

FARMHOUSE EQUITY RESEARCH, LLC

RESEARCH REPORT

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LEISURE GOODS

GTECH HOLDINGS CORPORATION

(GTK – \$33.75)

GTK: Initiating Coverage With Buy Rating and \$44 Price Target

EPS (\$)						REVENUES (\$000)			
Fiscal Year:			03/02		04/03				04/03
February	2002A	2003A	Change	2004E	Change		2003A	2004E	Change
Q1	\$0.30	\$0.49	63%	\$0.63	29%	Q1	231,417	238,442	3%
Q2	\$0.28	\$0.66	136%	\$0.66	0%	Q2	220,958	246,471	12%
Q3	\$0.37	\$0.57	54%	\$0.68	19%	Q3	256,466	263,931	3%
Q4	\$0.18	\$0.72	300%	\$0.73	1%	Q4	269,954	286,547	6%
Year	\$1.13	\$2.43	115%	\$2.70	11%	Year	978,790	1,035,390	6%
P/E	29.9x	13.9x		12.5x		Mkt Cap/Revs	2.0x	1.9x	
52-Week Range:						Proj. 3-Year Revenue Growth:			
Market Cap. (\$Millions):						Dividend/Yield:			
Est. Shares Out. (000):						Book Value/Share (2/03):			
Estimated Float (000):						Return on Equity (TTM):			
Est. Insider Holdings:						Debt/Equity (2/03)			
Est. Institutional Holdings:						Gross Margin (TTM):			
10-Day Average Volume:						12-Month Price Target:			
Next EPS Report:						Rating			

INITIATING COVERAGE OF GTECH HOLDINGS CORPORATION

- Leading Company In Its Industry.** We are initiating coverage of GTECH Corporation, the leading online lotteries services company, with a Buy rating and 12-month price target of \$44. In our opinion, GTECH's dominant position (70% worldwide market share), combined with its stable and highly predictable earnings and cash flows, represents an excellent long-term investment opportunity. The company has set up more than 340,000 retail lottery terminals worldwide, and does business on 6 continents. Through that global reach we believe the company will gradually begin to leverage its core competencies and contacts in transaction processing into contracts with government agencies for such diverse kinds of services as motor vehicle registration transactions and bus passes for rapid transit systems.
- Acquisition Strategy Makes Sense** – GTECH is in the enviable position of being the leader in an industry that has turned into a limited oligopoly. In the U.S. the company competes with Scientific Games (NASDAQ: SGMS, \$6.25, Not Rated), as well as IGT Online Entertainment Systems, a subsidiary of IGT (NYSE: IGT, \$81.61, Not Rated) and Intralot, a publicly traded company in Greece, for a restricted number of new lottery contracts that come up for bid each year. In the past 48 months, we believe that GTECH has won an impressive 90%+ of new bid business. While that success has created a stable and predictable revenue model, the downside is that new growth opportunities in both domestic and international lotteries is limited by the few remaining contracts to be had. It therefore makes sense to us that GTECH would look for ways to grow in areas that are synergistic to its core business. The recently announced \$62 million acquisition of PolCard, S.A. in Poland is a good

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example of the kind of business GTECH is looking to expand into: the processing of credit card transactions. While we applaud the company's plans to diversify its business and use its expertise to generate higher overall growth rates and profitability through acquisitions, we nevertheless consider GTECH's core lottery business as the primary driver for valuing the company. (We are hopeful that the company will break out core revenues from acquired revenues in releases going forward as that should make it easier to come up with meaningful valuation metrics.)

- Lottery Revenue Upside Is Still Considerable.** We believe that GTECH is well-positioned to be the company that state governments will want to talk with as they explore ways to increase revenues without increasing taxes. States have clearly become more dependent upon the revenues generated by lotteries, and we believe that GTECH may be able to leverage its relationships into expanded opportunities with new games and new distribution points. In addition, we believe that up to 40% of the world does not have a lottery, excluding areas where there are religious prohibitions. While GTECH's base lottery business may be growing at only 2-3% per year, we believe it is well within the realm of the possible that the company could grow at even more than 5-6% per year on a sustained basis if the company can even marginally increase its same-store sales while adding new customers such as China, India or Russia. Table 1 below summarizes some of the domestic and international opportunities that remain for GTECH.

Table 1: GTECH Domestic & International - New Customer Opportunities

<i>Competitors' States</i>	Sales	Points of Sale	Expected Timing
Florida	\$2.5 Billion	9,600	FY 2004 (Decision Due 6/2003)
Maryland	\$1.3 Billion	3600	FY 2006
<i>New States</i>			
Tennessee	\$0.85 Billion	3,000-4,000	FY 2004
North Dakota	\$0.007 Billion	300-400	FY 2004
Oklahoma	\$0.45 Billion	2,000-3,000	FY 2005 or 2006
<i>International</i>			
Germany			
Berlin		4,000-5,000	FY 2004 or 2005
Stuttgart		3,000-4,000	FY 2004 or 2005
China		100,000	FY 2005+
India (On-line only)		50,000 - 55,000	FY 2005
Russia		7,000 - 10,000	FY 2004 or 2005
Thailand		2,000 - 3,000	FY 2004 or 2005

Source: Company Documents

- A Lean And Well-Managed Organization.** Since July 2000, GTECH has gone through a period of significant transformation that we believe has made it a much stronger and better positioned company. GTECH trimmed its work force, reduced SG&A as a % of revenue from 12.6% in FY 2001 to 9.8% in FY 2003, and began investing more heavily in R&D as a means of tapping in to new markets. We

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believe that those efforts will pay dividends by the end of 2004 and into 2005 as the company sees its overall profitability continue to improve.

- **Assessing Risks In Multiple Countries.** Considering that GTECH operates on six continents and derives +/- 50% of its revenues from overseas, we believe that the company has in place appropriate system for making sure that its capital is allocated appropriately and that its risk in each country is appropriately assessed. The company employs a sophisticated economic model for each potential contract that it enters into that adjusts risks according to the credit worthiness of each country/customer. The higher the country risk the higher GTECH's hurdle rate needs to be so, for example, we believe that Brazil's hurdle rate is at least 20% based on the political, inflation and expropriation risks involved. In our opinion the use of sophisticated modeling techniques allows GTECH to put in extremely competitive bids in emerging countries where potential competitors may be unable to appropriately assess all the risks.
- **Seasoned Management Team.** We believe that Bruce Turner, President & CEO and Jaymin Patel, CFO have the experience and talent within the ranks of their senior management needed to take GTECH to the next level. As a former Wall Street analyst, Turner especially understands the kind of growth and profitability profile investors are looking for. And while we do not expect Turner and Patel to manage the company to Wall Street's expectations, we do believe that they will make a concerted effort to keep investors well informed of their plans.

VALUATION & PRICE TARGET

Despite the scarcity of comparables, we believe GTECH to be an undervalued company based on its strong balance sheet and recurring cash flows, excellent management, dominant market position and new market opportunities. We note that because there are few comparables, most other analysts covering GTECH rely on either Enterprise Value/EBITDA valuation (and compare that number to other companies in their coverage universe) or some DCF analysis. We believe that both methodologies are flawed and prone to misrepresentation, so therefore we decline to use them.

Our \$43 12-month price target is based on a multiple of 2.5x FY 2004 estimated revenues of \$1.04 billion, which is in-line with other profitable, high-growth, small-to-mid cap technology companies. That said, we can also make the argument that GTECH should trade at at least a 50% premium to its competitors such as Scientific Games given that GTECH is the dominant company in its category and its stock is much more liquid. Scientific Games currently trades at 11x forward P/E estimates; on that basis, GTECH should trade at 16.5x 12-month forward earnings per share of \$2.70 or \$44.55. On the other hand, it is reasonable to apply a discount to the earnings multiple of a bigger and slightly faster growing (15% versus 10% for GTECH) company like IGT (which currently trades at 20x 12-month forward earnings). On that basis a forward P/E multiple in the range of 16.5x for GTECH appears reasonable.

All of above explanation is perhaps a long way of saying that valuing shares of GTECH is an inexact science, but we feel better about using either revenues or earnings to justify our price target than other commonly used metrics.

INVESTMENT RISKS

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Among the risks in buying shares of GTECH are:

1. **Loss of Certain Large Contracts.** GTECH operates in a competitive environment. While the company is the dominant player in its industry, the risk always exists that one of its large U.S. or International customers could decide not to move to a competitor. While we believe that such a risk is relatively small, such changes do occur from time to time.
2. **Consumer Sentiment Towards Lotteries Could Change.** GTECH's revenues are highly dependent upon the assumption that lotteries are an established way of life for millions of people around the world. While we do not predict any near-term change in the way lotteries are perceived or of their usage, we nevertheless consider this a risk in owning GTECH shares.
3. **New Growth Initiatives May Not Pan Out.** While we believe that GTECH's core business is extremely solid, there is no guarantee that the company's planned acquisitions in other areas will be as productive or profitable.

Publicly trade companies mentioned in this report:

Scientific Games (NASDAQ: SGMS, \$6.25, Not Rated),
IGT (NYSE: IGT, \$81.61, Not Rated)

Unless otherwise noted, prices are as of the close Monday, April 21, 2003.

The Farmhouse Equity Research, LLC Rating System:

Strong Buy: We believe that shares of this stock are significantly undervalued and should be acquired immediately. Over the next 12 months, we believe that the share price will increase more than 50% on a sustained basis. As of 4/22/03, of the 8 companies we have under coverage, 4 are rated as Strong Buy.

Buy: We believe that shares of this stock are relatively undervalued and should be acquired on an opportunistic basis. Over the next 12 months, we believe that the share price will increase more than 25% on a sustained basis. As of 4/22/03, of the 8 companies we have under coverage, 3 are rated as Buy.

Market Perform: We believe that shares of this stock are fully and fairly valued. Over the next 12 months, we believe that the share price will track with the overall market. As of 4/22/03, of the 8 companies we have under coverage, 1 is rated as Market Perform.

Market Underperform: We believe that shares of this stock are relatively overvalued and should be sold on an opportunistic basis. Over the next 12 months, we believe that the share price will decrease more than 25% on a sustained basis.

Sell: We believe that shares of this stock are significantly overvalued and should be sold or sold short immediately. Over the next 12 months, we believe that the share price will decrease more than 50% on a sustained basis.

For the complete version of this report, please contact your CAPIS salesperson at 800.247.6729 or 214.720.0055 or Farmhouse Equity Research, LLC at 401.849.2626.

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GTECH Holdings Corporation & Subsidiaries

4/21/2003
(\$ in 000s except per share data)

FY: FEB

	2001A	May 1Q02A	August 2Q02A	November 3Q02A	February 4Q02A	2002A	May 1Q03A	August 2Q03A	November 3Q03A	February 4Q03A	2003A	May 1Q04E	August 2Q04E	November 3Q04E	February 4Q04E	2004E
Service Revenues	\$856,475	\$210,551	\$209,619	\$196,427	\$215,190	\$831,787	\$223,735	\$211,600	\$207,784	\$225,777	\$868,896	\$219,004	\$225,450	\$238,905	\$258,017	\$942,375
Product Sales	\$80,068	\$24,414	\$26,965	\$67,152	\$59,383	\$177,914	\$7,677	\$9,358	\$48,682	\$44,177	\$109,894	\$19,438	\$20,021	\$25,026	\$28,530	\$93,015
Net Sales	\$936,543	\$234,965	\$236,584	\$263,579	\$274,573	\$1,009,701	\$231,412	\$220,958	\$256,466	\$269,954	\$978,790	\$238,442	\$246,471	\$263,931	\$286,547	\$1,035,390
Revenue Growth				0.7%	11.4%	7.8%	-1.5%	-6.6%	-2.7%	-1.7%	-3.1%	3.0%	11.5%	2.9%	6.1%	5.8%
Sequential Revenue Growth					4.2%		-15.7%	-4.5%	16.1%	5.3%		-11.7%	3.4%	7.1%	8.6%	
Cost of Goods Sold																
Costs of Service	\$564,095	\$144,492	\$143,592	\$138,346	\$159,878	\$586,308	\$146,935	\$126,942	\$129,122	\$132,042	\$535,041	\$131,402	\$133,605	\$143,343	\$154,810	\$563,160
Costs of Sales	\$74,844	\$19,937	\$23,663	\$61,147	\$41,705	\$136,452	\$6,247	\$4,109	\$39,070	\$29,517	\$78,943	\$14,578	\$15,016	\$18,770	\$21,397	\$69,761
Total	\$638,939	\$164,429	\$167,255	\$189,493	\$201,583	\$722,760	\$153,182	\$131,051	\$168,192	\$161,559	\$613,984	\$145,981	\$148,621	\$162,112	\$176,208	\$632,922
Gross Profit	\$297,604	\$70,536	\$69,329	\$74,086	\$72,990	\$286,941	\$78,230	\$89,907	\$88,274	\$108,395	\$364,806	\$92,461	\$97,850	\$101,818	\$110,339	\$402,468
Gross Margin %	31.8%	30.0%	29.3%	28.1%	26.6%	28.4%	33.8%	40.7%	34.4%	40.2%	37.3%	38.8%	39.7%	38.6%	38.5%	38.9%
Operating Expenses																
SG&A	\$117,997	\$29,570	\$27,081	\$26,692	\$29,420	\$112,763	\$22,909	\$22,901	\$24,358	\$25,962	\$96,130	\$22,652	\$23,415	\$24,546	\$26,362	\$96,975
R & D	\$49,267	\$7,633	\$8,336	\$7,980	\$9,830	\$33,779	\$6,502	\$7,170	\$10,903	\$10,277	\$42,852	\$11,922	\$13,556	\$13,724	\$15,760	\$54,962
Goodwill Amortization & Other	\$48,435	\$1,473	\$1,590	\$1,493	\$1,493	\$6,049	\$0	\$0	\$0	(\$1,121)	(\$1,121)	\$0	\$0	\$0	\$0	\$0
Total	\$215,699	\$38,676	\$37,007	\$36,165	\$40,743	\$152,591	\$29,411	\$30,071	\$35,261	\$43,118	\$137,861	\$34,574	\$36,971	\$38,270	\$42,122	\$151,937
Operating Expenses as % of Rev																
SG&A	12.6%	12.6%	11.4%	10.1%	10.7%	11.2%	9.9%	10.4%	9.5%	9.6%	9.8%	9.5%	9.5%	9.3%	9.2%	9.4%
R & D	5.3%	3.2%	3.5%	3.0%	3.6%	3.3%	2.8%	3.2%	4.3%	6.8%	4.4%	5.0%	5.5%	5.2%	5.5%	5.3%
Total	17.9%	15.8%	15.0%	13.2%	14.3%	14.5%	12.7%	13.6%	13.7%	16.4%	14.2%	14.5%	15.0%	14.5%	14.7%	14.7%
Operating Income	\$81,905	\$31,860	\$32,322	\$37,921	\$32,247	\$134,350	\$48,819	\$59,836	\$53,013	\$65,277	\$226,945	\$57,887	\$60,879	\$63,548	\$68,217	\$250,531
Operating Margin	8.7%	13.6%	13.7%	14.4%	11.7%	13.3%	21.1%	27.1%	20.7%	24.2%	23.2%	24.3%	24.7%	24.1%	23.8%	24.2%
Interest & Other Income, Net	(\$11,170)	(\$1,039)	(\$5,490)	(\$3,049)	(\$15,052)	(\$24,630)	(\$1,978)	\$1,789	(\$60)	\$2,370	\$2,121	\$200	\$200	\$200	\$200	\$800
PreTax	\$70,735	\$30,821	\$26,832	\$34,872	\$17,195	\$109,720	\$46,841	\$61,625	\$52,953	\$67,647	\$229,066	\$58,087	\$61,079	\$63,748	\$68,417	\$251,331
Provision (benefit) for income taxes	\$27,587	\$11,712	\$10,196	\$13,251	\$6,535	\$41,694	\$17,800	\$23,418	\$20,122	\$25,705	\$87,045	\$21,492	\$22,599	\$23,587	\$25,314	\$92,993
Tax Rate %	39.0%	38.0%	38.0%	38.0%	38.0%	38.0%	38.0%	38.0%	38.0%	38.0%	38.0%	37.0%	37.0%	37.0%	37.0%	37.0%
Net Income	\$43,148	\$19,109	\$16,636	\$21,621	\$10,660	\$68,026	\$29,041	\$38,207	\$32,831	\$41,942	\$142,021	\$36,595	\$38,480	\$40,162	\$43,103	\$158,339
Basic Shares	69,128	61,520	59,076	57,790	57,604	58,998	57,583	57,225	56,981	56,571	57,081	56,628	56,684	56,741	56,798	56,713
Primary EPS	\$0.62	\$0.31	\$0.28	\$0.37	\$0.19	\$1.15	\$0.50	\$0.67	\$0.58	\$0.74	\$2.49	\$0.65	\$0.68	\$0.71	\$0.76	\$2.79
Fully Diluted Shares	69,310	62,672	60,482	59,188	59,086	60,318	59,261	58,299	58,062	57,980	58,391	58,270	58,561	58,854	59,148	58,708
Fully Diluted EPS	\$0.62	\$0.30	\$0.28	\$0.37	\$0.18	\$1.13	\$0.49	\$0.66	\$0.57	\$0.72	\$2.43	\$0.63	\$0.66	\$0.68	\$0.73	\$2.70
Reported EPS	\$0.62	\$0.30	\$0.28	\$0.37	\$0.18	\$1.13	\$0.49	\$0.66	\$0.57	\$0.72	\$2.43	\$0.63	\$0.66	\$0.68	\$0.73	\$2.70

Source: Company Financial Statements and Farmhouse Equity Research, LLC Estimates



Source: Bigcharts.com

New Coverage: April 22, 2003

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