Tightening regulations and tax hike expected to hit William Hill PLC and UK's gambling industry

By Anthony Prayugo

The UK government announced in May 2018 that it would cut the maximum stake on fixed-odds betting terminals (FOBT) from GBP 100 to GBP 2 for every 20 seconds to combat the growing gambling loss and gambling addiction problem. The law will be in effect from April 2019. As this action will inevitably reduce the tax revenue drawn from this industry, the government announced that it would also increase its Remote Gaming Tax (online gambling tax) level from 15% to 21%, further hitting the bookmakers' online business sectors. Most UK gambling firms blasted the FOBT regulation change as it will make many of its stores unprofitable and create job losses. Coincidentally, UK's aggregate gambling firms RMI-CRI 1-year PD rose from 12.97bps to 46.27bps during the same period. William Hill PLC, one of UK's leading bookmaker, is one of the gambling firms that has taken the hardest hit since the announcement where it has lost approximately 41% of its market capitalization since the beginning of this year. Its RMI-CRI 1-year PD also rose faster compared to the industry, rising from 4.54bps in May 2018 to 56.68bps in November 2018.

William Hill PLC saw a worsening financial result in the first half of 2018 as it incurred a GBP 916mn exceptional charges. Approximately 96% of the charges were associated with the UK government's decision to cut the maximum stake for FOBT, which William Hill claimed would have long-term consequences for its business. Ignoring the exceptional charges, William Hill pre-tax profit fell 13% to GBP 96mn. Further estimates showed that the new regulation would reduce its high street revenues by up to 45% and render 38% of its stores unprofitable. Closing these stores, each costing William Hill up to GBP 60,000, will force William Hill to cough up an additional GBP 50mn. The online gambling tax hike will also offset the gain from William Hill's growing online businesses, costing the company approximately GBP 20mn each year.

William Hill's RMI-CRI 1-year PD increased more rapidly compared to its peers during the same period. Potential reasons could be due to William Hill having the highest leverage among its peers (see Figure 1a) and it has higher exposure to the UK market compared to its peers, making it more vulnerable to regulation changes. Approximately 81.4% of its revenue is derived from the UK market, much larger than its peers of about 50% of their total revenues. Its net debt / equity is also among the highest in UK's gambling industry, reaching 74.0% in June 2018.

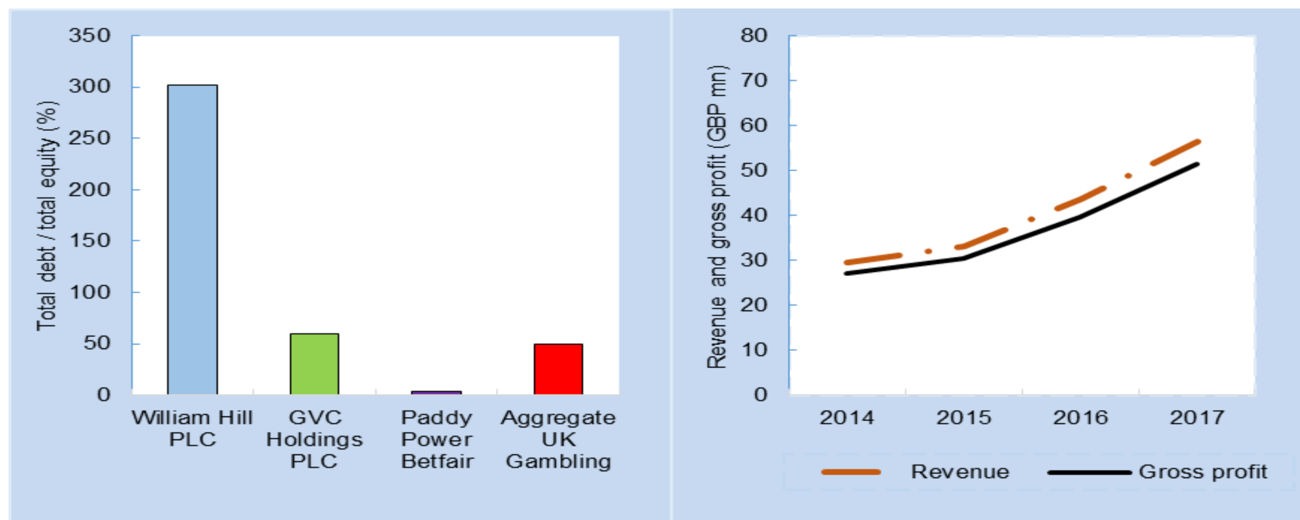

Figure 1a (LHS): Total debt / total equity for UK gambling firms as of June 2018. Figure 1b (RHS): William Hill's US operations revenue and gross profit. *Source: Bloomberg.*

The opposition against these new changes, however, is not unanimous. Firms that are not highly exposed to the UK market such as Paddy Power Betfair, supported the lowering of the FOBT maximum stake. Paddy Power

has around 100 retail shops in the UK, a smaller number compared to some of its peers. William Hill has around 900 while Landbroke and Coral, which are owned by GVC Holdings, boasts 3500 UK shops. Unsurprisingly, Paddy Power is the least affected as compared to Landbroke and Coral and William Hill by the new FOBT regulation change. Barclays Bank analyzed that the new regulation will hit Paddy around GBP 58mn, much smaller than William Hill (GBP 288mn) and Landbroke and Coral (GBP 439mn).

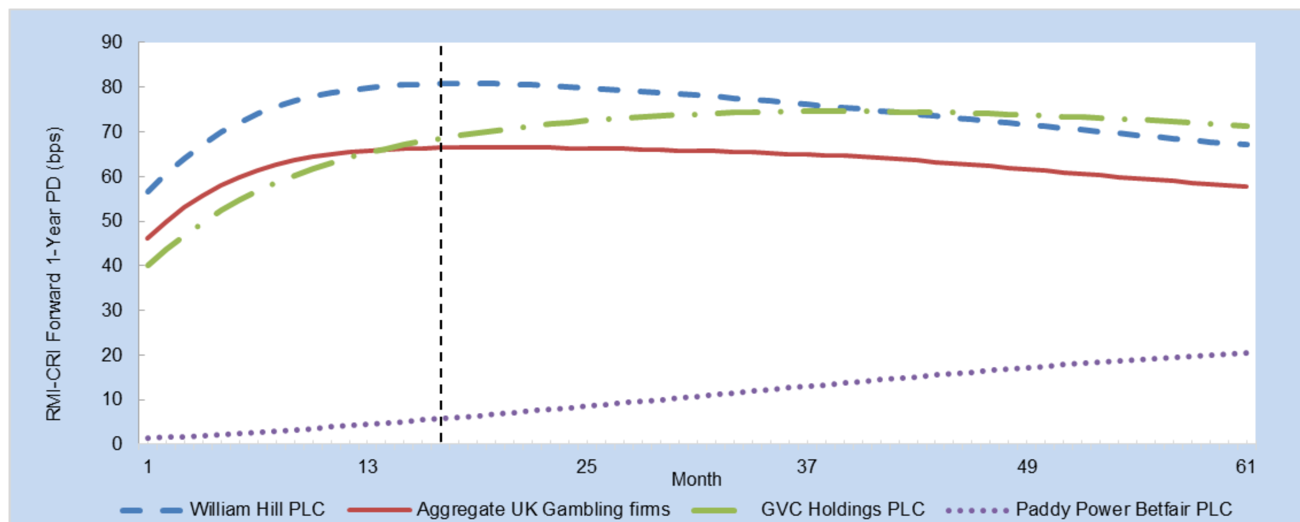

Figure 2: RMI-CRI Forward 1-year PD term structure for UK gambling firms on November 16, 2018. *Source: RMI-CRI.*

Figure 2 illustrates the term structure of the RMI-CRI Forward 1-year Probability of Default (Forward PD) for UK gambling firms. As illustrated in the figure, based on the market information available as of November 16, 2018, the credit profile for William Hill PLC could deteriorate in the following 17 months. Paddy Power, which has a lower exposure to the UK market and a relatively lower leverage, has a relatively lower Forward 1-year PD. The Forward PD computes the credit risk of a company in a future period, which can be interpreted similar to a forward interest rate. For instance, the 3-month Forward 1-year PD is the probability that the firm defaults during the period from 3 months onwards to 1 year plus 3 months, conditional on the firm surviving the next 3 months.

However, not all is doom and gloom for UK's bookmakers. The recent US Supreme Court decision to overturn the ban for most states to legalize sport betting opens opportunities for William Hill and other UK firms to expand their businesses to the US. Some UK bookmakers have already taken their business focus and expansion to the US. William Hill has penned a deal with MGM to offer sportsbooks at some of its casinos while Paddy Power has signed an agreement with Eldorado Resorts to offer sportsbooks at some of its resorts in states where sports betting is legal. Although William Hill's US businesses revenue currently only comprises about 5% of its total revenue, its growth has been strong and consistent (see Figure 1b). Its net revenue and gross profit have seen a 50% and 48.67% increase YoY as of June 2018.

The increasingly regulated gambling environment within the UK has made overseas expansion for UK bookmakers more urgent. If UK bookmakers can expand beyond their traditional UK base to places that offer new opportunities such as the US, then the losses from their current UK market might be less painful. Firms that fail to adapt to these changes, however, might lose their competitive edge in the future.

Credit News

China's daisy chain of debt guarantees looms as systemic danger

Nov 19. Cross guarantee, a move by Chinese companies to guarantee one another's debt- have left the world's third-largest bond market prone to contagion risks amid a record run of debt defaults this year. Cross-guarantees have long been important for private companies to get access to the banking system because extending guarantees to each other helps boost lenders' confidence. However, the links also pose the risk of a daisy chain of distress. Some companies have seen their bond yield surging due to default of their guaranteed companies and investors are seeking to avoid the risks posed by such cross-guarantees-regardless of the underlying performance of such companies. Meanwhile, regulators are making efforts to avert any credit collapse. PBOC has launched initiatives to aid credit to small and medium enterprises, and

support bond issuance. Most companies surveyed by S&P are also scaling back those cross-guarantees. (Bloomberg)

Weak credit growth raises odds of first China rate cut in years

Nov 16. The weak credit growth and the cooling economic growth has spurred talks about China central banking cutting its benchmark lending rate for the first time in three years. The central bank has left its 1-year lending rate at 4.35% since October 2015 and has been using other more targeted policy tools to influence borrowing cost. However, positive results are not being produced as quickly as the authorities had hoped as lenders are being more cautious. Data in October has seen credit growth slowing sharply despite increased injections by the central bank. Some analyst are also skeptical about the central bank cutting its benchmark rate due to its impact on exchange rate. The central bank may then have to decide whether to use its reserves to defend the yuan. (Reuters)

Brexit turmoil boosts demand for safe-haven German bonds

Nov 15. Investors are having a risk-off mood in the euro zone due to the spillover from Brexit after British Brexit Secretary Dominic Raab's resign thrusted PM Theresa May's government into turmoil. In the euro area, yields on higher-rated bonds fell 4 to 5 basis points, led by euro zone benchmark bond issuer Germany. Borrowing costs in Spain, Italy and Portugal also faced upward pressure as investors stayed away from riskier assets after the developments in Britain injected fresh uncertainty into world markets. In the meantime, Italian bonds were shield from the risk-off sentiment after PM Giuseppe Conte was seeking to work with the European Union on a budget impasse to avoid massive fines. (Reuters)

Shadow banking crisis is starting to hit India's consumers

Nov 15. Despite the start of the peak shopping season in India, businesses are seeing sluggish sales as shadow banking lenders grew more cautious about extending new credit to consumers. Car sales have fallen in the three months ending September as compared to a year ago and loans for buying consumer goods have fallen sharply. Nearly four out of every 10 consumer loans is being given out by the shadow lending industry and loan volumes have dropped to 10% of the levels of early 2018. The non-bank financial companies (NBFCs) have seen higher funding cost after defaults by a troubled financier in August. The Bloomberg Economics India Banking Liquidity Index also shows that there is about INR 1tn shortfall of cash in the banking system. The combined effect of higher funding cost and lower liquidity is expected to dampen loan growth. (Business Times)

German central bank warns of risks to growth and banks

Nov 14. German's central bank warned that banks may have insufficient buffers as vulnerabilities in the German financial system are building up and risks to growth have increased substantially. The longest expansion since unification has pushed up asset prices, particularly for real estate, leading banks to overestimate some collateral values and underestimate credit risk. Banks may also have insufficient buffers if an economic downturn is exacerbated by simultaneous credit defaults, asset repricing and interest rate changes. (Reuters)

GE shares tumble as new chief flags urgent need to cut debt (FT)

Italian banks step in to rescue struggling Carige (FT)

SGX inks pact with Bank of China, CFETS to promote their bond indices outside China (Business Times)

Regulatory Updates

EU bank stress tests should be redesigned, says watchdog head

Nov 15. The outgoing head of the European Banking Authority (EBA) who is set to become the eurozone's top banking regulator commented that the biggest problem for its stress tests is the time lag between

publication of results by the EBA and the disclosure of any capital raising that supervisors had forced banks to undertake in response. The EBA currently maintains only a coordinating role in the stress tests with the local supervisors being left to decide how to run them. The EBA has no power to overrule local supervisory decisions which sometimes have given banks special treatments in the stress test. The EBA could adopt the approach similar to the US, which will have more disclosures on the action each individual banks have to take. (FT)

Erdogan's party seeks changes to Turkish bankruptcy law over abuses

Nov 13. Turkish president Tayyip Erdogan submitted a bill to parliament to tighten Turkey's bankruptcy law aimed at preventing the abuse of the regulation by some healthy companies. A section of the current law is designed to give struggling firms temporary protection from creditors and has seen a surge in applicants since inception, even when some of those were actually not in distress. The bill submitted on Tuesday requires changes to required documentation, limits the number of institutions that can evaluate applicants, and adds a clause that applications may be rejected if the applicant is believed to be attempting to damage creditors. The new bill is likely to pass given its predominant position in the parliament. (Reuters)

IMF's Lagarde sees case for central bank digital currency (Business Times)

India seeking closer supervision of its central bank (Business Times)

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