July 26, 2017

Kambi Group

Q2 2017

QUARTR



Prepared Remarks

Good morning, and welcome to Kambi's second quarter results presentation. I am Kristian Nylén, Chief Executive, and joining me is our CFO, David Kenyon. Please turn to slide two. I will start with an overview of Kambi and the highlights of the quarter. David will update you on the financials, and I will then come back and update you on the renewal of a contract with 888, our new customer signing in Colombia, and our recent award win. After the summary, we will open up for questions. First, on slide three, let me give you a brief introduction to Kambi. Kambi is a premium turnkey sports betting provider. The service, which is managed from an in-house developed platform, is offered on multiple channels such as web, mobile, and retail terminals to currently 13 licensed gaming operators.

We employ nearly 600 highly skilled and dedicated staff located in our six offices around the world. The people, together with the platform, form the foundation of our scalable business proposition. Let's turn to slide four for the quarterly highlights. I will elaborate with more details on all highlights later on in the presentation, but let's start with an overview. We are very pleased to have secured a multi-year expansion with one of our key customers, 888. Together, we have enjoyed a very successful partnership, with 888 having seen a near 500% increase in sports betting revenues since switching to Kambi in 2013. I am also delighted that Corredor Empresarial has chosen to partner with Kambi. We identified Corredor as a key strategic partner in Colombia. We see a solid 16% increase in operator turnover growth.

This is despite the fact that this is a quarter that has a tough comparison, as Euro 2016 contributed to 11% of the Q2 numbers last year. This is clearly showing that our investment, dedication, and strategy to create the best-in-class service is paying off, and our operators are performing well. Talking about success, I am proud to say that Kambi was awarded the EGR B2B Sports Betting Supplier 2017, a recognition of our leading position in the market. I will now hand over to David, who will give you a detailed financial update. Turning to slide five.

Thank you, Kristian. Good morning, everyone. In summary, this quarter we have seen strong growth in the turnover of our operators, despite tough comparatives to last year, where we had the Euro 2016 tournament. Operator margin remained below the long-term average at 6.3%, which impacted our revenues for the quarter. The other key feature this quarter was the long-term extension of our contract with 888. This renewal affected our revenue and EBIT for the first six months of the year by approximately EUR 1 million. We will see a similar impact as we move forward, with Q3 2017 likely to be the quarter with the biggest delta between the two contracts, due to the timing of the different tiers of revenue share in the previous contract. Revenue for Q2 2017 was EUR 14.1 million, up from EUR 13.7 million in Q2 2016.

This was driven by a solid increase in the turnover of our operators, offset by the lower margin and the 888 impact. Operating profit for the quarter was EUR 0.3 million. The terms of the 888 renewal directly affected this operating profit. Our operating expenditure increased as planned as we continue to invest in building our premium sportsbook. Our net cash position at the end of June was EUR 22.8 million. So let's 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 Q2, we've seen a strong level of turnover placed with the operators we support, up 16% from Q2 last year. This was despite the Q2 last year containing the majority of the matches of the Euro 2016 tournament, which contributed 11% of that quarter's turnover. The margin represents the combined betting margin made by the operators. This quarter, the overall operator margin was 6.3%. The margin started badly in April, but did improve in May and June. It is in the nature of this business for the betting margin to fluctuate between quarters, depending on the results of sporting events. We believe that the expected long-term average for the betting margin is 6.5%-7%. We can see the drop-through from operator turnover growth to our revenue growth on slide seven. Sterling was weaker in Q2 2017 than in Q2 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% compared to Q2 2016. The betting margin multiplied by the turnover generates the operator's gross gaming revenue. The Q2 2017 operator margin was 6.3% compared to 6.6% in Q2 2016. The impact of this lower margin was that operator GGR increased by 13% 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. 52% of our operators' GGR in the quarter came from re-regulated markets incurring 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 8% in Q2 2017.

Kambi's commission is based on a percentage of this operator NGR. To promote and support growth, some of the customer contracts include tiers with lower commission rates on the higher levels of their sports betting revenues. This, along with the fixed parts of our revenues, is shown in the other column of the graph. In Q2, this also reflects a one-off positive revenue impact of EUR 0.3 million for the settlement of a contingent asset, as disclosed at the end of 2016. Let's turn to the full income statement on slide eight. Operating expenses for the second quarter were EUR 13.8 million, compared to EUR 11.7 million last year. The largest part is staff costs, which represented 47% of total OPEX. There was also an increase in the cost for live events data, as the number of live events we offer grows.

We are continuing to invest in the people and infrastructure required to create the best sportsbook on the market. Overall, this gives us a profit from operations of EUR 0.3 million, compared to EUR 2 million last year, and a profit after tax of EUR 0.1 million, compared to EUR 1.8 million last year. Now let's look at the cash flow on slide nine. Set out on this slide are the major components which impacted our cash position during the quarter. Our opening cash balance on the 1st of April was EUR 31.1 million. Capitalized development costs in the quarter were EUR 2.1 million, while the amortization charge on previously capitalized costs was EUR 1.6 million. The other column includes the timing effect of the annual interest payment on the convertible and the payment of certain corporate taxes. As a result of these transactions, our closing cash balance was EUR 30.2 million.

Now let me pass you back to Kristian. Turning to slide 10.

Thanks, David. Kambi has signed a long-term extension with 888, which means we will continue to supply 888 with our services. Contract extensions and renewals are always significant, and this one is no different, with 888 recognizing Kambi as its supplier of choice, following a very successful four years together, as 888 has grown more than fivefold. As a result of the strong growth delivered during this time, 888sport is now widely recognized as a significant player in the sports betting vertical, and I very much look forward to continuing this powerful partnership and supporting 888's growth for the long term. In the shorter term, it will make the quarterly comparables challenging, but with the extension, we have secured the revenue stream for the longer term. On slide 11, I will talk about our latest signing.

As I mentioned earlier, Kambi signed an agreement with Colombian games of chance network, Corredor Empresarial. This is Latin America's largest network of its kind. We see a massive potential in this exciting deal. We already have a sportsbook fit for this region. Betting on sport is very popular, and regulation is in place. Kambi will be the exclusive provider of its fully managed turnkey sports betting service to the newly created online brand, BetPlay. Kambi identified Corredor as a key strategic partner in Colombia. With its vast retail reach of more than 25,000 outlets, they have the potential to become the country's number one sports betting operator. This is the second deal for Kambi in Latin America, and together with Televisa in Mexico, we have secured two customers with the power to build market-leading positions in their respective territories.

Latin America is, together with Europe, our key focus areas, and we are confident we will be able to expand our market share in the region further as more countries move towards regulation. Turning to slide 12, I would like to brief you on our recent award win. I am very pleased that Kambi won the EGR B2B Sports Betting Supplier 2017 award. This achievement clearly recognized the hard work, commitment, and investment made by all Kambi staff to create the best sports betting service. It is also recognition of the quality of our service and our strong track record, which has been the key driver behind the signing of six new customers since the beginning of 2016. This award reaffirms Kambi's position as a leading B2B sportsbook provider in the industry. Let me summarize on slide 13.

The year-on-year operator turnover growth was 16%, despite last year's corresponding quarter featured the majority of the Euro 2016 tournament. Unfortunately, the trading margin was again below expectations, mainly due to a weak start of the quarter. We are very pleased to have secured a multi-year extension with one of our key customers, 888. Together, we have enjoyed a very successful partnership since 2013. I am also delighted about our latest signing. We early on identified Corredor Empresarial as a key strategic partner in Colombia. They have a potential to become Colombia's number one sports betting operator. We are confident we will be able to increase our growth and market share further with both new and existing customers. We continue to invest in technology and people to create the market's best sports betting experience and build on the positive momentum both Kambi and our operators are experiencing.

Not only has the day-to-day performance of the business remained strong, but we have managed to further strengthen our foundation for future growth. I would like to thank you for your interest in Kambi, and now open for questions.

Q&A

Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad. If you want to withdraw the question, you can do so by pressing 02 to cancel. Once again, that is 01 on your telephone keypad to register for a question. We will now have a brief pause while questions are being registered. We have a question from the line of Bilel Dar from Key Capital. Please go ahead. Your line is now open.

Thank you. I have a couple of questions, beginning with the new agreement with 888. How should we think about that in the context of older agreements that you have with some of the customers you signed a couple of years ago?

Hi, Bilel. Yeah, I think 888 contract is one of the oldest contracts we have in the portfolio. I think the business then was a little bit different than it is now. 888 as a customer is, as I said earlier here as well, more than five times as big now as we were back in 2013. I am not sure there is a good comparable really to 888 within our portfolio. Did that answer your question?

Yeah. If I ask it another way, if you would renegotiate deals with, let's say, Kindred, that also was signed a couple of years ago, would the impact be the same as in the case of 888 or lower? Just to get a sense for the magnitude.

I would surely hope lower impact. As I said, 888 was not a significant sports betting brand when we signed them last time. With Kindred, it is a little bit different. They were already a market-leading operator, and I think we were already on a, yeah, more How should I put it? The level was more corresponding to the kind of company they are at the moment. In 888, they have gone from a small to a large sports betting operator.

Yeah. Thanks. A question on costs. You mentioned in the report that relocation costs and higher rents caused a bump in the OPEX line. But how should we view costs going forward? I mean, to which degree is the cost growth relating to finding new business, and what's a reasonable assumption on cost growth going forward? I think in the past you said that 20% has been a level that is difficult to break, and at this point, you're close to the 20% growth mark.

Yeah. Hi, Bilel. It's David. I'd say Q1 was a slight anomaly. As we mentioned in the report, there were some slightly reduced costs in Q1 relating to some staff bonuses relating to the prior year. So that was kind of slightly artificially low. But if you exclude that, we're still running about 5% growth quarter-on-quarter, and overall approximately around 20% year-on-year. So I think that's still the level we should look at.

In terms of the feeds, because sports data that you use for odds compiling purposes is obviously a big component of your cost structure. If I look at the Kambi Turnover Index, it's up close to three times compared to the beginning of 2014. So has there been any scale effect on those cost lines, or do you expect to renegotiate those terms coming into 2018 and 2019?

We are definitely looking at, yeah, being as cost-effective as possible on our supplier side, and we are in constant discussions with all the different suppliers there are of data. Having said that, there are two kinds of data, you can say. You have the non-official data, where it's a lot of competition, and then you have the official data, where one supplier has bought the rights. And those kind of rights, we don't see the same pattern. Those rights are becoming more and more expensive, as the non-official data is becoming cheaper.

Then one final question on the pipeline. You have made substantial investments over the last couple of years in terms of IT and also staffing up within the trading department, and you are a substantially more complex and advanced company today compared to two years ago. Could you elaborate a bit on the pipeline, and if you are beginning to see the effects of these investments that you have made in terms of interest from potential customers?

Yeah, sure. First of all, I would say that it is important to remember as well that these investments are necessary to keep and make organic growth of our existing customer base as well. Having said that, I think the pipeline is looking much, much more positive now than ever, actually. I really feel that since, yeah, one and a half year ago, it has happened a lot, and the appetite for outsourcing has grown a lot. You can also see that, I do not think we have gone one single quarter since Q1 2016 without having a new signing. So I am very positive to that part of the business.

Okay. Thank you.

The next question comes from the line of Rasmus Engberg from Handelsbanken. Please go ahead. Your line is now open.

Yeah. Hi. The first question is, how long do you think you will need to have this aggressive growth of your costs? Do you have a plan on slowing down at some point in time? I'm sure you do.

Yes. I would say we have two large part of our staff cost increase, and that's on the IT side. There, I think we still want to invest quite significantly over the next coming years. Then you have on the trading side, where I start seeing that we getting very close to where we would see the cost flattening out. I don't expect us to grow the cost on the trading side over the long term from, yeah, pretty much, yeah, end of this year.

All right. We have the continued high growth for cost for this year, and then hopefully maybe a bit of a slower growth, at least in percentage terms, in 2018 maybe, sometime. That's correct?

Yeah. I think that's the correct assumption.

Given the, I mean, we don't really have, of course, from the outside, the kind of insights you have into the price erosion or volume discounts or what you want to call them. But if we were to say 20% cost growth, what type of operator gross profit growth do you need to maintain your profit? How should we think about that? Isn't that something like 30% at least that is necessary to justify the current profitability?

Yeah, I think if you look at the kind of fall-through from operator revenue growth or turnover growth to our revenue, yeah, I mean, we've been running typically around 50%-75% drop-through. So yeah, to exceed 20%, you're looking at 30%-40% growth, I guess, on operator turnover to be had.

Yes. Okay. Thank you.

Thank you.

The next question comes from the line of Charis Assis from Danske Bank. Please go ahead. Your line is now open. Please go ahead, Charis. If your phone is muted, please unmute yourself.

Sorry. Hi. Thank you for taking the questions. I have a couple of questions of my own. Just looking at your comment on the pipeline question, you said that it's looking brighter than ever, or it's looking better than ever? I missed that part. And why is that?

Yeah. Hi, Charis. Yeah, simply because the interest in the business is so much higher for sports betting solutions. We also see more markets becoming regulated, which is very, very positive for us. So, yeah, it's becoming more markets opening up and more operators interested in our service.

Okay. Then just given your comment on more markets opening up, would there be any specific markets that you guys seem to have a higher likelihood for signing any state-owned monopolies or, yeah?

That is always a tricky question. I would say when it comes to lotteries or state-owned monopolies, I think the likelihood of signing them will always be around the time they are regulating. So, the likeliest time you will ever see is probably between a year before a regulation is coming into effect and when the regulation is coming into effect.

Okay, thank you. Just a question on the Colombian client signing. How was the competition there, and who would you mention your biggest competitor was in terms of winning that contract?

I know for a fact that it was a very fierce competition. I think it was, yeah, for sure the highest price in Colombia. I am not going to mention any competitors, as you probably can understand, but it was very, very tough competition, and we are very, very proud to win that deal.

Okay. Just going on to your costs, you mentioned that from 2018, you will have lower growth in costs. How much lower growth should we think of? It is going to be If you can just guide further on that.

I mean, we don't set our forecast, Charis Assis. I guess we're certainly going to still keep recruiting in IT, and that's probably a higher part of the cost base than the trading. So, yeah, it's the trading part where you'll see some scale economies. I don't want to give you a number at this stage.

Okay. All right. Well, no further questions from me at the moment. Yeah. Just looking at, sorry, just one last question. Staff costs increase significantly sequentially going into Q3, Q4. Should they grow at the same rate, or are we expecting somewhat lower growth in Q3 due to vacation, or, yeah, how do we

Yeah, typically Q3 would be a slightly slower growth due to summer vacation. Yeah, that's fair.

But I guess in terms of increasing the number of employees in the company on an overall level, how much will the increase be similar to the one we've been seeing now, or?

I think you will see that the rate will slow slightly during the summer, but then we will probably resume during Q4.

David, could you repeat that? The rate will?

Yeah, I will tell you. The recruitment rate will probably slow slightly during the summer, but then pick up later in the year.

Okay. All right. Going into 2018?

Yeah, as we said, on the IT development side, we will keep recruiting at the current rate, maybe on the trading side, but that is where we will slow down recruitment to some extent.

Okay. All right. Thank you. No more further questions from me.

We have a follow-up question from the line of Bilel Dar from Keel Capital. Please go ahead. Your line is now open.

Hi, again. On costs, sorry for repeating myself, but to which degree do you feel that there is room to invest more into automated processes? Because looking at the headcount, you are approaching 600. You were closer to 400 a couple of years ago, which is a substantial change. But given your new sort of IT capabilities, is it reasonable to assume that you will benefit more from automated processes, or how should we view that?

Yeah, we are automating processes all the time, you can say, and there is definitely room for more automated processes than we already have. So far, we have utilized the extra capacity when we have done automation to expand our offer with new things. But I think we see an end of where we actually feel that there is a big need and demand for an increased offering. So, I think automation will probably, in the future, mean that we can at least level out the increase in our trading department.

Regarding Corredor, when do you intend to launch or go live, BetPlay?

I think it's, yeah, late Q3 or early Q4.

Okay. Great. Thank you.

Thank you.

As there are currently no further questions, I will hand back to the speakers for closing comments.

Okay. Thank you for your questions and for listening in. We will look forward to updating you on the 1st of November when we publish our third quarter results for 2017.