# MASTER THESIS

## THE ONLINE GAMBLING INDUSTRY

*- A Valuation and M&A Case*


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# Executive summary

The online gambling industry has been one of the most exciting markets in Europe during the last decade and is expected to grow with 9% annually in the upcoming years. Some of the companies in this industry are listed on the Swedish stock exchanges, and there have been more lining up for IPO's during the process of writing this thesis. We are currently witnessing a consolidation wave in Europe where many online gambling firms engage in active M&A strategies. One of the main motives behind this consolidation trend is the regulatory environment, currently under transformation. As of today, all of the companies on the Swedish stock exchanges are based offshore in "tax havens" such as Malta. Countries around Europe are now preparing to introduce local licenses and apply domestic tax rates for the game winning revenue generated locally, which will most likely increase tax liabilities for the companies active on each market. The involved companies are now looking to develop smart strategies in order to handle future cost increases and regulatory amendments.

Through our strategic analysis we found that Betsson is the most suitable target company among its peers since they are well-positioned to acquire a target given their proven historical capability of integration, scalable business model and multi-brand strategy. Given Betsson's attributes we argue that Mr. Green would be a suitable target for them to acquire, since they could help each other to further build on their strengths and support each other in approaching future opportunities and threats. More specifically, we argue that Mr. Green could help Betsson to complement their geographical concentration and assist in extending their core product and service offering within casino and gaming.

Mr. Green has been publicly traded since 2013 and for the last two years shown a negative net profit. This has mostly been due to tax provision liabilities in Austria. These provisions are precautionary and budgetary measures taken by Mr. Green and is retroactively compounded from previous years. Mr. Green disputes this tax allegations referring to EU legislation, but the court process is expected to take several years. These provisions have in the meantime hurt profitability and resulted in negative ROIC in FY14-FY15. However, given the anticipated industry growth and since these tax provisions are likely to shrink as the case resolves, Mr. Green's ROIC could significantly improve. After conducting a financial statement analysis, we have estimated pro forma statements, from which we used a DCF- and EVA model to estimate the intrinsic value of Mr. Green's equity to equal 1 554.7 MSEK, equivalent to a stock price of 43.09 SEK, and an 8% decrease from closing price as of December the 30th 2015. We have further estimated total synergies to equal 463.613 MSEK, yielding a resistance point of 2 008.3 MSEK. If the purchase price would end up below this point, we believe that Betsson should consider acquiring Mr. Green, realize synergies and thus create value to its shareholders.

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# Section A

The following part, which we have named Section A, will contain an introduction and motivational thoughts about our choice of topic for this thesis. Included in the introductory section will be our formulation of problem statements, identification of limitations and a description of the structure we have chosen to present our work. Following the introductory section will come a presentation of methodology, which will constitute the theoretical foundation upon which we will base our analysis on.

# 1. Introduction

## 1.1 Motivation and Introduction

The Master Thesis is the final piece of work that we, the authors, will produce during our time spent at Copenhagen Business School (CBS) enrolled in the Finance & Investments, Master of Science program. Our intention is to take advantage of the knowledge learned and the techniques we have studied in class. We want to combine this with insights that we have gained through a personal interest in the subject, to present our thesis in a professional way that goes in-line with high academic standards. Our goal is therefore to present a well-written thesis that in accordance with our academic program and also related to our personal interests.

The program Finance & Investments has been rather challenging and certainly improved our mathematical and technical skills. We have found throughout the course of the two years studying at CBS that the many of the concepts related to company analysis, stock valuation and mergers and acquisitions has been the most intriguing to us both.

We have chosen to simulate a mergers and acquisitions case within the Swedish online gambling industry (OGI). We define the OGI as the group of publicly listed companies on the Swedish stock exchanges that provide online gambling services. Following EU's definition: *Online gambling services are any service which involves wagering a stake with monetary value in games of chance, including lotteries and betting transactions that are provided at a distance, by electronic means and at the individual request of a recipient of services* (European Commission, 2012). As declared in the executive summary, strong motivational factors for us in choosing the OGI was strong historic organic growth and the fact that many companies were conducting explicit mergers and acquisitions driven strategies in order to reach for additional market share, enter new markets and beat competitors. Additionally, the listed companies on the Swedish stock exchange that we will mention in our thesis have outperformed index, which has been

widely reported in Swedish media and among industry experts. These were some of the main reasons that made us intrigued into further investigating the ongoing consolidation within the industry.

The OGI has been one of the fastest growing sectors for the last ten years and a report published by MarketLine (2016a) expects the European industry to continue to grow at a compound annual growth rate (CAGR) of 9.9% from 2015 to 2020, which will be equivalent to an aggregate value of 21.5 MEUR in 2020. Since Europe consists of many different countries which are individually responsible for their own legislation, laws often times varies from one country to the next in Europe. This segregates the industry into well-regulated countries and less regulated markets. Sweden is one of the countries where a government-backed company, Svenska Spel, is still allowed to exercise monopoly power on offline gambling. Furthermore, according to the industry authority Lotteriinspektionen, current legislation states that it is not permitted for other firms than the ones specially permitted to, to market their business or conduct gambling services targeted towards the Swedish population with the sole purpose of generating financial profit (Lotteriinspektionen, 2016a). Even though the EU-commission is investigating whether or not this model complies with EU's rules about market economy and free competition for customers, at the moment, Svenska Spel continues to operate as a monopoly. There are, however, ways around this. What we will further explain, the online gambling firms that we mention have registered for business offshore in so-called "tax havens" such as Malta and Gibraltar and are able to offer their services to the Swedish population online.

At the time of December 30$^{st}$ 2015, there were seven listed online gambling companies on the Swedish stock exchanges with market capitalizations ranging from Unibet's 23.4bn SEK to PlayHippo's 99.32 MSEK (Avanza, 2015; PlayHippo, 2016). As mentioned, the ongoing industry wide wave of consolidation that has involved numerous M&A transactions during the last couple of years involving some of the focus firms of this thesis, is likely to resume and attracted us to investigate further opportunities. With this in mind, we want to take a wider grip on the overall state of the Swedish OGI. Furthermore, we are also interested in investigating whether or not we can find opportunities for further consolidation and if a possible transaction can be executed in a profitable and value adding manner.

The overall main goal of the thesis is to, through strategic, financial and consolidation analysis determine which two firms out of the group of listed online gambling companies on the Swedish stock exchanges that can constitute candidates for an M&A deal in this simulated scenario. To also introduce our chosen structure, we will in section 8 decide which firm will act as the acquirer. We will assess the company's strategic goals, future growth possibilities, current financial position and historical M&A performance.

The follow up task then becomes, given the chosen acquiring firm's attributes and desires, which firm will constitute a suitable target firm for them to either merge with or acquire. We will then perform a financial statement analysis, pro forma estimation and a valuation in order to find the intrinsic value of the target firm. We will also assess whether or not there are operating and financial synergies to be generated, the strategic fit and what would be the resistance point for the acquirer and thus if the consolidation opportunity can create value for the shareholders.

## 1.2 Problem Statement

The OGI was particularly interesting to us as a choice of subject for our thesis due to a number of reasons. First, although the set-up is likely to change in the relatively near future, there are currently two segments of online gambling firms active in Sweden: regulated (domestically based) and unregulated (based offshore). Secondly, many of these offshore firms are listed on the Swedish stock exchanges and have historically been active within M&A. Lastly, while we can observe industry wide growth, the industry is also under transformation involving regulatory shifts and consolidation. These were three features we found particularly intriguing and attracted us to investigate the online gambling industry further.

With these underlying motives in mind, we feel that there is an opportunity for us in this setting to combine our motives into an exciting strategic and financial investigation. We want to combine classical firm valuation with theories of mergers and acquisitions to examine whether further consolidation is possible and, if so, financially justifiable. We will investigate and demonstrate through building a case set-up that will be presented throughout our initial analysis. It is further our hope that we through writing this thesis will take notice of a phenomenon that is very current, as the corporate transaction activity within the OGI has been substantial in recent years and is likely to continue. Additionally, we are questioning whether a merger or acquisition will be financially sustainable in our specific case. Classical M&A theory often times suggests that a majority of deals do not necessarily lead to stock increases or EPS accretion for the shareholders, at least from an acquirer's perspective. The research report *Perspectives on Merger Integration* published by strategy consultant McKinsey & Company (2010) states that as much as 70% of all M&A deals are doomed to fail. Another study by strategy consultant Bain & Company (2014) *Why Some Companies Become Synergy Overachievers,* where they surveyed 352 global executives, are also in support of the above statement, suggesting that in about 59% of the time deals fail due to inadequate due diligence and in 55% of the time due to overestimated synergies. Simultaneously, there is also another side of the coin and one can make the argument that in order to stay ahead of competition and continue to grow faster than the market, financing growth through successfully implemented M&A transactions might be the only appropriate strategic solution. With these thoughts in mind, we have thus intended to use a

conservative approach when analyzing the industry and our specific companies.

Another explanation behind our choice to narrow our focus to online gambling companies is that we can observe scalability in their business models, hopefully making valuation clear and understandable. Additionally, there must be reasons as to why M&A activity is high within this industry and we are intrigued to investigate how and why a potential merger of two companies can be successful.

In summary, we want to find an opportunity to evaluate an interesting M&A prospect, involving a realistic setting and assumptions, which could be accomplished between two online gambling firms publicly traded on the Swedish stock exchanges. It is thus our intention to investigate whether or not it would be financially supportable to pursue such a strategy and support our company valuation with financial, strategic and market analysis.

### 1.2.1 Research Questions

We have chosen to structure our problem statement to consist of one main research question. In order to fully evaluate this principal problem statement, it is essential for us to also investigate the related sub-questions listed below, which will build up a foundation of information and analysis for our case.

*What is the intrinsic value of the target firm, and what will be our estimated valuation of the combined firm, after the merge is completed?*

### 1.2.2 Sub-questions

*1. Through strategic and market analysis*

*Which factors drive market growth for online gambling companies, now and in the future? Considering the intense competition in this industry, how will new regulation affect the unregulated firms currently active on the Swedish market?*

*2. Through market and financial analysis*

*With the strategic and market analysis in mind, we want to find a company that is in a suitable position to act as the acquiring firm in our M&A case. What suitable consolidation opportunities can we thus find for an online gambling firm listed on the Swedish stock exchanges?*

*3. Through microeconomic analysis and company valuation*

*Given our choice of acquiring firm, which company looks to be the most suitable target for them to acquire?*

## 1.3 Limitations

When writing a master thesis, the scope of research and volume to be within the allowed limits in terms of quantity produced is quite rigorous. However, in order to produce quality throughout the thesis and to be able to produce a well-founded conclusion at the final stages, we realize that we have to define some limitations. These limitations are what we in the following section will declare and discuss.

In order to be able take a wider overlooking perspective analyzing the European OGM and simultaneously elect two firms to value and process an M&A transaction in-between, we have chosen to limit our scope of research to the Swedish OGI and the industry players that are listed on the Swedish stock exchanges as of December 30st, 2015. The cluster of companies include: Betsson, Unibet, Mr. Green, Cherry, Net Gaming Europe, PlayHippo, Net Entertainment, Evolution Gaming and Kambi. We can thus also reveal that, while we have been writing our thesis, there has been several additional IPO's of online gambling companies to the Swedish stock exchanges that we will thus not consider.

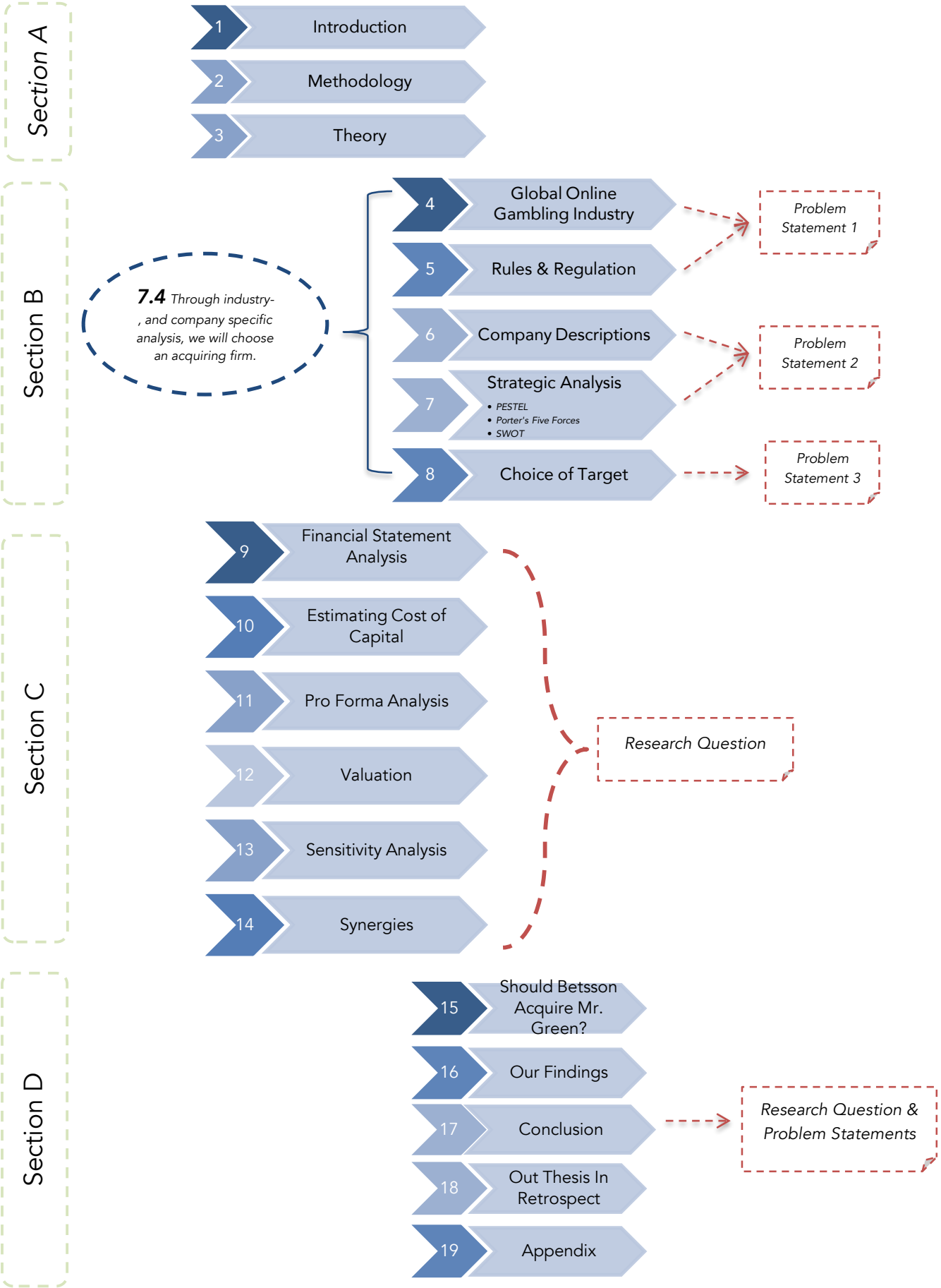
One of the advantages with choosing listed companies to research is the amount of financial information you can access, in comparison to a privately held firm. For this work specifically, we will use data from financial reports including the annual and quarterly reports that has been released from all companies involved during February and March in 2016. That is, that reflects the financial data from 2015 and historically. When analyzing the financial reports, we will however only consider the five most recent fiscal years.

Furthermore, for us to be able to be able to conduct accurate valuations and to make realistic assumptions we need as much data and information about the listed firms as we possibly can access. We will therefore consider it a limitation if not enough information is published about a specific company. This lack of publicly available information may have many different explanations. One reason is that some of the firms mentioned are newly introduced on the stock exchange and also quite small in comparison with industry peers and is simply yet to produce enough financial data.

There are multiple means of payments with which a company transaction can be financed and executed. We feel that, while acknowledging the utter importance in reality, this is beyond the scope of this thesis and we therefore choose not to consider it more than notably.

Regulations and accounting standards is something that we will acknowledge and mention when introducing the financial statement analysis section. We realize that while a company's financial statements have to be in accordance with certain established accounting standards, it also lies in the companies' interest to display its performance in the best possible way to investors. This is an important detail to consider, however, to analyze accounting standards in deeper detail is beyond the scope of this thesis.

Another related limitation concerning our choice to value a potential M&A deal includes the amount of control premium to be paid for the target. In reality, there might be rumors or stock analysis from investment bank analysts that predicts and speculate regarding a potential future merger that can affect investors and ultimately drive the stock price of the target either up or down depending on the consensus view of the deal. The control premium is defined by (Brealey, Myers, & Allen, 2011) as the premium that the buyer pays over the target's stand-alone value. The issue becomes, if the merger can be anticipated or if there are some pre-speculation rumors surrounding the deal, that the target stock price could appreciate over the stand-alone value and the potential control premium could be eaten up by the sudden increase in the market value. We will therefore acknowledge this idea but not consider it more than notably in our calculations. We will simply argue for and calculate a potentially adequate control premium, but disregard the hypothetical market effects. We will further assume, as Vernimmen, Quiry, Dallocchio, Le Fur and Salvi (2005) suggest, that as the control of a listed company changes hands, minority shareholders receive the same premium as that paid to the majority.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### 1.4 Structure of the Thesis

We have chosen to structure this master thesis into five main parts, with each containing several sub areas that are illustrated in the flow chart above. The first main part, Section A, will be introductory with the intent of providing the reader with a foundation and description of the motivations, problem statements and methodology we have faced and kept as guidelines throughout our work. This section will also include a theory section covering mergers and acquisitions, historical development including merger and acquisitions waves. A future outlook will also be touched upon as well as a discussion about what financial theories we have used for the valuation of our chosen target and merged firm. In the second section, Section B, we will describe the OGM, perform a strategic analysis including a PESTEL analysis, Porter's Five Forces and a summarizing SWOT analysis. Furthermore, the role of the industry players and an analysis of what the legislative environment currently looks like will also be covered. The third section, Section C, will consist of the actual case study where we argue for our choice of target firm and conclude why we think the target will be a suitable match with the acquirer in an M&A-deal. The fourth and final section, Section D, will contain our valuation of the combined firm provided along with a sensitivity analysis. After this, a conclusion regarding the overall view of the deal including the new share price and offer price. Finally, we will use our conclusions from our analysis in order to forecast the strategic and financial performance of the merged firm in the future. The objective is to make the forecast realistic, based on real and clearly defined assumptions and for it to be applicable in a real-world valuation.

# 2. Methodology

We will in this chapter present the scientific view, adopted research approach and methodology that were practiced in this thesis. In the following sections we will also explain the theories and the models we have applied in order to answer our formulated problem statements and research question. Methodology was defined by Descartes as the appropriate approach in order to attain true knowledge and legitimize ones findings (Bjerg and Villadsen, 2006). The methodology is thus the underlying foundation in order to, in the end, be able to state a valid and reliable conclusion.

### 2.1 Scientific View

Since people come from different cultures with diverse backgrounds, it leads to different perceptions. Their way of thinking and how to approach a problem when conducting a scientific research will differ. Because of this, each study should specify its guiding research paradigm, and clarify how the researcher relates to and perceives reality. The paradigm uncovers explanations to the philosophical terms: ontology, epistemology and methodology. Ontology pursues to uncover the nature of reality and how it is perceived

while the epistemology can be described as the relationship between the researcher and the subject studied. The methodology describes how the researcher should go about finding knowledge (Guba, 1990).

Two basic and opposing paradigms are positivism and constructivism. The positivists are searching for the true reality while the constructivists believe that there is no objective reality but rather a creation made by the members of society (Nygaard, 2012). When conducting research, a positivist will strive to be objective and realistic in a consistent manner, and as long as neutrality and objectivity is remained, a positivist believes one can obtain true knowledge. In contrast, a constructivist will acknowledge that reality is complex and that one brings bias into the research. Furthermore, a constructivist believes that reality can only be partially interpreted since there is no objectivity to be found in reality. New knowledge can therefore only be constructed as new information is processed together with existing knowledge (Nygaard, 2012).

We will use a constructivist viewpoint in our thesis since we do not recognize a strictly objective reality and therefore does not find the positivist paradigm as satisfactory. The researchers recognize that patterns that are identified as new knowledge is continuously constructed and processed together with interpreting already existing knowledge. Furthermore, since the researchers construct the models and conclusions in this study, it follows that the researchers will have an impact on the outcome.

## 2.2 Research Approach

In order to accurately respond to a formulated problem statement, a suitable research approach needs to be chosen by the researcher. We will use both qualitative and quantitative approaches in this thesis, while our overall research method will be the case study. The quantitative approach implies that the motive behind the conducted research is to create generalizable theories, which is why this approach is sometimes considered deductive. The aim can also involve revising already existing theories based upon rejecting or confirming formulated hypotheses from data. The quantitative part of this thesis will be financial analysis and valuation. Conversely, qualitative method is often described as an inductive process, which is used in the strategic analysis section. The researchers expect to find useful information along the way of the research process instead of solely using collected standardized data.

Given the scope of this thesis, the researchers find it useful to use both qualitative and quantitative methods, since neither induction nor deduction would be the appropriate absolute way. Had we used deduction as our choice of theory, our aim would have been to make a statistical interpretation based on the results gathered and test a hypothesis based on the collected data. Instead, the assumptions of already

accepted models and frameworks will be applied to our collected data, and the robustness of the underlying theories will not be tested, but only motivated and discussed. If we had induction as our theory of choice, the thesis would enter a new field not yet discovered and allow for new theories to emerge (Bryman and Bell, 2015). Since we will use both existing theories and case specific data, the abductive approach has been chosen. The abductive approach is characterized by the logical inference where the most likely explanation is derived. Additionally, using the abductive method, the researchers can shift between a theoretical base and empirical findings, which is in line with the scope and intent of our thesis (Haig, 2005).

## 2.3 Case Approach

We will use existing theories as well as case specific data to develop our thesis. The case study approach serves as a tool to improve ones' knowledge before making decisions, which for example is useful in the forecasting section. Yin (2013) defines case study as an empirical study, concentrated on real life issues where different sources of information can be used in order to explain the problem. Furthermore, this research method is appropriate as the research process has characteristics such as being: explorative, descriptive, explaining, understanding and appraising. We chose the case study approach to generate new knowledge since it is the most suitable for our purpose of investigating specific company situations and making decisions (Feagin, Orum and Sjoberg, 1991; Tellis, 1997). This approach is also in line with our previous discussion of the constructivist view. This study will therefore evaluate the possible M&A-opportunities available on the Swedish OGM and perform a valuation on the chosen target company, by analyzing and estimating the intrinsic value of that company.

The case study method has received criticism where one main argument against this approach is whether or not it qualifies as scientific, since it is not certain that one is able to produce generalizable knowledge (Flyvbjerg, 2006). He continues and argues that since a case study approach only produces contextual knowledge, it can neither be used to produce any new knowledge nor to develop new scientific theories. He also claims that since case studies lack validity and objectivity, it must be classified as unscientific. However, there are also many advocates of the case study approach. For example, Rendtorff (2015) argues that since one can combine theories with case studies, it can enhance ones perspective of the world, as one is able to expand the scientific and theoretical knowledge. Through a case study one can demonstrate universal knowledge from a phenomenological viewpoint, as it describes the relations and meanings characterizing an organizational or economic phenomenon Rendtorff (2015).

We argue that the case study approach is the best method to broaden our knowledge base before making important M&A decisions, since our intention with this thesis is not to try to explain or find the absolute truth. In contrast, our aim of this study is to perform a valuation of a target firm and estimate the synergies that can be created when merging with an acquiring firm. The intention is thus not to generate generic knowledge applicable in every company valuation.

## 2.4 Methodology Overview

In this thesis we will perform a fundamental analysis using both a strategic and a financial analysis. This should form a base for the forecast leading up to the valuation. In addition to this we will also analyze the synergies involved in order to evaluate the potential added value.

### 2.4.1 Strategic Analysis

In the strategic analysis we will first use the PESTEL framework to investigate to which degree these factors affect the OGI. We will then apply the Porter's Five Forces framework in order to develop more industry specific context. This framework focuses on the forces that determine the competitive intensity and to assess the attractiveness of an industry. The idea is that if the forces are high, the industry is not attractive since competition and other factors will cause margins and profitability to contract to lower levels. If the forces are low on the other hand, the industry yields promising and profitable business opportunities. That would define an attractive industry (Johnson, Scholes, Whittington, 2009). This model therefore gives an overview over the current market situation, as well as it can indicate the expected competition situation in the future.

Our strategic analysis will be summarized using the SWOT analysis. The purpose with the SWOT analysis is to give the reader an overview of the strengths, weaknesses, opportunities and threats that may affect the firms in the OGI in the future.

### 2.4.2 Financial Statement Analysis

We will start the financial statement analysis with reformulating the target company's income statements and balance sheets for the period 2010-2015. The purpose of the reformulation is to uncover any hidden dirty surplus items and obtain knowledge of the target company's core activities. Reformulating the income statement and balance sheet will distinguish between the company's operating and financing activities. Based on these reformulated statements, we will calculate key profitability and liquidity ratios.

The Du Pont model will be applied in order to evaluate the target company's operating profitability. From that model we will calculate return on invested capital (ROIC), turnover rate of invested capital and profit margin (PM). We will use ROIC instead of return on assets (ROA), since ROIC distinguishes between

operational and financial items. For an online gambling company value is created within operational activities, therefore ROIC is a more suitable measurement when analyzing the profitability. The ratios calculated will be used to evaluate the historical results of the target company. It will also be useful in the forecasting and valuation sections and when we compare ratios with peers in search for a target.

### 2.4.3 Forecast and Valuation

In order to perform the valuation of the targeted firm it is necessary to forecast the future performance of the company. The prognosis will be based on both the strategic and the financial analysis.

We will apply both the discounted cash flow model (DCF-model) and the economic value added model (EVA-model), in the valuation of the targeted company. The EVA model is an excess return approach similar to the residual income model (RI-model). Excess return models are applicable with benefit on companies where it is harder to estimate the free cash flow.

In our thesis we will not discuss the process regarding selection of a valuation model. According to the theory, both the EVA-model and the DCF-model should give the same value of the company. We will also in addition to the cash flow models mentioned, consider multiples valuation as a complimentary approach in order to also consider market valuation more directly.

In order to complete the valuation, we will also perform a sensitivity analysis. The purpose with this analysis is to critically evaluate the assumptions made in the forecast of the future operations. Hence, the sensitivity analysis works as a control of the prognosis.

### 2.4.4 Literature Review

The literature we have used primarily come from the curriculum related to our studies in. cand.merc FIN. We have been careful and remained critical regarding our literature sources in order to keep a high academic standard.

Annual reports from the online gambling companies will also be a source, both in the strategic and financial analysis sections. Authorized audit firms have approved all the annual reports, which are all publicly available financial documents. Naturally, the companies themselves prepare and submit these annual reports. It is therefore important to keep in mind that these reports are not necessarily the objective truth, but it is also in the companies' interest to try to give the best possible impression.

The stock values used in calculation for betas are gathered from the Thomson Reuters database,

DataStream. We have used Professor Aswath Damodaran's research for the market risk premium in the Capital Asset Pricing Model (CAPM). His research is well known and we recognize both him and DataStream as valid sources.

We have also taken into account industry experts and industry reports issued by consulting firms such as McKinsey & Company, Boston Consulting Group, Bain & Company and EY.

# 3. Theory

In this third section, we will describe underlying theories and the most common motives behind M&A. We will also explain the valuation methodology we will follow and which corresponding models we have chosen to use in this thesis.

## 3.1 Mergers & Acquisitions – Theoretical Definitions and Introduction

An M&A deal carried out through a financial transaction between two companies can have many underlying motives and be processed in a few different ways. It is defined by Gaughan (2007) as a combination of two corporations in which only one of the two parties survives and the merged corporation will be declared out of business. A merger differs somewhat from a consolidation deal, in which two or more companies is combined (as A + B) to form a new company (C) (Gaughan, 2007). The term merger is most frequently used when the size of the two firms involved are substantially different, whereas the term consolidation is used more appropriately when the involved firms are measured to be of about the same size (Gaughan, 2007).

M&A-transactions can often times be clustered into three main categories: horizontal, vertical or conglomerate. A horizontal merger occurs when two competitors simply merge. A relevant example would be two firms within the OGI defined as being of similar nature of operations and offering comparable services and products. A vertical merger often occurs when the firms involved have buyer-seller relationships. For example, an online gambling firm can acquire another firm that lies vertically in-line with themselves in the industry landscape and thus combine being a regular distributor of products with also developing or producing the products that previously was situated vertically below, figuratively speaking. Lastly, a conglomerate occurs when companies that neither are competitors nor have buyer-seller relationship merge. That is, essentially a firm that diversifies its portfolio with another company not related to its previous core business (Gaughan, 2007).

For the next set of paragraphs, we intend to go over some of the most important motives behind why

companies may decide to use M&A as a strategy. In the Appendix section A.1 – A.1.4, we have first described some historical shifts and waves that have occurred in global M&A and also what the environment and trends look like in 2016. Furthermore, we do think it is important to give the reader a sense of the underlying theory that we have considered in our thesis, before entering the pivotal case discussion.

## 3.2 Motives

Not all firms that implement M&A transactions have applied concrete strategies, and not all companies that have concretely formulated strategies stick to them (Damodaran, 2008). A firm can argue for either one single or several combined motives in order to view an M&A transaction as beneficial to create shareholder value in the future and we will below discuss the three most rational and common ones. In the Appendix section A.2 – A.2.5 we have listed and described a few other common motives for M&A transactions.

### 3.2.1 Growth

Gaughan (2007) mentions what has been perhaps the most fundamental motive for M&A activity, namely growth. To acquire a company in a line of business that, for example, either expands your services offering and product line or engages you to approach new geographical areas that you would like to expand within, can be a quicker way to execute through M&A than it would be utilizing organic growth. Growth development that involves investments in firms not related to your firms' core operations is commonly called diversification, and is elaborated on further on in this thesis as it is sometimes deemed to be an invalid motive to M&A activity. However, a firm that seeks to expand within its own industry may conclude that internal growth is not an alternative as, for example, a company might have a limited time window of opportunity and therefore organic growth might not suffice. Another troubling factor that must be considered is that while a firm has steady but slow organic growth, other firms might accelerate their expansion and grab market shares more rapidly (Gaughan, 2007).

Growth can also involve a firm wanting to expand its business to new geographical regions. For example, there could be a domestically operating company wanting to expand internationally, but there could also be an international company wanting to acquire market share in an additional country's market (Gaughan, 2007).

### 3.2.2 Synergies

Synergy is defined as the potential additional value that one can gain from combining two firms. It is probably the most well-known and, at the same time, misused rationale for mergers and acquisitions and is

often categorized into belonging to either operating or financial synergies (Damodaran, 2005). Evaluating potential synergies is essential in an initial phase when evaluating target firms but also at a later point in time in a negotiation stage as it determines the maximum acquisition premium an acquirer would be willing to pay for a target firm. It is crucial for the transaction to be completed that the merger premium, that is to a large extent based on synergies estimation, is large enough to satisfy current shareholders of the target to approve the acquisition but also limited to a certain amount beneath which it will be considered value creating for current shareholders of the acquirer (Vernimmen et al., 2005).

The type of operating synergies that are perhaps most evident and often times immediately advocated for in M&A cases are generated through economies of scale and could be realized as the combined firm becomes more cost efficient and, as a result, more profitable (Brealey et al., 2011). Examples of cost savings, is reduction of central services such as rental of office locations, more efficient office management or reductions of staff in key management position earning high salaries. Additionally, economies of vertical integration through M&A could generate synergies as companies take control of the production process by "expanding backwards" towards the output of products, or alternatively forward closer towards the end consumer (Brealey et al., 2011).

Operating synergies can also come from a greater pricing power through reduced competition and, in turn, a higher market share that should ultimately result in the outcome of higher margins and income from operations (Damodaran, 2005).

Additionally, a combination of different functional strengths or complementary resources can be found through a merger (Brealey et al., 2011). This scenario can be illustrated with a hypothetical example from the OGI: if a firm with a strong customer base acquires a firm with advanced marketing skills – each firm has characteristics that the other firm desires and can take advantage of each other's set of skills.

Lastly, a fourth operating synergy could come from higher growth rates and business opportunities in new or existing markets that could arise when combining the two firms (Damodaran, 2005).

A dubious reason for M&A that is sometimes practiced is called The Bootstrap Game. It is widely assumed among practitioners that increasing Earnings per Share (EPS) is a valid measure of success of the deal. Through continuously buying firms with relatively low P/E ratios, a firm could generate EPS accretion synthetically and thus trick investors that the deal has generated improved profitability through operating activities (Bruner, 2004). A firm implementing such an intense strategy has to keep this trend

going to not all of a sudden disappoint investors. If one deal fails or if this strategy cannot be continued for various reasons, investors might be disappointed and the firm's fall will be twice as hard.

Financial synergies on the other hand, can be realized through either higher expected future cash flows or through achieving lower cost of capital resulting in lower discounting factors to be applied to the series of expected future cash flows and ultimately, ceteris paribus, yield a higher enterprise value. For example, if the separate entities' cash flows are not perfectly correlated, a merger will result in a less volatile revenue stream of the combined entity. All else equal, rational investors will now consider the firm as less risky and creditors will be able to grant them lower cost of debt in the future (Gaughan, 2007). A lower cost of debt will, in turn, result in a reduction of the combined firm's WACC and since it constitutes the discount factor in our valuation models, a lower cost of capital will ultimately result in a higher value of the combined entity (Damodaran, 2005). In continuing the above discussion stating that more diversified expected future cash flows should contribute to a less risky firm, one must also make acknowledgement of the inconsistency in that argument. Damodaran (2005) also states in his publication *The Value of Synergy,* that investors should diversify their investments themselves and not rely on the company itself to invest in new businesses to diversify its operation and generation of cash flows.

In scenario where an acquiring firm is to purchase a target company, financial advisors and management is generally concerned with performing adequate due diligence and also to develop sufficient integration plans to have the merger completed efficiently and so that all estimated synergies is realized completely. According to McKinsey & Company (2010) the most successful M&A transactions can be found where managers have realized both combinational and transformational activities. Combinational activities are simply traditional best practices of the combined firm that should be accounted for in the due diligence process. Transformational activities on the other hand, are managerial activities to maintain flexible enough during an integration phase in order to be able to identify and capture new sources of value creation that was not accounted for in the due diligence process.

### 3.2.3 Debt Capacity and Tax Benefits

When two firms are combined that are driving different types of businesses where revenue is generated from two different sources, their combined revenue stream may become less volatile and more predictable. As a result, this stability makes creditors more convinced of the lower risk level of the firm and can thus to allow them to borrow more, which in turn, creates tax benefits for the combined firm. This tax benefit can be utilized through either higher cash flows or lower cost of capital (Damodaran, 2008).

Tax benefits can additionally become visible if a profitable firm acquires a firm currently incurring losses, as the combined entity can utilize the net operating losses of the target in order to reduce the tax burden of the acquirer (Damodaran, 2008).

## 3.3 Valuation of a Potential Target

The most fundamental thing to evaluate when considering acquiring a target firm is whether or not there is an economic gain that can be realized from the transaction, so that the acquisition can be economically justifiable (Brealey et al., 2011). That is, if the value of the firms together is larger than the sum of the values of the individual firms, the merger can be economically justifiable. Once a future economic gain can be theoretically assumed by this notion, the acquirer also has to think about the cost of the firm. How much does it cost to acquire this firm? Brealey et al. (2011) defines the cost of a firm as the cash paid less the present value of the target (B below), as can be seen in Equation 1 below.

*Equation 1*

$$Cost = Cash\,paid - PV_B$$

With these calculations in mind, we can now figure out if the merger has a positive Net Present Value (NPV), in which case we can argue for to complete the transaction, from an economical viewpoint, as shown in Equation 2.

*Equation 2*

$$Economic\ Gain = PV_{AB} - (PV_A + PV_B) = \Delta PV_{AB}$$

Brealey et al. (2011) defines the gain from an M&A transaction the way illustrated above. The gain equals the Present Value (PV) of the acquirer and target valued together, less the value of the entities counted separately. The $PV_{AB}$ i.e. of the combined firm includes a calculation of potential synergies that can be generated through the merger, but the analysis has to start with the stand-alone market value of the target ($PV_B$). One of the biggest and most common mistakes that one could make in an M&A analysis includes over-estimation of the top-line revenues that the combined firm will be able to generate in the future. This is particularly problematic, McKinsey & Company argues (McKinsey & Company, 2004), as these synergies form the basis of M&A deals intended to seek growth from new customers, product lines and geographical presence. Furthermore, even if the revenues and ultimately cash flows are projected correctly, you only add additional value to the combined firm if you can add an additional competitive

edge and generate further economic gains (Brealey et al., 2011).

As we mentioned in the Limitations section 1.3, we will evaluate how much a potential control premium above the stand-alone value of the target firm could be. Determining the value of potential synergies is very important in a negotiating stage as it will determine the maximum control premium that the acquiring company is willing to pay to the shareholders of the target (Vernimmen et al., 2005). We will take that into consideration in our valuation of the target firm and acknowledge that control premium derives from valuing the potential operating and financial synergies that the new majority shareholders hope to unlock (Vernimmen et al., 2005). We will however, not consider the possible market effects that rumors or other market analysis could have on the stock price and as a consequence, the control premium of the target company.

For us to be able to perform the best possible valuation of the target firm, we will use several valuation tools and methodologies. We are to use both fundamental and relative valuation techniques. A major goal of fundamental analysis is to, through cash flow analysis, estimate the intrinsic value of a firm (Wild & Subramanyam, 2004) without considering its market value. We will also use relative valuation techniques in order to put more focus on the current state of the economy and its market implications.

## 3.4 Valuation Methodology

Petersen & Plenborg (2012) defines present value approaches as the estimated intrinsic value of a company based on the projected future cash flows discounted at an appropriate rate that takes both risk and time value of money into consideration.

All present value approaches are theoretically the same and are all derived from the Dividend Discount Model, but the by far most popular present value model is the Discounted Cash Flow approach (DCF). The model ascends into two branches, the equity value approach and the enterprise value approach (Petersen & Plenborg, 2012) however, technically it should not matter which model we choose as both models should yield the same result. Nevertheless, we decided to use the enterprise value approach and subtract the net interest bearing debt to arrive at the equity value. With this model we do not have to make any explicit assumptions about dividend payout ratio.

We also choose to use the Economic Value Added approach (EVA), which is also a present value model but falls under the category of excess return approaches, which have been given increased attention in recent years (Petersen & Plenborg, 2012). The EVA model is just like the enterprise value approach as it

estimates the firm value directly, from which we again can subtract the net interest bearing debt to arrive at the equity value.

### 3.4.1 Discounted Cash Flow

As we will track Petersen & Plenborg (2012) method to follow the enterprise value approach, it is thus crucial to calculate the free cash flows addressed to the entire firm (FCFF) for each year, and then discount them with our estimated WACC. We calculated the FCFF for each year using Equation 3 below.

*Equation 3*

$$FCFF = NOPAT + Depreciation - Other\ non\ cash\ Items - Change\ in\ NWC - CAPEX$$

After we have calculated our FCFF for each year we proceed to discount the cash flows with our estimated WACC using Equation 4 below.

*Equation 4*

$$Enterprise\ Value_0 = \sum_{i=1}^{n} \frac{FCFF_t}{(1+WACC)^t} + \frac{FCFF_{n+1}}{WACC - g} * \frac{1}{(1+WACC)^n}$$

According to the formula above, the firm value is only affected by FCFF and WACC, where a higher FCFF and a lower WACC yields a higher firm value. We continue with adding the sum of the present value of future cash flows with the present value of the terminal value item to arrive at the Enterprise Value (EV). The terminal value is derived upon the assumption that the FCFF's will grow at a constant rate in perpetuity. The value of all FCFF's is estimated up until time *T,* where the remaining value after the terminal point in time *(T)* will be accounted for as unrecognized goodwill at that point. The continuing value will be estimated by using Gordon's Growth model. We ultimately subtract the net interest bearing debt from the EV to obtain the market value of equity, as illustrated by Equation 5 below.

*Equation 5*

$$Market\ Value\ of\ Equity = Enterprise\ Value - NIBD$$

### 3.4.2 Economic Value Added

We will follow the methodology from Petersen & Plenborg (2012) to also perform the economic value added approach (EVA). The EVA model is an excess return approach, which relies on accrual accounting data in contrast to the DCF models that commonly rely on cash flow data. We chose to implement this

technique in our valuation analysis as it contains some unique features. The model itself is estimating a company's intrinsic value by adding the initial invested capital to the present value of all future EVA's. When using the EVA model, focused is shifted from bottom-line net earnings to instead reflect a firm's operations as NOPAT and the invested capital (IC) is analyzed rather than the equity in the balance sheet (Petersen & Plenborg, 2012). We will calculate EVA as expressed by Equation 6 below:

*Equation 6*

$$EVA_t = NOPAT_t - WACC * Invested\ Captial_{t-1}$$

If ROIC is larger than WACC, NOPAT will in turn be larger than WACC multiplied by the beginning-of-year IC, which would ultimately lead to a positive EVA. A positive EVA indicates that a firm is creating value for its shareholders, and vice versa if EVA is negative than the firm is actually destroying shareholder value. The EVA approach thus shows how a company is valued in relation to its invested capital. If the present value of the respective expected future EVA's is positive, then the market value of the company is above the book value of invested capital (Petersen & Plenborg, 2012).

Once all the EVA's are calculated, Equation 7 can be used in order to estimate our Enterprise Value:

*Equation 7*

$$Enterprise\ Value = Invested\ Capital_0 + \sum_{i=1}^{n} \frac{EVA_t}{(1+WACC)^t} + \frac{EVA_{n+1}}{WACC - g} * \frac{1}{(1+WACC)^n}$$

The EVA model is a two-stage model that consists of three terms. The first term is the invested capital from the last fiscal year. The second term is all the PV of future EVA's in the forecast horizon and the last term is the PV of EVA's in the terminal period. As a last step, we again subtract NIBD from the EV to obtain the market value of equity, as we already saw in the DCF model and in Equation 5.

### 3.4.3 Market-to-Book Premium

We will in this thesis also use an alternative method for calculating the terminal value term instead of only using a constant growth rate in the terminal period. This is due to the fact that there are certain limitations when calculating the terminal value using the Gordon's Growth approach. For instance, the terminal growth rate estimate expressed as a percentage needs to be sufficiently lower than the discount rate, otherwise it will lead to extremely high and misleading ending values. Therefore, we will use a method known as the fair market-to-book-premium as a supplementary method to the more commonly used Gordon's Growth model that we will rank as primary, to calculate the terminal value terms in our DCF

and EVA models. As cash flow models are extremely sensitive to growth- and discount rates, we feel this approach choosing to use two different scientific versions of estimating terminal value are adequate at this point.

When using the fair market-to-book premium, the continuing value (CV) also known as the terminal value, can furthermore be calculated by defining a long-run M/B premium. This model is relying on the long-run level obtained through a historical analysis. The continuing value using the market-to book-premium is calculated using Equation 8 that follows:

*Equation 8*

$$\begin{aligned} CV_T &= E_t\left[V_T - NOA_T\right] \\ &= E_t\left[\left(\frac{V_T}{NOA_T} - 1\right) NOA_T\right] \\ &= \left(E_t\left[\frac{V_T}{NOA_T}\right] - 1\right) NOA_T \\ &\approx \left(\frac{E_t[V_T]}{E_t[NOA_T]} - 1\right) NOA_T \end{aligned}$$

where $\frac{E[V_T]}{E[NOA_T]}$ is the expected ratio of the market-to-book value, $V_T$ is the market value at the terminal period, $NOA_T$ is the net operating assets, also known as the invested capital at the terminal period.

### 3.4.3 Relative Valuation Approach

Valuation using multiples is popular among practitioners due to its low level of complexity and the rapid speed and simplicity in which a valuation can be performed. We can divide multiples into two different groups. One group estimates the enterprise value of the company as multiples of EBIT, EBITDA, NOPAT or sales, as for example: EV/EBIT or EV/SALES. The second group estimates the firm's value of equity as multiples of book value or earnings, such as: M/B and P/E.

There are a few acknowledgements important to consider when using multiples to value a company. Accounting differences is one of them. A multiples valuation can also be seen as a comparison of accounting numbers between related firms. This means that the companies compared must using the same accounting principles, otherwise it would lead to noise in the valuation. Another issue to consider is the measurement of average numbers as when the sample of comparable firms is decided on, an average of multiples if often calculated and implied on your focus firm. Petersen & Plenborg (2012) argues that the harmonic mean is the best measurement to use and reference to additional research published by Baker and Ruback (1999), which found that the harmonic mean generated a more precise value estimate compared to the other multiples based on mean, value-weighted mean and median.

Despite that multiples have some shortcomings, it also has some appealing features for valuation purposes. This approach relies on current market prices, and since we assume an efficient market in our thesis, this notion contains relevant and valuable information. The P/E ratio for example, express and reflect the opinions of investors of how much they would pay for the future earnings of a company. This is useful complementary information to our present value approach, which relies more on our own forecasts, assumptions and expectations of the future.

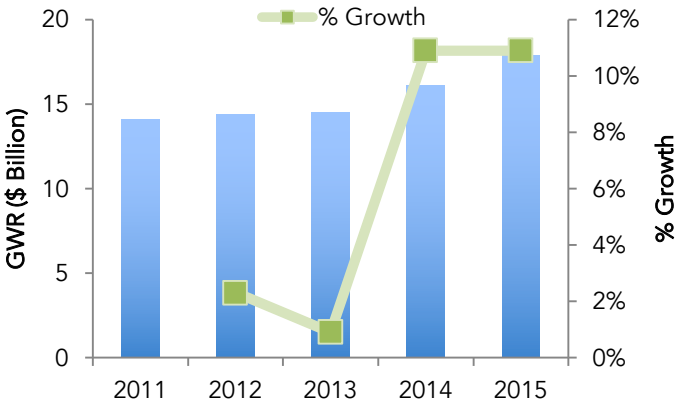
# Section B

In the following Section B, we will have a through breakdown of the OGI from a global perspective as well as more specifically related to Sweden as we will also describe the industry participants listed on the Swedish stock exchanges, which will also constitute the selection of firms from which we will argue a suitable acquiring and target firm. In the final stages of the section we will conduct a PESTEL analysis on the OGI, after which we will have enough information to select the firm to constitute the acquirer in our M&A case. The ultimate part of the following Section B, will be a SWOT analysis covering the acquiring firm.

## 4. Global Online Gambling Industry

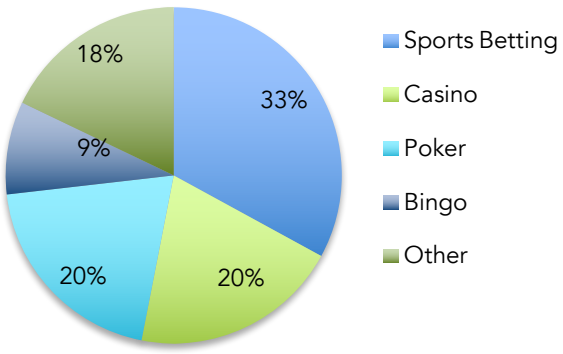
We follow the same definition of the OGI as MarketLine (2014), that it is gambling activities executed using the Internet on computers, tablets or mobile devices. The segments in this industry include online sports betting, poker, casino games, social gaming, bingo and different types of lotteries. In 2015 the European industry grew by 10.9% and reached a value of $17.9 billion (MarketLine, 2016). MarketLine, which is a database published research reports on both companies and industries, estimates further growth in the European industry until the end of their forecast period in 2020. We have below illustrated the online gambling industries' development of game winning revenue (GWR) and growth in Europe in Exhibit 1 while the segmentation of the OGI is displayed in Exhibit 2.

***Exhibit 1:*** *The OGI's GWR and growth in Europe*




*Source: Market Line (2016)*
*Created by authors*

***Exhibit 2****: Segmentation of the OGI*



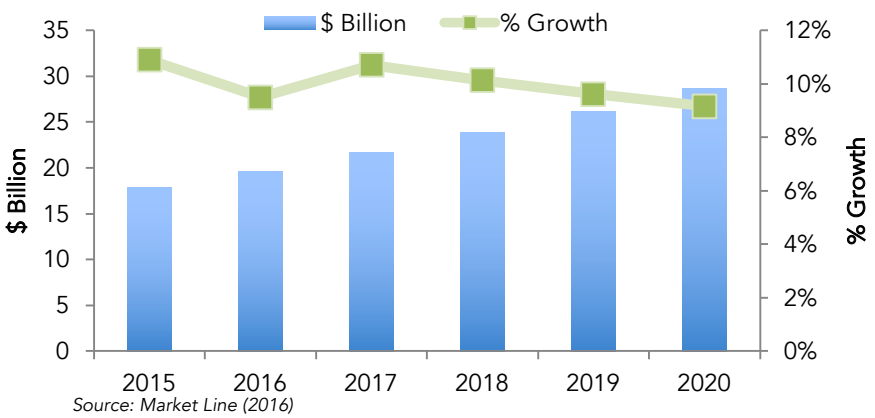

*Source: Market Line (2016)*
*Created by authors*

In Exhibit 2, we can notice that Sports betting is the largest and most lucrative segment of the European OGI, accounting for 33% of the industry's total value while the Casino and Poker segments accounts for 20% each of the total value using. The segment called "Other" represents gambling activities such as lotteries and accounts for 18% of the market and Bingo for the remaining 9%.

Europe is the biggest market and it accounts for 47% of the global OGI, while Asia-Pacific is second largest region and accounts for 33% of the industry. The Americas accounts for 19.4% share whereas the Middle East & Africa are the smallest markets by far. Middle East & Africa are the smallest markets largely due to the Internet and mobile technology in general is underdeveloped in comparison to the other geographical markets in general.

Looking at the European OGI, it generated total GWR of $17.9 billion in 2015. The industry showed a compound annual growth rate (CAGR) of 6.1% between 2011 and 2015. The future performance of the industry is forecasted by MarketLine (2016) to follow a similar pattern with an anticipated CAGR of 9.9%, which is expected to drive the European industry to a value of $28.8 billion by the end of 2020. These impressive growth rates are dependent on a number of large scale factors, the most important of which is the continuing rise and development of smartphone and Internet usage, which is forecasted to rise throughout the world (Statista, 2016). This, combined with increased confidence in online services and online payment methods will help the industry to grow (Marketline, 2016). Another factor experts point towards is the increasing liberalization of rules and regulation in both the general industry as well as the cross-border consumption, says Sigrid Ligné of the European Gaming and Betting Association (EGBA) (EurActive, 2015). In contrast to Exhibit 1, Exhibit 3 below illustrates how the anticipated growth and GWR will evolve the upcoming years according to MarketLine (2016).

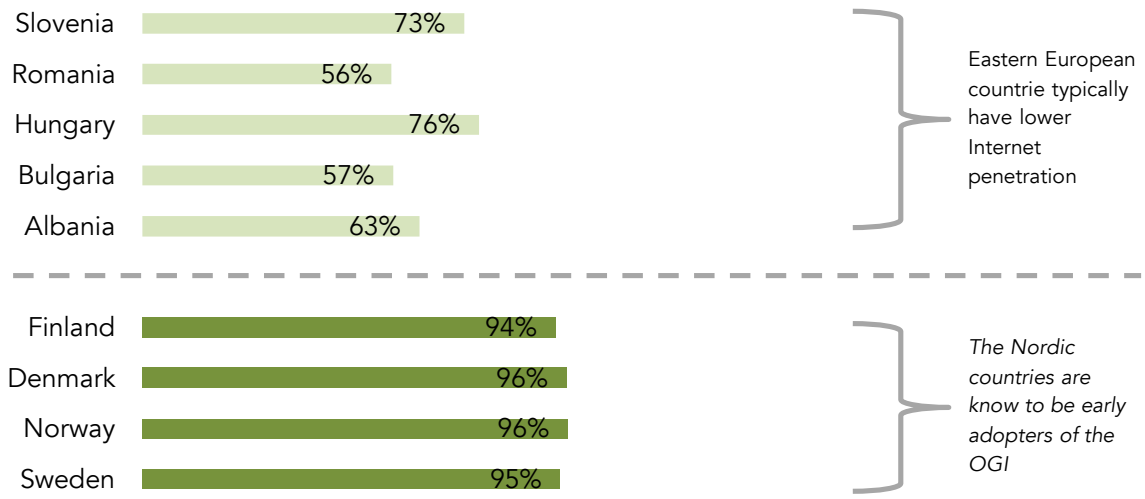
***Exhibit 3:*** *Projected GWR and growth in OGI in Europe*




*Source: Market Line (2016)*
*Created by authors*

The growth is weakest, as could be expected, in developed countries and the early adopters such as Sweden and the other Nordic countries. The East European countries, on the other hand, show significant growth in Internet usage, which is very important for the OGI. Exhibit 4 below illustrates a similar state, showing Internet penetration and comparing the Nordic countries to a selection of East European countries.

***Exhibit 4:*** Internet Penetration for East European Countries and the Nordics




*Source: Internet World Stats, 2015*
*Created by authors*

What is also vital when analyzing growth for the OGI is to consider the expansion of mobile device usage, especially in countries where Internet penetration already is high and where there are fixed prices for mobile data. People will use their smartphones or tablets to gamble without having to worry about costs related to Internet usage to a larger extent than if mobile service companies would charge money per hour

of data usage. By 2018, mobile gaming is expected to account for almost 50 percent of total online gaming worldwide. Mr. Green (2016) refers to H2 Gambling Capital's published report from January 2015, saying that it would still only represent less than five percent of all gambling activities.

Another aspect that provides the market with growth is increased confidence with e-services. Since gambling is shifting from physical environments such as casinos and bars to Internet platforms, the increased confidence with e-services provided benefits all market stakeholders. Most likely, if consumers do not trust the website or the service provider, they will not make a transaction with them. The progress in Internet gambling (iGambling) and Internet gaming (iGaming) corresponds to the previously observed trend in e-commerce. Mr. Green reports in their annual report 2015 that, according to the market intelligence organization H2 Gambling Capital, roughly 90 percent of global gambling is still conducted in physical locations (Mr. Green, 2016). The globally trending e-commerce in combination with the rise of iGambling has led to the development of more secure payment solutions, which facilitate e-payments. A customer today has to have many different payment methods to choose from in order to feel safe and thus ease the transition into making financial decisions online, regardless if the payment is for a new sweater or a gambling bet. Today's payment methods range from card-based online transfers to bank transfers or voucher systems that permit users to purchase coupons and subsequently use them securely on the Internet. Hence, confidence in online payment methods has increased, which is also contributing to expanding the iGambling market. Mr. Green also reports through a H2 Gambling Capital report that, what is also beneficial for the industry is that many tablet devices and smartphones are becoming more developed and now capable of handling more advanced gambling applications, combined with a behavioral shift where people are enjoying gambling using mobile devices to a larger extent.

There are currently approximately two billion smartphones used by the world's population and average growth in the next five-year period is expected to be about 15 percent (Juniper Research, 2014). In 2014, the average spend on mobile gaming via smartphones was approximately 6 billion EUR (Juniper Research, 2014). According to Mr. Green (2016), H2GC reports in January 2015 that live and pre-game betting constituted the majority of mobile gaming with 70 percent in total. The format of live betting is well suited for mobile devices since it can be carried out while at arenas or in front of the TV watching a game, which can be argued to increase the excitement for the outcome. Other gambling and gaming formats such as casino have been more slowly adopted onto mobile devices, and the reason for this is primarily a technical issue. The currently limited game offering is due to the fact that many game suppliers simply have not been able to convert their entire game catalogues to a program language that can be widely used on mobile devices yet. As a larger proportion of game suppliers' catalogues are converted

for mobile use, this is estimated to additionally increase mobile gaming.

H2GC estimates that during the next five-years that the main growth in casino and betting on mobile devices will surpass that of gambling on standard computers. Other gambling companies believe this transition to mobile gaming will move even faster than H2GC's assessment, and therefore base their strategy and investments in these mobile gaming products in order to be accurately prepared to meet future demand.

As the preceding discussion entails, in order for online gambling firms to thrive in the fast paced and ever-changing gambling environment it is essential to make significant investments in product development for smartphones and tablet devices. This is to ensure that their company is well positioned ahead of this shift in user behavior and continue to outgrow the industry also in this area. However, they are also dependent on the challenging task of gaming suppliers to adapt their game catalogues in an appropriate manner to fit the movements of the public demand and in order to get accustomed to the mobile platforms. Furthermore and perhaps more importantly, the ability of all operators to adapt to mobile gaming will impact competition and decide to a larger degree which firms will be successful in the future.

During the last couple of years, there has been intense competition among the firms operating on the European OGM as it is still very fragmented and no single operator dominates, or even participates, in all market segments, even though a wave of consolidation within the industry can clearly be noticed. However, there are operators that already dominate on local country markets. The market consists of listed public companies, private companies and also public monopolistic firms as in Sweden. Since the barriers of entry for new competitors are still relatively low, achieving a substantial market share requires good product development, a strong brand image as well as heavy marketing investments in order to reach the consumers once and additionally tempt them to remain as customers. Local regulation affecting these markets could distress competition in various ways. For example, in Sweden the public sector monopolistic firm Svenska Spel have submitted applications for a license to start an online casino, which will be discussed at great length under section 5 Rules and Regulation. This can easily be looked at as an attempt to try to win back market share from, or at least compete on equal terms with, the offshore firms currently distributing this service to the Swedish population through their online product platforms.

## 4.1 The Online Gambling Market in Sweden

There are two larger online gambling operators in Sweden, Betsson and Unibet that are surrounded by a few smaller operators with different niches. There are also three listed gambling software developers where Net Entertainment is the largest among the trio. We will describe the operators and the developers

on the Swedish market more thoroughly in section 6, Company Deceptions. The trend for the last couple of years in Sweden has been to digitize everything that possibly can be digitized. This is particularly true when it comes to sports betting, where several factors indicate a structural shift from offline to online gambling. Improved phones and digital platforms have opened up new doors for consumers to experience gambling and thus make the potential market even larger for operators and developers. Demographics as well as individual consumption patterns also speak for increased online gambling (Swedbank, 2015). As mentioned earlier and what will be covered in more detail in section 5 that additionally increases online gambling is the regulation of the markets, where the EU is pushing for member states to abolish national monopolies, such as in Sweden, and introduce national legislation that regulates the OGI as a free market place. In 2012, Denmark introduced a licensing system, which has led to a yearly growth of 17 percent while in 2017 the Netherlands are expected to follow suit, with significant growth yield potential (Swedbank, 2015).

Swedbank, one of Sweden's leading retail banks, stated in an analysis (2015) that they predict that established players on the Swedish market, indicating Unibet and Betsson in particular, may look for opportunities to grow even faster than the predicted rate of the industry of 9% - 13%, given their already strong market positions and their proven ability to acquire competitors.

In recent years, the market valuation of the online gambling companies has significantly increased on the Swedish stock exchanges, which can best be explained by the higher growth rates and the bright future outlook of the industry. Historically, these companies have had a lower average valuation compared to their European counterparts. This was, at the time, an argument for investing in the undervalued Swedish online gambling companies. However, that analysis no longer applies and there are several fundamental factors that justify higher valuations. The first argument investors can make governing a higher valuation is that the growth in the online segment is higher than in the offline. They are also less capital intensive than those operating offline, providing higher return on invested capital (ROIC). Unibet and Betsson are the more established companies that have had the highest growth rate historically. Even though they are challenged today on that note, they still remain as the most profitable proving higher margins than the average in the industry within Sweden. Several industry players have also proved that they can make strategic acquisitions and successfully integrate them and capitalize on the extracted synergies. As for the global and European industry: M&A activity is predicted to be one of few important factors of success in the upcoming years as consolidation widens.

The OGI is still enormously lucrative with relatively low barriers to entry in unregulated markets. However, increased competition and interchanging regulation has led to falling margins in the sector forming a new playing field in Sweden, Europe and globally in recent years (Swedbank, 2015). The trend of increased regulation is expected to continue, but the leaders of the industry should be able to offset this through, among other things, keeping up an active M&A activity trying to achieve synergies through economies of scale. A significant reason for the lower margins is that taxes are generally higher on regulated markets. But increased regulation also results in significantly higher costs in terms of management and adaptation to the different countries with widely differing law systems when it comes to gambling and sports betting. The barriers to entry are thus predicted to rise, as tax, license and administration costs will tend to increase. The upside is that the largest companies in the industry can afford to deal with these rising costs, while smaller companies have to struggle harder, which is likely to keep the consolidation pressure steady within the industry.

To summarize, the migration from offline to online games are gaining momentum in Europe, which affects the Swedish operators. The increase is attributable to larger smartphone and tablet device penetration of the gaming and gambling markets, boosted by the increased technical performance of these devices in combination with greater consumer confidence in regards to spending money using these devices. Increased regulation raises the entry barriers and leads to consolidation where larger companies will acquire smaller, to capitalize on economies of scale and other operating synergies. Swedbank, MarketLine and H2GC are all expecting the OGI to grow with 9-13 percent per year during the next decade. The largest companies in the industry have thus good opportunities to continue to be the winner in the ongoing consolidation wave of the European OGM.

# 5. Rules and Regulation

In the upcoming sections, we intend to describe the current regulatory environment, mainly on the Swedish market but also touch upon the current situation in Europe. The main issue that we will handle is the development of re-regulating markets opting for introducing local licenses, which will result in online gambling firms becoming liable to pay tax on GWR to the countries where they generate their revenue rather than the fundamentally lower tax rates they currently incur on Malta.

We will also attach further discussion regarding social responsibility associated with gambling. In the Appendix section A.3 – A.3.3, we cover addiction, match fixing and regulation of advertising. These are all important subjects that to some extent can affect the online gambling industry. However, to focus more

intensively on the scope of our thesis, we have decided not to include them under the following section 5 covering of rules and regulation.

## 5.1 Opening Discussion

The Swedish overall gambling industry has since the early 1990's been regulated under the Lotteries Act passed by the government in 1992. Although subject to a number of amendments since, it still very much influences the legislation of the offline as well as online gambling industry and also affects the forming of new relevant regulation (Lotteriinspektionen, 1992).

In 1997, the Swedish Government founded Svenska Spel through a merger of two other governmentally controlled entities. At the time, the government granted Svenska Spel the right to exclusively arrange certain forms of lottery services and gambling activities. ATG is another agent entirely controlled by the government that has the exclusive right to arrange betting related to horse racing (Lotteriinspektionen, 2016b).

For the last 10-15 years there has been a shift of interests in the industry. Gambling activities could up until this time, only be carried out on offline locations. With the evolution of the Internet, a growing number of gambling activities could also be carried out online. The result has been that offshore online gambling companies have been able to access the Swedish population via the non-physical markets and thus challenge the existence of Svenska Spel. As this phenomenon opened up the market because of somewhat blurry regulations, the control function, Swedish Gambling Authority (Lotteriinspektionen), felt it was necessary to additionally issue the Casino Act in 1999 to also covered roulette games, card games and dice games in addition to traditional match odds betting (Svenska Spel, 2011; Deloitte, 2014.)

With these laws in mind, it is illegal for the general public and non-allowed entities to organize some sort of gaming for the sole purpose of achieving monetary gain (Svenska Spel, 2014). There are, however, no immediate restrictions on participating in foreign gaming activities (DN, 2014). Today, as a result, state controlled Svenska Spel competes with a large group of offshore based international online gambling companies that are not covered by current legislation and thus able to approach the Swedish population from abroad. These firms are not liable to pay domestic tax on GWR but are only liable in their countries where they are registered for business. In most of the cases, these companies are registered in Gibraltar area or on Malta. The EU court has established that it is up to each member state to decide upon the form of regulation, which is why the market trend has developed in different directions. There are currently three sections where EU markets can be placed: Some countries have remained with monopolies such as

Norway and Finland, while Italy and France have deregulated and introduced special licensing systems and lastly, countries such as Netherlands and Sweden where deregulation is underway (Svenska Spel, 2011).

## 5.2 Tax Discussion

As briefly introduced above, what ultimately results from the current Swedish unregulated market place with the underlying monopoly structure is that online gambling companies can choose to establish their operations offshore. More often than not they establish themselves in countries where tax jurisdictions on GWR for online gambling firms are much more generous, and still access the Swedish and other markets all over the world.

For a few years now, countries in Europe have started to regulate their domestic markets and many have introduced local licensing systems that has to be granted for each individual firm, in order to be able to conduct business in that specific country. A specific example is the U.K, where responsible government entity formulates the following law statement in October 2015 (UK Government, 2015):

" *You must register for either General Betting Duty, Pool Betting Duty or Remote Gaming Duty if you either:*

- *Offer gambling services from outside the UK to people in the UK*
- *Are an off-course bookmaker (eg. a shop) in the UK who takes bets from people who are on the premises"*

Should the firms listed on the Swedish stock exchanges and mentioned in our thesis have to apply for a local license in Sweden in a similar fashion as the U.K case above, they would be liable to pay regular corporate tax rate of 22%. At the moment, Malta's current tax law suggests only 0.5-5% depending on which class license they are granted from the Malta Gaming Authority (MGA) on a scale ranging from 1-4 intended to cover EU-companies distributing gambling services (Malta Gaming Authority, 2016). Clearly, as more and more markets become regulated and/or issue local licenses there will be intense debates regarding which markets are attractive to approach and economically justifiable to continue business in, and which markets online gambling firms are thus to stay away from.

In the upcoming years we predict that there will be a significant focus on regulating this industry. Even though there are several looming regulatory reforms that could potentially affect the whole industry positively or negatively it is clear that, going forward, increased taxation on GWR on local markets will heavily burden online gambling firms' income statements. This poses a great future risk and should be thought through carefully. In the valuation section further on in our thesis, we will elaborate on how we

forecast the tax rate to evolve and thus affect profitability for our chosen target firm.

An ongoing issue that has been raised by the Austrian government is the ongoing court case of the Austrian government versus several European gambling companies active on the Austrian market. This case specifically involves one of our focus firms, Mr. Green that has been active on the Austrian market for some years. Currently, the Austrian government is claiming operators retroactively on tax based on GWR generated from customers on the local Austrian market. Mr. Green is disputing these allegations in its entirety, referring both to EU regulation as well as the Austrian constitution. However, if the Austrian government wins this case, there is an obvious risk that claims such as this will spread across the industry forcing many more market participants to pay tax retroactively in local countries (Gaming Intelligence, 2015).

## 5.3 Purpose of Svenska Spel Practicing Monopoly

As the Swedish government has through the late 20th century backed Svenska Spel (and a few other entities such as ATG that organizes horse betting), they have on protected premises been able to practice monopoly on all the sorts of gambling, gaming and casino services allowed in Sweden. One can thus imply that the government, to a large extent, has controlled the domestic industry.

The main motive behind keeping the monopoly structure has been to protect consumers, mainly from addiction and preventing excessive personal debts that might rise as a consequence, but also to prevent gambling from minors and promote trustworthy advertising (Svenska Spel, 2014).

Given the shape and praxis of this particular monopoly system exercised in recent years, the EU-commission does not find it feasible any longer for Svenska Spel to be backed by the government and in such a way that they control the market and thus forbid other corporations to engage in the gambling services directed towards the Swedish public. Therefore, a wide investigation was executed by the EU-commission to investigate the existing monopoly from a national economic standpoint, and request Sweden to comply with EU standards to comply with a free movement of services (EU Commission, 2013; Handels Utredningsinstitut, 2008). Additionally, the responsible EU function wants to see whether the system could be developed in line with the new generation and the increasing use of online gambling in the future. Moreover, and perhaps more importantly, EU wants to investigate how the future possibilities to re-regulating through a licensing system, through which the market can open up and welcome competition, could turn out (EU Commission, 2013; Handels Utredningsinstitut, 2008).

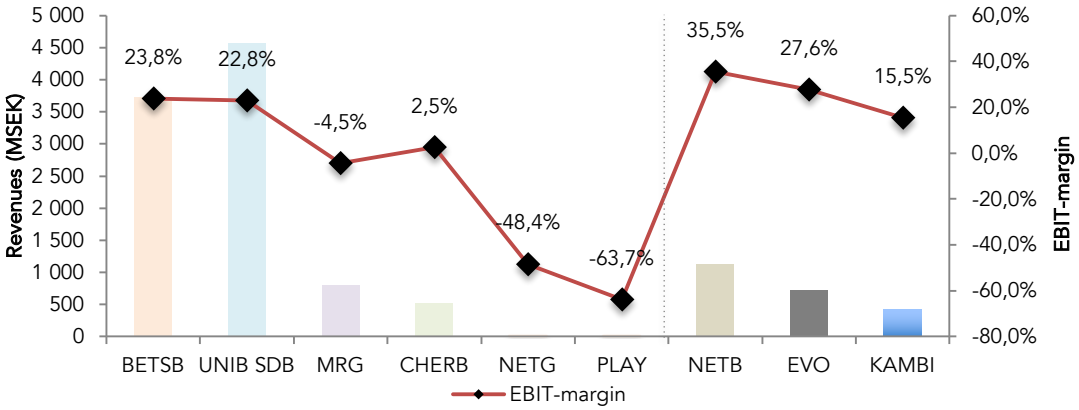
The EU-commission announced the following in a statement: "*the restrictive policy in the area of gambling services is not applied in a systematic and consistent manner and that the holder of the exclusive right is not subject to strict state control. The Commission enquiries cover the cross-border provision of online sports betting and poker services, but also deal with issues such as advertising and sponsorship. The Commission requests Sweden, in the form of an additional reasoned opinion on online betting and a reasoned opinion on online poker services, to take action to fully comply with EU rules*." (EU Commission, 2013).

Following the above tax discussion, our intention has been to shine the light on some of the overlooking and sometimes more abstract challenges that the OGI is facing. Questions involving ethics, moral and social responsibility has been in the media's attention and put pressure on the entire industry. Since we, the authors, intend to form this thesis around company valuation incorporating an M&A transaction between two specific firms, we will put more focus on the regulation that explicitly affects these two companies of choice involved in the transaction. As introduced, we believe that a central issue that will certainly affect the entire industry and our specific companies of choice are the potential licensing systems and the resulting amendments to in tax brackets. However, we do feel that the above debate covering the regulatory environment and the Appendix sections A.3 – A.3.3, where we consider social responsibilities as related to online gambling, are important to take into consideration when analyzing risks from a micro- as well as from a macroeconomic perspective.

# 6. Company Descriptions

We will in this section present short company descriptions of all the listed online gambling companies on the Swedish stock exchanges as of December 30th 2015. To add clarity and because the firms are somewhat different in operative nature, we have them categorized them into online gambling operators and online gambling developers. Their financial performance can be overviewed in Exhibit 5 below, measured by generated revenues and operating profitability as EBIT-margin.

***Exhibit 5:*** *Overview of Swedish Online Gambling Companies*




*Source: Annual Reports, Avanza, DataStream*
*Created by authors*

## 6.1 Online Gambling Operators

We define online gambling operators to be companies that offer remote gaming activities through the Internet, and the mobile Internet. Their segments include online sports betting, casino games, poker, bingo and social gaming. On the Swedish stock markets there are six listed operators: Betsson, Unibet, Mr. Green, Cheery, Net Gaming Europe and PlayHippo. In this section we will give a short general description and overview their financial situation (before any reformulation of financial statements) and their forward-looking strategy.

### 6.1.1 Betsson

Betsson AB was initially founded in 1963 but was between 1972 and 2006 named Cherry, until they changed their name to Betsson and distributed Cherry through a spin-off to its shareholders as dividend in 2006. The year after, 2007, Betsson distributes the online gambling software developer Net Entertainment to its shareholders. Net Entertainment had been incorporated under Betsson's umbrella of operations to develop entertainment software, games and applications to Betsson's platform. Since then, both Net

Entertainment and Cherry have been individual success stories of their own with impressive stock market rallies.

The Betsson Group is registered on Malta and has more than 870 employees in total. Their business plan includes acquiring and developing fast growing companies that are active within the OGI. Among them are brand names such as Betsson, Betsafe, Nordicbet, Oranje Casino and Kroon Casino. With approximately 9 022 161 registered users in 2015, an increase of 17% from previous year, they have a growing customer base and is one of the largest online gambling operators in Europe (Betsson, 2016). However only 16% of their revenue came from already licensed markets, which is lower than their main competitor Unibet, where 25% of their revenue came from licensed markets (Swedbank, 2015). They furthermore have on-site operating offices in Sweden, Denmark, Norway, Malta, Gibraltar, Italy, The Philippines, Estonia and China (Betsson, 2016).

Betsson express their long-term goals to include generating growth and profitability in a responsible manner. This means actively taking a stand against widely known issues such as corruption and gambling addiction within the industry, while simultaneously generating a high return to their shareholders on their investment. It is Betsson's goal to continue to grow faster than the OGM, which they plan to achieve through both organic growth and through pursuing an active M&A-strategy inside and outside the EU. They have a multibrand strategy in order to attract multiple customer segments, which is visible both in the B2C and B2B sectors. As can be viewed in Exhibit 6 and 7 below, Betsson generates 61% of their revenues from the Nordic countries, 68% of which are generated through casino games.

One of Betsson's strongest assets is their technically advanced application platform Techsson. Through Techsson, they are able to distribute sportbook betting, poker, casino, bingo and lotteries to their customers. The platform enables them to integrate many different types of systems, a technique which has been proven successful in recent years. The systems include all of their sources of GWR, but also their internal human resources and bonus systems are integrated with the platform. This adds scalability to their business model, as it will be simpler to incorporate potential future targets and new applications onto an already working platform and thus, be able to realize cost synergies and smooth implementation processes.

#### 6.1.1.1 Financial Analysis

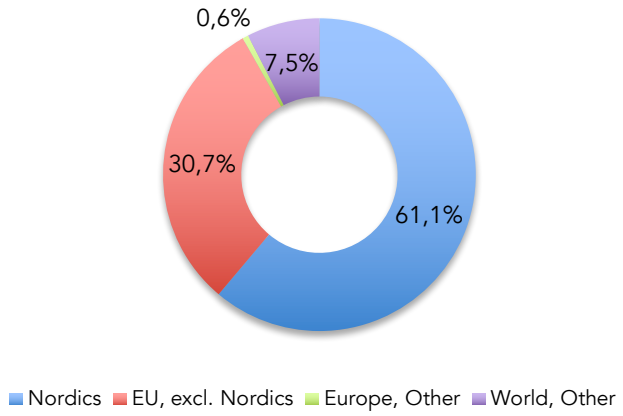
Looking at Betsson's reported financials before any reformulation, we can see that they have had steadily improved revenues for the past five years. In 2014 they earned 3 035.1 MSEK and 3 722 MSEK in 2015, equivalent to a 22.6% increase. The generated revenues resulted in EBIT of 821.2 MSEK and EBIT-margin of 27.1% in 2014 and 886.4 MSEK and 23.8% in 2015. After paying taxes of approximately 5.8% calculated on EBT of 883 MSEK, total net income of 2015 summed up to 831.7 MSEK, equivalent to a net margin of 22.3%. Debt owed to credit institutions in 2015 was 2 457.9 MSEK and a debt-to-equity ratio of 0.81 could be upheld. They held a considerable amount of cash available on hand valued to 524.9 MSEK at the end of 2015, an increase of 9.8% from 2014 (Betsson, 2016; Betsson, 2015).

#### 6.1.1.2 Strategic Analysis

Betsson have for the last ten years proved a strong record of successful M&A transactions. Most recently, they acquired Betsafe in 2011, NordicBet in 2012 and the two Dutch online casino providers Oranje Casino and Kroon Casino in 2014, which all have proven to be positive transactions thus far. Betsson's strategy includes acquiring companies to further develop their brands while their applications get integrated with the Techsson platform in an effective manner. The risk of losing existing customers is thus minimized, as there should be no intermissions while the applications are transferred and the process of realizing cost synergies can be eased. To achieve the goal set by the company's management to grow at a faster pace than the OGI, Betsson's CEO clearly expresses desirable growth to be reached organically and through acquisitions. Betsson's CEO entails in his commentary section of the Annual Report 2015 that they see a structural transformation boosting growth as, first and foremost, only 10% of global gambling and 35% in Sweden is still carried out offline. As the OGI is growing and more and more customers move online and Betsson's CEO predicts great growth opportunities going forward (Betsson, 2016).

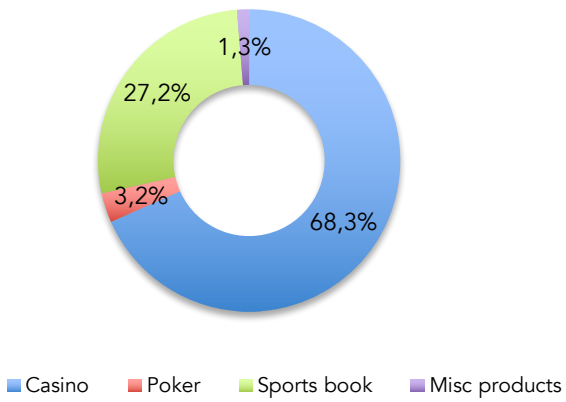
In terms of the regulatory setting, Betsson's CEO prediction goes in-line with other CEO's within the industry, that more and more markets will tend to become regulated or re-regulated and introduce individual licensing requirements to operate. As of today, there are still many unregulated markets including Sweden, which is why Betsson still is able to act on an offshore basis from Malta. Betsson looks to be well positioned and will gradually seek licenses in those countries where it seems commercially defendable, according to management.

***Exhibit 6:*** *Gross Winning Revenue – by Region*




*Source: Betsson Annual Report 2015*
*Created by authors*

***Exhibit 7:*** *Gross Winning Revenue - by Segment*




*Source: Betsson Annual Report 2015*
*Created by authors*

### 6.1.2 Unibet

Unibet is an online gambling operator company founded in 1997 and is today based on Malta. They offer sportsbook, poker, casino games, bingo, lotteries and other similar games. They are listed on OMX Large Cap since 2004 and currently have a market value of 21 044 MSEK as of December 30, 2015 (Avanza, 2016). Unibet is an international company with more than 650 employees in eight different countries. They operate on many of Europe's largest markets including the already licensed markets United Kingdom, France and Italy. In 2012, the successfully acquired Betchoice that enabled them to, among other things, expand their operations on to the Australian market. In 2014, Unibet distributed the online gambling software company Kambi to its shareholders.

Unibet has the most customers out of all firms mentioned in this thesis, summing up a customer base of 9.7 million registered users in more than 100 countries as of 2015. Unibet is a multibrand company however with a main focus on two brands, namely Unibet and Maria.com. Maria.com is a female dedicated brand with a focus on casino and similar games.

#### 6.1.2.1 Financial Analysis

Looking at Unibet's reported financials before any reformulation we can see that in 2015 they reported revenues of 4 562.9 MSEK (354.1 MGBP), and increase of 29% from 3 524.7 MSEK (312 MGBP) in 2014. Unibet experienced an EBITDA increase in 2015 with 18% compared to 2014, amounting to 1 041.2 MSEK (80.8 MGBP). Earnings per share hit an all-time high of 23.023 SEK (1.599 GBP), excluding one of items such as the major spin-off disposal of the brand Kambi to its shareholders, which

was an increase of 28% from 2014. Marketing costs for Unibet increased from 874.764 MSEK (69.7 MGBP) in 2014, to 985.175 MSEK (78.5 MGBP) in 2015, and their EBIT-margin decreased from 37% in 2014 to 22% in 2015. Unibet has cash available of about 1 046.67 MSEK (83.4 MGBP) and a debt-to-equity ratio of 0.87 (Unibet, 2016; Unibet, 2015).

#### 6.1.2.2 Strategic Analysis

Unibet have three specific key objectives to follow, in order to achieve their strategic goals. First objective is to create the best customer experience regarding placing bets, system performance and online customer service. These efforts generated a 15% increase in customer satisfaction scores in 2014, a score they would like to keep improving. Their second objective is that they want to establish sustainable growth, mainly through strong active customer growth but also through having a balanced diversified portfolio of revenue generating services. Finally, Unibet is working towards developing a business model that is scalable so that the GWR can be streamlined and easily transferable into earnings per share for their investors.

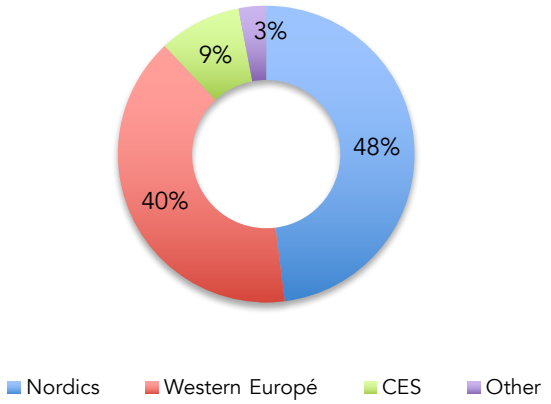
In 2014 and 2015, Unibet has been able to deliver growth across all their active markets. Although the World Cup in football has had some positive impacts on the result, the performance has been particularly strong in the Nordics and Western Europe.

In terms of regulation, Unibet welcomed that the UK introduced new licensing requirements, transforming the OGI from a globally based "dotcom market" to an improved national based "dotcom world". The difference being, that more markets successfully moves away from monopoly to instead enhancing the degree to which each country issues national licenses for each online gambling company. Unibet's CEO says that they are well positioned to encounter new markets as they re-regulate and believe that its customer focused business model enhances their chances of taking advantage of future opportunities. He also argues that the re-regulation favors large and already established operators, such as Unibet, as they are more able to comply with new licensing requirements and adjust their marketing strategies to gain market share. The CEO also adds, in the Annual Report 2015, that such development just described is likely to force further consolidation of market participants and raise barriers to entry such that smaller companies will be driven out of the market, which can further boost larger companies such as themselves (Unibet, 2016).

Unibet's sportsbook has been the driving force behind increasing the number users of the mobile app to place bets. In 2014 and 2015, Unibet significantly increased their share of GWR's generated from mobile devices, representing 43% in 2014 and 51.4% in 2015, of total GWR. As displayed in Exhibit 8 and 9

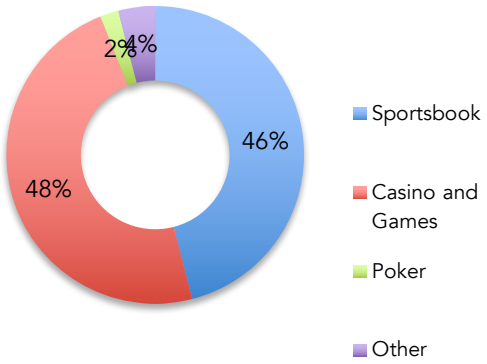
below, Unibet generates 48% if their GWR from the Nordic countries, while 46% of total GWR comes from the Sportsbook (Unibet, 2016).

***Exhibit 8**: Gross Winning Revenue – by Region*




*Source: Unibet Annual Report 2015*
*Created by authors*

***Exhibit 9:** Gross Winning Revenue – by Segment*




*Source: Unibet Annual Report 2015*
*Created by authors*

### 6.1.3 Mr. Green

Mr. Green in an online gambling operator that was founded in Stockholm in 2007 by three entrepreneurs and is today licensed with the Malta Gaming Authority in Valetta, Malta. Mr. Green wants to achieve their objective of building long-term profitable growth through implementing their vision to be market leaders in its niche and shape the future of online gaming. Mr. Green develops their own brand as well as invests in other gaming companies with high growth potential in order to reach their goals. In 2015, Mr. Green counted over 1 million registered customers and employed around 160 employees (Mr. Green, 2016).

The company has developed a brand name created around a tale with a main character called Mr. Green, whose life story customers can follow on the online platform through different games where this character will be present. The company wants to focus on delivering a unique customer experience with a sharp focus on "look and feel". This clearly stands out among competition and lets them create a strong brand loyalty among customers. Online casino is Mr. Green's biggest segment and where they expect to generate the most revenue. For the third consecutive year they were awarded Casino Operator of the Year in 2015 as well as the Mobile Operator of the Year 2015 at International Gaming Awards (Mr. Green, 2016), which is a highly praised organization within the industry.

Mr. Green also takes action when it comes to responsible gaming, and have developed an initiative called Green Gaming that involves budgeting, defining goals and risks for new customers to acknowledge (Mr. Green, 2016).

In 2014 and 2015 they made large investments to develop mobile friendly software that they were able to launch in 2015, in order to be well positioned for the future shift in user behavior – going from Internet browser usage to an increased usage of smart phones to access gaming environments. Mr. Green's CEO Per Norman, writes in their annual report 2015 that they recognize challenges ahead and will in the near future focus on the specific areas of product development, cost control and branding. During the fourth quarter the Board of Directors and management decided to look into the possibilities of moving from the First North Exchange to the larger Index NASDAQ OMX Stockholm, which is planned for to take place sometime during 2016 (Mr. Green, 2016).

#### 6.1.3.1 Financial Analysis

Looking at the reported financials before any reformulation Mr. Green increased the GWR of with 20% compared to 2014, amounting to 792.6 MSEK in 2015. However this was offset by an increase in cost of sales (cost of GWR), which made the EBITDA-margin to decrease to 17.3% in 2015 compared to 20.5% the year before. Mr. Green has made big provisions in 2014 and 2015 for a tax dispute in Austria. These are precautionary measures made by Mr. Green to be on the safe side, and the issue will be settle in court. These provisions have made the EBIT and net earnings in 2014 and 2015 negative. They had current cash available of around 190 MSEK. Mr. Green has no interest bearing debt (Mr. Green, 2016; Mr. Green, 2015).

#### 6.1.3.2 Strategic Analysis

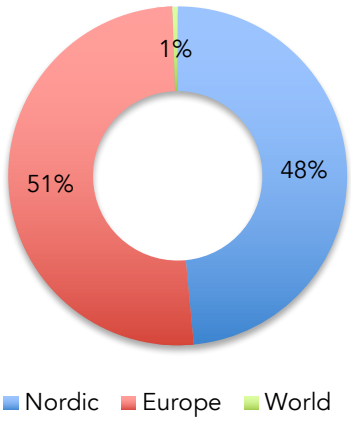
As previously mentioned, Mr. Green has made large investments to develop mobile friendly software in order to be well positioned for the future where they believe that most of the development and growth potential within the industry will be identified.

Mr. Green wants to move into already licensed and regulated markets, among them the British, which is the biggest online gambling market in the world. Their strategy to increase their business on already regulated and licensed markets will result in lower operational risk and greater marketing opportunities going forward. It will also mean that licensing costs will fluctuate depending on the specific country and license process.

Mr. Green wants to have a diversified portfolio of investments. In 2014 they acquired the Facebook based "social casino" Social Thrills AB, through which they have released Spin Tower Casino (Mr. Green, 2015). One major benefit of this investment is that the product does not need any specific licensing and can thus be offered throughout the world. It is also their belief that they through this investment can create a social media platform for Mr. Green's online casino to be launched on in the future. In addition to the acquisition of Social Thrills AB, they also acquired the outstanding shares of the brand Garbo, which is an online casino developed for mobile device usage and focused towards female customers. Mr. Green's senior management have developed a strategy to focus on online casino brands in the future that are particularly strong in the mobile market to be matched with their honored mobile interphase, and also to launch their products on new markets in order to be able to outgrow the industry.

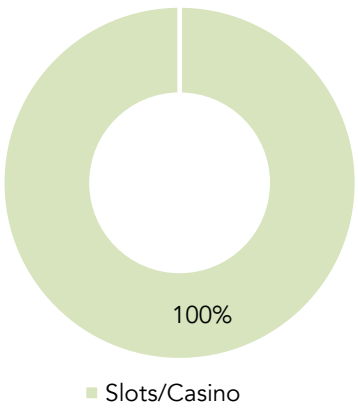
In 2016 Mr. Green has decided to use Kambi, as their sports bet developer in order to launch its own sportsbook service and offer their customers a richer and fuller gambling experience. In 2015, they generated 48% of their total GWR from the Nordic countries and 100% out of that came from slots and casino games, which is displayed din Exhibit 10 and 11 below. This means that they intend to not be 100% dependent on casino games in the future, but will also offer Kambi's sportsbook applications (Mr. Green, 2016).

***Exhibit 10***: Gross Winning Revenue – by Region




*Source: Mr. Green Annual Report 2015*
*Created by authors*

***Exhibit 11***: Gross Winning Revenue – by Segment




*Source: Mr. Green Annual Report 2015*
*Created by authors*

### 6.1.4 Cherry

In 1963 two entrepreneurs founded a small roulette company that in 1972 renamed itself to Cherry. Throughout the years since, Cherry has had ownership involvement in firms that are today success stories

of their own on the stock market, including Net Entertainment and Betsson. Cherry is both the market leader within traditional physical slot machines and online slot machines in Scandinavia. Their business idea is to own and develop fast growing and profitable companies within gambling and casino, and where the brand Cherry is to be considered the flagship. Some of their expressed financial goals include their GWR within online gambling to grow in a faster pace than the industry. Their growth should exceed 10% per year, their solidity should be at least 30% and that they expect to distribute 50% of the generated GWR's as cash dividends to their investors, are some of the other expressed goals (Cherry, 2016).

Due to a recent sale of an online slot machine brand, they have also been able to invest in structural marketing to increase brand awareness and make an additional dividend payment to their shareholders. In 2014 Cherry was awarded the Online Operator of the year by International Gaming Awards. This reward signifies a strengthened ability to create further scalability in their business model and grow within the OGI (Cherry, 2015).

Cherry can be subdivided into four businesses with online gaming focusing on lottery and slot machines with the brand Cheery being the main brand, physical casino machines of different kinds, Yggdrasil Gaming which is another brand name destined to grow fast within Cheery and lastly development projects (Cherry, 2016).

#### 6.1.4.1 Financial Analysis

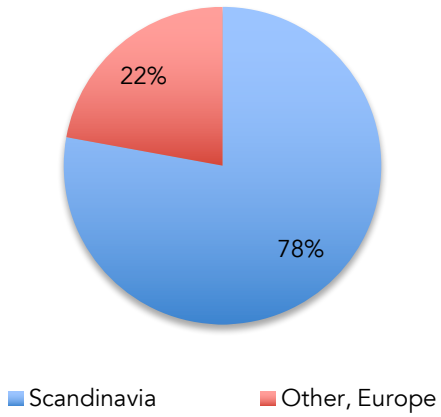
Cherry was in 2015 able to generate 527.3 MSEK of GWR, which was a 57% increase from 334.5 MSEK of GWR generated in 2014. For the first time, they were able to sustain a positive EBITDA in 2015 of 35.9 MSEK, from losing -17.9 MSEK in 2014, mostly due to an increase cost control as well as strong revenue generation, and despite the fact that they increase the number employees to 254 in 2015 from 194 in 2014. At the end of 2015, they had cash available of 23.7 MSEK and a debt-to-equity ratio of about 0.84 (Cherry, 2016; Cherry, 2015).

#### 6.1.4.2 Strategic Analysis

In contrast to all of the other listed online gaming companies on the Swedish stock exchanges, Cherry has another leg of income to protect them against negative earnings as they is also present in the physical casino environment where restaurants has physical slot machines and other casino games placed. Cherry has a strong historical record of growth within the online gaming segment, also being awarded the Online Gaming Operator of the Year three times is a sign of their strength as an operator and their ability to transfer their operations form offline to online (Cherry, 2016).

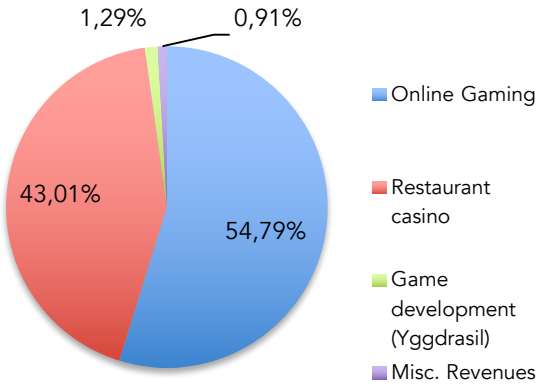
Cherry have made some successful company acquisitions in recent years and intend to keep this strategy going to continue to create growth and value for their shareholders in the future. Cheery expects the software market to continue to increase by an annual ten percent per year and has acquired another gambling and gaming developer Yggdrasil in order to be as well positioned as possible and to part-take in this growing segment within the OGI. Yggdrasil has already proved competence and has signed deals with other companies on the market such as Betsson, Unibet, Mr. Green and Vera & John (Cherry, 2016).

***Exhibit 12***: Gross Winning Revenue – by Region




*Source: Cherry Annual Report 2015*
*Created by authors*

***Exhibit 13***: Gross Winning Revenue – by Segment




*Source: Cherry Annual Report 2015*
*Created by authors*

### 6.1.5 Net Gaming Europe

Net Gaming Europe (NGE) is a Swedish holding company with a business idea involving investing in and developing fast growing companies within the same industry and through actively developing the subsidiaries to create value for their shareholders (NGE, 2016).

NGE is licensed in Malta where the online sites CasinoLoco.com and PokerLoco.com are the main brands. Their goals include finding long-term growth that exceeds the industry growth level, which they intend to accomplish with organic growth and/or through acquisitions (NGE, 2016).

At the end of 2015, they had 975 746 registered online users. PokerLoco.com, which is the oldest brand of the two, was put on the market in 2005 and has since taken a grip of the Latin American market with customers primarily from Argentina and Brazil. It is still under development and large investments such as payment solution systems and the development of a more advanced technical platform has been carried out. These investments are intended to build a foundation for NGE to stand on and keep on growing

organically as well as through acquisitions. CasinoLoco.com offers games distributed from Net Entertainment and Micro Gaming and has their biggest customer base in Europe and Scandinavia (NGE, 2016).

#### 6.1.5.1 Financial Analysis

NGE increased their turnover in 2014 from 2013 to 3.611 MSEK and furthermore to 10.480 MSEK in 2015, equivalent to 190% growth. The company is still in early stages of its development and as they have made large investments in marketing and to finance acquisitions during the last couple of years, they showed a negative final result for in 2015. As of the end of 2015, they had negative equity capital (NGE, 2016; NGE, 2015).

#### 6.1.5.2 Strategic Analysis

NGE's CEO believes that the progress of their new technical platform and investments in product development has made them well prepared to continue to grow in 2016 and beyond. The annual report of 2014 and 2015 includes comments from the CEO that new equity might be issued in the near future to finance growth through acquisition, to generate more cash for other investments or to cover for operating losses. NGE does not explain in their annual reports from which region their GWR is generated from, nor by which segment, which makes it difficult for us to conduct a deeper strategic analysis.

### 6.1.6 PlayHippo

PlayHippo was founded in Sweden in 2006 under the name United Media Sweden. It was listed on Aktietorget Stock Exchange in 2012 and changed its name in 2015. PlayHippo is a holding company that operates the sites PlayHippo.com, HappyBingo.com and LyckoBingo.com, with the business idea to invest in and develop products in the casino and lottery segment of the OGI and they currently have over 430 000 registered online users. In 2014 they had some technical difficulties with the platforms of HappyBingo and LyckoBingo, which led to losing a number of client and has of course affected the result negative. At the end of 2015, they received new equity capital from two board members, which is to stabilize operational growth and finance opportunities of 2016 (PlayHippo, 2016).

#### 6.1.6.1 Financial Analysis

In 2015 PlayHippo generated total GWR of 8.060 MSEK, an increase of 166% from 3.030 in 2014. PlayHippo also generated a negative EBIT of – 5.283 MSEK for 2015, while in 2014 EBIT was -1.552 MSEK and had a debt-to-equity ratio of about 0.07 (PlayHippo, 2016; PlayHippo, 2015).

#### 6.1.6.2 Strategic Analysis

PlayHippo's strategy has since 2012 been communicated to include rapid growth through acquiring other brands within the OGI. PlayHippo intends to continue to grow in this manner as well as through investments in important industry technology. They board of directors has decided that the goal for 2015 was to grow specifically within the online lottery and casino industry (PlayHippo, 2016). As with Net Gaming Europe, PlayHippo does not explain in their annual reports from which region their GWR is generated from, nor by which segment.

## 6.2 Online Gambling Developers

We define online gambling developers as companies that builds the software used for online sports betting, casino games, poker, bingo and social gaming. On the Swedish stock markets there are three listed online gambling developers: Net Entertainment, Evolution Gaming and Kambi. These are frequently employed as developers by the operators listed in Sweden and thus highly interdependent. We will also in this section briefly describe their operations, their current financial situation before carrying any reformulation of their financial statements, and examine their strategy going forward.

### 6.2.1 Net Entertainment

Net Entertainment is a premium developer and supplier of some of the world's most successful online casino gaming solutions. They were founded in 1996 by Pontus Lindwall (previous CEO and current member of the board of Betsson) and were at that time part of the Cherry-companies. In 1997 the company was divided into the three separate entities from the Cherry group, namely Betsson, Cherry and Net Entertainment. After being distributed to the shareholders of Betsson's in 2007, Net Entertainment they successfully listed on the NASDAQ OMX stock exchange in 2009 and the stock performance has been a success story ever since. During 2015, the total number of employees summed up to 718 serving the 130 different corporate customers including Unibet, Ladbrokes and Betsson that are currently offering Net Entertainment's over 200 games to online users (Net Entertainment, 2016).

Included in Net Entertainment's business model is to adapt their development of gaming systems to match the desire of operators as well as end-users. They generate their revenues through a fixed percentage of their operator's generated GWR from online users, in addition to an initial integration fee. In 2015, Net Entertainment serviced over 27.7 billion gambling transactions placed through the operators that supply Net Entertainment's applications (Net Entertainment, 2016).

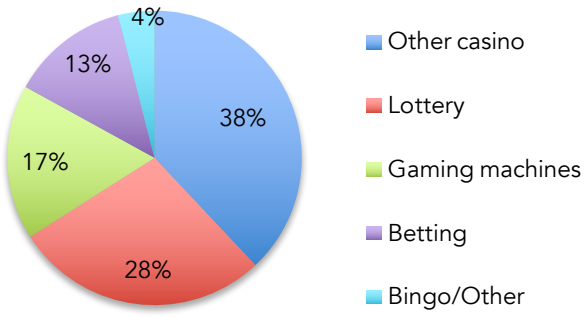
#### 6.2.1.1 Financial Analysis

Net Entertainment had total operating revenues of 1 132.4 MSEK in 2015, which was an increase of almost 33% from 2014. They have also remained very profitable, proving an EBITDA-margin of 35% amounting to 401.6 MSEK. The cash available on hand in 2015 was 679.5 MSEK and they upheld a debt-to-equity ratio of 0.35 (Net Entertainment, 2016; Net Entertainment, 2015).

#### 6.2.1.2 Strategic Analysis

Live Casino is a relatively new online gambling product on the market that was first launched by Net Entertainment in 2013. CEO Per Eriksson restates facts collected by H2 Gabling Capital, in the Annual Report of 2015 that the Live Casino is expected to grow by 19 % annually until 2018, as is expected to be a contributor of profitability and growth for Net Entertainment during the same period. Furthermore, the CEO is looking to further expand into new markets where the Italian market is currently in a regulating process, after which, the company is looking to acquire a local license. UK is expected remain as one of the strongest sources of growth in the upcoming years and mobile gaming is most likely going to be one of the applications that will prosper growth for Net Entertainment, according to Eriksson. Their main focus will continue to be to develop premium digital casino solutions, together with geographical expansion and a growing development of mobile applications (Net Entertainment, 2016; Net Entertainment, 2015). Since Net Entertainment develops gaming platforms and gambling solutions to the online gambling operators they do not report from which region their revenue comes from.

***Exhibit 14*:** Gross Winning Revenue – by Segment




*Source: Net Entertainment Annual Report 2016*
*Created by authors*

### 6.2.2 Evolution Gaming

Evolution Gaming was founded in 2006 by Jens von Bahr and Fredrik Östberg and is today a leading company that develops software for live casino applications and solutions to B2B clients. They are

currently listed on the First North NASDAQ stock exchange where the market capitalization amounted to over 10 billion SEK, through the IPO in March 2015. The stock performance has been remarkable with over 200% return in the first year as a listed company. Evolution Gaming has offices located on Malta, where they also are registered for business, while the headquarters are in Stockholm and a development studio established in Riga, Latvia. The two founders hold the positions of CEO and Head of Sales since the start and they employ over 1 900 people as of 2015 (Evolution Gaming, 2016).

Evolution Gaming provides live casinos where a real live dealer can interact with customers all over the world making gambling decisions on their desktop, smart phone or tablet device. Their customer base consists of more than 70 operators including Betsson, Mr. Green, Poker Stars and Unibet and while realizing that all companies demands are different, Evolution Gaming is able to offer customized solution that targets each individual company's needs (Evolution Gaming, 2016).

#### 6.2.2.1 Financial Analysis

Evolution Gaming had revenues of 48.528 MEUR in 2014 and 75.192 MEUR in 2015. While proving almost 55% growth, they have kept high operating margins with 13.091 MEUR of EBIT in 2014, an EBIT-% of 27% while in 2015 they increased EBIT resulting to 21.080 MEUR and an EBIT-% of 28%. In their balance sheet they show ending balance of cash available on hand of 19.930 MEUR and a debt-to-equity ratio of 0.36, which has to be regarded as relatively low compared to industry standards (Evolution Gaming, 2016).

#### 6.2.2.2 Strategic Analysis

Evolution Gaming's vision is to be the leading provider of live casino solutions in the world. The live casino scene in Europe has shown strong growth trends in recent years and was forecasted to grow about 22%, communicated by Evolution's management in the Annual report 2015. Evolution Gaming has communicated goals to grow at a higher pace than the market. They expect the driving forces in the market to be increased usage of mobile devices for their developed applications, technical advancements enabling minimal interruptions in their live-streamed casino environments as well as re-regulation of the markets. According to CEO von Bahr, it's clear that Evolution Gaming's live casino solutions has become a more important part of online gaming operators' product offering. They are therefore also highly dependent on future re-regulation of markets, meaning that even Evolution Gaming has to follow suit and apply for local licenses in countries where their customers operate (Evolution Gaming, 2016) Evolution Gaming do not explain further in their annual reports from which region their GWR is generated from, nor by which segment.

### 6.2.3 Kambi

Kambi is a sports betting developer based on Malta and is listed on First North NASDAQ stock exchange and focuses on B2C-clients. With over 440 people under employment they want to be a premium brand delivering the highest possible quality to customers when it comes to security, performance and user experience. More so than for the multi-brand companies we have gone through so far in this thesis, Kambi seem to focus more intensively on being the quickest and most accurate odds-maker on the market using high-technology algorithms in order to maximize online players' experience. Kambi means "perfection" in Japanese, which is a motto for them and characterizes how they want to deliver their betting services and thus company culture (Kambi, 2016).

Kambi currently services 12 large customers to whom they deliver sports betting solutions to. Among them all, Unibet, 888 Sport and PAF are the most famous (Kambi, 2016).

#### 6.2.3.1 Financial Analysis

Kambi generated revenue mainly consisting of fees generated from the sports betting services subscribed for by their online gambling operators fleet of 12 live customers. They charge monthly, fixed, variable and commission based fees based on the profits generated by the operators and the number of live events covered by the operators. In 2015, Kambi enjoyed a 32% increase in revenues that in total amounted 47.687 MEUR from to 36.017 MEUR in 2014. They held up an EBITDA-margin of 28% and the final net result summed up to 6.193 MEUR after tax. At the end of 2015, they had cash available of 23.155 MEUR and a debt-to-equity ratio of 0.51 (Kambi, 2016).

#### 6.2.3.2 Strategic Analysis

Kambi acknowledges in their Annual report 2015, that as the mobile platforms today represent about 40% of all placed bets around the world, not only is there a big opportunity to extract growth from mobile solutions but the betting market as a whole is also increasing. Therefore, they also realize that online solutions from stationary and mobile channels will not completely replace offline settings. However, the market participants that will find the most market share, according to Kambi's management, are the ones that can offer the highest quality on their online solutions (Kambi, 2016).

Kambi's senior management believes that as the sports betting industry will continue to see more regulatory change in the near future that will affect B2B positively, they will see upgraded opportunities to grab market share as well as further openings to approach company acquisitions (Kambi, 2016).

Europe has been where Kambi has put most focus towards and will do so also in the future. However, Latin America is the second region where they have identified the most opportunities for expansion and where they strategically placed a sales function in 2014 (Kambi, 2016). Kambi solely explains that they have 12 customers to whom they deliver high quality gambling solutions, but they do not explain further from which region their GWR is generated from, nor by which segment.

# 7. Strategic Analysis

In the following Section 7, we start by conducting a PESTEL analysis, followed by a Porter's Five Forces analysis. After this, we are prepared to introduce and argue for our choice of acquiring firm. We will conclude our strategic analysis with a SWOT analysis of the acquiring firm.

## 7.1 PESTEL

The following sections will consists of a PESTEL analysis, which is a strategic analysis framework that will help us evaluate both the macro- and the micro economical factors that affect the OGI and the involved market participants. Additionally, a PESTEL analysis will lay a foundation of market analysis, partly upon which we will decide on a suitable acquirer and target firm for our M&A-case. We will investigate all of the six factors included in a typical PESTEL analysis, that is: Political, Economic, Social, Technological, Environmental and Legal factors.

### 7.1.1 Political Factors

In 2014, a majority of the eligible voters elected the Social Democrat party to take over office from the two consecutive mandate period precedents the Moderate party. The Social Democrats filed a motion to the Swedish government in 2012, restating the statues and goals for the gambling market to be a stable and safe environment where social interests are nourished through that the demand for gambling services are supplied in a responsible manner. One ambition for the elected party is also to prevent gambling addiction and we elaborate further on how the different companies act in in issues concerning addiction in the Appendix section A.3 – A.3.3. The Social Democrats are proposing a re-regulation of the gambling market, with the suggestion to impose a tax rate of 20% on total GWR to be put in place as one of the consequences. This would follow the example of, for instance, Denmark and Estonia that has already imposed such taxation. However, what this motion also will bring is a market that is opening up for free competition (Riksdagen, 2012).

What is currently one of the most influential arguments as to why this motion will carry through is the ongoing case debate that the EU's regulatory organ is driving towards Sweden. As we discussed

previously in Section 5 covering rules and the regulatory environment, the EU Commission is questioning whether the monopoly that Svenska Spel still enjoys on casino and lottery in Sweden, really goes hand in hand with the concept of free market competition (EU Commission, 2013). This is a driving force behind why a probable re-regulation of the Swedish gambling market could occur under the Social Democrats current mandate period.

In 2015, the government elected General Director of the Swedish Lottery Inspection Håkan Hallberg as the investigator of the research to examine the possible means with which to carry through a re-regulation of the industry. Concretely in such a case, it will be possible and also a requirement for offshore companies currently accessing Swedish customers through the Internet, to apply for a local operating license to be able to keep approaching customers in Sweden. Furthermore, investigator Hallberg is to research the health issues connected with gambling and associated issues regarding consumer protection as related to addiction and the role of the government in a potential future liberalized gambling market (Folkhälsomyndigheten, 2015).

Whether or not the Social Democrat party is re-elected for another four-year mandate period in 2018, will most likely not affect the outcome of this debate. The second largest political party in Sweden, the Moderate Party will most likely have the same agenda. If not to move even more quickly, as one of their main political ideas with economic association is to advocate a liberalized market place that supports corporations' visions (Moderaterna, 2013). Betsson backs this in their Q4 report of 2015 (Betsson, 2016a) by saying that there is currently a consensus among different parties in the parliament to re-regulate the Swedish gambling market, confirming that the companies are very aware of this industry transformation. However the questions remain how, when and with what means and magnitude the new regulation will affect the industry as this will continue to pose as one of the most important political factors to be considered.

### 7.1.2 Economic Factors

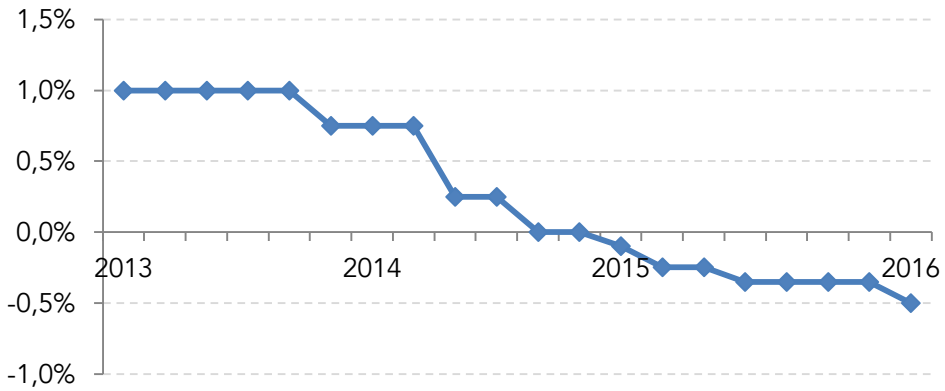
For companies active within the OGI, the overall performance of the economy does not seem to affect their business to a large extent. The current economic climate is hardly mentioned in the CEO commentary sections in annual reports and there is not an evident trend in the Swedish listed firms' income statements that prove cyclical differences. Given the current economic situation in Sweden and many other countries around the world, with low interest rates and energy prices, it yields consumers more available cash, which means, all else equal, that have more money to spend on gambling and gaming activities.

One of the factors that do affect our focus industry is, however, the repo rate. The interbank repo rate is set by the Central Bank to regulate at what interest rate i.e. at what cost, the commercial banks in Sweden are able to place money at the Central Bank over-night. At the end of 2014, this interest rate was set to zero and during the first Central Bank meeting of 2015 the repo rate was set to negative for the first time in Swedish history. On February 17th in 2016, the Head of the Swedish Central Bank Stefan Ingves and his team has pushed the rate even lower, to -0.5% (Riksbanken, 2016a). This economic climate is advantageous for the listed online gambling firms we are focusing on in our thesis, especially the ones that have an explicit strategy to grow through acquisitions. With the negative repo rate, commercial banks are "forced" to lend their money to companies and private households in order to avoid the negative over-night interest rates charged by the Central Bank. As a result, from a company perspective, companies have an easier time being granted loans to finance acquisitions and form a regular person's perspective, people are able to borrow more money and thus become "wealthier" and thus have more money left over to engage in gambling activities. In the real world, the scenario might not be as black-and-white as just described, but it is clear that this economic climate is boosting a consolidation within the online gambling industry.

In further detail, lower interest rates will, in addition to providing companies with external financing, also boost regular customers private economies as all costs for borrowing are kept at historically low levels. Furthermore, considering the pure stock performance of our, as interest rates are kept low investors' required rate of return on stocks should also be lowered and hence, will be more attracted to investments in the online gambling firms listed on the stock market.

The press release that was published together with the decision to lower the repo rate to record low -0.50% in February 2016, included a projection of the interest rate development set as a goal by the Head of the Central Bank. Not until 2018, do they expect to be able to set the rate to positive, having as underlying goal to push inflation up to two percent. As a result, economic conditions are set to be favorable for Swedish online gambling companies as they are able to remain customers with credit institutions who are able to provide them with relatively cheap debt to finance their operations possibly involving acquisitions (Riksbanken, 2016a). In Exhibit 15 below, we have displayed the development of the Interbank Repo rate between 2013-2016.

***Exhibit 15***: Sweden's Repo Rate Development, set by Riksbanken (Sweden's National Bank)




*Source: Riksbanken*
*Created by authors*

### 7.1.3 Social Factors

We consider the social factors affecting the OGI to be population and the associated population growth rate. Since the companies we look at mainly operate within the Nordics and Europe we are interested in looking at how the total population is expected to evolve in these geographic areas. The total population in the Nordics in 2015 is estimated to be in excess of 27 million, where Sweden with its 9.8 million inhabitants is the largest country with regards to both population and size. The total population in the Nordics is expected to rise above 30.9 million before 2050 (Norden.org, 2015). Compare this with the population in Europe of 507.4 million in 2014 (EU-Upplysningen, 2015), which is expected to rise to 691 million 2050 (Udviklingstal, 2009). Given that the consumers within the market both in Europe and the Nordic are increasing, all else equal, this is good for the companies, since they will have a bigger consumer base.

If any effect at all, it will be positive for almost any industry with a growing population. However we asses that the social factors touched upon here concerning the OGI are not that strong, in comparison to the Technological and Legal factors which are two highly present and important factors for this industry.

### 7.1.4 Technological Factors

Internet and the usage of mobile devices are probably the most important technological factors for online gambling firms. Sweden is one of the leading countries in the world when it comes to R&D and innovation (WIPO.int, 2015), but more importantly, Sweden has a leading position in terms of mobile and Internet penetration. According to a report published by Market Line (2015), mobile users grew at an average rate of 7.36% during the period 2000-2014 in Sweden. Also the number of people using the

Internet grew by an average of 6.61% during the period 2000-2014 despite the already developed market. The same trend is visible for most of the developed European countries, where a majority of the online gambling firms involved in our M&A-case generate a large share of their business. With the ever-increasing number of users of both the Internet as well as mobile devices, the number of possible gambling customers is also likely to rise. The more the firms are able to reach customers wherever they are geographically, the more a particular customer will be able and likely to place a bet and thus generate revenue.

Another vital factor for online gambling companies to run their games, betting- and casino simulations efficiently is to have a powerful technical platform that is able to integrate new systems and applications effectively. Once such a platform is in place, companies should have a great potential to utilize cost synergies in a situation of acquiring another firm and when to integrate their new contributing applications under the same umbrella of systems.

Taking this discussion further, another important feature is the speed and the ease with which customers are able to play games, place bets etc. One case in point would be the virtual live casino applications that require no lagging or system failures as the customer are to be able to engage with a real life croupier that is placed somewhere else in the world. Another case is the quickly growing live sports betting market. A person who wants to place a live bet on a random match, should be able to have the fastest updates with the most current odds placed by odds makers or the algorithms. The pace with which the firms are able to provide this service to customers will decide the quality of game or application.

### 7.1.5 Environmental Factors

Most of the firms represented in our M&A-case point in their annual reports to sustainable growth being an integrated part of their business model. It is further explained that their operations within online gambling, naturally, does not involve anything that affects the environment negatively. For example, there is no involved transportation or manufacturing process that comes with emissions affecting nature. Rather, these companies are concerned with sustainable growth in terms of social responsibility associated to gambling.

### 7.1.6 Legal Factors

A vital part of the future growth possibilities and development of the OGM depends to a great extent on how rules and the regulatory environment will develop. Tax implications following a wave of countries re-regulating their domestic markets is perhaps the most evident legal factor that will strongly affect the companies mentioned in this study. The companies that are, for example, based on Malta would have to

register for a local license in Sweden to be able to continue to conduct business in Sweden, and thus, be liable to pay regular corporate tax rate that could equal as much as 20-25%. Clearly, as one could imagine, this would seriously affect profitability and future cash flows, starting immediately once they re-register for business in the local country. While this has not been decided upon yet and is likely to remain undecided for the next years, this still constitute a great risk factor to the online gambling companies.

Another legal aspect that is worth considering is the role of governmentally controlled Svenska Spel. As mentioned in Section 5 covering Rules and Regulations earlier, firms other than the ones specifically allowed by the government, such as Svenska Spel, are not allowed to target the Swedish population with direct advertising under current legislation. As the debate continues whether or not Svenska Spel should be allowed to practice monopoly power, this constitutes a legal risk factor for the online gambling companies. First, should the EU rule against Svenska Spel continuing to practice monopoly, they are to be regulated on the same terms as every other firm on the Swedish market and thus pay local tax. Additionally, Svenska Spel would most probably engage in more online gambling and advertising to compete for the market share on more equal terms with the offshore firms.

Following this discussion, we believe the legal factor that have the most uncertain future and thus most vital for the involved companies to handle and communicate with investors, is the tax implication. From an investors' viewpoint the OGM is growing at a fast pace, however the possible tax expenses discussed constitute a threat whether or not the involved companies will be able to remain as profitable in the future.

## 7.2 Porter's Five Forces

Porter's Five Forces is a framework to assess the attractiveness of an industry, where an industry is defined as a group of companies producing roughly the same product. The underlying idea is that if the forces are high, the industry is not very attractive since competition and other factors will cause margins and profitability to shrink to lower levels. If the forces are low on the other hand, the industry is promising and yields profitable business opportunities. That would define an attractive industry (Johnson et al., 2009). The customers that are active on the OGM are characterized as having low switching costs. The company's product lines are often similar to each other and undifferentiated in nature. Rivalry is fueled since it is very easy for companies to expand due to the non-physical aspect of their business models.

### 7.2.1 Buyer Power

Despite Internet's global reach, countries all around the world still have restrictions on online gambling imposed by their governments. However, since online games of different kinds are becoming more accessible, especially through the increasing number of apps for smartphones and tablet computers, there

are plenty of buyers. However, since the majority of these are individuals have limited financial strength, this reduces the buyer power.

The switching cost for consumers between different platforms/sites are small since users are not under any contractually binding obligations to stay with a chosen site. Users are thereby able to switch sites easily and are most likely to do so when competitors offer promotions to persuade new customers. This increases the buyer power.

The online gambling operators are undifferentiated. All casino sites offer more or less the same games and the same is true for poker sites. The sports betting websites offers the ability to bet on more or less exactly the same sport events as its competitors. The differentiation factors between all these companies are in general quite superficial as they primarily differentiate each other by means of branding, marketing, and different promotions. The result of this is that buyers often easily search out the particular firm that offers the best odds on the games that they are most interested in. This impacts the price sensitivity, since many players will look for bets that offer them the highest return. These are factors that further increase the buyer power.

Combining all these factors, we consider the buyer power in the online gambling market to be considered moderate to high.

### 7.2.2 Supplier Power

Suppliers in this industry tend to be large in size. If governments act as the suppliers, then they have strong supplier power through their financial strength and also through their negotiating influence. The suppliers job is very important, since if their platforms is not good enough, the costumers will change sites since switching cost is low, this makes the number of qualified suppliers is fairly low, increasing the supplier power. Costs are also an important factor, since many online casino packages can be expensive, with almost all packages binding the companies into a royalty requirement to the manufacturer of the software.

Another issue that online gambling operators have to deal with is the setup of the business. They have to consider factors such as different tax policies depending on the country, as well as the IT infrastructure. The developers are often specialized in creating patented products, where some also provide software in order to help manage businesses. This includes programs allowing the online gambling operators to monitor their advertising campaigns, and also their customers and their financial information. The

supplier's position is strengthened by all of these aspects.

When it comes to payments there are a number of different options with MasterCard and Visa being the most popular choices among online operators and are accepted on nearly all sites. Since there are many different methods of payment it reduces the supplier power, yet the size of companies such as Visa and MasterCard and their brand increases their supplier power. Overall, we consider supplier power in the industry as moderate to high.

### 7.2.3 New Entrants

The OGM is fragmented, some nations completely forbid the business while other nations use specific restrictions and some nations has even made online gambling legal in all forms. In early 2013 the United States started allowing online gambling in selected states and legislation was put forward to allow online gambling nationwide as well, which could lead to the US becoming the largest potential market in the world, overtaking United Kingdom's position. This would be particularly interesting for new potential entrants, since the industry is fragmented and the requirements in order to enter the market remains quite low.

In the market there are a variety of retailers, from private to public operators as well as monopolies. Monopolies exist in numerous countries but perhaps Sweden is one of the clearest examples. In general, government regulation is very inflexible, where online gambling is restricted in many nations around the world. This is a substantial entry barrier for new entrants. However, this is not the case in Europe and especially in Sweden where many online gambling companies operate.

Brand recognition and strength is very important to attract customers and the bigger companies use expensive advertising and sponsorship campaigns to achieve this. However, due to diverse regulations in different countries, absolute dominance does not exist and it is possible for new entrants to find a niche within the industry.

This is also supported by the exponential growth across the whole industry as regulations and laws becomes more relaxed and as more people get access to the Internet, this growth will lead to new start-ups forming, with entrepreneurs who are prepared to overcome any entry barriers of the industry. We argue that the overall assessment of new entrants within the industry is to be considered moderate to low.

### 7.2.4 Threat of Substitutes

Betting shops and especially physical casinos is a substitute, and switching costs to these are small.

However, betting shops and physical casinos are not necessarily a cheaper alternative, as they most likely offers similar odds and with similar restrictions on minimum bets, as the online gambling companies. This would only be a beneficial alternative to customers with no, or limited Internet access, or in areas where the Internet on is unreliable or not at all available. We assess this threat of substitutes as low in Sweden, but a little bit higher in Europe.

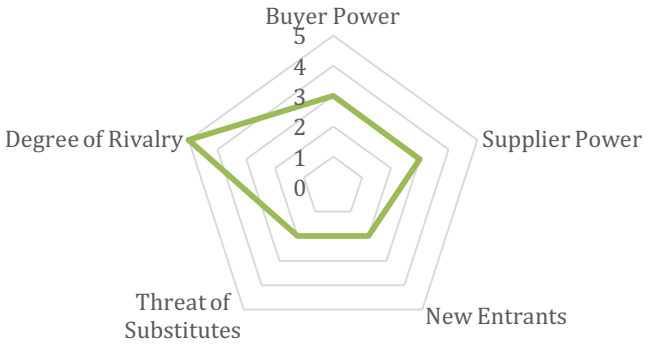
### 7.2.5 Degree of Rivalry

The industry is highly fragmented, consisting of a both large players and smaller niche players, which yields a high degree of rivalry. Combined with the low switching cost, low barriers to entry and that the industry is undifferentiated in nature, rivalry is further fueled. Another factor is that it is easy for companies to expand since the non-physical aspect of their business models. Hence, we assess that the rivalry in the online gambling industry is high.

### 7.2.6 Summarizing Porters Five Forces

We have made a radar chart, which can be seen in Exhibit 16, showing how we have asses each of the forces and also ranking them, where 5 is high and 0 is low, following our discussions above.

***Exhibit 16:*** *Radar chart of Porter's Five Forces*



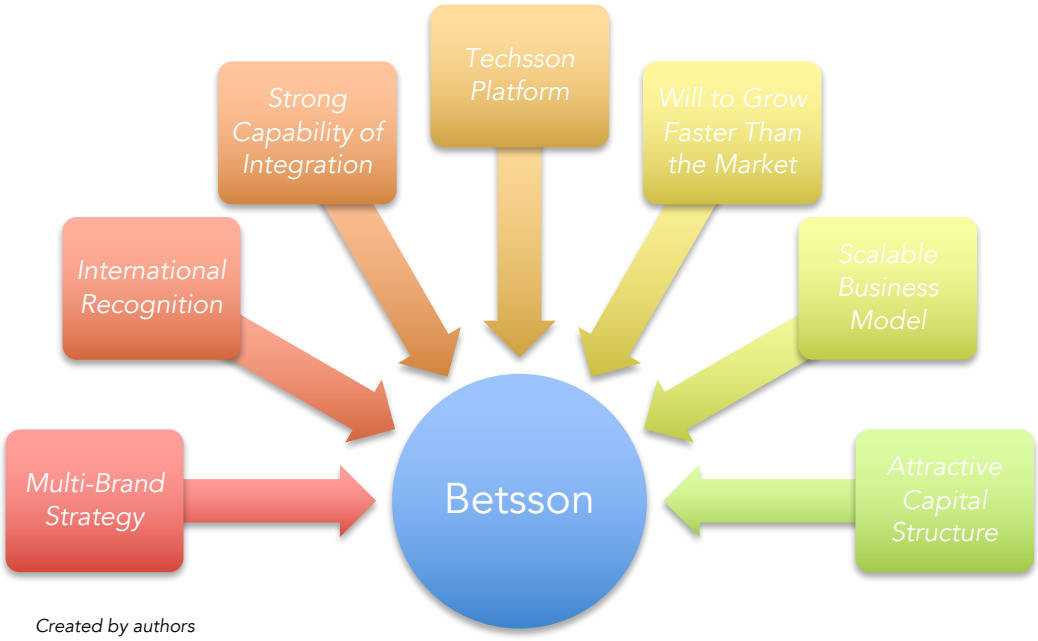

*Created by authors*

It is very easy for the consumers to switch sites and due to the undifferentiated nature of business in the OGI and rivalry within the industry is further increased since it is very easy for companies to expand due to that their business models has a non-physical aspect to it. The buyer power on the online gambling market is moderate and its easier than ever for individuals to access the market. This is a tendency that will only grow stronger with the increasing number of apps for smartphones and tablet devices. Additionally, the end users are often times individuals with limited financial power, this reduces the buyer power. Suppliers tend to be large, particularly in the case where represented by governments, which

increases supplier power as such suppliers tend to have strong financial muscle and even stronger negotiating power. In early 2013 the United States, the market with potential to become the largest online gambling country in the world relaxed its strict laws and allowed online gambling in selected states. This may prove particularly enticing to potential new entrants, especially as the industry is so fragmented. Some of the European countries are now regulated, others are on its way. Lastly we argued that betting shops and physical casinos could be considered as substitutes to online gambling especially, with minimal switching costs for the end consumer.

## 7.3 Choice of Acquirer

***Exhibit 17:*** *Betsson and Seven Characteristics Making Them a Suitable Acquirer*




*Created by authors*

Following our strategic analysis, comparing companies across the industry both in characteristics and features but also financially, we have decided that Betsson will act as the acquiring firm in our M&A-case. We will below go through the seven reasons advocating our choice why Betsson has suitable characteristics and is in an advantageous position to be acquiring or merging with another firm within the OGI. These are the seven characteristics displayed in Exhibit 17 above that will be described by six bullet points below.

- Betsson's business model involves running a multi-brand strategy, which includes acquiring, developing and distributing several operators at the same time. This enables them to target different

customer segments through niche brands such as Oranje Casino and Europe-Bet that are both distributed through Betsson's brand portfolio. The multi-brand strategy can therefore easily absorb an additional operator and thus continue to build on an even stronger brand offering.

- Betsson's largest market geographically is the Nordic region, where they generated 61.1% of their total revenues in 2015. The second largest market consists of EU-countries excluding the Nordics, which totaled 30.7% of total revenues in 2015. Furthermore, the rest of the world totaled 7.5% in 2015 with the last two quarters of 2015 represented 11.5% and 12.9% of total revenues respectively. It is thus evident that they are expanding in this market segment. Their CEO has at several times expressed that expansion both within and outside EU are alternatives they are investigating at the moment. A case in point is Europe-Bet based in Georgia that Betsson successfully acquired in 2015. We predict that the historically successful M&A-strategy for Betsson is worth following up on and is justifiable to continue with as one of the motives in order to increase their international recognition further.

- From Betsson's Annual Report 2015 we could find that Europe-Bet contributed to the Q4 earnings by 96.1 MSEK, which represents about 9.2% out of total revenues. According to the CEO, they will during 2016 migrate Europe-Bet into the common technical platform Techsson, after which they expect to be able to utilize additional cost synergies from the merge. This is a case in point that proves that Betsson has a strong ability to integrate newly acquired companies' applications onto Techsson. We deem this to be a very strong proponent to continue to be a successful acquirer and integrator.

- Based on data and projections by H2 Gambling (through company Annual Reports) and MarketLine, the online gambling industry will grow at approximately 9-10% up until 2020. Simultaneously, it is explicitly expressed by management that Betsson intend to grow at a faster pace than the industry is expected to. We believe this is realistic and one of the main reasons that we consider Betsson to be one of the strongest acquiring candidates on the market.

- We assess that Betsson has a scalable business model that enable them to increase their revenues in a profitable manner. For example, as new operating sites and games are either developed or acquired they are able to generate revenue and, most importantly, they have the capability to turn it into profit. We believe a scalable business model is one of the most important features a company within the OGI can have. We assess that Betsson has a robust business model that enables them to continue

to grow organically as well as through acquisitions.

- We also assess Betsson's capital structure to be attractive. First, at the end of 2015 they had established a cash position on their balance sheet amounting to 524.9 MSEK, which would equal approximately half the purchase price of Europe-Bet. One issue that can be raised at this point is the debt-to-equity ratio of almost 0.82 at the end of 2015 that might seem high and risky at a first glance. However, compared to the industry average among operators of 0.80, it can be considered a normal level. Furthermore, looking at the specific liability composition, the industry players' balance sheets do not in general consist of interest bearing debt items to a high degree but rather operating liabilities such as tax payables and accounts payables. Most other operators also have large cash positions. We therefore do not assess the capital structure of Betsson to be excessive and consider the risk of experiencing financial distress to be low.

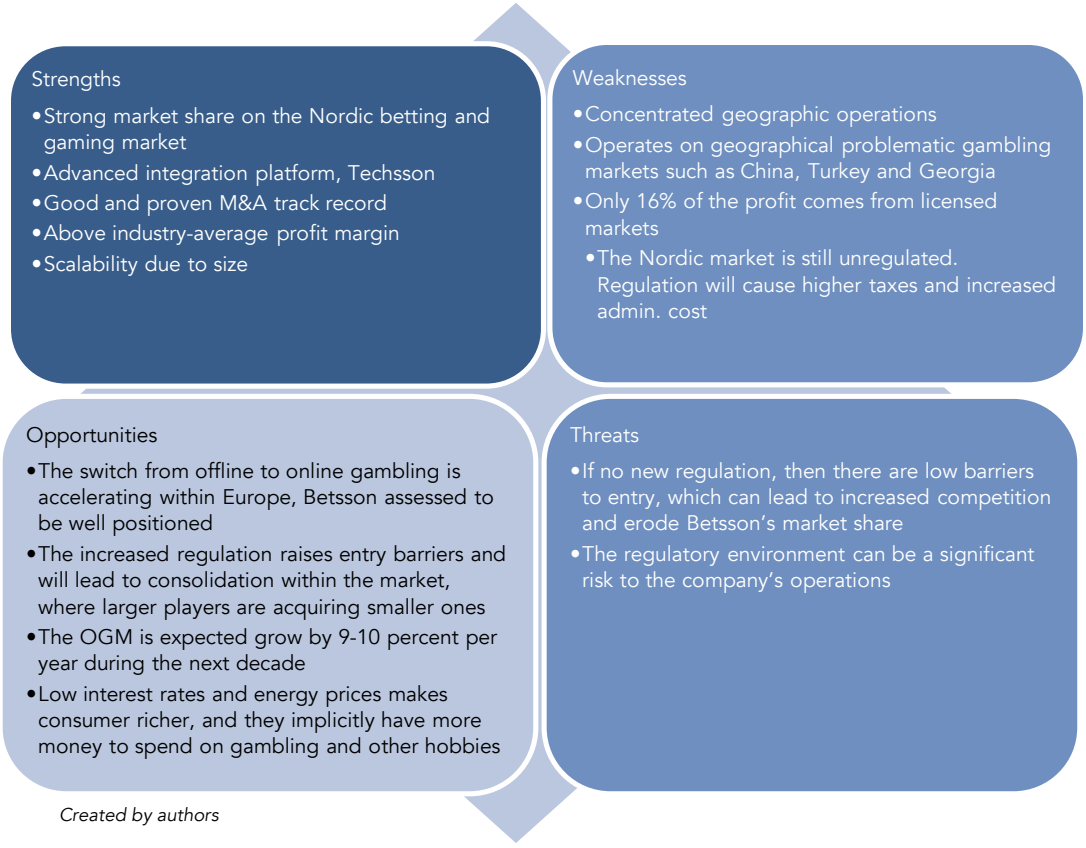
### 7.3.1 In conclusion

From our perspective, we believe one of the most driving growth factors of the OGI in 2016 and beyond will be economies of scale, as previously discussed. More specifically, the pace at which the involved companies will be able to increase their total turnover in order to keep margins high will be essential.

Betsson has for the past six years, including 2015, proved a CAGR in revenue of 15%, with 8% being a low mark and 27% being a high mark. In other words, they have been able to consistently grow at a higher pace than the industry over time. Restating market analysts' predictions of future industry growth of 9%-10%, we believe Betsson have strong chances to perform above these projections. During the last couple of years, Betsson have acquired several companies that have proved to contribute to creating additional revenue streams at the same time as remaining profitable. In fact, Betsson have had an EBIT-margin pending between 24% and 32% for the past six years. This tells us that, not only is Betsson able to increase their revenue growth rate but they have also remained profitable, in terms of organic growth and by implementing several acquisitions. We believe this is one of the most important skills that Betsson have, making them a suitable acquiring firm in our consolidation case. This also tells us that they have proved a strong capability of historically integrating new brands, much thanks to their technical platform Techsson. They have been able to integrate international firms into their product portfolio, further strengthening their brand name. Furthermore, Betsson have accomplished these integrations while retaining a capital structure that can be considered around industry average. We consider them to be able to remain at similar levels in the future while also continuing with an active M&A-strategy.

## 7.4 SWOT

***Exhibit 18:*** *Overview of Our Conducted SWOT Analysis of Betsson*




*Created by authors*

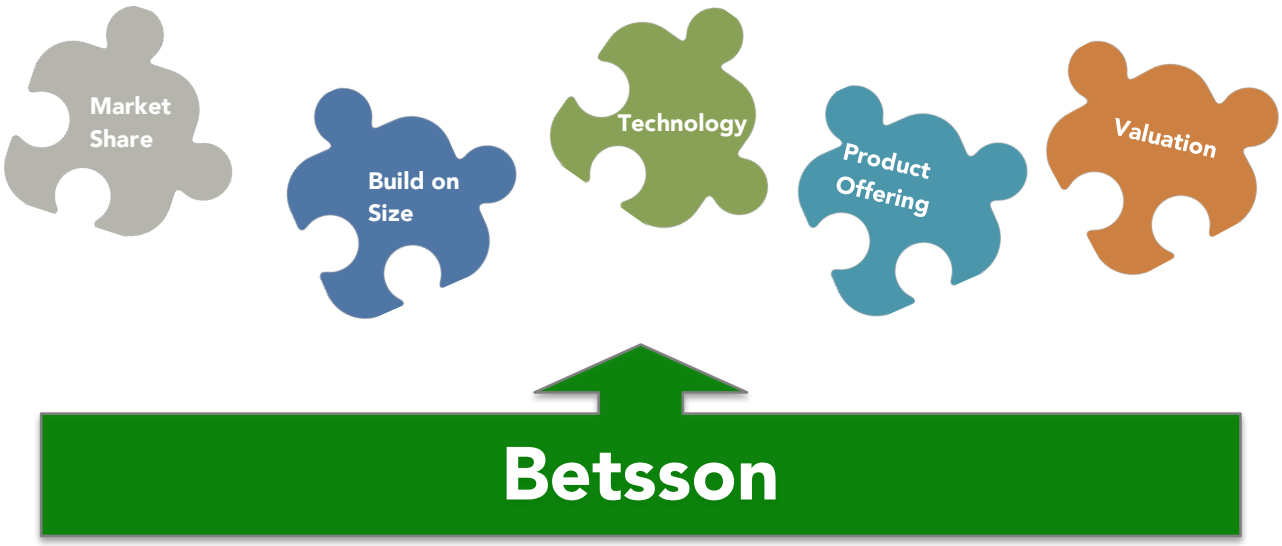
# Section C

In the third section of our thesis we will first argue for the choice of target firm, given the five most compelling characteristics that we think Betsson would value and benefit from in a potential M&A opportunity. We will then perform a thorough valuation of that target company including financial statement and profitability analysis, synergies estimation, pro forma analysis and sensitivity analysis. We have chosen to use the discounted cash flow model and the economic value added model and additionally a multiple valuation in order to estimate the intrinsic value of target as of December 30th 2015.

# 8. Choice of Target Company

Rather than dissecting advantages and disadvantages, possibilities and threats connected with each of the potential target firms we have introduced in our thesis, we think it is more clear and effective to argue for characteristics and features that Betsson could benefit from. From that point, together with a financial review and argumentation we will consider ourselves prepared to select a target firm for Betsson to acquire. In the following segment, we would therefore like to present to the reader a discussion about what characteristics a target firm should have in order to be beneficial for Betsson, after which we will motive our choice of target firm included in the M&A-case. The five most desirable characteristics for Betsson, is illustrated in Exhibit 19 below.

***Exhibit 19:*** *Desirable Characteristics in a Target Firm*




*Created by authors*

## 8.1 Market Share

We believe that since the industry has not yet entered a matured phase we will see continuous growth in upcoming years. Other markets both inside and outside EU that are less penetrated are therefore more likely to show higher numbers in terms of growth compared to the early adopters of the Nordic countries. As we previously discussed in chapter 4 and displayed in Exhibit 4, East European countries have lower Internet penetration and thus greater growth potential. Betsson has a strong market position in the Nordics generating approximately 61% of their annual GWR and it is clear this will remain an important market and source of revenue also in the future. However, while generating about 30% of their total turnover from countries inside the EU but outside of the Nordics, we believe one main characteristic that Betsson would

benefit from in a target firm is a strong market position in countries outside of the Nordics. In our opinion, acquiring a firm with relatively high market share in other markets than the Nordics would be an efficient strategy to introduce Betsson's strong brand name and reach new customers in high-growth markets.

## 8.2 Build on Size

Following up on our previous discussion of legal aspects in motion to be amended by legal authorities in Europe, there are worrisome risk factors that might become evident in the near and long-term future. Among them, tax rates are the most intensively debated issue. If in the future, Betsson would become liable to pay taxes under a significantly higher tax bracket, their income statement and profitability would be put under heavy pressure. Another aspect that could potentially contribute to decreased profitability are fees to cover for the required licensing to be able to conduct business in separate countries. Even though these might be considered as one-off items, they could be of substantial amounts.

It is general consensus as well as our own understanding that in order to remain profitable in the future, operational growth as well as company size will be vital in order to tackle the different unforeseeable obstacles and absorb the increased cost items mentioned above without having profitability suffer. We therefore believe that a strategic move for Betsson at this point would be to increase their overall market share through building on size in order to generate more top-line revenue and realizing cost synergies through an active M&A-strategy.

## 8.3 Technology

Since Betsson has a multi-brand strategy, their operations involve developing and offering several brand names simultaneously. Following an acquisition, the target firm will continue to run their operations independently and not be automatically absorbed by Betsson but simply stream their revenue into the Betsson corporate group. Even through new applications will be integrated and run through the Techsson platform, advanced technology knowledge as such is not considered a target characteristic that we believe Betsson is lacking and thus desire. Rather, we consider technology to be a vital feature and an absolute must for a target to have to thrive in this industry. Visual features on platforms and the general exposition of a company are extremely important and have to be alluring. That is, we believe that if the target is a gambling operator it must have well-developed applications and web sites that visually and interactively attract customers in using computers, mobiles devices and tablets to enjoy their applications. Furthermore, if the target is a software developer we believe that the ability to develop premium products with high technical qualities and well-designed formats will attract the most consumers and thus be highly valued. To conclude, in our opinion the target must be either a premium software developer or an operator with well-developed websites and applications that have high illustrative and attractive features.

## 8.4 Product Offering

Betsson has a strong sports book offering generating just over 27% of their total revenue, while their casino offering generate 68%. According to MarketLine (2016), the European industry is segmented into about 33% sports betting, 20% casino, 20% poker, 9% bingo and 18% other. We conclude that Betsson's product offering focusing on sports betting and casino services capture large customer segments and that they should focus on strategically utilizing and improving their strengths continuously. As there are many niche actors on the market, focusing on empowering your strengths is perhaps more important than trying to offer a complete set of gambling services. In our opinion, Betsson should therefore look for a target with strong sports and casino offering to further strengthen their position.

## 8.5 Relative Valuation

For Betsson to be interested in acquiring a target company, it needs to have an attractive valuation. We will call the intrinsic value of the target company in addition to the value of potential synergies to be Betsson's resistance point, beyond which it will not be considered a financially justifiable investment. However, there is a risk that the OGI is overvalued. Looking at the average P/E of the industry of 48 as of 2015-12-30, compared with the Swedish stock index average P/E of 16 based on 2016 year earnings estimates (NASDAQ, 2016), one can immediately observe high current valuations. It is to be acknowledged that some of the online gambling firms are to be considered young, and has yet to establish robust net profit, which is one explanatory factor for the high P/E valuations. The market valuations are strongly based on expectations of future growth rates and earnings. If Betsson is to find a potential target with market valuations lower than the industry average, there might be an opportunity for an attractive company investment. This would be one motivating factor behind a possible deal.

## 8.6 Choice of Target Firm: Mr. Green

The online gambling operator Mr. Green generates 51% of their GWR from European countries outside of the Nordics, which equaled 407.4 MSEK in 2015. This would contribute onto Betsson's GWR of 1 142.7 MSEK generated from countries outside of the Nordics in 2015. Mr. Green does not specify in greater detail in their financial reports which specific revenue split based on countries. However, we look upon acquiring Mr. Green as a great opportunity for Betsson to increase their market share in countries where they are already active but would like to expand, as well as to enter new markets. Judging from Mr. Green's Q4 report of 2015, they grew 16% in countries outside of the Nordics from generating 89.1 MSEK in Q4 2014 to 103.6 MSEK in Q4 2015. Additionally, having newly accepted licenses on the leading European markets of Great Britain and Italy we project great potential to increased market share inside EU as well. It is however important to take notice that penetrating new markets also involve

regulatory risks. Mr. Green's income statement was in 2015 constrained with 36.093 MSEK of Cost of Sales, amounting to almost 5% of total GWR directed towards betting duties in Austria. In Austria, Mr. Green and several other online gambling operators are currently involved in a court case with the local gambling authority whether or not they are liable to pay tax retroactively on their earned GWR. The items are recorded in the income statement as precautionary measures as the process is likely to continue for an extended period of time and Mr. Green is accounting for a worst-case scenario. This ongoing case demonstrates how the regulatory environment could possibly affect companies active in this industry as they approach new markets and as well-developed un-regulated markets, such as Sweden, becomes regulated. Furthermore, this is a risk factor that we recognize as being industry wide. With this discussion in mind, we believe that Mr. Green's possibilities to grow in new markets will overweigh the potential risks that come with the territory.

Simply adding Betsson's total GWR from 2015 of 3 722 MSEK with Mr. Green's of 792.6 MSEK, we can conclude that the joint firm would collect revenues exceeding 4 514.6 MSEK which is almost equal with Unibet's GWR of 2015, clearly making them one of the largest online gambling firms on the European market. As argued previously, we believe that with tough competition and looming regulatory changes involving the risk of increased tax expenses and licensing fees among other things, the largest firms in the industry is most likely to have the robustness and capability to tackle the obstacles most efficiently.

Entering Mr. Green's website (https://www.mrgreen.com), one is greeted by an attractive design and the intriguing character Mr. Green. An offer of receiving free spins and a welcoming bonus is also directly introduced, but also basically common industry practice among almost all online gambling companies. It is our interpretation that the available applications and games are among the most well designed in the industry and the gentleman character representing Mr. Green creates a tale-like curiosity that distinguishes them from many other firms. It creates an interactive touch and enables customers wanting to try out all applications to follow a recognizable pattern, which is something that we believe also makes Mr. Green stand out in front of competition. We conclude that Mr. Green has attractive visual characteristics on their platform of applications that we find is utterly important, as customers demand nothing but high standards in today's technically advanced environment. Additionally, having won the Mobile Casino of the Year award from the IGA (International Gaming Awards) in 2016 proves that Mr. Green has the competence and internal compatibility to extend their offer to mobile applications to carry the same quality as the web site to its customers with successful results.

Two software developers, Net Entertainment and Kambi, has previously been part of Betsson's and Unibet's corporate structure but was distributed to shareholders as stock-dividend. We believe that Betsson's management has valuable knowledge and previous experience from combining developers and operators under the same corporate group. As this is no longer the case we make the conclusion that they did not value this set-up as a suitable structure and we believe that management had well-founded reasons as to why these companies was distributed rather than kept. We conclude this as a contributing element as to why an operator is a better acquisition target than a developer.

## 8.7 Comparing the Financials

***Table 1:*** *Overview of Online Gambling Firms' Multiples, Separating Operators from Developers*

| | *Operators* | | | | | | *Developers* | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| ***2015*** | **Unibet** | **Mr. Green** | **Cherry** | **Net Gaming Europe** | **Play Hippo** | ***Average*** | **Net Entertainment** | **Evolution Gaming** | **Kambi** | ***Average*** |
| **EV/GWR** | 5.56x | 1.88x | 3.51x | 195.33x | 31.12x | *47.48x* | 17.17x | 15.71x | 8.21x | *13.7* |
| **EV/EBITDA** | 25.71x | 27.05x | 51.63x | nm | nm | *34.80x* | 35.80x | 43.71x | 28.76x | *36.09x* |
| **P/E** | 35.8 | nm | nm | nm | nm | *35.8* | 52.9 | 59.0 | 66.4 | *59.4* |
| **M/B** | 9.37 | 2.62 | 11.95 | 156.03 | 3.67 | *36.73* | 27.71 | 27.43 | 12.92 | *22.69* |

*Source: DataStream*
*Created by authors*

In Table 1 displayed above, we have decided to look at several different multiples for the valuation of our selected companies. Starting of by interpreting multiples related to Enterprise Value (EV), we can see that the 2015 numbers for all of the software developers of Net Entertainment, Kambi and Evolution Gaming, has higher EV/GWR (SALES) multiples compared to the average operator, excluding Net Gaming Europe and Play Hippo which are two very small operators with undetailed annual reports. Mr. Green is the company that has the lowest EV/GWR multiple of 1.88. Comparing across the EV/EBITDA multiples we can see that Unibet, Mr. Green and Kambi is well below the industry average.

Moving on to look at the earnings multiple PE, we experience some difficulty since some companies such as Mr. Green, Cherry, NGE and PlayHippo are not making any net profits in 2015 and the comparison is thus not logical to make. These firms are considered fairly young and are in expansive growth phases. Large investments are made in marketing and application development and they are simply not earning enough revenue to keep up profitability and generate positive net profits. Furthermore, due to low barriers of entry the market is scattered and the competition is tough among both public and private companies competing for the same customers. However, as there is also a wave of consolidation within the industry

we do not believe this state to remain for a long period of time as smaller companies will either go bankrupt or be acquired.

Comparing PE among the firms that made a net profit in 2015, the average PE equal 35.8 for operators and 59.4 for the developers. Kambi has the highest PE of 66.4 and Unibet the lowest of 35.8. Lastly we compare the Market to book (M/B) ratio. Mr. Green has the lowest M/B with 2.62, which is well below the average of both operators and developers. Also in the M/B ratio, the gambling software developers have the highest multiple. For example, Net Entertainment and Evolution Gaming both have a M/B above 27, which is very high.

In conclusion, we found Mr. Green to have a low EV/GWR multiple and M/B ratio as well as an EV/EBITDA multiple that lies below the industry average. It is thus clear to us that Mr. Green is attractively valued by the market, even though they had negative net earnings in 2015, making the comparison of PE multiples not logical to make in Mr. Green's case.

At this point, we argue that we have been able to successfully identify a consolidation opportunity in the OGI. We have decided that Betsson's financial and strategic position fits well into the role of the acquirer and identified Mr. Green as having desirable strategic and financial characteristics to be the targeted firm. These firms will thus act as the two main components constituting the M&A case which will be the center of focus in the continuing part of our thesis.

# 9. Financial Statement Analysis

Traditional financial statements generally consist of an income statement, balance sheet and a cash flow statement. These are generally not appropriately organized in order to analyze the operating performance (Koller, Goedhart, Wessels, 2010). As defined by Petersen & Plenborg (2012), a firm's activities are commonly defined as being operating-, investing- or financing. In company analysis in general and for our case discussion in particular, it is vital to separate these activities to better understand how Mr. Green's operational activities create value for their shareholders. Operational activities are where the firm's core business lies, which is financed by provided debt or equity. It is further useful to make this separation of accounting to distinguish Mr. Green from its competitors, as competitors can essentially copy financing and investing activities while operating activities are in general harder to replicate.

Our intention with the sections following below is to analyze Mr. Green's financial statements between 2013-2015 in detail by reformulating both the income statements and balance sheets analytically. We can only go as far back as 2013 since that was the year that Mr. Green became a publicly traded company, and thus from where we have access to sufficient financial data. We acknowledge that the ratios and measures we will calculate and the analysis we make will be based on audited reports with solely historical accounting information. Although the information is publicly available, it is in Mr. Green's best interest to display themselves in the greatest possible way. As we mentioned in the limitations section 1.3, we do believe it is important to take notice of this matter, however, it is beyond the scope of this thesis to further investigate the preciseness and arrangement of the financial statements.

### 9.1 Accounting and International Financial Reporting Standards

Mr. Green's consolidated corporate financial statements have been constructed in accordance with the International Financial Reporting Standards (IFRS) that has in turn been established by EU (Mr. Green, 2016). This indicates to us that the financial data is professionally presented and of satisfying quality. As we see no change in accounting standards and the way Mr. Green has chosen to report their financial data over the years, we see no obstructions in proceeding with reformulating the financial statements.

Our opinion of Mr. Green's financial statements is that they are professionally formulated and in accordance with all accounting standards and practices there is. However, when overlooking and gathering financial data from some of the other firms such as Net Gaming Europe and PlayHippo, it sometimes lacks sufficient information and details. In some cases, this has made it more difficult to be precise and straight forward when comparing financial data and ratios among the firms, a matter that also was touched upon in the limitations section.

## 9.2 Reformulation of Income Statement

We will start with reformulating data in Mr. Green's annual reports to an analytical income statement, where we classify each item to be either related or non-related to the core business and thus being operational or financial. The items that are creating value for shareholders are categorized as operational and, in opposition, the items related to the financial structure will thus be considered financial. The complete reformulated income statement can be found in the Appendix section A.4.1.

An equity statement that has no income other than net income from the income statement is a clean surplus accounting statement (Penman, 2013). If there were other items affecting the company's income, which is not stated in the income statement, those items would be referred to as dirty surplus items.

Penman states that the three most common dirty surplus items are unrealized gains and losses on securities, foreign currency translation gains and losses and unrealized gains and losses on certain derivatives. Through the reformulation we ensure that such items, are present in both the equity statement and income statement. We have accounted for the dirty surplus items regarding foreign currency translation gains and losses for Mr. Green.

## 9.3 Reformulation of Balance Sheet

In order to be able to correctly match the items from the analytical income statement with the balance sheet, we have reformulated the balance sheet to an analytical setting where we have separated operating assets from financial. Operating assets are generally the ones involved in the daily operations of a firm and are usually valued at cost and expected to yield a higher return than the required return of capital, the WACC. The non-operating or financial assets are investments in non-operating assets and are usually valued at fair market value. Once we have made the categorization, we are able to also find the net operating assets (NOA), also known as Invested Capital (IC) and the net interest bearing debt (NIBD) (Petersen & Plenborg, 2012). A firm's operating activities are further defined by Koller et al. (2010) as in Equation 9 below:

*Equation 9*

$$Operating\ Assets - Operating\ Liabilities = Invested\ Capital\ (NOA) = NIBD + Equity$$

The most notable detail from Mr. Green's reformulated balance sheet is that the NIBD is negative. Mr. Green has no interest bearing debt, all debt is categorized as operational debt used in the operations and not as a way of financing the business. Since Mr. Green has a substantial cash position of 190.281 MSEK in 2015, the NIBD position is negative. The complete reformulated balance sheet of Mr. Green can be found in the Appendix section A.4.2. The items mentioned in Equation 9 and in the reformulated balance sheet such as Invested capital, Operating Non-Current Assets, Operating Assets and Operating Liabilities will be further discussed in the Appendix section A.4 – A.4.6.

## 9.4 Trend Analysis and Common Size Analysis

In order to get a clear understanding of how the financial data and operating profitability has evolved over the most recent years, we will present a Trend Analysis below. The intention with this type of analysis is to be able to see how each revenue and cost item have developed over time. In the analysis we will set 2013 years' data with 100 as starting point, then it is clear to see how each item has developed in

comparison with the other from 2013 to 2014, and 2014 compared to 2015. We have chosen not to display all items from the income statement, but only key figures.

The calculation we have made leading to the Trend Analysis is formulated as Equation 10 below.

*Equation 10*

$$Trend\ Index\ Development = \frac{Revenue\ or\ Cost\ Item\ This\ Year}{Revenue\ or\ Cost\ Item\ Previous\ Year} * 100$$

***Table 2:*** *Trend Analysis, Consisting of Key Figures from Mr. Green's Financial Statements*

| Trend Analysis | 2013 | 2014 | 2015 |
|---|---|---|---|
| Total revenue | 100 | 188 | 120 |
| EBITDA, before items affecting comparability | 100 | 185 | 101 |
| EBITDA | 100 | 33 | 242 |
| EBIT | 100 | -83 | 115 |
| NOPAT | 100 | -69 | 198 |
| Profit / Loss For The Period | 100 | -71 | 200 |
| Cash and Cash Equivalent | 100 | 139 | 123 |
| Invested Capital (Net Operating Assets) | 100 | 85 | 87 |
| Equity | 100 | 90 | 95 |
| Net Interest Bearing Debt (NIBD) | 100 | 115 | 123 |

*Created by authors*

This view shows a substantial increase in total revenue both from 2013 to 2014 and from 2014 to 2015. Comparing *EBITDA before items affecting comparability* with the regular EBITDA item, it is clear that Mr. Green was not able to keep up the EBITDA-margin as the Austrian tax items are heavily burdening profitability. One can also spot that starting 2014 Mr. Green realized negative numbers for EBIT, NOPAT and as an incurred net loss. The negative trend continued into 2015 as losses have increased.

We decided to include a Trend Analysis to be able to also spot trend developments in the Balance Sheet. The first thing that comes to mind is the steadily *increasing Cash and Cash Equivalent* item, which makes the Invested Capital to gradually decrease. We can also identify an increasing trend in NIBD, which in Mr. Green's case is also due to the increasing *Cash and Cash Equivalent item.*

***Table 3:*** *Common Size Analysis, Consisting of Key Figures from Mr. Green's Financial Statements*

| Common Size Analysis | 2013 | 2014 | 2015 |
|---|---|---|---|
| Total revenue | 100% | 100% | 100% |
| EBITDA before items affecting comparability | 20.87% | 20.45% | 17.25% |
| EBITDA | 19.54% | 3.45% | 6.96% |
| EBIT | 10.74% | -4.73% | -4.55% |
| NOPAT | 10.55% | -3.86% | -6.37% |
| Profit / Loss For The Period | 10.16% | -3.84% | -6.38% |

*Created by authors*

In addition to the Trend Analysis, we have chosen to also include a Common Size Analysis. This analysis tool generally differs from a Trend Analysis in that all items are set and analyzed in relation to total revenue. For this analysis and our case in particular, this is a useful method as Mr. Green has shown great revenue growth in the past and is now in a stage where future profitability is examined and one can through this analysis table follow how other items has evolved in relation to revenue.

From the Common Size Analysis in Table 3 displayed above, we can tell that Mr. Green's operational cost items have increased at a higher pace than total revenues. It is thus evident that profitability has decreased, as the two EBITDA related items show lower margins out of total revenue in 2014 and 2015 compared to 2013. Furthermore, we have chosen to display negative EBIT, NOPAT and the Net Loss in 2014 and 2015 as, even though the analysis can become skewed, is still shows that as their revenues have increased every year, the operating loss measures and net loss have not increased but kept steady.

## 9.5 Profitability Analysis

To measure the profitability of a firm is a fundamental aspect of the financial analysis and profitability is crucial in order for the company to survive. It is also important that shareholders, the owners of the firm, receive a return on their investment that they are satisfied with. When we implement a profitability analysis we look at historical performance. Looking at how the historical profitability has evolved over time in order to define the future expectations of Mr. Green.

The analysis focuses on uncovering trends and levels of key ratios describing the different contributing factors to Mr. Green's profitability. To analyze the historical performance, we have decided to use the DuPont model, to structure our profitability analysis and to see which source profitability in operations comes from (Penman, 2013).

### 9.4.1 Return on Invested Capital

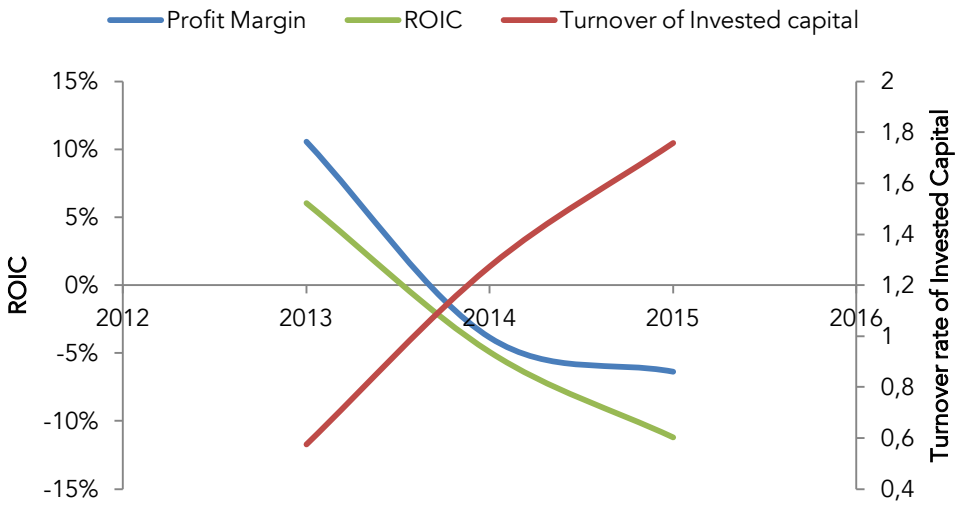
Return on invested capital (ROIC) is a ratio that describes the overall profitability of Mr. Green's operations. However, ROIC does not differentiate between value creation caused by an increase in gross profit or if the company is utilizing its resources more efficiently. Hence, it is necessary to break down the analysis of ROIC into separate parts and examine how the profit margin and the turnover rate of the invested capital have fluctuated historically (Penman, 2013).

Although ROIC is a "general" profitability measure of operations, it is often times considered the most vital ratio for investors since a higher rate of return on your invested capital will lead, ceteris paribus, to a higher estimated value of the firm (Koller et al., 2010). If ROIC exceeds the cost of capital of the firm then the company is said to create excess return and hence, create value for their shareholders. Note, that this setting is what the Economic value added model is built upon. According to Petersen & Plenborg (2012) ROIC is calculated as:

*Equation 11*

$$ROIC_t = \frac{NOPAT_t}{Invested\ Capital_t} = PM_t \times Turnover\ rate\ of\ Invested\ Capital_t$$

***Exhibit 20:*** *Key Financial Ratios of Mr. Green*




*Source: Mr. Green Annual Reports*
*Created by authors*

To further investigate the reason behind these variations in ROIC, we can decompose it into profit margin and asset turnover rate. These ratios will help us explain the relationship between revenues and expenses as well as how efficiently Mr. Green has utilized their capital over time.

Mr. Green's turnover rate of invested capital describes how the company utilizes its invested capital to generate income. The inverse relationship, 1/Turnover rate of invested capital, describes how much of the invested capital are required to create one unit of sales. According to Petersen & Plenborg (2012) the ratio is calculated as follows:

*Equation 12*

$$Turnover\ rate\ of\ invested\ capital_t = \frac{Sales_t}{Invested\ Capital_t}$$

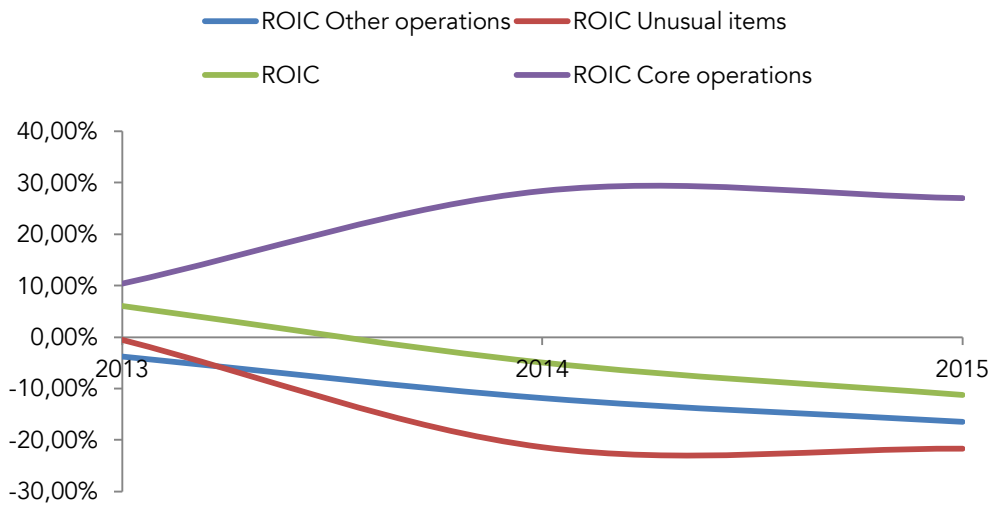
As illustrated from the figure above, Mr. Green's turnover rate has been increasing, going from 0.6 in 2013 to 1.65 in 2015.

We then break down the different components in the income statement into core operational items, other operational items and unusual items and calculate their corresponding ROIC, in accordance with (Penman, 2013), which can be seen in Equation 13 below:

*Equation 13*

$$ROIC(total)_t = ROIC\left(\frac{Core\ Items_t}{IC_t}\right) + PM\left(\frac{Other\ Items_t}{IC_t}\right) + PM\left(\frac{Unusal\ Items_t}{IC_t}\right)$$

***Exhibit 21:*** *Key Financial Ratios of Mr. Green*




*Created by authors*

As we can see from Exhibit 20 above, the ROIC (Core operations) has increased from 10% to 28%. ROIC (other operating items) has been decreasing for every year and was -17% in 2015. What is affecting Mr. Green's ROIC (total) is the fluctuations of unusual items, as illustrated in Exhibit 20 above, since ROIC (Core operations) is canceled out somewhat by ROIC (other operating items). This yields that the ROIC (total) follows the ROIC (unusual items). We can then conclude that the cause of the negative ROIC in 2014 and 2015 is the unusual item. The unusual items are both currency losses but mainly a reservation of possible tax to the Austrian Government. Mr. Green conducted a self-assessment in September 2014 in line with Austrian tax legislation. They did this since Austrian law now states that online gambling within Austria's territory is to be taxed at a 40 percent of the gross game win (sales). Mr. Green disputes this obligation, referring to Austrian Constitution and EU legislation. The company has however done a self-assessment as a precautionary measure, and it also prevents Mr. Green from later tax surcharges. It is expected that this appeal process with the Austrian government can take several years. It is not only Mr. Green that has contested this case, but several other firms are involved in similar problematic tax issues with the Austrian as well as other governments.

### 9.4.2 Profit Margin

The profit margin (PM) describes the percentage of sales that turns into operating profit. Mr. Green's profit margin has fluctuated considerably between 2013 and 2015 and is calculated in accordance to Petersen & Plenborg (2012) with the below Equation 14:

*Equation 14*

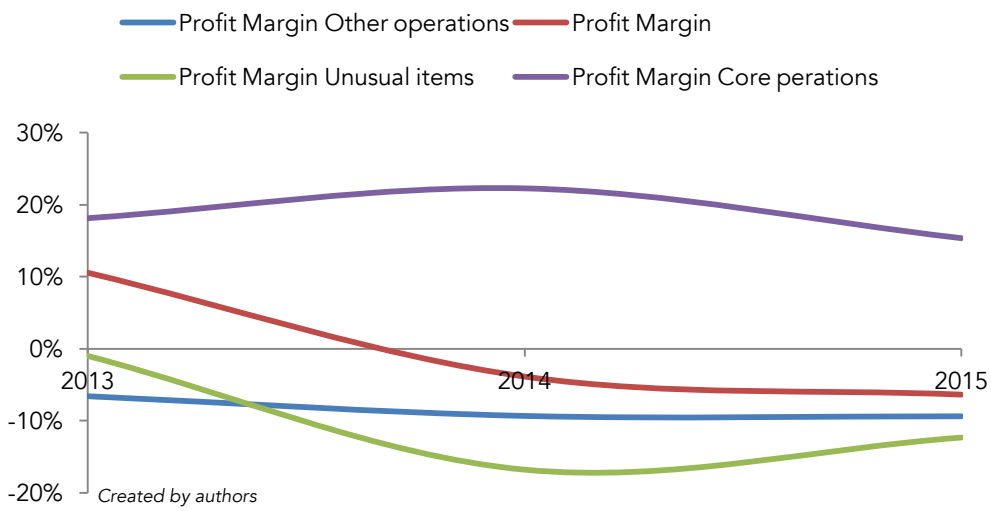
$$PM_t = \frac{NOPAT_t}{Sales_t}$$

To further break down Mr. Green's profit margin we use Equation 15 in accordance to Penman (2013):

*Equation 15*

$$PM(total)_t = PM\left(\frac{Core\ Items_t}{Sales_t}\right) + PM\left(\frac{Other\ Items_t}{Sales_t}\right) + PM\left(\frac{Unusal\ Items_t}{Sales_t}\right)$$

***Exhibit 22*:** Key Financial Ratios of Mr. Green




We can trace both parts of the profit margin back to the analytical income statement, where it is clear that Mr. Green has generated stable revenues over the years, however they have not been as successful in turning these revenues into profit. As seen from Exhibit 22 above, the profit margin from core operations has been stable throughout the period, fluctuating from 18.1% in 2013 to 22.3% in 2014 and 15.4% in 2015. Again, as we also saw when we did the break-down of ROIC, the core and other operational items cancel each other out and it is again the unusual items (currency losses and provisions on Austrian market) that makes the total profit margin negative for Mr. Green.

### 9.4.3 Return on Equity

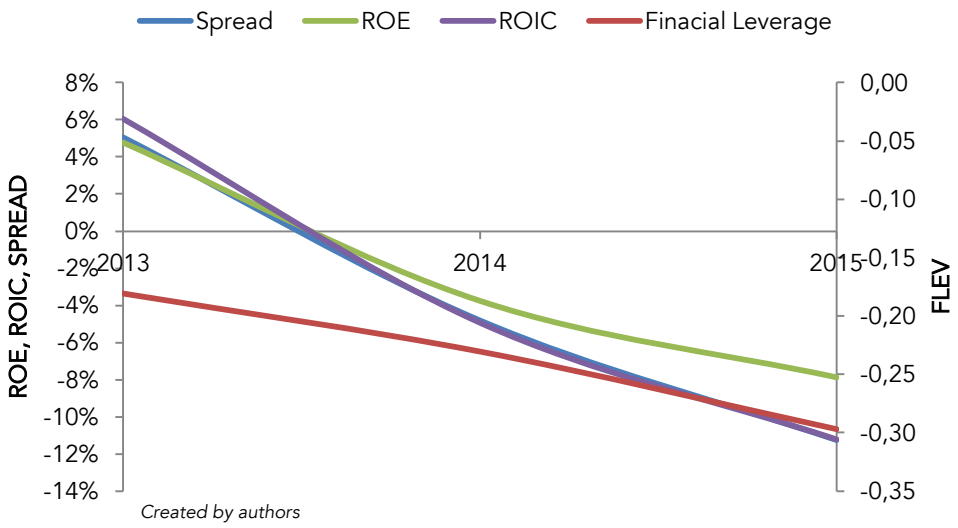
The purpose of this section is to analyze the drivers behind the return on shareholders' equity (ROE). The analysis is further based on a decomposition of ROE. All figures are based on numbers from the reformulated statements. ROE is a profitability ratio that shows how much profit a company has generated from the shareholders' invested capital. It is important to look at the current level but also the development over the years. The shareholders would like the ROE-level to exceed the corresponding cost of equity capital during any given year (Petersen & Plenborg, 2012). ROE is in accordance to Petersen & Plenborg (2012) calculated as follows by Equation 16 below:

*Equation 16*

$$ROE_t = \frac{Profit_t}{BV\ Equity_t} = ROIC_t + (ROIC_t - NBC_t) * \frac{NIBD_t}{BV\ Equity_t}$$

ROE consists of three parts, an operational component ROIC, a financial component (NBC) and a ratio called financial leverage (FLEV), which is the ratio of net interest bearing debt (NIBD) to equity. The decomposition of ROE indicates, that if the company has no gearing, ROE will be equal to ROIC. Or in other words, return on equity is equal to the return on operating assets. Over the examined period, Mr. Green has negative net interest bearing debt, since Mr. Green has more cash and cash equivalents than interest bearing debt. This implies that ROE will decrease if ROIC is greater than NBC. This is referred to as unfavorable financial leverage.

***Exhibit 23:*** *Key Financial Ratios of Mr. Green*




As Exhibit 23 above shows, both ROE and ROIC have been decreasing since 2013. ROE has gone from 4.8% in 2013 to -7.9% in 2015, ROIC has gone from 6.1% to -11.2% in the same time period. The decreasing ROE follows the decreasing ROIC, since Mr. Green has not been able to make a profit using its invested capital.

# 10. Estimating Cost of Capital

Since we will use two present value models, the DCF model and EVA model, to estimate the intrinsic value of Mr. Green's equity we need a required rate of return for the two possible types of investors, the creditors and the shareholders. Naturally, their investments carry different risks and they should therefore demand different required rates of return above a benchmark risk-free rate. The Weighted Average Cost of Capital (WACC) intends to reflect these rates into one measure that represents both investor classes (Petersen & Plenborg, 2012).

## 10.1 Cost of Equity

Most financial textbooks suggest the use of the Capital Asset Pricing Model (CAPM) when estimating shareholders required rate of return. CAPM certainly has its limitations, making strong theoretical assumptions (Damodaran, 2012a). However, we feel that this particular discussion is out of the scope of this thesis and we will thus not proceed to cover further details regarding this model. CAPM can be calculated once we have found all the inputs, following the discussions below. The calculations for cost of equity capital are carried out using the Equation 17 below, and provided in the Appendix section A.5 when calculating WACC (Petersen & Plenborg, 2012).

*Equation 17*

$$r_e = r_f + \beta_e \times (r_m - r_f)$$

### 10.1.1 Market Risk Premium

The market risk premium reflects the incremental premium required by investors, relative to a risk-free asset. Market risk premiums are a central component of every risk and return model. Given the importance, it is surprising how difficult the estimation of market risk premiums remains in practice. The estimation difficulties are especially related to information uncertainty, investors risk aversion and perceptions of macroeconomic risk (Damodaran, 2012). In the standard approach to estimating market risk premiums, historical returns are used with the difference in annual returns on market versus bonds over a period comprising the expected risk premium. This estimation method is limited in relation to the sensitivity for the chosen estimation period. We chose to follow the estimated market risk premium set by professor Damodaran's research, which estimates a market risk premium for Sweden of 6% (Damodaran, 2016).

### 10.1.2 Risk Free Rate

The risk-free rate used in the CAPM model rests under the assumption that a risk-free investment contains no default risk. Normally, this suggests a security that is issued by a government as governments are considered to be risk-free entities because of that they control the printing of currency (Damodaran, 2008a). The most used theoretical assumption is to use a risk-free rate that is sufficiently liquid, reflects the origin of the firm's cash flows and also that matches the duration and timing of the future cash flows (Damodaran, 2008a; Koller et al., 2010). As Mr. Green is listed only on the Swedish stock exchange, much of their cash flow is generated in SEK and because we forecast their future cash flows five years ahead as well as in perpetuity for the terminal value in the valuation models, we argue for using a risk-free rate symbolized by a 10-year Swedish government bond. As of December 30th 2015, a representative zero-coupon bond yielded 0.993%[1], which is the risk-free rate we will use in our calculations going forward (Riksbanken, 2016).

### 10.1.3 Beta Equity

The beta equity is the slope of a time series regression of equity returns relative to an index as a proxy for the market portfolio. In order to estimate the beta equity from a regression, the CAPM model with time-varying riskless interest rates is implemented, illustrated by Equation 18 below:

*Equation 18*

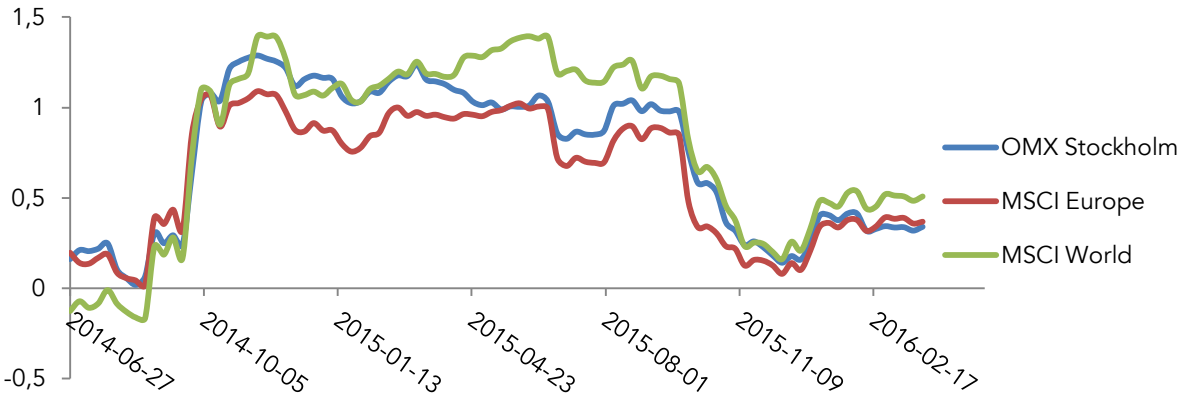
$$RE_\tau - R_\tau = \alpha_t^E + \beta_t^E [RM_\tau - R_\tau] + \varepsilon_\tau$$

Where $RE_\tau$ and $RM_\tau$ are the observed returns in period $\tau$ on the stock and the proxy for the market portfolio and $R_\tau$ is the risk free interest rate. Applying the CAPM enables us to test the validity of the model by checking whether the estimate of alpha is equal or different from zero.

In order to perform the estimation of beta equity, a three-year period is applied. An issue that should be considered in the application of the CAPM, is the choice of proxies for the market portfolio. Considering these limitations, we have decided to implement several proxies. The MSCI World, MSCI Europe and OMX Stockholm will all be used as proxies for the market portfolio and the 10-year Swedish government bond rate is applied as the risk-free rate. Since the beta is assumed to be constant, we decided to examine this by conducting a "rolling" beta estimation for each market portfolio. A one-year estimation window was applied for the rolling beta estimates, illustrated in Exhibit 24 below.

[1] One should notice that during January 2016, a 5-year Swedish government bond yields negative returns as the negative repo rate is starting to result in consequences.

***Exhibit 24:*** *Rolling Beta Equity: One-Year Window*




*Source: Datastream*
*Created by authors*

From Exhibit 24, it can be seen that the equity beta has not been constant over time. The beta had a substantial increase in October 2014. This increase in beta was mainly caused by the fact that Mr. Green announced that they are reserving money due to the ongoing tax court case in Austria. At the same time, the outbreak of Ebola, the falling oil prices and a concern of Europe's poor financial performance led to falling indices across the world. Since Mr. Green's stock movement downward was of stronger magnitude than the proxy indices illustrated in Exhibit 23, their beta increased. The beta value could thus at the time fluctuate between 0.9 and 1.3 for all the world indices. Around September 2015 the equity beta dropped substantially, which was due to Mr. Green's quarterly earnings report showing that the company continues to grow at a faster paste than the OGI, while at the same time the indexes around the world continued to decrease, forcing Mr. Green's beta to go down. The rolling beta estimations clearly illustrates that the beta is constantly changing over time. From our "rolling" beta estimation we get a $\beta^{\boldsymbol{Equity}}$ of 0.725, derived from the average of the rolling beta estimates.

In order to compliment this method of estimating Mr. Green's beta, we have also chosen to examine the beta of our chosen peer group. This would, in theory and according to Koller et al. (2010), mean that we would take into consideration the unlevered beta of companies that are affected by the same market factors as Mr. Green, and re-lever them to match Mr. Green's capital structure. In this particular case, we will first have to take into consideration that Mr. Green does not have any interest bearing debt outstanding, as found in the Financial Statement Analysis chapter 9, and there will therefore not be any reason to adjust an industry average to match Mr. Green's capital structure. As a result, the average value of the unlevered betas from peers will thus be considered a sufficient measure. Using Equation 19 below published by Damodaran (2006), we found the average of the peer group to be 0.94.

*Equation 19*

$$\beta_U = \frac{\beta_L}{(1 + (1 - \tau) \times \left(\frac{D}{E}\right))}$$

We have summarized our beta estimations in Table 4 below.

***Table 4:*** *Summary of Beta Estimation for Mr. Green*

| Source | Beta |
|---|---|
| Beta Rolling Regression of Mr. Green | 0.73 |
| Average Industry Beta of Peers | 0.94 |
| **Average Beta** | 0.83 |

*Created by authors*

Finally, now that we have all the required inputs we can estimate the cost of equity capital, following the CAPM formula in Equation 17, as we saw earlier, below:

$$5.99\% = 0.993\% + 0.83 * 6.00\%$$

## 10.2 Cost of Debt

As Mr. Green does not have any interest bearing debt outstanding on their balance sheet, there will not be any cost of debt to consider in cost of capital calculations for Mr. Green.

## 10.3 WACC Calculations

Since Mr. Green does not have any interest bearing debt, their cost of equity capital is thus also to be considered the company's weighted average cost of capital (WACC). Mr. Green's equity cost of capital is calculated to 5.99%, as is the WACC.

# 11. Pro Forma Analysis

In our pro forma analysis we estimate and argue for our forecasted values for Mr. Green in the explicit period and also in the terminal period.

## 11.1 Explicit Forecasting Period

Mr. Green has during the last couple of years had a spiking trend in revenue growth, although from low levels, which has made them the fourth highest grossing company within the OGI out of the listed firms on the Swedish stock exchanges. In 2015, they showed revenue growth of 20%, compared to the European overall industry, which grew about 10.9% according to Market Line estimates (MarketLine, 2016). Mr. Green's CEO reaffirms their goal to continue to grow at a faster pace than the market, which is projected to grow at an estimated CAGR of 9.9% until 2020. We do believe that Mr. Green will be able to achieve this goal, although just by one or two percentage points above the projected market growth, which can be seen in Exhibit 3 in section 4 covering the Global online gambling market. We believe that Mr. Green's superior level of growth over the industry average is likely to gradually stagnate between 2017-2020. As previously mentioned in the company description and target analysis, we believe that there are plenty of strong revenue drivers for Mr. Green going forward. The most vital include increased market share on re-regulated markets, a well-developed and award-winning mobile platform to meet customers increasing demand, an active M&A-strategy and lastly the sports book offering to be launched in 2016 furthermore diversifying its product portfolio of gambling services.

It might occur aggressive to some, to predict Mr. Green to grow at a faster pace that industry estimation considering the risks that the industry wide regulatory transformation could involve. Another strong factor that makes us believe in Mr. Green to produce supreme growth in revenue is their award-winning mobile application and the fact that they generate a large portion of total revenues from bets placed on mobile devices. Mr. Green predicts in the Annual Report 2016, that gambling via mobile devices is to increase with 23% in Europe during 2016 (Mr. Green, 2016). As they appear as one of the market leaders within this segment, we believe positively impact GWR growth.

Looking at the historic EBITDA-margin for Mr. Green we can see it has been steady around 20%, excluding *items affecting comparability*. The comparability items are mainly made up out of the Austrian tax provisions, which have caused the EBITDA-margin after comparability items to decrease. However, since these provisions are precautionary measures and retroactively compounded from previous years (Mr. Green, 2016), going forward these unusual items are projected to gradually decrease and will only affect the current year. Also, as time goes this issue is projected to be resolved, and we project that the EBITDA-

margin with *items affecting comparability* will steadily increase towards 16% according to our estimations.

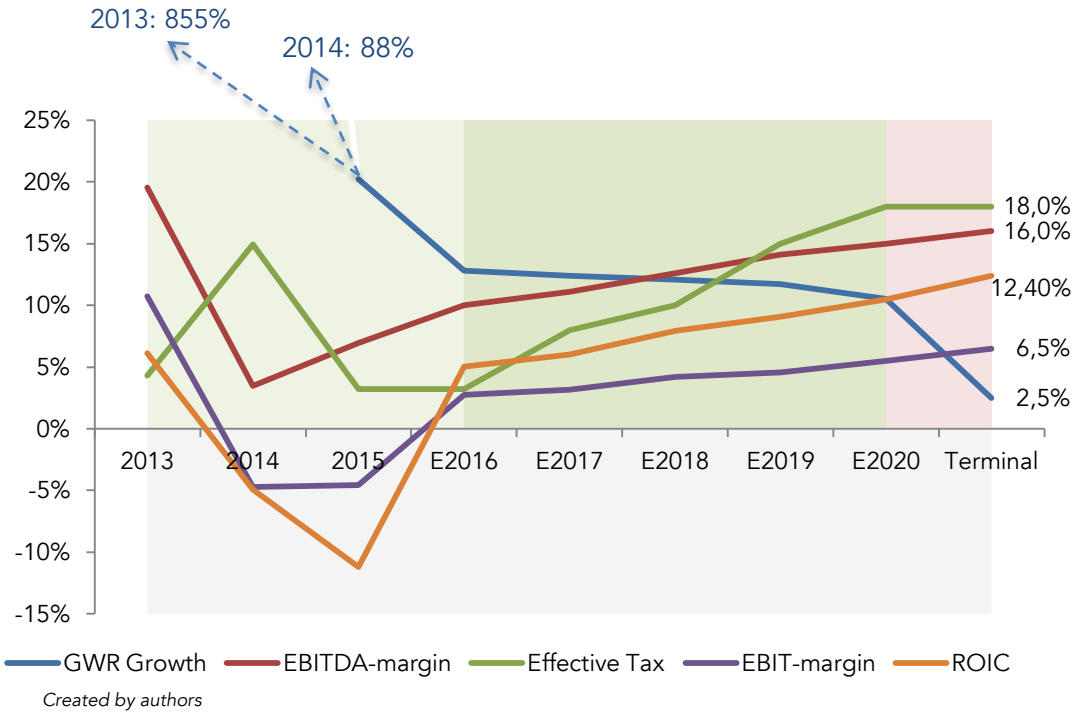
We have used the historical average depreciation and amortization rate from the three most recent years, all the years Mr. Green been listed, which has been around 7-8% of Mr. Green's assets. We have been conservative in predicting the tax rate development for Mr. Green. Again, looking historically, the company has paid around 5% in taxes. However, due to the ongoing re-regulation around Europe, we have taken this into consideration and increased the tax rate gradually as we believe increases in tax rates will progressively affect Mr. Green. A current case is the Netherlands, where industry news reporters SBC cites industry experts as well as the Dutch parliament reporting that they are to settle on a tax rate between 20-29% on GWR at some point in 2016-2017 (SBC News, 2016). Our estimation of future tax rates can be seen in Exhibit 25 below.

We predict that Mr. Green's net working capital and intangible and tangible assets will remain at an historical average level in relation to revenues, and as we see continued revenue growth development so will these balance sheet items.

Whether or not Mr. Green will decide to distribute dividends to shareholders or reinvest in developing activities is difficult for us to predict at this point. We believe that a large portion will be retained within the firm to establish a cash position for future acquisitions as well as to invest in technology and R&D. Mr. Green's CEO states in the Annual Report 2015 (Mr. Green, 2016) that they estimate the leverage effect to be substantial to reinvest investments and accelerate growth further. However, we also assume that dividends will be paid out in the future, as it has been in the past and lies in line with Mr. Green's dividend policy that dividend or repurchases of shares are means of distributing cash flows to the owners (Mr. Green, 2016). However it does not affect our forecasting assumptions more than notably.

We also make the assessment that Mr. Green will continue to build up a cash position and not take on any interest bearing debt to finance acquisitions or other operating activities. This further results in a capital structure to remain stable and that financial expenses will remain at historical levels. In Exhibit 25 below, we show both the historical development as well as the forecasted values in the explicit and terminal period of some of the key financial forecasting measurements; GWR Growth, EBITDA-margin, tax rate, EBIT-margin and ROIC.

***Exhibit 25:*** *Mr. Green in the Historical, Forecasted Explicit and Terminal Periods*




*Created by authors*

The reason why ROIC is increasing, can be explained by the GWR growth is increasing faster than the underlying growth in the net operating assets. This, in turn, increases the turnover of invested capital. Also, since we do assume that the item that affects comparability is an unusual item and will be lower for every year, hence that the tax issue in Austria will become lower and lower, since it will only affect the present year and not any previous years as it has done in 2014 and 2015. This has a positive effect on the EBITDA margin and also the NOPAT, this makes the profit margin to increase. As is confirmed by Equation 11, ROIC is a function of the profit margin and the turnover rate of invested capital, this increases the ROIC.

## 11.2 Terminal Forecasting Period

In the terminal period, we have followed the estimations from of OECD for growth in the European region, and set a total revenue growth of 2.5%, which is just slightly above the OECD estimation of 2.3% for the European region between 2020-2030 (OECD, 2016). We believe the market will at some point after the explicit forecasting period stagnates and growth to decline. However, the OGI is still in its early stages and macroeconomic factors such the increased availability of Internet connection in all parts of the world advocate our choice of a higher terminal growth percentage than what OECD estimates.

We further estimate that profitability measures of EBITDA and EBIT will remain stable at 16% and 6.5% respectively. As a consequence of realizing benefits mainly from economies of scale and technological improvements, we also estimate that marketing costs and thus Cost of Goods Sold (COGS) will remain at historical average levels in relation to generated GWR.

The future development of tax levels for unregulated markets becoming regulated as well as due to re-regulation of already regulated markets, will be extremely important to industry profitability in general and for Mr. Green specifically. While some markets are likely to imply tax-rates well above 20% (SBC News, 2016), a reasonable assumption we make is that the average will end up between 15%-18% in a couple of years as other markets will remain at very low levels, in comparison. With this in mind we set the tax-rate at 18% for the terminal period. Lastly, we will assume a constant WACC as Mr. Green's target capital structure is likely to remain solid and no components are to change in a dramatic fashion.

### 11.2.1 M/B Premium

In order to find a fair value for the M/B premium, a few comments are in order. The operating peer group within the OGI provides us with an average M/B ratio of 9.4, which we believe to be too high for the particular case of Mr. Green. If we look at the historical data for the company, we observe that Mr. Green's M/B ratio has been much lower. It has increased over the years going from 1.6 in 2013 to 2.6 in 2015. We have taken the historic M/B ratio of Mr. Green and the average M/B ratio of their peer operators and calculated an average between them and arrived at a M/B premium of 3.85, which we think is fair. It is set slightly above Mr. Greens historic M/B ratio but at the same time well below its peers'. The methodology behind this approach can be found in section 3.4.3.

# 12. Valuation

In the previous chapters, we have built an informational and analytical foundation to be able to perform a valuation of Mr. Green. We have carried out a strategic industry analysis and an evaluation of Mr. Green in particular. From the financial statement analysis, we have concluded that revenue growth is the most important value driver for Mr. Green, while items affecting comparability are destroying value for the firm, since it fluctuates heavily from year to year.

In section 3, we explained the valuation methodology and the practical implementation of the two valuation models we have chosen to work with in our thesis: The Discounted Cash Flow model and the

Economic Value Added model. As these models contain features that are based on subjective assumptions to some extent we have conducted a "reality check" of the valuations obtained by also using a multiple analysis comparing the other publicly traded firms mentioned in our thesis. We will further elaborate on criticisms of cash flow models in section 18 (Our thesis in retrospect).

## 12.1 Valuation DCF

As mentioned in the valuation methodology Section 3.6, we have used two methods for calculating the terminal value included in both cash flow models used. We have used Gordon's growth model and a second model involving a fair market-to-book ratio in order to calculate our continuing value term. Since Gordon's growth model has some limitations, it is only valid in a setting where the appropriate discount rate is sufficiently far from the growth rate. The market-to-book value method does not contain this limitation. For both models, we have used an explicit five-year forecast period of 2016-2020 and then applied a valuation of the terminal value. The values of the explicit and terminal forecasting periods can be seen in Table 5 below.

***Table 5:*** *DCF Valuation using Gordon's Growth and Fair M/B Value*

| | Gordon's growth model | | Fair market-to-book value | |
|---|---|---|---|---|
| | Value | Present value | Value | Present value |
| Explicit period | 59 785.0 | 48 632.1 | 59 785.0 | 48 632.1 |
| Terminal value | 1 746 863.1 | 1 305 796.8 | 1 706 087.6 | 1 275 316.7 |
| Enterprise value | | 1 354 428.8 | | 1 323 948.8 |
| Cash - Interest bearing debt | | 190 281.0 | | 190 281.0 |
| Equity value | | 1 544 709.8 | | 1 514 229.8 |
| Number of shares | | 35 849.4 | | 35 849.4 |
| Share price | | 43.09 | | 42.24 |

*Created by authors*

In both models, the sum of present values from the explicit forecasting period (year 2016-2020) is 48.63 MSEK in present value terms. For Gordon's growth model, the greatest value of the FCFF is found in the continuing value period with a present value of 1 305.8 MSEK, which represents 85% out of the total equity value. Together, this yields an enterprise value of 1 354.4 MSEK. As Mr. Green has no interest bearing debt but a substantial cash position, they have a positive net interest bearing debt item as can be seen in Table 5 above and we can thus add it in order to arrive at the final estimation of the equity value, which is 1 544.7 MSEK. Given the 35.849 million shares outstanding, the DCF valuation method using Gordon's growth model to value the terminal value item, implies a share price of 43.09 SEK. Our share

price of 43.09 is equivalent to an 8% decrease from 46.9 SEK as of December 30th 2015. The ending multiples can be viewed in Table 6 below:

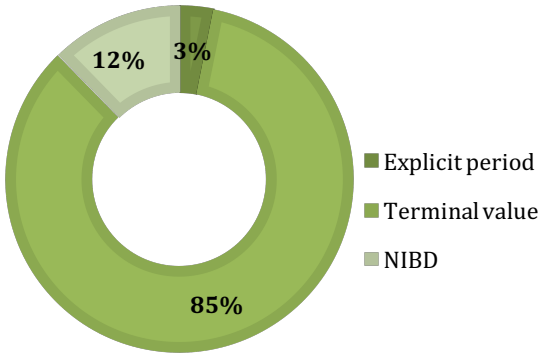
***Table 6:*** *Ending Multiples using Gordon's growth and Fair M/B Value*

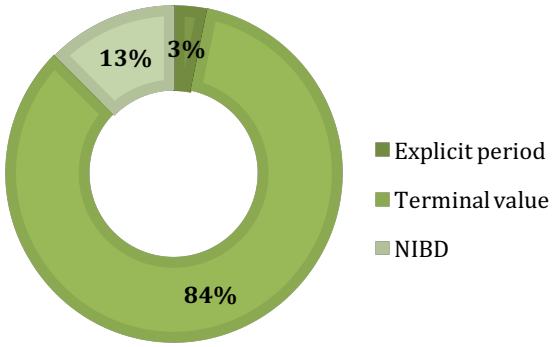
| Model | EV/GWR | EV/EBITDA | EV/EBIT |
|---|---|---|---|
| DCF- Gordon's | **0.95x** | 5.94x | 14.6x |
| DCF- Fair M/B | **0.93x** | 5.81x | 14.3x |

*Created by authors*

Given a fair market-to-book premium of 3.85 and using the methodology as described above, 84% of the value comes from the terminal term, equivalent to 1 275.3 MSEK in present value terms. Summing up these items yields an enterprise value of 1 323.9 MSEK. Again, since the company has no interest bearing debt but instead a net cash position of +190.281 MSEK we can add it to the EV to get our equity value of 1 514.2 MSEK. The fair market-to-book method then implies a share value of 42.24 SEK equivalent to a decrease of 10% from the level of December 30th 2015. Out ending EV/EBIT multiple is 14.3. As mentioned before, the M/B approach is an approach we use in addition to the DCF as a comparison, but will not put as much weight on analyzing. A summary of how much each part contribute to the whole market value of equity is displayed in Exhibit 26 below.

***Exhibit 26:*** *Contribution Split to Total Value of Equity*




***Left panel:*** *DCF with Gordon's Growth model.*
*Created by authors*

***Right panel:*** *DCF with M/B Premium model.*
*Created by authors*

## 12.2 Valuation EVA

In the same fashion as the DCF model, the EVA valuation is performed using the two different calculations of the terminal value term. The values of the different periods can be seen in Table 7 below.

***Table 7:*** *EVA Valuation Using Gordon's Growth Model and Fair M/B Value*

| | Gordon's growth model | | Fair market-to-book value | |
|---|---|---|---|---|
| | Value | Present value | Value | Present value |
| Explicit period | 58 220.5 | 45 003.6 | 58 220.5 | 45 0036 |
| Terminal value | 1 148 977.0 | 858 871.2 | 1 706 087.6 | 1 275 316.7 |
| Net operating assets | | 450 554.0 | | 450 554.0 |
| Enterprise value | | 1 354 428.8 | | 1 770 874.3 |
| Cash - Interest bearing debt | | 190 281.0 | | 190 281.0 |
| Equity value | | 1 544 709.8 | | 1 961 155.3 |
| Number of shares | | 35 849.4 | | 35 849.4 |
| Share price | | 43.09 | | 54.71 |

*Created by authors*

As we declared in the valuation methodology section 3.6, we follow Petersen and Plenborg's (2012) approach which states that all the valuation models rest on the same underlying assumptions. As a result, the DCF and the EVA model using Gordon's growth model should theoretically yield the same share price. The same cannot be said when using the fair M/B approach. As predicted, we can conclude that they both result in a share price of 43.09 as displayed in Table 5 and 6 above. The full valuation models are accounted for in the Appendix sections A.6 – A.6.4. Ending multiples can be viewed in Table 8 below.

***Table 8:*** *Ending Multiples using Gordon's growth and Fair M/B Value*

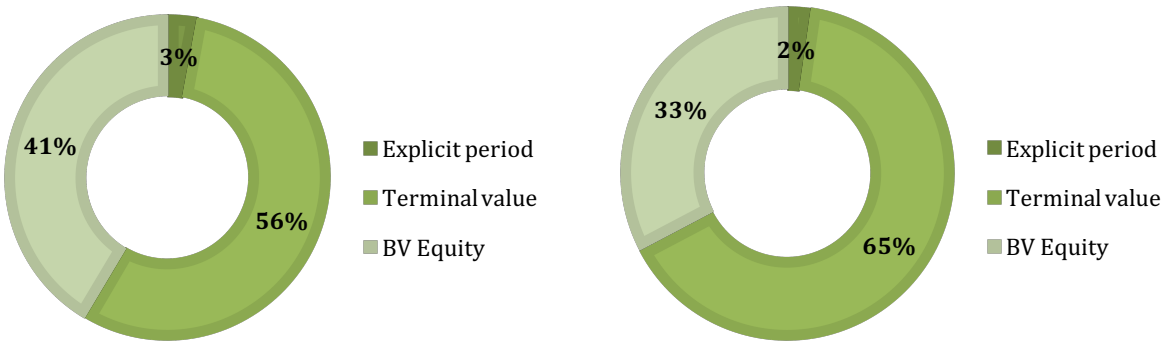
| Model | EV/GWR | EV/EBITDA | EV/EBIT |
|---|---|---|---|
| EVA – Gordon's | 0.95x | 5.94x | 14.6x |
| EVA – Fair M/B | 1.24x | 7.77x | 19.1x |

*Created by authors*

In the EVA model, the explicit forecasting period is seen to contribute to the total value with 45.0 MSEK in present value terms, equivalent to 3% of the total equity value for the Gordon's Growth approach and 2% for the fair M/B approach. As in the DCF model, we can see that the majority of the value is created in the terminal value term. Given the values from the table above and just as we saw in the DCF-model previously, we add the positive NIBD item in order to arrive at the equity value of Mr. Green. After dividing the equity value with the 35.849 million shares outstanding, we have an implied share price of 43.09 using the Gordon's growth approach with and ending EV/EBIT multiple of 14.6. The fair M/B premium yields a share price of 54.71 SEK, which represents an ending EV/EBIT multiple of 19.1. The

result of how much each part contributes to the total value of equity is displayed in Exhibit 27 below.

***Exhibit 27:*** *Contribution to Total Value of Equity*




***Left panel:*** *EVA with Gordon's Growth model.*
*Created by authors*

***Right panel:*** *EVA with M/B Premium model.*
*Created by authors*

## 12.3 Valuation Based on Multiples

We have used the trading multiples of Mr. Green's publicly listed competitors as a comparison to the stock prices of Mr. Green we calculated using the DCF and EVA models. This gave us a chance to contrast classical cash-flow models using an approach that considers the market's view on a company's outstanding equity. Using the harmonic mean as argued by Petersen & Plenborg (2012) of Mr. Green's peers as a multiple, as can be seen in the summary table below, the implied share price of Mr. Green lies within a very wide interval ranging from 48.6 SEK to 159.1 SEK. Not only does this result show that multiples sometimes can be a very imprecise measure for evaluating comparable companies, it also proves that online gambling firms are currently highly valued by the stock market. The input and results of our conducted multiples valuation is displayed in Table 9, 10 and 11 below.

***Table 9:*** *Mr. Green's Key Figures for Calculation of Multiples*

| Company | Mr. Green |
|---|---|
| Date | 12/30/2015 |
| Number of shares outstanding, millions | 35.849 |
| Equity, MSEK | 640.826 |
| Book value per share SEK | 17.88 |
| GWR (Sales) MSEK | 792.599 |
| EBITDA MSEK | 55.131 |

*Created by authors*

***Table 10:*** *Calculation of Multiples*

| Company | EV/GWR | EV/EBITDA | M/B |
|---|---|---|---|
| Betsson | 5.8x | 20.8x | 6.8x |
| Unibet | 5.6x | 25.7x | 9.4x |
| Cherry | 3.5x | 51.6x | 11.9x |
| Harmonic Mean | 4.7x | 28.2x | 8.9x |
| Median | 5.6x | 25.7x | 9.4x |

*Created by authors*

***Table 11:*** *Mr. Green Implied Share Prices Based on Multiples*

| | Price based on EV/GWR | Price based on EV/EBITDA | Price based on M/B |
|---|---|---|---|
| Mr. Green | 109.5 | 48.6 | 159.1 |

*Created by authors*

### 12.4 Valuation Summary

To summarize our valuation section, we have priced Mr. Green using two different valuation models namely the DCF and EVA model, where we have applied two different approaches for calculating the continuing value term, also known as the terminal value. Our primary valuation model is as mentioned the DCF and the EVA model using Gordon's growth approach, which yielded us a share price of 43.09. We also used the fair M/B premium as a second indicator of what the intrinsic value of Mr. Green should be. It resulted in a share price interval of 42.24 – 54.71. Given our valuations of Mr. Green we can conclude that they are fairly priced given the current share price of 46.9 SEK as of 30-12-2015. When using multiples valuation as a second sanity check, it indicates that Mr. Green is undervalued compared to its peers. Based on current trading multiples, Mr. Green should have a share price ranging from 48.6 - 159.1, which is a very wide price interval, but is also telling us that Mr. Green is undervalued compared to its competitors.

## 13. Sensitivity Analysis

The share prices and the valuation of Mr. Green is a combination of several components and subjective assumptions. In order to challenge our assumptions and the sensitivity of our valuation, we have performed a sensitivity analysis.

We started off by investigating to see which effect changes in the different inputs in the WACC calculation has on Mr. Green's share price. Since Mr. Green has no interest bearing debt as mentioned previously, the cost of equity capital is equal to the company's WACC.

***Table 12:*** *Sensitivity Analysis of Mr. Green's Cost of Capital*

| Change | Risk free | Share price | Change | Beta | Share price | Change | MRP | Share price |
|---|---|---|---|---|---|---|---|---|
| 50% higher | 1.49% | 37.80 | 50% higher | 1.25 | 25.45 | + 80 bps | 6.80% | 36.28 |
| 25% higher | 1.24% | 40.27 | 25% higher | 1.04 | 31.91 | + 40 bps | 6.40% | 39.38 |
| Used | 0.99% | 43.09 | Used | 0.83 | 43.09 | Used | 6.00% | 43.09 |
| 25% lower | 0.79% | 45.66 | 25% lower | 0.67 | 60.22 | - 40 bps | 5.60% | 47.59 |
| 50% lower | 0.66% | 47.55 | 50% lower | 0.56 | 82.15 | - 80 bps | 5.20% | 53.15 |

*Created by authors*

In Table 12 above we can see the factors that is included in the equity cost of capital and which affect it has on the share price when we change them, all else equal. From the table one is able to see that changes in beta causes the biggest change in the share price. As we could see in our one-year rolling window estimation of Mr. Greens beta in the cost of capital section, 10.1.3, Mr. Green's beta has fluctuated to a great extent and has at some points in time been both below 0.56 and above 1.25.

As the terminal value period has the most influence over the estimated value, it accounts for 85% of the total value of equity in our DCF-model and 56% in our EVA-model, when we use the Gordon growth for calculating the terminal value. A valuation is a calculation with great underlying uncertainty, including the assumptions related to our forecasting section, the WACC and the future growth of our chosen company. We have therefore chosen to also analyze the sensitivity of the share price with respect to changes in the terminal growth value and the WACC. The only drawback with this sensitivity analysis is that the other parameters in addition to the ones altered in the sensitivity analysis below, are considered constant amounts in the future.

***Table 13:*** *Sensitivity Analysis: Terminal Growth and WACC*

| Term. growth \ WACC | 4,49% | 4,99% | 5,49% | 5,99% | 6,49% | 6,99% | 7,49% |
|---|---|---|---|---|---|---|---|
| 1.00% | 50.89 | 44.42 | 39.42 | 35.43 | 32.18 | 29.48 | 27.22 |
| 1.50% | 56.30 | 48.18 | 42.11 | 37.41 | 33.67 | 30.62 | 28.09 |
| 2.00% | 63.89 | 53.20 | 45.58 | 39.90 | 35.49 | 31.98 | 29.12 |
| 2.50% | 75.29 | 60.22 | 50.21 | 43.09 | 37.76 | 33.64 | 30.35 |
| 3.00% | 94.32 | 70.78 | 56.70 | 47.35 | 40.69 | 35.72 | 31.86 |
| 3.50% | 132.53 | 88.40 | 66.44 | 53.32 | 44.60 | 38.39 | 33.75 |
| 4.00% | 248.24 | 123.77 | 82.71 | 62.28 | 50.07 | 41.96 | 36.18 |

*Created by authors*

In Table 13 above we have constructed a valuation grid based on our sensitivity analysis. The value in the center of the green area shows our calculated share price of Mr. Green. The values surrounding it are where we expect Mr. Green to be if the terminal growth parameter and the WACC is altered with 0.5% percentage points. The valuation grid shows how sensitive the share price is to changes in the terminal growth and/or the WACC. As we can see, the prices are fairly close to our share price in the green areas but as we move further away from the center the bigger variations we get, especially when the cost of capital is low and the terminal growth rate increases. We can see one of the drawbacks with Gordon's growth formula if we look at the values in the bottom left corner. When the cost of capital is close to the terminal growth rate it results in extremely high share prices. This was one of the reasons why we also chose to include a valuation where we calculate the terminal value using the M/B premium.

Since we also use the M/B to value to terminal value in our DCF model and EVA model we look at how sensitive the share price is to changes in the M/B premium and changes in WACC.

***Table 14:*** *Sensitivity analysis, M/B premium and WACC for EVA-model*

| M/B premium \ WACC | | 4.49% | 4.99% | 5.49% | 5.99% | 6.49% | 6.99% | 7.49% |
|---|---|---|---|---|---|---|---|---|
| Decrease with 30% | 2.96 | 46.36 | 45.40 | 44.47 | 43.57 | 42.69 | 41.83 | 41.00 |
| Decrease with 20% | 3.21 | 49.71 | 48.67 | 47.66 | 46.68 | 45.73 | 44.80 | 43.90 |
| Decrease with 10% | 3.50 | 53.59 | 52.46 | 51.36 | 50.30 | 49.26 | 48.25 | 47.27 |
| Used | 3.85 | 58.32 | 57.08 | 55.88 | 54.71 | 53.57 | 52.46 | 51.38 |
| Increase with 10% | 4.24 | 63.50 | 62.14 | 60.81 | 59.52 | 58.27 | 57.05 | 55.87 |
| Increase with 20% | 4.62 | 68.58 | 67.10 | 65.66 | 64.26 | 62.90 | 61.58 | 60.29 |
| Increase with 30% | 5.01 | 73.81 | 72.20 | 70.64 | 69.12 | 67.65 | 66.21 | 64.82 |

*Created by authors*

We have again constructed a valuation grid, Table 14. The value in the center of the green area shows our share price of Mr. Green. When we change the WACC with 0.5% percentage points and simultaneously change the M/B premium with ten percentage points at a time, we can see from the table above that changes in M/B premium and WACC does not affect the share price of Mr. Green to the same extent as changes in the terminal growth rate, as we saw in Table 13. From the analysis above we can conclude that the choice of the terminal growth rate with respect to the WACC is very crucial when it comes to estimating the share price.

# 14. Synergies

The below analysis and valuation of potential synergies will make up one of the cornerstones of our thesis. Synergies is defined as the added value generated by combining two companies, which would not have been possible to generate if the companies had operated separately (Damodaran, 2005). We have followed the approach from Damodaran and divided the synergies into operational synergies and financial synergies.

## 14.1 Operating Synergies

We start with estimating potential operating synergies. Operating synergies enable a company to maximize its profits from existing assets, increase the growth of a company or both (Damodaran, 2005). Operating synergies can be classified as either revenue synergies or cost synergies. We further divide the operating synergies into three categories: short, medium and long term. Estimating synergies is by all means no exact science but rather accompanied with degrees of uncertainty. We expect the short and medium term to be the least uncertain in comparison with the long term estimation of operational synergies. The combinational synergies that we defined in section 3.2.4 and could appear post-merger will chiefly become evident as a result of economies of scale in this case and we believe, along with McKinsey & Company (2010), that these are easier to quantify than transformational synergies. In contrast, transformational synergies that we predict could be generated in a more long term perspective are, in line with McKinsey & Company (2010) and our description in section 3.2.4, more complex to foresee. Traditionally, this type of synergies can come from unlocking previous constraints of a business model. We predict that such possibilities could also potentially be revealed, as Betsson and Mr. Green will now expand to reach a geographically wider area with more diverse customers and be able to offer a wider range of online gambling services.

### 14.1.1 Short Term

In a scenario where Mr. Green is to merge with Betsson there are some operational synergies that we categorize as short term and could be realized within the first one-two years. First, there are operational cost synergies to be realized from merging both head and local offices where fixed expenses such as rent and IT-support functions could be reduced. These would be strong examples of operational cost synergies made possible through economies of scale. We believe that while the just mentioned cost synergies might be of minor importance in terms of capital saved, operational benefits that not necessarily can be quantified into cost reductions can be of great importance for future operational agility and organizational structure. Having central functions such as IT-support, marketing, finance and HR-departments under the

same roof could streamline internal communication and operations and make way for further growth. In the below sections, we will discuss and quantify in more detail what synergies we deem is possible to generate.

We estimate that there are cost reductions related to compensation to be found realized from the M&A deal between Betsson and Mr. Green. An overview of the head count of the two sets of executive management and board of directors can be seen in Table 15 below. Since Mr. Green will be vertically integrated under Betsson's corporate umbrella, we do assume that central functions of the Chairman, CEO, CFO and Head Counsel are such positions that could not be combined or eliminated. Since Betsson's corporate group is organized such that several sub entities operate under Betsson independently, each entity requires a management structure with central functions. However, we think it is a realistic assumption to make that one board member from each company could be left out in the merged firm. With an average board member compensation per year (excl. of top management and chairman) of 469 200 SEK for Betsson and 1 064 000 SEK for Mr. Green, we assume the total executive compensation that could be reduced equals 1 533 200 MSEK per year. The overview of calculations is displayed in Table 16 below.

***Table 15:*** *Overview of Executive Management and Board of Directors Head Count*

| Executive Management and Board of Directors | | |
|---|---|---|
| **Position** | **Betsson** | **Mr. Green** |
| Chairman | 1 | 1 |
| Board members | 5 | 4 |
| CEO | 1 | 1 |
| CFO | 1 | 1 |
| Head Counsel | 1 | 1 |

*Created by authors*

***Table 16:*** *Overview of Executive Management and Board of Directors Compensation*

| Compensation Scheme *TSEK* | Betsson | Mr. Green |
|---|---|---|
| Board of Director's Total Compensation | 10 815 | 4 888 |
| Other Employees Total Compensation | 476 059 | 83 974 |
| Average comp. Board members excl. Chairman | 469 | 1 064 |
| **Total** | 1 533 | |

*Created by authors*

While synergies related to compensation cuts for executive management and board members are not to be considered a major potential reduction of costs, we have estimated that there are more potential to reduce

salaries from regular staff employed at local offices. Overlooking the employment spread in the Appendix section A.7, we can see that the two common countries where Betsson and Mr. Green both have employees are Sweden (where Betsson have 123 employees and Mr. Green have 29) and Malta (where Betsson have 760 employees and Mr. Green have 129). We therefore consider possible, the merge of functions and offices in these two countries. In table 17 below, we can overview average market salaries collected from Sweden (Unionen, 2015) and Malta (Times of Malta, 2015), with representative employee positions we assume could be found in each office.

As many functions and responsibilities would overlap in a situation where Betsson and Mr. Green merge offices, we estimate that 10% of the average staff responsibilities and positions in the Swedish office and in the Maltese office could be left out. If we multiple the average number of staff to be left out with the average representative salaries displayed in Table 17 below, we could therefore estimate compensation expenses to be lowered with a total of 38 296 800 SEK for Betsson and 6 802 530 SEK for Mr. Green amounting to about 45 099 330 SEK per year in cost reduction. It is also plausible that such operational improvements could be further extended and employee structure to be even more streamlined in the future, however in the short term we assume the above discussion to be realistic and that the synergies leading to compensation cuts are empowered through economies of scale.

***Table 17:*** *Overview of Executive Management and Board of Directors Compensation*

| Employee compensation | | |
|---|---|---|
| **Representative Salaries in Sweden (SEK)** | | |
| Administrator | 300 000 | |
| Key Account Manager | 456 000 | |
| IT System Developer | 360 000 | |
| **Average** | **372 000** | |
| **10% Cut in Staff** | **Betsson** | **Mr. Green** |
| | 4 575 600 | 1 078 800 |
| **Representative Salaries in Malta (SEK)** | | |
| Analyst | 504 900 | |
| Software Developer | 367 200 | |
| Project Managers | 459 000 | |
| **Average** | **443 700** | |
| | **Betsson** | **Mr. Green** |
| **10% Cut in Staff** | 33 721 200 | 5 723 730 |
| **Total compensation cut** | | |
| Betsson | 38 296 800 | |
| Mr. Green | 6 802 530 | |
| **Total** | 45 099 330 | |

*Source: Annual Reports, Betsson & Mr. Green*
*Created by authors*

In our opinion, in addition to direct cost reductions, there are also operational synergies in terms and functional benefits and organizational structure to be considered when combining office locations in Sweden and Malta. Both Betsson and Mr. Green lease their office locations in Sweden and Malta, and there are thus no tangible asset items related to offices registered on their balance sheets. There are cost items related to leasing of offices in their income statements, however given the low degree of detail published regarding rents or leasing agreements, we are not able to make any further analysis in quantifying with how much they would be able to reduce costs. We also acknowledge there would be costs associated with integration and implementation of new systems etc, however we assume that the costs of integration would be compensated by the operational synergies generated from merging of offices.

While this limits us to a certain degree where we are not able to estimate cost reductions related to merging of offices, we want to both clarify and amplify that, in our opinion, operational intangible synergies such of functional agility and streamlined business and IT-functions could be much greater than direct cost reductions. In line with what we defined in the Theory section 3.2.4, we claim that there could be transformational synergies to be utilized. We foresee operational benefits when IT-support, business support, software development and other analytical and system related functions, that are very important to an online gambling firm, are established in the same office vicinities. Furthermore, as we will argue more clearly in the long term synergies part, creating a robust and streamlined organizational structure is key when the firms approach new markets and develop new products.

We want to make clear the acknowledgement that while the estimation of potential synergies might be relatively true in theory out when preparing and making calculations before an acquisition, while the actual integration and implementation has to be flawless and could end up not being as easily executed as predicted. Below will follow valuable insights we gathered from previous research and the M&A industry.

- Strategy consultant Bain & Company reported in their study "*Why Some Merging Companies are Synergy Overachievers*" in 2014, that overestimating synergies from two combined companies is the second biggest cause of a disappointing transaction. The main overall reason was failure in the due diligence process, according to 352 global executives partaking in the survey conducted by Bain & Company.

- Deloitte (2015) reports in an analysis projecting the outcome of M&A-deals in 2016 that companies are committed on delivering 3-4% out of the total transaction value in synergies.
- According to McKinsey & Company (2010), about 42% of the time expectations of potential synergies post-merger was inadequate in providing a realistic integration plan to actually capture all potential value creation. They also take notice of that, restricting integration and utilization of synergies to only the ones projected in the estimation period pre-merger could also be an unwise mistake that leaves out additional unrevealed value creation to shareholders.

Given the insights from industry expert firms above, we like to consider our approach in estimating and quantifying possible operational synergies to be conservative. We do realize some of the common pitfalls and that overestimations are sometimes done and we consider our estimation to be realistic.

### 14.1.2 Medium Term

Marketing costs make up a large portion of an online gambling firm's income statement, especially in the early growth stages of a firm's lifetime when attracting new customers is a vital process to build up a stable stream of revenues. For Betsson, marketing costs totaled 752.920 MSEK in 2015 equivalent to 20.2% out of total GWR. In Mr. Green's case, marketing costs amounted to 287.2 MSEK in 2015, equivalent to 36.2% of revenues for the year. From analyzing the income statements of the other firms also mentioned in this thesis, it is clear to us that costs related to marketing are the overall highest cost items.

We predict that marketing skills could be combined and administrated more efficiently to realize operational cost synergies on a medium term basis. Furthermore, this would benefit the work on penetrating new markets where commercials and advertisements could effectively be adjusted to match local markets. It creates more confidence for customers in other countries to view commercials and other information material in their local languages. In a report published by the European Parliament (European Parliament, 2006) called *Consumer Confidence in the Digital Environment*, they list some of the aspects in an ideal online environment on international markets to, among other thinks, include:

- Websites should be clearly laid out and designed to deal with local differences e.g. address differences and should include clear and detailed descriptions of the goods.
- The Website should be in the local language.

The study also refers to other key factors related to consumer confidence in B2C e-commerce to also

include the nature and impact of marketing, site quality and user web experience (European Parliament, 2006).

We believe that the above discussion backs our argument that Betsson and Mr. Green can utilize each other's marketing skills in order to reach new markets and approach local customers efficiently. We have previously described in the company description section, that, as Betsson is the second largest online gambling company on the Nordic market and as their largest segment is casino services, it is clear that they have a strong market position within this segment. Since Mr. Green currently is an operator focusing only on casino services, we believe they can help Betsson to achieve additional competitive advantages and further strengthen their casino offering. Furthermore, as also described previously, Mr. Green is to launch a sports book service in 2016. As Betsson is a particularly strong player in the sports betting segment, we believe that Mr. Green can significantly benefit from Betsson's knowledge post-merger. We have previously underlined our opinion that, going forward, the firms that will thrive in the OGI are the ones that can further strengthen their competitive advantages, since there are many niche firms around that will specialize on other segments.
We are also influenced by a report from Duke University (Duke University, 2015) named *Financial Value of Brands in Mergers & Acquisitions: Is Value In the Eye of the Beholder?* where they argue that economies of scale can be reached when two marketing strategies are combined. While this to a certain degree contain a risk of being a trade-off for targeting and positioning of brands specific to a segment, we believe there is applicability to the OGI and that a target and acquiring firm can utilize each others marketing strengths and achieve economies of scale.

We follow the recommendation of Ernst & Young, whom in their report *Capturing Synergies in Deal Making* (2013) states that synergies do not last forever, and should not be estimated in perpetuity but instead estimated over a finite period. For our medium term estimation of marketing synergies, we have chosen a three year period to estimate. We assume that benefits from combining skills and knowledge as related to marketing can be kept updated for three years before they become obsolete. We have struggled to find quantified information on how companies in previous M&A transactions have been able to realize synergies in terms of quantified cost reductions related to marketing expenses. However, with the reasoning we have provided above we have chosen to make an assumption that the combined firm would be able to eliminate 3% the first year, 2% the second year and 1% the third year from the total marketing costs, due to efficiencies and improved processes. We further assume that the marketing cost will remain at the same ratio in regards to the revenue growth. In our opinion, these measures are to be considered conservative. Our calculations in regards to our medium term synergies can be viewed in Table 18 below.

***Table 18:*** *Operational Synergies: Medium Term*

| Medium Term Synergies | 2015 | E2016 | E2017 | E2018 |
|---|---|---|---|---|
| Growth Rate (MarketLine) | | 9,80% | 10,40% | 10,10% |
| WACC | | 5,88% | 5,88% | 5,88% |
| Discount factor | | 0,94 | 0,89 | 0,84 |
| Betsson Projected Marketing Costs | | 826 704 | 912 681 | 1 004 862 |
| Mr. Green Projected Marketing Costs | | 315 314 | 348 106 | 383 265 |
| Combined Projected Marketing Costs | | 1 142 018 | 1 260 788 | 1 388 127 |
| Estimated Marketing synergies | | 34 261 | 25 216 | 13 881 |
| PV Estimated synergies | | 32 358 | 22 493 | 11 695 |
| Sum 3 Years PV Synergies | 66 545 | | | |

*Created by authors*

### 14.1.3 Long Term

The combined entity consisting of Mr. Green and Betsson would naturally increase their market share. However, to simply increase ones market share does not create value in itself. We believe that the way the two firms will create operational synergies and benefit from each other's strengths will primarily be that they now have an easier access to each other's geographical markets, specific product knowledge and customer bases. In more detail, knowledge and experiences can be shared creating efficient and precise strategies to attract new customers on each respective market. Specifically, Mr. Green having roughly 51% of their revenues generated from within Europe but outside of the Nordics will open up for Betsson to take advantage of their customer base to strategically approach customers on new markets. Furthermore, with Betsson increasing their revenues coming from mobile devices with 105% in 2015 and Mr. Green having won several awards praising their mobile solution we predict the opportunities for creating synergies are good. Additionally, as Mr. Green can be characterized being an online gambling firm offering solely casino applications, Betsson with their strategic acquisitions of Kroon Casino and Oranje Casino in 2015 will benefit from Mr. Green's expertise.

Expertise in product offering and development can also be united and create ways for the separate entities to launch each other's product applications. Mr. Green published in their Annual Report 2015 that they have established plans to launch sportsbook betting services in 2016. It is probable Mr. Green can take advantage of Betsson's knowledge in the sports betting area where they are one of the market leaders in the Nordics.

The three above motives are important factors advocating how the new merged company will be able to

increase their revenues post-merger. With the above discussion on top of previous strategic analysis as a foundation, we also believe that great benefits can come from increased geographical market opportunities as well as diversified product portfolios. BCG published a report called *Divide and Conquer* (2013) that measured historical M&A deals and the synergy potential going forward. The OGI is not represented but we have taken an average from the Gaming and Service industry that yielded in 1.45%. Again we follow Ernst & Young's advice in their report *Capturing Synergies in Deal Making* (2013) and follow their recommendations that synergies resulting in revenue creation does not last forever, and we have thus not discounted potential revenue synergies in perpetuity but instead estimated them over a finite period. We have chosen a five year period (equal to the explicit forecasting period in our cash flow models). In our opinion the momentum of generating additional revenue from new markets and new services can be assumed to carry on for five years. That is, we think the synergy generation from revenue growth will be stronger than what is possible to realize from synergies related to marketing skills resulting in decreased expenses. Also, we find this to be an appropriate time period for this estimation since the market is re-regulating and under constant development. Forecasting further into the future will cause more uncertainty. We will thus, as we have mentioned earlier, follow BCG's report and assume that total revenues of 1.45% additional percentage points can be generated annually during our explicit forecasting period. Our calculations related to long-term synergies can be viewed in Table 19 below.

***Table 19:*** *Operational Synergies: Long Term*

| Long Term Synergies | 2015 | E2016 | E2017 | E2018 | E2019 | E2020 |
|---|---|---|---|---|---|---|
| Growth Rate (MarketLine) | | 9.80% | 10.40% | 10.10% | 9.70% | 9.50% |
| WACC | | 5.88% | 5.88% | 5.88% | 5.88% | 5.88% |
| Discount factor | | 0.94 | 0.89 | 0.84 | 0.80 | 0.75 |
| Betsson Revenue | 3 722 000 | 4 086 756 | 4,511,779 | 4,967,468 | 5,449,313 | 5,966,997 |
| Mr. Green Revenue | 792 599 | 870 274 | 960,782 | 1,057,821 | 1,160,430 | 1,270,671 |
| Combined Revenues | | 4 957 030 | 5,472,561 | 6,025,289 | 6,609,743 | 7,237,668 |
| Revenue synergies | | 71 877 | 79,352 | 87,367 | 95,841 | 104,946 |
| PV synergies | | 67 885 | 70,783 | 73,604 | 76,260 | 78,867 |
| Sum 5 Years Synergies | 367 400 | | | | | |

*Created by authors*

We followed the projected growth rate estimated by MarketLine (2016) and estimated the future revenues for both Betsson and Mr. Green. We have, as mentioned above, applied the 1.45% of estimated synergy generation suggested from BCG's industry report (BCG, 2013), and estimated the additional revenues that could be generated from the combined firm. We applied the new WACC of 5.88% applicable to the combined firm's cash flows, and calculated the PV of revenue synergies to finally sum them up to equal 367 400 TSEK.

## 14.2 Financial Synergies

As we elaborated in the Theory section focused on synergies earlier in our thesis, 3.2.3 Debt Capacity and Tax Benefits, financial synergies are most commonly realized from either an increase in the combined cash flows or from a decreased cost of capital, or a combination of both (Damodaran, 2005). In a situation where Betsson would acquire Mr. Green, we expect the combined firm to experience a less volatile revenue stream as the sources of income will become more diversified, both in terms of geographical origin and in terms of a wider variety of betting services and gaming applications potentially offered. We have conducted an analysis of how the merged firm's WACC could potentially alter as a result of the changing components included in the calculation of the combined firm's cost of capital. The final result is displayed in Table 20 below with further details accounted for in the Appendix A.8.1 – A.8.4.

***Table 20:*** *Calculation of WACC in Merged Firm*

| Column | A | B | C | D | E | | F | | G | H |
|---|---|---|---|---|---|---|---|---|---|---|
| | Weight of EV | Unlev. Beta | NIBD/E | Re-lev Beta | Input | Re | Input | Rd | Cap. Structure | WACC |
| Weight Betsson | 94.35% | 0.79 | 0.06 | | Rf | 0.993% | Rd | 3.95% | D/V 0.054 | 5.88% |
| Weight Mr. Green | 5.65% | 0.83 | 0.00 | | Beta | 0.83 | Tax 5% | 5% | E/V 0.946 | |
| Scaled by Weight | 100% | 0.79 | 0.06 | 0.83 | MRP | 6.0% | Aft. Tax Rd | 3.75% | | |
| | | | | | Re | 6.0% | | | | |

*Source: Betsson and Mr. Green annual reports*
*Created by authors*

We have initially used the individual firm's respective contribution of value (EV) to total EV in column A, to scale the unlevered beta values we have found for Betsson and Mr. Green individually in column B. The unlevered beta equity was accounted for already in the valuation part of Mr. Green to be 0.83, while we have estimated 0.79 for Betsson. Our full calculation and method is displayed in the Appendix section A.8.1 – A.8.2. Having already reformulated Mr. Green's balance sheet into analytical form in the valuation section, we could find that they do not have any outstanding interest bearing debt so we set the NIBD/E to 0. At this point, we have used the same approach in also finding the NIBD/E ratio for Betsson, resulting in 0.06. We have scaled the two ratios by each party's contributing percentage to EV to the combined firm's total in column C. The weighted unlevered beta from column B, has been re-levered with the weighted leverage ratio of 0.06 from column C using Equation 18, to find the adjusted beta to equal

0.83 in column D, which is the beta we will use when calculating the CAPM in column E for the combined firm and in the next couple of paragraphs.

The remaining inputs to calculate CAPM can be viewed in column E. We have displayed the calculations leading up the resulting Re of 6.00% for the merged firm, in the Appendix section A.8.3. This can be contrasted to the Re of Mr. Green, calculated in the Cost of Capital section of 5.99%.

We have settled on accounting for a working tax-rate of 5%, following calculations in the Appendix section A.8.3, where we could implicitly find the historical tax rate applied to Betsson's EBT from the last five years. We have also calculated the cost of debt to 3.95%, with a contributing credit spread of 2.4% estimated synthetically for Betsson via Petersen & Plenborg's Credit Analysis methodology following Standard & Poor's guidelines for credit rating. Full calculations of the cost of debt can be viewed in the Appendix section A.9.

### 14.2.1 WACC of Betsson

We have followed the approach from Petersen & Plenborg (2012) to calculate the WACC as can be seen in Equation 20 below:

*Equation 20*

$$WACC = r_E \times \frac{MV\ Equity}{NIBD + MV\ Equity} + r_D \times (1 - \tau) \times \frac{NIBD}{NIBD + MV\ Equity}$$

Having already reformulated Mr. Green's balance sheet into analytical form in the valuation section, we could find the NIBD. We have now applied the same approach in finding the NIBD for Betsson by reformulating Betsson's financial statements into an analytical version. The detailed reformulated financial statements can be found in the Appendix section A.10.1 – A.10.2.

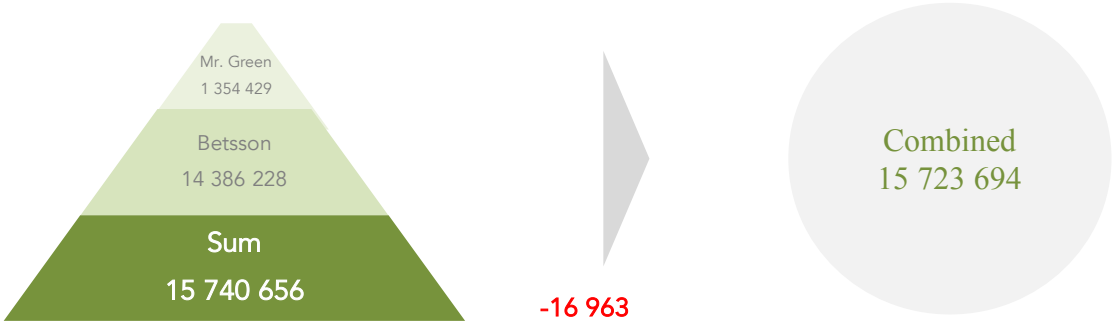
We have then added up the market value of equity of both firms in order to be able to find the final equations marked in the WACC Equation 20 displayed above. Column G has been populated with the total NIBD-to-Value and MVE-to-Value and the final calculation of WACC in column H resulted in 5.88%.

At this point, we think it is vital to also calculate the initial WACC of Betsson before the acquisition of Mr. Green, in order to clearly distinguish if there are any positive or negative financial synergies that

could be yielded from the combined firm. We found that the WACC of Betsson for 2015 was 5.87%, accounted for in the Appendix section A.11. The main contributing factor forcing the WACC of the merged firm higher than estimated for Betsson analyzed stand-alone, is the beta measure. As the unlevered beta is estimated higher for Mr. Green than for Betsson and as the new unlevered beta in Column D will be a weighted average between the two firms, the result will be higher than before.

As the WACC for the merged firm is lower than Mr. Green's initial cost of capital, Mr. Green's future cash flows will be discounted with a lower rate leading to a higher EV. In contrast, the WACC of the merged firm estimated to 5.88% is higher than the initial cost of capital for Betsson, which means that Betsson's future cash flows will be discounted tougher and thus depreciate the total value. As Betsson's contributing cash flows are much greater than Mr. Green's on an annual basis, the net effect will ultimately become negative indicating that the new WACC of 5.88% will actually destroy value for the joint firm. In other words, the financial synergies are deemed to be of negative nature. To support the theory that negative financial synergies could possibly emerge from the acquisition, we have to perform a valuation of the combined firm. As can be viewed in the Appendix section A.12.2, we add Mr. Green's expected future cash flows to Betsson's and discount them using the newly calculated WACC of 5.88%, relying on the same methodology as before using a DCF and an EVA model. The result was in line with the theory we anticipated. As Betsson's cash flows carry a heavier weight, they are discounted heavier in a combined firm scenario. The ultimate proof that negative financial synergies have emerged, can be viewed below in Exhibit 28, where Betsson's EV before the transaction could be estimated to 14 386 MSEK and Mr. Green's EV could be estimated to 1 354 MSEK. Adding them together yields a combined EV of 15 740.656 MSEK. In comparison, if we instead add the firm's cash flows to yield a combined sum of cash flows and discount them with the new WACC, the EV decreased to 15 723.694 MSEK as is displayed in the Appendix section A.12.2. We therefore can conclude that the merger could generate negative financial synergies amounting to -16.963 MSEK.

***Exhibit 28:*** Summing Up EV's and Deducting Financial Synergies (SEK)




*Created by authors*

## 14.3 Summary Synergies

In Table 21 below, we summarized the potential synergies that we have estimated resulting from the M&A transaction of Betsson and Mr. Green. We have taken into account expert opinions from published reports, such as BCG and Bain, and thoroughly investigated the firms' annual reports to take into consideration their segment allocation of revenue and operational strengths, in order to properly estimate the operational synergies as systematically as possible. In situations where we have not been able to find sufficient and satisfying data, we have made, in our opinion, realistic but conservative assumptions in order to arrive at the below result of 480 576 TSEK of potential operational synergies of the combined firm. The overall synergies, both operational and financial, then yields a result of 463 613 TSEK.

***Table 21**: Overview of Operational Synergies*

| Synergy TSEK | Cost / Revenue Item 2015 | Cost / Revenue Item 2015 | Estimated % | Synergies | Type |
|---|---|---|---|---|---|
| **Short Term** | **Betsson** | **Mr. Green** | | | |
| Average Comp. Board Members Excl. Chairman. | 469 | 1 064 | nm | 1 533 | Cost |
| 10% Elimination of Staff Sweden | 4 575 | 1 078 | nm | 5 653 | Cost |
| 10% Elimination of Staff Malta | 33 721 | 5 723 | nm | 39 444 | Cost |
| **Total Short Term Synergies** | **38 765** | **7 865** | | **46 630** | |
| **Medium Term** | | | | | |
| Marketing | | | 3%-1% | 66 545 | Cost |
| **Total Medium Term Synergies** | | | | **66 545** | |
| **Long Term** | | | | | |
| New Geographical Markets + New Products | | | 1.45% | 367 400 | Revenue |
| **Total Long Term Synergies** | | | | **367 400** | |
| **Sum of Total Operational Synergies** | | | | **480 576** | |

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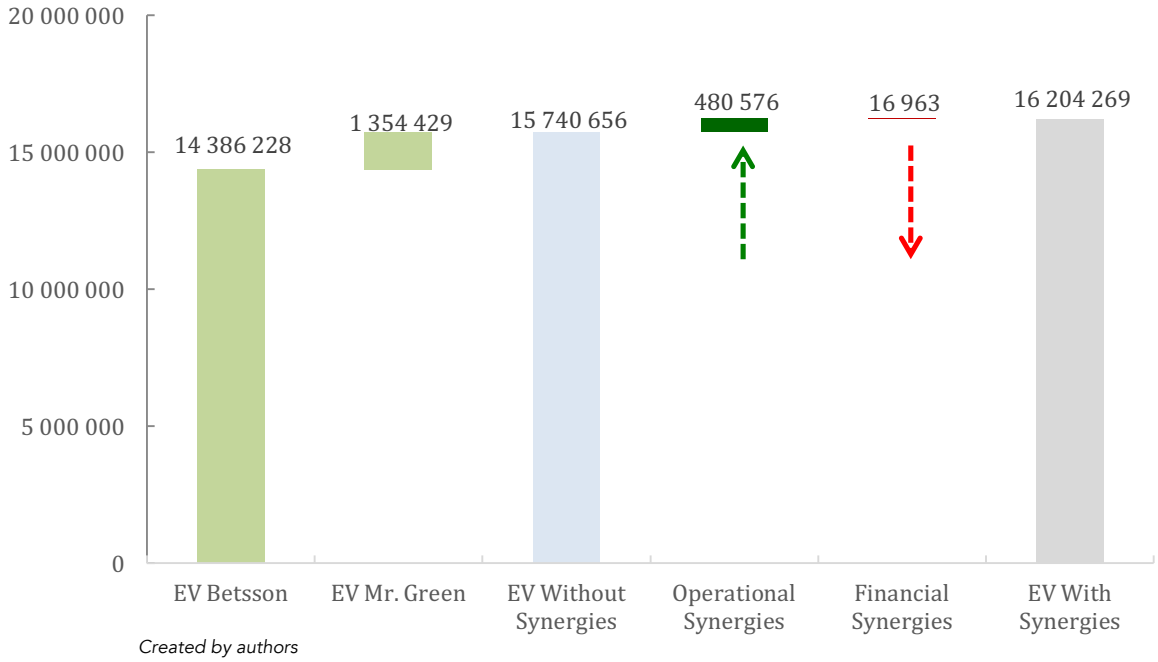
# Section D

In the last and final section of this theses we will summarize all our findings and argue for our thoughts regarding the M&A case. We will also bring up a discussion in section 18, Our Thesis in Retrospect, where we discuss what we could have done differently and some limitations regarding certain assumptions we have made.

# 15. Should Betsson acquire Mr. Green?

Exhibit 29 below illustrates how our estimated operational and financial synergies affect the enterprise value of the combined firm. We have estimated that the all the value in terms of synergies can be created operationally, mainly through cost savings. We furthermore conclude that the result of our analysis of the WACC for the combined firm will result in negative financial synergies of -16 963 MSEK.

***Exhibit 29**: Initial EV's and the Contribution of Synergies to Total EV*




*Created by authors*

Having performed a valuation analysis using the DCF-model and EVA-model we have concluded a fair market value of Mr. Green's outstanding equity of 1 544 709 MSEK which represents a share price of 43.09 SEK. Exhibit 29 above displays Enterprise Values, and since Mr. Green has positive a NIBD position, we add that to find the intrinsic market value of equity. The traditional valuation that we have performed constitutes the foundation for the purchase price we believe would be realistic for Betsson to pay for Mr. Green. In addition, the above analysis of synergies makes us realize that substantial cost benefits can be utilized, which we have incorporated in the calculation of purchase price. However we do realize, as Ernst & Young concludes in their report *Capturing Synergies in Deal Making* (2013) that synergies for revenue creation does not last forever, and we have thus followed their recommendation to not discount potential revenues in perpetuity but instead estimated a finite period of five years (equal to the explicit forecasting period in our cash flow models), where we assume they will be able to realize these benefits.

Having estimated the total potential synergy effect, we will conclude that the resistance point for the target firm Mr. Green, beyond which Betsson could not argue for the acquisition to be economically justifiable is estimated to 2 008.3 MSEK according to the calculations displayed in Equation 21 below.

*Equation 21*

$$Total\ Value\ of\ Mr.Green + Total\ Synergy\ Effects = Betsson's\ Resistance\ Point$$

$$1\,544.7 + (480.576 - 16.963) = 2\,008.3\ MSEK$$

The above realizations associated to synergies in addition to the fundamental valuation of Mr. Green including strategic, financial and industry analysis is, in our opinion, confident arguments advocating that Mr. Green would be a good acquisition for Betsson. In summary, we estimate that the global OGI with a special focus on the European market will continue to grow and that these two companies in particular has a strong chance to outgrow the market. This would be positive for all stockholders. We also think that, as the market is going through major regulatory reforms we think that consolidation will be one of the main success factors for the online gambling companies in order to remain profitable. If Betsson would, in reality, be able to negotiate a purchase price that lies beneath the calculated resistance point, we would advise them to not go through with the acquisition based on our analysis.

### 15.1 Betsson Buying Power

As we have made clear in the Limitations section 1.3, we will not cover an in-depth analysis of the means of financing and payment with which the named acquirer will perform the transaction because, as mentioned, it is beyond the scope of this thesis. As a result, we have chosen to also not consider Betsson's buying power as, in our opinion, we would then move further from our intention with this thesis.

## 16. Our Findings

We have in this master thesis looked closer at the Swedish online gambling industry and the firms within that are listed on the Swedish stock exchanges. As an introduction, we presented our topic by explaining how both the European and the Swedish OGM has evolved through time and what development we can expect ahead. Consolidations have historically been part of this industry's development and a source for many companies to achieve additional growth and a common strategy to approach new markets. Due to the ongoing industry-wide re-regulation, we believe this trend is likely to resume for the years to come.

Following up our introductory and methodology sections, we systematically work through explaining mergers and acquisitions theory including primary motives behind why two companies should merge, as well as valuation theory primarily covering the methods and techniques we have practiced in our thesis.

Before introducing the specific companies, we have described the global OGM in general, how the rules and regulation has affected the market historically and how the new regulation will make it tougher for smaller online gambling companies to survive.

In Section 6, we examine all of the online gambling companies listed on the Swedish stock market, where we describe their nature of operation and perform a brief financial and strategic analysis in order to overview the market participants on the same terms. After which, we present our strategic analysis with the PESTEL analysis framework, in order to assess the attractiveness of the Swedish market in particular. The PESTEL framework enables us to overview the political, economic, social, technological, environmental and legal factors that are affecting the listed online gambling companies in Sweden.

Our view is that the political situation in Sweden in general is quite stable and that the future can be predictable to some extent. Whether or not new gambling regulations will rule through under the current Social Democrats mandate period, of after a shift of power in 2018 at the earliest, the gambling market in Sweden will become subject to change at some point. Most likely, we will follow other countries example by imposing requirements on local licenses and local tax on all GWR. The political risk is thus very linked to the regulatory situation and while changes might become quite substantial, we also assume they can be somewhat predictable for the involved companies and investors.

The economic situation in Sweden in general is to be considered stable. The economic performance has recovered fairly well since the most recent financial crisis and the currently low inflation forcing the Central Bank to lower interest rates is a factor that is advantageous to companies that are applying active M&A strategies involving company transactions. As these transactions at times are partly financed with interest bearing debt, the current economic climate for the online gambling firms considered can be considered as beneficial. Furthermore, as interest rates are kept low, investors are lowering their required rate of return on stocks and households will save money on cost of debt related to mortgages issued from banks. This can make investors more interested in investing in stocks as well as engage in gambling activities.

The social factor we have identified to be most relevant for online gambling companies is population growth. A forecast for year 2050, indicates an estimated population growth for all the Nordic countries,

which in total is expected to have more than 30.9 million people by 2050, an increase of 14%. Europe is expected to rise above 690 million people by 2050, which would represent an increase of 36%. Growth in population will, all else equal, create a larger market for the online gambling companies.

The technological factors that affect the OGI includes the global usage of Internet, mobile and tablet devices. As these technological advancements become increasingly accessible, online gambling companies are likely to also reach an increased number of customers globally. Additionally, the quality of technical skills and other technological advancements will, although they might be expensive develop, boost the interest and appreciation of online gambling services.

Considering the environmental factors usually at risk for international companies, there are not any evident factors that we can identify affecting the environment negatively. Rather, most companies are mentioning in their annual reports their interest and the responsible actions they are taking to prevent more social environmental issues such as addictive habits.

The legal perspective is certainly important to evaluate in the context of the OGM. We think that a major part of future growth possibilities heavily depends on the regulatory development that we will see in the years to come. Further tax implications and mandatory local licensing systems are reforms that might shake the industry in its foundation, however we remain having a positive future outlook on the market and growth potential for the OGI as believe the possibilities will outweigh any regulatory obstacles along the way.

Following the PESTEL analysis we wanted to broaden our view and also investigate the competitive intensity through a bigger European perspective. This was done through a Porter's Five Forces analysis framework. From our analysis we found that the industry has low switching cost and due to the undifferentiated nature that exists within the OGI, rivalry between companies is driven by the fact that companies can expand quite easily since they have a major non-physical aspect in regards to their business models.

The strong escalation of apps for mobile tablets and smartphones has increased the accessibility of online gambling, especially in countries where it is already legal. In these countries the buyer categories are numerous, however since the majority of buyers are individuals with limited financial power, the buyer power is reduced. The industry suppliers tend to be big, especially in the cases when the suppliers are governments, then they have huge supplier power. In the case when governments are the supplier, they

have both financial muscles and an even stronger negotiation power. Physical casinos and betting shops can however still be considered partly as a substitute, with no particular switching costs, to the online gambling industry. However, the offline setting is more frequent in Europe than in the Nordics.

On the basis of having presented our description of the Swedish OGM, provided overviews of each respective company on the Swedish exchanges, the PESTEL and Porter's Five Forces analysis, we could make an argument for the choice of acquirer, which we identified to be Betsson. We chose Betsson as the acquirer due to several contributing reasons. Among them, their strong multi-brand strategy including acquiring, developing and distributing several operators simultaneously and a strong and proven M&A track record. Furthermore, Betsson's scalable business model much thanks to their award winning technical platform Techsson which has proven the ability to integrate newly acquired companies' applications in a successful manner. Lastly, since Betsson has an outspoken vision to grow at a faster pace than the industry, by using both organic growth and acquisition as strategic tools, we felt that they were the most suitable out of the cluster for the role as the acquirer.

We end the section with covering a strategic analysis including a SWOT analysis for Betsson, where we identified their main strengths as proving high profit margins combined with the proven M&A track record largely enabled by their advanced technical platform Techsson. Some of their characteristics we identified as weaknesses was that Betsson is perhaps too concentrated towards the Nordic market, which is one of the most mature markets in Europe and in order to thrive and generate further growth they need to expand further within Europe and also in the rest of the world. We also recognized that a low percentage of their GWR comes from licensed markets. The consequence can thus become that, as more and more countries introduces local license requirements, this will increase the cost of operating in these countries, which in turn will put pressure on Betsson's profitability. We recognized that one of the biggest opportunities for Betsson is that as reforms and increased regulations surrounding the OGM also will raise the entry barriers and hinder younger companies to grab market shares as it will become costly to enter new markets, Betsson can with their size and established brand name survive. In more detail, larger and more mature companies such as Betsson can take advantage of these environmental changes and consolidate with smaller players and benefit from economies of scale. In contrast and what is also important to highlight is that, new re-regulation of the OGI may also cause new moments of risk to Betsson's operations that are at this point in time difficult to predict. As more countries will introduce higher taxes to a level not yet decided upon and further sharpening of regulation, can hurt the company's operations and profitability in the future.

Having chosen Betsson as a realistic choice of target firm and given their specific characteristics, we looked at which company of our chosen peers that could be considered as a suitable target object for Betsson to acquire. Given the identified characteristics from the SWOT analysis that Betsson could potentially benefit from having, we found that Mr. Green should be considered a suitable target for Betsson to consolidate with. The main characteristics we found alluring for Betsson's sake was Mr. Green's market share composition and customer base, specific product offering being especially strong within the casino segment, their advanced access to technology and the attractive current valuation.

To perform a valuation of Mr. Green, we started off by estimating the cost of capital and went on with performing a financial analysis, pro forma analysis to forecast the future performance of Mr. Green. Mr. Green was founded in 2007 but was first listed on the Swedish stock exchange in June 2013 and, as a consequence, they have only released three sets of annual reports. We initiated our financial analysis with reformulating the income statement and the balance sheet of Mr. Green in order to find their operating profitability. Our objective was to identify where value was created to shareholders. We followed the Du Pont framework in order to find the profit margin, turnover rate of invested capital and the return on invested capital. We found that the turnover rate had a positive development over the years, while the profit margin had been negative for the last two years, which had caused the return of invested capital to also be negative.

The profit margin has been negative much in consequence to the large provisions in Austria for the years 2011-2014, provided in the annual reports, leading to a negative EBIT and further on net earnings. Additional provisions for 2014 and 2015 once again led to negative operating profits and net earnings. The 2014 and 2015 provisions are precautionary and budgetary measures taken for the retroactively claimed tax in Austria, however Mr. Green and many other companies has taken the Austrian government to trial to prove that they are in fact not liable for these tax charges. Mr. Green disputes the allegations, referring to Austrian constitution and EU legislation. The trial has as of now no end date in sight, and will thus be settled in the future.

With the reformulated income statement and balance sheet combined with the financial analysis as the foundation, our prognosis for Mr. Green's future performance is neutral in the short term, but with a slightly more optimistic view on the future. We expect the company to continue to outperform the market in terms of growth, as they have done historically and in-line with what they strive for according to their CEO. We estimate further that these unusual safety precaution items such as the provisions in Austria will gradually decrease, at the same time as the tax rate will tend to increase overall. The Netherlands are

predicted by industry experts as well as by the companies themselves to, in 2017, change their tax-laws which will have a negative effect on the online gambling companies. It is anticipated that many countries will follow suit and that the tax rate across Europe gradually will increase, when the online gambling companies are forced to pay local tax on their GWR in the respective country. We estimate that this will overall increase the current tax rate from approximately 5% to figures closer to 20%.

When valuing Mr. Green, using the DCF- and the EVA-model, we calculated the equity value to be 1 544.7 million SEK, which implies a share price of 43.09 SEK and further an EV/EBIT multiple of 14.6x We essentially used the same models but instead calculating the terminal value term with a fair market-to-book premium approach as a complementary method to Gordon's Growth model. That yielded an equity value ranging from 1 514.2 – 1 961.2, which resulted in a share price ranging between 42.24 – 54.71 SEK and an EV/EBIT multiple range of 14.3x – 19.1x. However, as we stated before, we do not to put as much weight on this approach, since the industry standard is to calculate the terminal value using the Gordon's growth formula. However, we do feel that it is a good alternative approach and offers a complementary methodology since we can look at our valuations from another perspective.

Thereafter, we performed a sensitivity analysis of our estimated share price, and found, not surprisingly, the share price to be very sensitive to the beta measure. We can also conclude that the share price is a lot more sensitive to the terminal growth value in respect to WACC, compared to the fair market to book premium in respect to WACC that acts a lot more stable.

In order to evaluate if the consolidation is justifiable from an economical perspective, we estimated the operational synergy effects that could potentially be realized in this consolidation. We started by dividing the synergies into operational and financial synergies and further split the operational synergies into short term, medium term and long term. We argued that the short-term and medium term synergies could be estimated with more certainty, compared to the long term synergies. The greatest short term synergies are cost synergies mainly related to salaries, compensation and administrative expenses. In the medium term, we also are keen on elevating cost synergies, but here related to marketing costs. Since the consolidated company will increase its market share both in the Nordics as well as in the European region, we believe that the long term revenue synergies will be established through approaching new geographical markets and a more diversified product offering. It is worth to keep in mind however that long term synergies in general and the revenue synergies in particular are more difficult to evaluate, hence it is important not to overestimate these figures. The total operational synergy effects add up to equal 480.576 MSEK.

We then looked at the financial synergies, since the WACC for the merged firm was lower than Mr. Green's initial cost of capital, Mr. Green's future cash flows will be discounted with a lower rate leading to a higher EV by itself. As Betsson's contributing cash flows are much greater than Mr. Green's on an annual basis, the net effect will ultimately become negative. As Betsson's cash flows carried a heavier weight, they are discounted heavier in a combined firm scenario, the financial synergies are estimated to be – 16.963 MSEK. Summing the operational synergies with the financial synergies we arrive at an estimation of total synergies to equal 463.613 MSEK.

A merger or acquisition deal will only add value if the companies engaged in the transaction are worth more together than they are separately. We have identified enough synergies and possibilities to gain at least 463.613 MSEK in effect and thus conclude that, in our opinion, the entities are valued higher together than they are apart. When the sum is added to the stand-alone value of Mr. Green, we find the maximum price that we would recommend Betsson to pay for Mr. Green in order to profit on the merger. We call this the resistance point of Mr. Green and thus the value is 2 008.3 MSEK, which would equal a share price of 56.02 SEK given that Mr. Green does not issue any new shares.

If the actual price of Mr. Green is below Betsson's resistance point, we believe the consolidation could add value and therefore be an economically justifiable investment for Betsson.

# 17. Conclusion

With section 16 above summarizing our findings, we would like to present our concluding thoughts from our thesis. In our view, the online gambling industry is exciting and will be able to show strong further growth in the years to come. Even though the companies listed on the Swedish stock exchanges we have mentioned in our thesis are to be considered early adopters that generate most of their GWR from the Nordics, we believe some of them in particular are to successfully survive in this competitive landscape in the future.

We found that one of the most fundamental market drivers is revenue growth. However, it is clear to us that the industry has some major transformational challenges ahead, some of which will put exceptional pressure on the firms we have included in our thesis. In particular, we have throughout this thesis declared our concern that the ongoing regulation of the market. Local countries are to, among other things, introduce licensing systems and accompanying country specific tax rates that most likely will end up much higher than the current tax brackets in Malta and Gibraltar where most online gambling firms currently reside. Having taken this into consideration, we have tried to remain conservative in our view

when predicting the development of tax expenses that will hurt profitability of all industry players at some point. However, it is also our definite belief that the firms that are able to embrace benefits related to economies of scale and further generate growth in top-line revenue through new technological developments and markets, will continue to strive in this fairly young industry.

With Betsson's historical track record demonstrating an ability to acquire companies and efficiently integrate them onto their technical platform Techsson, it is our belief that they will be able to resume this strategy to pursue additional growth beyond industry expectations. Given the main corporate characteristics of Mr. Green, we further think they would fit fairly well to merge into Betsson's corporate structure. Specifically, we believe that Mr. Green's focus on casino services and geographic concentration on the Nordics and countries within EU excluding the Nordics, will empower Betsson to build on their strengths as well as further on size, which we have identified as particularly important strategies in this industry. Additionally, as we also see a structural shift with consumers previously using computers to more tablet and mobile applications, Mr. Green with their award winning mobile solution and increasing share of revenue originating from mobile game win, stand out from competition and looks as an attractive target for Betsson to acquire.

Furthermore, having priced Mr. Green's intrinsic value of equity to 1 544.7 MSEK and estimated total operating synergies to be realizable post-transaction to 480.576 MSEK, it is our belief that Mr. Green is fairly priced on the stock market and that there are additional synergies to be found from a merge. In spite of that we estimated the total WACC of the combined firm to increase and thus identify negative financial synergies of -16.963 MSEK, we think that Betsson could further evaluate this M&A opportunity if the purchase price would end up beneath their resistance point of 2 008.3 MSEK. We thus also conclude that the premium paid for Mr. Green should not exceed the total value of synergies equal to 463.613 MSEK.

As mentioned throughout our thesis, we have tried to remain conservative and pertained a cautious outlook on the overall industry in general and similarly when valuing Mr. Green and Betsson individually. However, in the Appendix section A.13 we have explained and illustrated a scenario where we have altered the outcome of the ongoing court case in Austria. To again remind the reader, Mr. Green has taken precautionary measures and predicted a worst-case scenario where the full amount of the tax provision liabilities accounted for in Mr. Green's financial reports, would be incurred by the Austrian tax organ. In addition to common COGS including marketing expenses, tax expenses and *items affecting comparability* originating from Austria are the items that hurt Mr. Green's profitability. In the Appendix section A.13, we have illustrated how the share price of Mr. Green would improve if the scenario would alter and they

would win the court case and thus be able to again account for 25%-100% of the provisions that now count as financial losses. It is evident to us, looking at the values and the graph in Appendix section A.13, that the financial state of Mr. Green could significantly improve and we could instead have argued for an intrinsic value of Mr. Green's stock price to end up within the interval 47.87 SEK-68.57 SEK.

It is also our understanding, that should they win the court case it would benefit the whole industry and improve the financial state of other firms currently involved in similar situations with the Austrian as well as other governmental tax organs. Conversely, should they end up loosing the court case and thus consider their provisions to be forever lost, our outlook for the industry would again look significantly worse and the intrinsic values initially estimated would thus stand.

# 18. Our Thesis in Retrospect

In this final section of our thesis we would like to provide the reader with a reflecting discussion looking back at our work.

First, looking back on our choice of topic we still believe that it has relevance in today's commercial and business world. There is an ongoing industry wide debate were company CEO's and investment bank analyst are speculating in the future consolidation of the industry and we feel that not only is the topic highly relevant, but also the two specific companies we chose to focus on are hot topics related to future M&A activity. We do, however, realize that there are perhaps plenty of M&A opportunities within the industry and as we have limited our scope the firms listed on the Swedish stock exchanges, we have most certainly overlooked other interesting consolidation opportunities. We are thus humble in understanding that there might have been better companies to choose.

Second, having concluded that we see some financial support and strong strategic arguments advocating a successful merger, we leave out other important factors in this thesis that we should have considered in another scope as well as in reality. Almost no M&A transactions would be carried through if it did not make economic sense. However, what still remains after the contracts have been signed and the advisors are paid off, is an often time very challenging integration phase. As we declared earlier, many M&A deals have been doomed to fail looking in retrospect due to insufficient due diligence and underestimation of the integration plan. We thus imagine it would have been interesting to investigate further how this case could have been carried out in reality, or simply in an extended theoretical scope.

One of the drawbacks with using Gordon's Growth approach for estimating the terminal value is that the term is very sensitive with regards to the different inputs used. The low interest rates around the world have forced risk free rates and market risk premiums to decline. Hence, since we are using the CAPM to calculate the cost of equity capital, depending on the beta value, this can yield a very low cost of equity. When the cost of capital is estimated near the terminal growth rate, the resulting share price can sometimes be extreme, as we showed in our sensitivity analysis.

In our case, where Mr. Green has no interest bearing debt, the cost of equity is equal to the weighted average cost of capital. From the sensitivity analysis, Table 12, we saw that a beta of 1.25 would indicate a share price of 25.45, while a beta value of 0.56 would indicate a share price of 82.15. This shows how sensitive the share price is to the slightest change in beta. Beta is inaccurately assumed in many models to be constant, but as we showed in Exhibit 24 in section 10.1.3, where we performed a one-year "rolling" beta estimation for Mr. Green, we could see it had fluctuated substantially. As displayed, the beta has both been above 1.25, and well below 0.56, verifying a huge spread and creates uncertainty, when the variations in the share price become that substantial. This was one of the reasons we also decided to use the fair M/B premium as an alternative approach to estimate the terminal value term and ultimately the share price. This second approach is much more stable and the share price does not fluctuate at all to the same degree, which can be seen in Table 14. However, this approach is not industry standard and also has its limitations, which is why we rely more on our results from the DCF and EVA models where we use Gordon's Growth approach.

Finally, we are satisfied with having found, in our opinion, realistic and interesting answers to our research question and problem statements we provided to the reader initially. We feel that it has been interesting to carry out our analysis simultaneously as the industry gains momentum and is considered a hot topic among media and the general population. Although this specific case scenario has not officially been included in speculations, several deals have been completed during the course of this semester and many more are expected to come.

We have been limited by the scope of the thesis to a small extent and also by the amount of financial information and data we could extract from the companies involved. However, we do not assess that this has limited us in such a way that our problem statements could not be properly investigated and thus not result in a well-grounded concluding discussion.

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**Table of Contents: Appendix**

# Appendix

# A.1 Merger Waves and Trends

Below, we will describe the three most recent merger waves that have been observed through the 20th century. We have chosen to describe these historical shifts in trends in order for the reader to have a better understanding of how merger waves have developed historically and thus how the future could develop, in terms of mergers and acquisitions activity.

## A.1.2 General Description

Merger or acquisition deal trends tend to come in waves hitting an industry, a country or with a global force. A wave of transactions can for example start to emerge when at certain times there are a number of undervalued firms as well as overvalued firms in the market. When the overvalued bid for the undervalued companies' shares, the acquirer's valuation is depressed, which is compensated by the simultaneous movement of keeping the overvalued firm not to fall too far down because the investors now has realized that the company is, in fact, overvalued (Schleifer & Vishny, 2003). Rhodes–Kropf, Robinson & Viswanathan (2005) states in the Journal of Financial Economics that merger waves occur during valuation waves because at those times targets have mistakenly over-estimated synergies.

Another reason as to why merger waves are formed is when certain economic conditions are such that they are favorable to firms to pursue M&A transactions. One of the most evident economic conditions is, according to J.P Morgan (Zenner & Chivukula, 2014), the record low cost of debt we have experienced in the market during the past couple of years, post the financial crisis. This has become possible chiefly thanks to National Banks' and Central Banks' fiscal policies and lowered interest rates for both investment grade and non-investment grade borrowers. As this environment has formed, M&A transactions appear as a value creating activity through proving strong EPS accretion for investors, which is one of the most important measures relied on in an M&A context. Andrade (1999) states that EPS is one of the most important measures for security investors and analysts, and thus, firms that engage in M&A deals that depreciates EPS will be penalized by lower valuations and stock returns by the market.

Moreover, terms of technological innovation and change are often followed by merger waves according to Vernimmen et al. (2005). They further make a case in point describing that a period might come in which many new companies are founded as a consequence of technological change, but when growth are slowing down or outlooks for new start-ups start to dim, it can lead to a wave of consolidation. Betton et

al. (2008) adds one additional note on the subject, arguing that a merger that implements a new technological innovation may, as the news of innovation spreads, induce other competitors within the industry to follow up with takeovers in order to keep up with competition at a high technological and innovative level.

Below, we will go over some of the most recent and evident merger waves historically as we feel that it is vital for our analysis to understand historical movements and further to be able to predict future development and place our case in a probable realistic setting.

### A.1.3 The 1960's

The 1960's count as the third large merger wave in history and was formed when firms expanded through a progression of diversifying its businesses into unrelated fields (Gaughan, 2007). Conglomerates were the most common type of M&A deal and most transactions were paid for with shares during this decade when ITT, Gulf & Western, Fiat and Schneider were companies constituting some of the largest deals (Vernimmen et al., 2005). During this era, firms tended to expand by buying other companies rather than waiting for internal organic growth. This decade also proved another widely known concept within corporate finance, that is, the agency problem. An agency problem is defined by Brealy et al. (2011) as a conflict of interest between the agents of a firm (i.e. management) and the principles (i.e. shareholders) that is represented by the agents. As conglomerate mergers tend to lower operating risk within the firm but also to create business empires, CEO's could potentially overvalue the act if management compensation show little negative sensitivity to firm performance post-merger, which was the case at the time (Betton et al., 2008). Just in-line with the above theory, the agency problem that arose in the 1960's was constituted by CEO's investing, sometimes excessively, in conglomerate mergers to diversify risk but also to build business empires, without carrying the risk of receiving decreased compensation in a situation of bad company performance following the mergers. It is however further declared that while situations of agency problems arose during this decade, analysis of abnormal stock returns during the time of takeovers do not reflect investments detrimental to shareholder value (Betton et al., 2008).

### A.1.4 The 1980's

During the 1980's in what has been called the fourth merger wave, many of the conglomerates formed in in 1960's were broken up in a process of de-conglomeration, in order to correct the, by many deemed as excessive, conglomeration in the preceding decades. Many firms had become less efficient, poorly managed and valued at less than the sum of its parts (Vernimmen et al., 2005) and we therefore saw transactions to either downsize or to specialize operations (Betton et al., 2008). Most deals were paid for

using cash and corporate takeovers reached new levels of hostility (Vernimmen et al, 2005). During the emergence of this art of corporate takeovers, targets did not really have any well-planned defense tactics in play. After a while when entering the late 1980's, the strong development of defense tactics became a sophisticated art and investment banks formed teams of takeover defense specialists and halted the use of the hostile bids, that came to signify this fourth merger wave (Betton et al., 2008).

### A.1.5 The 1990's

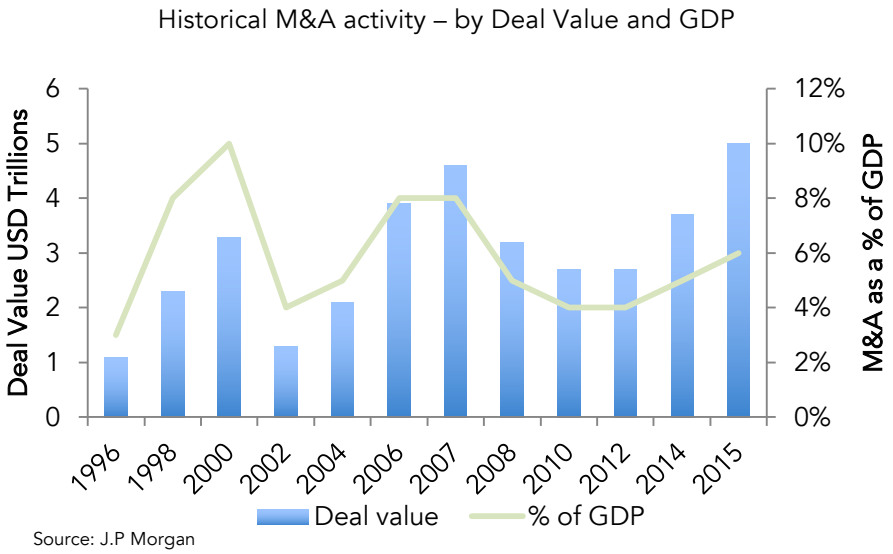
In the 1990's horizontal share transactions came to be most commonly exercised. In what is commonly called the fifth merger wave, management focused on targets in industries with strong growth prospects and high profitability (Betton et al., 2008). The wave was characterized by the banking industry in the United States where larger banks tried to consolidate the market through targeting and acquiring smaller regional banks. First Unions merge with Wachovia in 2001 constituted one of the largest deals amounting to $13.6bn (Gaughan, 2007). The wave of consolidation has continued steadily into the 21st century and now involves the U.S as well as the European industry. What caused the transfer of M&A-traffic to also affect European banks was essentially the narrowing spread between larger banks being able to borrow at lower money market rates and the lending at higher longer-term rates. At the same time, harder pressure was put on the regional banks and a cost advantage for large banks thus emerged that ultimately gave them opportunities to acquire the smaller banks (Gaughan, 2007).

### A.1.6 Where Are We Going in 2016?

2015 was a sensationally intense year for global M&A with transaction volume for the year 2015 amounting to $5.05tr, which represents 6% out of total global GDP. The prognosis for 2016 is looking strong as well and J.P. Morgan (January, 2016) predicts the next twelve months of 2016 to be even stronger for M&A where the total value of transactions will also be supported by a greater quantity of deals. J.P. Morgan also suggests four key themes that will signify the development of 2016.

- Confident CEO's have in general accumulated large cash balances and are willing to pursue generating quick growth through increasing top-line sales as well as more defensive moves to enhance scalability and strengthen their balance sheets.
- There will continue to be a supportive economic environment for transactions, where dealmakers will benefit from economic factors that are supportive to M&A.
- They see a continuing trend of corporations turning to execute cross-border transactions.
- Activist investors are moving forward their positions in order to seek expansion globally.

J.P Morgan predicts in their report that global M&A activity will follow the trend from recent years. They argue that the total deal value will increase in parallel the total value also growing relative to GDP. The below graph illustrates how M&A has progressed in recent years in terms of trillions of dollars and as a percentage out of total global GDP.

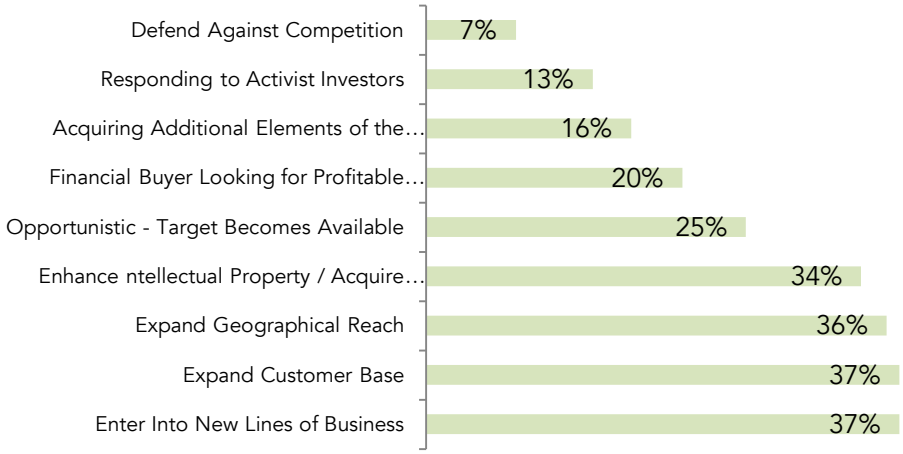


Source: J.P Morgan
Created by authors

From KMPG's (2016) survey among 500 global executives, one can conclude that the drivers of future deals in 2016 are expected to consist of the following:

- One (out of two) of the most important reasons for acquisitions that the specific S&P 500 member will initiate in 2016 will be to Enter into new lines of business (37%).
- 37% of the respondents also mentions Expanding customer base.
- Third on the list, we find Expand geographic reach.

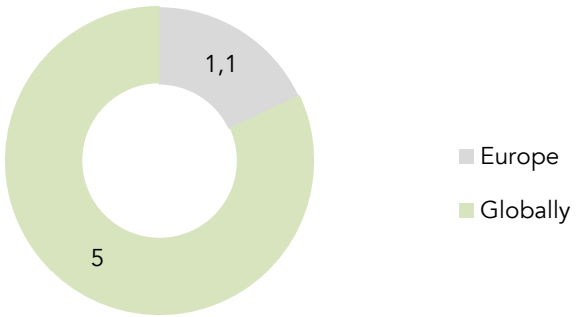
What are the primary reasons for acquisitions that could be initiated in 2016?




Created by authors
Source: KPMG (2016). Respondents to the survey yielding the above outcome were asked to select three reasons their company was most likely to initiate in 2016. KPMG has surveyed 550 deal executives for their

Deloitte (2015) declared in their outlook report expected to influence M&A-activity in 2016 that in Europe, cross-boarder M&A has been one of the key factors influencing deals completed in 2015 totaling over $1.1tr worth of deals, which can be compared to over USD 5.5 trillion on a global basis. European companies have been at the center of the action in cross-boarder deals, participating in 53% of all announced deals and North America-to-Europe has been the dominating deal corridor, with transactions worth $311bn.

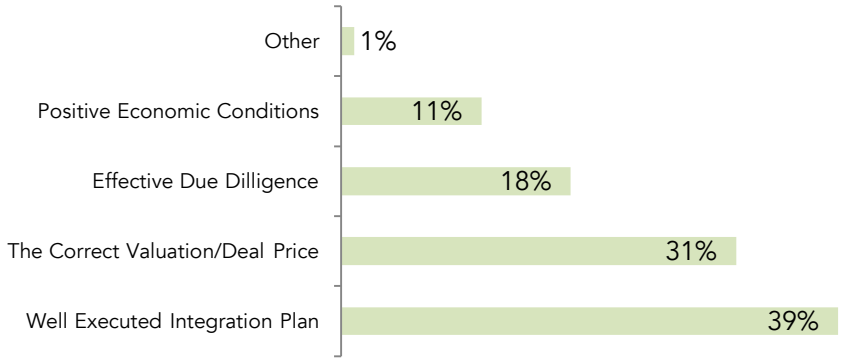
Europe's total deal value vs. US total deal value in 2015, in USD trillions.




Source: Deloitte (2015).
Created by authors

What KPMG also concludes from surveying the deal executives as explained above, the most important factors that lead to deal success are a well executed integration plan (39%), a correct valuation and deal price (31%), effective due diligence (18%) and positive economic conditions (11%). These are all factors that we will assume in our analysis when establishing the most important factors concerning our constructed deal, to make the scenario as authentic as possible to fit into a realistic setting (KPMG, 2016).

Result from KPMG's survey where deal executives were asked to select up to three of the most important factors to complete a successful deal.




Source: KPMG (2016).
Created by authors

# A.2 Additional reasons for M&A

## A.2.1 Acquire Undervalued Firms

Firms that are considered undervalued by financial markets are often times penalized through a depressed stock performance but can simultaneously be targeted for acquisition by those who recognize this mispricing (Damodaran, 2008). For this strategy to work, three important components need to come in place. First, a capacity to find the firms that trade for less than their true value which, theoretically, would assume the company have either better information than the average investor or better analytical tools than other investors in the marketplace have access to. Second, the acquirer will need to have enough capital available in order to complete the transaction. Third, the acquiring firm needs a certain degree of skill in execution of the deal as, for example, the price of the premium for listed firms can very quickly eliminate the valuation surplus, particularly in efficient markets (Damodaran, 2008).

### A.2.2 Diversify to Reduce Risk

By looking into buying firms that are focused on other business segments and thereby diversifying its nature of operations, acquiring firms' managers sometimes believe that they can reduce earnings volatility, risk and thus increase the potential value of the firm (Damodaran, 2008). However, there is an ongoing debate whether or not diversifying really adds any real value to the shareholders compared to reallocating the excess capital to shareholders for them to diversify their investments themselves. Many researchers dismiss the argument to diversify to reduce risk, among them Brealey et al. (2011) calls it a dubious reason for merging, as it is both easier and cheaper for stockholders to diversify themselves than for the corporation.

### A.2.3 Industry Consolidation

There are certain market conditions that seem to trigger waves of M&A-activity. The biggest opportunities for company transactions in order to improve efficiency and generate synergies seem to emerge when industries have too many firms and thus too much capacity. What these consolidations then force, are companies that cut employment and capacity somewhere in the company, to release capital that can be invested elsewhere in the combined firm. A case in point could be illustrated with when the banking industry in the United States during the 1980's had too many banks as a result of outdated restrictions on interstate banking (Brealey et al., 2011). What can often be an initial kick-starting factor to a wave of consolidation within an industry is the financial and regulatory environment. When these settings change to include more favorable conditions, it can prompt companies to merge with each other. Also, a decline in market growth makes it difficult for firms to grow organically and managers may look for investment opportunities in search for more and rapid growth (Vernimmen et al., 2005).

### A.2.4 Surplus of Funds

A firm that finds itself at a mature stage in an industry but still generates a substantial amount of cash on an annual basis could experience trouble finding profitable investment opportunities to exit from a steady maturity state to again excel to realize growth and a new business life cycle. In such a case, corporate finance theory expects the firm to distribute the excess cash to shareholder through dividend payments or through repurchasing stock (Brealey et al., 2011). Some energetic managers however, might not be willing to repurchase shares or simply pay out excess cash but will instead let the cash finance an acquisition to turn the downshifting trend in a mature state into a period of new

### A.2.5 Business Empires

In the hunt for synergies and growth, companies have for centuries been known to form business empires through M&A. The desire has been to consolidate an industry and achieve vertical integration to eliminate competition and/or to create rapid growth (Unoki, 2013). Since the 1900's there has been six distinct waves of high M&A activity. BCG concludes in their report The Brave New World of M&A (2007) that since the post-IT break-through of 2004, the world is currently experience a consolidation wave. The reasons behind this are according to BCG the increasing globalization, more liberalized regulation in some sectors and unparalleled funds for M&A.

## A.3 Online Gambling Industry: Social Responsibility

### A.3.1 Addiction

As previously confirmed, it is fundamentally illegal to organize gambling and advertising for gambling activities for the general public with the sole purpose of achieving monetary gain, according to Swedish Law (Svenska Spel, 2014). However, as it is not illegal for offshore companies to approach the Swedish population, or for regular people to engage gambling activities offered by these firms, they are to be supervised the same way as any other company on the market. This is especially true for the focus firms of this thesis as they are all publicly listed.

One of the strongest and most important motives behind why the Swedish OGI is to remain regulated and with Svenska Spel to remain a monopolistic entity is that 1-2% of the Swedish population is already troubled by gambling addiction problems and another 5% are in the risk zone of developing such habits in the future (Svenska Spel, 2014).

The National Gambling Authority (Lotteriinspektionen) has assigned the National Board of Health and Welfare (Svenska Spel, 2014) to investigate and document which instance in the welfare system that is responsible to care for these individuals that are troubled by gambling addiction and how the aid should be funded. A central difficulty that at the moment constructs a roadblock for the responsible authority is to decide whether or not gambling addiction should qualify in the same category next to drug and alcohol addiction and if troubled individuals should thus be allowed treatment under the Social Services Act as a consequence (Svenska Spel, 2014).

### A.3.2 Match Fixing

As a result of technological advancements and the emergence and growth of online markets in particular, sports betting opportunities have increased dramatically, both in terms of the number of sport events and the number of betting markets available (Rompuy, 2015). Cheating with physical means such as doping and other forms of result manipulation has always been present in the vicinities of professional sports and other competitions all over the world and perhaps the most well known scandals have historically come from physical doping. In recent years however, there are multiple cases proving that there is an increasing necessity to supervise and more consistently control for non-physical cheating and manipulation. Cases of match fixing, money laundering through sports and other forms of unethical systematic behavior in games is a snowballing trend. Manipulation of results has been a recurring problem in Europe and Sweden recently with scandalous cases where participants of professional sports intentionally have acted unlawfully to affect a result in a certain way. In 2014 the Swedish tv-program Mission: Inspection (Uppdrag Granskning) revealed how certain individuals and groups of people systematically "fixed" football matches in Sweden. That is, they paid of players, coaches and referees in order for the team they bet on, would win the game (SVT, 2014).

The non-profit organization EGBA (European, Gaming and Betting Association) is actively taking a stand to prevent match fixing (EGBA, 2014). In September 2014 Maarten Haijer, Secretary General of the EGBA, stated: "*The convention rightly addresses match-fixing as a cross-border issue that requires international cooperation. It is our hope that it will further set the tone for a more effective cooperation between all stakeholders to eradicate match-fixing.*" Additionally, many reputable gambling companies (for example Betsson) are members of ESSA (European Sports & Security Association) that, working closely with UEFA and FIFA, actively push to prevent match fixing and corruption (Betsson, 2014a).

The above discussion signals a second threat to the industry, in addition to addiction, that is widely debated in society questioning both ethics and moral of the market participants. We think the power of a strong opposition backed by negative media attention can create a force strong enough to, at certain bad times, put enormous pressure on management affect people into stop gambling. This would not only deflate stock prices immediately, it would also significantly hurt profitability as well as reputation that is difficult to build up.

### A.3.3 Advertising

As it is not permitted by the Swedish government for regulated firms, Svenska Spel in particular, to

advertise gambling services directed towards the Swedish population, the unregulated offshore firms we are focusing on in this thesis are beating the regulated companies by far when it comes to direct investments in advertising (Svenska Spel, 2014a). In 2014, unregulated firms invested 2.6bn SEK in advertising and marketing while the regulated firms invested about 500 MSEK of cumulated similar investments. According to the Lottery Inspection (Lotteriinspektionen) and the Swedish Health Association (Folkhälsoinstitutet), the total amount of advertising from gambling companies amounted to 3.578bn SEK with the unregulated companies contributing with 70% out of that (Svenska Spel, 2014a).

### A.4.1 Reformulated Income Statement Mr. Green

| Reformulated Income Statement TSEK | 2013 | 2014 | 2015 |
|---|---|---|---|
| Game win revenue | 336 765 | 658 970 | 792 599 |
| Other revenue | 13 084 | 398 | 0 |
| Total revenue | 349 849 | 659 368 | 792 599 |
| | | | |
| Cost of sales | -57 619 | -121 487 | -199 222 |
| Other operating revenues | 23 879 | 43 602 | 49 034 |
| Marketing | -139 913 | -262 439 | -287 171 |
| Personnel costs | -43 036 | -78 607 | -95 009 |
| Other operating expenses | -60 134 | -105 591 | -123 469 |
| EBITDA before items affecting comparability | 73 026 | 134 846 | 136 762 |
| | | | |
| Items affecting comparability | -4 667 | -112 081 | -81 631 |
| EBITDA | 68 359 | 22 765 | 55 131 |
| | | | |
| Depreciation and amortization | -30 769 | -53 968 | -91 164 |
| Earnings before interest and tax (EBIT) | 37 590 | -31 203 | -36 033 |
| | | | |
| Currency gains/losses | 1 316 | 1 232 | -16 128 |
| | | | |
| *Current Tax* | *-4 039* | *471* | 0 |
| *Deferred Tax* | *2 439* | *3 974* | 0 |
| Sum Income tax | -1 600 | 4 445 | 1 668 |
| Operational Tax | -1 984 | 4 497 | 1 653 |
| *NFE tax* | *384* | *-52* | 15 |
| NOPAT | 36 922 | -25 474 | -50 508 |
| | | | |
| Financial income | 69 | 427 | -17 |
| Financial expense | -1 816 | -189 | -49 |
| Net financial expenses before tax | -1 747 | 238 | -66 |
| NFE tax | 384 | -52 | 15 |
| Net financial expenses after tax | -1 363 | 186 | -51 |
| | | | |
| PROFIT / (LOSS) FOR THE PERIOD | 35 559 | -25 288 | -50 559 |

Source: Annual Reports
Created by authors

## A.4.2 Reformulated Balance Sheet Mr. Green

| Invested capital (operating) TSEK | 2013 | 2014 | 2015 |
|---|---|---|---|
| Total assets | 947391 | 1012927 | 1082163 |
| Investments in shares | 0 | 0 | 0 |
| Investments in associated companies | -18855 | 0 | 0 |
| Other investments | -4381 | 0 | 0 |
| Cash and cash equivalent | -111167 | -154954 | -190281 |
| Other operating liabilities and tax payable | -203586 | -340407 | -441328 |
| Invested Capital (Net Operating Assets) | 609402 | 517566 | 450554 |
| | | | |
| **Invested capital (financing)** | | | |
| Equity | 743805 | 672520 | 640826 |
| | | | |
| Loan and borrowings (non-current) | 0 | 0 | 0 |
| Loans and borrowing (current) | 0 | 0 | 0 |
| Investments in shares | 0 | 0 | 0 |
| Investments in associated companies | -18855 | 0 | 0 |
| Other investments | -4381 | 0 | 0 |
| Cash and cash equivalent | -111167 | -154954 | -190281 |
| Net Interest Bearing Debt (NIBD) | -134403 | -154954 | -190281 |
| | | | |
| Invested capital (financing) | 609402 | 517566 | 450545 |

Source: Annual Reports
Created by authors

## A.4.3 Invested Capital Mr. Green

Invested capital, or Capital Employed, represents the summarized invested amount of debt and equity that finances a firm's core operations. This is an important definition to make clear as many profitability measures depends strongly on this measure, and it could differ from company to company and is a matter of subjectivity adjustment. As a general note, one can say that the value creation on a shareholder's investment is dependent on the return a firm is able to create from the capital initially invested in the firm (Koller et al., 2010). An average between beginning and ending balance are often used to calculate Invested Capital, while when we use the Invested Capital measure we use the companies' established capital for the beginning of the period, as presented in financial statements (Wild & Subramanyam, 2004).

### A.4.4 Operating Non-Current Assets Mr. Green

Operating intangible assets amounted to 871.143 MSEK in 2015 where, in order, Goodwill, Other intangible assets, Brand and Customer contracts constituted the main items. Every year, or when indications of events or changed circumstances the value of goodwill and brand name will be analyzed and validated. Concrete examples of such events are when acquisitions take place and current goodwill is made up of the difference between actual purchase price and the fair market value of assets and liabilities. Currently, Mr. Green's goodwill is made of the acquisition of Green Gaming Group Plc (2013), Social Holdings Ltd (2014) and DSRPTV Gaming Ventures Ltd (2014) and MyBet Italia Srl (2015). After analysis and evaluation made by Mr. Green, they could not find reason to depreciate the value of goodwill, which remained at 499.473 MSEK in 2015. The amount of goodwill made up about 46% of total assets in 2015. The same decision was taken in regards to the value of the brand name, which after 2015 remains at 290.495 MSEK.

While goodwill might be difficult to estimate and somewhat abstract to grasp, one can make a comparison of the ROIC with the Invested Capital including and excluding ROIC with the difference showing the impact of mergers and acquisitions. Again Mr. Green's negative NOPAT in this case makes this method inapplicable, as it would be included in the ROIC calculation. Mr. Green's gaming platform made up the rest of operating intangible assets and consists of Platform development and Acquisition of subsidiaries, and experienced some depreciation during the year. The gaming platform is valued as of 2015 at 81.175 MSEK, which equals 7.5% of Total assets.

### A.4.5 Operating Current Assets Mr. Green

In our reformulated analytical balance sheet, the rest of the operating assets in addition to the non-current discussed in the section above, are the operating current assets. To a small extent, the contributing items are Inventories, Receivables and Prepaid Expenses. The main and increasing part is made up out of Cash and cash equivalents. As shown in the table below, Mr. Green has since 2012 built up a cash position amounting to 190.281 MSEK and the relative ratio to Total Assets have increased from 1.0% in 2012 to 17.6% in 2015.

| *MSEK* | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|
| Cash & Cash Equivalents | 1.291 | 111.167 | 154.954 | 190.281 |
| Total Assets | 127.957 | 947.391 | 1 012.927 | 1 082.163 |
| Cash to Total Assets Ratio | 1.0% | 11.7% | 15.3% | 17.6% |

Source: Annual Reports
Created by authors

### A.4.6 Operating Liabilities Mr. Green

The Operating Liabilities of Mr. Green's consist of Taxes Payable and, what we have defined as, Other Operating Liabilities. Mr. Green does not have any outstanding Interest Bearing Debt and has therefore a net cash amount of 190.281 MSEK as of 2015 on their balance sheet. Taxes payable consists of liabilities in relation to the Austrian tax situation. In total, Taxes Payable makes up 70.2% of Total Liabilities while the item Other Payables, Players Accounts and Accruals make up the remaining 29.8% of the Other Operating Liabilities.

Looking at the absolute amounts, it is obvious that the Austrian Tax situation now seizes a larger share of Total Liabilities, 45% in 2015 in comparison with 31% in 2014. It is also evident that the liability positions have grown in relation in Total Equity and also Total Revenues. With these facts in mind, we can conclude that this special tax issue puts heavy pressure on the Income Statement and Balance Sheet and thus, creates a great financial risk for Mr. Green in the future. However, one must also realize that management has taken precautionary measures in setting aside reserve capital to cover for a "worst case" scenario, which result may become evident in a couple of years. One might therefore also realize that, to a large extent, the financial risk is accounted for.

## A.5 Cost of equity

| Cost of Equity: Mr. Green | |
|---|---|
| Through CAPM | |
| Risk-free rate | 0.993% |
| Beta | 0.83 |
| MRP | 6% |
| Cost of Equity | 5.99% |

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The above table illustrates how we have calculated cost of equity capital for Mr. Green related to section 10.1 Cost of Equity, through using Equation 16 describing CAPM, also displayed below for simplicity.

Equation 16

$$r_e = r_f + \beta_e \times (r_m - r_f)$$

# A.6 Full Valuation Models

## A.6.1 DCF model – An EV Approach: with Gordon's Growth model

| Discounted Cash Flow model - an EV approach: Gordon's Growth model | | | | | | |
|---|---|---|---|---|---|---|
| | E2016 | E2017 | E2018 | E2019 | E2020 | Terminal |
| FCFF | 2,172 | 16,340 | -9,448 | 45,948 | 4,774 | 61,016 |
| WACC | 5.99% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Discount factor | 0.94 | 0.89 | 0.84 | 0.79 | 0.75 | 0.71 |
| Present value of FCFF | 2,049 | 14,544 | -7,935 | 36,405 | 3,568 | 43,031 |
| Present value of FCFF in forecasting horizon | 48,632 | | | | | |
| Present value of FCFF in terminal period | 1,305,797 | | | | | |
| Estimated market value of firm (aka enterprise value) | 1,354,429 | | | | | |
| Net interest-bearing debt | -190,281 | | | | | |
| Estimated market value of equity | 1,544,710 | | | | | |
| Shares outstanding | 35,849 | | | | | |
| Share Price | 43.09 | | | | | |

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## A.6.2 DCF model – An EV Approach: with Fair M/B premium

| Valuation | | | | | | |
|---|---|---|---|---|---|---|
| | E2016 | E2017 | E2018 | E2019 | E2020 | Terminal |
| FCFF | 2,172 | 16,340 | -9,448 | 45,948 | 4,774 | 61,016 |
| Invested capital, beginning of period | 450554 | 472080 | 485003 | 536973 | 539951 | 597886 |
| WACC | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Discount factor | 0.94 | 0.89 | 0.84 | 0.79 | 0.75 | 0.71 |
| Present value of FCFF | 2,049 | 14,544 | -7,935 | 36,405 | 3,568 | 43,031 |
| Present value of FCFF in forecasting horizon | 48,632 | | | | | |
| Fair Market to Book Premium | 3.9 | | | | | |
| Continuing Value (CV) | 1706088 | | | | | |
| Present Value of CV | 1275317 | | | | | |
| Enterprise Value | 1,323,949 | | | | | |
| Net interest bearing debt | -190,281 | | | | | |
| Value of Common Equity | 1,514,230 | | | | | |
| Shares outstanding | 35,849 | | | | | |
| Share Price | 42.24 | | | | | |

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### A.6.3 EVA model – An EV Approach: with Gordon's Growth model

| Valuation | | | | | | |
|---|---|---|---|---|---|---|
| | E2016 | E2017 | E2018 | E2019 | E2020 | Terminal |
| NOPAT | 23,698 | 29,262 | 42,521 | 48,927 | 62,709 | 75,963 |
| Invested capital, beginning of period | 450,554 | 472,080 | 485,003 | 536,973 | 539,951 | 597,886 |
| WACC | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Cost of capital | 27,001 | 28,291 | 29,066 | 32,180 | 32,359 | 35,831 |
| EVA | -3,303 | 971 | 13,456 | 16,747 | 30,350 | 40,132 |
| Discount factor | 0.94 | 0.89 | 0.84 | 0.79 | 0.75 | 0.71 |
| Present value of EVA | -3,116 | 864 | 11,300 | 13,268 | 22,687 | 28,303 |
| Invested capital (book value), beginning of period | 450,554 | | | | | |
| Present value of EVA in forecasting horizon | 45,004 | | | | | |
| Present value of EVA in terminal period | 858,871 | | | | | |
| Estimated marked value of firm (aka enterprise value) | 1,354,429 | | | | | |
| Net interest-bearing debt | -190,281 | | | | | |
| Estimated marked value of equity | 1,544,710 | | | | | |
| Shares outstanding | 35,849 | | | | | |
| Share Price | 43.09 | | | | | |

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### A.6.4 DCF model – An EV Approach: with Fair M/B premium

| Valuation | | | | | | |
|---|---|---|---|---|---|---|
| | E2016 | E2017 | E2018 | E2019 | E2020 | Terminal |
| NOPAT | 23,698 | 29,262 | 42,521 | 48,927 | 62,709 | 75,963 |
| Invested capital, beginning of period | 450,554 | 472,080 | 485,003 | 536,973 | 539,951 | 597,886 |
| WACC | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Cost of capital | 27001 | 28291 | 29066 | 32180 | 32359 | 35831 |
| EVA | -3,303 | 971 | 13,456 | 16,747 | 30,350 | 40,132 |
| Discount factor | 0.94 | 0.89 | 0.84 | 0.79 | 0.75 | 0.71 |
| Present value of EVA | -3,116 | 864 | 11,300 | 13,268 | 22,687 | 28,303 |
| Invested capital (book value), beginning of period | 450,554 | | | | | |
| Present value of EVA in forecasting horizon | 45,004 | | | | | |
| Fair Market to Book Premium | 3.9 | | | | | |
| Continuing Value (CV) | 1706088 | | | | | |
| Present Value of CV | 1275317 | | | | | |
| Enterprise Value | 1,770,874 | | | | | |
| Net interest bearing debt | -190,281 | | | | | |
| Value of Common Equity | 1,961,155 | | | | | |
| Shares outstanding | 35,849 | | | | | |
| Share Price | 54.71 | | | | | |

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## A.7 Operational Synergies

Average number of staff employed in each country for Betsson and Mr. Green as of 2015.

| Other Staff Employees | | | |
|---|---|---|---|
| Betsson | | Mr. Green | |
| **Sweden** | **123** | **Sweden** | **29** |
| Denmark | 8 | **Malta** | **129** |
| Gibraltar | 4 | | |
| Philippines | 0 | | |
| China | 4 | | |
| Italy | 3 | | |
| Estonia | 52 | | |
| Poland | 0 | | |
| **Malta** | **760** | | |
| Georgia | 630 | | |
| Total | 1584 | Total | 158 |

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## A.8.1 Pre-merge: Unlevered beta Betsson

**Table 20 – Column B**

To find the unlevered beta of Betsson to insert in Table 20 Column B, we have unlevered each industry peer with their respective D/E ratio downloaded form DataStream and applied an average tax rate of 5% to the Equation 18 (also published below for simplicity). We found the average of the unlevered industry betas was 0.69. The second input we have considered is Betsson's rolling beta collected from a regression using the same methodology as described in section 10.1.3. The regression gave us the measure 0.93, which we could unlever using Equation 18 with Betsson's specific D/E ratio resulting in 0.88. The average of the two measures 0.69 and 0.88 resulted in 0.79, which is the number we have populated Table 20 Column B with to signify Betsson's unlevered beta measure. A summary of the above calculation has been displayed below.

Equation 18

$$\beta_U = \frac{\beta_L}{(1 + (1 - \tau) \times \left(\frac{D}{E}\right))}$$

| Pre-merge | | | | |
|---|---|---|---|---|
| Unlevered beta Betsson<br>Index: OMX Sweden | Levered Beta | D/E from Data stream | Applied Tax rate | Unlevered Beta |
| Unibet | 0.55 | 0.84 | 5% | 0.31 |
| Mr. Green | 0.73 | 0 | 5% | 0.73 |
| Cherry | 0.94 | 0.84 | 5% | 0.52 |
| Net Entertainment | 1.21 | 0.35 | 5% | 0.91 |
| Kambi | 0.88 | 0.47 | 5% | 0.61 |
| Evolution Gaming | 0.93 | 0.35 | 5% | 0.70 |
| | | | | |
| Beta regression | 0.93 | | | |
| Beta Unlevered Regression | 0.88 | | | |
| Average Unlevered beta Industry | 0.69 | | | |
| Average | 0.79 | | | |

*Source: DataStream*
*Created by authors*

### A.8.2 Pre-merge: Unlevered beta Mr. Green
**Table 20 – Column B**

To find the unlevered beta of Mr. Green to insert in Table 20 Column B, we have to take into account again the fact that Mr. Green does not have any outstanding Interest Bearing Debt. We have therefore not unlevered each industry peer, as we did for Betsson in A.8.1 above because there would not be any logical reason to adjust an industry average with Mr. Green's D/E structure. Instead, the average beta accessed from DataStream of Mr. Green's industry peers in the table below equals 0.94.

The second measure we will consider is again the rolling beta collected from a regression following again the methodology of 10.1.3. with their respective D/E ratio downloaded form DataStream and applied an average tax rate of 5% to the Equation 18 (also published below for simplicity). We found that the average of the unlevered industry betas was 0.94. The second input we have considered is Mr. Green's rolling beta collected from a regression using the same methodology as described in section 10.1.3. and just as described in A.8.1 above. The regression gave us the measure 0.73, which we could then consider Mr. Green's unlevered beta. The average of the two measures 0.94 and 0.73 resulted in 0.83, which is the number we have populated Table 20 Column B with to signify Mr. Green's unlevered beta measure. A summary of the above calculation has been displayed below.

| Pre-merge | | | | |
|---|---|---|---|---|
| Unlevered beta Mr. Green<br>Index: OMX Sweden | Levered Beta | D/E from Data stream | Applied tax rate | Unlevered Beta |
| Betsson | 1.10 | 0.81 | 5% | 0.62 |
| Unibet | 0.55 | 0.84 | 5% | 0.31 |
| Cherry | 0.94 | 0.84 | 5% | 0.52 |
| Net Entertainment | 1.21 | 0.35 | 5% | 0.91 |
| Kambi | 0.88 | 0.47 | 5% | 0.61 |
| Evolution Gaming | 0.93 | 0.35 | 5% | 0.70 |
| Average Unlevered Beta Industry | 0.94 | | | |
| Beta regression Mr. Green | 0.73 | | | |
| Average | **0.83** | | | |

*Source: DataStream*
*Created by authors*

### A.8.3 CAPM
**Table 20 – Column E**

We have calculated the required return on equity using CAPM as described by equation 16 (also displayed below for simplicity). The inputs are populated in Table 20 column C and we found the resulting Re to equal 6% as can be seen from the summary table below.

Equation 16

$$r_e = r_f + \beta_e \times (r_m - r_f)$$

$$6.0\% = 0.993\% + 0.83 \times 6\%$$

### A.8.4 Historical Implicit Working Tax Rate

| Historical tax rate (TSEK) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| EBT | 382,437 | 555,417 | 573,571 | 596,204 | 814,798 |
| Income Tax Paid | -16,782 | -27,596 | -25,771 | -34,157 | -44,125 |
| Implied Tax Rate | 4.39% | 4.97% | 4.49% | 5.73% | 5.42% |
| *Average* | 5.00% | | | | |

*Source: Annual reports*
*Created by authors*

In the table above, we have used the EBT and the income tax amounts paid each year, from Betsson's income statements between 2011-2015 in order to implicitly extract an average tax rate of 5%. We will use this tax rate for Betsson when calculating WACC. The result is also in-line with our tax discussion, section 5.2, where the Gambling Authority of Malta where both Betsson and Mr. Green is legally based, declares the tax bracket in which gambling firms are to place themselves. Therefore, it is also applicable to Table 20, where we calculate the WACC for the merged firm.

## A.9 Synthetic Credit Spread Creation

In contrast to Mr. Green, Betsson have outstanding NIBD and we thus have to estimate cost of debt in order to calculate WACC to apply to Betsson and the combined firm. As Betsson do not have a credit rating from any of the major credit rating agencies, we have chosen to construct a synthetic credit rating for Betsson pre-merge. In the tables below, we have followed the methodology from Standard & Poor's guidelines (2016) and Petersen & Plenborg's Credit Rating sections (2012). Given their proven financial performance displayed the table below, we could translate the ratios to terms of implied credit rating where each percentage represents a given credit rating between AAA and CCC. In terms of the given financial ratios above, we can tell that Betsson has performed quite well resulting in an average and final credit rating of AA. According to Petersen & Plenborg's Credit Analysis section (2012) an AA rating should yield a credit spread between 0.7% as a low mark and 2.4% as a high mark. Given Betsson's nature of operations we deem it reasonable to apply the highest possible credit spread within the interval of 2.4% for this particular variable.

| Credit Risk Measure | 2011 | 2012 | 2013 | 2014 | 2015 | |
|---|---|---|---|---|---|---|
| Interest Coverage Ratio (EBIT) (x) | 123.3 | 158.2 | 115.1 | 121.1 | 244.2 | |
| Interest Coverage Ratio (EBITDA) (x) | 139.6 | 187.0 | 135.6 | 140.0 | 288.4 | |
| ROIC (%) | 28.74% | 22.99% | 19.46% | 19.05% | 18.45% | |
| Operating Income / Revenue (%) | 32.23% | 26.19% | 24.27% | 27.06% | 23.82% | |
| Total Debt / IC (%) | 50.69% | 57.48% | 50.91% | 47.51% | 56.84% | |
| Rating | | | | | | Average |
| Interest Coverage Ratio (EBIT) | AAA | AAA | AAA | AAA | AAA | |
| Interest Coverage Ratio (EBITDA) | AAA | AAA | AAA | AAA | AAA | |
| ROIC | AA | AA | A | A | BBB | |
| Operating Income / Revenue | AAA | AA | AA | AAA | AA | |
| Total Debt / IC | BB | BB | BB | BBB | BB | |
| Credit Score | 3.9 | 4.0 | 4.2 | 2.8 | 2.8 | 3.5 |
| Implied Credit Rating | | | | | | AA |

*Source: Petersen & Plenborg (20112), S&P Credit Rating Guidelines*
*Created by authors*

| Definitions of Credit Risk Measures | |
|---|---|
| **Measure** | **Equation** |
| Interest Coverage Ratio (EBIT) | EBIT / Net Financial Expense |
| Interest Coverage Ratio (EBITDA) | EBITDA / Net Financial Expense |
| ROIC | NOPAT / Invested Capital |
| Operating Income / Revenue | Income from Operations / Revenue |
| Total Debt / IC | Total Liabilities / Invested Capital |

*Source: Petersen & Plenborg (20112), S&P Credit Rating Guidelines*
*Created by authors*

To diversify the measure of cost of debt further and to challenge our assumptions and selected financial ratios leading up to the synthetic credit rating for Betsson, we have chosen to take a simple average between our estimated Rd and Damodaran's gathered research of industries' average Rd in Western European countries. The below table demonstrates into which industries Betsson borders which, taking the average of them all, equals an average 4.5% cost of debt.

| Cost of Debt | |
|---|---|
| **Industry** | Cost of Debt |
| Business & Consumer Services | 4.38% |
| Entertainment | 4.38% |
| Software (Entertainment) | 4.88% |
| ***Average*** | ***4.5%*** |

*Source: Damodaran Compiled Research (Updated January 2016)*
*Created by authors*

We are at this point ready to calculate the required return on debt for the combined firm in accordance with the below formula in order to finally have an average measure of 3.95% as shown in the table below.

$$r_D = r_f + r_S$$

$$0.993\% + 2.4\% = 3.39\%$$

| Cost of Debt | |
|---|---|
| Synthetic Creation of Cost of Debt | 3.39% |
| Damodaran Research Cost of Debt | 4.5% |
| ***Average*** | ***3.95%*** |

*Source: Petersen & Plenborg (20112), Damodaran Compiled Research (Updated January 2016)*
*Created by authors*

## A.10.1 Betsson Reformulated Income Statement

| Income Statement | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Game win revenue | 1 736 565 | 2 203 711 | 2 476 749 | 3 035 096 | 3 721 987 |
| Other revenue | | | | | |
| Total revenue | 1 736 565 | 2 203 711 | 2 476 749 | 3 035 096 | 3 721 987 |
| | | | | | |
| Cost of sales | -307 676 | -350 017 | -402 851 | -803 748 | -1 046 382 |
| Other operating rev. | 41 397 | 80 962 | 92 869 | 123 097 | 146 867 |
| Marketing | -414 822 | -626 795 | -734 481 | -548 233 | -752 918 |
| Personnel costs | -197 007 | -290 944 | -373 162 | -448 126 | -543 477 |
| Other operating exp. | -224 896 | -334 873 | -350 912 | -408 889 | -478 989 |
| EBITDA | 633 561 | 682 044 | 708 212 | 949 197 | 1 047 088 |
| | | | | | |
| Depr. and Amort. | -73 819 | -104 983 | -107 067 | -127 966 | -160 676 |
| EBIT | 559 742 | 577 061 | 601 145 | 821 231 | 886 412 |
| | | | | | |
| *Current Tax* | -40 640 | -39 049 | -40 918 | -46 096 | -56 595 |
| *Deferred Tax* | 13 044 | 13 278 | 6 761 | 1 971 | 5 350 |
| Sum Income tax | -27 596 | -25 771 | -34 157 | -44 125 | -51 245 |
| Operational Tax | -27 381 | -25 614 | -33 874 | -43 777 | -51 046 |
| *NFE tax* | -215 | -157 | -283 | -348 | -199 |
| NOPAT | 532 361 | 551 447 | 567 271 | 777 454 | 835 366 |
| | | | | | |
| Financial income | 2 859 | 4 370 | 2 540 | 7 594 | 8 632 |
| Financial expense | -7 184 | -7 860 | -7 481 | -14 027 | -12 063 |
| NFE before tax | -4 325 | -3 490 | -4 941 | -6 433 | -3 431 |
| NFE tax | -215 | -157 | -283 | -348 | -199 |
| NFE after tax | -4 540 | -3 647 | -5 224 | -6 781 | -3 630 |
| | | | | | |
| PROFIT / (LOSS) | 527 821 | 547 800 | 562 047 | 770 673 | 831 736 |

*Source: Annual Reports*
*Created by authors*

## A.10.2 Betsson Reformulated Balance Sheet

| Invested capital (operating) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| Total assets | 2 273 099 | 2 956 641 | 3 515 908 | 5 012 573 | 5 727 358 |
| Cash and cash equivalent | -509 672 | -467 186 | -589 090 | -501 377 | -541 800 |
| Other operating liabilities and tax payable | -930 742 | -1 025 015 | -1 163 840 | -1 410 094 | -1 724 321 |
| Invested Capital | 832 685 | 1 464 440 | 1 762 978 | 3 101 102 | 3 461 237 |
| | | | | | |
| Invested capital (financing) | | | | | |
| Equity | 1 334 337 | 1 577 799 | 2 032 218 | 3 073 767 | 3 153 717 |
| | | | | | |
| Loan and borrowings (non-current) | 0 | 344 547 | 0 | 523 353 | 505 166 |
| Loans and borrowing (current) | 8 020 | 9 280 | 319 850 | 5 368 | 344 153 |
| Cash and cash equivalent | -509 672 | -467 186 | -589 090 | -501 377 | -541 800 |
| Net Interest Bearing Debt (NIBD) | -501 652 | -113 359 | -269 240 | 27 344 | 307 519 |
| | | | | | |
| Invested capital (financing) | 832 685 | 1 464 440 | 1 762 978 | 3 101 111 | 3 461 236 |

*Source: Annual Reports*
*Created by authors*

# A.11 Betsson – Cost of Capital through WACC

| Betsson's WACC 2015 | |
|---|---|
| Levered avg. beta | 0,83 |
| Market Premium | 6,00% |
| Risk-free rate | 0,993% |
| Cost of Equity | 6,00% |
| Cost of Debt | 3,95% |
| Tax | 5% |
| After tax Rd | 3,75% |
| E/(D+E) | 0,942 |
| D/(E+D) | 0,058 |
| | |
| **WACC** | **5,87%** |

*Created by authors*

# A. 12.1 DCF Valuation Betsson using Gordon's Growth model

We have displayed a DCF valuation of Betsson in the table below. We have added these free cash flows (FCFF's) to Mr. Green's in order to value the combined firm's future cash flows, as can be seen further down in section A.12.2.

| Valuation Betsson: DCF | | | | | | |
|---|---|---|---|---|---|---|
| | E2016 | E2017 | E2018 | E2019 | E2020 | Terminal |
| **FCFF** | 942 857 | 333 954 | 232 069 | 452 217 | 392 228 | 552 549 |
| **WACC** | 5,87% | 5,87% | 5,87% | 5,87% | 5,87% | 5,87% |
| **Discount factor** | 0,94 | 0,89 | 0,84 | 0,80 | 0,75 | 0,71 |
| **PV of FCFF** | 890 618 | 297 974 | 195 594 | 360 023 | 294 964 | 392 506 |
| **PV of FCFF in forecasting horizon** | 2 039 172 | | | | | |
| **PV FCFF in terminal period** | 12 347 055 | | | | | |
| **Enterprise value** | 14 386 228 | | | | | |
| **Net interest-bearing debt** | 307 519 | | | | | |
| **Estimated market value of equity** | 14 078 709 | | | | | |
| **Shares outstanding** | 122 156 | | | | | |
| **Share Price** | 115,25 | | | | | |

*Created by authors*

# A. 12.2 DCF Valuation Combined Firm using Gordon's Growth model

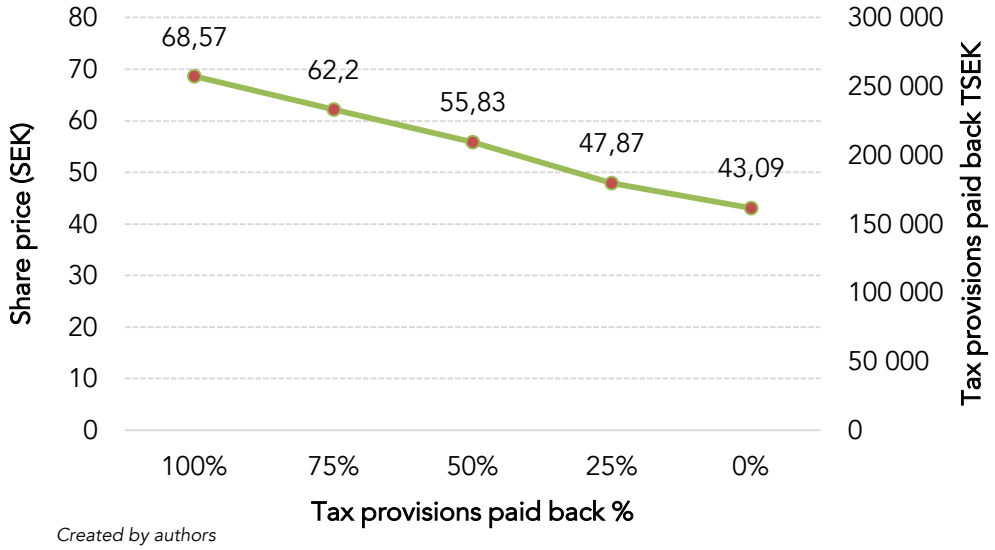
| Combined Valuation: DCF | | | | | | |
|---|---|---|---|---|---|---|
| | E2016 | E2017 | E2018 | E2019 | E2020 | Terminal |
| FCFF | 945 029 | 350 293 | 222 620 | 498 165 | 397 002 | 613 565 |
| WACC | 5,88% | 5,88% | 5,88% | 5,88% | 5,88% | 5,88% |
| Discount factor | 0,94 | 0,89 | 0,84 | 0,80 | 0,75 | 0,71 |
| Present value of FCFF | 892 537 | 312 460 | 187 546 | 396 368 | 298 331 | 435 460 |
| PV FCFF in forecasting horizon | 2 087 243 | | | | | |
| PV of FCFF in terminal period | 13 636 451 | | | | | |
| Enterprise value | 15 723 694 | | | | | |

*Created by authors*

# A. 13 Scenario Analysis: Development of Mr. Green's Realized Tax Provisions

| Scenario Analysis | | | | | |
|---|---|---|---|---|---|
| Tax provisions paid back % | 100% | 75% | 50% | 25% | 0% |
| Tax provisions paid back TSEK | 279,039 | 209,279 | 139,519 | 69,760 | 0 |
| Implied share price | 68.57 | 62.2 | 55.83 | 47.87 | 43.09 |

*Created by authors*




*Created by authors*

**List of Abbreviations**

BV: Book Value

CAGR: Compound Annual Growth Rate

CAPM: Capital Asset Pricing Model

DCF: Discounted Cash Flow

EBIT: Earnings Before Interest and Taxes

EBITDA: Earnings Before Interest, Taxes, Depreciation and Amortization

EBT: Earnings Before Tax

EV: Enterprise Value

EVA: Economic Value Added

GWR: Game Winning Revenue

IC: Invested Capital

IGA: International Gaming Awards

IPO: Initial Public Offering

M&A: Mergers and Acquisitions

M/B: Market-to-book ratio

MEUR: Million Euros

MSEK: Million Swedish Kronor

NIBD: Net Interest Bearing Debt

NGE: Net Gaming Europe

NOA: Net Operating Assets

OGI: Online Gambling Industry

OGM: Online Gambling Market

PM: Profit Margin

PV: Present Value

ROE: Return on Equity

ROIC: Return on Invested Capital

WACC: Weighted Average Cost of Capital