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Kambi Group Plc (KAMBI.SE)

Q2 2016 Earnings Call

CORPORATE PARTICIPANTS

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David Kenyon

Chief Financial Officer, Kambi Group Plc

OTHER PARTICIPANTS

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Analyst, ABG Sundal Collier

Jane Anscombe

Analyst, Edison Investment Research Ltd.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

MANAGEMENT DISCUSSION SECTION

Operator: Hello, ladies and gentlemen, and welcome the Kambi Group Q2 2016 Call. Today, I'm pleased to present Kristian Nylén, CEO of Kambi Group. And throughout this all participants will be in listen-only mode, and afterwards there'll be a question-and-answer session. Please begin.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Good morning and welcome to Kambi's second quarter result presentation. I'm Kristian Nylén, Chief Executive, and joining me is our CFO, David Kenyon.

Please turn to slide 2. I will go through the highlights of the quarter, David will give a financial update and then I will talk about the Euro 2016, our new customer signing, and current Kambi initiative. After conclusion of presentation we will open up for questions.

But first, on slide 3 let me give you a brief introduction to Kambi. Kambi is a premium turnkey sports betting service offered on multiple channels such as web, mobile, and retail tournaments. Our service is managed from an in-house developer platform which has been continuously developed over the last decade. The platform, together with our 493 highly-skilled staff forms the foundation of our service. Our service encompasses a broad offering from front end user interface, to odds compiling, customer intelligence and risk management. We currently offer our service to 12 operators, most of whom are outperforming the market.

So let's look at the quarterly highlights on slide 4. Q2 shows significant growth in comparison to the same period last year, and our operator turnover increased by 46% year-on-year which led to 28% revenue growth for Kambi. The Euro 2016 tournament was a major contributor to the strong performance. Euro 2016 was a success for Kambi both financially and operationally, and our Euro offering contributed to 11% of our operator turnover. I will go into more detail later in our presentation.

Again, we proved our capabilities to smoothly add new operators. LeoVegas, Rank Group, and Mr Green were as promised all integrated ahead of Euro 2016. A joint effort and commitment made the implementation process fast. The HTML5 pipeline is now available for all operators allowing them to take advantage of a front end technology with a multitude of differentiation possibilities. This commitment to user experience for our customers reads through to favorable financial performance. We now have a solid foundation, where both Kambi and its operators continuously can develop new innovative features. Yesterday evening, Kambi also added R. Franco to its customer portfolio. I will give some more detail about R. Franco later in our presentation.

I will now hand over to David, who will talk you through with financial highlights turning to slide 5.

David Kenyon

Chief Financial Officer, Kambi Group Plc

Thank you, Kristian. Good morning, everyone. Revenue for Q2 2016 was €13.7 million, up 28% on the Q2 2015 figure. This was driven by a significant increase in the turnover of our operators, which I'll look at in more detail later. This brings the revenue for the first half year to €26.9 million, up 30% from last year.

Operating profit for the quarter was €2 million at a margin of 14%, up from €0.8 million last year. For the first half year, the operating profit is €3.9 million at a margin of 15%, compared to €1.6 million in 2015.

Our cash flow, excluding movements in working capital for the quarter, was €0.1 million; and for the first half year, the cash flow was €1.5 million, compared to €1.2 million last year. The net cash position at the end of June were €20.3 million.

In summary, we're continuing to see outstanding growth in the operators we work with. This, in turn, has driven our financial performance.

So let's now look at income in some more detail, turning to slide 6. 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. The margin represents the combined profit margin made by the operators. In Q2, we see a high level of turnover placed with the operators we support, up 46% from Q2 2015. In the last few quarters, we've seen a step change in operator turnover and we are happy that we've been able to build on this in Q2.

This quarter, the overall operator margin was around 6.2%, below the long-term average. We have seen volatility in the match results this quarter, with a large number of favorites winning in the main football leagues, where we also typically operate with a high level of payback. However, the Euro 2016 tournament shows significantly higher margins. These movements in turnover and margin impacted a part of our revenue, which is commission, based on profits generated for our operators.

Our operator contract includes certain tiers of commission rates which can vary as their business grows, with lower rates on the highest parts of revenues. This aligns the interests of Kambi and its operators to grow their business. Our income also comprises some fixed fees and charges linked to the number of live events being provided. The net effect of all these was to increase our income by 28% compared to Q2 last year.

Let's look at the full income statement on slide 7. Operating expenses for the second quarter were €11.7 million. The main elements include staff costs, live information feeds and office costs. On this note, as part of our planned expansion, we are on course to open a large office in Bucharest later this year.

Our tax charge for the quarter was reduced by approximately €0.2 million due to the UK tax treatment for share options, whereby the company receives corporation tax relief on the gains made by its UK employees. There's a similar level of cost included in the quarter's operating expenses for employee's social security costs on these gains. Overall, this gives us a profit from operations of €2 million, compared to €0.8 million last year; and a profit after tax of €1.8 million, up from €0.5 million last year.

Now, let's look at the cash flow on slide 8. Set out on this slide are the major components which impacted our cash position during the quarter. Our opening cash balance on April 1 was €28.9 million. Working capital for the quarter was impacted by the timing of some annual volume-related discounts which were settled during Q2. The impact of these discounts is a specific cash flow pattern that impact Q2 only. This, along with an increase in bettors due to the impact of Euro 2016 in June, impacted cash flow for the quarter; a pattern we also saw last year.

Capitalized development costs in the quarter were €2.1 million. The amortization charge on previously capitalized costs was €1.4 million for the quarter. In terms of tangible fixed assets, we invested in our IT infrastructure and new offices totaling €1 million for the quarter. We also made the annual interest payments on our debt during Q2. As a result of these transactions, our closing cash balance was €27.5 million.

So now let me pass you back to Kristian, turning to slide 9.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thanks, David. As I already mentioned, we are delighted to announce a new deal with R. Franco. R. Franco is a privately-owned international gaming group. The group is one of the founding fathers of the Spanish retail segment with over 40% of the Spanish AWP market. During the last couple of years there has been a strong focus on server-based retail offering and online gaming. Currently, we look to replace R. Franco's existing sports book currently operating on Wanabet.es, and we'll drive expansion through its omni-channel offering across all of Spain and Latin America.

Turning to slide 10. Euro 2016 was obviously the highlight of the quarter. As previously mentioned, 11% of quarterly turnover was generated from the tournament. It's also a very important marketing event for our operators. Therefore, it's imperative to have the most competitive offerings, new innovative features and above all a solidly performing technical platform. Considering our operators' results, I believe we succeeded in all the above areas. Our systems performed throughout the tournament with 100% uptime. The matches were offered with a very competitive payback of 97.5%, and we had a variety of relevant offers peaking at over 750 offers for the finals. We also added new exciting instant bet offers. The most popular offer was a bet on the next occurrence. In other words, what will happen next – a throw-in, a corner, a free kick and so on. I will soon talk more about some other Euro features.

As with all sporting events, we can't control what happens on the pitch on any given day. We can only manage the risk effectively, and the financial success of a large tournament is for us and our operators very much dependent on what happens on the pitch.

For Euro 2016, there was, as predicted, many up and downs, a lot of late goals, most of them not very favorable for [indiscernible] (00:11:12). But there were also movements such as the equalizer for Russia against England on added time, but at a sizeable impact on the quarter results. To summarize, Portugal are the champions and enough good outcomes in the individual matches helped make the Euro a financial success.

Turning to slide 11. To further boost the player experience Kambi made a number of new widgets available specifically for the Euro such as player specials. The Euro widget offering enable our operators to highlight a rich variety of content as well as simplify the bet placement. It also gave our operators opportunity to include their own Euro-specific widgets. This empower the operators to create a tailored and engaging user experience for their players.

Turning to slide 12. Being able to keep a wide range of bet offers open during the most exciting moments in a game is complex, but crucial for providing a good user experience. Here is an example from England-Iceland match when England is awarded a penalty. Looking at the betting client to the right side of the slide, when an offer appears in gray, it's not open for betting; otherwise it is. Please enjoy the last minute of English's success during the Euro. Please play the video.

[Video Presentation] (00:12:50-00:13:53)

Kambi's operators were, as far as we know, the only operators in the industry with full offering during time of penalty. This seemingly small feature, which is part of a larger context of course, is fundamental to our operators to acquire new players and retain existing ones.

Turning to slide 13. And, finally, I would like to highlight a current initiative in the business. As part of a larger branding review, we have put renewed focus on how to communicate our brand and where we deliver value to our customers. We have identified five messages. We are the secure choice. We believe partnering with a secure supplier is essential for business continuity, and Kambi has its service up to excel in this area. As a public company, regulatory compliance and integrity are a top priority. We invest heavily in our technical systems and are using the highest quality data feeds.

We are committed to the player experience. Sports betting is ingrained in our DNA, and there is a genuine drive throughout the company to provide the ultimate sports betting experience to the end user. We are data-driven. Data is the heart of our business. Everything we do is based on interpreting data; for example, algorithms for pricing, risk management, and front-end development.

We empower our operators. We understand the necessity of giving our operators great tools to provide a unique experience, in line with their brand, and we are making great strides to support them. And lastly, we drive financial performance. Most importantly, we have a proven track record of supporting operators such as EvenBet and 888 to outperform the market.

So let me summarize our key points on slide 14. Again, we see a stellar performance from our operators. The Euro tournament was a success, both from an operational perspective as well as from a financial. And, yesterday, we signed yet another exciting partner in R. Franco, and we are very well-positioned for further growth.

I would like to thank you for your interest in Kambi and now open up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from the line of Anders Hillerborg of ABG. Please go ahead. Your line is open.

Anders Hillerborg
Analyst, ABG Sundal Collier

Q

Hi, guys. I got a few questions for you today. First, could you comment a bit on the royalty levels in Q2 2016 versus Q2 2015? I mean, this was a bit of an issue in Q1. And could you elaborate a bit on sort of how this royalty level is versus last year?

David Kenyon
Chief Financial Officer, Kambi Group Plc

A

Yeah. Hi, it's David. I'd say there is some – on some of our contracts there is a bit more business which is at lower commissions than Q2 last year basically due to the growth of the business. So as I mentioned, on the top level of the business some contracts have lower commission rates. And due to the growth we've seen more revenues at lower commissions versus last year. Pretty much it's I'd say fairly similar Q2 2016 to Q1 2016, but if you look versus Q2 last year, more business continues to grow, more business at lower commission rates.

Anders Hillerborg
Analyst, ABG Sundal Collier

Q

And how do you expect this to develop in Q3? Did you expect the commission level to come back up again as sort of some clients have their commission levels reset during Q2?

David Kenyon
Chief Financial Officer, Kambi Group Plc

A

Yeah. We might see that pattern in one or two of our customer contracts. Equally or effectively we'll continue to grow the business of our existing operators there. Others will also [indiscernible] (00:18:17).

Anders Hillerborg
Analyst, ABG Sundal Collier

Q

Thanks. And then a question on the R. Franco client there. You mentioned 40% share of the AWP market. Could you elaborate a bit on what is the AWP market and how does that translate into sports betting revenues?

Kristian Nylén
Chief Executive Officer, Kambi Group Plc

A

Yeah. So the AWP stands for amusement with prizes, so it's mainly like slot machines and bingo machines in a retail environment. So R. Franco has a very wide network of, yeah, different smaller operators who are utilizing this and their aim is to also add sports betting to their retail environment now. So I see great potential in that.

Anders Hillerborg
Analyst, ABG Sundal Collier

Q

Yes. And how confident could we be this will happen? Is this sort of an ambition or is this sort of an actual plan to drive a lot sports betting?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

It's an actual plan.

A

Anders Hillerborg

Analyst, ABG Sundal Collier

Okay. Great. And then on Q3 I think Unibet reported this morning a really strong start to Q3 driven by very strong Euro Cup revenues as a big portion of revenues from the Euro Cup seems to have ended up in Q3 rather than Q2 despite very few gains in Q3. Is this sort of in line with your trading as well that Euro Cup was even stronger in Q3?

Q

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Yeah. I mean, we had some great results in the Q3. You have the draw Germany and France and you have the final which also ended up in a draw, so some of the late matches was very favorable. And on top of that you also get all the revenues from the tournament long bets coming in in Q3. We have Portugal as the winner; that was also very favorable. So I can confirm that it was a decent start there for Q3.

A

Anders Hillerborg

Analyst, ABG Sundal Collier

Okay, sounds good. And then just finally, we have some M&A sort of activity among your clients. So William Hill sort of potentially being acquired by 888 and Rank and then also Suertia being acquired by France Pari. So what kind of risk or opportunity do you see from these acquisitions or potential acquisitions?

Q

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

At this point it's very hard to say. I mean, it's very new to us as well and we haven't really been in contact with any of our operators about this yet. But, yeah, with the 888/Rank-William Hill deal, I mean we have said before that could obviously be very positive and obviously very negative if that were to happen in the long-term. In the short-term, we obviously have a contract that still is running. And the same goes with Suertia, I would say. I would say the risk of that is much, much lower. It's one of our smallest of operator.

A

Anders Hillerborg

Analyst, ABG Sundal Collier

Yes. Okay. Great. Thanks a lot, and enjoy the rest of the summer.

Q

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thank you.

A

Operator: We're now over the line of Rasmus Engberg at Handelsbanken. Please go ahead. Your line is open.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Yes. I had a question relating to what Anders asked as well. Your operator margin hit an all-time low in this quarter. Is that a structural trend and to what extent is it just structural trend relating to increased paybacks?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. I mean, to some extent, it is of course. I mean, as I have communicated for a long time, I believe the long-term average should probably be half a percentage lower now than a year ago, but it's hard for me to say exactly where it will land. But what we see this quarter is mainly, yeah, a lot of bad results in April and May, especially in May. So I don't think 6.2% is an average level for the future. I still believe it should be closer to 7%.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Yes. And your new contract with R. Franco, when do you think that might be operational?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I think it will be operational some time in Q4.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Okay. And then, finally, this weakness in the pound, are you seeing a benefit from that or does that get sort of taken by your end customers or how does that actually work for you? I know you have a lot of staff in the UK.

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

Yeah. I mean the weak pound basically reduces our GBP revenues, so any revenues we make coming from customers and users based in the UK those obviously worth a bit less to us in euros. On the flip side, our UK cost base is again lower. So that's mainly office costs and staff costs.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

But, I guess, your proportion of cost is much higher than your proportion of revenues from the UK?

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

Yeah. That's a fair assumption. Yeah, yeah.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Yeah. All right. I think that was it for me. Thank you.

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

Thank you.

Operator: [Operator Instructions] Okay. And we'll go over to Jane Anscombe at Edison Investment Research. Please go ahead. Your line is now open.

Jane Anscombe

Analyst, Edison Investment Research Ltd.

Q

Yes. Good morning. Can you just quickly talk a little bit about the competitive environment in the B2B market at the moment given that we saw GVC winning Betfred a little earlier this quarter – last quarter?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah, sure. Good morning, Jane. Yeah, I mean it's coming, more and more competitors into the market. I still believe that we are quite alone in the segments that we are working on a very high premium level. So I still feel we're in a very, very good position. But, of course, GVC/bwin can be a future threat, but at the moment I still believe we are in a very, very good position.

Jane Anscombe

Analyst, Edison Investment Research Ltd.

Q

And is that partly because there's so many companies around the world that are still looking to introduce sports betting to their gaming ranges, like the Spanish company you just signed?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah, probably. I think there you see more and more. I mean, we started this venture back in 2010 and then we were pretty much alone on the different players and the interest from the industry wasn't that high. Now it's very, very different. You see a lot more suppliers, but you also see much, much bigger interest from the rest of industry of outsourcing sports betting. So I think we're on a very, very good position. And one more thing to stress; I believe Kambi is in a position where we actually can deliver a service that is well in line with the absolute top-tier B2C operators and I don't see any other B2B supplier at this point being in that position.

Jane Anscombe

Analyst, Edison Investment Research Ltd.

Q

Thanks for that.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Thank you.

Operator: [Operator Instructions] Gentlemen, as there are no further questions in the queue, can I please pass it back to you for any closing comments?

A

There is actually a question via e-mail. Who do you see as your one to two second biggest competitors?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. At the moment, the one we see the most at the moment is SBTech. Second one, yeah, potentially bwin/GVC in the future. But again, it's hard to say. The one we're seeing the most is SBTech.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

All right. Thank you for your questions and for listening in. We look forward to update you on the 2nd of November when we publish our third quarter report for 2016.

Operator: This now concludes today's webcast. Thank you all very much for attending and you may now disconnect.

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