



Bally Technologies (BYI)

Equity Research

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BYI: Systems Segment Shines Bright like a Diamond; Drives 3Q Upside

Rating: BUY PT: \$62 (previously \$60)

Stock Data	
Stock Price	\$49.08
52 Week Low - High	\$41.74 - \$51.16
Shares Out (mil)	38.6
Market Cap (mil)	\$1,894
3-Mo. Avg. Vol	185,700
Cash (mil)	\$86.0
Debt (mil)	\$635.2

Revenue (\$ millions)					
FY Jun	2012	2013		2014	
1Q	\$195.0	\$235.2A	\$235.2A	\$250.3E	\$248.9E
2Q	\$210.4	\$238.3A	\$238.3A	\$255.0E	\$253.0E
3Q	\$228.6	\$259.1A	\$248.6E	\$274.3E	\$268.4E
4Q	\$245.8	\$261.2E	\$260.5E	\$281.8E	\$285.0E
Year	\$879.8	\$993.8E	\$982.6E	\$1,061.4E	\$1,055.2E

EPS (\$)					
FY Sep	2012	2013		2014	
1Q	\$0.48	\$0.77A	\$0.77A	\$0.88E	\$0.82E
2Q	\$0.54	\$0.80A	\$0.80A	\$0.94E	\$0.87E
3Q	\$0.69	\$0.89A	\$0.84E	\$1.09E	\$1.02E
4Q	\$0.78	\$0.93E	\$0.93E	\$1.17E	\$1.15E
Year	\$2.49	\$3.38E	\$3.34E	\$4.08E	\$3.86E
P/E	19.7	14.5	14.7	12.0	12.7

Guidance range: **\$3.35** **\$3.45** **n/a** **n/a**

Note: EPS is adj. for non-recurring items. Please see attached model for details.



Source: ThomsonOne

Bally reported another strong quarter beating expectations on better than anticipated System sales while Game sales lagged a bit and Gaming Ops was roughly in-line. Mgt also raised its FY13 guidance from \$3.20-\$3.40 to \$3.35-\$3.45 to reflect the upside to 3Q, as well as the partial impact from its new \$150M accelerated stock buyback (ASB). We are taking our FY13 est up by 4c to reflect the upside to 3Q and we are also raising our FY14 est by 22c to reflect a full year impact from the ASB and higher systems revenue slightly offset by reduced game sales. Bally's Systems business really shined through in 3Q13 and we look for continued growth in FY14. We continue to like shares at current levels and reiterate our BUY rating and & raise our PT from \$60 to \$62.

- Strong 3Q results.** Bally reported 3Q revenue of \$259.1M (+13.3% y/y), which was \$10M above our est and \$13M above consensus driven by strong systems sales. Operating margins improved +140 bps y/y to 23.4%, which was in-line with our est although we note a decline of -40 bps q/q due to increased R&D spending on iGaming initiatives primarily. Finally, GAAP EPS was 93c and we calculate adj. EPS of 89c (excl FX loss and assuming 36.5% tax rate), which was 5c ahead of our est and 4c above the Street. We note EPS could have been even better as mgt indicated another \$1.5M in non-recurring SG&A items (-2c) that were note broken out.
- System sales strong, & should get even better.** As we highlighted in our preview, Systems sales came in above expectations increasing +25% y/y on new installations in Ohio (Caesars Cincy) and S. Africa (Sun International, Peermont) and several new international markets combined w/ healthy iView DM sales and multiple add-on products. System GMs also remained healthy at 73% for the qtr which was in line w/ our est. Going forward we look for systems contributions to remain strong in FY14 as large contracts with BCLC and Sun International ramp up and Bally continues to expand its presence globally. We also view Bally's systems lead as a strategic advantage in the emerging interactive gaming space with the company's ability to seamlessly link its land based systems technology with its mobile and internet offerings providing an integrated technology platform and a complete 360 degree view of the patron for its operator customers.
- Competitor promotions impact game sales.** As we mentioned in our preview and our most recent *Slot Survey*, we believe Bally's game sales were negatively impacted by competitor promotions in the qtr leading to Equip sales growth of only +8.2% y/y, which missed our est by \$2.0M. For the qtr, Bally shipped 4,098 games including 2,842 replacements (788 Canadian VLTs) and 825 expansionary units (400 IL video gaming units). Both Canada and IL units were slightly above expectations while U.S. replacements (ex Canada VLTs) were down -10.7% y/y and missed our est. We also note that Bally has ~200 units remaining on its Western Canada VLT contract, which should be delivered in 4Q12. We also believe the current IL VGT shipments should be sustainable for several more qtrs has Bally has shipped 1,200 of its ~4,000 plus games under contract implying ~600 shipments per qtr through the end of FY14. Going forward, we look for U.S. repl sales to rebound q/q in 4Q and look for healthy single digit growth in FY14 w/ a substantial pickup in new content from new internal studios and 3rd party relationships like High 5 games.

-Continued on next page-

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- **Gaming Ops in-line, NASCAR launch in 4Q.** As we highlighted in our preview and survey data, Bally's Gaming Operations segment slowed a bit in 3Q as results were roughly in-line after several quarters of outperformance. For the qtr, Gaming Ops revenue increased +10% y/y and GMs came in at 70.6%. Total games installed declined -46 units q/q to 66.6k driven by the removal of -163 VLT games primarily in Maryland due to the reconfiguration of gaming floors w/ live tables added. Premium leased games increased only +36 units q/q to 17.3k games installed which included +45 net WAPs added and a reduction of -9 non-WAP games. While the pace of installation activity slowed, we note revenue yields came in slightly better than expected at \$16.78/day (+4.0% y/y, +3.1% q/q) vs. our est for \$16.59. We believe the improved yield performance was the result of a higher mix of better yielding WAP games and continued strength in the NY VLT market. We estimate Bally's premium leased games earned \$44.25/day in 3Q13 with WAPs still earning close to \$100/day. Going forward, we look for the recent launch of Bally's *NASCAR* game to drive incremental WAP placements in 4Q and FY14. We note *NASCAR* was ranked the most highly anticipated premium leased game in the latest *EILERS-FANTINI Slot Survey*. We continue to believe that Bally is under represented in the WAP sector with only ~9% market share while its "sold game" floor share is ~14% implying the potential for another 1,000 net WAP placements which would add 30c in recurring annual earnings.

Summary thesis

Overall Bally posted another strong qtr beating expectations and raising guidance despite being negatively impacted by large competitor promotions in the qtr and a bit of a slow down in its Gaming Ops business. Bally's systems business took center stage and shareholders were finally rewarded for several years of improvements and upgrades to the Systems segment. The most exciting part about the systems segment outperformance was that no single project or customer accounted for more than 12.5% of sales in the qtr and that major projects in S. Africa and Canada contributed very little to 3Q implying a healthy sales outlook in 4Q and FY14. Furthermore, mgt continues to return capital to shareholders with meaningful share repurchases including a new \$300M authorization and \$150M ASB which should provide a nice boost to earnings in FY14. We continue to believe BYI shares are undervalued trading for only 13.5x and 11.5x our CY13 and CY14 EPS estimates. As such, we reiterate our BUY rating and \$60 PT on BYI shares.

--Model attached--

BYI – Income Statement (\$ in 000s, except per share data)

Year End: June	FY06	FY07	FY08	FY09	FY10	FY11	Sep Q1:12	Dec Q2:12	Mar Q3:12	Jun Q4:12	FY12	Sep Q1:13	Dec Q2:13	Mar Q3:13	Jun Q4:13E	FY13E	Sep Q1:14E	Dec Q2:14E	Mar Q3:14E	Jun Q4:14E	FY14E	
Revenue by segment																						
Gaming Equipment	225,100	324,100	410,100	357,000	273,700	246,600	64,400	70,200	79,300	96,800	310,700	82,700	82,600	85,800	90,687	341,787	80,515	85,226	97,360	98,489	361,590	
Gaming Systems	120,500	134,100	206,300	211,800	217,500	193,000	45,600	54,000	56,800	55,300	211,700	51,300	56,700	71,300	67,643	246,943	62,657	64,421	67,541	71,295	265,914	
Gaming Ops	147,000	176,412	236,000	275,000	287,000	318,600	85,000	86,200	92,500	93,700	357,400	101,200	99,000	102,000	102,912	405,112	107,124	105,374	109,409	111,978	433,885	
Casino Ops	48,994	47,675	47,355	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Total revenue	541,594	682,318	899,691	843,862	778,200	758,200	195,000	210,400	228,600	245,800	879,800	235,200	238,300	259,100	261,242	993,842	250,296	255,021	274,310	281,762	1,061,389	
% change y/y	14.1%	26.0%	31.9%	-6.2%	-7.8%	-2.6%	14.2%	15.2%	19.7%	15.0%	16.0%	20.6%	13.3%	13.3%	6.3%	13.0%	6.4%	7.0%	5.9%	7.9%	6.8%	
% change q/q	n/a	n/a	n/a	n/a	n/a	n/a	-8.8%	7.9%	8.7%	7.5%	n/a	-4.3%	1.3%	8.7%	0.8%	n/a	-4.2%	1.9%	7.6%	2.7%	n/a	
Gross profit by segment																						
Gaming Equipment	46,600	121,400	182,800	166,800	138,000	112,100	28,400	30,000	36,600	44,800	139,800	39,200	43,900	43,500	46,704	173,304	39,734	43,678	50,870	51,707	185,990	
Gaming Systems	88,200	96,400	151,300	150,208	156,500	142,600	34,500	40,100	40,400	40,900	155,900	39,500	43,200	52,200	49,380	184,280	45,426	47,027	49,305	52,046	193,804	
Gaming Ops	66,100	103,700	155,600	194,900	203,900	229,800	60,700	62,400	67,500	67,100	257,700	70,100	69,700	72,000	73,067	284,867	75,791	74,131	77,680	79,672	307,274	
Casino Ops	32,709	29,629	28,515	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Gross profit	232,402	351,129	518,215	511,908	498,400	484,500	123,600	132,500	144,500	152,800	553,400	148,800	156,800	167,700	169,151	642,451	160,951	164,836	177,856	183,425	687,067	
% Margin	42.9%	51.5%	57.6%	60.7%	64.0%	63.9%	63.4%	63.0%	63.2%	62.2%	62.9%	63.3%	65.8%	64.7%	64.7%	64.6%	64.3%	64.6%	64.8%	65.1%	64.7%	
SG&A	184,640	207,103	239,271	212,700	203,200	225,033	57,200	61,304	63,764	62,753	245,021	64,500	67,852	72,218	72,756	277,326	68,456	69,493	73,378	74,667	285,994	
% of sales	34.1%	30.4%	26.6%	25.2%	26.1%	29.7%	29.3%	29.1%	27.9%	25.5%	27.8%	27.4%	28.5%	27.9%	27.9%	27.9%	27.4%	27.3%	26.8%	26.5%	26.9%	
R&D	45,087	51,912	60,825	77,300	80,300	88,086	23,400	22,377	24,838	25,581	96,196	25,100	26,599	29,098	29,250	110,047	29,450	29,650	29,850	30,050	119,000	
% of sales	8.3%	7.6%	6.8%	9.2%	10.3%	11.6%	12.0%	10.6%	10.9%	10.4%	10.9%	10.7%	11.2%	11.2%	11.2%	11.1%	11.8%	11.6%	10.9%	10.7%	11.2%	
Extraordinary Charges (gain)	15,581	-	-	-	11,379	-	-	-	-	10,000	10,000	-	-	-	-	-	-	-	-	-	-	
D&A	24,301	22,376	18,913	18,900	19,400	19,845	5,600	5,806	5,648	5,686	22,740	5,600	5,687	5,755	5,755	22,797	5,755	5,755	5,755	5,755	23,020	
% of sales	4.5%	3.3%	2.1%	2.2%	2.5%	2.6%	2.9%	2.8%	2.5%	2.3%	2.6%	2.4%	2.4%	2.2%	2.2%	2.3%	2.3%	2.3%	2.1%	2.0%	2.2%	
EBIT	(37,207)	69,738	199,206	203,008	184,121	151,536	37,400	43,013	50,250	48,780	179,443	53,600	56,662	60,629	61,390	232,281	57,290	59,938	68,873	72,953	259,053	
% margin	-6.9%	10.2%	22.1%	24.1%	23.7%	20.0%	19.2%	20.4%	22.0%	19.8%	20.4%	22.8%	23.8%	23.4%	23.5%	23.4%	22.9%	23.5%	25.1%	25.9%	24.4%	
Non-operating income (expense)	(28,033)	(33,958)	(25,193)	(18,019)	(13,318)	(8,142)	(5,129)	(4,067)	(2,600)	(3,188)	(14,984)	(4,216)	(4,194)	(4,732)	(3,200)	(16,342)	(3,333)	(3,307)	(3,280)	(3,254)	(13,174)	
% of sales	-5.2%	-5.0%	-2.8%	-2.1%	-1.7%	-1.1%	-2.6%	-1.9%	-1.1%	-1.3%	-1.7%	-1.8%	-1.8%	-1.8%	-1.2%	-1.6%	-1.3%	-1.3%	-1.2%	-1.2%	-1.2%	
Pretax income	(65,240)	35,780	174,013	184,989	170,803	143,394	32,271	38,946	47,650	45,592	164,459	49,384	52,468	55,897	58,190	215,939	53,957	56,631	65,592	69,699	245,879	
% margin	-12.0%	5.2%	19.3%	21.9%	21.9%	18.9%	16.5%	18.5%	20.8%	18.5%	18.7%	21.0%	22.0%	21.6%	22.3%	21.7%	21.6%	22.2%	23.9%	24.7%	23.2%	
Tax provision (benefit)	(24,012)	10,975	66,793	64,781	60,721	45,182	11,853	14,688	17,713	19,295	63,549	18,429	19,389	17,527	21,239	76,584	19,829	20,812	24,105	25,614	90,361	
% tax rate	36.8%	30.7%	38.4%	35.0%	33.5%	31.5%	36.7%	37.7%	37.2%	42.3%	38.6%	37.3%	37.0%	31.4%	36.5%	35.5%	36.8%	36.8%	36.8%	36.8%	36.8%	
Net income - Continuing Ops	(41,228)	24,805	107,220	120,208	110,082	98,212	20,418	24,258	29,937	26,297	100,910	30,955	33,079	38,370	36,951	139,355	34,128	35,819	41,487	44,084	155,519	
% margin	-7.6%	3.6%	11.9%	14.2%	14.1%	13.0%	10.5%	11.5%	13.1%	10.7%	11.5%	13.2%	13.9%	14.8%	14.1%	14.0%	13.6%	14.0%	15.1%	15.6%	14.7%	
Discontinued operations income	1,124	-	-	8,057	29,260	(403)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
Minority interest, net of tax	-	-	-	(1,927)	(1,880)	455	(17)	(16)	53	218	238	1,588	48	(43)	(15)	1,578	(15)	(15)	(15)	(15)	(60)	
Net income - GAAP	(40,104)	24,805	107,220	128,265	137,462	98,264	20,401	24,242	29,990	26,515	101,148	32,543	33,127	38,327	36,936	140,933	34,113	35,804	41,472	44,069	155,459	
% margin	-7.4%	3.6%	11.9%	15.2%	17.7%	13.0%	10.5%	11.5%	13.1%	10.8%	11.5%	13.8%	13.9%	14.8%	14.1%	14.2%	13.6%	14.0%	15.1%	15.6%	14.6%	
GAAP EPS	(\$0.79)	\$0.40	\$1.85	\$2.22	\$2.38	\$1.81	\$0.45	\$0.54	\$0.67	\$0.61	\$2.26	\$0.77	\$0.80	\$0.93	\$0.93	\$3.43	\$0.88	\$0.94	\$1.09	\$1.17	\$4.08	
GAAP EPS - Continuing Ops	(\$0.77)	\$0.45	\$1.85	\$2.08	\$1.88	\$1.82	\$0.45	\$0.54	\$0.67	\$0.61	\$2.26	\$0.77	\$0.80	\$0.93	\$0.93	\$3.43	\$0.88	\$0.94	\$1.09	\$1.17	\$4.08	
Pro forma EPS	(\$0.57)	\$0.50	\$1.87	\$2.03	\$2.06	\$1.85	\$0.48	\$0.54	\$0.69	\$0.78	\$2.49	\$0.77	\$0.80	\$0.89	\$0.93	\$3.38	\$0.88	\$0.94	\$1.09	\$1.17	\$4.08	
Diluted shares outstanding	52,174	55,543	58,000	57,000	57,677	54,149	45,567	44,771	45,052	43,607	44,664	42,115	41,494	41,199	39,599	41,102	38,599	38,274	37,949	37,624	38,112	
Non-GAAP cash flow items:																						
EBITDA - adj	55,624	129,357	261,784	277,995	265,353	225,450	57,592	63,981	70,435	79,126	271,134	76,507	79,049	82,934	83,873	322,363	79,923	82,721	91,806	96,036	350,485	
% margin	10.3%	19.0%	29.1%	32.9%	34.1%	29.7%	29.5%	30.4%	30.8%	32.2%	30.8%	32.5%	33.2%	32.0%	32.1%	32.4%	31.9%	32.4%	33.5%	34.1%	33.0%	
Free cash flow	(6,095)	5,116	49,809	130,791	117,514	43,554	44,659	13,316	10,304	51,240	119,519	33,502	31,102	65,194	22,934	152,732	33,761	36,102	42,420	45,167	157,451	
% margin	-1.1%	0.7%	5.5%	15.5%	15.1%	5.7%	22.9%	6.3%	4.5%	20.8%	13.6%	14.2%	13.1%	25.2%	8.8%	15.4%	13.5%	14.2%	15.5%	16.0%	14.8%	

Notes
 Pro forma EBITDA and EPS excludes the following items:
 FY06: Excludes \$15.6 million in impairment charges and \$14.2 million in inventory charges
 FY07: Excludes \$6.2 million in inventory charges and a \$2.2 million fee to amend the company's credit facility
 FY08: Excludes \$2.1 million in inventory charges, \$3M gain on insurance settlement, and \$1.5M FX charge
 FY09: Excludes \$3M insurance settlement proceeds in 2Q09, Excludes Vicksburg Casino Results for the full year.
 FY10: Excludes Rainbow casino results for the full year, \$22M gain on Rainbow sale, \$11M in Alabama related writedowns due to charity hall closures, and \$3.0M in FX losses & discrete tax items.
 FY11: Excludes \$2 million R&D tax credit benefit in 2Q, \$1 million legacy platform write-down in 3Q. 4Q excludes \$4.1M debt extinguishment charge
 FY12: Excludes \$2 million in FX loss in 1Q12, Excludes \$1.8M Impairment in 3Q12, Excludes \$10M legal reserve in 4Q.
 n/a = not applicable or data not available
 Source: Company reports and Eilers Research, LLC estimates.