

---

# Evolution Gaming

(Nasdaq Stockholm AB: EVO)



---

Arpan Bagui | February 2021

<b>I.</b>	Company Overview
<b>II.</b>	Industry and Company Context
<b>III.</b>	Industry Tailwinds
<b>IV.</b>	Reasons for Competitive Advantage
	1) Economies of Scale
	2) Switching Costs
	3) Unparalleled Pricing Power
<b>V.</b>	Risks and Mitigants
<b>VI.</b>	Looking Ahead

# Company Overview



Evolution Gaming (Nasdaq Stockholm AB: EVO) is the leading B2B provider of *Live Casino* systems. They develop, produce, market, and license online casino solutions to operators.

## The Product

A virtual casino experience – they develop software, utilize professional studios and augmented reality, and conduct live streams to create a virtual setting for people to play casino games. Every aspect of creating this product enables EVO to **differentiate** themselves.

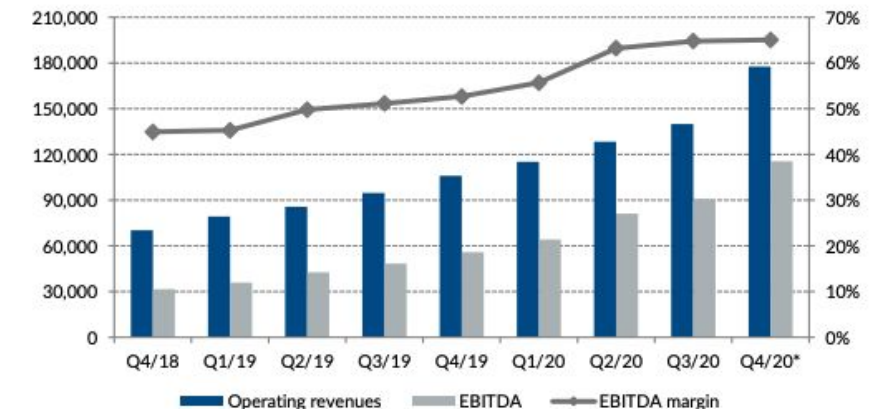


## Cost Structure

EVO's largest cost items are personnel (recruitment, IT, product development) as well as facilities and production studios. EVO also has a lot of operating expenses go directly towards product development.

## Revenue Structure

EVO licenses out streaming from its various tables, earning fixed and commission fees over the course of the contract. Contracts are on average 3 years, and most revenue comes through commission fees (10% of operators' winnings on average).



EVO's fixed costs of setting up a table can be distributed across hundreds of new potential players instead of a few like at a traditional casino table.

# Industry and Company Context



The online casino industry is composed of two verticals:  
Casino Operators + Live Casino System Providers

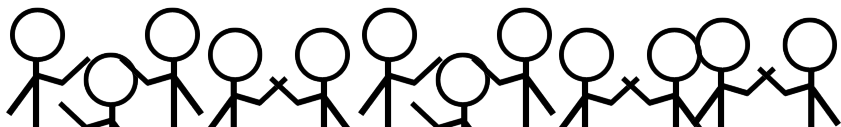
## Casino Operators

- **Customer-facing** businesses that act as hosts for many gambling services
- **Undifferentiated** and highly **commoditized**
- **Hundreds** of competing firms, an estimated **94.5%** of the landscape are minor players



A place to gamble

Revenues



Live gambling systems

Licensing and commission

## Casino System Providers

- **B2B** businesses that provide gambling systems and games to casino operators
- **Differentiated** by types of games offered and quality of systems provided
- **Very few** minor player firms, the landscape is dominated by a few powerful firms



EVO licenses to LeoVegas; EVO had **53%** operating margin in 2020 while LeoVegas had **6%**



# Industry Tailwinds: Gambling Goes Mobile



## Better Technology

- Lower latency internet and broadband capabilities which allows for less delayed streaming
- Higher definition cameras and better augmented reality allows for more realistic experiences
- In 2019 67% of EVO's revenue came from mobile devices, up from 13% in 2014

## Other Trends

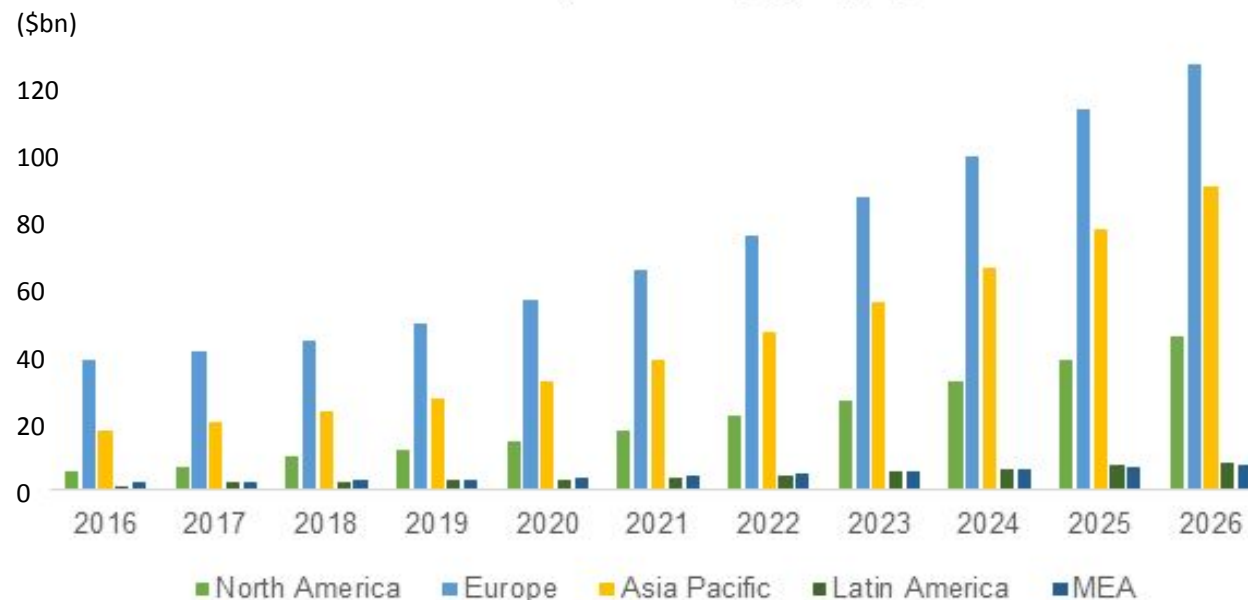
- Many countries, including the US, are moving towards legalizing online gambling which greatly increases TAM
- COVID played a huge role in destigmatizing gambling, spending at online casinos was up 33% in April 2020
- COVID accelerated the shift towards virtual casinos, and now brick and mortar casinos are using EVO to transition

## Key Numbers:

- CAGR of about **11%** from now to 2030
- EVO's market share is **70%**
- Proportion of casino industry that is virtual increased **55%** from 2011 to 2020

The gambling industry is a **quality** industry with strong tailwinds helping it grow. EVO is on the right side of it too, growing along with the **shift towards virtual** casino experiences.

Global Online Gambling Market Size, By Region, 2016 - 2026



# Reasons for Competitive Advantage: Overview



Evolution Gaming is a **quality** business. Three main areas of competitive advantage:

## Economies of Scale

Evolution Gaming has **over 300 operators** as customers and a **massive market capitalization** compared to its peers. This is fundamentally a result of its business structure, and as a result the larger it gets the easier it will be to **maintain its lead**.

## Switching Costs

It is **nearly impossible** for operators to switch over to alternative live gaming service providers. This makes EVO's success very difficult to replicate because competitors are **not able to pull away** customers from EVO.

## Pricing Power

EVO enjoys huge pricing power as a result of its **near monopoly status**. It can get away with premiums no other competitors could and this pricing power will only continue to increase as EVO grows. There's just **no competitor in EVO's league**.

### Evolution Gaming (EVO.ST)

Market Cap (\$bn)	26.5
EV/EBITDA	45x
ROIC FY19	41.5%

### Playtech (PTEC.L)

Market Cap (\$bn)	2
EV/EBITDA	5x
ROIC FY19	3.9%

# Reasons for Competitive Advantage: Economies of Scale



“Every monopoly is unique, but they usually share some combination of the following characteristics: proprietary technology, network effects, economies of scale, and branding.”

- Peter Thiel

## 1) EVO is built to scale

- They have consistently decreased their personnel expenses as a % of revenue
- They can more freely invest in intellectual property because they can split that fixed cost over a huge network of users

## 2) Zero customer acquisition costs

- For every new studio and table they get hundreds of new customers
- All of the risk is on the operator

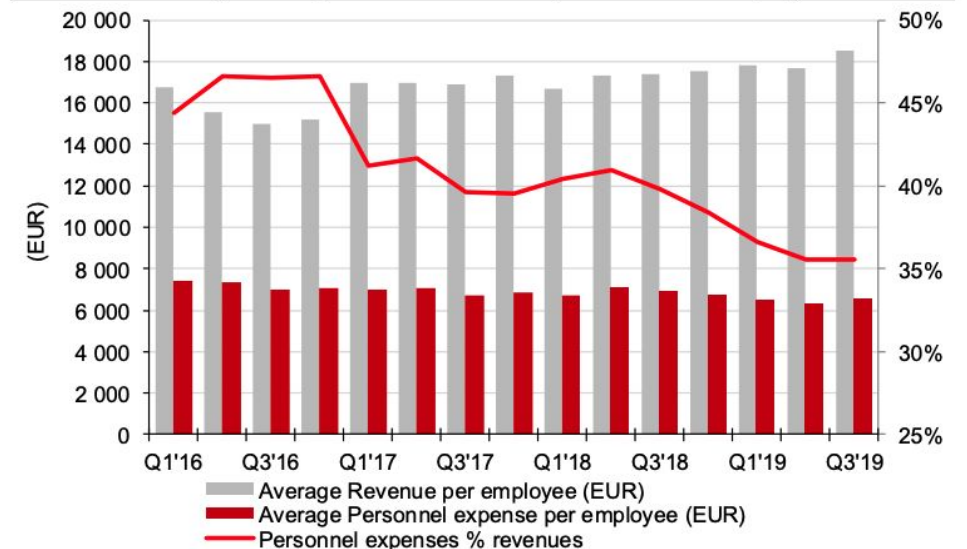
## 3) Their games are designed with no cap

- Most of their games have very high customer capacities
- They're investing more in show games, which allow them to handle even more customers

## 4) Network effects

- Because of their huge market share, friends get other friends to play, creating a network that exacerbates economies of scale

Evolution Gaming: Average Revenue & Cost per full-time Employee



Source: Evolution Gaming, Redeye Research

# Reasons for Competitive Advantage: Switching Costs



“It is barriers to entry, not differentiation by itself, that creates strategic opportunities.””

- Bruce Greenwald

- EVO arrives to re-regulated markets first and gets operators to form contracts with them (as market leaders it's the safe bet for operators anyway)
- Operators can't switch, customers are used to EVO games, EVO dealers, and expect that quality
- If an operator drops the game, people will go to another operator that has it, EVO has all the leverage



EVO deepens its moat by solidifying its market share, the inability to pull customers away is a barrier-to-entry for new entrants

EVO's service is more crisp and higher quality. Even if the difference isn't clear, customers prefer what they're used to and that's EVO.



Evolution Gaming

V.



Playtech





“We are constantly striving to further strengthen Evolution’s leading position.”

- *Martin Carlesund, CEO of Evolution Gaming*

- EVO’s management team highly prioritizes staying ahead of the pack and has since 2006 by reinvesting in itself and constantly developing new games
- EVO has such strong brand recognition that it translates over to the B2C side. That loyalty turns into pricing power and ability to set higher commission fees.
- EVO is forcing competitors out of it’s vertical, Playtech made an acquisition in B2C gambling and is going farther that direction. This suggests EVO will hold its monopoly position.

## EVO is a monopoly

- 70% market share and higher in some regions
- 2 large acquisitions of competitors (Ezugi and NetEnt)
- Was investigated by UK Competition and Markets Authority
- Huge pricing power and profit margins



# Risks and Mitigants



Legal	<p><b>Risk:</b> Being part of the gambling industry, EVO will always be exposed to regulatory risks from the government. This could affect which markets are serviceable.</p> <p><b>Mitigants:</b> Gambling is generally moving towards de-regulation, meaning this isn't a pressing concern. Furthermore, EVO's revenues are distributed across various legal jurisdictions, meaning a legal issues will likely be contained to a small portion of EVO's profits.</p>
Beating the Casino	<p><b>Risk:</b> Because EVO acts as an online casino, there's even more potential to "beat the house". An organized cyberattack or otherwise that rigs games or allows people to cheat would pose a huge disruption.</p> <p><b>Mitigants:</b> EVO has a Mission Control Room (MCR) that handles all security issues. They conduct 24/7 monitoring of studios to prevent situations like fraud. That being said, I find this the biggest risk to EVO.</p>
New Entrants	<p><b>Risk:</b> With a market share of 70% , there isn't a lot more room up. EVO's high ROIC will eventually attract competent newcomers. If a newcomer could replicate EVO's strategy in another geography or improve on it with Virtual Reality technology they could pose a threat to EVO's market share.</p> <p><b>Mitigants:</b> EVO has proprietary control over its games and dealer training program (Evolution Academy). This means no one will be able to totally replicate EVO's strategy. EVO is also expanding into new geographies which reduces the chance of another competitor emerging in another market.</p>

Revenue Distribution by Region

Nordic	6%
UK	8%
Rest of Europe	45%
Asia	23%
North America	7%
Other	9%

Customer dependency (% of revenues)

Year	2017	2018	2019
Top 1-5	38%	32%	27%

## EVO is currently making efforts to expand into new markets and new verticals

### Questions for the CEO:

1. What are your plans to innovate? Is it more games? Virtual reality? Blockchain payment support?
2. The U.K. CMA investigated your merger with NetEnt on antitrust grounds. Is that something you're worried about in the future?
3. What is your strategy for penetrating different markets with different regulations and cultures?

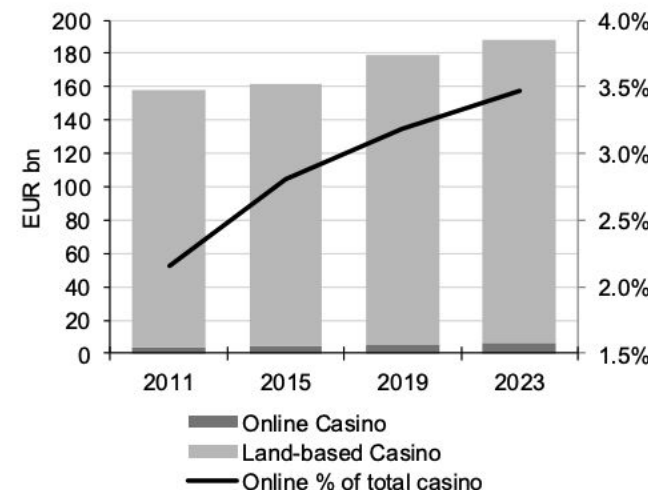
Expanding into new markets is absolutely necessary to maintain first-mover advantages.

Expanding into other products like sports-betting is risky because of existing players who have economies of scale.

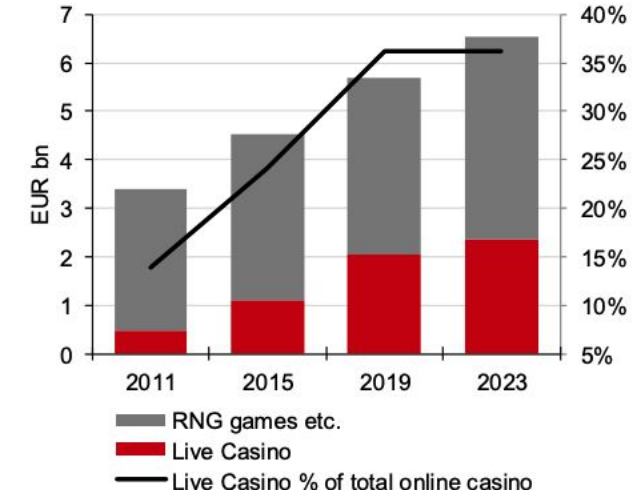
Organic growth alongside acquisitions like their current strategy is working and should be continued.

EVO should take a big role in helping brick and mortar casinos transition to online.

The RoW casino market: land vs. online



The RoW online casino market: RNG vs. live



Q & A