

Sporting chance

During the early 2000s, we saw substantial growth of online gambling across the globe. In 2006, it all came crashing down in the US when congress passed the Unlawful Internet Gambling Enforcement Act (UIGEA). The UIGEA *“prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the internet and that is unlawful under any federal or state law”*. US based operators were forced to close down virtually overnight and illegal offshore operators struggled with shrinking liquidity imposed by the banking system. This shifted the attention of online gaming operators back to Europe, Australia and the UK, where both gaming and sports betting are regulated (or not explicitly illegal), and thriving.

US sports betting was always illegal due to two separate laws. The Wire Act (1961) made it illegal to place wagers across state boundaries and was crafted by the Kennedy administration as part of their efforts to crack down on organised crime financing. The Professional and Amateur Sports Protection Act of 1992 (PASPA) was crafted by the first Bush administration and it required states to craft their own legislation banning sports betting.

Recently, the law in the US changed, with PASPA being ruled unconstitutional by the Supreme Court. This leaves individual states free to regulate sports betting as they choose and creates new markets. The impact of this change is uncertain because each state will be able to craft what it wants. What is certain is that it will be a game changer for both the European and US markets.

We own Paddy Power Betfair and GVC, which are well placed to benefit from the ruling. US casinos lack the trading expertise of managing a sportsbook, as well as the necessary online front-end technology which their European counterparts have been developing in-house over the past two decades.

The size of the US opportunity depends on the number of states that make changes, the time they take to implement them, whether online wagering is allowed in addition to “on-premise” sportsbooks, the tax rate, and any integrity fees paid to the various sporting bodies (NBA, NFL etc.). We know which states already had draft legislation in anticipation of the PASPA repeal. They are therefore most likely to legalise over the next few years. On the basis of just these states’ population and GDP, we can estimate an addressable market comprising roughly one quarter of the US population and one third of US GDP. Whilst that might not sound like a lot, the US population is roughly five times the UK and GDP roughly seven times. Therefore, even that fraction (between a quarter and a third) of the US market opening up, promises to be an opportunity bigger than the UK market (presently the world’s largest).

Relative to Europe and Australia, the US will be more highly regulated, with each state having disparate requirements. This will mean higher operating costs. Licences will be limited to existing licence holders (including commercial casinos, tribal casinos, racecourses, lotteries etc.), who will have to partner with a sportsbook operator. In addition, the right to operate an online sportsbook (versus on own premises) will differ by state, with some states limiting the online opportunity only to existing commercial casinos (New York draft legislation) and others allowing more online competition (New Jersey).

Higher regulatory costs don’t necessarily mean lower profitability, as some may fear. Along with limited licences, they can act as barriers to entry. By way of example, William Hill’s highest margin segment is their US business (Nevada) which has much higher regulatory barriers versus Europe and Australia. A large market will be created but it won’t be open to all and sundry to compete. It should be highly profitable over the medium-term for those who get the chance.

Existing US licence holders will be more likely to choose European partners who have specific know-how in bookmaking (online and on-premise), online technology, marketing expertise and regulatory experience. Paddy Power Betfair and GVC possess these characteristics in abundance and consequently we believe are well positioned to capitalise on this American opportunity. We think we have backed the right horse.

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