8 June 2009

Leisure & Gaming

Year End	Revenue* (€m)	PBT** (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/07	24.7	(1.9)	(2.5)	0.0	N/A	0.0
12/08	20.6	1.8	1.2	0.0	10.1	0.0
12/09e	24.6	3.5	2.3	0.0	5.3	0.0
12/10e	27.5	4.0	2.7	0.0	4.5	0.0

Note: *Revenue is net win. **PBT and EPS are normalised, excluding amortisation of intangibles, exceptional items and share option charges. Current exchange rate: £1=€1.15.

Investment summary: Making good progress

Betshop's recent sponsorship deal with Serie A football team Palermo should further increase its profile in its core southern Italian market. At the same time it is making good progress diversifying its products (poker generated over 25% of Q2 revenue) and its geographies, with growth in Cyprus and Greece. The balance sheet is much improved and the share rating appears very low. Any settlement with the US Department of Justice (DoJ) would remove a major uncertainty, and long-awaited M&A activity within the sector is also expected to enliven multiples.

AGM trading update

Leisure & Gaming (L&G) has reported 'solid trading in line with expectations' for the eight weeks to 25 May after a record Q1. Poker has continued to grow strongly and even allowing for a seasonal summer slowdown we increased our 2009 normalised PBT estimate by €0.5m to €3.5m. Chairman Philip Parker signalled his intention to leave by the end of the year, having presided over a five-year period of considerable change, and we expect new board appointments to be announced in due course.

Excellent operational progress

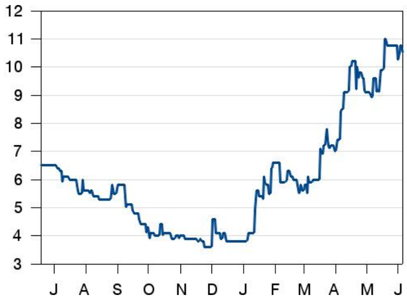
Much of 2007 and 2008 was devoted to restoring L&G to a sound financial footing, post the exit from the US market, and reducing margin volatility through operational changes (better risk management and a revised commission structure). The last 12 months have seen a number of key operational developments including the launch and rapid growth of Italian poker; the Palermo sponsorship; the expansion of the network in Cyprus and a successful new Greek online offering.

Valuation: Rebuilding credibility

The P/E ratio is very low due to past disappointments and some share sales. However, recent results have been encouraging, the business is cash generative and the proposed capital reorganisation will allow dividends to be paid. The 2009 P/E ratio of 4.5 times is well below the sector average while a settlement with the DoJ would remove a major uncertainty and prompt a re-rating.

Price	10.5p
Market Cap	£10m

Share price graph



Share details

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

Price

52 week	High	Low
	11.0p	3.6p

Balance Sheet as at 31 December 2008

Debt/Equity (%)	N/A
NAV per share (c)	14.7
Net cash (€m)	1.0

Business

L&G's main business, Betshop, provides land-based and online betting and gaming in Europe. Its main markets are Italy, Cyprus and Greece. L&G sold its US-facing business in October 2006 and Betshop does not accept bets from US customers.

Valuation

	2008	2009e	2010e
P/E relative	91%	43%	49%
P/CF	5.4	3.5	3.5
EV/Sales	0.1	0.2	0.2
ROE	8%	14%	14%

Geographical analysis of revenue

UK	Europe	US	Other
0%	100%	0%	0%

Analyst

Jane Anscombe 020 3077 5740

janscombe@edisoninvestmentresearch.co.uk

Leisure & Gaming is a research client of Edison Investment Research Limited

Diversifying geographically and by product

After a period of reorganisation Betshop Italia's franchise network now has a much more effective operational structure in place and the number of outlets is growing. Management's strategy is to diversify the business by product and geographically to reduce the reliance on Italian football and deliver more consistent earnings. The last six months have seen considerable progress in this respect with the introduction of poker in Italy and expansion in Cyprus and Greece. In Q109 the Italian retail outlets contributed 68% of amounts wagered as compared to 84% in Q108.

Italy

Betshopitalia now has over 580 partner-operated branded retail outlets, up from 470 in August 2008. Expansion has been carefully controlled after a period of weeding out underperforming units in 2007/08. We view Betshop's recent two-year sponsorship of Serie A team Palermo as an illustration of management's increased confidence. It adds new marketing opportunities and significant credibility to the brand name and is already proving very popular with agents. Additionally, from August Betshop will provide a white label sports betting service for Palermo and we believe that this will be followed by a number of similar white label deals.

Sports margins are relatively high at 22-25% since 85% of bets are multiples. There will always be some volatility (since it is difficult to hedge against home wins) but better risk management and a revised partner commission structure has produced greater stability in gross profit margins. This is being reinforced by the introduction of new products with more stable margins.

AAMS finally approved poker from September 2008 (for Italian tournaments) and Betshopitalia launched real money online poker in November. The industry has taken off rapidly and we believe that marketing by high profile brands such as PokerStars is raising awareness and growing the market. L&G reported Q1 tournament fees of €10.9m generating a gross rake (commission) of €1.7m and net rake (after betting duties, software fees and partner shares) of €0.4m. The AGM update indicated that tournament fees are now generating over €3.5m a month. Margins are stable since the rake is set by the regulator at 10-15% (typically 14%). As well as sports betting the regulator is slowly approving other new gaming products, including skill games such as blackjack and online scratch cards, which also produce relatively consistent margins.

Cyprus, Greece… and other new market opportunities

Betshop's risk management team is based in Cyprus together with Goalslive.com (its popular results portal with over 1.6m unique users). During 2008 Betshop recruited 47 partners with retail outlets, of which 21 joined in the last quarter. The gambling culture is similar to Italy with an average bet size of €8. Betshop is building the brand and looking to add more partners and products.

In June 2008 Betshop launched an online sports betting and casino offering for Greece with a local partner, which is devoting significant resources to marketing. Average bet sizes are around €9 but most bets are singles so overall margins are lower. Betshop is keen to enter the land-based market as soon as licences are made available but it is still unclear when this will be; Stanleybet's legal challenge to OPAP's monopoly is currently being considered by the European Court of Justice.

Betshop believes that other European markets offer potential to replicate its Italian business model and diversify revenue streams. These could include markets that are due to become licensed and regulated such as France or emerging markets such as Romania (where it already holds a licence).

Summarised results and estimates

Exhibit 1: Segmental analysis

	2007		2008			2009	
€m	Year	H1	H2	Year	H1e	H2 e	Year e
Sports	102.6	39.3	35.1	74.4	33.9	32.6	66.5
Casino	30.5	18.7	20.4	39.1	18.2	18.8	37.0
Lotto /skill	4.7	1.4	1.6	3.0	1.2	1.3	2.5
Poker	0.0	0.0	2.7	2.7	22.3	22.7	45.0
Amounts wagered	137.8	59.4	59.8	119.2	75.6	75.4	151.0
Sports	21.9	10.6	7.5	18.1	9.4	7.0	16.4
Casino	1.8	0.6	0.7	1.3	0.6	0.7	1.3
Lotto /skill	1.0	0.3	0.4	0.7	0.3	0.2	0.5
Poker	0.0	0.0	0.5	0.5	3.4	2.9	6.3
Net win	24.7	11.5	9.1	20.6	13.7	10.8	24.5
Margin %	17.9%	19.4%	15.2%	17.3%	18.1%	14.3%	16.2%
Other income	0.3	0.1	0.8	0.9	0.1	0.1	0.2
COS	(21.5)	(8.2)	(7.1)	(15.3)	(9.5)	(7.0)	(16.5)
Gross profit	3.5	3.4	2.8	6.2	4.3	3.9	8.2
% of net win	14.2%	29.6%	30.8%	30.1%	31.4%	35.7%	33.3%
Admin expenses	(5.2)	(2.0)	(2.2)	(4.2)	(2.0)	(2.5)	(4.5)
Operating profit (norm)	(1.7)	1.4	0.6	2.0	2.3	1.4	3.7
Net interest	(0.3)	(0.1)	(0.1)	(0.2)	(0.1)	(0.1)	(0.2)
Pretax (norm)	(2.0)	1.3	0.5	1.8	2.2	1.3	3.5

Source: Company accounts/Edison Investment Research

On 15 April L&G reported very strong Q1 trading with amounts wagered up 48% to €42.1m, net win up 38% at €8.7m and gross profit up 22% to €2.8m, boosted by favourable sports results and a 31.4% sports margin. The AGM update indicated further progress, particularly in poker although unsurprisingly there appears to have been some cannibalisation of Italian sports betting (and possibly also some recession effect). Despite this we expect a significant increase in H109 normalised PBT to around €2.2m (2008: €1.3m). The full year outcome depends on sports margins and on poker's performance over the summer months. H209 will also include the first Palermo sponsorship costs, but although this is a headline €1.0m a year, we believe that at least 70% will be funded by agents and Betshop's software provider Microgame. Overall, even allowing for a summer dip in poker, we have raised out full year PBT estimate by €0.5m to €3.5m.

Much improved balance sheet and cash flows

With the 2007 restructuring behind it L&G generated €2.0m of cash in 2008 to end the year with net cash of €1.0m (total cash of €3.6m less borrowings and loans of €1.6m and net client liabilities of €1.0m). By the end of March net cash (calculated on the same basis) had risen to about €3.0m. The cash balance includes €2.4m held in escrow for Italian licence guarantees although management is trying to find ways to reduce this.

The US situation

L&G faces a regulatory risk in respect of its former US-facing operations, in common with other operators. In April PartyGaming announced a Non-Prosecution Agreement and financial penalty, seen as good news by the market because it removed a significant uncertainty and impediment to M&A activity. As set out in L&G's accounts, it sustained a cash loss on its US-facing companies and fully complied with UIGEA. It has not received any notification of legal action and is “seeking to clarify” its position. Any satisfactory settlement with the DoJ would be excellent news.

Exhibit 2: Financials

Note: 2006 results are proforma for continuing operations with discontinued included at FRS3 level.

Year end 31 December Accounting basis: IFRS	€m	2006 Proforma	2007	2008	2009e	2010e
PROFIT & LOSS						
Revenue		23.3	24.7	20.6	24.6	27.0
EBITDA		(3.7)	(1.6)	2.0	3.7	4.1
Operating Profit (before GW and except.)		(3.8)	(1.6)	2.0	3.7	4.1
Goodwill Amortisation		0.0	0.0	(0.3)	(0.2)	(0.2)
Share options		(0.4)	(0.1)	0.0	0.0	0.0
Exceptionals		(5.7)	0.0	(0.2)	0.0	0.0
Operating Profit		(9.9)	(1.7)	1.5	3.5	3.9
Net Interest		(0.4)	(0.3)	(0.2)	(0.2)	(0.1)
Discontinued operations		(72.4)	0.0	0.0	0.0	0.0
Profit Before Tax (norm)		(4.2)	(1.9)	1.8	3.5	4.0
Profit Before Tax (FRS 3)		(82.7)	(2.0)	1.3	3.3	3.8
Tax		(0.2)	(0.1)	(0.7)	(1.1)	(1.2)
Profit After Tax (norm)		(4.4)	(2.0)	1.1	2.4	2.8
Profit After Tax (FRS 3)		(82.9)	(2.1)	0.6	2.2	2.6
Average Number of Shares Outstanding (m)		63	79	89	102	102
EPS - normalised (c)		(7.1)	(2.5)	1.2	2.3	2.7
EPS - FRS 3 (c)		(132.2)	(2.7)	0.7	2.3	2.8
Net win margin (%)		24%	23%	27%	32%	33%
EBITDA Margin (%)		(4%)	(1%)	3%	5%	5%
Operating Margin (before GW and except.) (%)		(4%)	(1%)	3%	5%	5%
BALANCE SHEET						
Fixed Assets		20.7	20.6	16.0	15.7	15.4
Intangible Assets		20.6	20.5	15.8	15.5	15.2
Tangible Assets		0.1	0.1	0.2	0.2	0.2
Investment in associates		0.0	0.0	0.0	0.0	0.0
Current Assets		6.8	3.6	5.7	8.0	9.5
Stocks		0.0	0.0	0.0	0.0	0.0
Debtors		1.9	1.3	2.1	2.0	2.0
Cash		3.7	0.6	1.5	3.9	5.4
Cash held in escrow		1.2	1.7	2.1	2.1	2.1
Current Liabilities		(8.5)	(7.5)	(7.9)	(8.5)	(8.5)
Creditors		(5.5)	(4.2)	(5.3)	(6.0)	(6.5)
Short term borrowings		(1.8)	(2.2)	(1.6)	(1.5)	(1.0)
Client funds		(1.2)	(1.1)	(1.0)	(1.0)	(1.0)
Long Term Liabilities		(1.0)	0.0	0.0	0.0	0.0
Long term borrowings		(1.0)	0.0	0.0	0.0	0.0
Other long term liabilities		0.0	0.0	0.0	0.0	0.0
Net Assets		18.0	16.7	13.8	15.2	16.4
CASH FLOW						
Operating Cash Flow		2.9	(3.7)	2.0	3.7	3.8
Net Interest		(0.2)	(0.3)	(0.2)	(0.2)	(0.1)
Tax		(0.3)	(0.2)	(0.3)	(1.1)	(1.2)
Capex		(3.1)	(1.7)	(0.5)	(0.4)	(0.5)
Acquisitions/disposals		(17.7)	0.0	0.0	0.0	0.0
Financing		0.0	4.0	(1.1)	0.5	0.0
Dividends		0.0	0.0	0.0	0.0	0.0
Net Cash Flow		(18.4)	(1.9)	(0.1)	2.5	2.0
Opening net debt/(cash)		(20.2)	(0.9)	1.0	(1.0)	(3.5)
Other		(0.9)	0.0	2.1	0.0	0.0
Closing net debt/(cash)		(0.9)	1.0	(1.0)	(3.5)	(5.5)

Source: Company accounts /Edison Investment Research