

27 August 2008

Leisure & Gaming

Year End	Net win (€m)	PBT* (€m)	EPS* (€c)	DPS (€c)	PE (x)	Yield (%)
12/06 **	23.3	(4.2)	(7.1)	0.0	N/A	0.0
12/07	24.7	(1.8)	(2.4)	0.0	N/A	0.0
12/08e	25.0	3.0	2.5	0.0	2.7	0.0
12/09e	27.5	3.5	2.8	0.0	2.4	0.0

Note: *PBT and EPS are normalised, excluding amortisation and exceptional items. ** 2006 figures are proforma for continuing operations. Exchange rate used: £1=€1.26.

Investment summary: Interims on course

Leisure & Gaming (LNG) interim results confirmed a successful turnaround, with a first-half PBT of €1.3m (2007: loss of €1.5m). As well as a strengthened Italian business, the group is beginning to grow in new markets such as Cyprus and Greece, while the eventual introduction of new games, including poker, will also diversify income streams. Our full-year forecasts are unchanged, and the share rating has scope to improve markedly as LNG continues to rebuild credibility.

A reshaped operation

In October 2007, LNG implemented significant operational changes in Italy, including consolidating the partner network, restructuring commissions and improving risk management. The benefits were apparent in the interim results, with significantly improved margins and lower overhead costs. On 31 July, LNG announced that CFO Richard Creed has been appointed CEO to succeed Henry Birch, who had decided to leave to pursue other interests after presiding over the successful turnaround.

A sound financial base

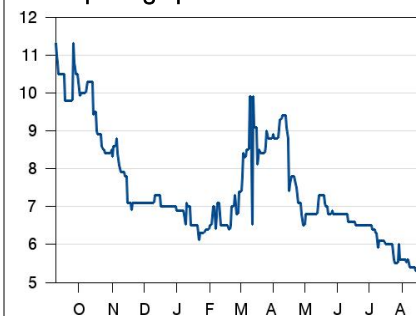
LNG's net debt at 30 June was €2.5m (gearing: 14.6%), including €1.0m of client liabilities, but excluding €2.2m of cash held in escrow against Italian licenses. In July, LNG placed 9.2m new shares at 6p per share, raising €0.7m, while the underlying business should again be cash-generative in the seasonally stronger H2.

Valuation: Rebuilding credibility

LNG's share rating remains depressed by past disappointments and some regulatory concerns, while sentiment has not been helped by William Hill's withdrawal from the Italian market. Volatile sports margins remain a risk, but LNG has successfully established a strong presence in Italy and 2009 results should benefit from the long-awaited introduction of new gaming products (including poker), new shop openings, the new online licence and greater geographic diversification.

Price 5.38p
Market Cap £5m

Share price graph



Share details

Code LNG
Listing AIM
Sector Travel & Leisure
Shares in issue 94.1m

Price

52 week High 11.50p Low 5.25p

Balance Sheet as at 30 June 2008

Debt/Equity (%) 14.6
NAV per share (€c) 20
Net borrowings (€m) 2.5

Business

LNG's main business is Betshop Italia, an online sports betting business with a network of branded franchise shops, mainly in Italy, and Betshop.com, a pan-European online gambling business.

Valuation

	2007	2008e	2009e
P/E relative	N/A	24%	24%
P/CF	N/A	3.0	2.4
EV/Sales	N/A	N/A	N/A
ROE	N/A	13%	14%

Geography based on revenues

UK	Europe	US	Other
1%	99%	0%	0%

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Restructured business delivers improved margins

LNG's interim results were marginally ahead of expectations, helped by more consistent sporting margins, lower commission costs and lower overheads. LNG reports that 'trading in the seasonally quiet Q3 is in line with management's expectations'. Our full-year forecasts are unchanged.

Interim results

The encouraging interim progress reflected four key features: consolidation of the partner network and elimination of large unprofitable outlets; the revised commission structure; better underlying sports margins and lower overheads.

Exhibit 1: Summarised interim results and forecasts

€m	H107	H207	2007	H108	H208e	2008e	2009e
Amounts wagered	65.4	43.7	109.1	41.3	53.7	95.0	105.0
Net win: Sports	10.9	9.0	19.9	10.0	11.0	21.0	22.0
<i>Sports margin %</i>	<i>19.2%</i>	<i>23.4%</i>	<i>20.9%</i>	<i>26.7%</i>	<i>22.6%</i>	<i>24.4%</i>	<i>23.5%</i>
Horses	1.3	0.6	1.9	0.6	0.9	1.5	1.8
Casino	1.1	0.7	1.8	0.6	0.7	1.3	1.5
Lotto/skill	0.6	0.5	1.1	0.3	0.9	1.2	2.2
Total net win	13.9	10.8	24.7	11.5	13.5	25.0	27.5
Other income	0.2	0.1	0.3	0.1	0.1	0.2	0.2
COS	(12.9)	(8.6)	(21.5)	(8.2)	(9.8)	(18.0)	(19.5)
% net win	<i>92.8%</i>	<i>79.6%</i>	<i>87.0%</i>	<i>71.3%</i>	<i>72.6%</i>	<i>72.0%</i>	<i>70.9%</i>
Gross profit	1.2	2.3	3.5	3.4	3.8	7.2	8.2
Admin expenses	(2.6)	(2.5)	(5.1)	(2.0)	(2.1)	(4.1)	(4.7)
Net interest	(0.1)	(0.2)	(0.3)	(0.1)	(0.1)	(0.1)	0.0
Pretax profit / (loss)	(1.5)	(0.4)	(1.9)	1.3	1.7	3.0	3.5

Source: Leisure & Gaming / Edison Investment Research

Amounts wagered declined by 37% to €41.3m, of which sports betting accounted for €37.4m or 91%. The average number of active Italian partners/outlets in H108 was 474, 11% lower than the comparative period. However, the consolidation that took place last autumn removed several of the largest partners, who were also the most unprofitable. On a like-for-like basis, we understand that amounts wagered increased by an encouraging 28%, helped by Euro 2008, which generated €2.5m of amounts wagered.

Sports margins improved from 19.2% to 26.7%, with the comparative period having been affected by a run of unfavourable results, including Milan's win in the 2007 Champion's League. Euro 2008 delivered a satisfactory net win of €0.6m.

Net win from horses, casino and lottery/skill games was adversely affected by the reduction in the number of partners/outlets. In addition, horse betting was affected by difficulties with software and results feeds, and net win more than halved to €0.6m (2007: €1.3m), although the win margin improved to 31%. We expect LNG to introduce new software that will, for example, allow customers' winnings to be credited at the end of each race rather than at the end of the day.

Overall, LNG's net win margin improved from 21.3% to 27.8%. The gross profit margin improved even more dramatically, from 1.8% to 8.2%, mainly due to the revised commission structure. Historically, partners (agents) had been paid weekly commissions on net win, but without loss-making weeks being netted off, which resulted in high overall commission rates in periods of trading volatility. From October 2007, bi-weekly and monthly commission schedules were introduced, reducing overall rates and improving LNG's margins.

Outlook for the 2008 full year

The interim results demonstrated the much more robust operational structure of the group. We believe our 2008 full-year margin assumptions are reasonably cautious, with an estimated 24.4% sports margin and 7.6% gross margin. Q3 is seasonally quiet but Q4 is normally the seasonally strongest of the year, with the football season in full swing. The greatest sensitivity remains sporting margins on Italian football, but better risk management and commission structures should mean there is far less risk of volatility than in the past. We have maintained our pre-tax profit estimate at €3.0m and applied a cautious 25% tax rate to arrive at our 2.5c EPS estimate.

2009: New shops, new products, new geographies

LNG has 32 new branded outlets operating under the 'Bersani' corner licenses, with a further 20 expected to open over the next several weeks (seven of its 59 licenses may be sold). The new licenses allow for a much greater product range, but new products have to be approved by the regulator (AAMS), and this process has been disappointingly slow (not just for LNG but for all Italian operators). However, poker and skill games are finally expected to be allowed by the end of this year, and Betshop is currently negotiating with poker software providers. We expect further news on new product introductions in coming months, and cross-selling opportunities could provide a material uplift to revenues not currently in our forecasts.

LNG has also recently acquired an online gambling license in Italy. In part, this reduces the regulatory risk associated with its estate of 'telematic' licenses: moves to change the terms of these (which could restrict profitability and/or scope to grow) are currently the subject of a court challenge and are not expected to be implemented, not least because of the importance of the taxes to the AAMS. More particularly, the online licence allows it to take online bets from any location in Italy, which offers a major opportunity to develop the business (albeit that it would require brand/marketing expenditure outside the group's core southern base).

As well as diversifying its product stream, LNG aims to broaden its geographic base. A new online marketing partner in Greece was signed in April 2008 and appears to be performing well. In Cyprus, Betshop is replicating its Italian partnership model and currently has 15 outlets. In Romania, it has an operating license and one outlet, but has so far found it difficult to recruit a suitable partner.

Overall, we are projecting a 17% increase in pre-tax profit in 2009 to €3.5m, producing EPS of 2.8c. We have factored in an assumed deterioration of the economic environment, although sports betting should be relatively resilient. More consistent margin performance is key to our projections, with significant potential uplift from new shops, new products and new geographies.

After past disappointments, the share rating remains depressed, but we believe it has significant scope to improve if LNG can sustain the positive momentum of the past nine months.

Exhibit 2: Financials

Note: Net debt includes client funds liabilities and excludes cash held in escrow. Results for 2006 are proforma for continuing operations assuming Betshop had been acquired on 1 January 2006.

Year end 31 December	2006	2007	2008e	2009e
Accounting basis: IFRS	Proforma			
€m				
PROFIT & LOSS				
Gross takings	95.5	109.1	95.0	105.0
Net win	23.3	24.7	25.0	27.5
EBITDA	(3.7)	(1.5)	3.1	3.5
Operating Profit (before GW and except.)	(3.8)	(1.5)	3.1	3.5
Amortisation	0.0	(0.1)	(0.3)	(0.3)
Share options	(0.4)	(0.1)	(0.1)	(0.1)
Exceptionals	(5.7)	0.0	0.0	0.0
Operating Profit	(9.9)	(1.7)	2.7	3.1
Net Interest	(0.4)	(0.3)	(0.1)	0.0
Discontinued operations	(72.4)	0.0	0.0	0.0
Profit Before Tax (norm)	(4.2)	(1.8)	3.0	3.5
Profit Before Tax (FRS 3)	(82.7)	(2.0)	2.6	3.1
Tax	(0.2)	(0.1)	(0.8)	(0.9)
Profit After Tax (norm)	(4.4)	(1.9)	2.3	2.6
Profit After Tax (FRS 3)	(82.9)	(2.1)	1.9	2.2
Average Number of Shares Outstanding (m)	63	79	90	94
EPS - normalised (c)	(7.1)	(2.4)	2.5	2.8
EPS - FRS 3 (c)	(132.2)	(2.7)	2.1	2.3
Net win margin (%)	24%	23%	26%	26%
EBITDA Margin (%)	(4%)	(1%)	3%	3%
Operating Margin (before GW and except.) (%)	(4%)	(1%)	3%	3%
BALANCE SHEET				
Fixed Assets	20.7	20.6	19.5	18.5
Intangible Assets	20.6	20.5	19.4	18.4
Tangible Assets	0.1	0.1	0.1	0.1
Investment in associates	0.0	0.0	0.0	0.0
Current Assets	6.8	3.6	4.0	6.0
Stocks	0.0	0.0	0.0	0.0
Debtors	1.9	3.0	3.5	4.0
Cash	4.9	0.6	0.5	2.0
Current Liabilities	(8.5)	(7.5)	(6.0)	(6.5)
Creditors	(5.5)	(4.2)	(4.5)	(5.0)
Short term borrowings (including client fund liabilities)	(3.0)	(3.3)	(1.5)	(1.5)
Long Term Liabilities	(1.0)	0.0	0.0	0.0
Long term borrowings	(1.0)	0.0	0.0	0.0
Other long term liabilities	0.0	0.0	0.0	0.0
Net Assets	18.0	16.7	17.5	18.0
CASH FLOW				
Operating Cash Flow	2.9	(4.0)	2.0	2.6
Net Interest	(0.2)	(0.3)	(0.1)	0.0
Tax	(0.3)	(0.2)	(0.5)	(0.8)
Capex	(3.1)	(1.7)	(0.2)	(0.3)
Acquisitions/disposals	(17.7)	0.0	0.0	0.0
Financing	0.0	2.5	0.5	0.0
Dividends	0.0	0.0	0.0	0.0
Net Cash Flow	(18.4)	(3.7)	1.7	1.5
Opening net debt/(cash)	(20.2)	(0.9)	2.7	1.0
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	(0.9)	0.1	0.0	0.0
Closing net debt/(cash) (including client fund liabilities)	(0.9)	2.7	1.0	(0.5)

Source: Company accounts/ Edison Investment Research

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