

An opportunity of a lifetime

An old market adage says that stock prices rarely go up in straight lines. And this has never been truer than for Flutter Entertainment. After a stellar year in 2020, the stock has struggled in 2021 and we thus thought it was a good time to update clients on what's been happening with the company and its outlook.

We last wrote about Flutter in July 2020 as excitement was building around the US market opportunity for both US and UK listed operators. In 2018, the US Supreme Court repealed the federal law banning sports betting which allowed individual states to legalise the market. Flutter Entertainment bought Fanduel, a daily fantasy sports betting operator which would allow Flutter to cross-sell its sports betting products into an existing client base. This strategy has been successful and allowed Flutter to lower customer acquisition costs, accelerate their path to scale and gain dominant market share.

As it stands, more than 30 states have legalised sports betting with nearly half allowing online wagering. During 2020, US online betting and gambling revenue numbers exceeded even the most optimistic projections, resulting in substantial upgrades to long-term total addressable market predictions. This in turn led to a material re-rating for any companies with exposure but especially US "pureplays", such as DraftKings and Penn National Gaming. Indeed, DraftKings' share price increased more than six times. UK companies benefitted too, but less so since the majority of these businesses were still made up of mature markets.

Nevertheless, investors started to look at the valuations of companies such as DraftKings and Penn and started to apply higher (albeit still discounted) multiples to the Fanduel part of Flutter's business. Certainly, this helped to drive the re-rating of Flutter through 2020 and as a result, Fanduel was representing roughly half the market value of Flutter. Therefore, going into 2021, Flutter's plan was to IPO a small stake in Fanduel which would in theory unlock some of the value not fully reflected in the share price.

However, this was not meant to be. In 2021 Flutter faced a multitude of headwinds which have impacted the stock price over the year.

Firstly, there has been a substantial de-rating of US peers such as DraftKings and Penn. Despite the fact that the overall market performance continues to exceed expectations, many of the US operators have failed to deliver and in hindsight were overoptimistic in their market share targets. DraftKings in particular offered very aggressive promotions in order to attract new customers; however, start-up losses have ballooned as a result, pushing the point of achieving break-even into later years.

Unfortunately, this hit investor confidence in the business model and the question of whether it will ever achieve profitability. Since investors were using DraftKings' lofty multiple as a comparison for valuing Fanduel, this de-rating has impacted the value assigned to Fanduel and therefore Flutter overall. Ironically, almost uniquely among the US operators, Flutter's revenue and market share are actually exceeding expectations and start-up losses are well within guidance. Management expect Fanduel to break even at the EBITDA level in 2023 which we believe to be well within reach.

The second reason was the postponement of the much-anticipated IPO. Fanduel became embroiled in a dispute with Fox Corp over the exercise price of an option for 15% of Fanduel; this is currently being

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arbitrated. In addition, Fanduel's CEO left after they could not agree terms over pay. We anticipate that the possibility of an IPO will return to the table in the new year.

Third, regulatory concerns reared their heads once again both in the UK and Netherlands. The UK gaming reform measures are likely to be announced next year. We believe that the probable impact on earnings has been more than priced in. In Australia, increased regulation and taxes have resulted in market consolidation which has paradoxically benefitted larger incumbents with scale. Therefore, over the medium-term, we are not concerned about the impact on the earnings potential of the company. In the Netherlands, PokerStars (a poker brand acquired through the merger with The Stars Group) was required to close their business and reapply for an operating licence which will take around a year, after which, some of the lost earnings would likely be recouped.

Lastly, Flutter's third quarter results were weaker than expected due to sports results going against the company. Quarterly results volatility is a feature of this business but does not impair future quarters' expectations, nor the value of the business.

So, after all of this, where do we stand on the company as an investment opportunity?

Ultimately, we continue to believe that Flutter stands on the cusp of one of the most exciting market opportunities of our lifetime. US GDP is around 7 times larger than the UK and the population is 5 times bigger. Flutter have been exceedingly successful in their strategy thus far winning substantial market share - at lower cost than competitors. The point where the US starts to be accretive to earnings is in sight. Although the road has not been smooth, we do not believe that any of the issues which have raised their heads this year change the long-term outlook for the company. We have conviction that our investment thesis remains intact.

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