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BLOG: The challenges facing Amaya and PokerStars

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Amaya's purchase of PokerStars leaves a lot of questions unanswered. This is a game changer alright, but success is not a given.

Friday was without doubt the most exciting day this industry has witnessed since Black Friday or since Full Tilt was acquired. And once again, the reason was PokerStars.

This remarkable company continues to defy expectations and will continue to do so for the foreseeable future. However, surprises can work in both directions and the deal does not mean global domination is a given for the expanded Amaya Gaming group.

The assumption that a Scheinbergless PokerStars will be welcomed into the US is fair enough. You cannot, in theory, legislate against or punish a company – you can only sanction the principals involved in taking decisions that you deem unsatisfactory.

Indeed, New Jersey Division of Gaming Enforcement Director David Rebuck told NorthJersey.com he will thoroughly scrutinize the deal before adding: "We are also encouraged by this development and the expanded opportunities it might provide for New Jersey's internet gaming industry."

The slow start to New Jersey's regulated market has left it crying out for a PokerStars.

As Jeff Ifrah of Ifrah Law, one of the company's outside counsel, told me last week: "Stars is a market maker and if you want a market in the US, you need a market maker. New Jersey has unfortunately seen what happens when you try and launch an online poker industry without a market maker. It should not have had to happen like this but this is really good for online poker and really good for PokerStars."

While Rebuck seems ready to welcome PokerStars with open arms, the problem with New Jersey might not be its lack of a market maker so much as its lack of acceptance by America's major banks and credit card companies. The arrival of PokerStars and all its grey markets is not going to change that.

While Deutsche Bank, Barclays and Macquarie Capital were happy to back this deal, US banks such as JP Morgan Chase and Bank of America will not touch online gambling transactions, even in regulated jurisdictions such as New Jersey.

I was speaking to the American Banking Association VP for regulatory compliance Steve Kenneally on the subject of New Jersey and credit card acceptance before the deal became public last week.

"There is concern about the impact a violation could have on a bank's reputation if a minor funds an account through their bank or if an adult compulsively gambles all of their money away," said Keneally. "These banks don't feel that the potential reward of increased revenues compensates them for the increased risk."

The presence of PokerStars in the market would increase the potential reward but it is doubtful whether its presence alone can change an entrenched policy. American Express doesn't allow its cards to be used for any gambling transaction online or off.

"In today's environment where only New Jersey, Nevada and Delaware allow lawful internet gambling there is not much of a financial incentive for large banks operating in multiple states to allow these transactions compared with the potential risk. When/if online gambling becomes legal in more states and more customers ask for this service from their banks, I would expect more banks to allow these payments," concluded Kenneally.

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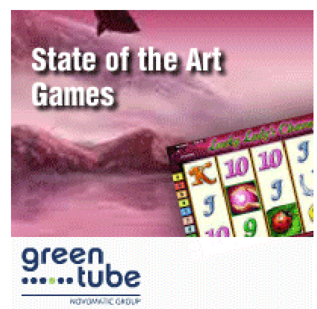

So we might have to wait well into 2015 or 2016 before the banks decide the upside is worth the risk.

Of more immediate interest is the effect the transaction will have on the principal parties involved in the deal. Amaya has evolved from humble beginnings to become the biggest company in online gambling.

Amaya was founded in 2004 but just three years ago, it was still a small Canadian technology company best known for its Mosino in-hotel entertainment system. It had just started to provide SMS lotteries to countries such as Kenya, Moldova and Armenia. Those deals have faded into the background as chief executive David Baazov has taken them on a three-year acquisition spree that has seen Chartwell, Cryptologic, Ongame, Cadillac Jack, Diamond Game and, now, PokerStars and Full Tilt join the Amaya camp.

Baazov's ability to raise cash is phenomenal. The acquisition of PokerStars is his crowning glory and a triumph for the Canadian finance industry. Baazov has worked closely with Canaccord Genuity throughout this period and the latter can now count itself a significant shareholder in the biggest online gaming company the world has ever known.

Revenues grew from $17m in 2011 to $145m in 2013. They will likely be up to about $1.5bn by the end of 2014. But that growth has not come without teething problems. Amaya lost CAD$29.2m last year, a figure that was expected to grow to some CAD$50m this year.

Accusations of fraud dogged the lottery operation in Kenya. Amaya's strategy of buying distressed companies and cleaning them up for entry into regulated markets (particularly the US) is still a work in progress.

The sale of grey markets operator Wagerlogic was very impressive at first glance. Amaya bought Cryptologic for just $29.48m and sold its B2C business for $66m. However, the acquisition vehicle has been guaranteed $20m a year for two years, which will be well in excess of Wagerlogic's revenues.

Amaya has not been able to stop the decline of Ongame, which has continued to sink like a stone and now has an average of just 300 players a day. The rumour mill has Caesars down to try its luck at resuscitating Ongame. It had been looking to build its own product to accompany the WSOP brand but this has been fraught with difficulties.

As several sources have said to me since, Baazov is brilliant at buying companies but is he any good at running them? Well, he's just about to acquire the best management team in the business. The expertise of Isai and Mark Scheinberg will be missed when they depart upon completion but the PokerStars DNA has been hardwired into CFO Michael Hazel and general counsel Paul Telford. The newer arrivals to the management team, COO Rafi Ashkenazi and business development chief Guy Templer, have brought their own expertise to the team and seem to have slotted in seamlessly.

Baazov has said he will leave them to continue doing what they do best, which is running the world's favourite online poker brand. However, the company is faced with a contracting poker market (which it is dominating more and more) and a new generation of tech-savvy consumers with their noses stuck on social sites.

The company is already diversifying with casino games launched and sports betting on the horizon. PokerStars will continue to grow whatever happens in the US… or in Amaya HQ in Canada. While there was a lot of talk in Amaya's presentations about Amaya facilitating PokerStars entry to the US, it should really be the Canadian company piggybacking on the success of PokerStars rather than vice versa.

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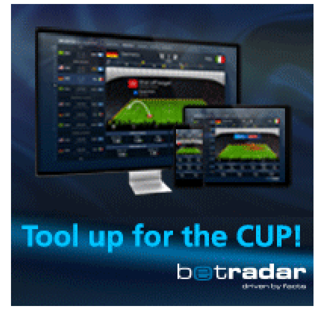

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