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Q3 2017 Jackpotjoy PLC Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Jackpotjoy plc's Q3 2017 Results Conference Call. (Operator Instructions) Please note that this call is being recorded today, Tuesday, the 14th of November 2017 at 1 p.m. London Time. If you have not received a copy of Jackpotjoy plc's Q3 2017 earnings release that was issued before market opened today, you can find it under Jackpotjoy's profile on the SEDAR website or on the Jackpotjoy plc website at www.jackpotjoyplc.com.

Please be aware that we will be discussing some information about the business that is forward-looking and which is based on management assumptions and subject to a number of risks that could cause actual results to differ materially from current expectations. Our annual information form dated 29th of March 2017 and our management information circular dated 27th of April 2017, which you can find on the SEDAR website under Jackpotjoy plc's profile, discusses many of these assumptions and risks. Intertain does not intend to publicly update any forward-looking information, except as required by applicable securities laws. Please note that we will also be discussing some non-IFRS measures on today's call. For the definitions and reconciliations of these non-IFRS measures, please refer to Page 4 in the RNS we issued earlier today.

I will now turn the conference over to Mr. Neil Goulden, Executive Chairman of Jackpotjoy plc. Please go ahead.

Neil Geoffrey Goulden *Jackpotjoy plc - Executive Chairman*

Thank you very much, and welcome, everyone, to our Q3 results conference call. With me here today are: Andy McIver, Chief Executive; Keith Laslop, Chief Financial Officer; and Jason Holden, our Director of Investor Relations.

During today's call, I will briefly cover the financial and operating highlights for Q3 and update you as to our outlook for the remainder of 2017. In addition, I'll summarize the recent management changes which have taken place. Keith will then review the financial headlines in more detail and cover some of the data points in the underlying subsidiaries before we open up the call for questions. Please follow the operator's instructions when we get on to the Q&A session. A transcript of this call will be ready within 48 hours on Jackpotjoy plc's website and a replay option will also be available.

Now in terms of the operating highlights, I'd like to draw your attention to 3 key areas. First, revenue. The third quarter has continued the trend of previous periods during FY '17 in terms of delivering good top line growth. Group revenues increased 14% with sales growth of 12% at our largest business segment, Jackpotjoy, and 21% constant currency growth at Vera&John. Adjusted EBITDA increased 4%. And that reflects the well-flagged increase in marketing cost during the period. This is related to the launch of a major TV advertising campaign in the U.K.

Second, customers. Q2 has continued to see solid progress on our core KPIs, active customers, average revenue per customer and real money gaming revenue. The number of average active customers grew by 13% in the 12 months until the 30th of September 2017 to over 250,000. When combined with the 2% growth in real money gaming revenue per active, that means that average real money gaming revenue per month has increased 16% to GBP 22.6 million in the year until 30th of September 2017. This represents the same rate of growth we reported at the end of the half year.



Third, cash. We remain highly cash-generative with cash conversion at over 100% during Q3, excluding one-off and exceptional items. The reduction of debt remains a priority. Our net debt reduced by GBP 23.4 million during the period. This resulted in an adjusted net leverage ratio of 3.35, down from 3.6 at the 30th of June. In terms of outlook for 2017, we are confident of meeting recently increased market consensus. And we are seeing good trading momentum continue into the early stages of Q4.

Finally, we announced in October the group -- that Andrew McIver will be stepping down from his role as Chief Executive Officer, having successfully overseen the listing on the London Stock Exchange earlier this year. Andy will cease to be a Director on the 31st of December and will remain with the company until the 31st of January 2018. On behalf of the board, I'd like to thank him for his contribution to the group and wish him well in the future. Andy is also available on the call to join the Q&A session which will follow. In my new role as Executive Chairman, I will be responsible for leading the development and execution of long-term strategy, while Simon Wykes has joined as Group Managing Director to provide additional operational expertise.

I will now turn the call over to our CFO, Keith Laslop, who will walk you through the company's financial highlights. Keith?

Keith Laslop *Jackpotjoy plc - CFO and Director*

Thanks, Neil. I'll start off elaborating a bit in our cash flow generation and future uses of cash as that is always a focus area for our business. We generated GBP 32.6 million of operating cash flow in Q3, which is 78% higher than Q3 2016. And over the first 3 quarters of 2017, we've generated GBP 78.2 million of operating cash flow, which is a 24% increase over the same period in 2016. Post debt service, the free cash flow to equity was GBP 15.5 million this quarter. The details of our cash flow conversion bridge can be seen within the Q3 presentation, which should be live right now on www.jackpotjoyplc.com.

Cash on our balance sheet was GBP 39.2 million at the end of Q3 and grew GBP 15.6 million during the quarter. Assuming Botemania grows EBIT at circa 150% during the second year of the earnout, then the amount we'll pay against this in June 2018 will be close to GBP 50 million. This number is different from what we record in our balance sheet, as under IFRS, we need to discount both the -- we need to both discount and probability weight any contingent considerations. In the notes to the financial statements, we list our undiscounted estimation of the cash that we'll need to pay at the time the earnouts are due. And all earnouts are estimated to be comfortably met by existing cash resources.

Our net leverage ratio, including all debts, non-compete payments, earnouts and net of cash, decreased from 4x at December 31, 2016, to 3.3x -- 3.35x at the end of September this year. This reduction in leverage will continue and is very important for our company.

Mobile results are a focus area in our business, and one that we might not spend enough time talking about. Over the last 12 months, approximately 60% of the revenue in each of our 3 segments has come in via mobile. Also in the last 12 months, mobile ARPU has exceeded desktop ARPU by circa 115% to 140%, depending on the segment. Given these stats as our revenue mix continues to change, which we think it will, given some of our peers have 80-plus percent of revenues coming from mobile, our revenues themselves should grow, given these positive attributes.

On these calls, I also like to provide some data points on the underlying subsidiaries. For the JPJ segment, Q3 revenues were GBP 52.2 million, 12% growth year-over-year. EBITDA was GBP 23.2 million, which is 3% growth year-over-year. As Neil mentioned previously, we started a new TV campaign in Q3 with Paddy McGuinness. And TV spend can skew results dramatically if 1 quarter has a TV campaign and the other doesn't. So therefore, if we look at the first 3 quarters of 2017 versus the same period in 2016, revenues grew 14% year-over-year and EBITDA grew 18%.

Some highlights of the individual Jackpotjoy segment businesses for the quarter. For JPJ U.K., record 32,000 daily average players and improved monetization of players through mobile continued in Q3, where mobile revenues as a percentage of total revenues improved to 62% in Q3 from 61% in Q2 and 57% in Q1. For Starspins and Botemania, together they were our fastest-growing segment -- subsegment this quarter, consistent with previous quarters, and together were responsible for 23% of our revenue under the JPJ segment.

Both Starspins and Botemania had record revenue, deposits and mobile share revenue in Q3. Starspins' percentage of revenue from mobile was 72%, up from 68% last quarter whereas Botemania was at 66%, up from 58% last quarter. Worth mentioning that a mobile player that

also plays on desktop for these brands continues to provide over 3x the ARPU of a desktop-only player. And for JPJ Sweden, we had strong revenue again this quarter, even in a very competitive environment in Sweden pre regulation. And we had a record 53% of revenue from mobile, up from 48% last quarter.

Moving to the Vera&John segment. And these figures are in euros to reduce FX fluctuations. Gaming revenues were EUR 20.5 million in Q3, which is a 21% growth year-over-year, and EBITDA of EUR 5.4 million, which is a 31% increase year-over-year. In sterling terms, revenue growth was 28% year-over-year and EBITDA growth was 40% year-over-year. Finally, with Mandalay, revenues of GBP 4.9 million, which is negative 8% growth year-over-year, and EBITDA of GBP 1.9 million, which is a 36% increase year-over-year.

We continue to make changes to bonus spend in preparation for changes to U.K. POC tax, which started in October 1 this year, and the EBITDA growth as a result of reduced marketing spend as we have historically only gone on TV with Mandalay brands every second year. As mentioned last quarter, we continue to explore merging this subsegment together with our other bingo assets, given the future focus on cross-sell between all brands as well as its relative size with the other subsegments.

I will now pass the call back to Neil.

Neil Geoffrey Goulden *Jackpotjoy plc - Executive Chairman*

Thank you, Keith. And now it's time to move to questions and answers. So we're going to hand back to the operator to the first caller, please.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from the line of Suthan Sukumar.

Suthan Sukumar *Eight Capital, Research Division - Research Analyst*

A question here for me on the international market expansion opportunity. I think in the past, you guys have talked about opportunities in the Asian market with respect to a B2B offering and potentially Latin America. Could you provide some color on that front, please?

Keith Laslop *Jackpotjoy plc - CFO and Director*

Sure. Latin America -- well, Brazil, we have launched. It is growing. Historically, we've spoken about opportunities in these various countries. And then subsequently through negotiations or through further investigation, we have not gone into those countries. So we prefer to discuss these individual countries once they're active contributors to our bottom line. But we are live in Brazil, which of course, physical bingo is very popular in Brazil, so it could be a huge market for us. But again, it could take years to come to fruition. And in Asia, we have started a B2B offering. We have multiple B2B offerings in Asia and they are growing strongly.

Suthan Sukumar *Eight Capital, Research Division - Research Analyst*

Okay, great. And just lastly for me, I mean, your customer KPIs continue to improve quarter-over-quarter. How does Q4 look to be shaping up based on the current run rate?

Neil Geoffrey Goulden *Jackpotjoy plc - Executive Chairman*

I think in terms of October, no surprises there, the trend has continued. And the beauty of bingo-led gaming is just the fact that it is very stable. You can see in our deck that's available on the website, just in terms of our KPIs and how they've trended over time. And the slope is very consistent. And one of the reasons we love bingo-led gaming is the consistency, predictability and no volatility of our results.

Operator

The next question comes the line of Victoria Pease.

Victoria Elaine Pease *Edison Investment Research Limited - Analyst*

Now my first question is actually within the Jackpotjoy segment. Jackpotjoy U.K. comprise 65% of the revenue, which is slightly lower than previously, and I know that once you got Botemania and Starspins growing. But did the Jackpotjoy U.K. grow more slowly than you



expected? And the second question is on the free bets into the POCT, which many operators are talking about being billed retrospectively from August. You don't seem to have that in your numbers. And I was wondering if you could just let us know why that is and perhaps the impact to Q4.

Keith Laslop *Jackpotjoy plc - CFO and Director*

Sure. I will cover the second question first. So POC tax on bonuses, that came into effect from the 1st of August. However, it impacts every operator depending on when they file their remote gaming duty return. So as our year-end is December, our remote gaming duty returns are on a calendar quarter basis. So for us, it starts October 1. Now every operator might be different. And it all depends on when they file their remote gaming duty returns.

Victoria Elaine Pease *Edison Investment Research Limited - Analyst*

But does that mean you have proportionally more to pay in the next quarter? Or is it just that your -- you pay several quarters after or several months after?

Keith Laslop *Jackpotjoy plc - CFO and Director*

We should be starting to collect from October 1. And with respect to JPJ U.K., I think the growth was fine. Now we did do a conversion from Flash to HTML5 for the site. For those of you who are actively on JPJ U.K., you will have noticed this from September 9. And that did impact September somewhat. There's always -- there's teething issues that happen with any major change like that. And some -- and there's always a bit of shock to the systems for certain players because it does look different, HTML5 from Flash. Happy to say that October is back to where we would expect.

Victoria Elaine Pease *Edison Investment Research Limited - Analyst*

Okay, great. And just one follow-up actually on Vera&John. I was just wondering if you could let us know where the growth is coming from in particular with Asia. Is it Sweden? Or is it a good mix?

Keith Laslop *Jackpotjoy plc - CFO and Director*

I'd say it's a good mix. Revenue growth, of course, is coming from a wide variety of jurisdictions. We have a Danish license that we obtained this year, which is starting to bear fruit, definitely have some revenue growth in Asia. As mentioned, we had -- as mentioned previously, we had some softness in Asia in the end of 2016 and in Q1 2017 due to some payment processing issues we had in Asia, which were fixed in Q2. So there is a bit of quarter comparison impact there as well.

Operator

The next question comes from the line of Jeremy Kahan.

Jeremy Kahan

Could you quantify the losses or the investment you're making in some of the start-up geographies like Brazil or Denmark?

Keith Laslop *Jackpotjoy plc - CFO and Director*

Jeremy, right now, we prefer not to provide that information because as you can imagine, it's a bit competitively sensitive. I think what you would have seen, and this is within our deck as well, that historically over the last 3 years, Vera&John does not have operational leverage. And that is because of these investments, you can see some strong operational leverage this quarter. I think in the years ahead, you should assume that there is strong operational -- well, there is operational leverage within the Vera&John segment. But there will also be new jurisdictions that we will invest in. How much we invest in any specific jurisdiction, that is somewhat confidential.

Jeremy Kahan

Understood. And then a follow-up, can you just talk about when you might contemplate refinancing the debt?

Neil Geoffrey Goulden *Jackpotjoy plc - Executive Chairman*

Yes, it's Neil jumping in on that one. I think it's no secret that this is high on the agenda for the Jackpotjoy plc Board. When I joined the group last year, the 2 key strategic objectives we set ourselves were to relist in the U.K. and recapitalize the business so that we could pay the

earnout to Gamesys assets fell due. Through an early prepayment of that earnout, we were able to negotiate new terms with Gamesys in terms of the platforms. So all of that was done before Christmas last year. That meant leaving in place our U.S. debt and putting a second-lien debt in place. It was seen at that time as not being an optimal structure. Firstly, we have, firstly, in U.S. dollars, when we are 70%-plus sterling provider or sterling earner. And secondly, the second lien was at a fairly high rate of interest. So it's been on our agenda for quite a while to look at that. We are closely monitoring the sterling markets. Because if we do it, we will want to move predominantly into sterling and certainly out of U.S. dollar debt and we'd want to do it at advantageous terms. And we think that at the right time, we can achieve that, achieve what we want in terms of currency, achieve what we want in terms of flexibility for early repayment because we want to deleverage and to get a reduction in our cost of debt. So very high on the agenda, can't say more on that at the moment. And if we do manage to crystallize, we will be making an announcement at that time.

Operator

There are currently no further questions in the queue. (Operator Instructions) So the next question comes from the line of Lauren Sarli.

John Alfred Paulson *Paulson & Co. Inc. - Founder, President, Portfolio Manager & Director*

This is John Paulson. Could you comment a little bit more on the U.K. point-of-consumption tax that comes out in the fourth quarter and how that will impact profitability and what the potential magnitude of that impact could be?

Keith Laslop *Jackpotjoy plc - CFO and Director*

Sure. So the new point-of-consumption tax that is coming for us from October 1 means that we also pay point-of-consumption tax on bonuses. Previously, that consumption tax was only paid on NGR whereas now we're paying it on GGR. And the difference between the two is bonuses and promotions. For us, the impact should be, if we choose to bonus the exact same, 3% to 4% impact to our U.K. businesses. The U.K. businesses are roughly 2/3 of our overall revenue, so call that 2% to 3% across our group. Now as I've mentioned in previous quarters, I firmly believe this POC tax increase will be more than offset by revenue gains because the POC tax on bonuses will be most keenly felt by smaller players in the market that tend to use primarily bonusing to market to their players. We tend to be relatively bonus-light.

John Alfred Paulson *Paulson & Co. Inc. - Founder, President, Portfolio Manager & Director*

I see. And when you say the POC impact could be affected by revenue gains, you mean the normal revenue gains that you've been achieving in the businesses?

Keith Laslop *Jackpotjoy plc - CFO and Director*

Well, I think the POC impact, so this new tax, it will make it very difficult for new entrants to start up as primarily new entrants have used bonusing as a primary way to attract new players. And smaller players that don't have the deep pockets to market using other ways have historically used bonuses or have been very heavy in terms of bonusing to market towards players. And historically, that's how our smaller schemes have acted as well. So Mandalay historically has bonused very heavily. It's from scaling back aggressively those bonuses in 2017, that's why you're seeing some softness in our Mandalay brand. So you can think of the rest of the -- or the long tail of the market, there are a lot of brands, folks on the U.K. market, that will be reacting the exact same way as Mandalay. And we think that with the long tail of the market bonusing less, new entrants' ability to enter the market being curtailed, it will benefit the market leader, which we're the market leader.

John Alfred Paulson *Paulson & Co. Inc. - Founder, President, Portfolio Manager & Director*

I see. So this -- the bonus cash will make it more difficult for new entrants to enter, which could benefit you as a market leader. That's interesting. Last question, it's clear that the lower growth in EBITDA compared to revenues was due to the integrated advertising campaign for Jackpotjoy, which you just do periodically. How long does that -- does that campaign last for the full quarter, for the rest of the fourth quarter?

Keith Laslop *Jackpotjoy plc - CFO and Director*

Yes. We'll be advertising significantly in Q4 as well with this campaign.

Operator

There are no further questions in the queue. So I will hand back over to your host, Neil Goulden, to conclude today's call.



Neil Geoffrey Goulden *Jackpotjoy plc - Executive Chairman*

Thank you very much. Thank you, everyone. Keith and myself remain available if anyone has further questions. But in the meantime, thank you very much for dialing in. As we said earlier, the transcripts will be on the website as will a replay facility. Thank you very much for your time.

Operator

Thank you for joining today's call. You may now disconnect your handsets.

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