Stars Group Inc. Bets Large on its Future

Description

Companies making large multi-billion-dollar acquisitions often use the word *transformational* to describe the transaction. More often than not, they are anything but.

On April 21, **Stars Group Inc.** (TSX:TSGI)(NASDAQ:TSG) announced that it would pay US$4.7 billion to acquire Sky Betting & Gaming, a U.K.-based online sportsbook with US$869 million in annual revenue.

"The acquisition of Sky Betting & Gaming is a landmark moment in The Stars Group's history," stated Rafi Ashkenazi, Stars Group CEO. "SBG operates one of the world's fastest-growing sportsbooks and is one of the United Kingdom's leading gaming providers."

Landmark … transformational … what's the difference?

Stars Group obviously feels the addition of a meaningful online platform for sports betting significantly diversifies the company's revenue streams, while also making it the world's largest publicly traded online gaming company.

Yes, it's a big deal, both figuratively and literally, but is it enough to get you to buy its stock?

The upside of this deal

As mentioned earlier, Sky is a fast-growing online gaming company in the competitive U.K. market. In 2014, Sky had 6% market share. Today, it's got 12%, putting it in a tie with bet365 and just behind PaddyPower Betfair.

In a market that's grown by 19% annually over the past three years to US$7.1 billion, the doubling of its market share is a significant financial boost. Not surprisingly, Sky's revenue and adjusted EBITDA increased by 46% and 51%, respectively, over the same period.

Equally important is the fact it generates 82% of its revenue from mobile users with just 18% from desktop betters. Younger users tend to place their bets using a smartphone. Sky has more customers ages 18-34 than any of its peers, which sets up for a lengthy relationship.

But probably the biggest selling feature of the Sky acquisition is diversification. Without Sky, Stars Group generates 54% of its revenue from poker, 22% from sports, 21% from casino games, and 3% from Oddschecker.com. With Sky, poker revenue drops to 37% of overall revenue, making its business far less reliant on one product.

The downside of this deal

The company is paying $3.6 billion in cash, another $900 million for Sky's debt, and issuing approximately 37.9 million shares of its stock for a total outlay of $5.6 billion — a multiple of 15.3 times adjusted EBITDA.

Sky shareholders will own approximately 15% of Stars Group, which will see long-term debt almost triple from $2.4 billion at the end of December to $6.9 billion by the third quarter when the deal is expected to close.

Stars Group paid $116 million in interest on its debt in 2017. With an additional $4.5 billion in debt added to the pile, its annual interest expense increases to approximately $331 million, or slightly more than Sky's adjusted EBITDA in 2017.

With interest rates moving higher, it's a potential risk.

Should you be buying?

Once the deal is complete, the combined company will have annual revenue of US$2.2 billion and US$881 million in adjusted EBITDA.

While I have some reservations about the price it paid for Sky, it definitely makes Stars Group a stronger business. Given how much free cash flow it generates — US$482 million in 2017 — the quick repayment of the added debt shouldn't be a problem.

Trading at 4.8 times sales, TSGI stock is a buy, in my opinion.

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