1. **Lack of Defensiveness**
    - TLC is not a defensive stock; it is leveraged to Powerball / discretionary spend. Revenue, earnings and cashflow will all be down YoY in H2 and in 1H24.
    - This is representation bias, people are relying too heavily on similarities between previous events and neglecting objective data.
    - 2H23 revenue will be **down** ~10% (consensus -5%); 2H23 EBITDA will be **down** >10%.
    - TLC share price has outperformed the market despite the 10-year up 100bps, probably on this defensiveness, which could easily come undone.

2. **Ambitious Earnings Outlook**
    - FY24 consensus revenue +8% (higher if 2H23 revenue misses) cycling an accelerated jackpot sequence in 1H23 into a big discretionary spend headwind.
    - Well established that household lottery spending is financed by a reduction in non-gambling expenditures. Sure, Powerball prices have gone up but 8% topline growth is very ambitious.
    - Very clear step-down in Lottery spend in the US, in particular Powerball. Much lower website engagement. Much higher correlation of Sales to Jackpots in 2023 than 2021-22 implying people are playing less for smaller jackpots.
    - We don't know TLC sales, but we can use Website hits as a gauge. Website hits to Sales are a good indicator in the US. Website hits are trending lower, so are google searches. The real test going forward is people spending less (what you're seeing in Wagering).

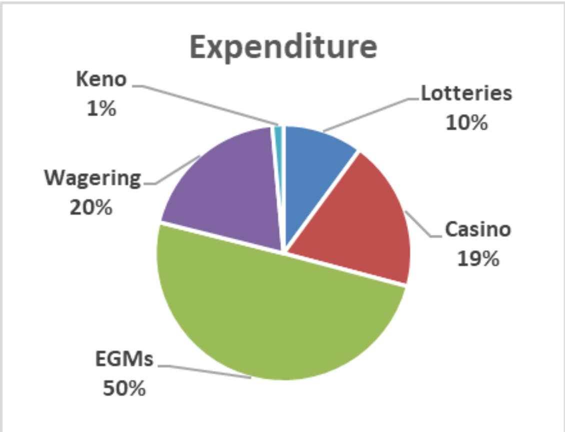
3. **Valuation is crazy**: 17x FY24 EBITDA, 3.2% Div yield, FCF yield of 4.2% v 10-year bond of 4.4%. If Keno is worth 10x (at best) that puts Lotteries on 18.5x EBITDA
    - TLC's concession is ~30 years i.e. It has to re-invest for licences.
    - Consensus FCF/share is 19c. At 7.2% WACC (very generous) and 5% CAGR on FCF (very generous):
        . $NPV = 19 \times (0.072 - 0.051 - (1+0.05)^{30} \times (1+0.072)^{-30})$
        i. *\$4.00 vs share price of \$5.18*
    - Where does this gap come from? An implicit assumption that lottery licences roll over for free? BTW all it takes is one international person to win a US/European lottery and lottery licences globally will take a dive. Some premium may be justified, but that much?

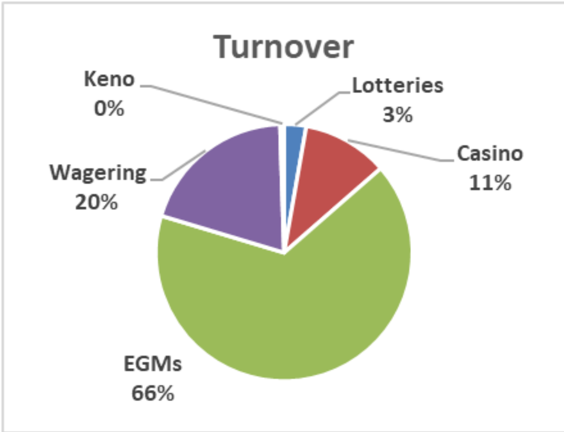
4. **ESG/RI risk**: A 50% return-to-player is harmful. Aussie Super, Aware, QSuper and REST own close to 15% of TLC and at some point, there will be real pressure on these funds to explain why they are investing in lottery play that is negatively correlated with education and income. Funding good causes from people who can least afford it is not "responsible investing".

Lotteries face ESG risks

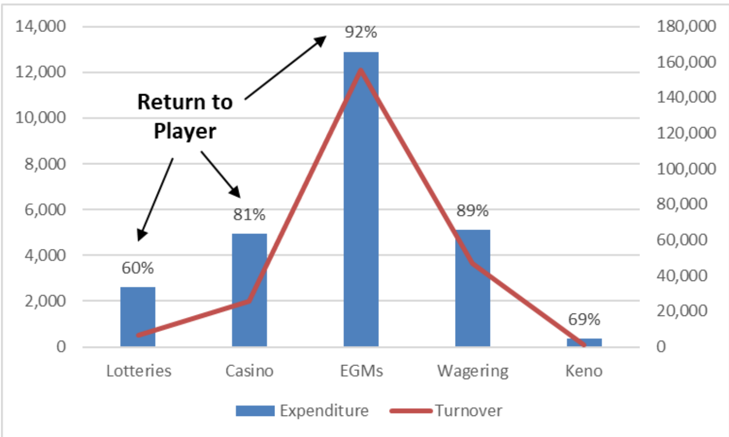
In response to the parliamentary inquiry on online gambling, the Lottery Corporation argued that lotteries should be excluded from gambling advertising restrictions. It argued that people spend less money on lotteries and that lotteries are less harmful than other forms of gambling.

- TLC is cherry-picking their data, highlighting what suits them and downplaying the rest by framing selective truths.
- While people spend less money (lotteries is ~3% of total turnover), player loss from lotteries is ~10% of total gambling losses as the return to player is so bad.
- That is a convenient way of describing "harmful".





- Player loss on Lotteries is around half that of Wagering (the subject of this parliamentary inquiry).



The Reality

Lotteries are attractive to poor people (Ariyabuddhiphongs, 2011) and the frequency of lottery play has been related to lower self-control, lower intellectual efficiency and lower status (Cook, 1998). Although gambling in general increases with education, lottery gambling follows the opposite trend. Lottery sales have also been found to increase with jackpot size and the increase is larger in areas with more economically disadvantaged populations (Guryan & Kearney, 2008).

Pressure on Super funds owning TLC will grow momentum

Last week ASIC commenced proceedings in the Federal Court against Active Super alleging misleading conduct and misrepresentations to the market relating to claims it was an ethical and responsible superannuation fund. Similar proceedings were filed against Mercer Super in February.

If super funds feel pressure about owning gambling stocks, it may be difficult for some of TLC's largest shareholders to defend TLC vs other forms of gambling which is taxing the hope of their very members at a 40-50% rate.

While one may argue some of the funds raised might go to good causes, it is at the expense of those who can least afford it. In addition, funds raised from lotteries could be better obtained through more direct taxation or other means without encouraging gambling. In any case, these "good causes" would need to be funded by Government's anyway; its simple misdirection that the average punter may fall for, but a super fund should not.

- The "Fourth Pillar" of Aware Super's Responsible Investment Report is "Exclusion", which at present does not include Gambling (but we do understand Aware doesn't invest in Casinos and Wagering companies, but can invest in Aristocrat and TLC). Let's see how that evolves.
- The "Fifth Pillar" is "Investing for positive impact". I'm not quite sure how a regressive tax rate on mostly poor an uneducated people is a "positive impact".
    - I can't even find a similar thing for Australian Super but how it can defend to own 10% of TLC may change over time.

TLC AU Equity | 25) Export | Settings

LOTTERY CORP LTD/THE ISIN AU0000219529

1) Current | 2) Historical | 3) Matrix | 4) Ownership Summary | 5) Insider Transactions | 6) Options | 7) Issuer Debt

Search Name Default - No Search Selected | 21) Save Search | 22) Delete Search | 23) Refine Search

Text Search | Holder Group All Holders | Investment Manager View

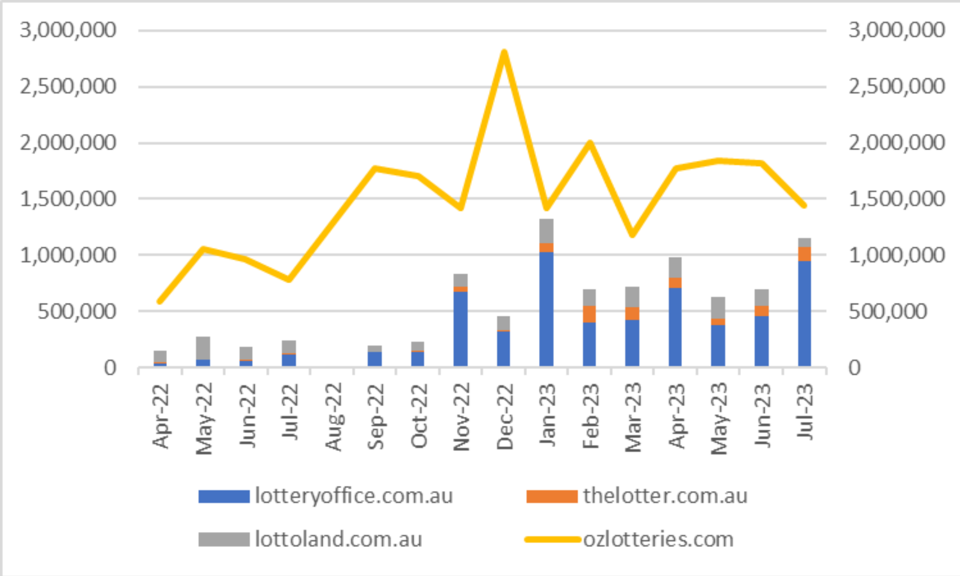
24) Color Legend Shrs Out 2,225.8M % Out 52.45 Float/Shrs Out 98.28 SI % Out 0.74

	Holder Name	Portfolio Name	Source	Opt	Position↓	% Out	Latest Chg	File Dt
			All	All				
1.	AustralianSuper Pty Ltd		EXCH		232,281,974	10.44	23,247,286	03/15/23
2.	State Street Corp		ULT-AGG		134,931,945	6.06	-33,706,881	06/09/23
3.	BlackRock Inc		EXCH		123,793,533	5.56	123,793,533	05/24/22
4.	Vanguard Group Inc/The		EXCH		112,955,745	5.07	112,955,745	09/16/22
5.	Aware Super Pty Ltd as trustee of Aware Super	Multiple Portfolios	MF-AGG		58,999,660	2.65	18,537,102	12/31/22
6.	AMP Ltd		ULT-AGG		44,291,412	1.99	6,813,802	12/31/22
7.	Norges Bank	Multiple Portfolios	MF-AGG		44,140,820	1.98	44,140,820	12/31/22
8.	QSuper Ltd	Multiple Portfolios	MF-AGG		24,746,403	1.11	2,587,912	12/31/22
9.	Australia & New Zealand Banking Group Ltd		ULT-AGG		23,440,328	1.05	2,608,171	05/17/23
10.	Insignia Financial Ltd		ULT-AGG		19,913,082	0.89	-164,317	04/30/23
11.	Government Pension Investment Fund Japan	Multiple Portfolios	MF-AGG		15,137,118	0.68	15,137,118	03/31/23
12.	Dimensional Fund Advisors LP	Multiple Portfolios	MF-AGG		14,787,464	0.66	-280,731	08/07/23
13.	Legg Mason Inc		ULT-AGG		14,286,555	0.64	1,555,545	06/30/23
14.	REST SUPER AUSTRALIA	Multiple Portfolios	MF-AGG		13,732,234	0.62	733,489	12/31/22

Double-edge sword for TLC on Advertising

Lotteries enjoy a unique position benefiting from televised draws and fewer advertising restrictions. TLC arguing to be excluded from advertising restrictions is already having a significant unintended consequence from resellers of foreign tickets. While it is true these companies have been around for a while with limited success, there is a much bigger push recently in Australia (see below). There is also a push globally, perhaps driven by a wider acceptance of online gambling but also the rise of iLottery and App/Online players in the US (Jackpocket, Lotto.com, Lottery.com, Jockpot.com).

- Mostly as a result from a push by The Lottery Office, website hits are almost as high as OzLotteries (Jumbo).



US Lotteries in 2023

Lower real household disposable income = lower spend on gambling (and lotteries)

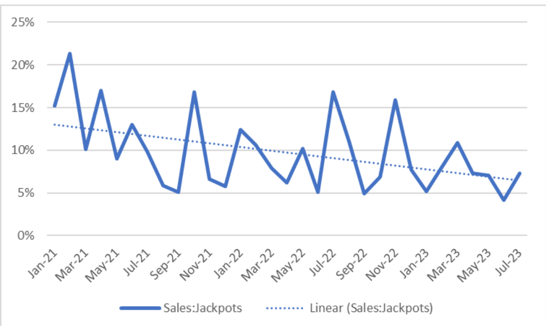
It is well established that household lottery spending is financed by a reduction in non-gambling expenditures, not by a reduction in expenditures on other forms of gambling (Kearney, 2005). Lotteries are also coming off COVID tailwinds.

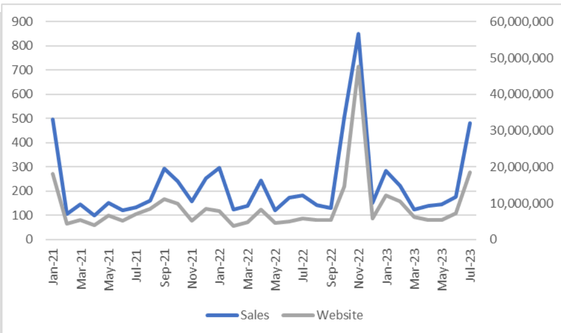
This is especially evident in US Powerball when you examine sales to jackpots i.e. it's far less-popular than it was despite much better jackpot sizes than 2021 (2022 is a unfair comp).

	2021	2022	2023
Jackpots	27,366	34,048	24,410
Sales	5,236	6,706	3,217
Av Jackpot	222	217	264
Draws	123	157	92
Sales per Draw	43	43	35
Sales : Jackpots	19%	20%	13%
Max Jackpot	731	2,040	1,000
Max Sales	248	608	241

	2021	2022	2023
Mean	222	217	266
Median	186	149	190
Mode	20	20	20
Standard Deviation	164	263	229
Skewness	0.96	3.96	1.14
Range	711	2,020	980
Minimum	20	20	20
Maximum	731	2,040	1,000
Count	123	157	91

You can see this trending down over time and also see less website engagement on powerball.com. Although you buy your tickets at state level, which have websites, powerball.com correlates highly with Powerball ticket sales (R^2=.89).



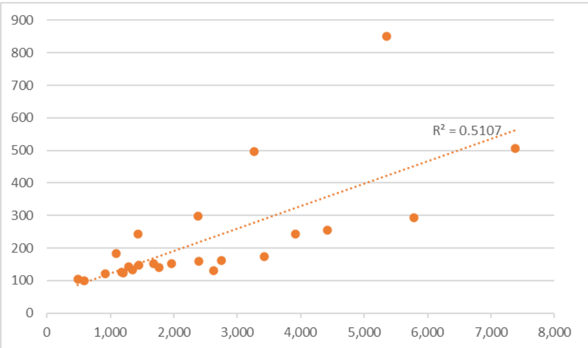


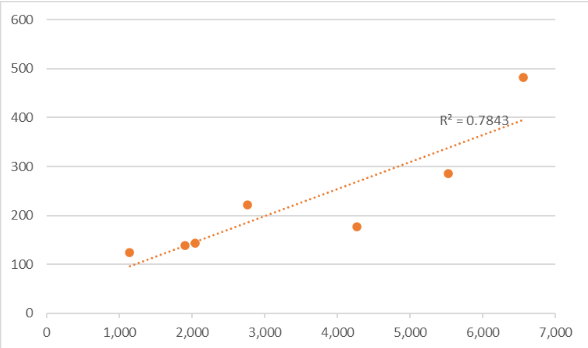
Even Mega Millions, which is having its biggest and best jackpot sequences is seeing less sales (~9%) on a like-for-like basis.

	2021	2022	2023
Tickets	1,991	2,227	1,955
Jackpots	19,113	23,608	21,682
Tickets/Jackpots	10.4%	9.4%	9.0%
Median	117	180	229
Standard Deviation	183	205	366
Maximum	1,000	1,340	1,580

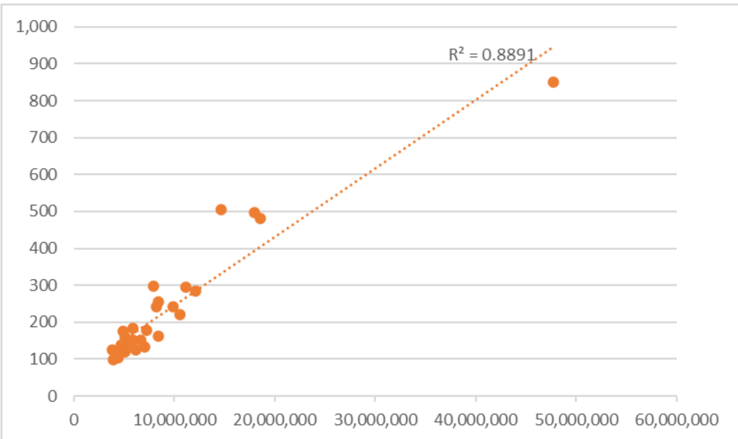
The tougher consumer backdrop in the US has seen a decrease in Lottery spend but also a bigger reliance on bigger jackpots

i.e. people are playing more when there are bigger jackpots and less otherwise from January 2023





Website hits to Sales are a good indicator in the US

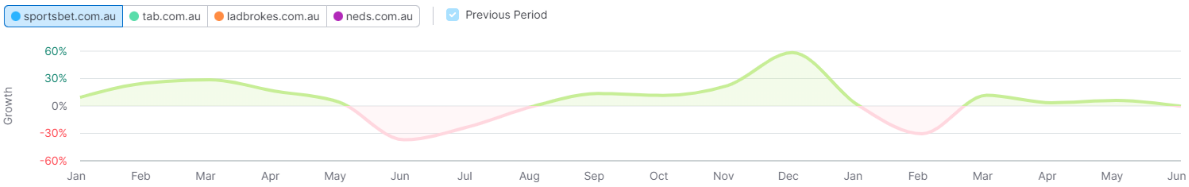


What do we know about Australian gambling so far in 2023?

We know from Sportsbet that people are spending less money wagering, reporting gross revenue -4% YoY despite a big increase in marketing (+23% YoY) and from Entain, which looks down 5-6% YoY for gross revenue (-2% YoY net revenue).

£m	H1 2023	H1 2022	YOY	YOY CC
Average monthly players ('000s)	**1,066**	**993**	**+7%**	
Sportsbook stakes	4,953	5,209	-5%	-4%
Sportsbook net revenue margin	*12.1%*	*11.8%*	*+30bps*	*+30bps*
Revenue	**601**	**612**	**-2%**	**-1%**

Website Hits YoY show the softer Q1 where Sportsbet Net revenue was -4% and +2% in Q2.



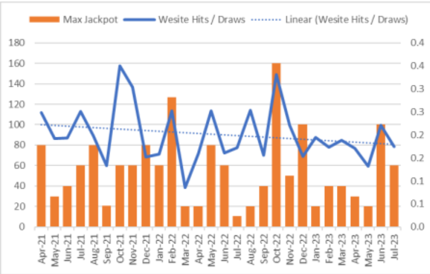
Australian Lotteries

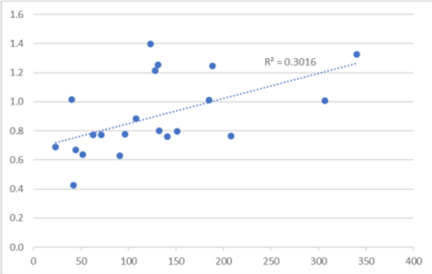
Powerball jackpots were down 38% YoY in the June-half

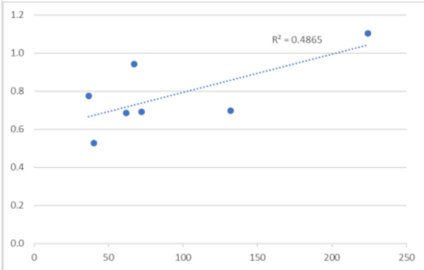
- This comes at a time where you're going to see TLC loaded with H2 costs. So, both revenue and earnings will be down >10% YoY – doesn't sound too defensive.
- Stock has been outperforming the last few months (despite bond rate up 100bps) probably due to this view. There is big risk to this view.

Australia looks to have held up a little better to begin 2023, but it is still softer

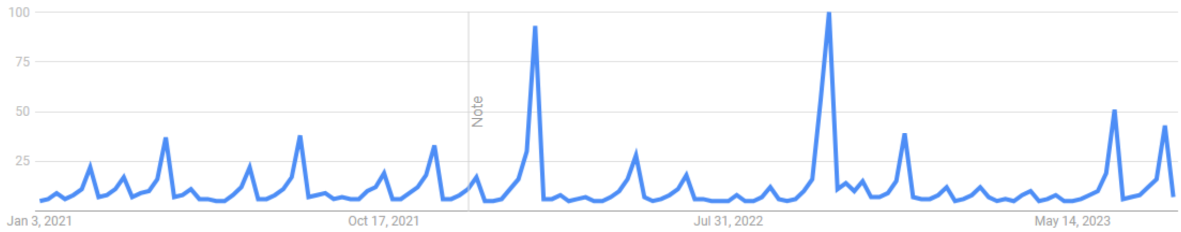
- Similar to the US, there is a lot higher correlation to website hits (which is correlated with sales) and the size of the jackpots in 2023 vs 2022, indicating people are playing more when there are bigger jackpots and less otherwise i.e. discretionary







Google Searches are softer



Earnings outlook is a big risk

FY24 consensus revenue +8% (higher if 2H23 revenue misses) cycling an accelerated jackpot sequence in 1H23 into a big discretionary spend headwind.

Valuation is crazy: 17x FY24 EBITDA, 3.2% Div yield, FCF yield of 4.2% v 10-year bond of 4.3%.

- If Keno is worth 10x (at best) that puts Lotteries on 18.5x EBITDA
- TLC's concession is ~30 years i.e. It has to re-invest for licences.
- The implied cost of capital at 17-18x EBITDA is unrealistic

- Consensus FCF/share is 19c. At 7.2% WACC (very generous, see below) and 5% CAGR on FCF (very generous):
    - $NPV=19\times(0.072-0.051-(1+0.05)^{30}\times(1+0.072)^{-30})$
      =19 * ((1 - (1 + 0.05)^30 * (1 + 0.072)^-30) / (0.072 - 0.05))
    - $4.01 vs share price of $5.18

US Industry WACCs (as of 5 January 2023)

Industry Name	*Number of Firms*	*Beta*	*Cost of Equity*	*E/(D+E)*	*Std Dev in Stock*	*Cost of Debt*	*After-tax Cost of Debt*	*D/(D+E)*	*Cost of Capital*
Retail (Grocery and Food)	13	0.67	7.76%	60.31%	28.26%	5.37%	3.76%	39.69%	6.17%
Beverage (Alcoholic)	23	1.01	9.83%	81.36%	49.87%	5.37%	3.76%	18.64%	8.70%
Business & Consumer Services	164	1.17	10.78%	78.45%	45.78%	5.37%	3.76%	21.55%	9.26%
Beverage (Soft)	31	1.30	11.57%	86.75%	41.72%	5.37%	3.76%	13.25%	10.54%
Entertainment	110	1.45	12.45%	75.03%	57.81%	5.75%	4.03%	24.97%	10.35%
Hotel/Gaming	69	1.46	12.51%	60.03%	38.05%	5.37%	3.76%	39.97%	9.01%

- TLC has traded up while the 10-year bond rate has traded up 100bps since April this year and the TLC share price has gone up – makes little sense.

I've used the Australian Government Bond ETF as I don't have Bloomberg.