

THE BIG SECRET ON WALL STREET

AMERICAN VICE #1

# THE HIGH ROLLER

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

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## The High Roller

### Making Internet Casinos Fun... and Profitable

### Innovative Tech Provides Huge Advantage

*"Shoot the tires!"*

It was 1906, and San Francisco's horse-and-carriage-driving population hated the new-fangled automobile, derided in local papers as "a menace to man and beast."

Cars weren't *banned*, exactly, but they were frowned upon as a vice. At the time, fewer than 500 personal autos were registered in northern California, and the drivers who dared to take one on the road were constantly harassed and pulled over for minor speeding infractions. (Terrifyingly, the Golden Gate Park superintendent recommended that sharpshooters be positioned along park roads to pop the tires of speeders.)

In those days, Buick dealer Charles Howard couldn't sell a car to save his life.

The young would-be salesman – stuck with three expensive models gathering dust in his San Francisco showroom – started to wonder if he'd come to the wrong city to seek his fortune.

Then, just after 5 a.m. on April 18, 1906, opportunity arrived... in the form of the deadliest earthquake in U.S. history.

*As the first shockwave hit, an eyewitness wrote, "Power and trolley lines snapped like threads. The ends of the power lines dropped to the pavement not 10 feet from where I stood, writhing and hissing like reptiles. Brick and glass showered about me. Buildings along First Street from Howard to Market crumbled like card houses. One was brick. Not a soul escaped. Clouds... obliterated the scene of destruction. The dust hung low over the rubble in the street."*

Three decades before the advent of the modern Richter scale, the exact magnitude of the 1906 San Francisco earthquake couldn't be calculated. But the human cost was clear: as many as 3,000 people died and 80% of the city was leveled in the quake and subsequent fire, leaving three-quarters of the

400,000-person population homeless.

And the despised automobile suddenly looked a whole lot better.

As thousands of panicked citizens struggled to escape the burning city, horses passed out from smoke, carriages splintered... and “frivolous” autos became the most reliable vehicles on the road.

As another eyewitness wrote, *“Before the fire most of us had thought of the car as a wealthy man's plaything and one of doubtful reliability. The fire-fighting had demanded the use of all available vehicles – horse-drawn and mechanical – and most of the automobiles in San Francisco, including new ones still in dealers' showrooms, had been pressed into service... Cars quickly proved their superiority to horses. They were much faster and could be operated twenty-four hours a day. I often heard it said that the San Francisco fire of 1906 established the reliability of the automobile.”*

In the wake of the earthquake, Charles Howard repurposed his mini-fleet of Buicks into ambulances and moving vans... for a sizable rental fee. In the days after the disaster, it cost \$5 a day to rent a horse-drawn carriage... but an automobile fetched \$100.

With 250,000 souls fleeing the city, the money was good... but the publicity for Howard's dealership was better.

A few years later, San Francisco had been rebuilt from ashes, and the auto had become a respected mode of transportation. And Charles Howard had risen from a failed salesman to the country's most well-known Buick dealer... with one out of every 10 Buicks sold in the U.S. rolling out of his fancy four-story showroom.

Then he spotted an even bigger opportunity, wrapped up in another disaster: gambling.

After the 1929 stock market crash, the Great Depression plunged the country into gloom for a solid decade. In an effort to drum up a little extra cash, in the early '30s, state governments legalized betting on horse racing, and the gambling industry (much like escapist Hollywood) blossomed. Across the country, careworn Americans flocked to the track to put down a few dollars on steeds like Bold Venture or War Admiral... and watch the thoroughbreds' owners take home glittering thousand-dollar sweepstakes prizes.

By 1935, the *Saturday Evening Post* reported, “the number of states having racing and betting has risen from seven to 27... (and) the money handled in legalized wagering has risen to about \$500,000,000 annually” (that is, about \$11 billion in today's money).

Once again, “vice” saved the day. And Charles Howard smelled more money (and fame) in the air. So he bought a racehorse of his own: Seabiscuit.

Even people who've never been to the racetrack have heard of Seabiscuit: the bowlegged underdog who unexpectedly beat champion racer War Admiral in the 1938 "Match of the Century," held at Baltimore's Pimlico Race Course. A third of the U.S. tuned in to the radio to listen as the upstart edged out the Admiral by four lengths. That year, Seabiscuit got more press column inches than either Adolf Hitler or President Franklin D. Roosevelt. (The Academy Award-nominated **movie** about his life hit theaters in 2003.)

Along the way, Seabiscuit became one of the all-time leading money winners in the history of horse racing, which meant another fortune (\$9.5 million in 2023 dollars) for Charles Howard.

*Despite his success at Pimlico (and earlier, in San Francisco), Howard wasn't just lucky. He was smart.*

*He repeatedly cashed in on a fundamental truth about human nature: people are willing to pay to escape.*

Whether that's literally renting vehicles to get out of a burning city... or blowing a paycheck at the track to forget their sorrows... humans are all trying to run away from something. And running away costs money.

Today, millions of Americans are being crushed by the **unbearable weight of inflation**. As prices spiral out of control, the average U.S. salary can no longer support the basic middle-class dream of home ownership and a secure retirement (and the recession hasn't even started yet...). It's no surprise that Charles Howard-esque gambling venues are popping up in many forms to offer a momentary distraction (for a price, of course). We'll be examining one of those businesses in this issue.

## Americans Are Running Away From Inflation

As I (Porter Stansberry) have **written previously**, inflation does far more damage than simply eroding living standards. Debasing the currency eats away at the very foundation of a productive society.

For economies to grow, people need the ability to produce more than they consume. This generates savings. Savings enable investment, which is the foundation of all economic vitality. But with today's cost-of-living crisis, savings and investment have become impossible for most Americans.

According to a survey from the consumer-financial-services firm Bankrate, more than one-third of U.S. adults have more credit card debt than cash – the highest level on record. And 57% of adults don't have enough cash to cover an unexpected \$1,000 expense.

Unable to cover their basic costs of living, younger generations are increasingly putting off saving and investing for the future. Two-thirds of Gen Zers believe they may never make enough money to retire. And a recent survey from online real-

estate marketplace Zillow indicates that 52% of Gen Zers and 57% of millennials believe they need to win the lottery in order to become homeowners.

As more Americans face greater uncertainty over their financial future, they're increasingly turning to get-rich quick schemes in place of long-term investing. The average holding period for U.S. stocks has fallen from five years in the 1970s to less than 10 months today. Meme-stock speculation has replaced buy-and-hold investing. And America has turned into a nation of gamblers.

### Betting on an American Pastime

Forty years ago, Americans looking to gamble in a casino had only two real options: Las Vegas or Atlantic City. Since then, nearly every U.S. state has legalized gambling. Today, there are roughly 1,000 casinos across the country, and business is booming. In 2022, Americans forked over a record \$60.4 billion to the country's legal gambling establishments. That was up 14% from 2021's \$53 billion, the previous all-time high. Industry experts estimate that 70% of the U.S. population participated in some form of gambling in 2023.



Today, sports-betting apps and online casinos offer the chance to place wagers online – even via a smartphone. Gamblers no longer need to trek to the nearest bricks-and-mortar casino. They can get all the action they want from the comfort of their couch, 24 hours a day.

From the casino's perspective, online gambling offers the chance to dramatically

expand their potential customer base. In a brick-and-mortar casino, the number of players is limited by physical floor space. In the online-gambling world, a digital slot machine can be streamed over the internet to an unlimited number of gamblers.

Given the added convenience for players, and the larger market of customers for casinos to tap into, online gambling is booming. The global market for online gambling reached \$65 billion in 2022, and industry experts project it will grow at an average of 12% per year from 2023 to 2030 – roughly four times faster than the expected growth rate of the global economy.

As an investor, the secret to profiting from a booming new industry lies in finding the right business model. This often means avoiding the companies participating directly in the boom itself. Instead, the easier money is made by providing supplies and services to those companies chasing the frenzy. As legendary Fidelity Investments fund manager Peter Lynch once explained:

*“During the Gold Rush, most would-be miners lost money... but people who sold them picks, shovels, tents, and blue jeans made a nice profit.”*

The same dynamic is at play in today’s online-gambling boom. The popular sports-betting apps and online-casino operators are capital-intensive businesses, with low or negative profit margins. So today, we’re taking a page from Lynch’s playbook to introduce a “picks and shovels” equivalent in the gambling industry.

This company is one of the most capital efficient businesses in any industry, with 40% returns on equity and profit margins approaching 60%. Since going public in 2015, this business has grown its revenues by an average of 50% per year.

Despite the company’s incredible economics and growth trajectory, the stock trades near the lowest valuation level since going public eight years ago.

## The Picks and Shovels Play in Online Gambling

Based in Stockholm, Sweden, **Evolution AB (OTC: EVVTY)** is one of the world’s largest developers of online casino games and software. Generating better than 50% net income margins on \$2 billion in annual revenue, the company has a simple, highly profitable business model: It licenses its games to casinos in exchange for a cut of each game’s profits – typically around 10% – plus licensing fees. But the key to its capital efficiency is that it doesn’t operate any casinos or take any bets from players.

Evolution was founded in 2006 by Jens Von Bahr and Fredrik Österberg, with an initial focus on the fast-growing online-gambling market in Europe. One year earlier, the UK legalized online gambling, kicking off a broader movement across Europe, and then globally.

The early forms of online gambling were limited to computer-generated games. Evolution founders Bahr and Österberg saw several flaws in this early iteration. First, the experience of playing against a computer was dull compared with playing against a live, human game host.

Plus, playing against computers created trust issues with gamblers. The players couldn't see a physical deck of cards in computer-generated blackjack games, or a roulette ball spinning on an actual table. Thus, many assumed the computers were programmed to stack the odds heavily in the house's favor (more so than the typical house advantage built into live casino games).

Evolution's founding vision was to revolutionize online gambling by creating the world's first live-streamed table games run by a human host. The company built a live online gaming studio in Riga, Latvia. The initial set up consisted of a young woman operating a roulette table, with a mounted camera streaming the action through an internet feed to online gamblers.



While Evolution's early gaming technology was rudimentary by today's standards, the live-streaming aspect was a giant leap forward in the online-gaming experience – and a key to the company's success to this day. Evolution earned the respect of online gamblers by promising (and delivering on) an authentic, honest gaming experience that it described "as real as it gets."

Evolution published the players' statistical odds of each game to show the house edge. And in its original studio, the company even ran a BBC newscast in the background to prove that the game was played in real time.

Evolution's live games rapidly took market share from the existing, computer-generated games on the market. And it enjoyed a first-mover advantage in a number of European countries that legalized online gaming. It was the first live online-gaming provider in Italy in 2011, Denmark in 2012, and Spain in 2013.

In the face of rising competition, Evolution continued taking market share by staying at the leading edge of gaming innovation. It introduced one of the industry's first mobile gaming apps in 2012, and was the first live-gaming company

to produce high-definition live streams in 2016. Evolution developed social-gaming features such as live chats, allowing gamblers to communicate with each other during game play.

It also built custom studios to deliver a first-of-its-kind entertaining gaming experience. As one example, Evolution created a 1920s underground speakeasy environment for its live craps table, where dealers used 1920s terminology while running the game.

By far, Evolution's biggest step forward in gaming innovation came in 2015, with the hiring of Chief Product Office (CPO) Todd Haushalter.

### The World's First Live Gambling Game Shows

Todd Haushalter has been a self-described gambling fanatic all his life – starting at age 10 when he organized neighborhood dice games. After earning his MBA in hotel administration from the University of Nevada, Las Vegas, he worked his way up from a high-stakes table dealer to the vice president of gaming operations at MGM Resorts International. He brought this wealth of experience in the live land-based gaming environment to Evolution in 2015.

When Haushalter joined Evolution, the company produced only online versions of the regular table games found in land-based casinos (blackjack, baccarat, roulette, and poker). Haushalter set out to revolutionize the industry by pioneering new live-gaming concepts built around TV-style game show formats.

In 2017, Evolution launched the world's first live online-casino game show, *Dream Catcher*. In this game, the host spins an upright wheel with a flapper on top, and players guess which number the wheel will stop on. The wheel contains a series of numbers ranging from 1 to 40. Players who correctly name which number the wheel lands on win the payoff associated with the number (i.e., if the wheel stops on 10, the bet pays out 10 to 1).





The first thing to note is how far the production value had come from Evolution's early days of a woman spinning a roulette wheel in a cubicle. *Dream Catcher's* high production value was amplified by an engaging live host, offering a gaming experience that players couldn't find anywhere else. Topping it all off was the chance to win supersized payouts, with no limits on bonus rounds, resulting in payoff potentials of thousands of times on their original wager.

The end result: a uniquely entertaining gaming experience that replicated the excitement of a TV game show, while offering gamblers the chance to bet small and win big.

*Dream Catcher* quickly became one of the industry's most popular games. Evolution followed *Dream Catcher* up with the 2018 launch of *Lightning Roulette*, a turbocharged version of traditional roulette that offers up to 500x payouts (versus 35x in traditional roulette). Evolution's *Lightning Roulette* became the largest live roulette table in the world. It also won multiple industry awards, including the 2018 Product Innovation of the Year at the Global Gaming Expo in Las Vegas, one of the industry's largest conferences.

Riding the momentum, Evolution doubled down on gaming innovation with 10 new product launches in 2019. Two notable hits included a replica of the hit TV game show *Deal or No Deal*, and a live game show built around one of the world's most popular board games, *Monopoly Live*.

In *Monopoly Live*, a host spins an upright wheel like the one found in *Dream Catcher*. When certain segments of the wheel are selected, it activates a Mr. Monopoly digital character who springs into action to step around the board collecting prizes and bet multipliers. The game became wildly popular for its first-of-its-kind immersive graphics and multi-layered game play. And the largest payouts reach in excess of 6,400x the original wager.

These highly entertaining live game-show formats, with the chance to win massive payouts, make Evolution's games fun just to watch. This has led to gamblers uploading videos of their exploits on Evolution's game shows onto various social media platforms, like YouTube and Instagram. Searching for any of Evolution's top games will bring up videos with hundreds of thousands of views, including a YouTube video titled "Top 5 BIGGEST WINS on MONOPOLY Live" that's been viewed half a million times.



Even celebrities have gotten in on the action. To offer one example, in January 2022, a viral video surfaced of hip-hop star Drake playing one of Evolution's live roulette games, where he scored a \$354,000 payout.

This organic enthusiasm from players around the world spreading Evolution's brand awareness on social media provides an incredibly powerful – and free – sales force. As Warren Buffett once explained...

*"Any business with delighted customers has a sales force they won't have to pay. You don't see them, but they are talking to people all the time."*

And for Evolution, this popular success has resulted in financial success.

## And the Money Rolls In

By delighting players with its best-in-class gaming experiences, Evolution's business has provided meteoric growth for itself. Since going public in 2015, Evolution's revenue has grown at a compounded annual rate of 50%. Even more impressive is the consistency of this growth – generating steadily higher revenue in every single quarter for the last 10 years:

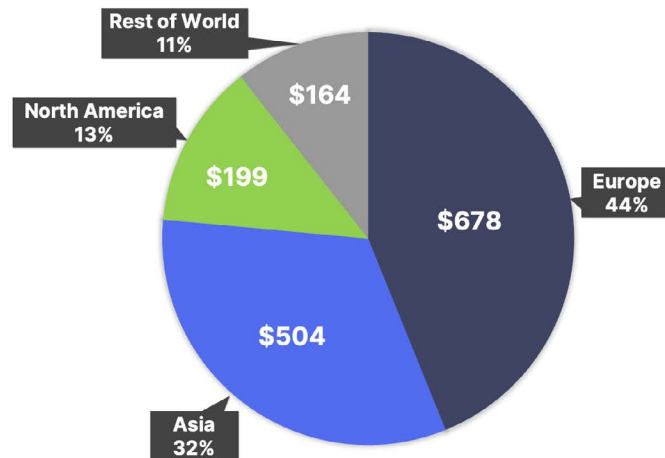
### Evolution Revenue – Steady as She Grows



Source: Bloomberg | \* Indicates data is an estimate.

Today, Evolution is one of the largest and fastest-growing providers of live online casino games. The company operates more than 1,300 live casino tables across six continents, serving over 600 casino operators globally. The company’s largest market is in Europe, followed by Asia and North America:

### Evolution's Revenue by Geography (FY2022, in Millions)



Unlike many companies producing profitless growth from the online-gambling boom, Evolution generates a robust and fast-growing profit stream. From 2017 through 2022,, the company’s net income has surged nearly 15-fold, from \$83 million in 2018 to \$1.1 billion in 2023.

A key advantage of Evolution’s business model is that it avoids one of the biggest costs associated with online gambling: customer acquisition. That’s because

it doesn't distribute its games directly to the end customer. As a business-to-business ("B2B") supplier of games for online-casino operators, Evolution benefits from its casino partners spending billions of dollars on marketing and acquiring customers.

To see how this works, let's compare Evolution's B2B model with a business-to-consumer casino operator, like DraftKings (Nasdaq: DKNG), one of Evolution's biggest customers.

## A Royalty on the Rise of Online Gambling

DraftKings is one of the leading providers of live-sports betting and fantasy-sports betting in the U.S. The company also operates an online casino that hosts many of Evolution's hit games including *Dream Catcher*, *Lightning Roulette*, and *Deal or No Deal* (all custom designed around the DraftKings brand).

DraftKings has posted incredible growth since its founding in a spare bedroom in 2012 to a \$3.3 billion business today. The company has over 2 million monthly active users and has become one of the most popular stocks of the online-gambling boom. Its growth has even exceeded Evolution's since 2015, generating an incredible 90% compounded yearly revenue growth.

But despite generating nearly twice as much revenue as Evolution, DraftKings lost nearly \$1 billion in 2022. That's because its growth has required massive spending on marketing and advertising, categorized under the "sales, general and administrative" (SG&A) expense on DraftKings financials. DraftKings spends 50% of every revenue dollar on SG&A expenses.

Evolution, on the other hand, spends almost nothing on advertising – because it doesn't have to. It only needs to create the most compelling games that generate the most player interest. By doing so, it allows casino operators like DraftKings to generate considerable revenue. That's how Evolution benefits from tapping into DraftKings user base, without spending a dime on directly acquiring those customers.

In this way, Evolution's business model is similar to a royalty on the cash stream of online gambling. This royalty model is vastly more profitable and capital efficient than engaging in the never-ending fight to acquire customers in the world of online casinos.

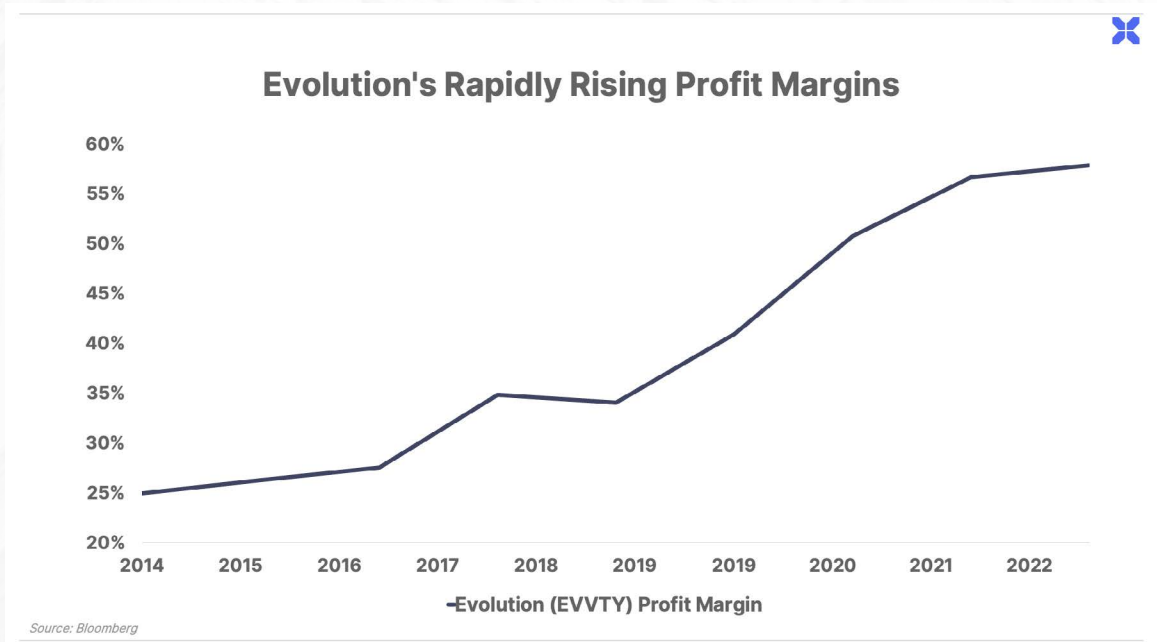
After Evolution invests in the upfront cost of developing a hit game, it then streams the game to hundreds of its casino partners and taps into their hard-won customer base. Evolution earns money from the casinos by taking a percentage of each game's winnings, known as commission fees. These commission fees range between 4% and 17% of winnings, depending on the game type, number of tables, and active hours the game runs. Evolution also charges casino companies a one-time setup fee of €50,000 (about \$55,000), plus a monthly service fee of €20,000 (about \$22,000) per game.

When Evolution produces a hit game, the company doubles down on sequel concepts, introducing slight modifications at minimal development expense. Some examples of variants on successful concepts include extending the *Lightning Roulette* concept to similar games like *Lightning Baccarat* and *Lightning Dice*. The company also develops minor modifications that adjust the speed and volatility of game play, like *XXXtreme Lightning Roulette*, which bumps up the maximum payouts from 500x to 2,000x.

Regular readers will recall that this is a similar strategy developed by one of the world’s leading video-game makers, Activision Blizzard (which Microsoft recently acquired). **In our recommendation**, we showed how Activision unleashed its capital efficiency when it began emphasizing long-running sequels of hit games such as *Call of Duty*, instead of constantly reinventing new gaming concepts.

Evolution shares another feature of the video-game business model: massive scalability. After developing a hit game, the incremental costs of distributing these games to new customers is minuscule – leading to tremendous profit margins on each new customer. In the case of Evolution, many of its games are designed to be streamed to an unlimited number of gamblers. So after making the upfront investment to develop its games, Evolution earns extremely high profit margins as its casino partners grow their customer bases – and, thus, Evolution’s.

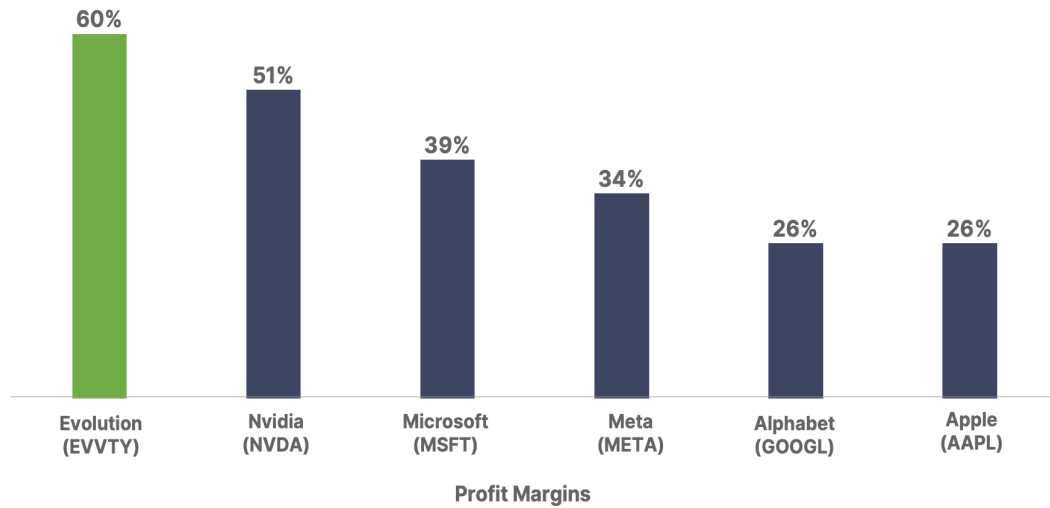
This gives the company tremendous operating leverage, whereby revenue grows much faster than expenses, leading to rising profit margins over time. Evolution’s profit margins have more than tripled from 18% in 2014 to 57% today:



Evolution's profit margins not only blow away its gaming peers, but they exceed many of the world’s dominant technology giants like Google, Microsoft, Apple, Meta, and Nvidia.



### Evolution's World-Class Profit Margins

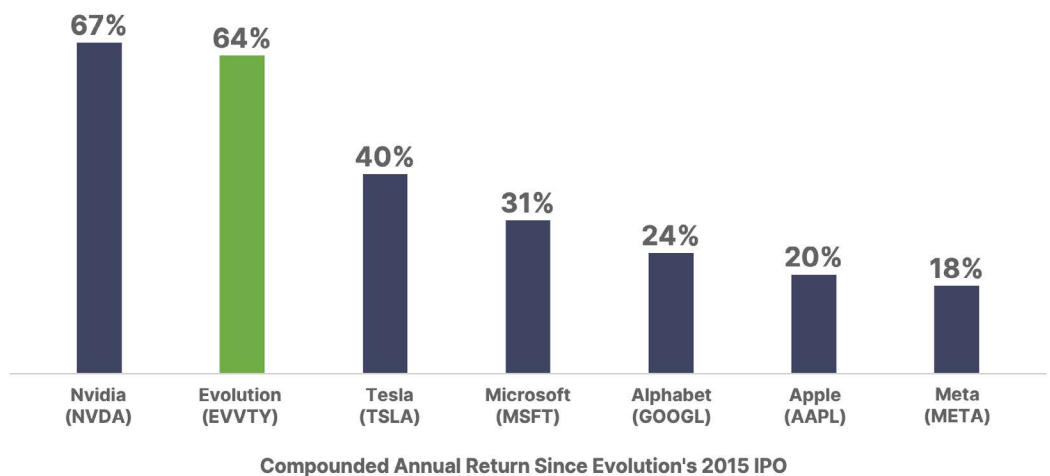


Source: Bloomberg

While the “Magnificent 7” mega-cap tech stocks have made headlines for their strong performance in recent years, Evolution shares have outperformed most of these market leaders since going public in 2015:



### Evolution Outperforms Many Mega-Cap Tech Leaders



Source: Bloomberg

Of course, these world-beating financial results inevitably attract imitators. Since Evolution pioneered the live online-gaming model in 2006, more than 40

competitors have emerged. But Evolution has only furthered its lead against them.

And there's one key reason why Evolution continues to remain the leader despite a growing array of competition: culture. And as the legendary corporate management guru Peter Drucker once said, "Culture eats strategy for breakfast."

## Culture as a Competitive Advantage

Evolution's world-class business model is a direct reflection of its world-class management team. CEO Martin Carlesund and the company's board have proven to be highly effective at fostering a culture of innovation. And this culture has allowed the company to lead the industry in both game development and financial performance.

In a 2021 interview with *Gaming Intelligence*, Carlesund explained how the company fosters a "creative, innovative hub of game creation." He said that it starts by attracting the best and brightest talent, which has become easier over time as Evolution has emerged as the best-in-class operator. Carlesund has found employees who share in the company's vision to not just create the best *gaming* company – but the best company *of any kind* anywhere in the world.

This includes key hires like CPO Haushalter, the Las Vegas casino exec who revolutionized the industry with the introduction of the live game-show format found in many of Evolution's most popular games. But hiring great talent is only part of the equation. As management author Tom Peters describes in his 1982 best-seller *In Search of Excellence*, creating a culture of innovation means giving employees the freedom to fail:

*"You cannot innovate unless you are willing to accept mistakes. Tolerance for failure is a very specific part of the excellent company culture – and the lesson comes directly from the top."*

In a 2020 interview with *iGaming NEXT*, Haushalter explained how Evolution's CEO and board gives him the permission to "miss" when developing new games:

*"I have the best CEO in the world... my boss is serious about innovation... and so is our board. They're like 'we have to be innovative; we have to push new products.' And if we miss a deadline or the game doesn't hit, we try to learn from it, but we don't get in trouble for missing on things."*

In many companies, spending heavily and failing on new product development often leads management teams to pull back on investment because, they say, "it's not working." This might improve quarterly earnings results, but it stifles long-term competitive advantage.

Throughout its lifetime, Evolution has taken its failures in stride and continued pushing the boundaries on gaming innovation. It went from introducing a handful of new games each year in 2019 to releasing over 100 new titles in 2023.

Not every game is a hit, but it only takes a few big winners to generate outsized payoffs. Consider the case of *Crazy Time*, Evolution's multi-layered game show that contains a core game, plus four additional games within the game that are unlocked through bonus rounds. This creates an elaborate gaming experience – and the multiple bonus rounds allow for the opportunity to earn a payout of 100,000 times an initial wager.

In February 2020, Haushalter unveiled *Crazy Time* at a gaming exhibition in London, describing it as the most expensive game ever developed in the industry:

*"It's a carnival of activity, with a wheel loaded with bonuses. There are shows within a show. Crazy Time is the most fun casino game ever made and the most expensive!"*

The investment paid off. *Crazy Time* became the most popular game show in the online-casino world. As it's done with its other hit games, Evolution enjoyed a free viral marketing campaign from players uploading videos of their supersized payouts that circulate widely on YouTube and other social media platforms.

Several competitors have since rolled out *Crazy Time* knockoffs, but none has come close to replicating the success of the original. Nearly four years after its unveiling, *Crazy Time* remains at the top of the industry, by a wide margin. The website [livecasino.watch](https://www.livecasino.watch) posts player statistics of the most popular game shows among online casinos. The data below shows the average daily players of the top 10 most popular game shows in the 30 days through November 25. *Crazy Time* ranks at the top of the leaderboard, beating number 2 by 250%.

### Top Game Shows at Online Casinos (30-Day Average Through November 25)



Rank	Game (Producer)	Average Daily Players
1	Crazy Time (Evolution)	11,108
2	Mega Wheel (Pragmatic)	4,452
3	Monopoly Big Baller (Evolution)	3,414
4	Funky Time (Evolution)	3,033
5	Sweet Bonanza CandyLand (Pragmatic)	2,790
6	Monopoly Live (Evolution)	2,571
7	Crazy Time A (Evolution)	2,570
8	Lightning Roulette (Evolution)	2,534
9	XXXtreme Lightning Roulette (Evolution)	1,962
10	Adventures Beyond Wonderland Live (Playtech)	1,885



Evolution games make up seven of the top 10 most popular online game shows, with a combined total of 27,192 daily average players in November 2023.. Evolution is nearly four times ahead of its next closest competitor, Pragmatic, with just two games in the top 10 and a combined total of 7,242 average daily players in the last month. Playtech is a distant third, with just one game in the top 10 averaging less than 2,000 daily players over the same time period.

Next, we'll dive deeper into the competitive landscape to show how Evolution's industry lead continues growing stronger over time.

## Assessing the Competition

Founded in 1999, London-based Playtech is one of the oldest online-gaming providers in the industry. Based on revenue, Playtech is Evolution's largest competitor. The company generates roughly the same amount of revenue as Evolution – producing an estimated \$1.9 billion in revenue for 2023. But Playtech is only expected to earn \$190 million of income on that revenue, or a 10% profit margin. Meanwhile, Evolution generated 60% profit margins on \$2 billion in revenue, translating into \$1.1 billion on the bottom line.

The reason for this huge earnings disparity comes down to the type of games each company produces. Playtech's original focus was on computer-generated online games, which have become increasingly commoditized over time. Evolution, on the other hand, has focused almost exclusively on live games. The massive popularity of Evolution's live games means more wagers placed per game, and thus much higher profit margins.

After Evolution's success in pioneering live games, Playtech has tried to catch up by introducing its own live games. But as the table above shows, Playtech has yet to produce the same level of engagement as Evolution – with just one live game show in the top 10, versus Evolution's seven. Because Evolution's live games attract many more players, it enjoys substantially higher profit margins on the games it produces.

The failure of Playtech to generate anywhere near the same level of Evolution's player engagement and profit margins is a testament to the power of Evolution's innovation prowess – the let-them-fail culture outlined earlier that has led to so many successes over the years.

Behind Playtech, privately held Pragmatic is number three in the live-gaming space. Pragmatic started in 2015, and has produced a few hit live games, including *Mega Wheel* and *Sweet Bonanza Candy Land*. Yet it remains a distant third in terms of revenue. As a private company, Pragmatic's financial statements are not publicly available. However, industry estimates indicate the company generates around \$100 million in annual revenue. Under the generous assumption that Pragmatic earns similar profit margins as Evolution did when it was at a similar size, then we can roughly estimate that Pragmatic earns somewhere in the range of \$35 million annually.

That means Evolution earns roughly three times the annual profits of its next two closest rivals combined. And that puts Evolution in a position of strength to continue widening its competitive advantage over the competition going forward.

## Evolution's Dominant Scale Advantage

Because Evolution is the most profitable online gaming provider in the world, it has more money to invest in new games each year. This will only feed Evolution's best-in-class culture of innovation: with more money to invest, the company can take more shots on goal each year versus its competitors, increasing the likelihood that it will develop the next *Monopoly Live*, *Lightning Roulette*, or *Crazy Time*.

Meanwhile, Evolution's unmatched profitability and player engagement has unlocked another key competitive advantage: Evolution can afford to offer gamblers the best odds in the industry.

The odds players get from casino games are measured by the return to player ("RTP") metric. RTP is the average percentage of an initial wager that gets returned to players. Since casino games always have a house edge, the RTP is always less than 100%. This reflects the fact that gamblers, on average, get back less money than they put at risk. So a 95% RTP means players will typically lose five cents of every dollar they wager in each game.

Evolution's leading profit margins allow it to offer players the highest RTP in the industry. Top Live Casino is a website that tracks RTP across the online-casino industry. The table below shows games with the highest RTP numbers, with Evolution games making up four of the top six, including several games above 99%.



### Evolution's Return to Player

**1st place:** Infinite Blackjack by Evolution: **99.51%**

**2nd place:** First Person Blackjack by Evolution: **99.21%**

**3rd place:** 2 Hand Casino Hold'em from Evolution: **99.18%**

**4th place:** Prestige Mini, Mini and Grand Baccarat Live by Playtech: **98.94%**

**5th place:** Golden Baccarat Live by Playtech: **98.77%**

**6th place:** Free Bet Blackjet by Evolution: **98.45%**

Source: Toplivecasinos

Many gaming providers focus on the highest short-term profits by offering a low RTP. But players recognize and reward companies that offer a generous RTP with higher game play, which makes for better long-term success. In that 2020 interview with *iGaming NEXT*, Haushalter explained how offering the industry's highest RTP is part of the company's culture of putting the customer first:

*"Our company has the highest RTP of any gaming company in the world. Slot companies, land based, probably have a blended average of a 10%-house-edge 90% RTP. Online slot companies are probably 95%. And we're quite a bit above 95%, and players notice that. And it's always a debate in the industry. Maybe we should make the game more casino friendly. But players figure that out; they always do... So we always design with the thought of 'if your mother would play this game, how would you make it? Would you jack the speed up and RTP down?' No you wouldn't. You would make it so it would delight her."*

By investing heavily in developing the most compelling gaming experiences, and by offering best-in-class RTP numbers, Evolution's customer-centric culture is the ultimate competitive advantage that will contribute to its long-term command of the market.

Evolution brings that same philosophy to its casino partners.

Even though Evolution is playing from a position of strength – online casinos have very incentive to partner with Evolution to make the most money – CEO Carlesund doesn't take their position for granted. In the 2021 interview with *Gaming Intelligence*, Carlesund noted that he's not interested in using Evolution's dominant competitive position to force casino operators into exclusive agreements. Instead, he wants to constantly earn their business by being the best possible partner to casinos:

*"We want to be a good partner, we want to give our partners a good product that lets them earn a lot of money. I don't want to be a big powerhouse that forces them to go a certain way. We want to earn their business."*

Evolution invests heavily into ensuring its casino partners can deliver a world-class playing experience for their customers, the gamblers. The company has a 30-person development team focused exclusively on optimizing the playing experience across all devices and operating systems around the world. So when the newest Apple iOS or Google Chrome updates are released, Evolution adjusts to the software changes, and its casino partners keep earning money. This is how Evolution achieved an industry-leading 99.8% continuous runtime of its games in 2023.

Then, there's fraud detection. Casinos foot the bill for any losses incurred by third-party gaming providers due to fraud. Evolution invests in state-of-the-art systems to detect and stop fraud through both manual and automated software systems. Evolution's 55-person game integrity and risk department tracks every single game and transaction in real time. This ensures that casinos continue to make money by keeping away the cottage industry of cheats looking to exploit weak games.

By providing the best support and service to its partners, Evolution has secured a winning reputation among casino operators. This includes 12 consecutive years of winning the EGR B2B “Live Casino Supplier of the Year” Award – the premier honor in the e-gaming industry – from 2010 to 2021.

In order for competitors to catch up with Evolution, they not only have to replicate the company’s unmatched gaming experience for gamblers, they also have to replicate this world-class service to casino partners.

As Evolution’s CEO Carlesund often says in regard to competition in online gaming,

*“Barriers to entry are relatively low, but the barriers to success are considerably high.”*

The best part is, those barriers become larger over time as Evolution grows.

## **Pouncing on an Attractively Low Valuation**

As Evolution’s profit stream grows faster than its competitors, it can afford to out-innovate in new games, while delivering best-in-class player odds. Meanwhile, the massive infrastructure that goes into supporting its casino partners also requires scale to replicate.

This presents a chicken-and-egg problem for new entrants. The competition needs profits to invest in achieving the scale needed to beat Evolution, but those profits only come after achieving sufficient scale in the first place.

This is why we expect Evolution to continue its historic trend of gaining market share and growing faster than the online-gaming industry as a whole. Since 2015, the global market in online gambling has expanded at a 39% compounded annual rate. As we said before, over that same period, Evolution has ballooned at a 50% compounded annual rate.

Like many online businesses, the online-gambling market experienced a boom in demand during the COVID-19 lockdowns. Since then, a mean reversion in consumer spending has caused Evolution’s annual revenue growth to slow from 90% in 2021 to a more sustainable 24% in 2023.

As a result, Evolution’s valuation has plunged from a peak of 80x enterprise-value-to-EBITDA (earnings before interest, taxes, depreciation, and amortization) to less than 20x today. This reflects one of the lowest valuations Evolution has traded at since going public in 2015:



## Evolution's Recent Plunge in Valuation



### -Evolution (EVTY) Enterprise Value to EBITDA

Source: Bloomberg

Since April 2021, the stock has fallen 47% – from \$197 to \$125 on March 5, 2024. This presents an attractive valuation for new investors – given Evolution's world-class profit margins and capital efficiency. As the market for online gambling matures, growth is expected to slow. Yet, this growth slowdown has been priced into Evolution's drop in valuation – and then some.

Looking ahead, industry experts project online gambling will grow at a roughly 12% annual rate. As mentioned earlier, Evolution has historically grown at rates well above the overall industry. Assuming a conservative case where Evolution simply grows in line with the industry, while maintaining its current profit margins, we expect the company could deliver a 15% compounded annual return for investors.

This will come from 12% growth on the top line – plus the capital return investors will earn through dividends and share buybacks. Starting in 2016, Evolution's management committed to returning 50% of earnings to investors through dividends. Since then, the dividend has increased 20-fold, and we expect further growth in the payout as the company's earnings continue to increase. Evolution currently pays \$2.18 in annual dividends to holders of its over-the-counter shares (EVTY), which reflects a 2% dividend yield.

Earlier this month, Evolution announced a buyback authorization of \$437 million, reflecting roughly 2% of the company's \$20 billion market capitalization. Given the company's high capital efficiency and stellar profit margins, Evolution will likely continue rewarding shareholders with ongoing share repurchases and dividend growth. Given the additional returns available from reinvesting dividends and a shrinking share count, we believe investors can achieve a compounded annual return better than 15%, even under a conservative future growth outlook of 12% going forward.

The management team also runs the business with a pristine balance sheet. Evolution has maintained zero net debt (i.e., total debt minus cash) for most of its history, including a current net cash balance of \$1 billion. Plus, insiders have skin in the game, owning 12% of the shares outstanding. Adding to that insider confidence comes from the very top: In November, CEO Carlesund purchased 10 million shares in the open market.

**Action to Take:** For the latest updates on our open positions, please visit our live portfolio [here](#).

**Note:** as a Swedish-based company, Evolution primarily trades on the Stockholm exchange under the ticker EVO. For U.S. investors, the easiest way to invest without buying through a foreign exchange is to purchase the over-the-counter (“OTC”) shares that trade under the ticker EVVTY. OTC stocks tend to trade with less liquidity than stocks on major exchanges, like the New York Stock Exchange or the Nasdaq. The average trading daily volume in EVVTY in 2023 was roughly 40,000 shares, representing about \$4.5 million in daily trading volume. We recommend using limit orders when transacting in OTC shares to ensure getting a good price on orders.

For *The Big Secret on Wall Street* portfolio, we’re creating a new Exponential Growth category to include companies like Evolution AB, which offer the potential for above-average growth. Evolution’s leading market share in the fast-growing online-gambling market makes it a good fit for this new category. Stocks in this group will show greater upside potential, but will have greater risks as well. Fast-growing industries require changing technologies, a shifting regulatory framework, and the ever-present threat of new competitors determined to take share in the burgeoning market. Online gambling is no different.

While we’re confident in Evolution’s leading industry position, the inherent uncertainties of the relatively young market means we’re assigning the stock a high risk rating of 4 (out of 5, with 5 indicating the highest risk, and 1 indicating the lowest risk). We urge investors to size positions according to this level of risk, with higher-risk positions commanding a smaller percentage of investable capital versus lower-risk stocks.