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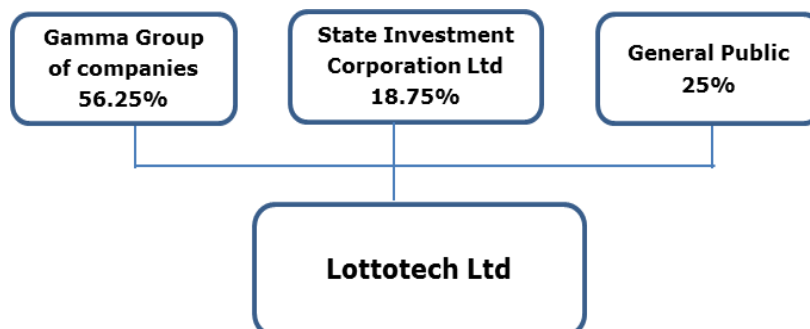
Lottotech Ltd – Monopolistic game player

Lottotech is the exclusive operator of the Mauritius National Lottery on the Government of Mauritius with in place a licence for a period of 10 years as from 2009 which is renewable for periods not exceeding 5 years. The company derives its revenue from draw-based game (*Loto*) and instant games (*Scratch cards*). Moreover, Lottotech contributes a percentage of its net proceeds (*currently 46%*) to the Consolidated Fund of the Government of Mauritius as per the licencing requirements, which in turn is used to finance community enhancement projects and settlement of public debt. The company's management is assisted by A.S. Burstein Management Ltd, a subsidiary of Gamma Civic, with regards to the operations of the National Lottery as well as strategy and business development. The retailers' distribution network has expanded since its time of launch from 542 to currently 895 over Mauritius and Rodrigues. The company aims to further reach the population by increasing its number of retailers to 1,000 by the end of Dec.2014.

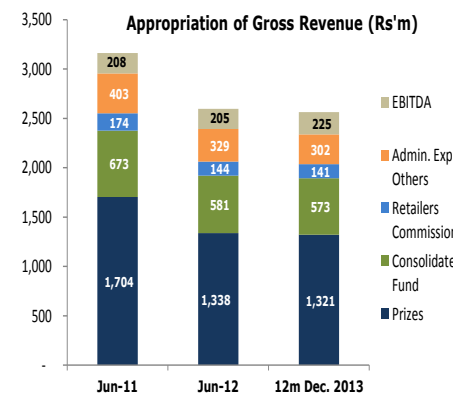
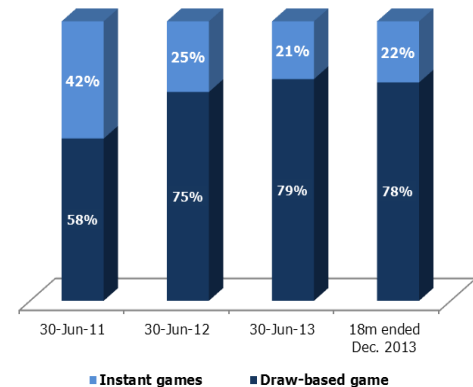
Shareholding Structure

Main shareholders of Lottotech are the Gamma Civic Ltd and State Investment Corporation having stakes of 75% and 25% respectively. The former company is listed on the Stock Exchange of Mauritius with exposure in building materials, construction, property and lottery operations while the latter Company is the investment arm of the Government of Mauritius.

The current shareholders will make available up to 85m of existing ordinary shares for the offer for sale. Hence post listing of Lottotech, the shareholding structure will be as follows:



% contribution to Gross Revenue



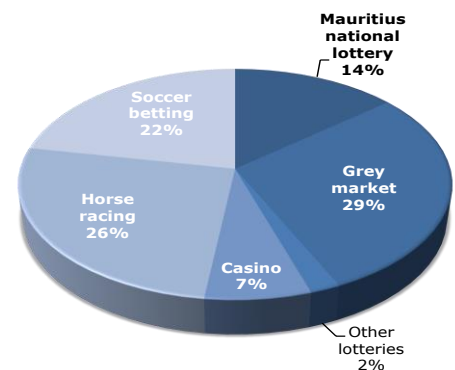
Lottotech Game's Portfolio



Gaming & Gambling Industry – Mauritius

Gaming and gambling industry in Mauritius consists of licensed casinos, sports & horse racing betting and lotteries. According to Statistics Mauritius, the industry which forms part of Arts, entertainment and recreation contributed 0.2% to GDP growth in 2013 and for 2014 it is expected to reach 0.3%.

Moreover, as per an analysis conducted by Business Magazine on gaming and gambling industry, the market represented a yearly amount of Rs20bn in 2013. Upon breakdown of the gaming and gambling market composition, the grey market had the lion share of the pie representing 29%, followed horse racing 26% and soccer betting 22%. The Mauritius national lottery had a market share of 14% and management of Lottotech expects to grab some market share out of the grey market which shall be impacted by strict regulations set by the Government with an objective to better regulate that segment. However, given that horse betting and sport betting are oldest activities it will be difficult for the Loto business to capture the market share of these activities.



Source: Business Magazine- gaming and gambling market composition

In terms of taxation, there is no gambling tax imposed on the Loto and lottery businesses. However, in the last budget speech there was an increase in gambling and betting duties namely application of betting duty to bets on football matches (rate per outlet Rs24k per week) and in fixed gambling registration duty. Therefore, the Loto and lottery business might be subjected to special levy in the future, should the business be expanding significantly.

Salient Features of Listing

Offer	Offer for Sale of up to 85,000,000 ordinary shares of no par value to the public at an offer price of MUR10 each, fully payable on application, following which 340,000,000 ordinary shares of no par value will be listed on the Official List of the Stock Exchange of Mauritius Ltd.	
Price of Offer	MUR10 per ordinary share.	
Allotment	<p>Up to 20% of ordinary shares will be reserved to be allocated to retailers of Lottotech, directors and employees of Gamma Group and The State Investment Corporation Ltd, with a discount rate of 5% on the offer price</p> <p>The balance of the ordinary shares on offer will be allocated to the public.</p> <p>In the event of over-subscription of the ordinary shares allocated to the public, the Board will define the allotment criteria and retains the right to allocate the ordinary shares in such a manner as it deems appropriate.</p>	
Timetable	Opening of Offer for Sale	5 May 2014
	Closing of Offer for Sale	16 May 2014
	Allotment of fully-paid ordinary shares to shareholders	9 June 2014
	Commencement of trading of ordinary shares on the Official List of the Stock Exchange of Mauritius Ltd	11 June 2014
First trading session	Existing shareholders of Lottotech prior to the Offer for Sale, will make available up to 50,000 ordinary shares at an indicative price of MUR10 per ordinary share	

Shareholders of Lottotech – Lottery Winners?

	18 mth ended 31-Dec-13	6 mth ended 31-Dec-13	Year ended		
			30-Jun-13	30-Jun-12	30-Jun-11
Total Sales (Rs m)	3,876	1,326	2,550	2,597	3,161
Loto (Rs m)	3,028	1,005	2,023	1,940	1,835
Instant Games (Rs m)	848	321	527	657	1,326
Avg Loto Sales per week (Rs m)	38.8	38.7	38.9	37.3	35.3
% Change			4.3%	5.7%	
Avg Instant Games per week (Rs m)	10.9	12.3	10.1	12.6	25.5
% Change			-20%	-50%	
Pricing of a Loto line = Rs. 20					
No of lines played (Loto sales/Rs. 20) (m)	151.4	50.3	101.2	97.0	91.8
Avg. No of lines per week (m)	1.94	1.93	1.95	1.86	1.76
Total No of possible Combinations for loto (m)	3.84	3.84	3.84	3.84	3.84
Max Coverage ratio to win the jackpot per week*	50.6%	50.4%	50.7%	48.6%	46.0%
Number of rollovers	51	17	34	34	36
% rollovers	65.4%	65.4%	65.4%	65.4%	69.2%

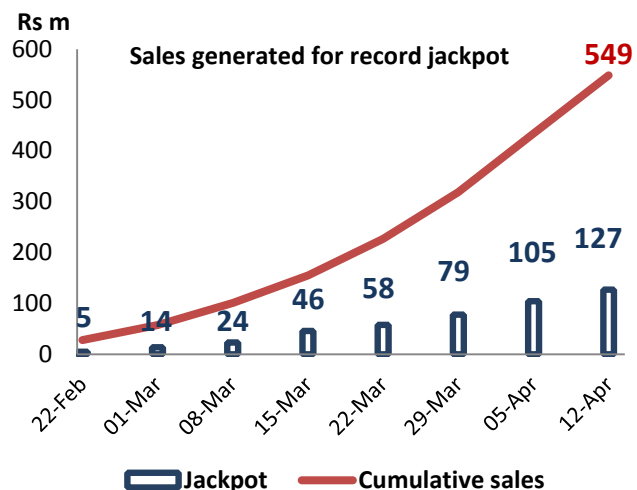
*This is the maximum coverage since we are implying no two identical lines were played

Sales increases with rollovers

Lottotech's ticket sales are expected to increase with rolling over of its jackpot since people tend to play more when jackpot is higher.

Popular game - 75% of adults play Loto

According to 2012 survey of Statistics Mauritius, there are 964,616 adults in Mauritius. Player participation rate for Loto and Quick Win games combined is high and estimated to be around 75% of the adult population, with an almost equal participation of men and women (source; Ipsos Reid, 2013). The number of players in Mauritius is approximately 720k. The number of different possible combinations of 6 figures out of 40 amounts to 3,838,380 and hence probability of winning is 1 in 3.8m.



High probability of rollover

The relatively small number of players coupled with the low probability of winning offers a very high potential for rolling over of its jackpot. During its 3 last financial years, on average the jackpot was rolled over for 34.6 weeks out of 52 which amounts to 66%. This is also highlighted by the low coverage ratio which averaged 48%. In reality, this coverage ratio is much lower as lottery players may be playing identical lines. Press article mentioned that among the 5.7m lines played when the jackpot reached Rs100m earlier this year, 3.4m were identical.

Record jackpot of Rs120m



Since the beginning of the year 2014, there were 9 rollovers (in 16 weeks) and the jackpot reached record of Rs120m after 8 consecutive rollovers. The total sales for the 8 weeks amounted to around Rs549m which represents a significant difference compared to the jackpot of Rs127m. As shown by the graph above, there is a strong correlation between successive rollovers and increased ticket sales. Based on these statistical data, we can say that the shareholders of Lottotech are the real lottery winners of the game.

Lottotech Valuation	Rs m.
Enterprise Value (EV)	3,719
Debt	(2.6)
Gratuity Obligations	(2.4)
Surplus Cash	82
Equity Value	3,796
Equity Value per share (Rs.)	11.17
Minority Discount (10%) (Rs.)	1.17
Offer Price (Rs.)	10.00

Key Valuation Assumptions

- The Discounted Cash Flow (DCF) valuation methodology was employed based on the business model of Lottotech, which operates on a cash basis and is at early operating stage.
- Given its debt free capital structure, Cost of Equity ranging from 13%-15.8% has been employed in the calculation of the Enterprise Value.
- Free Cash Flows spanning across Lottotech's three concession periods of up to 2019, 2020-2024 and 2025-2029 respectively were taken into account.

Lottotech's Enterprise Value (EV) was determined to be Rs3.7bn by an independent valuer, from which an equity value of Rs3.8bn was then derived, coupled with the consideration of outstanding liabilities and surplus cash as at 31 December 2013. Given only 25% of the total listed shares will be available for trading, a 10% minority discount was applied to Lottotech's equity value, resulting in a value of Rs3.4bn. Given the total number of 340m shares to be listed on the Official market, an issue share price of Rs10.00 is thus derived.

Financial Highlights

Key Financials (Rs m.)	Jun-11	Jun-12	FY 2013	FY 2014F	FY 2015F
Gross ticket sales	3,161	2,596	2,563	2,820	3,045
Net Income	754	650	671	729	787
EBITDA	141	153	210	286	361
Operating Profit	91	102	160	236	311
PAT	75	88	141	200	263
Adjusted EPS (Rs.)	0.22	0.26	0.42	0.59	0.77
Key Ratios					
EBITDA Margin (%)	4%	6%	8%	10%	12%
Operating Margin (%)	3%	4%	6%	8%	10%
Net Margin (%)	2%	3%	6%	7%	9%
P/E (x)	45.3	38.8	24.1	17.0	12.9
DPS (Rs.)	-	-	0.49	0.47	0.62
Div. Yield (%)	-	-	4.9%	4.7%	6.2%

**FY 2013 figures were readjusted to the 12 months ending December 2013 trading period. Issue price of Rs10.00 was applied across Dividend Yield calculations.*

We forecast Lottotech's PER to improve to 17x in FY 2014 and 13x in FY 2015, based on the potential increase in gross ticket sales (predominantly from the current Loto game), as well as taking into consideration the potential impact of cost management initiated in FY 2013. We also assume a +5% margin on the minimum dividend payment policy of the company (75% of PAT), which translates into a dividend yield of 4.7% for FY 2014 and 6.2% for FY 2015. The company is debt-free (other than the Rs2.6m leasing on motor vehicles) and we do not expect any major capital expenditure in the short to medium term. Game enhancements to increase revenue will mostly be funded through available cash.

BULL CASE

- Enjoys a monopolistic situation in Mauritius, being the sole licensed operator until 2019. As per the Gambling Regulation Act, only one operator at a time can be licensed to operate the Mauritius National Lottery.
- Expect to increase its market share by capturing business from the grey market as the government becomes more strict on regulations.
- Expansion of distribution network to 1000 retailers by December 2014.
- No cap on the amount of times the current Loto jackpot can roll over.
- Even if the 2nd weekly draw might take some time before being implemented, the group has other plans to enhance the existing Loto game which may boost up sales.
- No capital expenditure will be required for additional games planned (KENO, video lottery terminals, mobile wagering and other interactive games)
- Debt free and cash rich business model.

BEAR CASE

- Sales/Revenue growth is highly dependent on the implementation of new games, given the small population size and the fact that only a weekly draw is currently operational.
- Regulations and more stringent rules such as the delay or refusal of approval of new games, advertising restrictions, and increase in license fees will adversely impact growth.
- The business model is highly reliable on its technology infrastructure.
- Subjected to reputational risks such as negative advertising about the gambling industry.
- Significant Management fees are currently being paid. Moreover, we have seen the government taxing different areas of the gambling sector as they grow and hence Lottotech might be subjected to further taxes in the future.
- The stock is being offered at a higher P/E multiple than that of the market (13x).
- The dividend yield of 4.9% will be sustainable only if the Company is able grow its earnings as per its 'impact analysis' or if gross sales increases considerably.

Recommendation**Two fold strategy**

Since there is no transaction fee to acquire the shares, we believe there is an opportunity for short-term gain in the event the stock is oversubscribed. There is only 85m on offer among which up to 20% is reserved for retailers of Lottotech, directors and employees of Gamma group and SIC. Investors may end up with lower number of shares than expected and they may look for buying opportunities on the market, creating an opportunity for short-term gains.

Income Stock

The dividend policy of the company is to distribute 75%-100% of its profit after tax to shareholders. The stock offered an interesting annualized dividend yield of 4.9% in 2013. Investors seeking income can thus take exposure Lottotech.

Potential for capital appreciation

Management has plans to enhance the Loto game with side jackpots. Enhancements in the game are already present in other countries such as Canada and are quite popular. Introduction of a second weekly draw in the future will significantly boost sales of the Loto game. New games such as 1-2-3 daily game, KENO, Video Lottery Terminals and Mobile wagering and interactive games were also present in its proposal to the SIC and the launching of any of these games should grow top lines of the business. Thus, Investors may also invest in Lottotech for long-term growth potential with introduction of new games as well as enhancement of existing game.

Based on the above, we recommend **subscribing** to the shares of Lottotech Limited.