

International Game Technology (IGT - \$16.92 - NYSE) Catalyst Surfaces – Moving to Hold

<u>FYE: 9/30</u>	<u>EPS</u>	<u>P/E</u>	<u>PMV</u>		
2016P	\$1.15	15.9x	\$24	Dividend: \$0.44	Current Return: 2.6%
2015P	1.05	17.5	22	Shares O/S: 247.0 million	
2014E	1.00	18.2	21	52-Week Range: \$21.20 - \$12.14	
2013A	1.25	14.6	---		

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 –

- On July 16, IGT announced that it had entered into an agreement to be acquired by GTECH S.p.A. for \$6.4 billion, comprised of \$4.7 billion in cash and stock and \$1.7 billion of net debt, implying a 9.1x 2014E EV/EBITDA multiple.
- IGT and GTECH will combine under a newly formed holding company organized in the United Kingdom (NewCo).
- IGT shareholders will receive \$18.25 per IGT share in a combination of \$13.69 in cash plus 0.1819 ordinary shares of NewCo for each IGT share, and GTECH shareholders will exchange each of their existing GTECH shares for one newly issued NewCo share.
- The combined company would have over \$6 billion in TTM revenues and over \$2 billion in TTM EBITDA as of March 31, 2014 and the companies expect over \$280 million in synergies over a three-year period.
- The transaction has been approved by the boards of directors of both companies. IGT shareholders can elect all-stock, all-cash, or a mixed consideration subject to proration. The stock consideration portion is subject to adjustment with a 15% up and down collar.
- IGT management noted slight tax advantages but stated that tax advantages were not the primary driver of the deal. Management expects 200-300 bps of tax savings from the UK domicile. IGT management also noted that the break-up fee, which will be detailed in the forthcoming merger agreement, is 'standard.'
- NewCo will continue under the name GTECH plc and have its corporate headquarters in the UK and maintain operating headquarters in Las Vegas, Providence and Rome and will apply for listing solely on the NYSE. IGT's shares will cease trading on the NYSE and GTECH's shares will cease trading on the Borsa Italiana.
- De Agostini S.p.A. (currently owns 59% of GTECH's shares) has agreed to vote in favor of the transaction and is expected to own approximately 47% of NewCo's outstanding ordinary shares.
- Existing IGT and GTECH shareholders will own approximately 20% and 80%, respectively, of NewCo shares. The transaction is expected to be completed in 1Q or 2Q of 2015, subject to the receipt of required antitrust and gaming jurisdiction approvals, and approval by IGT and GTECH shareholders.
- With limited overlap in products and geography, we believe the combined company will benefit from global scale and a bigger platform offering content and technology across global gaming market segments.
- While we believe that as a global industry leader with North American ship share of 35% and the highest installed base of 53,400, IGT could've attracted a higher multiple (and price), the lack of a replacement cycle and anemic yields in the gaming operations business make it less likely that another bidder will emerge.
- As such with the materialization of our catalyst, we are changing our recommendation on IGT to Hold from Buy.
- Recall, on June 16, lottery operator GTECH S.p.A. announced that it was engaged in preliminary, exploratory discussions regarding a potential transaction with IGT. In a separate press release, IGT also confirmed that it was engaged in exploring a broad range of strategic alternatives.
- 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.
- On April 22, 2014, IGT reported second quarter FY 2014 adjusted EBITDA: -33% to \$149.3 million and revenues: -15% to \$512.8 million. The company reiterated its FY 2014 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.
- 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 9x multiple to Product Sales cash flow, an 11x multiple to Gaming Ops and a 10x multiple to Double Downs, we calculate a FY 2014 PMV of \$21 per share. At current price levels, IGT is trading at 19% discount to our FY 2014 PMV and we rate the shares Hold.

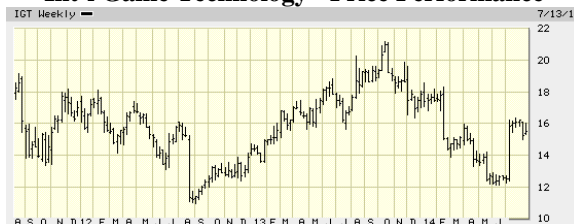
Table 1

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 (margin)	362	271	275	277	276	273
Valuation Multiple	7.0x	9.0x	9.0x	9.0x	9.0x	9.0x
Segment Value	\$2,537	\$2,442	\$2,472	\$2,489	\$2,485	\$2,459
Gaming Operations						
Revenues	\$1,079	\$1,111	\$1,145	\$1,179	\$1,215	\$1,252
EBITDA (margin)	440	329	337	343	348	351
Valuation Multiple	7.0x	11.0x	11.0x	11.0x	11.0x	11.0x
Segment Value	\$3,079	\$3,623	\$3,709	\$3,776	\$3,828	\$3,862
Double Downs						
Revenues	\$265	\$300	\$330	\$356	\$377	\$392
EBITDA (margin)	114	95	109	124	140	158
Valuation Multiple	8.0x	10.0x	10.0x	10.0x	10.0x	10.0x
Segment Value	\$913	\$954	\$1,090	\$1,239	\$1,402	\$1,579
Total Private Market Value	\$6,529	\$7,018	\$7,271	\$7,504	\$7,715	\$7,900
Less: Debt	(1,343)	(2,204)	(1,750)	(1,615)	(1,453)	(1,265)
Less: Convertible Debt	(850)	-	-	-	-	-
Less: Options Payments (b)	(13)	(18)	(31)	(44)	(57)	(71)
Plus: Cash and Equivalents	713	356	-	-	-	-
Equity Private Market Value	\$5,037	\$5,152	\$5,489	\$5,845	\$6,205	\$6,564
Basic Shares Outstanding	248.9	247.0	247.0	247.0	247.0	247.0
PMV per share	\$ 20	\$ 21	\$ 22	\$ 24	\$ 25	\$ 27
Current Market - Discount to PMV	16.4%	18.9%	23.9%	28.5%	32.6%	36.3%
(a) After-tax payments to buy out option holders at Private Market Value						
Source: Company filings and Gabelli & Company estimates						

Other Companies Mentioned:

GTECH SpA (GTK.MI)
Sony (SNE – NYSE)

Int'l Game Technology - Price Performance



Source: Public data. As of July 17, 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.

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Important Disclosures

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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.

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As of June 30, 2014 our affiliates beneficially own on behalf of their investment advisory clients or otherwise approximately 1.31% of IGT and less than 1% of Sony and GTECH. 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.