

17 January 2008

Leisure & Gaming

Year End	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	PE (x)	Yield (%)
12/05	206.8	1.4	7.6	0.0	0.9	N/A
12/06**	95.5	(4.2)	(7.1)	0.0	N/A	N/A
12/07e	95.0	(1.8)	(1.3)	0.0	N/A	N/A
12/08e	95.0	3.1	2.2	0.0	3.0	N/A

Note: *PBT and EPS are normalised, before exceptional items and share option charges.
**2006 figures are for continuing operations assuming Betshop was acquired on 1 Jan. 2006.

Investment summary: Ups and downs

L&G's 2007 trading update highlighted the volatility in its sportsbetting business with losses in the May to September period outweighing good gains in Q1 and Q4.

Management has implemented significant changes to the company's operations which should reduce volatility and ensure a return to profitability in 2008 even excluding the likely introduction of new gaming products. L&G also noted that corporate discussions with several interested parties are continuing.

Key operational improvements

The most important operational changes, implemented from the beginning of October 2007, have been to restructure franchise commissions (effectively making franchisees share some trading losses), to focus on quality not quantity by cutting out unprofitable agents and shops, and to strengthen the risk management team. Q4 trading was very encouraging with gross profit of €1.8m on net win of €6.6m, a gross margin of 27% compared with our estimate of 14.5% for the 2007 full year.

We forecast over €3m of profit in 2008

We have assumed that turnover is unchanged in 2008, the net win percent is 25% and, crucially, that operational improvements deliver a gross margin of 33%. We have not included anything for the long-awaited new gaming products although the Italian regulator has finally published protocols for skill gaming (including poker) and their successful introduction could lead to forecast upgrades in 2008. Our €3.1m normalised pre-tax forecast compares with last May's published estimate of €6.8m.

Valuation: Need to rebuild credibility

L&G's rating now looks very low but it needs to rebuild credibility given its record of volatile quarterly earnings and the downgrade from previous forecasts. It remains over-exposed to a single product (football) although likely new gaming products will help. It would also benefit from greater scale and resources to exploit its brand and distribution assets.

Price 6.5p
Market Cap £6m

Share price graph



Share details

Code LNG
Listing AIM
Sector Travel & Leisure
Shares in issue 84.9m

Price

52 week High 22.5p Low 6.5p

Balance Sheet as at 30 June 2007

Debt/Equity (%) 3
NAV per share (p) 23
Net borrowings (£m) 0.5

Business

L&G's main business is Betshop (acquired 23 June 2006), a European sportsbetting business with a network of branded franchise shops mainly in Italy. L&G sold its US-facing operations in October 2006.

Valuation

	2006	2007e	2008e
P/E relative	N/A	N/A	36%
P/CF	1.6	N/A	3.0
EV/Sales	0.1	0.1	0.1
ROE	N/A	N/A	N/A

Geography based on revenues

UK	Europe	US	Other
2%	98%	0%	0%

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Trading update

L&G ended 2007 on a high note with a strong Q4. However, it was not enough to offset significant trading losses in Q2 and Q3 caused both by adverse sporting results and by over-expansion and operational inefficiencies. The expected €1.8m pre-tax loss compares with earlier hopes of a €2.5m profit. Looking forward, the business is being much more tightly managed and new products could lead to an upgrade in our 2008 forecasts.

Exhibit 1: Summarised results and forecasts

Note: 2006 Proforma is for continuing operations (Betshop, Grouse and central costs) as though Betshop had been acquired on 1 January 2006. * Normalised profit is before exceptional items and share option charges.

€m	2006 Proforma	2007e	2008e
Turnover	95.5	95.0	95.0
Net win	23.3	22.0	24.0
Net win %	21.3%	23.2%	25.3%
Gross profit	3.5	3.2	8.0
Admin expenses	(7.3)	(4.8)	(4.9)
EBIT (normalised *)	(3.8)	(1.6)	3.1
Exceptional items	(5.7)	0.0	0.0
Share option charges	(0.4)	0.0	0.0
Net interest	(0.4)	(0.2)	0.0
Pre-tax profit /(loss) (normalised *)	(4.2)	(1.8)	3.1
Pre-tax profit /(loss) (reported)	(10.3)	(1.8)	3.1
EPS (normalised *)	(7.1)	(1.3)	2.2

Source: Leisure and Gaming / Edison Investment Research

The €95m estimated 2007 turnover is unchanged over the 2006 proforma result (although it does imply a reduction in the second half compared with the first). We estimate that in 2007 the top 25% of shops accounted for around 70% of the revenue of the Italian business and in 2008 we expect to see L&G focusing on a smaller, more tightly run estate of shops (perhaps 400 or 500). However, continuing strong demand for sportsbetting in Italy, an increasing contribution from horseracing and a likely boost from Euro 2008 underpins our forecast for unchanged turnover in 2008.

In November 2007 L&G opened the first of its 59 new shops operating under new 'corner' licences (38 for horse-betting and the rest for sports). The licences allow for a greater range of gaming products, as well as cash betting over the counter. Despite industry-wide hold-ups from the regulator it now has 6 open, with the remainder due to open over the next few months. L&G hopes to introduce a single slot machine deal across its Italian franchise network which will deliver incremental revenue and also intends to market its online offering (Betshop.com) more aggressively in 2008. It has also opened a shop in Romania and is continuing to explore opportunities in other markets such as Greece (where it has a new marketing partner).

Balance sheet and cash flows

L&G had €0.9m net cash at 31 December 2006 (not including client funds). In January 2007 it paid €1.8m for the 59 new Italian licences and in June it raised €2.5m from a placing of 13.46m new

shares at 13p. We also estimate an operating outflow for 2007 of about €2.0m. Overall we forecast 2007 year-end net debt of around €0.3m (although this includes funds relating to bank guarantees). The business should be cash generative in 2008.

Exhibit 2: Financials

Note: 2006 figures are proforma for continuing operations only, assuming Betshop had been acquired on 1 January 2006 and excluding the US-facing operations which were sold in October 2006 (as described in previous Edison reports).

Year-ending 31 December	2005	2006	2007e	2008e
Accounting basis: IFRS	16 mth	Proforma		
€m				
PROFIT & LOSS				
Revenue	206.8	95.5	95.0	95.0
Net win	18.5	23.3	22.0	24.0
EBITDA	1.3	(3.7)	(1.5)	3.2
Operating Profit (before GW and except.)	1.1	(3.8)	(1.6)	3.1
Goodwill Amortisation	0.0	0.0	0.0	0.0
Share options	(1.0)	(0.4)	0.0	0.0
Exceptionals	0.0	(5.7)	0.0	0.0
Operating Profit	0.2	(9.9)	(1.6)	3.1
Net Interest	0.3	(0.4)	(0.2)	0.0
Profit Before Tax (norm)	1.4	(4.2)	(1.8)	3.1
Profit Before Tax (FRS 3)	0.5	(10.3)	(1.8)	3.1
Tax	(0.3)	(0.2)	0.7	(1.2)
Profit After Tax (norm)	1.1	(4.4)	(1.1)	1.9
Profit After Tax (FRS 3)	0.2	(10.5)	(1.1)	1.9
Average Number of Shares Outstanding (m)	14	63	85	87
EPS - normalised fully diluted (c)	7.6	(7.1)	(1.3)	2.2
EPS - FRS 3 (c)	7.8	(16.7)	(1.3)	2.2
Net win margin (%)	9%	24%	23%	25%
EBITDA Margin (%)	1%	-4%	-2%	3%
Operating Margin (before GW and except.) (%)	1%	-4%	-2%	3%
BALANCE SHEET				
Fixed Assets	94.3	31.4	27.6	27.5
Intangible Assets	93.2	31.4	27.5	27.4
Tangible Assets	1.2	0.0	0.1	0.1
Investment in associates	0.0	0.0	0.0	0.0
Current Assets	31.2	5.6	3.5	4.0
Stocks	0.0	0.0	0.0	0.0
Debtors	16.9	1.9	2.3	2.5
Cash (net of client funds)	17.0	3.7	1.2	1.5
Current Liabilities	(13.6)	(7.2)	(7.4)	(6.2)
Creditors	(13.6)	(5.4)	(5.9)	(6.2)
Short term borrowings	0.0	(1.8)	(1.5)	0.0
Long Term Liabilities	(14.6)	(11.8)	(4.8)	(2.0)
Long term borrowings	0.0	(1.0)	0.0	0.0
Other long term liabilities	(14.6)	(10.8)	(4.8)	(2.0)
Net Assets	97.3	18.0	18.9	23.3
CASH FLOW				
Operating Cash Flow	3.8	3.7	(2.0)	2.7
Net Interest	0.1	(0.2)	(0.2)	(0.2)
Tax	0.0	(0.3)	0.0	(0.5)
Capex	(1.6)	(3.1)	0.0	(0.2)
Acquisitions/disposals	(31.9)	(16.9)	(1.8)	0.0
Financing	46.6	4.4	2.5	0.0
Dividends	0.0	0.0	0.0	0.0
Net Cash Flow	17.0	(12.5)	(1.5)	1.8
Opening net debt/(cash)	0.0	(14.3)	(0.9)	0.3
HP finance leases initiated	0.0	0.0	0.0	0.0
Loans acquired with acquisitions	0.0	0.0	0.0	0.0
Other	0.0	(0.9)	0.3	0.0
Closing net debt/(cash)	(17.0)	(0.9)	0.3	(1.5)

Source: Company accounts / Edison Investment Research

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