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RESEARCH



## Gaming Realms

23<sup>rd</sup> July 2019

### Refocus into highly profitable licensing model complete

Gaming Realms is a creator and licensor of real money and social games with operations in the UK, U.S. and Canada. The business was set up by the team behind Cashcade Ltd, creator of bingo brand Foxy Bingo and which was sold to PartyGaming for just under £96 million in 2009.

#### ■ Disposal of real money B2C assets complete and cash received

Gaming Realms has completed the disposal of its real money gaming business Bear Group Limited to a subsidiary of Oslo Bors listed River iGaming plc, as well its residual 30% stake in River UK Casino Limited. An initial cash sum of £7.35 million has been received, with an additional £1.5 million due on or before 31<sup>st</sup> December 2020. River has also assumed £2.65 million of liabilities associated with Bear Group.

#### ■ Strategy now focused on highly profitable licensing model

The transaction close marks the company's exit from being a direct supplier of games to the challenging UK real money gaming B2C market. **The focus is now upon expanding the high margin licensing division, which grew revenues by 167% in 2018.** Two recently signed distribution deals, with Relax Gaming and Scientific Games, provide the opportunity for a marked acceleration of growth from H2 this year and beyond.

#### ■ Valuation suggests 360% upside

With costs reduced significantly following the transaction close and the licensing model having very high margins, Gaming Realms looks well placed to grow profits significantly in the coming years. Our discounted peer based EV/EBITDA valuation suggests a target price of 26.79p, 360% upside from the current price. We update coverage with a stance of **Conviction Buy**.

Table: Financial overview. Source: Company accounts & Align Research

Year to end Dec	2019E	2020E	2021E	2022E
Revenues (£m)	9.84	6.62	8.94	11.87
Adjusted EBITDA (£m)	(0.92)	1.04	3.47	6.15
Pre-tax profit (£m)	2.87*	(3.63)	0.20	1.31

\* including gain on disposal

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### CONVICTION BUY – PRICE TARGET 26.79p

**GAMING REALMS**  
PLAYING A NEW GAME

#### Key data

EPIC	GMR
Share price	5.825p
52 week high/low	9.3p/4.05p
Listing	AIM
Shares in issue	284,428,747
Market Cap	£16.57m
Sector	Travel & Leisure

#### 12 month share price chart



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## Disposal complete and focus now on highly profitable content licensing

On 22<sup>nd</sup> February 2019 Gaming Realms announced that it had agreed to sell its real money gaming business Bear Group Limited to a subsidiary of River iGaming plc, a company listed on the Merkur Market of the Oslo Bors, as well as sell its residual 30% stake in River UK Casino Limited. Gaming Realms also agreed to grant to River Technologies Limited, another River Group company, a sole perpetual licence to its real money gaming platform.

On 17<sup>th</sup> July 2019 it was announced that the transactions had completed following the receipt of the necessary regulatory approvals. An initial cash sum of £7.35 million was received by Gaming Realms, with deferred consideration of £1.5 million due without set off on or before 31<sup>st</sup> December 2020. Additionally, River assumed £2.65 million of liabilities associated with Bear Group. **The conclusion of these transactions marks the company's exit from being a direct supplier of games to the challenging UK real money gaming consumer (B2C) market.**

Gaming Realms will be using part of the funds received to repay its Barclays Bank overdraft facility, creditors, and costs relating to the transaction, which together total £3.1 million. **The remaining £4.25 million of cash is expected to provide sufficient working capital for the game development and licensing division until it is cash positive, with this expected in 2020.** The disposal is also expected to deliver significant cost savings, with headcount reduced by around 50, thus allowing the group to focus resources on its expanding and high margin game development and licensing business.

## Operations

Following the disposal Gaming Realms is looking to become a leading supplier of games to the global gaming industry by following a licensing led strategy. The current operators are as follows:

### Licensing/Content Development

The licensing division, established in 2017, focusses on IP brand and content licensing to partners in the US and Europe across a range of gaming sub-sectors including online, lotteries, physical slot machines, social, scratch cards and others. The company has developed a Remote Game Server which allows its flagship "Slingo Originals" games library ([www.slingooriginals.com](http://www.slingooriginals.com)) to be licensed to third party operators as premium content. There are currently over 30 games hosted on the server.

Slingo, a portmanteau of slots and bingo, is a popular online game with a 20 year history which was acquired by Gaming Realms in 2015. The game sees a five reel slot machine display numbers which are then matched to a traditional bingo card. This makes it a quick and fun way of playing, which is well suited to the mobile format due to its speed. The company has ambitions to develop Slingo into a games category in its own right, alongside more established gaming categories such as slots, casino, poker etc.

Given the highly profitable nature of licensing activities, Gaming Realms is increasing its focus on growing this division, intending to expand the reach of its IP and content into new territories. The business model sees the company distribute its games by integrating into third party aggregators, typically earning a revenue share, while retaining the IP and avoiding the risks associated with directly operating in the gaming market. **High margins are earned due to there being relatively few direct sales costs associated with such deals in the long-term, with the more significant costs seen in the early months as deals are set up.**

## Recent licensing deals

Reflecting the focus on the division, a number of branding, distribution and licensing deals have been signed since the beginning of 2018. These include:

**Jan 2018** – a three-year licensing and revenue share agreement was signed with 888 Holdings Plc (888), to distribute Slingo Originals content. Under the deal, 888 hosts Slingo games on its "Dragonfish" B2B platform, distributing across 200+ bingo sites.

Also in January, a two-year licensing and revenue share agreement was agreed with New Jersey based online casino, GoldenNuggetCasino.com, to launch Slingo Originals content. In 2017, Golden Nugget Casino held a 30% share of the New Jersey online gaming market, making it the largest operator in New Jersey.

**Feb 2018** - a multi-show game licensing agreement was agreed with ITV, initially based around the television shows Dancing on Ice, The Only Way is Essex and Hell's Kitchen. The new games are hosted on Gaming Realms' proprietary platform under the umbrella brand tellygames.com and come after an agreement in 2017 to launch loveislandgames.com.

**May 2018** - a three-year licensing deal was announced with Sony Pictures Television for Gaming Realms to create and host the new gaming website millionairegames.com on its proprietary platform following the return of 'Who Wants To Be A Millionaire?' in the UK for its 20<sup>th</sup> anniversary. The site went live in tandem with the return of the show on ITV in May, with a Slingo game format of 'Who Wants To Be A Millionaire?' also created.

**June 2018** - a two-year licensing and revenue share agreement was signed with GVC Holdings, one of the world's largest sports betting and gaming groups, to roll out Slingo Originals content worldwide. Under the deal GVC agreed to distribute the content across all of its sites and had a six-week exclusive period of hosting Gaming Realms' new 'BlackJack X-Change' casino game. This follows an agreement made in July 2017 for GVC to distribute Slingo Originals in New Jersey.

**November 2018** - a 3-year revenue share agreement with Endemol Shine Gaming for the distribution of Deal or No Deal Slingo. Under the deal, the distribution of Deal or No Deal Slingo will expand to include the group's network of B2B operators across the UK, EU and US.

**May 2019** - a 3-year agreement with Scientific Games' Digital Group (SG Digital) for the distribution of the Slingo Originals portfolio via SG Digital's opening gaming system platform. Under the deal all the Slingo games will be distributed to over 200 operators globally via SG Digital's platform, one of the industry's largest content aggregation platforms. SG Digital is no stranger to Gaming Realms, with the companies having previously worked together on the development and distribution of games such as Slingo Rainbow Riches. SG is a significant player in the industry, currently valued at \$1.8 billion on the NASDAQ and recently posting Q1 revenues of \$837 million. The content is expected to go live on the SG platform during Q4 this year.

**June 2019** – a 3-year agreement with Relax Gaming which will see Slingo content go live on the Relax platform by September this year. Gaming Realms will receive a share of the revenue generated from gaming operators adopting its Slingo games via Relax Gaming's distribution platform, which provides access to over 350+ casino brands and has notable access to the Nordic markets.

## Future development

To further grow the licensing business, Gaming Realms is looking to develop around 12 games per annum and go live with between 12 to 15 new client integrations each year. Further large clients in the UK and Europe will be targeted, as well as in the potentially lucrative US market which is seeing changes in regulation lead to the lifting of certain gambling restrictions. **Gaming Realms currently holds a game supplier licence for the state of New Jersey, where Slingo content already accounts for c.3.5% of online casino turnover. The company is currently applying for a license in Pennsylvania and will pursue other opportunities in the US as they arise.**



*Key licensing, distribution and content partners. Source: Company*

## Social Gaming

This now non-core division provides a range of games which are designed for entertainment purposes only and are generally free to play. As no money can be won by the players of these games they are not considered to be gambling from a regulatory point of view. The social games division operates through the Blastworks Inc. subsidiary, which is based in Victoria, Canada.

Many of the social games are based on traditional gambling themes, such as casino and slots, with Slingo branded games making up c.80% of the total – the Slingo Arcade app was launched in 2016 with Slingo games repurposed for a social audience. In July 2016 a further dimension was added to the business via the acquisition of a 62.5% stake in Hullabu Inc, a company that in conjunction with Blastworks has produced a number of hidden objects games, including the popular “Hidden Artefacts”.

**With the social business making only modest revenues and requiring high marketing spend to develop it is considered non-core by the company. Gaming Realms is currently reviewing options for a potential sale or rationalisation of the division.**

## Full year results

Since our last update Gaming Realms has also released results for the year to 31<sup>st</sup> December 2018, with these reflecting a significant year of change. The period saw the disposal of the Affiliate Marketing business in March and part of the B2C Real Money Gaming business in July as the company looked to reduce exposure to challenging conditions in the UK B2C gaming market, including tighter regulation and an increase in point of consumption tax.

From the continuing operations, total revenues fell by 19% to £6.2 million, with declining revenues in the Social business being offset by growth in Licensing. Justifying its new strategy, the **Licensing** division had an excellent year, growing revenues by 167% to £2.2 million and making an EBITDA profit (before central costs) of just under £1 million. This was after the division went live with 13 new partners during the year, taking the total to 17, and grew the library of proprietary games to 28 from 9.

In **Social**, revenues fell by 43% to £3.9 million but posted an adjusted EBITDA profit of £1.5 million after reducing marketing spend by 81% and administrative expenses by 71%. At the group level the EBITDA loss from continuing operations was cut from £3.66 million in 2017 to £0.56 million.

On the balance sheet, cash stood at £0.47 million at the period end, down from £2.28 million, with the most notable liability being £3.2 million owed to Jackpotjoy Group as part of the company's December 2017 convertible loan agreement, along with a £0.2 million derivative liability. Notable cash inflows included the write back of £8.8 million of non-cash amortisation and impairments, £5.73 million received as proceeds from the disposal of assets, offset by a £12.42 million write back of profits booked on the disposal of assets and £3 million on purchase of intangibles.

## Outlook

Into the first quarter of 2019 and gross gaming revenue (GGR) - total revenue generated by Gaming Realms' partners from its licensed content, increased by 37% quarter-on-quarter to £10.8 million. Slingo Originals content went live on 8 new sites during the quarter, taking the total distribution to 34 gaming sites globally. **Based on the successful delivery of the Scientific Games and Relax Gaming deals the business is targeting to be cashflow positive by Q1 2020.**

## Forecasts

Following the series of disposals over recent years Gaming Realms has now been shaped into a business which has the opportunity to earn very high margins on its licensed content. The elimination of costs associated with the former real money gaming operations, boosted by the reduction in staffing costs, also provides the potential for much higher EBITDA margins and a strong operational gearing profile with profits set to grow markedly over the coming years as new distribution deals go live.

Taking these factors into account and working with management, we have collated forecasts for the financial years up to and including 2022. Our key findings are summarised in the table below:

Year to 31st Dec	£	2019	2020	2021	2022
Real Money (net)		4,400,085	300,000	0	0
Licensing		3,458,906	5,815,382	8,694,540	11,869,294
Social		1,717,494	499,995	249,998	0
Advertising & Other		268,116	0	0	0
<b>TOTAL</b>		<b>9,844,601</b>	<b>6,615,377</b>	<b>8,944,537</b>	<b>11,869,294</b>
COGS		-4,260,817	0	0	0
<b>GROSS PROFIT</b>		<b>5,583,784</b>	<b>6,615,377</b>	<b>8,944,537</b>	<b>11,869,294</b>
Admin expenses		-6,507,735	-5,572,277	-5,473,999	-5,717,117
<b>ADJUSTED EBITDA</b>		<b>-923,951</b>	<b>1,043,100</b>	<b>3,470,538</b>	<b>6,152,177</b>
Growth in Licensing		53.87%	68.13%	49.51%	36.51%
EBITDA margin		-9.39%	15.77%	38.80%	51.83%

By division, the 2019 financial year will see just over six months' worth of contributions from the disposed of **Real Money Gaming** business, with a residual £0.3 million earned in 2020. Following the disposal Gaming Realms will see the elimination of certain expenses associated with the division including bonuses & free spins, gaming duty, third-party licence fees, revenue shares, marketing and payment processing fees.

For the **Social** business, we assume that no significant further investment is made, especially in marketing which is key to growth, and that the business is effectively wound down by 2021, with a resultant decline in revenues to that year. Ancillary **Advertising and Other** revenues are also assumed to fall to zero from 2020. The significant movements in revenue come from the **Licensing** division, where revenues are expected to grow by double digit percentage figures over the forecast period as additional distribution deals go live on third-party platforms. We expect growth to be highest in 2020, a year when a maiden full contribution will be made from the recent agreements with Scientific Games and Relax Digital.

With Gaming Realms earning a licence fee based on the gross gaming revenues of its partners, the gross margin is effectively 100%, which we take into account in our forecasts. Combined with the significant reduction in staff numbers following the recent disposal, EBITDA margins are expected to rise strongly through to 2022. We expect the company to move into profitability at the adjusted EBITDA level in 2020, with a profit of £1.04 million. **As licensing revenues rise and the operational gearing kicks in, the figure is expected to more than treble to £3.47 million in 2021 and rise to £6.15 million in 2022.**



## Valuation

Given Gaming Realms' high non-cash charges associated with amortisation and interest, our preferred valuation method is the EV/EBITDA multiple. We use end-2022 as our valuation point given that the new business model should have matured by then and be delivering significant profits. For modelling purposes we treat the Jackpotjoy convertible loan as debt given the uncertainty over the eventual conversion price should the note be converted.

**With a current market cap of £16.57 million and forecast net cash at the end of 2022 of £8.6 million then Gaming Realms currently trades on an EV/EBITDA multiple of just 1.3 times our 2022 forecasts. This looks very cheap, reflecting the execution risks of meeting our forecasts, but provides significant upside should the company go on to meet our expectations.**

### Peer derived multiple

To illustrate what kind of valuation Gaming Realms should command if it meets our forecasts then we look to several games licensing/development companies which provide similar services. In comparison to our previous notes, we shift these peers away from the Gambling sub-sector given Gaming Realms' move to the higher margin licensing model based on unique content creation and distribution, which should command a premium valuation from investors.

	Market Cap (£m)	Net cash (£m)	Historic EBITDA (£m)	EV/EBITDA
<b>NetEnt</b>	556	42.2	68.8	7.5
<b>Evolution Gaming</b>	2,980	69.4	95.3	30.5
<b>Activision Blizzard</b>	27,915	1,340	2,145	12.4
<b>Electronic Arts</b>	20,982	3,515	1,245	14.0
<b>Codemasters</b>	309	18.2	18.7	15.5
<b>AVERAGE</b>				<b>16.0</b>

From our analysis we see that games licensing/development companies can command much higher valuations than those in the gambling sector. Our chosen peers above currently trade on an average EV/EBITDA multiple of 16 times. This is in contrast to companies such as Stride Gaming, a previous peer to Gaming Realms, which is currently in discussions with Rank Group over a potential £115 million takeover valuing it on a historic EV/EBITDA multiple of just 5.8 times. Stride retains an exposure to the difficult UK real money gaming market and saw adjusted EBITDA fall by 23% in the six months to February 2019.

Applying the peer average EV/EBITDA multiple of 16 times to our 2022 forecasts for Gaming Realms implies an equity valuation of £107 million. **Discounted back to end 2019 at a rate of 12% derives a value of £76.2 million, or a price per share of 26.79p.**

It is clear from our forecasts that Gaming Realms shares look very cheap should our forecasts be met. Therefore execution risk is the principal factor to consider. However, we point out that our forecasts could be considered conservative as we assume no further significant distribution deals are signed over the forecast period. Assuming management deliver on expectations over time, we would expect a significant re-rating in the shares from the current valuation. **We therefore update coverage of Gaming Realms with an end 2019 target price of 26.79p and Conviction Buy stance.**



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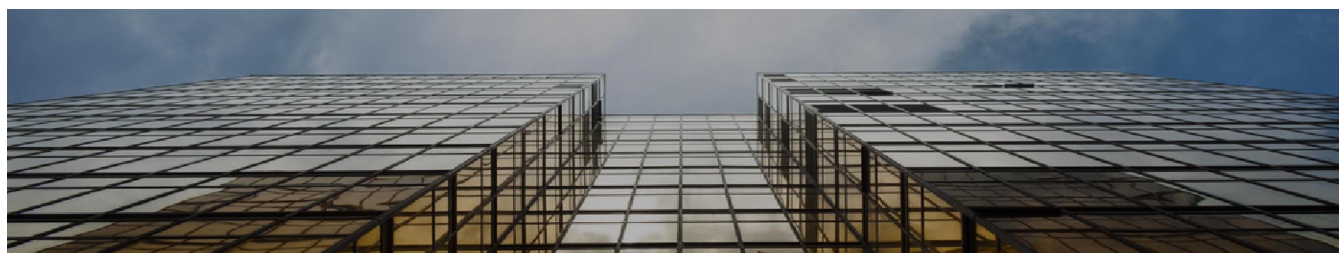
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