Having a flutter

We have owned Flutter Entertainment (Flutter) for a few years now, having originally identified the company as a highly profitable and cash generative compounder, with unique competitive advantages. The company is benefitting from secular trends within the gambling space, such as the shift from retail to online, and from totalisator to fixed odds betting. Although the intervening years have not always been a smooth ride for shareholders, our conviction remains that we have backed the right horse. Indeed, as we write this, we believe that materially larger growth opportunities exist for the company now than have for many decades.

Flutter's strategy is to focus on regulated jurisdictions where the company believes that it can achieve a top 3 market share. As it stands, the potential market value of those countries which are starting to regulate their gambling markets has never been larger; moreover, we believe that Flutter has never been in a better position to take advantage of these opportunities.

To build a brand from scratch in a nascent market is tough. Therefore, Flutter has on occasion bought an existing operator or a related business in order to gain access to the existing customer base and accelerate its path to scale.

An example of this is the success of the Paddy Power and Betfair merger. Although the Betfair Exchange was operating in a mature, low-growth market, Flutter launched the Betfair Sportsbook which targeted Betfair's sophisticated customer base, many of whom were already betting on sports elsewhere and represented a different market to Paddy Power's existing users. The market segmentation strategy was very successful, driving accelerated growth of the combined business for many years.

This is also the approach that Flutter has taken in the USA with the acquisition of Fanduel – a daily fantasy sports (DFS) operator where customers pay to enter online competitions with prize money. After federal legislation banning sports betting in the US was repealed, states have been steadily legalising this form of gambling. Flutter has successfully cross-sold its sports-betting products to Fanduel's existing customers, the majority of whom already bet with unregulated, offshore companies that have been operating illegally in the USA.

More than two years after New Jersey first legalised online betting, Fanduel's market share is above 40%. With roughly half of their customers having come from DFS, this has lowered customer acquisition costs and accelerated their path to scale. The two main operators (Draftkings and Fanduel) control roughly 95% market share in DFS which has been a low growth niche. Those same two operators currently enjoy over 80% market share in sports-betting (which is a much larger and growing business) in the newly legalised states. We believe that the US has the potential to be the largest sports betting market in the world by far, with five times the population of the UK and seven times the GDP. As time goes on, we are gaining more conviction that Flutter's strategy will be the winning one.

In October 2019, Flutter announced its intention to merge with The Stars Group (TSG). From the start we were excited about the opportunities that the merger afforded the combined company, which would be the largest online sports-betting and gambling operator in the world. For a business that benefits from scale and cross-selling, this represents a significant advantage. In the UK, the company's online sports-betting market share increased from 21% to around 37%. In Australia, online betting market share increased from 26% to around 40%. The cost synergies of combining the businesses are expected to be significant.

TSG also gives access to a new vertical in the form of PokerStars. Similarly to both the Betfair Exchange and DFS, poker is a low growth market which lends itself to natural monopoly positions. New players tend to be attracted by greater liquidity or larger prize pools. PokerStars has 70% market share globally and so offers opportunities to cross-sell sports-betting into its poker and casino customer base. It also brings scale, with the combined entity enjoying top three market share in countries including Germany, Spain, Italy and Brazil. We have seen Flutter deploy this playbook multiple times now and we are convinced it will be successful once more.

More recently, the prospect of increased regulation has once again reared its head in the UK. However, the recommendations made in the House of Lords' review were largely anticipated, as evidenced by the benign share price reaction on the day of the announcement. It has been a difficult few years for the gambling sector as far as regulatory action is concerned. However, we are now starting to see some market consolidation benefiting the larger players, Flutter included. For example, in Australia, despite the cuts to marketing spend made in order to offset the increased taxes, the company has been gaining market share and growth has accelerated.

Although it hasn't been the easiest few years to be a Flutter shareholder, we remain as excited, if not more so, about the company's prospects. The significant opportunities presented by the TSG merger in respect of growth in new geographies, as well as the USA market opening up, make it an attractive market in our view. Viewed in combination with Flutter's historic winning strategy makes us more confident that Flutter's recent winning streak will not be a one-off.

Important notice