

Tatts Group (TTS.AX / TTS AU)

DECREASE TARGET PRICE

Rating	NEUTRAL
Price (16-Feb,A\$)	4.02
Target Price (A\$)	(from 4.50) 4.20
Target price ESG risk (%)	NA
Market cap (A\$mn)	5,903.4
Yr avg. mthly trading (A\$mn)	402.2
Projected return:	
Capital gain (%)	4.5
Dividend yield (net %)	5.9
Total return (%)	10.3

Target price is for 12 months.

Research Analysts

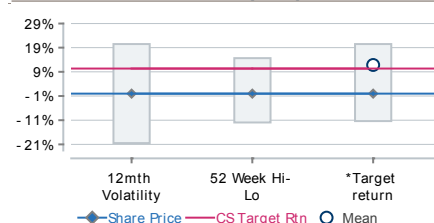
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1H17: Wagering weighs on result

- **Lotteries: exceeded previous TTS guidance**, issued mid-December with a slightly better run-of-jackpots as TTS closed the period. Overall, the business was managed well, against some very bad-luck and the lowest jackpot run in about five years. The outlook appears more favourable and challenging comps should diminish as 2H17 progresses. We expect 8% EBIT growth in FY18, restoring lottery earnings above the previous FY16 base.
- **Wagering: still no green shoots**. Spring carnival revenue may have been down 5%+, a sharp deterioration from the 4%+ revenue run-rate that TTS revealed in August 2016. TTS began to optimise its book yield, with reductions in free bets/promotions and improved risk management, but this came with a reduction in betting volume (turnover). This is an important case study in the context of Tabcorp's (TAH) revenue synergy target which assumes it can maintain turnover and improve book yields. We are skeptical.
- **We have downgraded EPS 3-7%** reflecting an A\$15mn wagering EBITDA reduction that ultimately needs to be recovered by TAH. Without recovery, about A\$150mn in value erosion represents further over-payment by TAH.
- **M&A: The TAH and Pacific Consortium proposals are close in value**. Based on TAH's closing share price, TTS shareholders would accrue A\$4.00 vs. A\$3.91 under a Pacific consortium proposal (A\$3.40 cash + A\$0.51/share CS valuation for a wagering/gaming business). We believe the difference is that TAH has a strategy to restore value to the wagering business while the Pacific Consortium merely hopes for a takeover of the wagering business. We therefore consider the TAH offer superior. We also wonder whether the Pacific Consortium will alter its proposal despite lower TTS earnings.
- **The ACCC, 9 March 2017** releases findings on TAH/TTS proposed merger.
- **NEUTRAL rating retained**. Our A\$4.20 target price (previously A\$4.50) for TTS is set using the TAH Scheme and our A\$5.00/share valuation for TAH (down from A\$5.35 at last update).

Total return forecast in perspective



Source: Company data, Thomson Reuters, IBES, Credit Suisse estimates

Performance	1M	3M	12M
Absolute (%)	-8.43	3.88	1.01
Relative (%)	-10.48	-4.65	-18.13

Financial and valuation metrics

Year	6/16A	6/17E	6/18E	6/19E
Revenue (A\$ mn)	2,928	2,813	2,945	2,331
EBITDA (A\$ mn)	495	452	478	435
EBIT (A\$ mn)	420	372	395	351
Net Income (Adj.) (A\$ mn)	263	228	233	198
EPS (Adj.) (Ac)	18.00	15.57	15.91	13.50
Change from previous EPS (%)	n.a.	(2.7)	(4.8)	(6.6)
EPS growth (%)	1.8	(13.5)	2.2	(15.1)
Consensus EPS (Ac)	18.30	16.80	17.80	18.30
P/E (x)	22.3	25.8	25.3	29.8
Dividends (Ac)	17.50	37.50	15.50	13.00
Dividend yield (%)	4.4	9.3	3.9	3.2
Price/Book (x)	2.0	2.0	2.2	2.2
Net debt/EBITDA (x)	2.1	2.6	3.2	3.3

Source: Company data, Thomson Reuters, Credit Suisse estimates

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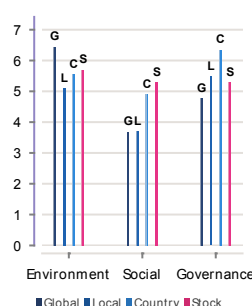
Tatts Group (TTS.AX / TTS AU)

Price (16 Feb 2017): **A\$4.02**; Rating: **NEUTRAL**; Target Price: **(from A\$4.5) A\$4.2**; Analyst: **Larry Gandler**

Income Statement	6/16A	6/17E	6/18E	6/19E
Revenue	2,928	2,813	2,945	2,331
EBITDA	495	452	478	435
Depr. & Amort.	(75)	(80)	(83)	(84)
EBIT	420	372	395	351
Associates	-	-	-	-
Net interest exp.	(41)	(48)	(59)	(66)
Other	0	0	0	0
Profit before tax	378	324	336	285
Income tax	(115)	(95)	(102)	(87)
Profit after tax	263	228	233	198
Minorities	-0	-0	-0	-0
Preferred dividends	-0	-0	-0	-0
Associates & Other	0	0	0	0
Normalised NPAT	263	228	233	198
Unusual item after tax	(30)	(1)	0	0
Net profit (Reported)	234	227	233	198
Balance Sheet	6/16A	6/17E	6/18E	6/19E
Cash & equivalents	70	69	75	74
Inventories	2	2	2	2
Receivables	82	80	81	82
Other current assets	238	183	190	153
Current assets	393	334	348	311
Property, plant & equip.	157	303	389	397
Intangibles	4,462	4,421	4,380	4,339
Other non-current assets	222	222	222	222
Non-current assets	4,841	4,946	4,991	4,958
Total assets	5,233	5,281	5,340	5,269
Payables	594	571	581	591
Interest bearing debt	1,130	1,250	1,590	1,520
Other liabilities	536	511	511	511
Total liabilities	2,261	2,332	2,682	2,622
Net assets	2,973	2,948	2,657	2,646
Ordinary equity	2,973	2,948	2,657	2,646
Minority interests	0	0	0	0
Preferred capital	-	-	-	-
Total shareholder funds	2,973	2,948	2,657	2,646
Net Debt	1,060	1,181	1,515	1,446
Cash Flow	6/16A	6/17E	6/18E	6/19E
EBIT	420	372	395	351
Net Interest	(38)	(48)	(59)	(66)
Depr & Amort	75	80	83	84
Tax Paid	(124)	(70)	(102)	(87)
Change in Working capital	23	(11)	0	(17)
Other cash and non-cash items	(92)	(5)	2	2
Operating cashflow	263	317	319	268
Capex	(98)	(118)	(59)	(51)
Capex - expansionary	-	-	-	-
Capex - Maintenance	-	-	-	-
Acquisitions & Invest	0	(68)	(69)	0
Asset sale proceeds	190	0	0	0
Other	-	-	-	-
Investing cashflow	92	(186)	(128)	(51)
Dividends paid	(237)	(256)	(524)	(209)
Equity raised	0	4	0	0
Net borrowings	197	120	340	(10)
Other financing cash in/(outflows)	(540)	0	0	0
Financing cashflow	(581)	(133)	(184)	(219)
Total cashflow	(226)	(1)	6	(2)
Adjustments	(1)	0	0	0
Movement in cash/equivalents	(228)	(1)	6	(2)

Earnings	6/16A	6/17E	6/18E	6/19E
Equiv. FPO (period avg)	1,464	1,465	1,465	1,465
EPS (CS adj.) (c)	18.0	15.6	15.9	13.5
EPS growth (%)	1.8	(13.5)	2.2	(15.1)
DPS (c)	17.5	37.5	15.5	13.0
Dividend Payout (%)	97.2	240.9	97.4	96.3
Free CFPS (c)	11.3	13.6	17.7	14.8
Valuation	6/16A	6/17E	6/18E	6/19E
P/E (CS) (x)	22.3	25.8	25.3	29.8
PEG (x)	12.3	(1.9)	11.5	(2.0)
EV/EBIT (x)	16.6	19.1	18.8	21.0
EV/EBITDA (x)	14.1	15.7	15.5	16.9
Dividend Yield (%)	4.4	9.3	3.9	3.2
FCF Yield (%)	2.8	3.4	4.4	3.7
Price to book (x)	2.0	2.0	2.2	2.2
Returns	6/16A	6/17E	6/18E	6/19E
Return on Equity (%)	8.9	7.7	8.8	7.5
Profit Margin (%)	9.0	8.1	7.9	8.5
Asset Turnover (x)	0.6	0.5	0.6	0.4
Equity Multiplier (x)	1.8	1.8	2.0	2.0
Return on Assets (%)	5.0	4.3	4.4	3.8
Return on Invested Cap.	7.2	6.3	6.6	6.0
Gearing	6/16A	6/17E	6/18E	6/19E
ND/ND+E (%)	26.3	28.6	36.3	35.3
Net Debt to EBITDA (x)	2.1	2.6	3.2	3.3
Int Cover (EBITDA) (x)	12.0	9.4	8.1	6.6
Int Cover (EBIT) (x)	10.2	7.7	6.7	5.3
Capex to Sales (%)	3.3	4.2	2.0	2.2
Capex to Depr (%)	284.7	298.9	140.7	116.6
EBITDA Segmentals	06/16A	06/17E	06/18E	06/19E
Lotteries	345.5	324.1	348.6	304.3
% chg	10.2	(6.2)	7.5	(12.7)
Wagering	133.3	118.5	121.1	123.3
% chg	(13.2)	(11.1)	2.2	1.8
Maxgaming	64.7	65.6	66.3	67.3
% chg	0.1	1.4	1.1	1.6
Bytecraft	3.4	5.6	5.7	5.8
% chg	23.0	62.9	2.0	2.0
Talaris (Discontinued)	0.0	0.0		
% chg	(100.0)			
Other	(52.2)	(61.8)	(63.8)	(65.7)
% chg	19.8	18.6	3.1	3.1
Total EBITDA	494.8	451.9	477.9	435.1

MSCI IVA Rating AA



TP ESG Risk (%): 0.00
 TP Risk Comment: No material ESG risks. TTS valuation already captures social concerns related to problem gambling. TTS has established responsible gambling codes of conduct for some of its lottery games. We see some, limited downside risk for the wagering division, which is currently investigating the deductibility of race information fees on interstate content with Queensland Racing.
 MSCI IVA Risk: Neutral
 MSCI IVA Risk Comment: CS ESG risk assessment in line with MSCI rating

Source: Company data, Credit Suisse Estimates, MSCI ESG Research

Figure 1: Comparison between TAH and Pacific Consortium Offer

TAH Offer		Pacific Consortium Offer				
Value of Shares Tabcorp	A\$3.48 = 0.80 TAH Shares	N/A				
Value of Shares in Wagering Co	N/A	\$0.49				
Special Dividend	\$0.20	\$0.20				
Cash Component	\$0.225	\$3.105				
Interim dividend paid	\$0.095	\$0.095				
Total Value to Tatts Shareholders	\$4.00	\$3.89				
<i>Credit Suisse do not incorporate takeover value from a strategic acquirer of Wagering and Gaming Co. There is no guarantee TAH or another party will buy the business. Another party may strategically wait for earnings decline.</i>						

Wagering & Gaming Co Valuation		FY19E EBITDA	Multiple	Value
Wagering		123	8.5x	1042
Gaming		73	7.0x	512
Corporate		(45)	7.0x	(315)
Total		151	8.2x	1239
less net debt including NSW CMS Licence				513
Equity Value of Wagering & Gaming Co				726
Shares				1,469
Value per share				\$0.49

Source: Company data, Credit Suisse estimates

Reference Appendix

Our new “**Total return forecast in perspective**” chart helps visualize Credit Suisse and consensus views of a company’s 12-month return within the context of forecasting risks and its historical trading pattern:

12mth Volatility is calculated as the annualised standard deviation of weekly total return series over the past 12 months. It illustrates variability of stock returns; in other words, risk. The way to think about it is that one would rather take 10% forecast return from a stock that has 20% volatility, than from the stock that has 40% volatility. The shaded area shows the one standard deviation range based on past 12 months volatility. In statistical terms, once you make a number of brave assumptions, there is a 68% probability that the share price will end up inside that range in 12 months’ time.

52wk Hi-Lo is maximum and minimum daily closing price over the past 52 weeks. It is often handy to know the price momentum especially when the stock is trading close to its highs and lows: Is the stock trading close to its peak? Is the momentum against the stock?

***Consensus is IBES consensus supplied by Thomson Reuters.** IBES is a survey of sell side research analysts, collecting a few dozen data points such as EPS, DPS, Sales, Target Price, ROE and so on. ***Mean is the average of target returns**, while the shaded area around the mean represents the range of estimates from the lowest to the highest estimate. This aids visualisation of a number of important factors such as: the range of analyst estimates; where Credit Suisse’s estimates on this stock sit relative to consensus; and where the share price is relative to consensus mean and consensus range target.

Target return is calculated as capital gain plus forecast dividend yield (net) over the next 12 months. For “CS tgt” we have used Credit Suisse’s target price and Credit Suisse forecast for 12-month forward dividend, grossed up for franking. For the consensus mean and range, we have used consensus target price and consensus dividend forecasts for 12 month forward.

Companies Mentioned (Price as of 16-Feb-2017)**KKR and Co LP** (KKR.N, \$18.18)**Macquarie Group** (MQG.AX, A\$88.19)**Morgan Stanley** (MS.N, \$46.49)**Tabcorp Holdings** (TAH.AX, A\$4.35)**Tatts Group** (TTS.AX, A\$4.02, NEUTRAL, TP A\$4.2)

Disclosure Appendix

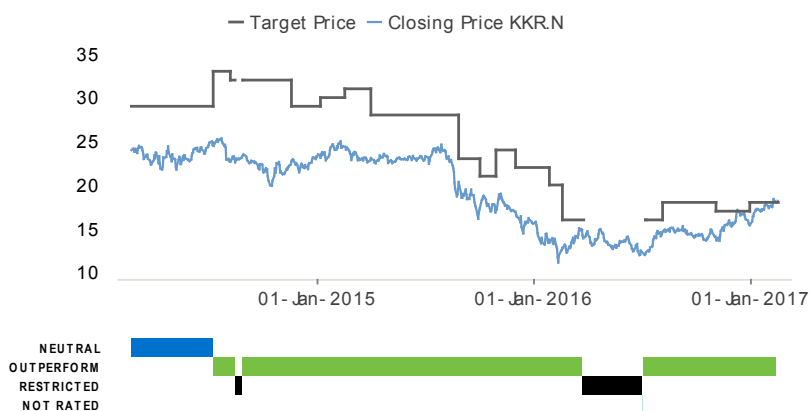
Analyst Certification

Larry Gandler and Ben Levin each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

3-Year Price and Rating History for KKR and Co LP (KKR.N)

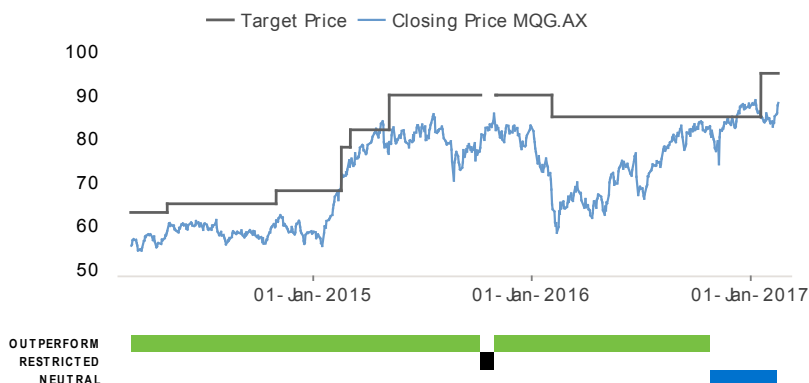
KKR.N	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
21-Feb-14	23.98	29.00	N
09-Jul-14	24.85	33.00	O *
07-Aug-14	22.65	32.00	
15-Aug-14	22.58		R
28-Aug-14	23.39	32.00	O
07-Oct-14	21.52	32.00	*
18-Nov-14	22.69	29.00	
06-Jan-15	23.11	30.00	
16-Feb-15	24.42	31.00	
01-Apr-15	23.08	28.00	
27-Aug-15	20.34	23.00	
02-Oct-15	17.44	21.00	
29-Oct-15	17.30	24.00	
01-Dec-15	16.92	22.00	
27-Jan-16	13.39	20.00	
18-Feb-16	12.81	16.00	
25-Mar-16	13.90		R
05-Jul-16	12.06		NR
07-Jul-16	12.09	16.00	O
05-Aug-16	14.63	18.00	
03-Nov-16	13.89	17.00	
30-Dec-16	15.39	18.00	

* Asterisk signifies initiation or assumption of coverage.

**3-Year Price and Rating History for Macquarie Group (MQG.AX)**

MQG.AX	Closing Price	Target Price	
Date	(A\$)	(A\$)	Rating
02-Mar-14	56.27	63.00	O
02-May-14	58.70	65.00	
31-Oct-14	61.17	68.00	
17-Feb-15	70.90	78.00	
04-Mar-15	73.52	82.00	
08-May-15	79.18	90.00	
08-Oct-15	77.84		R
02-Nov-15	81.93	90.00	O
04-Feb-16	64.86	85.00	
28-Oct-16	81.76	85.00	N
18-Jan-17	84.81	95.00	

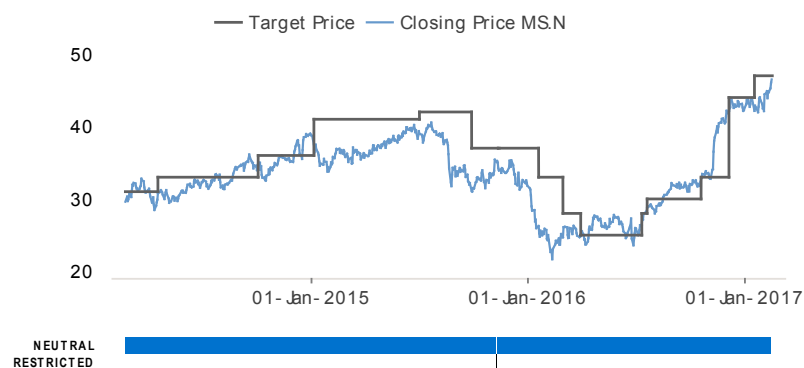
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3-Year Price and Rating History for Morgan Stanley (MS.N)

MS.N	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
21-Feb-14	29.62	31.00	N
17-Apr-14	30.76	33.00	
03-Oct-14	35.05	36.00	
05-Jan-15	37.50	41.00	
02-Jul-15	39.00	42.00	
28-Sep-15	31.09	37.00	
11-Nov-15	35.02		R
12-Nov-15	35.02	37.00	N
19-Jan-16	26.26	33.00	
29-Feb-16	24.70	28.00	
30-Mar-16	25.07	25.00	
11-Jul-16	26.46	28.00	
20-Jul-16	28.78	30.00	
19-Oct-16	32.93	33.00	
05-Dec-16	42.09	44.00	
17-Jan-17	42.15	47.00	

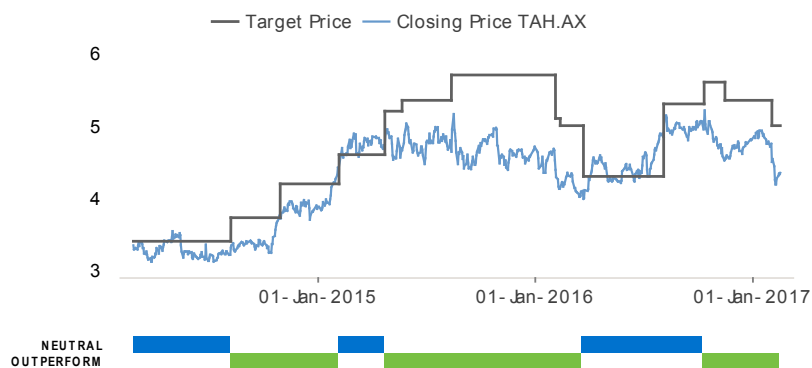
* Asterisk signifies initiation or assumption of coverage.



3-Year Price and Rating History for Tabcorp Holdings (TAH.AX)

TAH.AX	Closing Price	Target Price	
Date	(A\$)	(A\$)	Rating
24-Feb-14	3.35	3.40	N
07-Aug-14	3.32	3.73	O
29-Oct-14	3.73	4.20	
05-Feb-15	4.39	4.60	N
23-Apr-15	4.73	5.20	O
22-May-15	4.66	5.35	
13-Aug-15	4.64	5.70	
04-Feb-16	4.39	5.10	
12-Feb-16	4.15	5.00	
22-Mar-16	3.99	4.30	N
04-Aug-16	4.84	5.30	
11-Oct-16	5.07	5.60	O
15-Nov-16	4.53	5.35	
02-Feb-17	4.50	5.00	

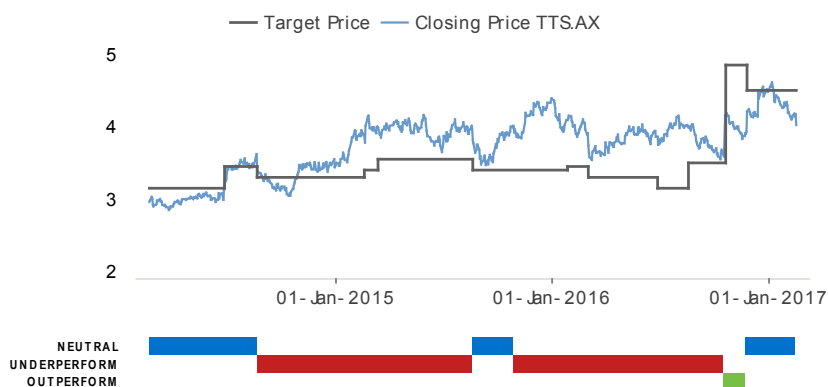
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3-Year Price and Rating History for Tatts Group (TTS.AX)

TTS.AX	Closing Price	Target Price	
Date	(A\$)	(A\$)	Rating
20-Feb-14	2.96	3.15	N
27-Jun-14	3.21	3.45	
21-Aug-14	3.41	3.30	U
18-Feb-15	3.87	3.40	
13-Mar-15	3.99	3.55	
20-Aug-15	3.81	3.40	N
30-Oct-15	3.96	3.40	U
27-Jan-16	4.09	3.45	
02-Mar-16	3.74	3.30	
27-Jun-16	3.86	3.15	
18-Aug-16	3.99	3.50	
20-Oct-16	4.17	4.85	O
25-Nov-16	4.21	4.50	N

* Asterisk signifies initiation or assumption of coverage.



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Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.

Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.

Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

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Overweight : The analyst's expectation for the sector's fundamentals and/or valuation is favorable over the next 12 months.

Market Weight : The analyst's expectation for the sector's fundamentals and/or valuation is neutral over the next 12 months.

Underweight : The analyst's expectation for the sector's fundamentals and/or valuation is cautious over the next 12 months.

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Neutral/Hold*	38%	(60% banking clients)
Underperform/Sell*	14%	(52% banking clients)
Restricted	2%	

**For purposes of the NYSE and NASD ratings distribution disclosure requirements, our stock ratings of Outperform, Neutral, and Underperform most closely correspond to Buy, Hold, and Sell, respectively; however, the meanings are not the same, as our stock ratings are determined on a relative basis. (Please refer to definitions above.) An investor's decision to buy or sell a security should be based on investment objectives, current holdings, and other individual factors.*

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Tatts Group (TTS.AX)

Method: Our Tatts Group (TTS.AX) target price of A\$4.20 is set using an implied bid price based on an estimate that Tabcorp could trade higher toward our A\$5.00 target price. Tabcorp has offered each TTS shareholder 0.8 TAH shares + cash. We hold a NEUTRAL as we see limited prospect of another competing bid, while there is better value to play the merger through Tabcorp.

Risk: The key risks to our A\$4.20 target price and NEUTRAL rating for Tatts Group relates to lack of deal completion which may occur should Australian competition regulators raise any concern. Longer term, there may be market share losses in wagering and potential future licence wins or losses (note Vic Lotteries licence due in FY18).

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See the Companies Mentioned section for full company names

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This research report is authored by:

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