



Casinos and Gaming

The Evolution of Gambling

iGaming is an activity which is experiencing a modern-day renaissance throughout the US. In May 2018, the US Supreme Court decided to legalize sports betting country-wide pushing many states to propose new laws to further legalize many forms of gambling. Prior to that, the federal ban meant that Americans were spending an estimated \$150B annually on *technically* illegal gambling. This new legislation environment has encouraged many existing European operators to establish footholds in the US with their long history of experience and extensive technology infrastructure. In order to win the lions share of this market, it seems that US companies will have to leverage the expertise of these established European brands.

iGaming effectively involves online gambling for both live events and casino games (such as slots, roulette and poker). This business essentially brings the brick & mortar casino experience to a user's phone or computer. Live event sportsbooks operate at a lower margin than virtual casino gaming. Yet, this business model forgoes all physical locations and instead allows players to join from all over the world to play live, allowing the online casino market to benefit from much higher overall margins. In traditional casino businesses, games lack true scalability as they can only support a fixed number of players at any given time for a given game. However, online casinos can support virtually unlimited players at the same game while bearing none of the overhead costs. Where dealer costs would be considered variable for the brick & mortar model, they are fixed costs for online casinos and can therefore be leveraged across thousands of concurrent players.

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Industry Overview

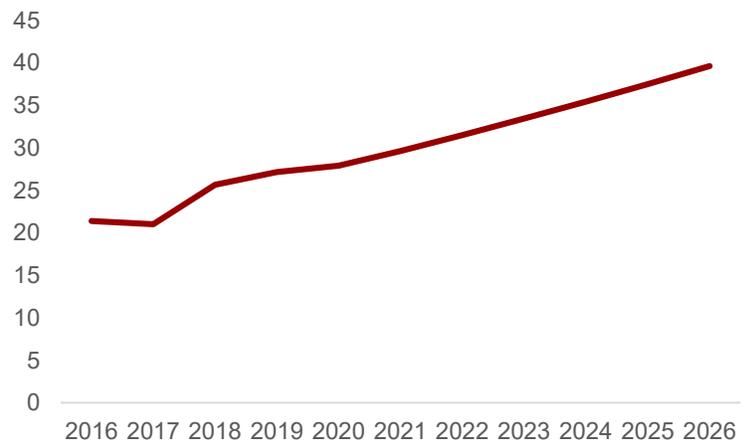
The scalability in and of itself makes this model significantly more attractive. Evidently, one of the most crucial elements of this model is having robust software integrations in order to support large volumes of virtual traffic, an integral part of the value chain.

Of course, a direct source of competition for the iGaming industry would be the ~400 land-based casinos across the United States. These are comprised of both native tribe and commercial casinos which can be found in Nevada and Atlantic City. These land-based hotel casinos brought in an estimated \$55B of revenue in 2019, a figure which has tripled since 2009. Similar to the boom card rooms experienced from 1982-1997, online casinos are continuing to take market share from their asset-heavy counterparts and this industry is expected to grow at a CAGR of ~12% through 2027, cannibalizing commercial casino revenue in its wake.

The iGaming industry itself is not without competition either. It is a highly fragmented market comprised of both regional and global players. The largest companies include Bet365, Entain PLC, The Flutter Entertainment and Kindred group. These large players have been focused on acquisitions in an attempt to consolidate the industry.

North America is the fastest growing industry with promising regulatory trends. The current legalization only allows companies based in Nevada, Pennsylvania and New Jersey to operate legally whereas Canada is largely unregulated on the online gambling front. Further legalization in the US is expected to drive robust growth for this geographic segment.

Figure 1: Revenue (\$ Billion)



Las Vegas travel rates have experienced a significant uptick recently, land-based casinos have seen a decline in overall market share. Consumers have been opting to forego the travel expenses and are increasingly opting for virtual casinos. iGaming companies have noticed that consumers still want the "feel" of a live casino and have begun employing more live dealers to facilitate play. As previously mentioned, many of these games are not restricted by concurrent players and are able to have hundreds of players on a single game at any given time.

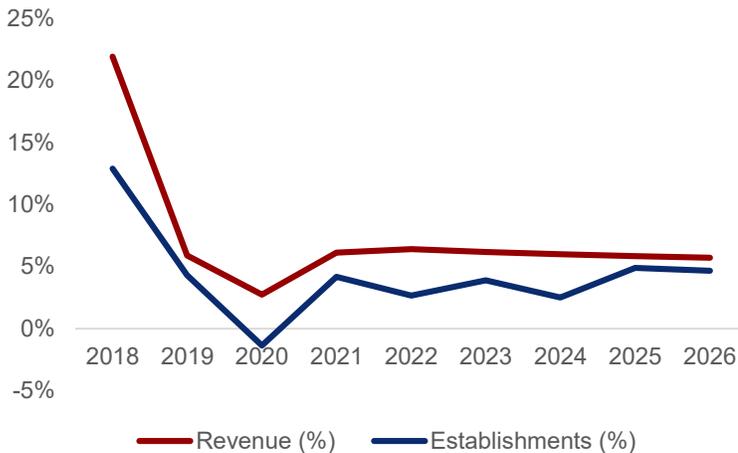
The global casino market is expected to reach over \$159B and the American market alone is estimated to reach over \$40B by 2027. 25% of this market is expected to be held by virtual-only casinos. This industry has largely been a Covid beneficiary whereas its brick-and-mortar counterparts saw an 11% decline in 2020. Growth is not expected to subside for the online gambling industry.

Key Trends

Legalization

People's moral perception around gambling is changing, a survey done by Gallup News showed that 69% of Americans found it morally acceptable, while 58% did not in 2009. This trend has led policymakers in America to start legalizing Gambling, and thus creating tailwinds for the industry. For example, when New Jersey legalized online betting in 2018, revenue for the USA online gambling industry grew 22% that year. With the increasing acceptance of gambling, the industry is set to legalize all over the USA. This will lead the Online Gambling industry to reach 37.5 billion in revenue by 2025, increasing by 6.1% each year. It should be noted that the legalization is occurring on a state-by-state basis, and operators are geographically locked to their domestic markets. This means there is no threat of external competition, and ultimately will lead the industry to be geographically fragmented. However, the rest of the world is not as welcoming as America. 39 countries have completely banned it and 93 have not explicitly prohibited or licensed it.

Figure 2: Growth in Revenue vs New Establishments



COVID-19

COVID-19 has been a significant tailwind for this industry. During the COVID-19 breakout, all brick and motor casinos were shut down, which led to a sharp increase in the demand for online casinos. For example, in Australia, spending on online casinos rose sharply by 67% in April. Many operators in face of COVID-19 closed physical casinos and went digital. This has caused a long-term shift in supply as there are now fewer physical and more digital establishments. For example, states such as Rhode Island have legalized online lottery marketing and has created a state-sponsored online lottery platform. During COVID-19 a third of gamblers tried at least one new gambling activity, showing the diversification in the interest of gamblers. This is supported by an increase in new types of gambling activities with the increase in the popularity of cryptocurrency.

Competitive Landscape Moving Forward

The global online casino industry is highly fragmented, due to different license requirements in different geographies. For example, in the USA, the operator must have a license issued by the local state government. This leads to a handful full of operators becoming the most dominant. Globally market leaders use mergers & acquisitions, and partnerships to expand into new markets. This is because of the bureaucracy companies face while acquiring licenses. Moving forward acquiring a license is going to become easier, leading to more organic expansion.

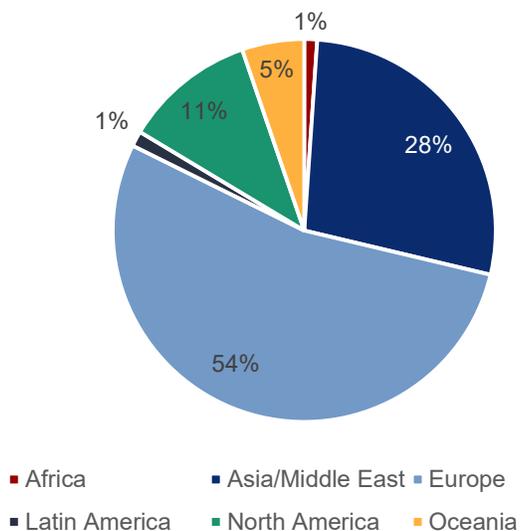
Key Trends

Evolving Infrastructure

As this industry matures, infrastructure will continue to be built out. Online casino operators have been increasingly using mobile apps to reach consumers. This trend has been accelerated due to COVID-19 introducing more casual consumers, who find it easier to use smartphones rather than a personal computer or laptop.

Blockchain Technology is increasingly being utilized in the online gambling industry, as it provides an increased level of security and anonymity. Most customers on cryptocurrency casinos use Bitcoin as their preferred way of doing transactions on the platforms as it removes their banking details from the platform to mitigate the risks of getting hacked. However, newer casinos are using other cryptocurrencies for differentiated benefits. For example, Edgeless, is the first Ethereum powered, virtual casino that uses blockchain technology to ensure payouts. These types of casinos have been getting more popular with the recent excitement in the cryptocurrency space.

Figure 3: Global Market Share of Online Gambling



European Operators

The European market is still by far the largest, with its focus on sports betting. Due to the wide scale popularity of soccer and tennis, it currently has 49.2% market share of the global online sports betting industry. European operators have a dominant market share; however, it is not saturated, the industry is rapidly growing as countries such as Spain, Germany, Italy, and France see strong growth in the online casino industry due to cultural changes. This serves as a major tailwind for large operators in the UK to move into rapidly growing markets. European operators are moving into the USA, this is because the USA being the fastest growing market for its increasing legalization, European operators are increasingly expanding in the USA. This is to be expected as they can leverage their brand and know how to gain an advantage over domestic operators.

Emerging Markets

Africa currently has a market share of 1.1% of the global online casino industry. This is due to lack of widespread infrastructure. Now African gamblers mainly focus on soccer and horse racing which have been historically offered only at physical establishments. With half of the adult population regularly betting on such events, when the industry flips online, it will serve as major tailwind for the industry. However, due to established European operators such as Betway increasingly entering the African online casino industry, domestic operator will face harsh competition. Soccer being the most popular sport to bet on in Africa, is the reason for the rapid growth in sports betting in the past. Most African adults bet on the top 5 soccer leagues and the champions league. Moving forward most gambling traffic that moves online will stay focused on betting on soccer events.

Middle Eastern online casino market has had a hard time historically because of the harsh regulation on gambling. However, this has not stopped from middle eastern gamblers from gambling, in fact they make up a significant portion of the global online gambling revenue. This is because foreign operators face less regulation than domestic operators. Moving forward we will see less regulation in the Middle Eastern markets for domestic operators as it makes economic sense of the middle eastern countries.

Case Study

Evolution Gaming

There is no doubt that the iGaming industry is experiencing tailwinds, with increasing legislation in countries like the U.S. and Canada, investors are betting on the market to become more competitive and profitable. To gain a deeper understanding of the iGaming industry, and companies within it we discuss a case study by Alta Fox Capital, covering Evolution Gaming (EVO), a market leader in Europe.

According to the study, EVO generates 50% EBITDA margins, and has seen a sustainable organic growth of over 40%. Their business model consists of providing licenses for the games they create, to online casino operators, but they still carry the responsibility of running the games themselves. What differentiates business like EVO from land-casinos is the reduced overhead costs – as they can support a limitless number of players betting at the same time while avoiding costs such as free drinks to players, casino maintenance expenses etc. The benefits of EVO's online casino far extends overhead costs, as according to Alta Fox Capital the firm's scalability provides more attractive unit economics than any land-based casinos. Through their integration of augmented reality, tactically adjusted bonuses, and payouts, combined with optimized player-dealer communication the overall casino experience is far more immersive. The unit-economics play a role in outperforming the gambling industry with a revenue CAGR of 47% since 2016. The superior unit economics of EVO are a result of their zero customer acquisition costs – those are incurred by the casino operators that partner with EVO. Thus, players get to play EVO's games while shifting from various operators. EVO is providing firms in the iGaming industry with a model for success, given how they handle customer concentration – one of the biggest risks for a B2B gambling provider. EVO's top customers represented only 6% of its revenues in 2019 and their top target nation, the UK, represents only 14% of its 2019 revenues. So, what has led to EVO's status as the market leader in the iGaming industry – in the live casino market.

The firm has utilized its first mover advantage by launching in 2006 and has a large sum of data from its large operating history allowing it to optimize future experiences for consumers. They have developed a strong brand image over the years, while offering innovative and high-quality products. As mentioned previously, their scaling advantages are key to their success as well – EVO offers hundreds of games 24/7 and utilizes their global network to manage capacity. The volume of games they produce and offer in various languages, along with their large network has led to their profitability. Land-casinos cannot offer the volume of games, and as a 24/7 service as firms in the iGaming industry do, with EVO being a prime example.

Recent Game Launches

2014

- Live Three Card Poker

2015

- Live Caribbean Stud Poker

2016

- Live Ultimate Texas Hold'em

2017

- Dream Catcher
- Live Caribbean Stud Poker Progressive Jackpot
- Live Casino Hold'em Jumbo 7 Jackpot

2018

- Lightning Roulette
- First Person Roulette
- Salon Privé range
- First Person Blackjack
- Dragon Tiger
- Live Texas Hold'em Bonus Poker and First Five Jackpot
- Infinite Blackjck
- Football Studio

2019

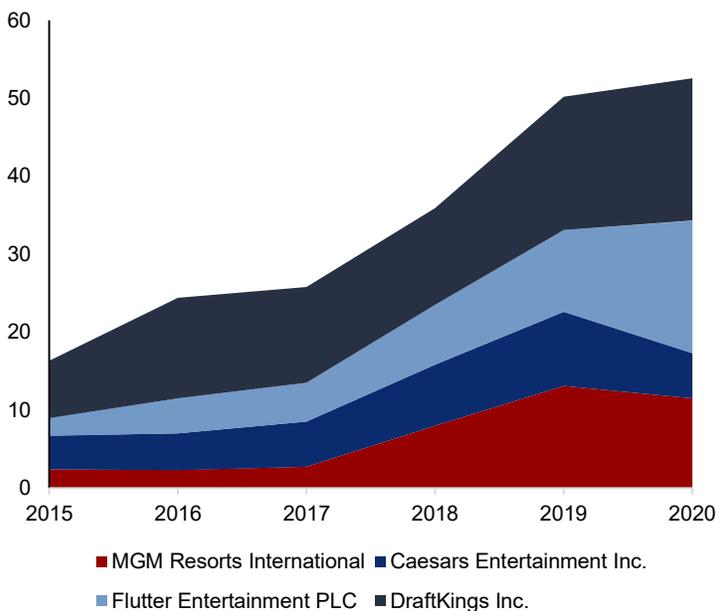
- MONOPOLY Live
- 2 Hand Casino Hold'em
- Deal or No Deal Live
- First Person Lightning Roulette
- Lightning Dice
- First Person Dream Catcher
- Super Sic Bo
- Free Bet Blackjack
- Side Bet City

Case Study

Evolution Gaming

EVO is proof that there is profitability in the iGaming industry, but it has benefited through early legalization in Europe. North America has recently begun easing its restrictions as well, with the province of Ontario, Canada releasing a plan to establish an online gambling market. The partnership with iGaming firms and the government will provide consumers with secure services and operational fairness. The provincial government stated that a big reason for the introduction of this market would be to capitalize on the missed tax revenues, which through this plan will only allow registered firms to operate – allowing the government to generate funding for investments, programs and services that can benefit the society. The U.S has seen an increase in legalization as well – with a notable event occurring through the IPO of Draft Kings. The recently public firm is looking to take advantage of the users it captured during the initial stages of the pandemic, with many being attracted to the highly addictive and entertaining world of sports betting. This event demonstrated the growth occurring in the industry, the following figure represents the percentage growth in the market capitalization of the key players in the iGaming industry

Figure 4: Percentage growth in Market Capitalization of key players



Blockchain's role

iGaming is a sector with an attractive amount of capital and has huge growth potential, but a key concern going forward are issues regarding fairness and trust. There are concerns over the calculation of odds, protection and payment of monetary stakes, combined with issues surrounding data protection and digital security. The degree to which these risks are currently impacting the industry may be minor but going forward can hurt the reputation of online casinos and their long-term ability to grow. A solution to this concern could be the development of Blockchain in the iGaming industry, according to an article in Forbes: 'Blockchain would eliminate the facilitation of a central authority (an escrow service/third-party company that processes bets) when betting online'.

Blockchain technology will enable a trustless system and build trust directly between parties without relying on the facilitation of a central authority such as a casino "house" or sportsbook operator. Given that with Blockchain integration, every transaction would be logged, stored and distributed across a network of computers which would allow better storage and processing of bets placed, creating a transparent record. This transparency could play a big role in making online casino gambling legal throughout the U.S, as it would remove possible tampering creating a new level of trust. With gambling laws relaxing, and technology such as Blockchain and Cryptocurrency developing, we will continue to see growth in the iGaming industry.