Bank charges	-3.5	-3.9	Hold % of sales
D&A	-1.8	-1.8	Hold flat
Other	-11.5	-11.5	Hold flat
EBIT	24.2	30.3	
Total costs	-75.8	-79.7	5% cost growth

Source: Citi Research

Other group costs

We expect operators to look across their businesses to reduce cost. Estimating where it may be possible to reduce costs is hard in a very diverse group of businesses, however we make an assumption that 0.5-1.0% of cost cuts outside the European online businesses may be achievable.

We would consider the following areas as particular targets:

- Closures of loss-making/marginally profitable retail shops;
- Content costs – especially horseracing content, a declining category;
- Head office infrastructure and support;
- Extraction of synergies from recent acquisitions.

Market share gains

The UK market is one of the most competitive online gambling markets in the world. The combination of a cultural and legal acceptance of gambling and a regulatory framework which meant that most online operators could avoid paying gambling taxes has encouraged this environment and allowed numerous smaller operators to prosper.

However, the imposition of the Point of consumption tax is likely to squeeze all operators. Even strong operators, currently offshore with a 30% EBIT margin, could see this margin halved to 15%. Smaller operators with margins at or below 15% could become loss-making without some mitigating action.

Data on the bottom 15% of the market is hard to come by. A 2011 Deloitte report estimated that average margins for these smaller players was between 10-20%. Many mid-tier players (e.g. Ladbrokes, bwin.party) that do publish financial information are not making online margins significantly above 15%. These companies all have a broader group strategy and some financial flexibility to subsidise near-term weakness in UK profitability.

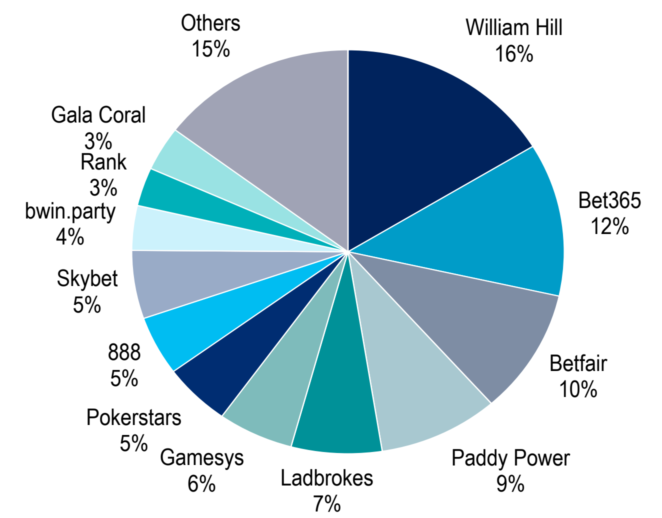
We expect that a significant proportion of the bottom 15% of the market will not have the margin headroom or financial flexibility to support their UK operations in the long term

However, we expect that a significant proportion of the bottom 15% of the market will not have the margin headroom or financial flexibility to support their UK operations in the long term – especially against a significant ramping up of marketing spend by the majors. This leaves two options open to these smaller players

- **1) Remain offshore/avoid the tax.** We see this as a short-term approach as the UK government has promised to ensure compliance and is threatening prison terms of up to seven years. ISP blocking, restrictions on marketing and controls on payments are also likely to make this approach difficult to sustain in the medium term.
- **2) Exit/run for cash**. We see this as a more likely scenario. Some operators (e.g. Rank's disposal of Bluesquare) are already disposing of businesses that they do not see as viable on a standalone basis. An alternative is for private companies to run for cash and wind down operations progressively.

As a result we think that a significant proportion of these smaller operators will not be viable. In our scenario analysis we assume that 50% of these operators (i.e. 7.5% of the market) exit.

Figure 24. Estimated UK online gambling market share for 2012 based on Gambling Data from 2011 and adjusted to reflect reported 2012 growth rates



Source: Gambling data, Citi Research

Figure 25. Estimated UK online gambling market share by category for 2012 based on Gambling Data from 2011 and adjusted to reflect reported 2012 growth rates

	Sports-betting	Casino	Poker	Bingo	Total
William Hill	18%	22%	7%	7%	16%
Bet365	23%	6%	2%	3%	12%
Betfair	19%	5%	5%	0%	10%
Paddy Power	13%	7%	8%	3%	9%
Ladbrokes	8%	9%	3%	4%	7%
Gamesys	0%	13%	0%	13%	6%
Pokerstars	0%	0%	37%	0%	5%
888	1%	8%	9%	6%	5%
Skybet	4%	8%	9%	1%	5%
bwin.party	0%	3%	6%	12%	4%
Rank	0%	1%	0%	20%	3%
Gala Coral	2%	2%	0%	16%	4%
Others	12%	18%	13%	17%	15%
Total	100%	100%	100%	100%	100%

Source: Gambling data, Citi Research

We see the market breaking down into three categories – market leaders, mid-market players, and the tail.

Market leaders

The market leaders include William Hill, Betfair and Paddy Power

Within the market leaders are William Hill, Betfair and Paddy Power. We think that the market leaders have displayed key success factors that will enable them to continue growing and take market share. Namely track record of growth, management expertise, technology and market scale/expertise. We think that these operators are well placed to take market share.

- William Hill – We see William Hill as one of the best-placed operators. As UK market leader and with (we estimate) the largest marketing budget (probably over £60m pa in the UK), WMH should have scope to take more than its fair share from any smaller operators which may fall away. Management has already locked in substantial marketing capacity (e.g. 55% of Channel 4 racing) for FY14 which we see as a sign of intent.

- Betfair – Betfair's strategy is likely to be different to others. New CEO Breon Corcoran has already been cutting costs and winding down unregulated markets to refocus marketing on key markets such as the UK. It wants to build a stronger mass market customer base but may choose to use its exchange USP rather than marketing spend. Commission increases are currently being trialled and could be used to boost profitability and act as an offset to POC tax. Irrespective of the PoC tax, we expect a further £10m of cost cutting in 2015 as the new CEO completes his transition of the business.

- Paddy Power – Paddy Power has long been a deft marketer and has built a strong market position despite relatively modest group marketing spend of £57m pa and probably less than £20m in the UK. However, the group's PR stunts and engagement with social media have helped it to deliver very strong awareness and market share. We expect his approach to continue.

- Bet365 – Unlike most peers, privately owned Bet365 is domiciled in the UK and therefore already pays gaming taxes. Post the introduction POC it will only have to pay gaming tax on its UK domiciled customer revenues or c40% of total revenues (according to Gambling data). This means that it could pay substantially less tax post POC. A lower tax bill could give the group more firepower to increase marketing spend.

Mid-tier players

We think these operators are likely to see their businesses sustained after the tax is introduced but struggle to see how they will grow meaningfully against their larger competitors given their smaller scale and/or lack of product diversification and lack of marketing scale.

- Ladbrokes – We are uncertain about the route that Ladbrokes will take. Its business has delivered weak profits in the last two years but recent technology improvements, the Playtech marketing deal and a strong retail presence means that it will likely continue to strive for growth and therefore should at least sustain its market share.

- Bwin.party – The UK represents only c10% of group revenues so the POC tax will have minimal impact on the group overall. However this is part of a wider barrage of tax increases across the group's operations and this continues to make us sceptical about the prospects for its European business. The presence of an effective call option on the US market opening up means it continues to be of interest to investors.

Other companies

- Pokerstars – With clear leadership in the poker market, Pokerstars is well placed in this liquidity driven market, with many other operators seeming to downplay poker expectations. The UK is only c10% of group revenues.

- Gamesys – There is little public information on this Bingo and Casino specialist. It has however been growing fast (+25% in 2012). According to media reports (realbusiness.co.uk) the company made EBITDA of £47.5m in 2012.

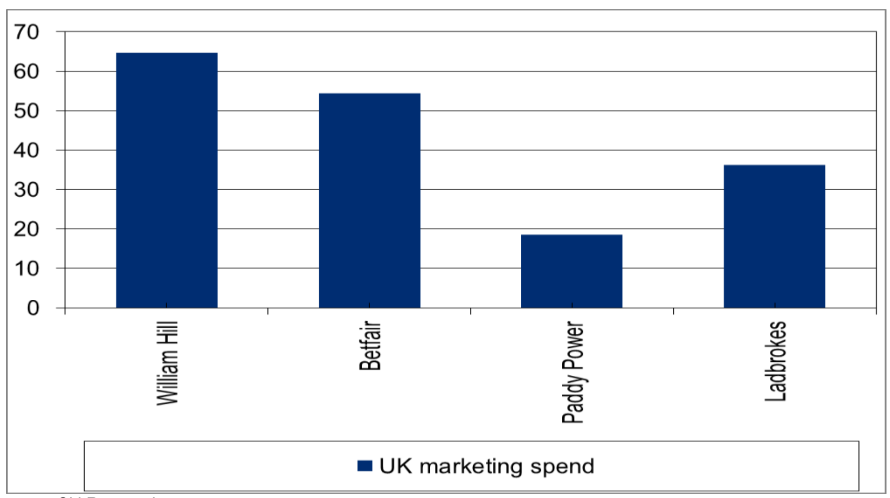
- 888 – 888 has been delivering good growth from its poker and casino offering. Reported margins remain low at c18% but UK represents less than 40% of group revenues.

- Skybet – Growth at over 40% last year has been very strong at this subsidiary of Sky. There is no disclosure of profitability but this strong growth, support of a large parent, guaranteed media exposure and some high profile sponsorship deals (e.g. Football League) should mean Skybet can hold its own.

- Rank group – Online revenues represent only c10% of group revenues with the group's main focus on terrestrial bingo and casino operations. Nevertheless the group has a strong online Bingo business with c20% market share. Online EBIT margins are c30%.

- Gala Coral – The group has relatively limited scale in the UK online sports and casino market (c2% share) but it has c16% bingo market share. Online EBITDA margins are c35%.

Figure 26. Estimated UK marketing spend (£m)



Source: Citi Research

Figure 27. Potential revenue gains from 7.5% share shift (£m)

Market share gains	Sports-betting	Casino	Poker	Bingo	Total gain	UK Sales uplift
William Hill	11	14	1	2	28	9%
Betfair	11	3	1	0	15	8%
Paddy Power	7	5	2	1	14	8%
Ladbrokes	4	6	1	1	12	9%

Source: Citi Research

Strong incremental margins

It is difficult to second guess which companies will gain most. We therefore assume that the 7.5% market share that could be freed from smaller operators will be spread proportionately across the top 12 players. As a result we assume in our scenario that they each gain 8-9% sales growth from this migration.

We expect incremental margins on these sales to be strong. We estimate that variable costs in the industry are c50% of total costs, but with the addition of an additional 15% tax incremental margins are unlikely to exceed 35/40%. We see this as an achievable target for the market leaders (e.g. William Hill). For this scenario we assume an incremental margin at 10%pts above the expected post-POC EBIT margin.

Figure 28. Potential EBIT uplift from market share gains.

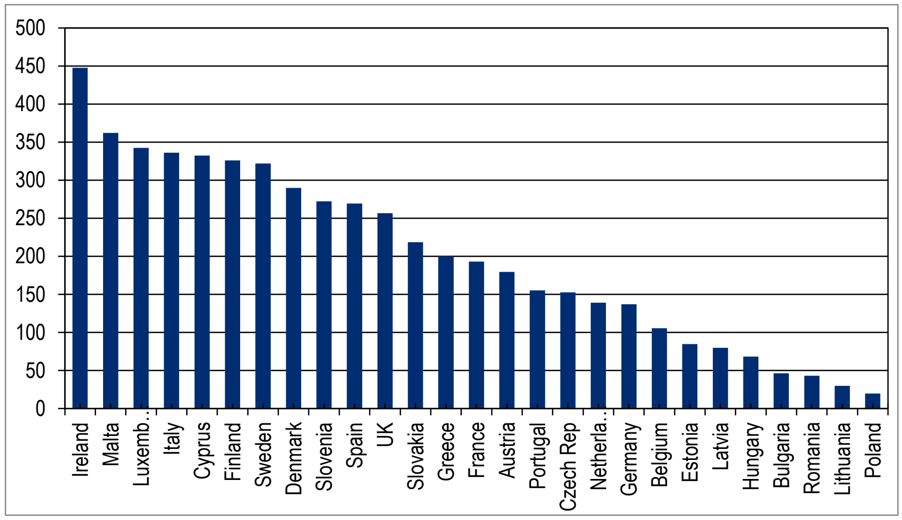
Market share gains	Total gain	UK Sales uplift	Incremental margin	Incremental EBIT	% Mitigation from share gains
William Hill	28	9%	33.8%	10	19.7%
Betfair	15	8%	16.5%	3	8.4%
Paddy Power	14	8%	25.4%	4	13.8%
Ladbrokes	12	9%	16.6%	2	9.7%

Source: Citi Research

Other avenues to mitigate the impact

Pan-European growth

Figure 29. Average annual gambling loss per adult (€)



Source: H2GC

We continue to be bullish about the scope for growth from the UK given the strong background and liberal regulation for gambling. However, other European countries are embracing online gambling and penetration rates are rising. We expect progress to be slow given that historically much of the gambling activity outside the UK has been on machines and lotteries and it will take time for consumers to adapt to the new products. However, we think that the UK operators have three key advantages over incumbent operators.

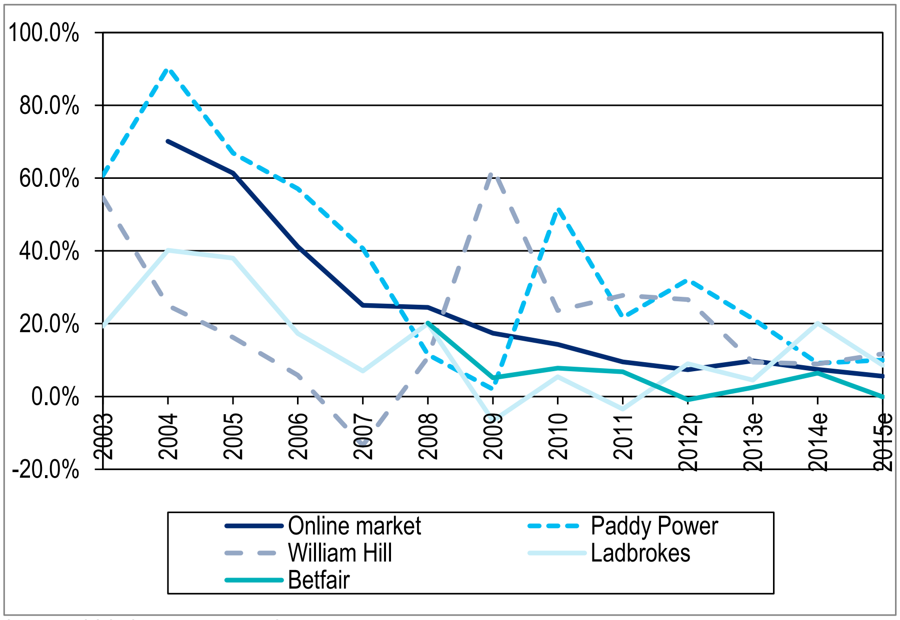
- Higher customer payouts – Traditional lottery products may have payouts as little as 60-70% compared to 93% for online sports and 97% for casino;
- Strong proven online technology – especially mobile;
- Strong digital marketing expertise in the most competitive European market.

Italy and Spain continue to offer the most interesting opportunity outside the UK

Italy and Spain continue to offer the most interesting opportunity outside the UK given the large market size, high propensity to gamble, favourable taxation and low penetration of online gambling to date. It's therefore no surprise that operators have targeted both markets aggressively since they were regulated.

Bwin.party had a pre-existing market position in both markets. Paddy Power and William Hill have built good market shares in these markets over the last year. Betfair operates its sportsbook in Spain and may launch its exchange in Spain and Italy once regulations permit. Ladbrokes does not appear to have a meaningful online market share in either market.

Figure 30. Online net Revenue growth trends

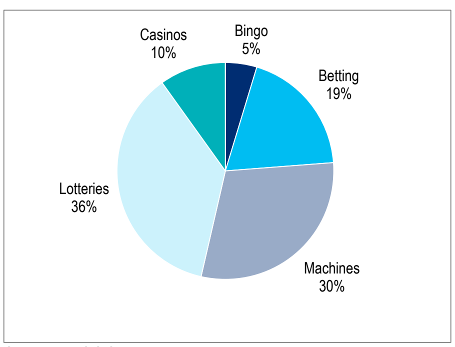


Source: H2GC, Company reports, Citi Research

In the near term we expect continued losses from new ventures in Italy and Spain but we think that they should move to breakeven or profitability in FY15 or FY16.

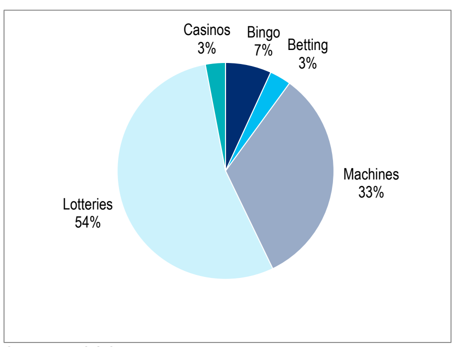
- In the case of Paddy Power this means a loss of €20m in FY12 should be eradicated by FY16 and this is assumed in our forecasts given the group's explicit guidance.
- William Hill has not commented on the scale of losses in newly regulated markets but we estimate revenues of less than £25m and high single-digit EBIT losses. A turnaround is not explicitly assumed in our forecasts.
- Ladbrokes is part way through building a land-based betting business in Spain (as well as established retail operations in Belgium and Ireland). These operations generate c10% of group EBIT and we don't expect meaningful growth in the near term.
- Bwin.party has a decent market position in both markets but does not disclose profitability by market. Data from AAMS suggests that it has been losing market share in Italy.

Figure 31. UK land based gambling



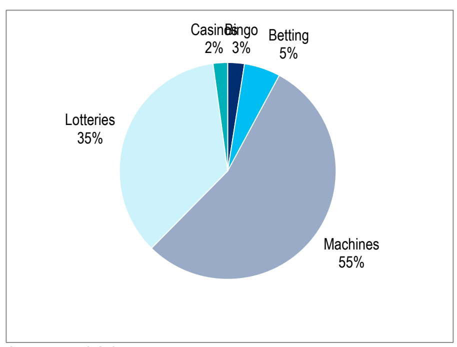
Source: H2GC

Figure 32. Spanish land based gambling



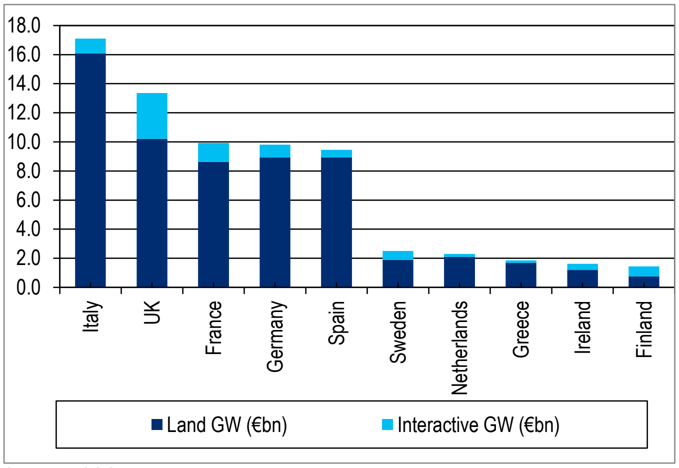
Source: H2GC

Figure 33. Italian land based gambling



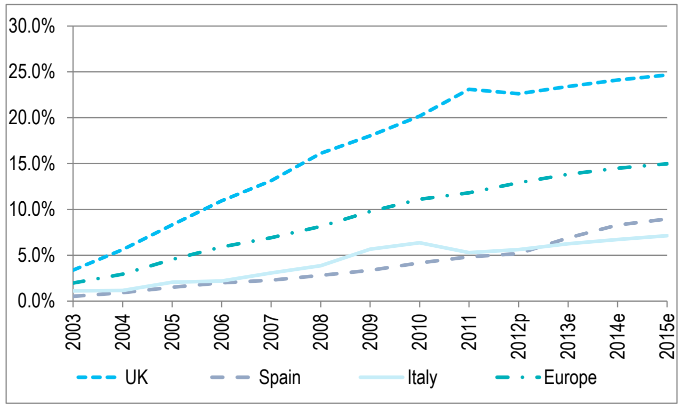
Source: H2GC

Figure 34. Land based and Online GGY by country (€bn)



Source: H2GC

Figure 35. % online penetration



Source: H2GC

Italy – Recently licensed, high propensity gamble market with new products on the way

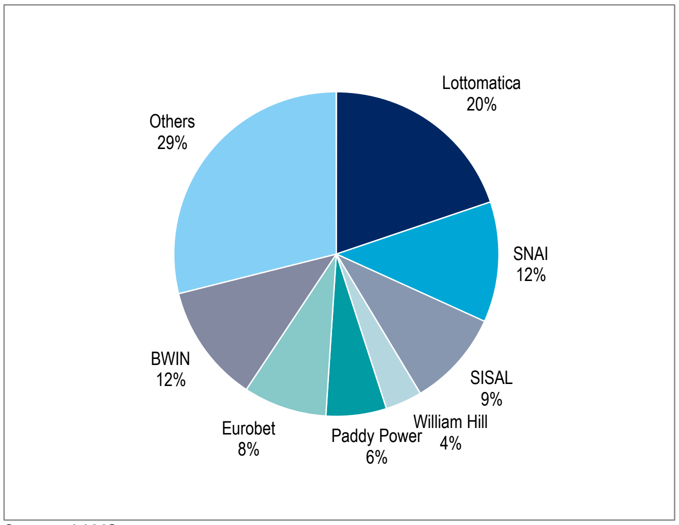
Italy has a strong gambling heritage led by machines and lotteries. However, favourable regulation has allowed the creation of a strong regulated online market over the last 18 months. Following the launch of slots in December 2012 most products are now allowed.

The Italian market is highly competitive with local incumbents Lottomatica, Sisal and SNAI holding the top three positions. Since the market has opened up William Hill and Paddy Power have established credible market positions. Based on the published data from the AAMS we estimate gross win for William Hill was c£12m in FY12 and Paddy Power (mainly sports) was c€6m.

Sports activity has been limited to 28 markets up to now, compared to c110 that William Hill offers in the UK

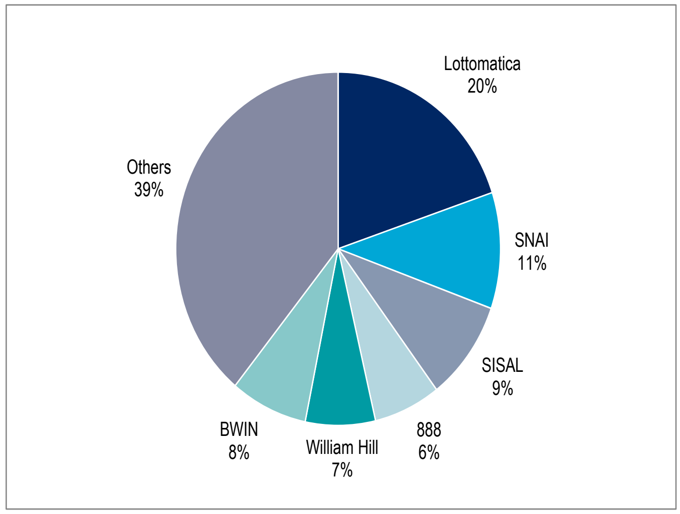
Sports activity has been limited to 28 markets up to now, compared to c110 that William Hill offers in the UK. This will be dramatically increased with the Palinsesto, which will effectively create an in-play market in Italy for the first time. In addition, operators should continue to innovate and launch new products (e.g. William Hill mobile due for launch in Q4).

Figure 36. Online sports betting share in 2012 - €166m GGY



Source: AAMS

Figure 37. Online Casino share in 2012 - €147m GGY



Source: AAMS

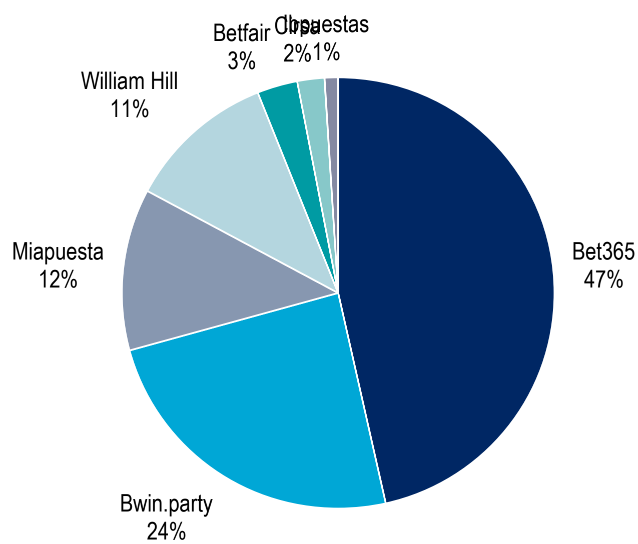
Spain – Recently licensed, high propensity gamble market with new products on the way

In the absence of strong incumbent sports betting operators in Spain, UK-based operators have quickly established themselves as market leaders in the online sports betting market in Spain. However, overall penetration of sports betting remains very low compared to the UK in what has traditionally been a lottery and machine market.

Based on annualised Q1 2013 data we estimate that William Hill has a run rate GGR of c£11m however exercising its option over Miapuesta could dramatically improve this position depending on the proportion of customers that are adopted.

Comparable data for the casino market shares are not available at the time of writing but data from DGOJ indicates that that the gaming market is a similar size to the sportsbetting market. However slots are prohibited at this time.

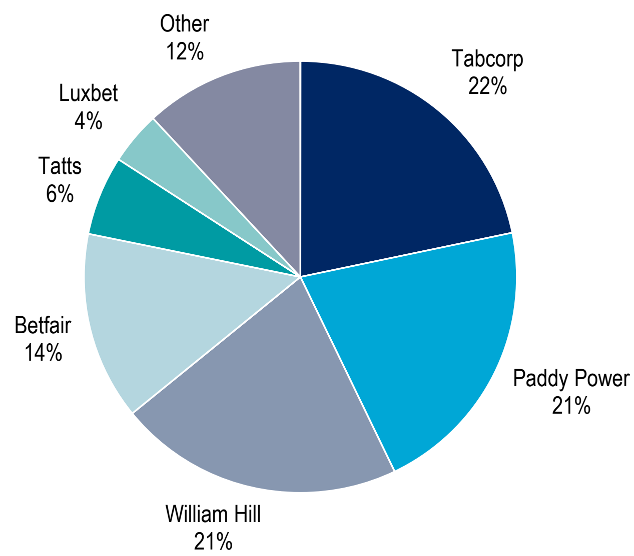
Figure 38. Estimated sports market share (2012) Annualized GGY of €120m



Source: William Hill, DGOJ

Australia is already a profitable market

Figure 39. Australian online market share – (2012)



Source: Company Reports and Citi Research; William Hill pro-forma for Tom Waterhouse acquisition

Paddy Power and more recently William Hill have both acquired leading market positions in the Australian online sports betting market - online casino and poker are banned.

Figure 40. Australian wagering market trends

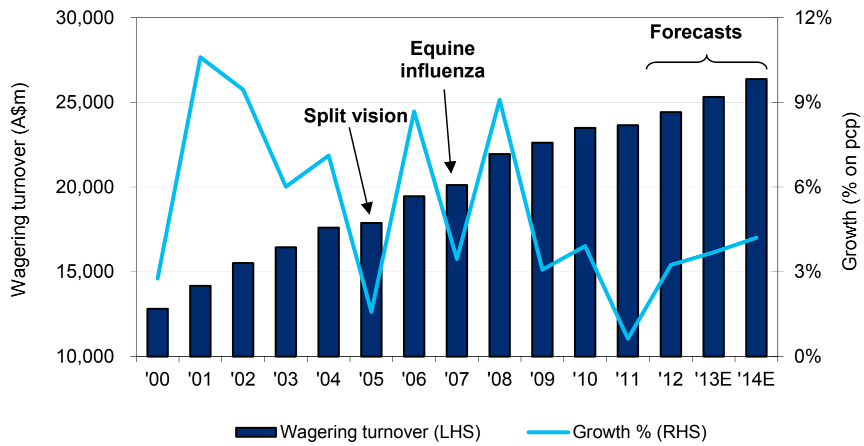
Industry market share ($m)	**'10**	**'11**	**'12**	**'13E**	**'14E**	**'15E**
Tabcorp	9,992	10,166	10,330	10,908	11,354	11,818
Tatts	3,356	3,426	3,473	3,812	3,928	4,156
Other TAB's	2,675	3,017	2,996	2,678	2,631	2,649
Bookmakers	6,594	6,893	6,850	7,019	7,405	7,759
TOTAL INDUSTRY	22,618	23,501	23,649	24,416	25,317	26,382
Growth (% on pcp)	3%	4%	1%	3%	4%	4%
Market Share (%)	'10	'11	'12	'13E	'14E	'15E
Tabcorp	44.2%	43.3%	43.7%	44.7%	44.8%	44.8%
Tatts	14.8%	14.6%	14.7%	15.6%	15.5%	15.8%
Other TAB's	11.8%	12.8%	12.7%	11.0%	10.4%	10.0%
Bookmakers	29.2%	29.3%	29.0%	28.7%	29.2%	29.4%

Source: Citi Research

The overall wagering (sports betting) market continues to grow at 3-4% pa

The overall wagering (sports betting) market continues to grow at 3-4% pa and represents c15% of all gambling activity in Australia (betting is c22% of the UK gambling market). The market continues to move online with c35% of wagering now done online vs c32% in the UK. Like the UK, the market is increasingly moving to mobile.

Figure 41. Australian wagering market trends



Source: Citi Research

We see regulation as a positive catalyst for the sector.

We see regulation as a positive catalyst for the sector. In-play betting is currently prohibited online but allowed over the telephone. This seems anomalous and we see scope for regulation to be amended in the medium term. Given that in-play sports betting represents c50% of European GGY from betting, this suggests there is considerable upside from such regulation – although we note that horse racing represents c70% of William Hill's Australian gross win, compared to 30-40% in Europe, somewhat limiting the upside potential.

Longer term the prohibition of online poker and casino seem illogical in the context of a broadly liberal gambling framework where customers can visit illegal offshore operators if they so choose – potentially losing the Australian government millions of dollars in tax revenue.

Paddy Power has already established a profitable and fast growing business in Australia making margins of c20%. William Hill has invested a total of £482m in the Sportingbet and Tom Waterhouse operations this year, but after allowing for costs to improve performance we expect only 14% EBIT margins this year. Management had promised to deliver a return above its post-tax cost of capital by 2017. Assuming a post-tax WACC of 7.5%, this would imply an EBIT of £43m in FY17, over 20% above our £35m EBIT forecast in FY17.

UK Retail holding its own but ex growth

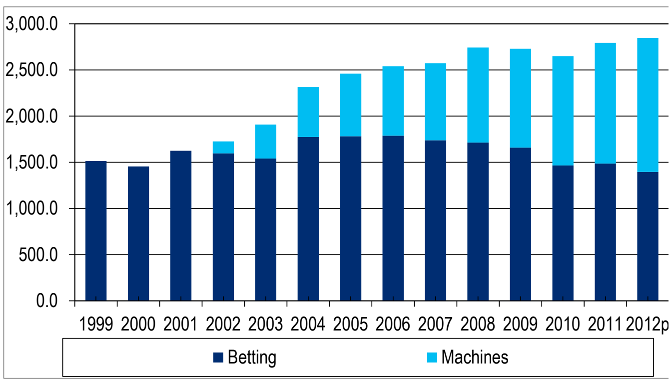
We see the presence of a large retail estate as a double-edged sword. In the short term it provides the operators with a nice counter balance against rising online taxes, but it also acts as a drag on growth long term.

We expect a continuation of the broadly stable revenue and EBIT outlook for retail operators

We expect a continuation of the broadly stable revenue and EBIT outlook for retail operators with machine innovation offsetting steadily declining OTC betting as has been the case in the recent past. Operators have been careful cost controllers however and this has meant that EBIT per shop levels have broadly been maintained despite the flat topline. However, in real terms profitability is under pressure.

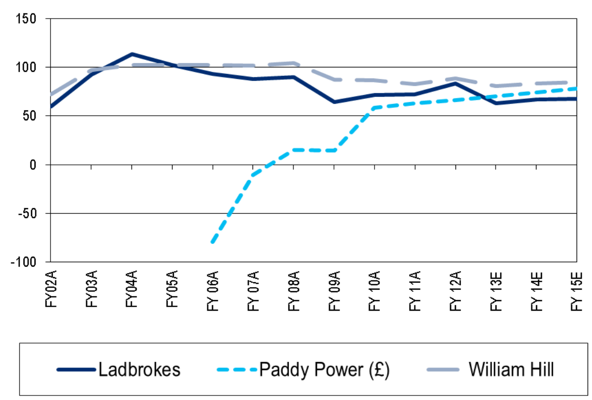
In this context Paddy Power (80% online) and Betfair (100% online) as predominantly online operations look well placed. Ladbrokes by contrast looks too exposed to this ex growth business especially post the POC tax when we estimate that online EBIT will represent only c15% of group EBIT. William Hill's growing online business offers a nice hedge at c50% of group EBIT.

Figure 42. UK Retail GGY evolution (£m)



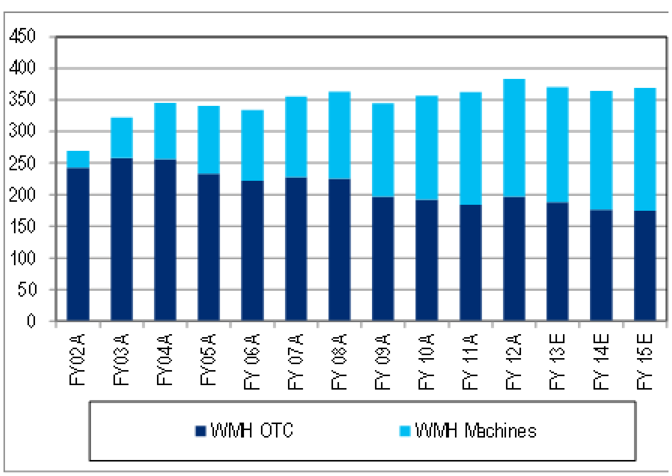
Source: H2GC

Figure 43. EBIT per shop evolution (£'000)



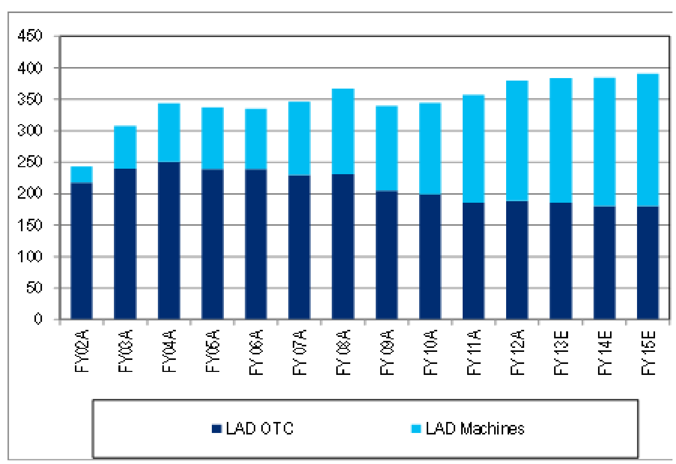
Source: Company data, Citi Research estimates

Figure 44. William Hill Retail net revenue per shop



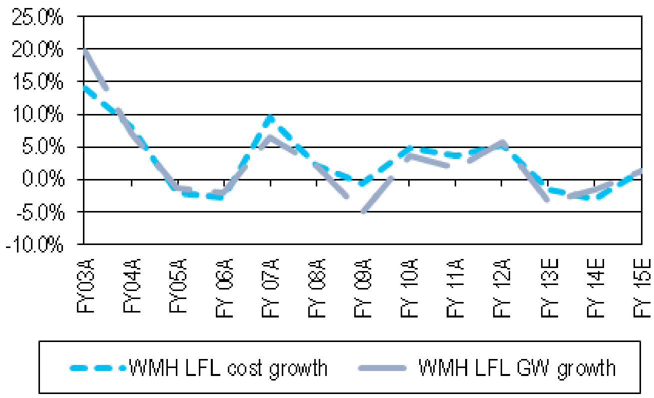
Source: Company data, Citi Research estimates

Figure 45. Ladbrokes Retail net revenue per shop



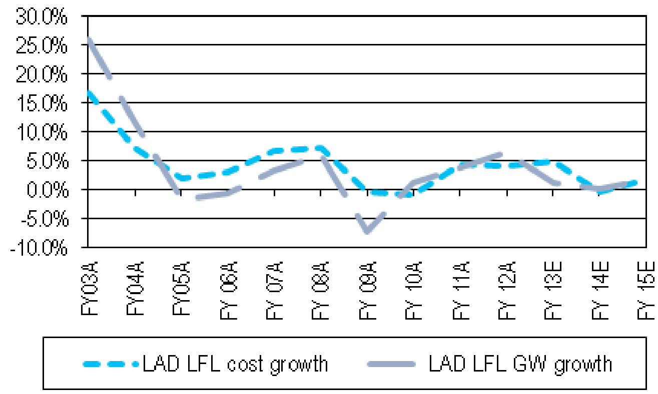
Source: Company data, Citi Research estimates

Figure 46. William Hill Gross win and costs per shop



Source: Company data, Citi Research estimates

Figure 47. Ladbrokes Gross win and costs per shop



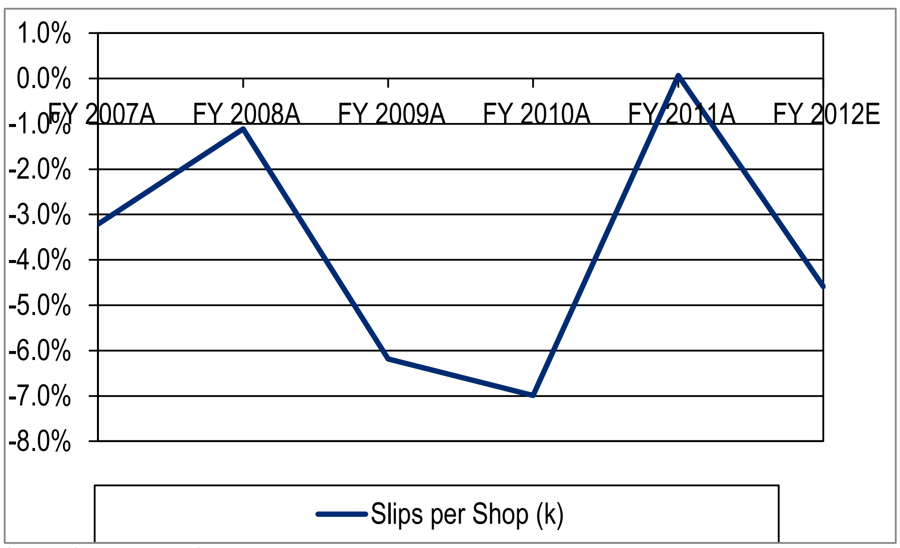
Source: Company data, Citi Research estimates

Reliance on an ever smaller number of customers

William hill estimates that its machine income is generated by c25% of its customers. Given that machines contribute c50% of retail net revenue and as machines continue to grow as a proportion of the whole, this suggests that the group is ever more reliant on a smaller number of customers.

Footfall data is not publicly available for the high street bookmakers but data on betting slips is published by Ladbrokes. From this we calculate slips per shop as a LFL measure of footfall. This data suggests that patronage of Ladbrokes betting shops is declining.

Figure 48. Ladbrokes slips per shop



Source: Company data, Citi Research estimates

We are not calling time on betting shops as overall net revenue trends look robust, but we do not see this as a growth business. Paddy Power's strategy of cherry-picking high footfall stores looks to be a sound approach, but Ladbrokes' approach of adding c5% new space this year looks to us to be an odd strategy.

We are concerned that this over-reliance on retail betting leaves the group exposed to further declines in footfall and or tightening regulation on machines – should that occur. We estimate that a 1% decline in retail LFL net revenues translates into a c3.5% decline in group EPS for Ladbrokes, whereas for William Hill a 1% decline in retail LFL net revenues would impact EPS by only 2%.

Company Focus

Buy	**1**
Price (22 Aug 13)	£9.93
Target price	£9.75
Expected share price return	-1.8%
Expected dividend yield	1.6%
Expected total return	**-0.2%**
Market Cap	£1,039M
	US$1,627M

Price Performance
(RIC: BETF.L, BB: BET LN)

Betfair (BETF.L)

Commission Changes and Cost Cutting to Largely Offset the Tax

- **We see potential for more cost cutting** – Since the new CEO arrived last year Betfair has already announced £30m savings of which £10m will be reinvested. We also include in our numbers a further £10m in FY15/6 to mitigate the PoC tax. But, we think that the group's lower margins relative to peers suggests that more can be done, and a further 2% cost cutting would be >10% accretive on our numbers.
- **However pricing changes alone could fully offset PoC** – We have previously flagged the significant potential from commission increases and cash returns (*Betfair (BETF.L) - Upgrade to Buy – commission increases and cash returns to drive value*, 10 June). We think changes in in pricing could fully offset the PoC tax (we assume a 15% revenue increase) and if so Betfair would face less pressure to cut costs.
- **Betfair to focus on market share gains** –The new sportsbook was only rolled out last year, and is therefore still quite small despite strong growth. We think Betfair will use the likely market shake-up from the new tax to increase market share and drive scale. Betfair has already acquired Blue Square (effectively for its customer list), and with a hefty cash war chest we would not be surprised to see further acquisitions potentially in advance of the tax. Management has said that if this cash is not used within the next year it will be returned to shareholders. We also expect a focus on organic growth through marketing and therefore see Betfair as likely to be one of the market share "winners".
- **Other potential issues** – Although unlikely to be material, differential pricing could be used to encourage "sophisticated bettors" to offshore their bets, bypassing this tax. Given c.65% of revenue is from these sophisticated bettors, if even 10% of these bettors moved offshore it could protect margins by c.1%.
- **Sportsbook/Exchange USP** – The cashout product is now available on 90% of football markets, and with 38% usage amongst football customers, is gaining traction. Other products such as best odds guarantee, and the eventual progression to one exchange/sportsbook product will likely give Betfair a strong USP in the market.
- **Feedback from pricing trials expected soon** – The company recently extended its pricing trials to a further 18 countries to better understand how pricing might impact the ecosystem and revenues. This means that testing has been ongoing for over four months now and we would expect some feedback from the company potentially at 1H results.

Betfair (GBP)

Year to 30 Apr	**2012A**	**2013A**	**2014E**	**2015E**	**2016E**
Sales (£M)	388.5	387.0	399.6	424.7	426.7
Profit Before Tax (£M)	56.7	38.3	66.1	69.2	58.6
Diluted EPS (p)	48.4	30.8	53.4	55.9	47.4
Diluted EPS (Old) (p)	48.4	30.8	53.4	55.9	47.4
PE (x)	20.5	32.2	18.6	17.7	20.9
EV/EBITDA (x)	10.3	12.0	8.3	8.0	8.9
DPS (p)	10.2	13.0	16.0	19.6	21.3
Net Div Yield (%)	1.0	1.3	1.6	2.0	2.1

BETF.L: Fiscal year end 30-Apr — **Price: £9.93; TP: £9.75; Market Cap: £1,039m; Recomm: Buy**

Profit & Loss (£m)	**2012**	**2013**	**2014E**	**2015E**	**2016E**
Sales revenue	388.5	387.0	399.6	424.7	426.7
Cost of sales	-339.7	-351.5	-337.1	-359.3	-371.8
Gross profit	48.8	35.5	62.5	65.5	54.9
Gross Margin (%)	12.6	9.2	15.6	15.4	12.9
EBITDA (Adj)	**86.0**	**73.3**	**102.5**	**103.7**	**91.2**
EBITDA Margin (Adj) (%)	22.1	18.9	25.6	24.4	21.4
Depreciation	-15.4	-14.6	-15.1	-16.1	-14.9
{[001763]}	-21.8	-23.2	-24.8	-22.1	-21.3
EBIT (Adj)	**48.8**	**35.5**	**62.5**	**65.5**	**54.9**
EBIT Margin (Adj) (%)	12.6	9.2	15.6	15.4	12.9
Net interest	3.6	1.4	1.6	1.7	1.8
Associates	4.3	1.4	2.0	2.0	2.0
Non-op/Except	-2.5	-87.7	-20.0	0	0
Pre-tax profit	**54.2**	**-49.4**	**46.1**	**69.2**	**58.6**
Tax	-7.6	4.2	-10.6	-11.1	-9.4
Extraord./Min.Int./Pref.div.	-11.9	-21.1	0	0	0
Reported net profit	**34.7**	**-66.3**	**35.5**	**58.1**	**49.3**
Net Margin (%)	8.9	-17.1	8.9	13.7	11.5
Core NPAT	51.7	32.1	55.5	58.1	49.3

Per share data	**2012**	**2013**	**2014E**	**2015E**	**2016E**
Reported EPS (p)	32.5	-63.7	34.2	55.9	47.4
Core EPS (p)	48.4	30.8	53.4	55.9	47.4
DPS (p)	10.2	13.0	16.0	19.6	21.3
CFPS (p)	91.5	80.7	75.2	79.6	63.9
FCFPS (p)	36.1	44.1	37.3	42.8	29.0
BVPS (p)	193.7	129.6	148.9	186.0	213.6
Wtd avg ord shares (m)	105	102	102	102	102
Wtd avg diluted shares (m)	107	104	104	104	104

Growth rates	**2012**	**2013**	**2014E**	**2015E**	**2016E**
Sales revenue (%)	-1.2	-0.4	3.3	6.3	0.5
EBIT (Adj) (%)	16.5	-27.3	76.2	4.7	-16.2
Core NPAT (%)	42.2	-37.9	72.9	4.7	-15.3
Core EPS (%)	46.1	-36.3	73.2	4.7	-15.3

Balance Sheet (£m)	**2012**	**2013**	**2014E**	**2015E**	**2016E**
Cash & cash equiv.	135.4	168.1	189.4	214.0	222.9
Accounts receivables	29.6	18.7	19.3	20.5	20.6
Inventory	0	0	0	0	0
Net fixed & other tangibles	33.7	25.7	26.3	25.5	25.1
Goodwill & intangibles	132.4	54.6	53.4	54.2	54.6
Financial & other assets	8.3	9.2	9.2	18.7	37.8
Total assets	**339.4**	**276.3**	**297.6**	**332.8**	**361.0**
Accounts payable	118.5	109.6	113.2	120.3	120.8
Short-term debt	0	0	0	0	0
Long-term debt	0	0	0	0	0
Provisions & other liab	24.8	34.7	33.2	23.1	23.1
Total liabilities	**143.3**	**144.3**	**146.4**	**143.4**	**143.9**
Shareholders' equity	196.1	132.0	151.2	189.4	217.0
Minority interests	0	0	0	0	0
Total equity	**196.1**	**132.0**	**151.2**	**189.4**	**217.0**
Net debt	**-135.4**	**-168.1**	**-189.4**	**-214.0**	**-222.9**
Net debt to equity (%)	-69.1	-127.3	-125.3	-112.9	-102.7

Valuation ratios	**2012**	**2013**	**2014E**	**2015E**	**2016E**
PE (x)	20.5	32.2	18.6	17.7	20.9
PB (x)	5.1	7.7	6.7	5.3	4.6
EV/EBITDA (x)	10.3	12.0	8.3	8.0	8.9
FCF yield (%)	3.6	4.4	3.8	4.3	2.9
Dividend yield (%)	1.0	1.3	1.6	2.0	2.1
Payout ratio (%)	21	42	30	35	45
ROE (%)	17.0	-40.4	25.1	34.1	24.2

Cashflow (£m)	**2012**	**2013**	**2014E**	**2015E**	**2016E**
EBITDA	86.0	73.3	102.5	103.7	91.2
Working capital	17.7	32.8	3.0	5.9	0.5
Other	-6.0	-22.1	-27.3	-26.9	-25.2
Operating cashflow	**97.7**	**84.0**	**78.1**	**82.7**	**66.4**
Capex	-59.1	-38.1	-39.3	-38.2	-36.3
Net acq/disposals	-0.1	-5.7	0	0	0
Other	0	0	0	0	0
Investing cashflow	**-59.1**	**-43.8**	**-39.3**	**-38.2**	**-36.3**
Dividends paid	-9.6	-11.2	-17.4	-19.9	-21.2
Financing cashflow	**-57.6**	**-7.0**	**-17.4**	**-19.9**	**-21.2**
Net change in cash	**-19.7**	**32.7**	**21.4**	**24.5**	**8.9**
Free cashflow to s/holders	**38.6**	**45.9**	**38.8**	**44.5**	**30.1**

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Company Focus

bwin.party digital entertainment plc (BPTY.L)

Tax Headwinds All Over Europe

Neutral	**2**
Price (22 Aug 13)	£1.32
Target price	£1.30
Expected share price return	-1.2%
Expected dividend yield	2.9%
Expected total return	**1.7%**
Market Cap	£1,069M
	US$1,674M

Price Performance
(RIC: BPTY.L, BB: BPTY LN)

- **Low exposure to UK** – Only c.10% of bwin.party's revenues come from the UK and we expect its exposure to the online POC tax is of a similar magnitude. However this is one tax of many that we expect bwin.party to have to incur and we expect bwin's tax charge to rise from c.£83m in FY12 to £150m by FY15. Although we assume no special mitigation for the UK POC tax, we do already assume 5% costs are cut across the business in response to these taxes. As a result we leave our forecasts unchanged ahead of H1 results on 30 August.
- **We expect downgrades at H1** – We forecast 1H net revenue -17% at £341.4m with EBITDA (excluding share based payments) margin of 18.2% at £62m. Despite a c.-17% YoY revenue decline reported for Q1 and a weaker than expected Q2, management has not revised FY13 guidance of -10% revenue decline (Citi -12%). Similarly the FY13 margin target of 19.1% looks optimistic on our forecasts (Citi 18.2%). We think that if results come in at or below our forecasts, management will need to revise guidance.
- **1H forecasts** – We expect poker revenues of £60m (-38% yoy), sports revenues of £124m (-3% yoy), casino revenues of £109m (-22% yoy) and bingo revenues of £29m (-9% yoy).
- **Structural weakness in Europe** – We expect bwin's underlying European growth rates to continue to lag UK-based competitors in the medium term given its large exposure to poker, currently in decline, and broad geographic spread which means it is harder to compete in products such as mobile. In addition the loss of unregulated revenues may ensure "cleaner" earnings, but in the short term could continue to act as a drag on earnings.
- **New Jersey should go live towards the end of this year** – We expect this to drive upgrades through 2013. We expect other states to eventually follow NJ resulting in a patchwork of regulatory frameworks. Our bottom-up analysis suggests that the US market could be worth €7.9bn by FY18. We think bwin.party can capture c.15% market share which with margins of c.15-20% would be worth 53p. California will probably be the most important state to watch near term although we don't expect regulation before 2014.
- **Remain Neutral** – bwin.party trades at a deserved discount to peers in our view, at FY13E PE of 14.5x and EV/EBITDA of 9.1x vs. the sector at 16.1x and 9.9x respectively. We would wait for a better entry point.

bwin.party digital entertainment plc (EUR)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (€M)	816.0	801.6	705.4	752.5	843.9
Net Income (€M)	165.4	112.3	86.7	93.1	65.9
Diluted EPS (¢)	20	14	11	11	8
Diluted EPS (Old) (¢)	20	14	11	11	8
PE (x)	7.9	11.3	14.5	13.5	19.0
EV/EBITDA (x)	5.8	7.9	9.1	7.9	9.1
DPS (¢)	3	3	4	4	4
Net Div Yield (%)	2.0	2.2	2.5	2.6	2.7

BPTY.L: Fiscal year end 31-Dec — Price: £1.32; TP: £1.30; Market Cap: £1,073m; Recomm: Neutral

Profit & Loss (€m)	2011	2012	2013E	2014E	2015E
Sales revenue	816.0	801.6	705.4	752.5	843.9
Cost of sales	-96.2	-114.0	-141.6	-147.1	-182.0
Gross profit	719.8	687.6	563.9	605.4	661.9
Gross Margin (%)	88.2	85.8	79.9	80.5	78.4
EBITDA (Adj)	**186.8**	**145.0**	**128.2**	**138.8**	**116.7**
EBITDA Margin (Adj) (%)	22.9	18.1	18.2	18.5	13.8
Depreciation	-20.9	-21.3	-24.7	-26.3	-29.5
{[001763]}	-5.9	-4.0	-3.5	-3.8	-4.2
EBIT (Adj)	**160.0**	**119.7**	**100.0**	**108.7**	**83.0**
EBIT Margin (Adj) (%)	19.6	14.9	14.2	14.5	9.8
Net interest	-2.7	-7.2	-3.6	-3.6	-3.6
Associates	-1.3	0.2	0	0	0
Non-op/Except	-546.3	-136.2	-70.5	-69.8	-46.8
Pre-tax profit	**-390.3**	**-23.5**	**25.8**	**35.3**	**32.5**
Tax	6.6	-1.4	-9.6	-12.0	-13.4
Extraord./Min.Int./Pref.div.	-18.3	-38.8	0	0	0
Reported net profit	**-402.0**	**-63.7**	**16.2**	**23.3**	**19.1**
Net Margin (%)	-49.3	-7.9	2.3	3.1	2.3
Core NPAT	165.4	112.3	86.7	93.1	65.9
Per share data	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Reported EPS (¢)	-48	-8	2	3	2
Core EPS (¢)	20	14	11	11	8
DPS (¢)	3	3	4	4	4
CFPS (¢)	7	1	17	15	12
FCFPS (¢)	2	-4	12	10	7
BVPS (¢)	94	83	85	88	90
Wtd avg ord shares (m)	846	819	810	810	810
Wtd avg diluted shares (m)	846	819	810	810	810
Growth rates	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Sales revenue (%)	0.2	-1.8	-12.0	6.7	12.2
EBIT (Adj) (%)	6.4	-25.2	-16.5	8.8	-23.7
Core NPAT (%)	12.3	-32.1	-22.8	7.4	-29.2
Core EPS (%)	12.3	-29.9	-21.9	7.4	-29.2
Balance Sheet (€m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Cash & cash equiv.	289.0	169.7	243.5	296.3	318.9
Accounts receivables	129.7	139.4	135.3	130.9	127.2
Inventory	0	0	0	0	0
Net fixed & other tangibles	55.9	75.2	76.4	78.9	81.0
Goodwill & intangibles	738.6	679.6	615.5	570.5	549.1
Financial & other assets	91.6	31.5	34.8	51.0	65.2
Total assets	**1,304.8**	**1,095.4**	**1,105.5**	**1,127.5**	**1,141.3**
Accounts payable	112.7	72.0	65.7	63.9	60.1
Short-term debt	33.2	6.9	6.9	6.9	6.9
Long-term debt	0	29.5	29.5	29.5	29.5
Provisions & other liab	365.4	318.1	315.5	316.1	314.6
Total liabilities	**511.3**	**426.5**	**417.6**	**416.4**	**411.1**
Shareholders' equity	797.3	671.7	687.9	711.2	730.2
Minority interests	-3.8	-2.8	0	0	0
Total equity	**793.5**	**668.9**	**687.9**	**711.2**	**730.2**
Net debt	**-255.8**	**-133.3**	**-207.1**	**-259.9**	**-282.5**
Net debt to equity (%)	-32.2	-19.9	-30.1	-36.5	-38.7

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	7.9	11.3	14.5	13.5	19.0
PB (x)	1.6	1.9	1.8	1.8	1.7
EV/EBITDA (x)	5.8	7.9	9.1	7.9	9.1
FCF yield (%)	1.5	-2.6	8.0	6.7	4.4
Dividend yield (%)	2.0	2.2	2.5	2.6	2.7
Payout ratio (%)	16	25	35	35	51
ROE (%)	-78.0	-8.7	2.4	3.3	2.6
Cashflow (€m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
EBITDA	186.8	145.0	128.2	138.8	116.7
Working capital	-73.0	-84.4	-2.2	2.6	-0.1
Other	-52.0	-54.2	8.6	-18.9	-18.9
Operating cashflow	**61.8**	**6.4**	**134.6**	**122.5**	**97.7**
Capex	-41.6	-39.7	-34.6	-38.4	-42.2
Net acq/disposals	153.3	-21.4	0	0	0
Other	-20.5	14.7	0	0	0
Investing cashflow	**91.2**	**-46.4**	**-34.6**	**-38.4**	**-42.2**
Dividends paid	-15.0	-33.0	-26.2	-31.3	-32.9
Financing cashflow	**-50.1**	**-79.7**	**-26.2**	**-31.3**	**-32.9**
Net change in cash	**95.3**	**-119.3**	**73.8**	**52.8**	**22.6**
Free cashflow to s/holders	**20.2**	**-33.3**	**100.0**	**84.1**	**55.5**

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Company Focus

- **Estimate Change**

Neutral	**2**
Price (22 Aug 13)	£1.95
Target price	£1.90
Expected share price return	-2.5%
Expected dividend yield	4.6%
Expected total return	**2.2%**
Market Cap	£1,788M
	US$2,800M

Price Performance
(RIC: LAD.L, BB: LAD LN)

Ladbrokes (LAD.L)

We're Not Convinced

- **Least exposed but least to gain** – With only c12% of group revenues from UK online customers LAD has one of the smallest exposures of this peer group – with the potential tax liability representing c8.5% of EBIT. However this reflects the historical weaknesses in its online business which lacks scale compared to peers. Our forecasts assume only 15% of group EBIT comes from online in FY15 and we remain to be convinced that the group can close the gap to peers given its lack of marketing scale and persistent technology delays.
- **Forecast reductions** – Following disappointing H1 results we cut our FY13-FY15 forecasts by c10%. This reflects the group's weak retail performance, especially poor in machines in July, but we also cut our Digital forecasts given the weakness in KPI's. Netting off within the FY15 downgrade is a c4% uplift for POC tax mitigation.
- **Still a steep hill to climb** – H1 results emphasised again how far the group has to go to catch up with peers. Digital operating profit was -28% YOY but more concerning was the weakness in KPIs – in particular real money sign-ups -20% and average monthly active player days -20% for sports – despite the launch of the new sportsbook and mobile app during the period.
- **Playtech has its work cut out** – Playtech has undoubted skill in online marketing, but we think that any turnaround will take time. Near-term technology priorities include cutting over to the Playtech casino software and re-launching mobile on the Mobenga platform – both are promised by end Q1 14. However this leaves just eight months for the group to ramp up sales and deliver a profit improvement before POC tax hits. We assume +20% net revenue growth in FY14 but this looks optimistic at this point.
- **Highly exposed to retail** – With c85% of EBIT expected to come from Retail in FY15, the group is highly exposed to this ex-growth business. Although we don't expect this, an acceleration in the decline of OTC staking or adverse machine regulation would hit the business hard with a 1% decline in Retail revenues dropping through to c3.5% to EPS we estimate. Against this backdrop the group's strategy to increase UK store numbers by c5% looks odd.
- **Cheap for a reason** – On our revised forecasts Ladbrokes trades on 11x FY14 PE and 8x EV/EBITDA. This is a substantial discount to its more online-focused peers but broadly in line with its long-term history and reflecting a four-year EPS CAGR of -2% (ex-high rollers). We leave our 190p target price unchanged.

Ladbrokes (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (£M)	976.1	1,053.3	1,132.1	1,192.6	1,222.5
Profit Before Tax (£M)	157.5	206.4	148.3	173.6	164.7
Diluted EPS (p)	15.2	21.2	14.4	16.9	16.0
Diluted EPS (Old) (p)	15.2	21.2	16.0	18.9	17.7
PE (x)	12.8	9.2	13.5	11.5	12.2
EV/EBITDA (x)	9.1	7.3	9.3	8.3	8.4
DPS (p)	7.8	8.9	8.9	8.9	8.9
Net Div Yield (%)	4.0	4.6	4.6	4.6	4.6

LAD.L: Fiscal year end 31-Dec — Price: £1.95; TP: £1.90; Market Cap: £1,790m; Recomm: Neutral

Profit & Loss (£m)	2011	2012	2013E	2014E	2015E
Sales revenue	976	1,053	1,132	1,193	1,222
Cost of sales	-779	-813	-959	-997	-1,041
Gross profit	197	241	173	196	182
Gross Margin (%)	20.2	22.8	15.3	16.4	14.9
EBITDA (Adj)	**239**	**291**	**228**	**254**	**242**
EBITDA Margin (Adj) (%)	24.4	27.6	20.2	21.3	19.8
Depreciation	-41	-39	-41	-43	-44
{[001763]}	-7	-16	-15	-16	-16
EBIT (Adj)	**190**	**236**	**173**	**196**	**182**
EBIT Margin (Adj) (%)	19.5	22.4	15.3	16.4	14.9
Net interest	-33	-30	-24	-22	-17
Associates	0	0	0	0	0
Non-op/Except	-23	-6	-35	0	0
Pre-tax profit	**135**	**201**	**114**	**174**	**165**
Tax	-17	-10	-13	-17	-16
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net profit	**118**	**190**	**100**	**156**	**148**
Net Margin (%)	12.1	18.1	8.9	13.1	12.1
Core NPAT	139	196	133	156	148
Per share data	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Reported EPS (p)	12.9	20.6	10.8	16.9	16.0
Core EPS (p)	15.2	21.2	14.4	16.9	16.0
DPS (p)	7.8	8.9	8.9	8.9	8.9
CFPS (p)	20.3	26.6	21.7	24.7	23.9
FCFPS (p)	11.8	15.5	11.3	18.3	18.6
BVPS (p)	33.9	46.7	49.9	58.2	65.6
Wtd avg ord shares (m)	908	908	915	915	915
Wtd avg diluted shares (m)	917	922	925	925	925
Growth rates	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Sales revenue (%)	-0.4	7.9	7.5	5.3	2.5
EBIT (Adj) (%)	-8.2	24.0	-26.9	13.3	-7.2
Core NPAT (%)	1.0	40.6	-31.9	17.2	-5.2
Core EPS (%)	0.0	39.9	-32.1	17.2	-5.2
Balance Sheet (£m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Cash & cash equiv.	26	19	20	107	198
Accounts receivables	81	74	70	74	76
Inventory	0	0	0	0	0
Net fixed & other tangibles	201	215	270	287	292
Goodwill & intangibles	629	667	651	635	619
Financial & other assets	100	88	95	95	95
Total assets	**1,038**	**1,063**	**1,106**	**1,199**	**1,280**
Accounts payable	143	140	111	132	135
Short-term debt	131	0	6	423	447
Long-term debt	349	406	406	0	0
Provisions & other liab	108	94	133	119	106
Total liabilities	**731**	**641**	**656**	**674**	**688**
Shareholders' equity	306	421	450	525	592
Minority interests	1	1	0	0	0
Total equity	**307**	**422**	**450**	**525**	**592**
Net debt	**454**	**387**	**392**	**316**	**249**
Net debt to equity (%)	148.0	91.6	87.1	60.1	42.1

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	12.8	9.2	13.5	11.5	12.2
PB (x)	5.7	4.2	3.9	3.3	3.0
EV/EBITDA (x)	9.1	7.3	9.3	8.3	8.4
FCF yield (%)	6.0	8.0	5.8	9.4	9.6
Dividend yield (%)	4.0	4.6	4.6	4.6	4.6
Payout ratio (%)	51	42	62	53	56
ROE (%)	42.0	52.3	23.0	32.0	26.5
Cashflow (£m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
EBITDA	239	291	228	254	242
Working capital	10	-5	35	0	0
Other	-62	-41	-62	-26	-21
Operating cashflow	**186**	**245**	**201**	**229**	**221**
Capex	-78	-102	-96	-60	-49
Net acq/disposals	1	-3	-20	0	0
Other	0	2	2	0	0
Investing cashflow	**-77**	**-103**	**-113**	**-60**	**-49**
Dividends paid	-69	-74	-81	-81	-81
Financing cashflow	**-101**	**-149**	**-87**	**-81**	**-81**
Net change in cash	**9**	**-7**	**0**	**88**	**91**
Free cashflow to s/holders	**108**	**143**	**105**	**169**	**172**

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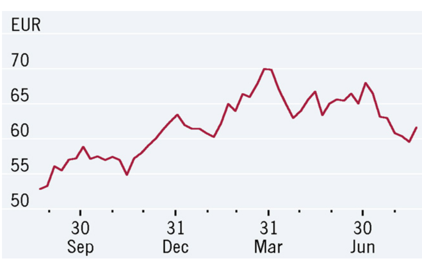
Company Focus

■ Estimate Change

Buy	1
Price (22 Aug 13)	€61.90
Target price	€75.00
Expected share price return	21.2%
Expected dividend yield	2.2%
Expected total return	**23.4%**
Market Cap	€3,041M
	US$4,061M

Price Performance
(RIC: PAP.L, BB: PAP LN)



Paddy Power (PAP.L)

Under Performance Looks Overdone

- **Time for a flutter** – Paddy Power's share price has lagged in the last six months as the weak Australian $ has been a drag on earnings and director share sales have weighed on sentiment. We trim our FY13/14/15 EPS by 2.5%/3.9%/1.2% to reflect recent FX moves and likely lower-than-expected interest income. This is netted off by c4% POC tax mitigation in FY15. Nevertheless we expect good H1 results to reassure investors and retain our Buy recommendation and €75 target.

- **H1 results preview** – Following the group's strong AGM statement in May we expect good H1 results. We forecast H1 revenues of €381m, EBIT of €75.5m, PBT of €77m and EPS of €1.37. For H1 we forecast net revenue growth of +29% in Online (ex-Australia), +29% in Australia, +33% in UK Retail and -3.3% in Irish Retail. Given that only 20% of group EBIT is from UK and Irish retail the group should not be overly exposed to the weather related poor trading in July.

- **Hit hard by POC but good upside from mitigation** – Our forecasts assume that EPS falls 3% in FY15 as the group absorbs POC tax. Although PAP has a small marketing budget relative to peers, its marketing flair and ability to create positive PR is unrivalled. We don't doubt that PAP can hold its own in the marketing race which is likely to ensue, despite its smaller budget.

- **Strong track record of growth** – PAP has delivered some of the best net revenue growth in the industry and consistently good EPS momentum. Recent investments in Italy and mobile gaming have held back profits by €20m in FY12, but as these investments start to deliver this should help accelerate growth, leaving the group with a four-year EPS CAGR of 9% on our estimates despite the POC hit.

- **Valuation looks attractive** – Based on our FY14 forecasts the stock is now trading 18.8x PE but this falls to only 16.6x PE adjusted for cash. Historically, with the exception of the 2008/09 financial crisis, the group has traded between 15x and 22x reflecting its strong track record of growth and earnings momentum as well as the fact that c80% of EBIT is from online. Ahead of H1 results we think that this represents an attractive entry point and reiterate our Buy recommendation and €75 target.

Paddy Power (EUR)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (€M)	499.3	653.8	755.5	829.0	912.2
Net Income (€M)	103.5	121.0	136.4	160.3	156.0
Diluted EPS (€)	2.12	2.48	2.80	3.29	3.20
Diluted EPS (Old) (€)	2.12	2.48	2.87	3.42	3.24
PE (x)	29.2	24.9	22.1	18.8	19.3
EV/EBITDA (x)	19.9	17.2	14.9	12.5	12.2
DPS (€)	1.00	1.20	1.38	1.59	1.67
Net Div Yield (%)	1.6	1.9	2.2	2.6	2.7

PAP.L: Fiscal year end 31-Dec — **Price: €61.90; TP: €75.00; Market Cap: €3,041m; Recomm: Buy**

Profit & Loss (€m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Sales revenue	499	654	756	829	912
Cost of sales	-71	-100	-135	-150	-207
Gross profit	428	554	621	679	705
Gross Margin (%)	85.7	84.7	82.1	81.9	77.3
EBITDA (Adj)	**147**	**168**	**191**	**221**	**218**
EBITDA Margin (Adj) (%)	29.4	25.7	25.3	26.6	24.0
Depreciation	-21	-26	-30	-33	-36
{[001763]}	-6	-6	-7	-8	-8
EBIT (Adj)	**120**	**136**	**154**	**180**	**174**
EBIT Margin (Adj) (%)	23.9	20.8	20.3	21.7	19.0
Net interest	2	3	3	4	6
Associates	0	0	0	0	0
Non-op/Except	22	0	0	0	0
Pre-tax profit	**143**	**139**	**157**	**184**	**179**
Tax	-21	-18	-20	-24	-23
Extraord./Min.Int./Pref.div.	-1	0	0	0	0
Reported net profit	**121**	**121**	**136**	**160**	**156**
Net Margin (%)	24.3	18.5	18.1	19.3	17.1
Core NPAT	104	121	136	160	156
Per share data	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Reported EPS (€)	2.49	2.48	2.80	3.29	3.20
Core EPS (€)	2.12	2.48	2.80	3.29	3.20
DPS (€)	1.00	1.20	1.38	1.59	1.67
CFPS (€)	3.34	4.43	4.28	4.71	4.75
FCFPS (€)	2.50	3.38	3.12	3.44	3.35
BVPS (€)	4.85	5.84	7.31	9.07	10.67
Wtd avg ord shares (m)	47.6	48.2	48.2	48.2	48.2
Wtd avg diluted shares (m)	48.8	48.8	48.8	48.8	48.8
Growth rates	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Sales revenue (%)	12.6	30.9	15.6	9.7	10.0
EBIT (Adj) (%)	15.2	13.8	13.0	17.1	-3.5
Core NPAT (%)	24.9	16.9	12.7	17.5	-2.6
Core EPS (%)	23.1	16.9	12.7	17.5	-2.6
Balance Sheet (€m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Cash & cash equiv.	111	171	220	318	404
Accounts receivables	31	26	30	33	36
Inventory	0	0	0	0	0
Net fixed & other tangibles	105	117	143	172	204
Goodwill & intangibles	145	159	152	145	136
Financial & other assets	25	39	63	44	29
Total assets	**416**	**512**	**609**	**712**	**810**
Accounts payable	137	173	200	220	242
Short-term debt	0	0	0	0	0
Long-term debt	0	0	0	0	0
Provisions & other liab	49	61	61	61	61
Total liabilities	**186**	**234**	**261**	**281**	**303**
Shareholders' equity	230	278	348	431	507
Minority interests	0	0	0	0	0
Total equity	**230**	**278**	**348**	**431**	**507**
Net debt	**-111**	**-171**	**-220**	**-318**	**-404**
Net debt to equity (%)	-48.2	-61.6	-63.4	-73.7	-79.6

Valuation ratios	**2011**	**2012**	**2013E**	**2014E**	**2015E**
PE (x)	29.2	24.9	22.1	18.8	19.3
PB (x)	12.8	10.6	8.5	6.8	5.8
EV/EBITDA (x)	19.9	17.2	14.9	12.5	12.2
FCF yield (%)	4.0	5.5	5.0	5.6	5.4
Dividend yield (%)	1.6	1.9	2.2	2.6	2.7
Payout ratio (%)	47	48	49	48	52
ROE (%)	53.0	47.6	43.6	41.2	33.3
Cashflow (€m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
EBITDA	147	168	191	221	218
Working capital	8	48	23	17	19
Other	9	0	-5	-8	-5
Operating cashflow	**163**	**216**	**209**	**230**	**232**
Capex	-41	-51	-57	-62	-68
Net acq/disposals	-102	-4	0	0	0
Other	0	0	0	0	0
Investing cashflow	**-143**	**-56**	**-57**	**-62**	**-68**
Dividends paid	-39	-53	-61	-70	-78
Financing cashflow	**-50**	**-143**	**-61**	**-70**	**-78**
Net change in cash	**-28**	**18**	**91**	**98**	**86**
Free cashflow to s/holders	**122**	**165**	**152**	**168**	**163**

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Company Focus

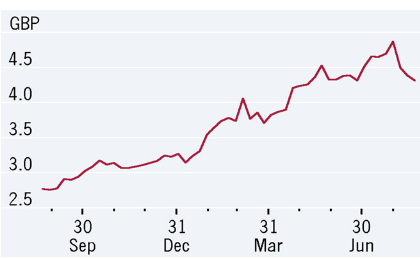
William Hill (WMH.L)

Leadership Set to Continue

- Estimate Change
- Target Price Change

Buy	**1**
Price (22 Aug 13)	£4.35
Target price	£5.15
from £5.00	
Expected share price return	18.5%
Expected dividend yield	2.6%
Expected total return	**21.1%**
Market Cap	£3,764M
	US$5,894M

Price Performance
(RIC: WMH.L, BB: WMH LN)



- **Market leader** – With c16% of the UK online market WMH has a leadership position. With this scale online and in retail comes substantial marketing firepower. We expect the group to use its scale to drive growth. We upgrade FY15 EPS by c5% to reflect some initial cost cuts, but we see scope for further mitigation, potentially delivering another c5% upside to forecasts. We see three other sources of longer term potential not included in our analysis.
- **Australian turnaround potential** – Following H1 results, market expectations have been rebased to reflect the FX headwinds and investment in digital marketing capabilities. The recent Tom Waterhouse deal should take the group's market share up to 21%, putting it on a par with PAP and Tabcorp online. Management's track record from its European digital marketing turnaround makes us comfortable with the upside potential in this business. If the group hits its returns targets in FY17 this implies c£10m EBIT upside. Favourable regulation remains a medium-term opportunity.
- **Italy and Spain upside** – Together we estimate these markets represent c5% of online turnover and are loss making. We expect the launch of the Palinsesto to open considerably more sports markets in Italy from the current 28 (cf 110 in UK) which should play into the hands of WMH's in-play leadership in UK. However WMH is the only major without a mobile offering in this market, which we expect management to rectify in H2. In Spain the group has established an 11% market share but this could be doubled when it exercises the Miapuesta option. We don't assume an explicit turnaround, but assuming that the losses are similar to PAP's €20m in FY12 then there is considerable upside potential.
- **Mobile gaming upgrades** – WMH's H1 gaming growth was only 2% (+7% ex unregulated market exits). This still lags best in class (e.g. PAP +21% for 1 Jan-12 May). The imminent launch of an API layer and later in the year a single wallet should significantly accelerate the launch and usage of new gaming products. For now we assume only +9% online net revenue growth in FY14.
- **Valuation** – The sharp pullback in the share price since H1 results has created a good buying opportunity. The stock now trades on 14.0x FY14E PE, a 10% premium to the long-term average for the peer group (12.7x). Given the group's leadership position, good diversification away from retail and potential to mitigate the POC tax, we see this as an attractive entry point. Our DCF target increases to 515p (from 500p) to reflect our estimate increases.

William Hill (GBP)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (£M)	1,136.7	1,276.9	1,484.4	1,562.1	1,660.0
Profit Before Tax (£M)	239.4	297.7	297.3	328.1	315.7
Diluted EPS (p)	21.9	27.1	28.9	31.1	29.9
Diluted EPS (Old) (p)	21.9	27.1	28.9	31.1	28.6
PE (x)	19.9	16.0	15.0	14.0	14.6
EV/EBITDA (x)	13.4	11.0	10.8	10.3	10.5
DPS (p)	8.9	10.4	11.3	12.4	12.4
Net Div Yield (%)	2.0	2.4	2.6	2.9	2.9

WMH.L: Fiscal year end 31-Dec — Price: £4.35; TP: £5.15; Market Cap: £3,766m; Recomm: Buy

Profit & Loss (£m)	2011	2012	2013E	2014E	2015E
Sales revenue	1,137	1,277	1,484	1,562	1,660
Cost of sales	-867	-950	-1,143	-1,191	-1,309
Gross profit	270	327	342	372	351
Gross Margin (%)	23.7	25.6	23.0	23.8	21.1
EBITDA (Adj)	**314**	**374**	**394**	**425**	**405**
EBITDA Margin (Adj) (%)	27.6	29.3	26.6	27.2	24.4
Depreciation	-27	-32	-38	-40	-42
{[001763]}	-14	-12	-12	-10	-9
EBIT (Adj)	**272**	**332**	**344**	**374**	**354**
EBIT Margin (Adj) (%)	23.9	26.0	23.2	24.0	21.3
Net interest	-33	-33	-47	-46	-38
Associates	2	4	3	3	3
Non-op/Except	-54	-25	-18	0	0
Pre-tax profit	**186**	**273**	**279**	**328**	**316**
Tax	-41	-47	-34	-56	-54
Extraord./Min.Int./Pref.div.	-31	-41	-15	0	0
Reported net profit	**114**	**185**	**230**	**272**	**262**
Net Margin (%)	10.0	14.5	15.5	17.4	15.8
Core NPAT	167	208	247	272	262
Per share data	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Reported EPS (p)	14.9	24.1	26.9	31.1	29.9
Core EPS (p)	21.9	27.1	28.9	31.1	29.9
DPS (p)	8.9	10.4	11.3	12.4	12.4
CFPS (p)	31.8	38.3	32.1	37.1	35.9
FCFPS (p)	24.0	29.6	22.5	27.3	25.5
BVPS (p)	126.5	145.7	129.5	149.2	167.6
Wtd avg ord shares (m)	753	757	841	863	863
Wtd avg diluted shares (m)	761	768	854	877	877
Growth rates	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Sales revenue (%)	6.1	12.3	16.2	5.2	6.3
EBIT (Adj) (%)	-0.4	21.8	3.8	8.7	-5.5
Core NPAT (%)	11.8	25.0	18.7	10.1	-3.8
Core EPS (%)	11.3	23.9	6.7	7.3	-3.8
Balance Sheet (£m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
Cash & cash equiv.	114	152	183	222	238
Accounts receivables	50	38	40	42	45
Inventory	0	0	0	0	0
Net fixed & other tangibles	245	252	328	396	470
Goodwill & intangibles	1,398	1,433	1,925	1,925	1,925
Financial & other assets	0	0	0	0	0
Total assets	**1,808**	**1,875**	**2,476**	**2,585**	**2,678**
Accounts payable	185	200	254	267	284
Short-term debt	0	0	0	0	0
Long-term debt	461	403	830	730	630
Provisions & other liab	263	235	303	334	356
Total liabilities	**909**	**838**	**1,387**	**1,332**	**1,270**
Shareholders' equity	888	1,022	1,089	1,254	1,409
Minority interests	12	15	0	0	0
Total equity	**900**	**1,037**	**1,089**	**1,254**	**1,409**
Net debt	**346**	**251**	**647**	**508**	**392**
Net debt to equity (%)	38.5	24.2	59.4	40.5	27.8

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	19.9	16.0	15.0	14.0	14.6
PB (x)	3.4	3.0	3.4	2.9	2.6
EV/EBITDA (x)	13.4	11.0	10.8	10.3	10.5
FCF yield (%)	5.5	6.8	5.2	6.3	5.9
Dividend yield (%)	2.0	2.4	2.6	2.9	2.9
Payout ratio (%)	41	38	39	40	42
ROE (%)	13.1	19.4	21.8	23.3	19.7
Cashflow (£m)	**2011**	**2012**	**2013E**	**2014E**	**2015E**
EBITDA	311	370	392	422	402
Working capital	33	26	-3	0	0
Other	-102	-102	-114	-97	-87
Operating cashflow	**242**	**294**	**274**	**325**	**315**
Capex	-60	-66	-82	-86	-91
Net acq/disposals	2	-18	-858	0	0
Other	0	0	0	0	0
Investing cashflow	**-58**	**-84**	**-940**	**-86**	**-91**
Dividends paid	-92	-110	-108	-101	-107
Financing cashflow	**-179**	**-173**	**696**	**-201**	**-207**
Net change in cash	**5**	**37**	**30**	**39**	**16**
Free cashflow to s/holders	**183**	**228**	**192**	**239**	**224**

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Best Ideas

Summary — We name PAP.L a Most Preferred stock and BPTY.L a Least Preferred stock relative to our fundamental analyst coverage for the next 3 Months, replacing BETF.L as a Most Preferred stock and LAD.L as a Least Preferred stock, both of which we last selected on 25 Jun 2013.

Rationale — Introducing new ideas ahead of upcoming H1 results.

bwin.party digital entertainment plc

(BPTY.L; £1.31; 2)

Catalyst and Thesis — We have been disappointed with the group's operational performance and expect H1 results to lead to a further lowering of market expectations.

Paddy Power

(PAP.L; €61.65; 1)

Catalyst and Thesis — We expect a continuation of the group's market leading online growth. We expect upcoming H1 results to be a positive catalyst.

Betfair

Company description

Betfair is predominantly an online sports betting exchange which allows customers to both back and lay a bet. Unlike traditional bookmakers Betfair earns commission (1-5%) on all bets and does not take a position on an event. Betfair has recently rolled out a fixed odds sportsbook to complement the exchange which operates the same way as traditional bookmakers. Betfair also offers ancillary products such as traditional casino games and poker.

Investment strategy

The recent strategy update provided a more reassuring backdrop to the business. The new sportsbook provides a more balanced approach to attracting new customers and driving cross sell, whereas the exit from unregulated markets ensures a focus on sustainable revenues. In our view a successful sportsbook/ exchange complementary product could be a standout USP in a crowded, commoditised yet fast growing online gaming market.

We recognise an incremental tax threat but see significant upside from commission increases. We therefore have a Buy rating on the shares.

Valuation

On our forecasts, our DCF valuation derives a fair value of 975p (based on WACC of 9.4%, Beta 1.0, Risk free rate 2.3%, Risk premium 7.2%). FY15E PE is 15.4x (falling to 12.6x with an £150m buyback) and EV/EBITDA 6.4x compared to sector FY15E PE of 14.2x and EV/EBITDA 8.0x (adjusted for Apr y/e).

Risks

Downside risks are the possibility of increased taxes and lower than expected commission increases driving weaker organic growth. Upside risks to our target price include improved operational performance particularly through greater than expected commissions. Substantial industry growth could mean that Betfair outperforms our forecasts.

bwin.party digital entertainment plc

Company description

bwin.party is the largest listed online gaming company as a result of the merger between Bwin and PartyGaming in 2011. Poker, casino and sports betting each make up c.30% of revenues and bwin.party's largest geographic exposure is to Germany (22% of FY11 revenues). bwin.party offers its products in unregulated countries and as European countries continue to regulate online gaming we expect bwin.party to face an increasing tax burden.

Investment strategy

We rate bwin.party Neutral. bwin.party's share price has halved since the 2011 merger, reflecting a wave of increased regulation and taxation, and an average operational performance. In 2011, the majority of operations were in unregulated "grey" regions and we see downside to earnings from further gaming taxes and a probable exit from poker and casino in Germany. However we see significant upside as regulation progresses in the US.

Valuation

We have a 130p target price on bwin.party. Given the near term-pressure on earnings we use DCF to better assess the long-term value of the business. Our DCF valuation derives a fair value of 130p based on a WACC of 10.7%, beta of 1.1 and 7% risk premium.

Risks

We highlight the following risks to our valuation and target price:

Changes in regulation especially in Germany and US could mean that eventual tax rates and market growth differ from our expectations.

Expansion in new Geographies could be faster and more successful than we anticipate.

Higher industry growth could mean that bwin.party outperforms our forecasts.

Less competition in the US could mean that bwin.party gains higher market share. Lower marketing competition could improve margins.

The company could cut costs further than the €65m Synergies targeted over the next few years.

Ladbrokes

Company description

Ladbrokes is the UK's second-largest bookmaking chain, operating around 2,200 shops, a telephone bookmaking business and e-gaming operation. It also operates just under 600 retail shops in Ireland, Belgium and Spain.

Investment strategy

Ladbrokes is looking to drive growth through investment in online and international retail operations. However, success is not guaranteed, given strong competition and execution risk.

Turnaround potential does exist. The company has closed the machines gap with William Hill with its machine contract with Global Draw. New technology and heavy marketing spend could also drive growth online but recent delays are disappointing. We rate the stock Neutral.

Valuation

We set our 12-month 190p price target using the group's 10 year average 1 year forward PE multiple of 10.7x.

Risks

Downside risks include the possibility of a clampdown on machines by the government, a rise in Gross Profits Tax (GPT), continuing cost pressures (pictures, staff, taxes & duties), margin pressure from online competitors, volatile profits from high-roller telephone betting and execution risk in its international strategy.

Upside risks are continued exceptional profits in its telephone division allowing further reinvestment into its estate, an earlier-than-expected profit stream internationally and possible international partnerships in the online segment. These risks could cause the share price to deviate significantly from our target price.

Paddy Power

Company description

Paddy Power offers betting and gaming services via three main channels, LBOs (licensed betting offices) the telephone and the internet. 80% of EBIT now comes from online gaming, predominantly in Europe and Australia. The group only operates in fully regulated markets.

Investment strategy

Paddy Power has focused on the fast-growing online betting space to drive growth over the last few years. In FY07, online profits as a percentage of EBIT stood at c45%. For FY12, the total online business contributed c80% to overall profits. This growth has been delivered via innovative marketing, strong brand loyalty and some high-profile acquisitions in Australia.

We expect the company to leverage its strong balance sheet to participate in online M&A to further drive EPS growth. Failing any opportunities being found, we would

expect a return of capital to shareholders. We rate the shares as Buy given strong growth rates, especially as 100% revenues come from already regulated regions.

Valuation

We base our 12-month €75.0 price target using DCF valuation methodology. We use a WACC of 8.6% (beta of 0.8, risk-free rate of 3.0%, risk premium of 7.0%) and terminal growth of 3.0% to derive our target price. The stock remains highly cash generative and Management has always been prudent with the balance sheet; the group currently has a net cash position.

Risks

Downside risks to our target price include potential volatile sports margins related to unfavourable sports results. On the regulatory front there is the possibility of the Irish government raising Ireland's turnover tax. Other regulatory risks include the possibility of a tax on Irish punters winnings.

Risks to the UK retail and online business include a possible clampdown by the UK government on machines, a potential rise in UK Gross Profits Tax (GPT), continuing cost pressures (pictures, staff, taxes & duties) and retail margin pressure from online competitors. There is also the risk that the UK government may introduce the need for a British license for overseas online companies.

Upside risks are possible international partnerships in the online space as well as potential M&A activity. On the Australian side, any relaxation in regulatory rules allowing in-play betting or online gaming (casino/poker) would help to drive online growth. These risks could cause the share price to deviate significantly from our target price.

William Hill

Company description

William Hill is the largest bookmaker in the UK, with over 2,300 shops. The group offers licensed betting and gaming via its betting shops, telephone-based operations and online. The company has transformed its Online division, William Hill Online in the last 6months by buying out its online partner Playtech and purchasing Sportingbet's Australian business. Online now represents c50% of group EBIT.

Investment strategy

We rate William Hill as a Buy. The group's retail business continues to be a steady cash cow for the group but the real growth is coming from the online business which now represents c50% of group EBIT. The group has been delivering some of the best online net revenue growth rates in the industry through its strong execution and we expect recent corporate activity to support that growth in future.

Valuation

We base our 12-month 515p target price using a DCF valuation methodology. We use a WACC of 8.7% (beta of 1.0, risk-free rate of 2.7%, risk premium of 6.6%) and terminal growth of 1.5% to derive our target price.

Risks

Downside risks to our target price include the possibility on a clampdown by the government on machines, a potential rise in Gross Profits Tax (GPT), continuing cost pressures (pictures, staff, taxes & duties) and retail margin pressure from online competitors. There is also the risk that the UK government may introduce the need for a British license for overseas online companies.

We feel there is key-person risk in the form of CEO, Ralph Topping. He has already done a good job since taking over as CEO in February 2008. This includes transforming the online segment as well as exiting its international retail strategy following low returns and making a strategic move into the US land-based betting business.

Upside risks are possible international partnerships in the online space as well as potential M&A activity.

These risks could cause the share price to deviate significantly from our target price.

Appendix A-1

Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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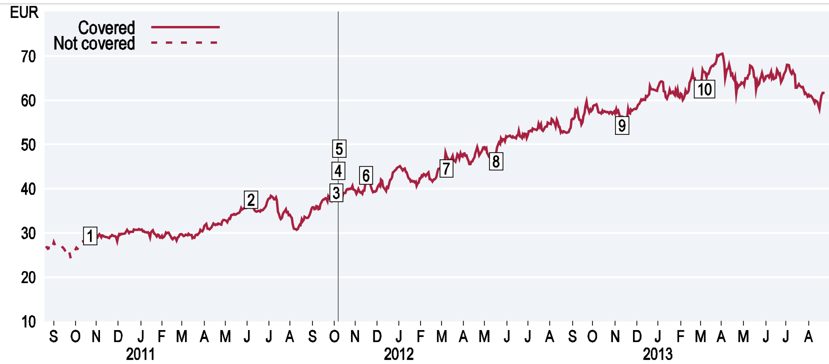
Paddy Power (PAP.L)

Ratings and Target Price History
Fundamental Research

Analyst: James Ainley
Covered since August 23 2011



	Date	Rating	Target Price	Closing Price
1	22-Oct-10	2M	*28.50	28.53
2	7-Jun-11	2M	*37.00	36.13
3	5-Oct-11	2M	*40.00	39.00
4	7-Oct-11	Stock rating system changed		
5	8-Oct-11	*2	40.00	38.06
6	16-Nov-11	2	*42.00	42.90
7	8-Mar-12	2	*48.00	47.30
8	17-May-12	2	*51.00	48.24
9	12-Nov-12	*1	*64.00	56.31
10	7-Mar-13	1	*75.00	66.37

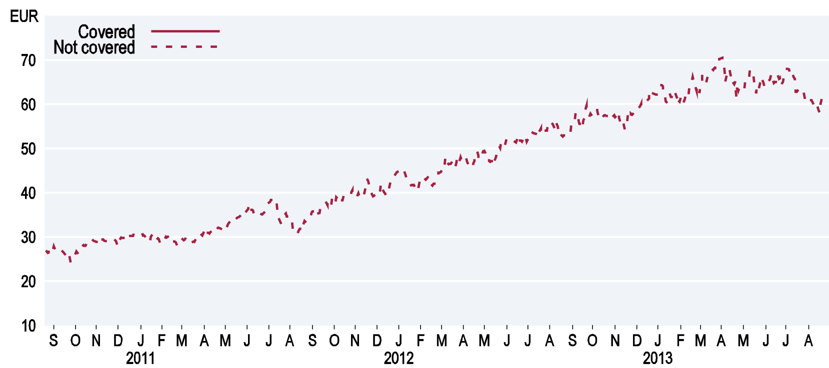
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Paddy Power (PAP.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: James Ainley
Covered since August 23 2011



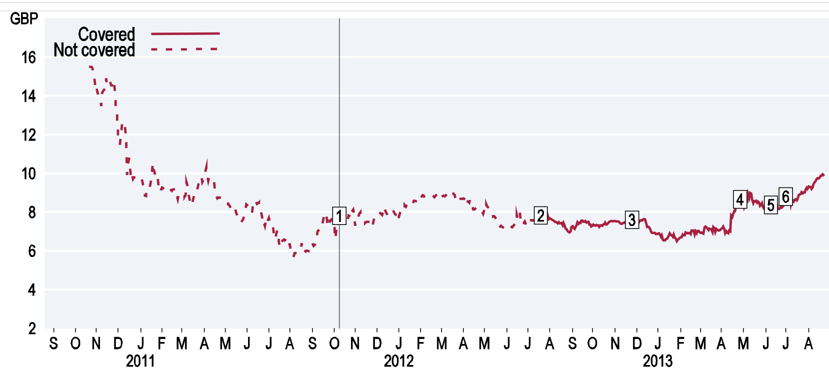
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Betfair (BETF.L)

Ratings and Target Price History
Fundamental Research

Analyst: Josh Lipman
Covered since April 26 2013



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		
2	19-Jul-12	*3	*6.60	7.64
3	26-Nov-12	3	*6.30	7.60
4	26-Apr-13	*2	*8.80	8.42
5	10-Jun-13	*1	*9.50	8.36
6	1-Jul-13	1	*9.75	8.53

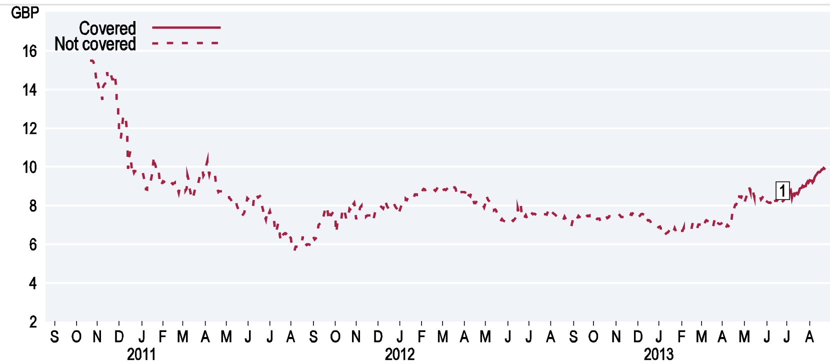
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Betfair (BETF.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Josh Lipman
Covered since April 26 2013



	Date	Rating	Target Price	Closing Price
1	25-Jun-13	*ADD MP	-	8.23

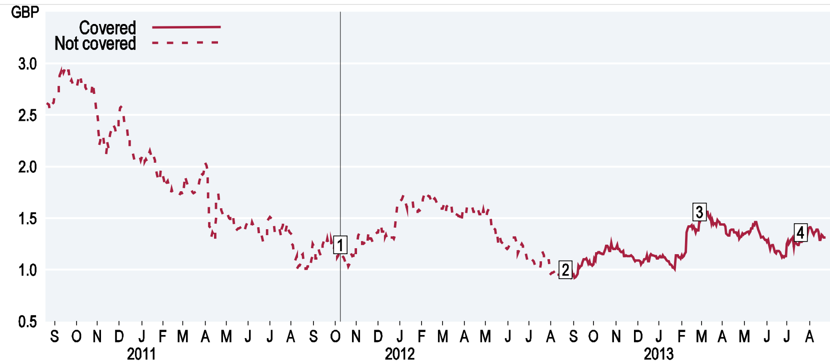
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

bwin.party digital entertainment plc (BPTY.L)

Ratings and Target Price History
Fundamental Research

Analyst: Josh Lipman
Covered since February 27 2013



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		
2	22-Aug-12	*3	*0.88	0.97

	Date	Rating	Target Price	Closing Price
3	27-Feb-13	*2	*1.40	1.50
4	19-Jul-13	2	*1.30	1.27

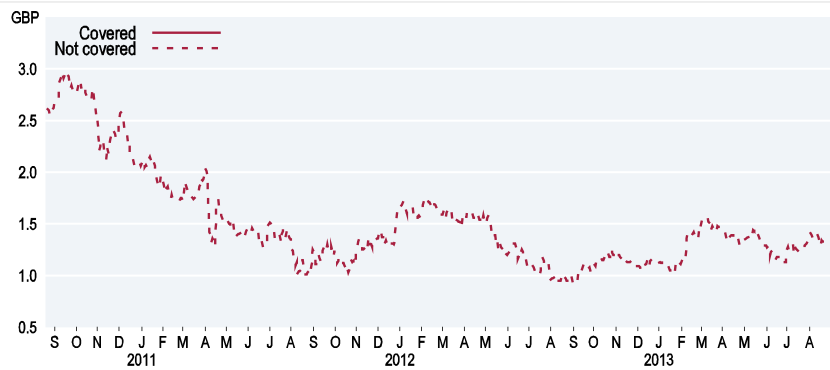
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

bwin.party digital entertainment plc (BPTY.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Josh Lipman
Covered since February 27 2013



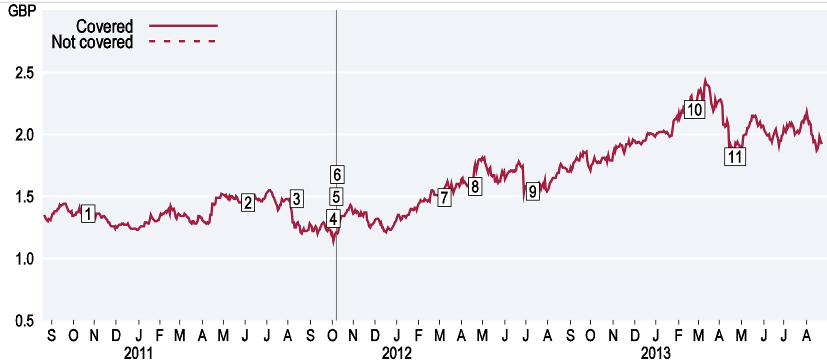
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Ladbrokes (LAD.L)

Ratings and Target Price History
Fundamental Research

Analyst: James Ainley
Covered since August 23 2011



	Date	Rating	Target Price	Closing Price
1	22-Oct-10	2M	*1.40	1.34
2	6-Jun-11	2M	*1.60	1.48
3	12-Aug-11	2M	*1.45	1.28
4	4-Oct-11	2M	*1.25	1.14
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*2	1.25	1.21
7	8-Mar-12	2	*1.60	1.57
8	20-Apr-12	2	*1.75	1.76
9	11-Jul-12	2	*1.60	1.54
10	25-Feb-13	2	*2.40	2.26
11	23-Apr-13	2	*1.90	1.93

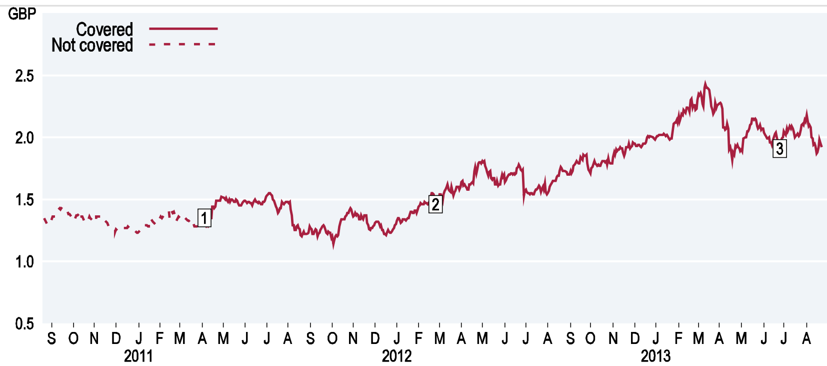
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Ladbrokes (LAD.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: James Ainley
Covered since August 23 2011



	Date	Rating	Target Price	Closing Price
1	5-Apr-11	*ADD LP	-	1.29
2	24-Feb-12	*REM LP	-	1.51
3	25-Jun-13	*ADD LP	-	1.95

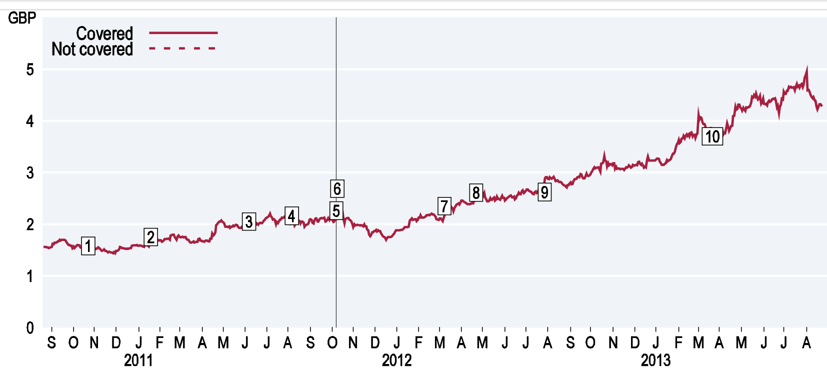
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

William Hill (WMH.L)

Ratings and Target Price History
Fundamental Research

Analyst: James Ainley
Covered since August 23 2011



	Date	Rating	Target Price	Closing Price
1	22-Oct-10	1M	*1.86	1.58
2	19-Jan-11	1M	*2.13	1.75
3	7-Jun-11	1M	*2.41	2.01
4	5-Aug-11	1M	*2.55	2.05
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*1	2.55	2.10
7	8-Mar-12	1	*2.60	2.18
8	23-Apr-12	1	*2.88	2.57
9	27-Jul-12	1	*3.06	2.89
10	21-Mar-13	1	*5.00	3.78

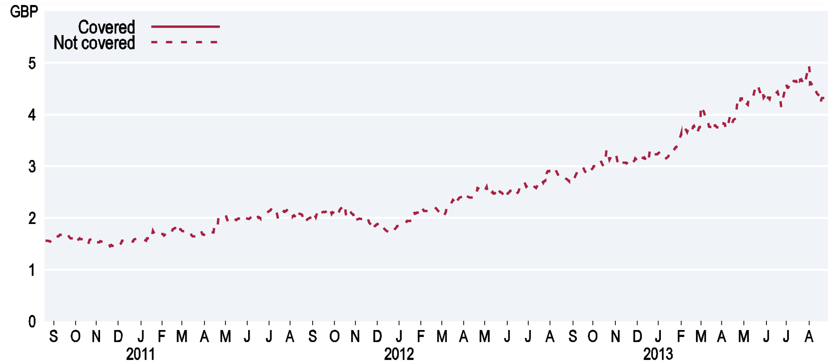
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

William Hill (WMH.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: James Ainley
Covered since August 23 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2013	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Research Global Fundamental Coverage	48%	40%	12%	6%	88%	6%
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Citigroup Global Markets Ltd	James Ainley; Josh Lipman; Mauro Baragiola

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