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Kambi Group

Q3 2017

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MODULAR FINANCE

Prepared Remarks

Good morning and welcome to Kambi's third quarter result presentation. I am Kristian Nylén, Chief Executive, and joining me is our CFO, David Kenyon. Please turn to slide two. In a moment, I will give you a brief overview of the quarter, as well as some of our events so far in Q4, after which David will take you through the numbers. I will then talk you through the quarter in a little bit more depth, and as usual, the Kambi initiative, which this quarter involves the completion of a strategic review. Following the presentation, we will open up for questions. First, on slide three, let me give you a brief introduction to Kambi. Kambi is a premium end-to-end sports betting service offered on multiple channels such as web, mobile, and retail terminals.

Our service is managed from an in-house developed platform, which has been continuously developed over the last decade. The platform, together with our 602 highly skilled staff, forms the foundation of our service. Our service encompasses a broad offering from front-end user interface through to odds compiling, customer intelligence, risk management, and customer empowerment capabilities. We currently offer our service to 14 operators, most of which are, as I will discuss later, outperforming the market. Let's look at the quarterly highlights on slide four. Q3 delivered continued strong growth, with operator turnover increasing by 16% despite an unusually high trading margin of 7.5%. This takes our trading margin for the first nine months of the year to 6.6%, which is within our projected annual range of 6.5%-7%. Furthermore, we are pleased to see that revenues are on par with Q3 2016, despite very tough comparatives.

You may have seen Kindred this morning reference an increase in Q4 trading margin to date, and we can confirm a very strong start to the fourth quarter at Kambi. We also signed a new customer in the shape of National Lottery in Bulgaria. National Lottery is the largest privately owned gaming operator in Bulgaria, and we will be launching our Sportsbook later this quarter with its established 7777 brand. Meanwhile, so far this quarter, we have already signed two important customer renewals, LeoVegas and Paf, and launched PlayCity Sportsbook online in Mexico, following a successful retail rollout, and Greentube in both Romania and Italy. If you recall, in Q2, we signed Colombia's Corredor Empresarial as a new customer. In the coming weeks, its new BetPlay brand will go live into the country's recently regulated market with the Kambi Sportsbook.

Finally, earlier this week, industry publication EGR published its annual Power 50 rankings, which ranked six Kambi customers inside the top 40 places. I will now hand over to David, who will talk you through the financial highlights, turning to slide five.

Thank you, Kristian. Good morning, everyone. In Q3, the trading margin was strong and above the long-term average at 7.5%. We have also seen growth of 16% in the turnover of our operators, despite the tough comparatives which Kristian mentioned. Revenue for Q3 2017 was EUR 14.8 million. Operating costs of EUR 13.7 million were slightly down quarter-on-quarter as a result of seasonal factors. Operating profit for the quarter was EUR 1.1 million, and our net cash position at the end of September was EUR 24.9 million. Let us now look at the income in some more detail, turning to slide six. This slide sets out what we call the Kambi Turnover Index. The graph shows the trends of the results generated by Kambi for its operators. The turnover is the total stakes placed with the operators by their end users on Kambi's sports betting service.

In Q3, we have seen a robust level of turnover placed with the operators we support, up 16% from Q3 last year. This was despite Q3 last year containing the final matches of the Euro 2016 tournament and the Olympics, which together contributed around 10% of that quarter's turnover. On the graph, we can see from the circled areas that the operator turnover development from Q2 to Q3 this year followed a seasonal trend we have seen every year. In Q2, the Copa América and the Confederations Cup meant that the whole quarter saw turnover from football, whilst in Q3, the main European football leagues did not kick off until mid-August. The margin represents the combined trading margin made by the operators. This quarter, the trading margin was 7.5%. Trading margin to fluctuate between quarters, depending on the results of sporting events.

We believe the expected long-term average for the trading margin is 6.5%-7%, and we are in this range for the year to date. We can see the conversion from operator turnover growth to our revenue growth on slide seven. Sterling was weaker in Q3 2017 than in Q3 2016. The impact was to reduce the reported value of transactions from end users based in the U.K. After FX, operator turnover grew by 16%. The trading margin multiplied by the turnover generates the operator's gross gaming revenue. The trading margin of 7.5% was in line with that of Q3 last year. Overall, operator GGR increased by 16% year-on-year. As part of our revenue model, we share certain costs with our operators. These can include player incentives, such as free bets and betting duties.

Increases in these areas, along with the addition of certain other gaming-related taxes, such as VAT in Belgium, impacted the growth of operator net gaming revenue, which was 13%. The Belgian VAT was introduced in August 2016, so the year-on-year impact of it will fall away in future quarters. Kambi's commission is based on a percentage of the operator's NGR. To promote growth, some of the customer contracts include tiers with lower commission rates and the higher levels of their sports betting revenues, and this, along with the fixed part of our revenues, is shown in the other column of the graph. As mentioned in the Q2 report, in July, we extended our partnership with 888. The terms of the renewal affected our revenue for this quarter compared to last year.

Q3 2017 is the quarter with the biggest impact from the new contract due to the timing of the different tiers of revenue share in the previous contract. This impact will significantly diminish in future quarters. The net effect of all these factors is that revenue for Q3 2017 is in line with Q3 last year. Let's turn to the full income statement on slide eight. Operating expenses for the third quarter were EUR 13.7 million. This figure was slightly down on Q2. This is a seasonal pattern which we also saw last year, with a reduction in staff costs as a result of the holiday season. Total operating expenses are forecast to increase during Q4 by 3% to 5% compared to Q3, as we invest in building a market-leading sportsbook to maximize our long-term revenue potential.

Overall, in Q3, profit from operations is EUR 1.1 million compared to EUR 3.1 million last year, and profit after tax is EUR 0.8 million compared to EUR 2.7 million last year. Now let's look at the cash flow on slide nine. Set out in this slide are the major components which impacted our cash position during the quarter. Our opening cash balance on the 1st of July was EUR 30.2 million. Capitalized development costs in the quarter were EUR 1.7 million, while the amortization charge on previously capitalized costs was also EUR 1.7 million. Working capital increased by EUR 1.5 million due, amongst other things, to the timing of invoice payments from certain operators. Our closing cash balance was EUR 32.2 million. Now let me pass back to Kristian, turning to slide 10.

Thanks, David. As I touched on earlier, Kambi signed Bulgaria's National Lottery as a customer in Q3. They are an established online gaming brand in Bulgaria, has more than 2 million registered customers, and holds strong positions in casino and lottery verticals. We expect to launch a sportsbook from National Lottery's 7777 brand during this quarter as a replacement to their existing sports betting product. This makes Q3 the seventh consecutive quarter in which Kambi has signed a new customer. Turning to slide 11. I'm pleased to announce two new customer extension agreements. Both LeoVegas and Paf have signed with Kambi for the long term. LeoVegas initially signed with Kambi in 2016, while Paf was Kambi's very first customer, signing in 2010. We are pleased to have put in place new agreements with both.

While we continue to sign new customers, the resigning of current customers is equally important and shows the satisfaction and success our customers have with our sportsbook. Importantly, these extensions mean Kambi has, over the past few months, secured three of its major customers on long-term deals. Turning to slide 12. Here you can see the continued geographic expansion of Kambi and its customers. During the quarter, we launched our sportsbook with Greentube's Admiral brand in Romania and its StarVegas brand in Italy. In recent weeks, Televisa's PlayCity brand launched online in Mexico. This was following the successful rollout of a Kambi retail solution across 16 of its casinos. In the coming days, Corredor Empresarial will launch its BetPlay brand in Colombia, along with a Kambi sportsbook. We are confident both PlayCity and BetPlay will find success in their respective markets. Now on to slide 13.

During Q3, Kambi completed a strategic review of the business. The process reaffirmed our belief that our distinctive capability, our flexible, scalable model, is the most efficient and effective method to remain the premium choice for the operators. Kambi has developed a market-leading sportsbook core with an open API-managed layer of operator empowerment, and also deployed a first version of price differentiation. These empowerment tools enable our customers to repackage the sportsbook and develop new experience to meet their own individual strategies. This makes the model highly scalable and allows Kambi to focus on the continued development of the sportsbook core to drive greater turnover and margin for our operators. It also gives Kambi and its operators opportunity to develop in pace with leading in-house powered operators. Our model resembles that seen in other major industries. Take, for instance, car manufacturing.

As you can see on the image, Volkswagen discovered that 60% of the cost of manufacturing a car sat between a front wheel and a gas pedal. With that, they invested in a platform that could be used for various brands and models, from super minis to SUVs. Currently, this platform is used for 16 models across four brands: Volkswagen, Audi, SEAT, and Škoda. Turning to slide 14. As mentioned earlier, we are proud to have six of our customers ranked inside EGR Power 50, which was published this week. All six finished inside top 40 places. Kindred and 888 in the top 10, four in the top 20 with Rank and LeoVegas. LeoVegas was also the highest climber of the year. Mr Green and Paf also placed well.

It is also worth noting that Kambi's customer 32Red, recently acquired by Kindred, was ranked 22nd on the Power 50 last year. With no other end-to-end supplier contributing more than one customer to the Power 50, Kambi can confidently say it is a market-leading provider of sports betting solutions. Let me summarize our key points on slide 15. We delivered an excellent Q3 performance with revenues on par with the same period last year, despite very tough comparatives. We not only added a new client, but have continued to secure our existing revenue base with another two key operator extensions. Following our strategic review, we are more confident than ever that Kambi is well-positioned for long-term revenue growth. I would like to thank you for your interest in Kambi, and now open up for questions.

Q&A

Thank you. Ladies and gentlemen, if you have a question for the speakers, please press 01 on your telephone keypad now. There will be a brief pause while questions are being registered. Our first question comes from the line of Christian Hellman from Nordea. Please go ahead. Your line is open.

Hi. Thank you for taking my questions. My first question, I might have missed it, but I think David was talking about costs and some guidance for Q4 on the back of Q3. Could you just repeat what you said there in terms of cost being up quarter-over-quarter?

Yeah. We said that they are expected to increase by 3%-5% Q4 from Q3. 3%-5%.

Yeah. Okay, great. Another question on the contract extension with LeoVegas. You signed with LeoVegas just last year, so it has not been that long since your first contract with them. Why extend it already now?

I do not want to go into too many details, but let us say it was not a very long contract, the first one.

Okay. Yeah, that makes sense. I guess I assumed that it was longer than what you are implying now. Another question on the 888 impact that you had in this quarter. It was 9%, shaved off 9% of all your growth. You said it will, because of how the tiers were structured during the year, it will come down significantly forward. Could you give some more guidance on that? Will nine be, let us say, 4.5 in Q4, or what significantly?

Yeah, I would say the Q4 impact will be probably just over half of what we are showing this quarter. So yeah, about maybe five instead of nine, if you like. So yeah, just over half.

Okay, perfect.

It will be decreasing again in Q1.

And even less in Q1.

Correct, yeah.

But in Q1, how will that work? Because didn't you take charges for Q? Or was those charges done in Q2, or will you restate Q1, or how will that work?

It was actually all taken in Q2, so yeah, the last year-on-year impact you'll see will be in Q1, and then it will disappear entirely in the year-on-year analysis.

Okay. But in Q1, it will be less than what it will be in Q4.

Correct, yeah.

Perfect. My final question, just on Or two questions. One on the Bulgarian launch, which will happen in Q4. Could you share something with whether it will be sort of early? I guess we're already in the early parts of Q4, but would be sort of mid-Q4 or very late Q4, or do you have some timing on it?

Yeah, I don't want to Yeah, I think, no, yeah, probably mid rather than late at least.

Okay, thanks. Then final question, just on the future, if we look into 2018 in terms of your pipeline or potential pipeline of potential new customers signing with Kambi. I think you said during the Q2 call that the pipeline was stronger than ever. Since then you signed with the Bulgarian National Lottery. What's your feeling right now?

I can just reiterate the same feeling. It feels very, very solid at the moment.

Okay, fair enough. Thanks. That will be it for me.

Thank you.

Thank you. Our next question comes from the line of Mattias Lundberg from SEB. Please go ahead. Your line is open.

Good morning. I have a couple of questions. The first one regards the contract renewal with LeoVegas. Is it fair to assume, as you mentioned, that the effect of this renewal will not affect earnings in Q4, but then in future years, but not significantly, that there was a price reduction and that the new contract is for a longer period than the last contract?

To answer the last question first, yeah, I think that's fair to assume. On the first question, yeah, as we said, the combination of LeoVegas and Paf, both of them together, it will be not very big impact, but I don't want to go into detail on each and every of the contracts. But I can tell you this, that it's a difference in the timing of signing, so I think the later one was probably more in line with where we thought the market should be.

Okay, thank you. I'm thinking a bit about the effect of commission tiers on your revenue bridge from operator turnover to Kambi revenue growth reported in the other segment in that graph. Is that effect the largest in the end of the year and the smallest in the beginning, or how should we think there?

I think, yeah, slightly larger at the end of the year, but it's not a material difference in the kind of weighting, if you like, between the different quarters so much these days. But yeah, slightly larger at the end of the year than at the start of the year.

Great. Thank you for clarifying. I have a third question. I noticed that Svenska Spel had a tender out earlier this quarter, or actually this summer, about some additional tennis odds. Is that something you can comment on? Do you know who received that contract? Anything like that?

Yeah, I mean, we are not a supplier of odds feeds. It's not our business model. We are an end-to-end supplier. This is not at all in line with our business model. I can't comment on who is answering on that tender. But it's surely not us.

Thank you for your answers. That was all for me.

Thank you.

Thank you. I will remind you that if you do want to ask a question, you will have to press 01 on your telephone keypad now. Our next question comes from the line of Rasmus Engberg from Handelsbanken. Please go ahead. Your line is open.

Yes, hi. Can I ask you when the Kindred contract is to be renegotiated, and if you think that, obviously, they have grown tremendously since the previous contract. Is there any potential impact from that, do you think? When is it renewed?

I cannot comment on that. I mean, obviously, we hope that it will happen well in advance of the end of 2018, but when, I cannot comment on, and on what impact it will have, I cannot comment on either.

Okay, thanks. I think in a previous call that you shed some light on what you saw in terms of cost expansion in 2018. If that was so, or even if you didn't, what do you think we should sort of have given it's a World Cup year, but there seems to be a slowdown now towards the end of this year?

I mean, we obviously, the first time we forecast OPEX. I mean, when we hit those targets, that'll be a 16% growth in OPEX 2017 versus 2016. So, I mean, yeah, that's a fair working assumption for the year ahead.

But for 2018, I mean, sorry.

Yeah, I mean, it's 16% this year, but you know, that's probably going to be, give or take, where we're heading next year.

Okay. Excellent. Good. I think that was probably all my questions. Yes. Thank you.

Thank you. As there are no further questions at this time, I will hand back to you, speakers.

Okay. Thank you for your questions and for listening in. We will look forward to update you on the 14th of February when we publish our fourth quarter results for 2017.