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Kambi Group Plc (KAMBI.SE)

Q2 2017 Earnings Call

CORPORATE PARTICIPANTS

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David Kenyon

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Rasmus Engberg

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Kambi Group Q2 Report 2017. Today, I'm pleased to present Kristian Nylén, CEO; and David Kenyon, CFO. For the first part of call, all participants will be in a listen-only mode, and afterwards, there'll be a question-and-answer session. Please note that this call is being recorded. Speakers, please begin.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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 2. I will start with a overview of Kambi and the highlights of the quarter. David will update you on our 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 summary, we'll 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 provider. The service, which is managed from an in-house developed platform, is offered on multiple channels such as Web, mobile and retail channels to currently 13 licensed gaming operators. We employ nearly 600 highly skilled and dedicated staff located in our 6 offices around the world. The people, together with the platform, form a foundation of our scalable business proposition.

Let's turn to slide 4 for quarterly highlights, I will elaborate with more details on all highlights later on the presentation, but let's start with an overview. We are very pleased to have secured a multiyear extension 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'm also delighted that Corredor Empresarial has chosen to partnering 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 the quarter that has a tough comparison as Euro 2016 contributed to 11% of Q2 numbers last year. This is clearly showing that our investments, dedication and strategy to create the best-in-class service is paying off and our operator are performing well.

Talking about success, I'm 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 5.

David Kenyon

Chief Financial Officer, Kambi Group Plc

Thank you, Kristian. Good morning, everyone. In summary, this quarter, we have seen strong growth in the turnover of our operators despite tough comparative 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 €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 €14.1 million, up from €13.7 million in Q2 2016. This was driven by solid increase in the turnover of our operators, offset by the lower margin and the 888 impact. Operating profit for the quarter was €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 €22.8 million.

So let's now look at the 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 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 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 operating 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 margins to fluctuate between quarters, depending on the results of sporting events. We believe that the expected long-term average for betting margin is 6.5% to 7%. We can see the drop through from operator turnover growth to our revenue growth on slide 7.

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 UK. After FX, operator turnover grew by 16% compared to Q2 2016. The betting margin multiplied by the turnover generated the operator 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 far as for 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 operator GGR in the quarter came from re-regulated markets including 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 costs of our revenues, is shown in the other column of the graph. In Q2, this also reflects a one-off positive revenue impact of €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 8. Operating expenses for the second quarter were €13.8 million compared to €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 [indiscernible] (00:08:21) 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 €0.3 million compared to €2 million last year and a profit after tax of €0.1 million compared to €1.8 million last year.

Now, let's look at the cash flow on slide 9. [ph] Set also on (00:08:51) this slide are the major components, which impacted our cash position during the quarter. Our opening cash balance on the 1st of April was €31.1 million. Capitalized development costs in the quarter were €2.1 million while the amortization charge on previously capitalized costs was €1.6 million. The other column includes the timing effect of the annual interest payments on the convertible and the payment of certain corporate taxes. As a result of these transactions, our closing cash balance was €30.2 million.

So now let me pass you back to Kristian. Turning to slide 10.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thanks, David. Kambi had 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 market. 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 an extension, we have secured revenue stream for the longer term.

On slide 11, I will talk about our latest signings. As I mentioned earlier, Kambi signed an agreement with a Colombian games for 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 for region. Betting on sport is very popular and regulation is in place. Kambi will be the exclusive provider of its fully managed 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 a 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. The Latin America is together with Europe our key focus areas, and we are confident we'll be able to expand our market share in the regions, however, as more countries move towards regulation.

Turning to slide 12, I would like to brief you on our recent award win. I'm very pleased that Kambi won the EGR B2B Sport 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's 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.

So, let me summarize on slide 13. The year-on-year operating 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 weak start of the quarter. We are very pleased to have secured a multiyear extension with one of our key customers, 888. Together, we have enjoyed a very successful partnership since 2013.

I'm also delighted about our latest signing. We earlier 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 our business remains 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.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We have a question from the line of [indiscernible] (00:15:02) from Keel Capital. Please go ahead. Your line is now open.

Q

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?

Kristian Nylén
Chief Executive Officer, Kambi Group Plc

A

Hi, [indiscernible] (00:15:23). 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 was now – is now. 888 as a customer is, as I said earlier as well, more than 5 times as big now as they were back in 2013. So I'm not sure there is good comparable really to 888 within our portfolio.

Did that answer your question?

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I will surely hope lower impact. As I said 888 was not a significant sport betting brand when we signed them last time. With Kindred, it's 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, a more – yeah, the level was more corresponding to the kind of company they are at the moment and [ph] 888 (00:17:03) they have gone from a small to a large sports betting operator.

Q

Okay. Thanks. And then a question on costs, you mentioned in the report that re-location costs and higher rents caused a bump in the OpEx line but how should we view costs going forward? I mean, to which degrees did the cost grow 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% that's been sort of a level that is difficult to break and at this point you're closing the 20% growth mark.

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

Yeah, hi, [indiscernible] (00:17:47). It's David. Yeah, I mean, I'd say Q1 [indiscernible] (00:17:50) as we mentioned in the report, there was some slightly reduced costs in Q1 relating to some staff bonuses relating to the prior year. So that was – comes slightly artificially low. But if you exclude that, we're still running about 5% growth quarter-on-quarter and a growth of approximately around 20% year-on-year. So, I think that's still the level you should look at.

Q

And then in terms of fees, because sports data that you use for odds compiling purposes is obviously a big component of your cost structure. If I look at the sports betting turnover index is up close to 3 times compared to the beginning of 2014. So has there been any scale effects on those cost lines or do you expect to renegotiate those terms coming into 2018 and 2019?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

We are definitely looking at, yeah, being as cost effective as possible on our supply side. And we are in constant discussions with all the different suppliers of data. Having said that, there are two kinds of data, you can say, you have the non-official data where it's lot of competition. And then you have official data where one supplier has total 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.

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah, sure. First of all, I would say that it's important to remember as well that these investments are necessary to keep and make organic growth for our existing customer base as well. Having said that, I think the pipeline looking much, much more positive now than ever actually. I really feel that since, yeah, one and a half year ago, this has had happened a lot and the appetite for outsourcing has grown a lot. And you can also see that I don't think we have gone one single quarter since – yeah, Q1 2016 we were also having new signing. So I'm very positive for that part of the business.

Q

Okay. Thank you.

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

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Yes. Hi. And 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.

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

Yes. I will say we have [ph] to (00:21:37) large part of our staff cost increase and that's on the IT side, and there I think we still want to invest quite significantly over the next coming years and then you have, on the trading side where I start seeing that we getting very close to where we would see the cost slackening out. So I don't expect us to grow the cost on the trading side over the long term from very much end of this year.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

So 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 [indiscernible] (00:22:37).

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. I think that's the correct assumption.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

And still 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? Is it – how should we think about that? Isn't that something like 30% at least that is necessary to just [indiscernible] (00:23:27) the current profitability?

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

Yeah. I think [indiscernible] (00:23:32) the kind of pull through from operator revenue growth to a turnover growth [indiscernible] (00:23:36) revenue, yeah, I mean we've been running typically around 50% to 75% drop through. So, yeah, [indiscernible] (00:23:42) 20% looking at 30% to 40% growth I guess on operator turnover to beat that.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Yes. Okay. Thank you.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Thank you.

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

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Q

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, Kristian, you said that it's looking brighter than ever or it's looking better than ever? I missed that part. And why is that?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

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

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

That's 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 regulation is coming into effect and when the regulation is coming into effect.

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Q

Okay. Thank you. And 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?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I know for a fact that it was a very fierce competition. I think this was for, yeah, sure the highest price in Colombia. I'm 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.

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Q

Okay. And then just going on to your cost, you mentioned that from 2018 you'll have lower growth in cost. How much lower growth should we think of it's going to be? If you can just guide further on that.

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

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

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Q

Okay. All right. Well, no further questions for me at the moment. Yeah. Just looking at – sorry, just one last question, staff costs increased significantly sequentially going into Q3, Q4, should that go at the same rate or are we expecting somewhat lower growth in Q3 due to vacation or, yeah, how do we...

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

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

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Q

But I guess in terms of increasing the employee – 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...

David Kenyon

Chief Financial Officer, Kambi Group Plc

A

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

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

David, could you repeat that, the rate will...

Q

David Kenyon

Chief Financial Officer, Kambi Group Plc

Yeah. So, the recruitment rate will probably slow slightly during the summer and then pick up later in the year.

A

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

Okay. All right. And then going into 2018?

Q

David Kenyon

Chief Financial Officer, Kambi Group Plc

Yeah. As we said on the IT development side, we'll keep recruiting at the current rates and maybe on the trading side, that's where we'll slow down recruitment to some extent.

A

Sharish Aziz

Analyst, Danske Bank A/S (Sweden)

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

Q

Operator: And we have a follow-up question from the line of [indiscernible] (00:28:45 from Keel Capital. Please go ahead. Your line is now open.

Q

Hi again. On costs – sorry for repeating myself, but to which degree do you feel that – or is there room to invest more into automated process? Because looking at the head count, you're 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 process or how should we view that?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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 fees. But I think we see an end of where we actually feel that there is a big need and demand for an increased offerings. So, I think automation will probably, in the future, mean what we can, at least, level out the increase in our trading department.

A

Q

And then regarding Corredor, when do you intend to launch, go-live that play?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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

A

David Kenyon

Chief Financial Officer, Kambi Group Plc

Yeah.

A

Q

Okay, great. Thank you.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thank you.

A

Operator: As there are currently no further questions, I'll hand back to the speakers for closing comments.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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

Operator: This then concludes our conference call. Thank you all for attending. You may now disconnect your lines.

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