

OPAP's Monopoly Profits 'Unsustainable', Say Analysts

Scott Longley, 2 Dec 2008

GamblingCompliance Ltd.

An "unsustainable" monopoly position in its home market of Greece will see sports-betting operator Opap lose its status as the world's most profitable gaming company, according to analysis from the leisure team at Morgan Stanley. Meanwhile, Rank is downgraded after hefty earnings downgrades.

The Morgan Stanley analysts have Opap as one of the bottom picks of the sector and suggested the company was an "anomaly" and that its "supernormal" profits were unsustainable.

"We expect EBIT of €979m. This compares to our estimate of total UK retail industry profits of £500m to £600m... It makes Opap the most profitable gaming company in the world, including MGM with its asset base of \$17bn. The supernormal profits are based on Opap's monopoly position, and we believe that this monopoly will continue to come under further pressure over the next two years."

In addition, the analysts suggested that there are further downside risks, including a weakening Greek economy and emerging competition in sports-betting which they believe will knock 3 percent off overall gross win. The analysts cited recent comments from the European Commission to the effect that Greek legislation on sport-betting is not in line with EU laws and that an infringement procedure has already been put in train.

In the same note, the analysts also noted that an increasingly grim forecast on the prospects for the UK economy has forced them to chop their earnings forecasts for UK bingo and casino operator Rank by over 30 percent for 2010.

The team suggested the UK will now experience a multi-year recession lasting at least the next two years, compared with previous hopes for a V-shaped recovery in 2010.

In light of this, they now see Rank earnings falling 20 percent next year and a further 32 percent the year after. The note added: "We now expect EBIT to deteriorate gradually every year, with an ongoing decline in bingo only partially offset by limited growth in casino and online gaming."

The analysts added that they now believe there is significant balance sheet and financing risk, as Rank has already been through a cost rationalisation process and that it doesn't have much by way of any room for manoeuvre.

"Rank has already suspended its dividends, implemented a significant cost savings plan and curtailed capex plans. It has only limited freehold assets remaining following sale and leasebacks, and with its cost base already pared back, we think further unexpected weakness in trading could seriously challenge the company's finances."

Should Rank suffer in line with previous recessions, Morgan Stanley's bear case would be a like-for-like sales decline of 5 percent. Under such circumstances, the analysts suggested the company would need to issue new equity to reduce its debt levels.

The Morgan Stanley team has better news, however, for Ireland-based bookmaker Paddy Power, suggesting the company's cash position and "self-funded growth strategy" will help the company weather the downturn in the UK and Irish betting markets. "It has no debt, and its annual free cash generation is €80m to €90m, we estimate... Paddy Power's investment plans are organic, and we estimate annual capex of around €30m, driving 10 percent to 12 percent annual growth in total retail outlets. All of this expansion is funded internally."