

International Game Technology (IGT - \$14.07- NYSE)

Earnings Update - Buy

<u>FYE: 9/30</u>	<u>EPS</u>	<u>P/E</u>	<u>PMV</u>		
2016P	\$1.30	11.5x	\$19	Dividend: \$0.44	Current Return: 3.1%
2015P	1.15	12.8	18	Shares O/S: 248.9 million	
2014E	1.00	13.8	17	52-Week Range: \$21.20- \$13.31	
2013A	1.21	10.8	---		

COMPANY OVERVIEW

Reno, Nevada-based International Game Technology is a global gaming company specializing in the design, manufacture, and marketing of electronic gaming equipment and network systems, as well as licensing and services.

Reason For Comment – Second Quarter Results

On April 22, 2014, IGT reported second quarter FY 2014 (FYE 09/30) results:

- Adjusted EPS: \$0.20 vs. \$0.36, last year
- EBITDA: -33% to \$149.3 million
- Revenues: -15% to \$512.8 million
- Gaming Operations – Revenues decreased 9% to \$230.4 million primarily due to lower jackpot revenue and gross margin was 61% vs. 62% last year. Average revenue-per-unit per day was down 5% to \$47.00 primarily due to lower jackpot yields but +4% due to seasonal gaming trends. Installed base totaled 53,400 down 6% yoy.
- Product Sales – Revenues decreased 27% to \$202.6 million and gross margin was 51% vs. 52% with average selling price up 4% to \$14,700.
- Interactive –Social gaming revenues grew 27% to \$80 million, primarily driven by an increase in Daily Active Users (DAU) +5% and average bookings per DAU +16%.
- The company reiterated its FY2014 EPS guidance of \$1.00-\$1.10. On March 26, 2014, IGT reduced FY 2014 EPS guidance to \$1.00-1.10 from \$1.28-1.38 citing a sharp decline in North American gross gaming revenues and further degradation in the international currency, compliance and importation environment.
- The company has undertaken cost-cutting measures including the reduction of its global workforce by 7% to realize cost savings of \$30 million in the current fiscal year and an estimated \$50 million on an annual run-rate basis.
- Earlier in the quarter, IGT secured a global licensing agreement with Sony, which provides IGT with expanded franchise rights for *Wheel of Fortune* through 2024.
- On July 16, 2013, Bally Technologies (BYI) announced an agreement to acquire SHFL Entertainment at a price of \$23.25 in cash for a total consideration of \$1.3 billion, implying an 11.2x TTM EV/EBITDA multiple. This deal in the gaming equipment space highlights the value of intellectual property, product diversity and market share. As the market leader in slot machines – both product sales and gaming operations, IGT should benefit from multiple expansions underscored by deal activity. At current levels, IGT is trading at a reasonable valuation and is supported by a healthy balance sheet. We continue to recommend purchase of IGT shares.

Investment Case

- Given a tepid replacement cycle and anemic US gross gaming revenue trends, we believe FY 2014 will be a challenging year for IGT. However, we believe IGT's earnings growth 2015 onward will be driven by increased momentum from the strength of its strategy of leveraging its core business while broadening the distribution of its premier content.
- IGT remains a global industry leader and has grown North American ship share to 40% in 2013 from 36% in 2012.
- The company has the highest installed base of 53,400; its closest competitor, SGMS, has 40,295 units.
- IGT expects online social gaming revenue growth of 15%+ over the next 3-5 years driven by its strategy of Vegas-style gaming experience supported by premium content with the option of monetizing non-paying users.
- In online real money gaming (RMG), IGT expects 10%+ revenue growth over the next 3-5 years driven by the introduction of US online wagering and continued expansion of RMG internationally. In New Jersey RMG, 20 IGT slot games are offered on the state's gaming websites.
- The company's capital allocation priorities include funding growth in the business including investing in the business (R&D) and strategic outlays focused on talent, technologies, distribution and content as well as return of capital focused on

balance sheet management (maintaining investment grade credit rating), paying consistent dividends (supporting target minimum current return of 2%) and share buy backs.

- In FY 2014, we expect IGT to generate \$2.1 billion in revenue, \$695 million in EBITDA and earnings per share of \$1.00. Applying a 7.5x multiple to Product Sales cash flow and 9x multiple to Gaming Ops, we calculate a FY 2015 PMV of \$18 per share. At current price levels, IGT is trading at 21% discount to our 2015 PMV and we continue to recommend purchase of the stock.

Table 1

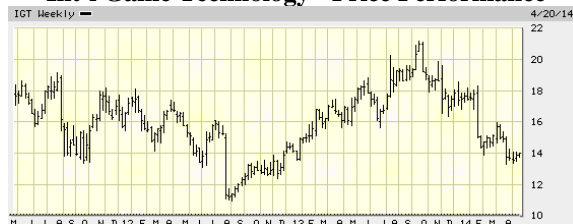
International Game Technology Private Market Value Analysis 2013A-2018P

FYE: 9/30 (in \$ millions except per share data)	2013	2014E	2015P	2016P	2017P	2018P
Product Sales						
Revenues	\$1,031	\$1,062	\$1,082	\$1,102	\$1,118	\$1,130
EBITDA	414.0	314.1	321.9	332.8	342.7	351.2
Valuation Multiple	6.0x	7.5x	7.5x	7.5x	7.5x	7.5x
Segment Value	\$2,484	\$2,356	\$2,414	\$2,496	\$2,570	\$2,634
Gaming Operations						
Revenues	\$1,079	\$1,111	\$1,145	\$1,179	\$1,215	\$1,252
EBITDA (margin)	502.4	381.3	395.1	413.2	431.9	451.3
Valuation Multiple	7.0x	9.0x	9.0x	9.0x	9.0x	9.0x
Segment Value	\$3,517	\$3,431	\$3,556	\$3,718	\$3,887	\$4,062
Total Private Market Value	\$6,001	\$5,787	\$5,970	\$6,215	\$6,457	\$6,696
Less: Debt	(1,343)	(1,354)	(1,061)	(1,096)	(1,104)	(1,083)
Less: Convertible Debt	(850)	(850)	(850)	(850)	(850)	(850)
Less: Options Payments (b)	-	-	-	(6)	(23)	(42)
Plus: Cash and Equivalents	713	356	-	-	-	-
Equity Private Market Value	\$4,521	\$3,940	\$4,058	\$4,263	\$4,481	\$4,722
Basic Shares Outstanding	262.6	238.2	228.2	218.8	210.0	201.7
PMV per share	\$ 17	\$ 17	\$ 18	\$ 19	\$ 21	\$ 23
Current Market - Discount to PMV	18.3%	14.9%	20.9%	27.8%	34.1%	39.9%
(a) Includes \$850MM 3.25% 2014 convert at face value						
(b) After-tax payments to buy out option holders at Private Market Value						
Source: Company filings and Gabelli & Company estimates						

Other Companies Mentioned:

Bally Technologies (BYI – NYSE)
Scientific Games (SGMS-NASDAQ)
Sony (SNE – NYSE)

Int'l Game Technology - Price Performance



Source: Public data. As of April 23, 2011 IGT was rated a BUY

I, **Amitabh Kapoor**, the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

Amitabh Kapoor (914) 921-7786

©Gabelli & Company 2014

Important Disclosures

ONE CORPORATE CENTER RYE, NY 10580

GABELLI & COMPANY

TEL (914) 921-5130

FAX (914) 921-5098

Gabelli & Company is the marketing name for the registered broker dealer G.research, Inc., which was formerly known as Gabelli & Company, Inc. Gabelli & Company ("we" or "us") attempts to provide timely, value-added insights into companies or industry dynamics for institutional investors. Our research reports generally contain a recommendation of "buy," "hold," "sell" or "non-rated." We do not undertake to "upgrade" or "downgrade" ratings after publishing a report. We currently have reports on 566 companies, of which 46%, 38%, 3% and 13% have a recommendation of buy, hold, sell or non-rated, respectively. The percentage of companies so rated for which we provided investment banking services within the past 12 months is 0%, 0%, 0% and less than 1%.

Ratings

Analysts' ratings are largely (but not always) determined by our "private market value," or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

We prepared this report as a matter of general information. We do not intend for this report to be a complete description of any security or company and it is not an offer or solicitation to buy or sell any security. All facts and statistics are from sources we believe to be reliable, but we do not guarantee their accuracy. We do not undertake to advise you of changes in our opinion or information. Unless otherwise noted, all stock prices reflect the closing price on the business day immediately prior to the date of this report. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

As of March 31, 2014 our affiliates beneficially own on behalf of their investment advisory clients or otherwise approximately less than 1% of Bally, SGMS, Sony and International Game Technology. Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. The analysts who wrote this report may receive commissions from our customers' transactions in the securities mentioned in this report. Our affiliates may receive compensation from the companies referred to in this report for non-investment banking securities-related services, or may be soliciting these companies as clients for non-investment banking securities-related services. The analysts who wrote this report or members of his household owns no shares of the above mentioned companies.