Perpetual Equity Investment Company Limited

Flutter – a global sports betting and gaming powerhouse

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Our analysis of portfolio incumbent Tabcorp and the broader gaming sector led to our investment in Flutter. We believe this innovative company will be the beneficiary of a trend towards online, which seems to have accelerated since COVID.

Flutter Entertainment plc is a global sports betting, gaming and entertainment provider headquartered in Dublin, with a portfolio of leading international brands and operations. Its vision is to be a global leader in online sports betting and gaming.

When we began our work on Flutter, the business was predominately a sports betting business operating under the market leading brands of Paddy Power and Betfair in the UK and Europe, and Sportsbet in Australia.

The business has developed significantly since that time, with the 2018 acquisition of a majority stake in FanDuel, a US-based Daily Fantasy Sports (DFS) business. This coincided with the deregulation of sports betting in the US, providing a platform for the Flutter group to launch an entry into the nascent US sports betting market.

In May 2020, Flutter completed a merger with The Stars Group to become the largest listed online gaming operator in the world. The combined business:

- is the global leader in online poker
- has the leading brands in sports betting in the UK, Ireland, Australia and the US
- has the world's largest online betting exchange
- is one of the world's largest online casino businesses
- is well diversified across geographies and product lines.

Flutter has a proven track record of leveraging its brands, innovative product launches, unique marketing strategies and a relentless focus on investing in customers to profitably grow market share through cheaply acquiring high value recreational customers.

We have observed this with Sportsbet's dominance over Tabcorp in Australia and in the Paddy Power brand in the UK. We expect this to continue as Flutter enters other markets. From a financial perspective, with over 95% of revenues online, Flutter is well positioned to benefit from the ongoing shift in consumer behaviour from retail to online, and to compound revenue and earnings growth for years to come.

We hold the management team in high regard and have confidence that it will continue to deliver favourable returns for shareholders.

How big is the US sports wagering opportunity?

There has been no shortage of euphoria about the potential growth in the US sports wagering market. We believe the hype.

Consider Australia, which has some similar characteristics to the US market, where there's a sports mad population with mass smartphone usage and who don't mind a punt. Australia has about 10 percent of the adult population of the US and has a sports/horse betting size of A$4.8bn; extrapolate that, and it's not hard to get a market size of US$30bn+.

However, this doesn't tell the whole story. An extremely popular form of sports gambling is in-play, which is illegal in Australia. We believe US sports, such as American Football or baseball, are conducive to in-play betting given their stop-start nature. Because there is so much data captured on every aspect of sports in the US, we expect the number of bet types will grow exponentially, which should help drive revenue. We envisage an enormous amount of innovation occurring over the next few years.

Importantly, the size of the market could be immense – and it's starting from a very low base. As it stands, 24 states across the US have legalised sports betting with 19 states currently live. Alongside sports betting, New Jersey and Pennsylvania have been early adopters of legalising online casino and poker. The initial traction of these products has materially exceeded expectations with the cross-sell from sports-betting products driving material revenue outcomes.

Due to the impact of COVID-19, we have seen evidence that the pace of state regulation will accelerate as governments look for additional revenue sources to counter budget pressures. We agree with the market's optimism and are bullish about the long-term prospects for this market.

This investment is not without risk. While regulatory risk is always front of mind, we also need to be wary that an integration between two large businesses, such as Stars and Flutter, will always have hiccups. However, we believe the biggest risk is future competition, especially in the US market. Exciting and high growth markets tends to attract new capital; new competition may come from a business that does not yet exist.

While we recognise the barriers of entry, if Flutter stops innovating, it will leave itself vulnerable. We will continue to monitor this and have confidence the management team will continue to innovate and be nimble. If Flutter is able to maintain a solid market position in the US, and the US market grows as expected, the upside from this investment could be substantial over the next 5-10 years.

There are many waves which could drive growth should our base case eventuate. From new states regulating sports betting, to more innovation of in-play product, to growth in horse racing through growth of fixed odds offerings, to leveraging into online casinos and poker. There are many strings to this bow. There will be bumps in the road, but Flutter has the balance sheet, cashflow generation, management team and tailwinds to be a good long-term investment.