M&A activity could signal start of a wave of consolidation

Two recent proposed transactions have highlighted what many analysts are predicting could be a wave of consolidation in the online gambling industry. Ladbrokes' proposed merger with Gala Coral, and the tussle between 888 Holdings plc and GVC Holdings plc to acquire bwin.party, represent what many believe will be the first of a series of high-stakes M&A bets, in response to amongst other things the higher taxation and increased competition faced by operators, particularly as a result of the recent regulatory changes to the UK market. In this article, Rob Willis and Charles Turnham of Olswang LLP examine the drivers behind these deals and the lessons to be learnt.

The Ladbrokes and Gala Coral merger

The proposed recommended merger between Ladbrokes and Gala Coral was announced in late July 2015 and will, subject to competition clearance and shareholder approval, create Ladbrokes Coral plc, which will be the UK's biggest bookmaker across the retail and online gambling sectors, valued at £2.3 billion. In view of the fact that the combined entity will control a 46% share of the UK retail gambling market, clearance from the UK Competition and Markets Authority is far from certain and, even if received, it seems likely that a significant number of leveraged buyout divestments will be required in advance of completion, which (if approved) is expected to occur in mid-2016.

The deal echoes an earlier iteration of an attempted combination between the two companies in 1998, when an unconditional acquisition of Coral (as it was then known) by Ladbrokes was blocked on competition grounds by Peter Mandelson, the then Business Secretary. Although this deal clearly has a large retail dimension, the online opportunity available to the combined business is nonetheless a key strategic driver of the merger. The July announcement noted that "digital sportsbetting and gaming remain the key growth opportunities in our market and the merger enables the combined entity to drive further online growth," to be delivered through enhanced multi-channel and marketing capabilities across multiple brands. Ladbrokes acknowledged that it has historically been slow to deliver competitive products and technology in the online space, and announced its intention to leverage Coral's recent success in this area and deliver synergies across a larger customer and revenue base.

The takeover battle for bwin.party

The high-profile poker game for control of bwin.party (owner of major online gaming brands bwin, partypoker, partycasino and Foxy Bingo and, of course, the result of a significant merger itself in 2011) is, at the time of writing, ongoing between online gaming entertainment and solutions provider 888 Holdings and Sportingbet owner GVC Holdings.

Following a formal sale process initiated by bwin.party, it was announced in mid-July 2015 that the bwin.party board would be recommending a cash and shares offer from 888 at 104.09p per share, valuing the business at £898 million. This recommendation came notwithstanding the rival proposal from GVC who, in conjunction with the Canadian gaming giant, Amaya, was offering 110p per share via a combination of cash and GVC shares. bwin.party commented that it had decided to go with 888's offer as the bid from GVC, though containing "many attractive features," also carried "additional execution risks."

Not accepting defeat, GVC announced in early August 2015 that it had made a fully-funded cash and share proposal to acquire bwin.party at 125.5p per share, implying a value of £1.03 billion for the company. This time, GVC is no longer involving Amaya and instead, a significant proportion of the funding would come from US private equity investor Cerberus Capital (also an investor in Gala Coral).

The industry is now awaiting the outcome of this close fought battle with a further announcement from bwin.party expected imminently.

What is driving this M&A activity?

As set out in the 888/bwin.party announcement, consolidation in the online space is being driven by both industry growth and the increasingly challenging operating environment facing the sector. Central to this latter development in respect of the European online gambling industry has been the much-publicised introduction of the point of consumption ('PoC') tax in the UK. The new tax went live on 1 December 2014 and is charged at 15% on online gaming revenues derived from UK-based customers, irrespective of the location of the operator. This fiscal increase will be of particular concern to operators with low online profit margins, of which Ladbrokes (pre-merger) is a prime example. Offshore operators will be following the progress of the Gibraltar Betting and Gaming Association's[1] case against PoC with keen interest, after a July 2015 decision of the UK High Court referred the imposition of the tax to the European Court of Justice.

In the UK retail space, the profitability of lucrative Fixed-Odds Betting Terminals has been hit by the imposition of an increase in Machine Gaming Duty to 25% with effect from 1 March 2015. William Hill's announcement in August 2015 of a one-third fall in 2015 half-year profits against 2014 due to the payment of an additional £44 million in gaming duties illustrates the impact of both of these measures. Against that background, it is no surprise that William Hill was also in the market earlier this year for some game-changing M&A activity when it tabled its (ultimately unsuccessful) £700 million takeover offer for 888.

The importance of effective technology in the online space was also a key driver in Ladbrokes' bid for Gala Coral. The joint announcement emphasised Gala Coral's strength in this area and signposted Ladbrokes' plans to harness this strength in order to drive the multi-channel offering of the combined group.

In light of these drivers, it is perhaps unsurprising that Jim Mullen, Ladbrokes CEO, regards further consolidation in the sector as "inevitable," noting that such pressures mean that "operators will need to be far more efficient." Whilst it seems likely that the drive towards consolidation in order to offset rising costs will result in the smaller players in the UK and European markets being snapped up by bigger fish (echoing the flurry of acquisitions of Australian digital operators by UK and Irish powerhouses such as Ladbrokes, William Hill and Paddy Power in 2013-14), the example of 32 Red plc illustrates that there remains hope that smaller operators can thrive against the operational challenges in the industry, in particular the new PoC regime. The Gibraltar-based online casino company, which focusses principally on UK customers, reported an increase of 22% in net gaming revenues for the first half of 2015, with active and new casino customers up 22% and 14% respectively, a performance that Chief Executive Ed Ware attributed to the company's enhancements in CRM methodology and marketing techniques. However, a likelier indication of the overall direction of travel is perhaps to be found in Unibet's acquisition of Stan James's online business for £19 million, announced in July 2015. Unibet's intention is to enhance the profitability of the acquired business through technological enhancements and an improved mobile offering.

A further stimulus for consolidation in the global online gaming sector is likely to come from North America, where the success of companies such as Amaya and Intertain reflects a strong appetite for investment in the sector

A further stimulus for consolidation in the global online gaming sector is likely to come from North America, where the success of companies such as Amaya (owner of Pokerstars and Full Tilt Poker) and Intertain (buyer of Costa Bingo, Vera & John and Gamesys'[2] Jackpotjoy, Starspins and Botemania brands) reflects a strong appetite for investment in the sector, driven by its international nature and the robust stock market performance of Canadian online gaming companies, as well as anticipation of future opportunities in the US market. Furthermore, there are large amounts of global capital available for investment in the sector: it is estimated that gambling-focussed private equity funds are holding large amounts of uncommitted 'dry powder,' with US, UK and European-facing PE gaming funds holding circa £18.9 billion, £11.6 billion and £13.8 billion respectively as at January 2015[3].

It is estimated that the online gaming industry generated global gross revenues of approximately $34.8 billion in 2014, representing 8.6% of the global gaming market. Even more significantly, the online sector is expected to grow to approximately $48.6 billion by 2018, implying a compound annual growth rate of 8.7%[4]. In the light of this stellar rate of growth, it is not surprising that the sector seems set for a hectic period of consolidation, powered by in-bound investment from North America and a significant stockpile of PE capital. In this context, both the Ladbrokes/Gala Coral and the bwin.party transactions can perhaps be seen not only as short-term responses to an increasingly challenging operating environment, but additionally as instructive lessons to the industry of the importance of market participants positioning themselves advantageously for this growth opportunity through mergers offering shared marketing and technology expertise, a broader, multi-platform product offering and significant cost and revenue synergies.

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1. Advised by Olswang LLP.
2. Advised by Olswang LLP.
3. 2015 Prequin Global Private Equity & Venture Capital Report, January 2015.
4. H2 Gambling Capital, June 2015.