COLLINS ◆ STEWART

UK Betting

4 March 2005

Smaller Companies Research

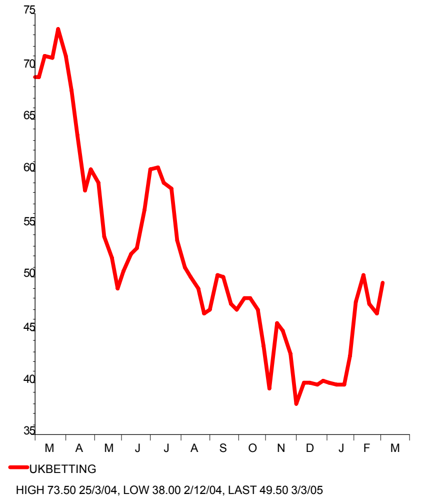
Year to December	2003A	2004E	2005E	2006E
Turnover (£m)	54.5	87.9	108.4	117.5
CS PBT (£m)	(4.7)	(0.8)	2.5	3.7
CS EPS (p)	(5.1)	(0.7)	1.9	2.9
DPS (p)	–	–	–	–
P/E (x)	–	–	25.4	17.2
Yield (%)	–	–	–	–

Price: 49p

Market Cap: £47m

Relative to	1m	3m	12m
FTAllShare (%)	+6	+25	-33
FTSE Small Cap (%)	+7	+21	-32

www.ukbetting.com



Source: Datastream

Summary

Investors will be well aware that online gaming stocks have performed exceptionally well this year; our analysis suggests the sector has risen over 80% in the last three months. Against this background UK Betting's rise of 27% over the same period looks relatively pedestrian, particularly given the unique nature of the UK Betting's business model. This has lead us to wonder whether UK Betting has been overlooked or perhaps misunderstood.

UK Betting is unique in that it owns the largest sports content network in Europe, with 7m users, and leverages it to acquire customers for its gaming sites. Whilst this customer acquisition strategy is now proven and should accelerate (given increasing advertising of its own gaming sites on its content sites), the benefits have barely been felt on the gaming side of the group. Historically the gaming product offering was low margin sports betting; the more lucrative fixed odds games, casino and poker sites having been a relatively recent addition. In the last six months, the introduction of casino, poker and fixed odds betting sites where margins are guaranteed have seen gaming profits start to rise. In 2005 we estimate that Ebitda contribution from gaming will rise to a profit of £2.7m from a loss of £0.1m in 2004. Of this, over 75% will come from casino, poker and fixed odds games. UK Betting is finally starting to monitise its gaming customer base and that its group profit is primarily derived from poker, casino and fixed odds. Thus with the market currently busily re-rating online gaming stocks, perhaps UK Betting has been overlooked in this regard.

Looking to 2006 UK Betting is trading on just a sector average P/E rating of 17x despite having earnings growth of 48%, more than twice the sector average. Thus its PEG ratio of 0.4 is less than half any of its peers. Further given the unique nature of the business model we have highlighted in this note, the opportunity for expansion into other territories and the absence of any potential issues from overseas gaming legislation, we believe the shares should trade at a premium to the sector.

Analyst:
Stephen Ford
+44 (0)20 7523 8421
sford@collins-stewart.com

9th Floor, 88 Wood Street
London EC2V 7QR
Tel: +44 (0)20 7523 8700
Fax: +44 (0)20 7523 8140
www.collins-stewart.com

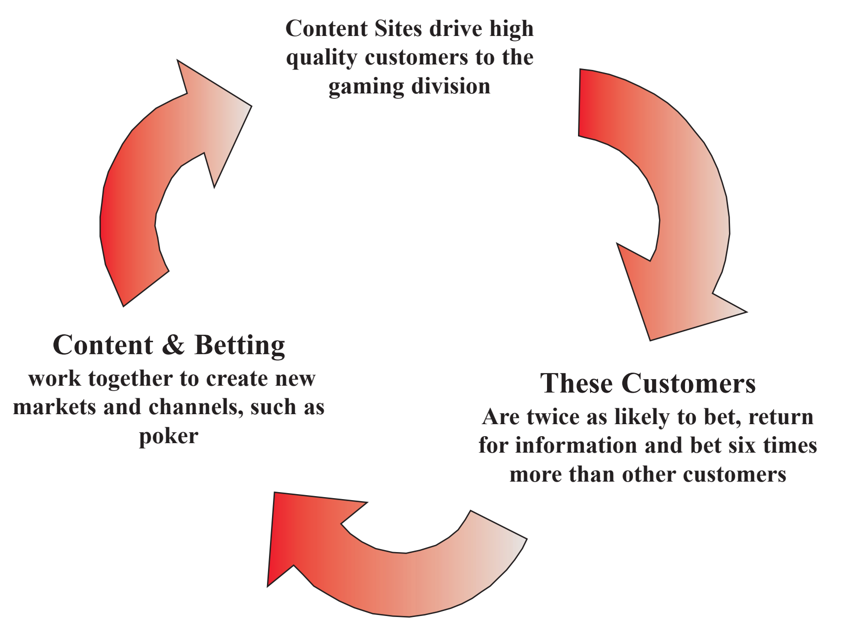
Introduction

Investors will be well aware that online gaming stocks have performed exceptionally well this year; our analysis suggests the sector has risen over 80% in the last three months. Against this background UK Betting's rise of 27% over the same period looks relatively pedestrian, particularly given the unique nature of the UK Betting's business model. This has lead us to wonder whether UK Betting has been overlooked or perhaps misunderstood.

Unique Business Model

UK Betting is unique in that it owns the largest sports content networks in Europe, with 7m users and leverages it to acquire customers for its gaming sites.

The content and betting model



Source: UK Betting

Following a series of acquisitions UK Betting now owns a number of well-known sports content sites including *sportinglife.com*, *teamtalk.com*, *rivals.net*, *sportal.com*, *football365.com*, *sports.co.uk*, *planet-rugby.com* and *oddschecker* (the largest odds aggregation business in the UK). These sites attract 7m users which makes them the largest network of sports content sites in Europe. The content created and eyeballs generated are monitised in a number of ways such as white labelling to third parties, phone services, advertising and e-commerce. This leaves the content side of the business profitable in its own right, prior to considering its value as a customer acquisition tool for the gaming side of UK Betting.

The UK Betting gaming sites include sports betting sites such as *ukbetting.com*, *totalbet.com* and *GoldBet.com* together with casino and poker sites such as *ukbetting casino*, *ukbetting poker*, *totalbet casino* and *totalbet poker*. Crucially about 60% of new customers are derived via UK Betting's content sites providing a unique low cost customer acquisition strategy. These customer acquisitions have been achieved whilst UK Betting has taken up less than 20% of the total bookmaker advertising space on its own content sites, the rest being sold to third parties. However, now that UK Betting is moving into profit, it is able to slowly decrease third-party bookmaker advertising and increase its own advertising. This will increase the rate of growth of gaming customers and provide a greater proportion of high quality leads (customers acquired via content sites have a higher propensity to bet as they regularly return to the sites to check scores, form and tips).

Rapid Improvement in Monitisation of Gaming Customers

Whilst this customer acquisition strategy is now proven and should accelerate, the benefits have barely been felt on the gaming side of the group as historically the product offering was low margin sports betting; the more lucrative fixed odds, casino and poker sites having been a relatively recent addition.

Prior to mid 2004 the UK Betting gaming business only offered the opportunity to place fixed odds sports bets, with the sales mix skewed to horse racing. Traditionally online margins on UK fixed odds sports books, particularly horse racing are low due to competition. Indeed it can be difficult to lay off risk and balance the books; consequently bookmakers may even loose money if results are unfavourable, usually if favourites keep winning. Thus despite an improving sales mix towards higher margin sports such as football and the acquisition of GoldBet in the less competitive Italian market, the sports book has not made material contribution to the group.

However, in the last six months, post the introduction of casino, poker and fixed odds betting sites where margins are guaranteed, profits from the gaming business have started to rise. In 2005 we estimate that Ebitda contribution from gaming will rise to a profit of £2.7m (pre-allocation of Plc costs) from a loss of £0.1m in 2004. Of this gaming profit we estimate that over 75% will come from casino, poker and fixed odds games. Arguably they represent an even higher percentage of group profit, although this partly depends on how customer acquisition costs are allocated. Nevertheless what is clear is that UK Betting is finally starting to monitise its gaming customer base and that its group profit is primarily derived from poker, casino and fixed odds. Thus with the market currently busily re-rating online gaming stocks, perhaps UK Betting has been overlooked in this regard. This is particularly the case when considering two crucial advantages UK Betting holds over its quoted peers.

Key Advantages

Firstly, as we have pointed out, it has a unique low cost customer acquisition strategy of delivering gaming customers via its online content sites. The value of this strategy increased last year when Google restricted online gaming promotional opportunities. Further, looking into the future, this strategy should continue to increase in value as it seems likely that gaming sites relying purely on traditional advertising and marketing for customer acquisition, will see increasing advertising spend steadily erode margins.

UK Betting's second key advantage, in comparison to many of its quoted peers, is that it is not soliciting bets from territories where online gaming is illegal. Some companies have made great success of receiving business from territories such as the US where operating an online gaming site is illegal. Whilst we hasten to point out that there is nothing illegal about non-US sites receiving bets from the US, there is a concern over the longevity of such models. Any move to legalise online gaming in such territories could quickly see a vast increase in competition from some household names, with no guarantee that the current market leaders will maintain share or even be granted licences. Such fears have historically weighed heavily on the ratings of such stocks.

Opportunities

We believe the following are key, easily achievable opportunities for UK Betting:

1. *Drive increased usage of its content sites.* Increasing penetration of broadband will only increase appetite for content and deals such as the recent link to BBC video content will help drive traffic to UK Betting content sites.

2. *Convert more content viewers into betting customers.* As highlighted earlier increasing UK Betting's advertising on its own content sites will in turn accelerate the growth in gaming users.

3. *Convert more existing sports book customers to casino and poker customers.* As we have shown gaming profit is made primarily through casino, poker and fixed odds games. Whilst UK Betting has 225,000 registered sports book users, only a fraction of these are registered casino and poker customers. There is a clear opportunity to convert more of the existing sports book customers as well as acquiring new customers.

4. *Introduce Casino, Poker and Fixed Odds games to new territories.* In this regard today's announcement that GoldBet is to launch Casino and Poker products for the Italian market is a positive development. If the model works in the UK then it should work in other territories. UK Betting estimates that its key territory, the UK, represents less than 7% of the global gaming market. Thus there is plenty of opportunity to take the model into other territories by translating the content sites into other languages.

Financials

Our current forecasts for UK Betting are set out below.

UK Betting P&L Forecasts

Year to December £m	**2003A**	**2004E**	**2005E**	**2006E**
Turnover				
Content	7.7	14.8	14.2	15.5
Gaming	46.8	73.1	94.2	100.5
	54.5	87.9	108.4	116.0
Ebitda				
Content		1.2	1.3	2.1
Gaming		(0.1)	2.7	3.2
	(2.9)	1.1	4.0	5.3
Plc costs	(0.8)	(1.0)	(1.0)	(1.1)
	(3.7)	0.1	3.0	4.2
Depreciation	(0.6)	(0.8)	(0.6)	(0.6)
Pre goodwill op. profit	**(4.3)**	**(0.7)**	**2.4**	**3.6**
Amortisation	(0.9)	(1.9)	(1.9)	(1.9)
Interest	(0.4)	(0.1)	0.1	0.1
Exceptional items	–	(1.5)	–	–
PBT	**(5.7)**	**(4.2)**	**0.6**	**1.8**
Tax	–	–	(0.0)	(0.1)
PAT	**(5.7)**	**(4.2)**	**0.6**	**1.7**
CS EPS (p)	(5.1)	(0.7)	1.9	2.9
CS P/E (x)	–	(74.1)	25.4	17.2
FRS 10 EPS (p)	(6.1)	(3.4)	0.5	1.4
FRS 10 P/E (x)	–	–	106.7	35.4
Fully diluted w. ave. shares	92.6	122.3	126.2	126.2

UK Betting Cashflow Forecasts

Year to December £m	2003A	2004E	2005E	2006E
Operating profit	**(4.3)**	**(0.7)**	**2.4**	**3.6**
Depreciation	1.6	0.8	0.6	0.6
Other	(1.8)	(0.4)	(0.5)	(0.5)
Operating cashflow	**(4.5)**	**(0.3)**	**2.5**	**3.7**
Net interest	(0.4)	(0.1)	0.1	0.1
Tax	–	(0.2)	–	–
Capex	(0.2)	(0.6)	(0.6)	(0.6)
Acquisitions	(3.6)	(2.9)	–	–
Other	–	(1.5)	–	–
Financing	15.4	1.2	–	–
Net cash inflow	**6.7**	**(4.4)**	**2.0**	**3.2**
Cash b/f	**(2.0)**	**4.6**	**0.2**	**2.1**
Cash c/f	**4.6**	**0.2**	**2.1**	**5.3**

Comparitors

We have set out below a comparison of some of UK Betting's quoted online gaming peers.

UK Betting Comparitors

	Currency	Mkt Cap (m)	Price	3m price move	EPS 2005	EPS 2006	Growth 2005- 06	DPS 2005	P/E 2005	P/E 2006	PEG 2006	Yield 2005
BetandWin	Euro	635	52	136%	0.28			0.0	185.7			
Bet On Sports	Sterling	94	116	31%	7.40	8.3	12%	6.7	15.7	14.0	1.1	5.8%
Gaming VC		210	700	67%	76.00	79.0	4%	42.0	9.2	8.9	2.2	6.0%
SportingBet	Sterling	1143	347	100%	13.00	15.9	23%	1.6	26.7	21.8	1.0	0.5%
UK Betting	Sterling	47	49	27%	1.90	2.9	48%	0.0	25.4	17.2	0.4	0.0%
Unibet	SEK	4321	690	146%	23.6	28.8	22%		29.3	23.9	1.1	0.0%
Average				85%			22%		21.3	17.2	1.2	
									ex Bet & Win			

Note: EPS and DPS numbers are consensus forecasts rebased to a December year end

It is clear that UK Betting has underperformed its peers in the last three months having only risen 27% against a sector move of 85%. This may in part be because the market hasn't focused on the strong operational gearing within the business, which now that UK Betting is moving into profit will result in strong profit growth from 2005 to 2006. In fact looking to 2006 UK Betting is trading on just a sector average P/E rating of 17x despite having earnings growth of 48%, more than twice the sector average. This is also demonstrated by a PEG ratio of 0.4, less than half any of its peers. Further given the unique nature of the business model we have highlighted in this note, the opportunity for expansion into other territories and the absence of any potential issues from overseas gaming legislation, we believe the shares should trade at a premium to the sector.

LONDON
Collins Stewart Limited
9th Floor
88 Wood Street
London
EC2V 7QR
Tel: +44 (0)20 7523 8000

NEW YORK
Collins Stewart Inc
41st Floor
444 Madison Avenue,
New York
NY 10022
Tel: +1 212 652 9000

MILAN
Collins Stewart Filiale
Italiana
Via Santa Marta 25
20123 Milano
Italy
Tel: +39 02 4547 1057

PARIS
Collins Stewart Tullett
France
89-91 Rue du Faubourg
Saint-Honore,
75008 Paris
Tel: +33 (1) 49 24 19 17

DUBLIN
Collins Stewart
Alexandra House
The Sweepstakes,
Ballsbridge
Dublin 4
Tel: +353 1 631 9030