CREDO

Foxduel

My late father, a larger-than-life character, had a saying about the three most useless assets in life. The first two had to be censored for this article. The third, and punchline, was a minority stake in a private company. He was a lawyer, so no doubt witnessed many a battle between majority and minority shareholders. Though I never really understood the analogy in my youth, I have come to appreciate it later in life as an investor.

The story started in 2018, when the United States Supreme Court repealed “PASPA” – an act which hitherto banned states from legalising sports betting. Shortly thereafter, Paddy Power Betfair (PPB) merged its US assets with FanDuel’s (controlled by Fastball Holdings) and contributed extra cash to acquire a 61% stake, at an implied valuation of roughly $1.25bn. The following year PPB acquired The Stars Group, creating Flutter Entertainment plc as we know it today. As part of that deal, only the (100% owned) non-US assets were merged. The two companies’ respective US assets, FanDuel and FOX Bet had large minority shareholders, therefore had to be kept and run separately.

Moreover, just to get the deal “over the line”, their respective US minorities had to agree to roll over their existing option agreements into the new deal. Firstly, Fastball which held a minority stake of 37% in FanDuel, was granted the option to sell that stake to Flutter over four years, in two tranches in June 2021 and 2023. Secondly, Fox Corporation (Fox), a minority holder in The Stars Group, was granted a 10-year option to buy an 18.6% stake in FanDuel at “fair market value” in July 2021 with a 5% annual escalator.

Any lingering doubt amongst the (mostly UK-based) naysayers about the potential “fair market value” of FanDuel were put to rest after DraftKings (FanDuel’s nearest peer) agreed to go public via a SPAC (special purpose acquisition company) in December 2019. Over the course of the following twelve months, DraftKings’ share price skyrocketed five-fold, putting its market capitalisation at around $20bn by the end of 2020. That likely put a floor on FanDuel’s valuation given that DraftKings was the number two player by market share and on account of FanDuel being more profitable.

Adding to the confusion, in December 2020, Flutter agreed an accelerated acquisition of Fastball’s 37.2% stake at an implied FanDuel valuation of only $11.2bn. As part of that deal, Flutter was at pains to point out that it was acquiring the stake at a “discount to fair market value” – reflecting a number of unique factors including Fastball’s minority position (i.e. no control premium) and their provision of price certainty and liquidity (with FanDuel being unlisted and Flutter the only plausible buyer) to Fastball.

In April 2021, Fox filed suit against Flutter to enforce its (purported) right to acquire an 18.6% stake at the same price that Flutter paid for that interest in December 2020, triggering an arbitration process. Subsequently, in the spring of 2021, Flutter considered listing a small stake in FanDuel, which could have put to rest any confusion as to “fair market value”. However, Fox kyboshed that initiative, contending that Flutter required their consent to IPO FanDuel. Ultimately, the arbitrator stepped in and Flutter agreed not to proceed with an IPO until Fox’s entitlements had been fully reviewed, which is expected in early 2023.

Early last month, after eighteen months of deliberation, the arbitrator issued a ruling determining the "fair market value" of FanDuel to have been $20bn in December 2020. Astonishingly, both sides declared victory thereafter. Fox, not letting the truth get in the way of a good story, issued a statement saying they were "pleased with the fair and favourable outcome". Flutter's CEO commented that "today's ruling vindicates our position…". Rhetoric aside, the market concurred with Flutter's interpretation - its share price reacted positively to the announcement. The chorus of commentary from the sell-side was also singing Flutter's victory tune.

At that valuation, it seems implausible that Fox would exercise the option, when you contrast the ~$22bn strike price valuation for FanDuel as compared to Flutter's market capitalisation of $28bn (both at the time of writing). Moreover, as a pre-condition, Fox would need to get licensed in certain states where FanDuel is active, which is costly and administratively onerous. Put simply, it would make no sense for Fox to spend $4.1bn to buy an 18.6% stake in an (illiquid) private company, when it could spend a similar amount to buy ~14.6% of the (liquid) publically traded parent, through which it would effectively be buying a similar sized (~13.9%) stake in FanDuel on a "look through basis". In addition, it would be getting ~14.6% in Flutter's non-US business, which generates two thirds of Flutter's revenue and more than 100% of profits (given that the US is currently lossmaking). In our opinion, Flutter's steep discount to the sum of its parts is a result of its listing in the United Kingdom. We have witnessed UK companies move their listing to the US to garner a higher valuation. So much for the efficient market hypothesis which earned its authors a Nobel prize. Those laureates must be turning in their grave.

Going forward, Flutter holds all the cards. Whereas Fox did not want an IPO in July 2021 because that would have provided (much needed) clarity on the fair market value, now that the strike price has been decided, the tables have turned 180 degrees. Paradoxically, an IPO now would be in Fox's interest as it would provide clarity on the value of its option, price certainty and liquidity. Equally, in my opinion, an IPO is no longer in the interest of Flutter because without it, Fox is beholden to Flutter (as Fastball was before).

At FanDuel's Capital Markets Day in November 2022, Flutter's CEO was asked about his preference for a US listing for Flutter itself, as compared to an IPO of a minority stake in FanDuel. The questioner noted that DraftKings had six times the dollar trading volume of Flutter despite being a quarter of the size. Flutter's CEO responded that this very question is something they are currently asking themselves and working through. He noted that there is a lot more retail engagement in US stocks than in Europe and DraftKings was clearly benefiting from this.

'Foxduel' has been entertaining to watch, with twists and turns one would expect to see on HBO's drama series "Succession", which is supposedly based on the Murdoch family. Fox clearly chanced their arm, overplayed their hand and now risk ending up with an option on the third most useless asset in life – a minority position in a private company. It could not be more deserved. ■

Important notice