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Q1 2019 JPJ Group PLC Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the JPJ Group plc's Q1 2019 Results Conference Call. (Operator Instructions)

Please note that this call is being recorded today, Wednesday, 15th of May, 2019, at 1 p.m. London time.

If you have not received a copy of the JPJ Group's plc Q1 2019 earnings release that was issued before market opened today, you can find it under JPJ Group plc's profile on the SEDAR website or on the JPJ Group plc website at www.jpjgroup.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, 2019, and our management information circular dated 3rd of May, 2019, which you can find on the SEDAR website under the JPJ Group plc's profile, discuss many of these assumptions and risks. JPJ Group plc 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 JPJ Group plc. Please, go ahead.

Neil Geoffrey Goulden ***JPJ Group plc - Executive Chairman***

Thank you, operator. Good afternoon, everyone, and welcome to JPJ's Q1 Results Call. With me today are Keith Laslop, our CFO; and Simon Wykes, our CEO Jackpotjoy Operations.

As in previous calls, I will cover some of the highlights from the quarter, Keith will add some color on the financials and Simon will give you an operational update. We'll also touch on the outlook for the current financial year. We will then open up for questions, which will be facilitated by Molly, the operator. Copies of today's results are on our website, and a transcript of today's call together with the call replay option will be on our website within 48 hours.

I'd like to start by picking out 3 highlights from today's Q1 announcement. Firstly, the group delivered double-digit growth in revenue and EBITDA. Revenues were up 13%, and adjusted EBITDA, up 16%. As a group, we are benefiting from our strategy of diversification, both geographically and in our product mix. It is a deliberate strategy of ours to balance regulated and unregulated markets, and we can report today that the U.K. revenues are now 49% of the group, and we are 51% in the rest of the world.

Secondly, Vera&John was a standout performer with top line growth of over 60%. Vera&John now represents circa 40% of group revenues. This growth is being driven by the success in new markets, such as Germany, Brazil, and Japan as well as B2B growth in Asia.

Thirdly, we continued to deliver a very strong free cash flow conversion. Net debt fell to GBP 275 million from GBP 302 million at the year-end, and net leverage fell from 2.68x at the year-end to 2.44x at the end of Q1.

At the quarter end, we have a GBP 106 million in cash on our balance sheet, up from circa GBP 18 million at the year-end. At the year-end, we said that the board remained committed to returning excess cash to shareholders when we could do so on a progressive and sustainable basis. Leverage is now below, just below, the level at which we can return cash to shareholders. However, the Point of Consumption tax in the U.K, which remains circa 50% of our business, has increased from 15% to 21% and has come in earlier than anticipated from the 1st of April. This will inevitably lead to a slow down in our rate of deleveraging. Our leverage target remains 1 to 2x EBITDA, in line with our U.K. peers. As previously indicated, we will report more fully on the utilization of our cash balance when we report our half 1 results in mid-August. Until that time, we are comfortable holding the cash on the balance sheet as a retained optionality: optionality to pay down debt; paying a dividend, which is both progressive and sustainable; share buyback program, if our share price continues to undervalue the cash generation and growth within the business; and high return-on-investment, bolt-on acquisitions. All of those options remain open to us with the cash on the balance sheet.

Finally, in terms of outlook for 2019. Our strong start to the year underpins our confidence that we remain well positioned for future growth in a consolidating sector. Overall, the group continues to trade in line with expectations. On that point, I'll hand you over to Keith.

Keith Laslop ***JPJ Group plc - CFO & Director***

Thanks, Neil, and hello, everyone. As Neil mentioned, I'll dive into some further detail on the highlights. And with respect to the P&L, Vera&John was our standout segment this quarter, and Vera&John revenues increased 62% to GBP 34.2 million in Q1 2019. Adjusted EBITDA was GBP 13.3 million, which is a 234% increase year-over-year. In euro terms, revenue and EBITDA growth was even higher. As always, we expect Vera&John to continue to be our fastest-growing segment. However, it will always be more volatile than the JPJ segment and, therefore, we feel is a great complement to our JPJ segment.

Not only did Vera&John have record margins in Q1 2019 at 38.8% adjusted EBITDA margin, but Vera&John's adjusted EBITDA margin also surpassed the JPJ segment's margin for the first time. We don't believe investors should assume the same percentage of adjusted EBITDA margin going forward as the margin percentage will be significantly impacted by investment costs into new jurisdictions as well as marketing costs in existing jurisdictions. However, we continue to be very happy with the performance of our Vera&John brand and are very excited about its future.

On to the JPJ segment. Q1 revenues were GBP 49.1 million, 7% decline year-over-year, and adjusted EBITDA was GBP 18.8 million, which is a 21% decline year-over-year. The revenue decline year-over-year is mainly the result of enhanced responsible gaming measures that were introduced in 2018 and the impact on many of our U.K. cohorts due to those measures. However, active customer growth of 8% within the JPJ U.K. brand provides evidence that growth will return in H2 borrowing for the regulatory changes.

The adjusted EBITDA decline is due to the increased revenue -- due to the decreased revenue as well as the increased marketing in the U.K. and Spain, which Simon will discuss shortly. We're comfortable with the results of our marketing efforts with JPJ U.K. first-time depositors up 35% year-on-year. We aim to stay #1 in the U.K. bingo-led gaming market and will market our brands accordingly.

Moving to the balance sheet and cash flow statement. Cash generation is always a key area in our business, and Q1 2019 was no different. We generated GBP 20.6 million of operating cash flow in Q1 2019, which equates to 28p per share of operating cash flow. Although payment service provider, contractual reserves as well as payments or prepayment of marketing expenses had a significant impact on our working capital balance of this quarter, these amounts tend to average out over time, and on a last 12 months or LTM basis, we had 91% of operating cash flow conversion.

The details of our cash flow conversion bridge can be seen within our corporate presentation, which should be live now on www.jpjgroup.com. This organic cash generation as well as the sale of our Mandalay brands, which completed in March, again, for GBP 18 million, of which, GBP 12 million was received and GBP 6 million deferred to September of this year, means that we have GBP 106 million of unrestricted cash in our balance sheet. Adjusted debt has reduced to GBP 275 million, and adjusted net leverage has reduced to 2.44x. As Neil mentioned, we will update the market further on our plans for excess cash in our interim results in August. I will now pass the call over to Simon.

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

Thanks, Keith. We're continuing to focus on our 3 key operational priorities to build on the success in delivering both revenue and adjusted EBITDA growth in 2018. Those priorities are: one, putting the customer first; two, adding capability; and three, geographical diversification. Our kickoff with our relentless focus on ensuring the customer is at the heart of everything we do. Our customers have responded to this approach, and our average monthly active customers grew again in quarter 1 by 8% year-on-year.

Last quarter, I talked about how our decision to invest more in above-the-line marketing activity for our Jackpotjoy brand in the U.K. in 2019. This includes the new Paddy McGuinness adverts and the sponsorship of Loose Women. We are delighted with the results, which have enabled Jackpotjoy in the U.K. to match the group customer growth. That means customer numbers were also up 8% year-on-year on the Jackpotjoy brand in the U.K. This growth was achieved by successful above-the-line marketing, which increased first-time depositors by 35% year-on-year. This meant, first-time depositors reached their highest levels since 2012.

Whilst we are obviously pleased with the quantity of customers generated by the campaign, the quality is of even greater an importance. And it's not unusual to see large increases in customer volumes resulting in significant drops in the average revenue generated by (inaudible) depositor. I'm delighted to say that the revenue generated by the first-time depositors in the quarter was up by a very encouraging 27% on the equivalent cohort last year. These impressive results provide us even more confidence in the ability of the business to grow both customer volumes and revenue going forward.

As I've stated before, the disproportionate impact of RG and AML measures on us, as the U.K.'s longest-established market leader, may have led us to lose some revenue market share over the last few months. Around the half year mark, we did lose circa 20% of our highest-spending customers due to enhanced RG and AML measures. And we believe these customers chose to continue gaming elsewhere rather than providing us the documentation we needed to allow them to remain active with us. And this is likely to have resulted in a small drop in share. However, we believe that we are undoubtedly growing share in terms of active customers, and the quality of the new customers joining us has encouraged us to invest even further in quarter 2 with similarly encouraging results to date.

Our second priority is about adding capability to the organization. We continue to add capability into all areas of the business, particularly in relation to marketing and technology. Our marketing capabilities in acquiring and retaining customers is evidenced by the continued growth in both our customer base and the value generated by each customer. Our proprietary platform, enJoy, continues to strengthen, generating 43% of our revenue in the quarter, up from 38% in Q4 2018.

We are also continuing to fuel our Asian growth by building out our operational marketing and technology teams based in the region. The original deal with Gamesys provides the option for us to internalize staff from April 2019 although there is no financial incentive for us to do so until quarter 2 2020. We continue discussions with Gamesys about how we best achieve this for both organizations' mutual benefit, and we will update the city after we have communicated internally.

Thirdly, moving on to geographical diversification. Whilst we are very proud of our market-leading position in the U.K. market, we are very keen to continue to grow outside of the U.K. And to reiterate what Neil mentioned before, in quarter 1, the U.K. represented 49% of our revenue. We continue to enjoy significant growth internationally, particularly in Germany, Japan and Brazil.

The successful execution of our operational strategies has allowed us to deliver double-digit growth in both revenue and adjusted EBITDA in the quarter, particularly in the Vera&John segment. I'll now pass the call back on to Neil.

Neil Geoffrey Goulden ***JPJ Group plc - Executive Chairman***

Thank you, Simon. Thank you, Keith. Let's now move on to the question and answers. Molly, can you please announce the first caller?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from the line of Simon Davies calling from Deutsche Bank.

Simon Davies

A couple from me, please. First can you flesh out your comments in terms of current trading? Are you seeing similar rates of growth kicking in, in April? Any geographic shifts in spend? And secondly, can you flesh out your comments on the step-up in first-time depositors? Obviously, a very big number. Is that -- does that reflect the attractions in terms of current CPAs? Or are there any other drivers? And what happened to your overall marketing spend in the JPJ division during the first quarter?

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

Yes. Okay. So if I take those in order. I mean, in terms of April trading or early trading in quarter 2, we are seeing very similar trends in Q1 continuing into Q2 as we saw the similar trends from Q4 last year. So we are a very predictable company in that way. If there was any difference, I'd probably highlight Spain. We had an absolutely phenomenal quarter 1 in 2018 in Spain, which we struggled up against, but we -- I think we delivered a record euro number figure in April. So Spain if I -- but Spain, by its own nature, because it's a bit smaller, it's a bit more volatile, so it doesn't go in a nice straight line upwards. It has great quarters and weaker quarters. So is a flatter quarter in Q1, but it's showing all the signs of having a great quarter in quarter 2.

In terms of the FTD growth, yes, I mean the majority of the FTD growth has been delivered through -- we believe, through above-the-line marketing. Though obviously, above-the-line marketing improves all areas of the marketing mix, the aim was to grow first-time depositors, but I think when we reviewed the whole -- our marketing campaign last year, where we thought we might have missed the trick was when we lost VIPs to other brands. We didn't feel we were getting our share of customers from other brands who refused to filling documentation around AML and RG and that they were finding other brands, which is why I wanted to raise our profile.

The quality of the revenue coming out of these cohorts, as I said, is exceptionally strong. So we believe we are achieving our goal of not only growing the overall customer base but crucially attracting VIPs who are looking for a new home having not been prepared to provide the documentation around RG and AML at other sites.

Simon Davies

Does that involve a ramp-up in marketing -- in total marketing spend?

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

We have increased marketing, but not hugely in Q1. So we were still doing above the line in quarter 1 in the U.K. in 2018. We are certainly more aggressive in Spain in Q1 '19. You'll see the difference in Q2. So it is higher quarter-on-quarter, but not massively. There will be a more significant increase in marketing in Q2, but nothing to spook you. We're probably talking low single-digit million.

Simon Davies

And can I just add one? In terms of Asia, obviously very strong growth in the period. How much did that reflect your push into B2B? And how much traction are you having in the B2B offering in particular in Japan?

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

Yes. I mean, we're very pleased with our B2B offering, and we're also getting growth in our B2C Japanese business. So it was really a fraction of -- in Asia, I think, we believe, we found the formula to make Asia successful. And clearly, we're putting some focus in there. But just to reiterate, not at the exclusion of every other territory. We very much see Asia this year is driving big growth whilst we invest extra cash into other territories so that we can turn the profit streams on both at a later date.

Operator

The next question comes from the line of David Brohan calling from Goodbody.

David Brohan ***Goodbody Stockbrokers, Research Division - Analyst***

Just 2 questions from me. The first one on Sweden. Can you comment on how the competitive environment (inaudible) there since the start of the year? And how you kind of -- you'll pull back marketing? Or how are you kind of thinking about Sweden? And then just on the second one. In terms of Spain, can you -- do you see Spain kind of returning to that high growth as you move throughout the rest of the year. And certainly April was a kind of a record month. But how should we kind of think of Spain as we move throughout the rest of the year?

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

Okay. So if I kick off with Sweden, I mean, I think, as you will have seen in any commentary on this, Sweden has adjusted difficultly to the regulation. We've seen an increase in monopolies, and the new limits on bonusing and spin speeds have had an impact on revenue over the short term. We are still encouraged that we are retaining active customers, so customer levels are still fine, and so we are expecting over time for those customers to adjust to the new reality and for their revenue per user to begin to creep back towards previous levels. In terms of marketing in Sweden. We decided early on that we weren't going to throw huge bonuses as a one-off at the beginning of quarter 1, so in January, which many of our competitors do. And we also decided that we weren't going to invest heavily in marketing in the first half of the year because there was so much marketing activity going on that we thought we'd just be lost in the noise. So our intention has always been to launch, retain our existing customers, which we look like we've done, let them adapt, and then we turn on marketing later in the year when all the noise has died down. We've always taken a view in Sweden that there are number of operators operating on single-digit or teenage margins, and therefore, they were under pressure and were going to follow some more desperate actions. So we decided to wait and hold our fire in Sweden. In terms of Spain. I mentioned Spain is volatile. I mean, through my just over 18 months within the business, I know there have been quarters where we were all thinking it's about to fall off, and we were worried about it over the quarters, but it's going like a [trade]. I expect Spain to stay choppy because that's the nature of the business in this size. But I see no reason why we can't continue to deliver double-digit revenue growth in Spain certainly in constant currency terms.

Operator

The next question comes from the line of Richard Stuber calling from Numis.

Richard Paul Stuber ***Numis Securities Limited, Research Division - Analyst***

Just a quick question on Japan. I think it now -- it's now 25% of your revenue. Can you just give a bit of indication in terms of how sustainable you think that is? And particularly, any commentary on whether you see any changes on the regulatory landscape? And anything about how competitive that market is? And the second question, just a follow-up of that. Neil, I know you said at the beginning you (inaudible) balance of regulated and unregulated revenues. I think it's gone from 77% to 73% at the moment. Do you think that's about the right level? Or do you have a medium-term sort of target or expectation where that will get to?

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

Okay. So I will kick off with Japan. I mean, way that we see regulation going in Japan is Japan is making moves toward regulating land-based casinos in Japan. We expect in the fullness of time for that regulation to extend into online casino, and we intend to be the first applicant for the licenses when they become available. In terms of time and scale. Japan didn't -- we have to move quickly on land-based casino. So in a decade's time, I would expect Japan to be regulated. Would I expect it to be regulated in 12 months? No. So it's going to be at some time frame between those. It is -- there are a lot of people being interested into getting into Japan. We think we found the magic formula. For obvious operational reasons, I'm not going to articulate too much exactly what we think that magic formula is, but we're very pleased with our position in Japan. And I think we're one of the if not the strongest operator in the region.

Neil Geoffrey Goulden ***JPJ Group plc - Executive Chairman***

And as to your second question on geographical diversification. I think we are really keen to emphasize the point that we are a global business. 51% of our business now comes of outside the U.K., and it's a matter of balancing risk, balancing risk for the business, balancing risk for investors. You could say that the highest-risk areas are actually regulated there is at the moment, if you look at Italy and some of the things we're seeing in the U.K. So we're keen to diversify geographically. Japan has been a success for us. Simon has explained that in a bit more detail. But we don't want to sit back. And our highest-growth area is Germany, but we also got new businesses starting to grow in Brazil and now launched with a First Nation tribe in Canada. So we think Canada could be a huge market for us. It's -- doesn't take much revenue at the moment, but it could be a big market. And we're beginning to look at the next market we might want to go into. So we take a balanced view of regulated and unregulated. We don't have a set target. We just risk assess what others are doing. We're very happy actually with the diversification of our business because we think that balance is the risk. So we don't have a specific target, Richard.

Operator

The next question comes from the line of Roberto Ciaccia calling from Berenberg.

Roberta Ciaccia ***Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst***

It's Roberto from Berenberg. Just 2 questions from me. One is a follow-up from Richard's question. If you have to -- on geographical diversification basically. So if you have to project your revenues in 3, 4 years' time, what would you -- do you think your geographical split will be? And what will be your ideal geographical split? And the second question. On the U.K. market. This morning, in their conference call, William Hill said that they expect to lap the negative comparison for responsible gaming measures in June of this year. I just wanted to know if you can confirm this, and therefore, if you expect to return to growth in the second part of 2019 in the U.K.

Neil Geoffrey Goulden ***JPJ Group plc - Executive Chairman***

Okay. In terms of geographical diversification, I don't think we have specific targets, Roberta, certainly no targets looking 3, 4 years out. Regulation in the gambling sector is a dynamic situation. For example, we have a license in Italy, but we're not activating that license because we don't think that market is attractive, albeit it's a regulated market. We're really comfortable with areas like Japan, which has a growing body of regulation around gambling, and we anticipate it will eventually regulate. We'll be first in the queue for a license when it does. So regulated, unregulated, geographical expansion is just about balance and getting the balance right. I don't think we have any specific targets.

Keith Laslop ***JPJ Group plc - CFO & Director***

I think on your second question. We put in place a number of enhanced measures on both the responsible gaming side as well as bonus changes in Q2 last year. So yes, it would logically follow that they would start to annualize out borrowing, of course, any further regulatory changes.

Operator

(Operator Instructions) The next question comes from the line of Victoria Pease calling from Edison.

Victoria Elaine Pease ***Edison Investment Research Limited - Analyst***

Just a few quick questions. On Spain, I know that you said the quarters could be a bit more choppy, but is it fair to say -- see tax rate came down last year and so market has become more competitive. Would you say that's become more of an issue? Secondly, just if you had an idea for overall marketing spend for the year. I know that it seems to be a bit higher than last year. And you said such to continue for the duration of the year. And finally, just on Germany, if you had a number on the plunge of revenue, that will be helpful.

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

So if I start off with the Spanish market. I mean, clearly, our position in Spain is that we're in the bingo-led segment of -- rather than the border online casino. And I think we've seen most of the increase in competition in Spain focusing in on sports betting and online casino rather than bingo-led. Bingo-led is pretty established now. And because of the liquidity requirements, know, there are 3 significant players. No one else is showing any great signs of breaking into that. So but we do expect it's becoming a more attractive market. And clearly, it's a market where Spain is looking to grow the online gaming industry rather than restrict it. So therefore, that will attract certain areas there. I mean, in terms of marketing, we are kind of still seeing -- spending mid-teenage-digit proportion of revenue on marketing. We very much look at marketing on a continuous basis really based about what returns we're getting. So if we think there is an opportunity to spend more money because we are pleased with the returns, then we will take advantage of that. And if we decide we're not quite getting the returns at the current time, we'll dial down marketing. So we tend to -- we have a target in mind, but we will adapt to that, and we've already changed our marketing mix across countries quite dramatically this year just to make sure we spend our money where we get the greatest returns.

And in terms of Germany. It's low single-digit in terms of percentage of our overall revenue. It is growing fast. It has been -- the growth has been -- still looks fantastic year-on-year. Not as good as it was sequentially for 2 key reasons: first one is PayPal stopped being a payment processor for Schleswig-Holstein tolerances. It decided it didn't want to service that part of the market. So that was a loss of the #1 payment solution in Germany. And also, during the whole course of the gaming debate in Germany, Schleswig-Holstein requested that we cease marketing for a spell, which we were happy to comply with. So that will see Germany slow down slightly, but we expect everything to return to normal. It's beginning to return to normal around now.

Operator

The next question comes from the line of Deirdre Murphy calling from Guggenheim Partners.

Deirdre Murphy

Just one on the remote gaming. Duty change, have you disclosed what the full year EBITDA impact is of this?

Keith Laslop ***JPJ Group plc - CFO & Director***

Yes. It's around GBP 1 million per month within the U.K. So GBP 9 million roughly in 2019.

Operator

We have no further questions in the queue, so I'd like to hand back to your host for any concluding remarks.

Neil Geoffrey Goulden ***JPJ Group plc - Executive Chairman***

Thanks very much, Molly. Thank you all for joining us. We are -- have got conference calls booked in with the number of people over the next few days, so we look forward to speaking to you then. Thank you for attending today's call.

Simon Michael Wykes ***JPJ Group plc - Group MD & Director***

Thank you.

Operator

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