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Kambi Group Plc (KAMB.SE)

Q3 2017 Earnings Call

CORPORATE PARTICIPANTS

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

David Kenyon

Chief Financial Officer, Kambi Group Plc

OTHER PARTICIPANTS

Christian Hellman

Analyst, Nordea Bank AB

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Mathias Lundberg

Analyst, Skandinaviska Enskilda Banken AB

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Kambi Group Q3 Report 2017. Today, I'm pleased to present Kristian Nylén, CEO; and David Kenyon, CFO. For the first part of this call, all participants will be in listen-only mode and afterwards there will be a question-and-answer session. Speakers, please begin.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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 2. 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, [indiscernible] (00:56) quarter involves the completion of our strategic review. Following the 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 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, more so, which are, as I will discuss later outperforming the market. So let's look at the quarterly highlights on slide 4.

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% to 7%. Furthermore, we are pleased to see that revenues are on par with Q3 2016, despite very tough comparatives.

You may have seen [indiscernible] (02:49) this morning referenced an increase in Q4 trading margin year-to-date and we can confirm a very strong start to the fourth quarter for Kambi. We also signed a new customer in the shape of a 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. We have 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 Romania and Italy.

If you recall in Q2, we signed Colombia's Corredor Empresarial as the new customer. And in the coming weeks, its new BetPlay brand will go live into account this recently regulated market with the Kambi's Sportsbook.

And 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 with financial highlights, turning to slide 5.

David Kenyon

Chief Financial Officer, Kambi Group Plc

Thank you, Kristian. Good morning, everyone. In Q3, the trading margin was strong and above the long-term average at 7.5%. We've also seen growth of 16% and the turnover of our operators, despite the tough comparatives, which Kristian mentioned. Revenue for Q3 2017 was €14.8 million, operating costs of €13.7 million was slightly down quarter-on-quarter, as a result of seasonal factors. Operating profit for the quarter was €1.1 million, and our net cash position at the end of September was €24.9 million.

So, let's now look at the income into more detail, turning to slide 6. This slide sets out what we call the Kambi Turnover Index. The graph shows this trend are the results generated by Kambi for its operators. The turnover is the total stakes placed to the operators by their end users on Kambi's sports betting service.

In Q3, we've seen a reversal of the turnover placed through the operators we support, up 16% from Q3 last year. This was despite the Q3 last year containing the final matches of Euro 2016 tournament and the Olympics, which together contributed around 10% of that quarter's turnover. On the growth, we can see from the circled areas, that the operated turnover development from Q2 to Q3 this year, followed the seasonal trend we've seen every year. In Q2, the Copa América and the Confederations Cup amended the whole quarter, so 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%. It's in the nature of the business for the 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% to 7% and we're in this range for the year-to-date.

We can see the conversion from operator turnover growth to our revenue growth on slide 7. Sterling was weaker in Q3 2017 than in Q3 2016. The impact was to reduce the reports [indiscernible] (06:59) of transactions from end-users based in the U.K. After FX, operating turnover grew by 16%. The trading margin multiplied by the turnover generated the operator's gross gaming revenue. The trading margin of 7.5% was in line with that of Q3 last year. Overall, operating GGR increased by 16% year-on-year.

As far as 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 operating net gaming revenue which was 13%. The Belgium 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 operators 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 [ph] cost (08:15) for 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 a quarter with the biggest impact from the new contract due to the timing of the different tiers of revenue share in the previous contracts. These impacts will significantly diminish in future quarters. The net effect of all these factored is that revenue for Q3 2017 is in line with Q3 last year.

Let's turn to the full income statement on slide 8. Operating expenses for the third quarter were €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 and maximizing our long-term revenue potential. Overall in Q3, profit from operations is €1.1 million, compared to €3.1 million last year, and profit after tax is €0.8 million. compared to €2.7 million last year.

Now, let's look at the cash flow on slide 9. [indiscernible] (09:53) 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 €30.2 million. Capitalized development costs during the quarter were €1.7 million, whilst the amortization charge on previously capitalized costs was also €1.7 million. Working capital increased by €1.5 million due amongst other things to the timing of any invoice payments in certain operators. Our closing cash balance was €32.2 million.

Now, let me pass you back to Kristian, turning to slide 10.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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 hold strong positions in casino and lottery verticals. We expect to launch a Sportsbook from the National Lottery's 7777 brand during this quarter as a replacement to our existing sports betting products. 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, re-signing of current customers is equally important and share with the satisfaction and success our customers have with our Sportsbook. Importantly, these extension mean Kambi has over the few past 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. And in the coming days, Corredor Empresarial will launch its BetPlay brand in Colombia, along with its 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 distinct capability, our flexible, scalable model is the most efficient and effective method to remain the premium choice for the operators. Kambi has developed market leading Sportsbook core. We then open API managed layer of operator empowerment and also deployed a first version of price differentiation. These empowerment tools enables our customers to repackage the Sportsbook and develop new experience to meet their own individual strategies. This makes them more highly scalable and allows Kambi to focus on the continued development of the Sportsbook core to drive great turnover margin for our operators. It also gives Kambi and its operators opportunity to develop in pace with leading in-house of our operators.

Our model resembles that seen in other major industries, take for instance car manufacturing, as you can see on the image, Volkswagen [indiscernible] (14:30) about 60% of the cost of manufacturing a car set between the front wheel and gas pedal. They invested in a platform that could be used for various brands and models from superminis to SUVs. Currently, this platform is used for 60 models across four brands, Volkswagen, Audi, SEAT and Škoda.

Turning to slide 14. As mentioned earlier, we are proud that 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, we have Rank and LeoVegas. LeoVegas was also the highest climb of the year and Mr Green and Paf also placed well. It's also worth noting that Kambi's customers 32Red recently acquired by Kindred was ranked 22 in the Power 50 last year. We know our end-to-end supplier contributing more than one customer to the Power 50, Kambi can confidently say, it's a market leading provider of sports betting solutions.

So 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. And 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.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Christian Hellman from Nordea. Please go ahead. Your line is open.

Christian Hellman
Analyst, Nordea Bank AB

Q

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 costs being up quarter-over-quarter?

David Kenyon
Chief Financial Officer, Kambi Group Plc

A

Yeah, we said that we're expecting change to increase by 3% to 5% Q4 from Q3.

Christian Hellman
Analyst, Nordea Bank AB

Q

Yeah, okay, great. And then another question on the contract extension with LeoVegas. You signed with LeoVegas just last year, so it's not been that long since your first contract with them, why extend it already now?

Kristian Nylén
Chief Executive Officer, Kambi Group Plc

A

I don't want to get into too many details, but let's say it was not a very long contract, the first one.

Christian Hellman
Analyst, Nordea Bank AB

Q

Okay. That makes sense. I guess I assumed that it was longer than that what you're implying now. And another question on the 888 impact that you had in this quarter, it was 9% – shaved off 9% of your growth. You said it will – because of how the tiers were restructured during the year, it will come down significantly going forward. Could you give some more guidance on that, will 9% be, let's say, 4.5% in Q4 or what's significantly?

Kristian Nylén
Chief Executive Officer, Kambi Group Plc

A

Yeah, I'd say the Q4 impact will be probably just over half of what we're showing this quarter. So, yeah that maybe [ph] 5% (18:48) if you like, so yeah just over half. And that...

Christian Hellman
Analyst, Nordea Bank AB

Q

Okay. But...

Kristian Nylén
Chief Executive Officer, Kambi Group Plc

A

...if you can think and if you want.

Christian Hellman

Analyst, Nordea Bank AB

Q

And – and the even less in Q1?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Correct. Yeah.

Christian Hellman

Analyst, Nordea Bank AB

Q

But in Q1, how will that work, because didn't you take charges for Q1 or those charges down in Q2 or will you restate Q1 or how will that work?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

It is – if that sales happened in Q2, so the last year-on-year impact you will see will be in Q1 and then it will disappear entirely in the year-on-year analysis.

Christian Hellman

Analyst, Nordea Bank AB

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah.

Christian Hellman

Analyst, Nordea Bank AB

Q

...what it will be in Q4?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Correct. Yeah.

Christian Hellman

Analyst, Nordea Bank AB

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

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

Christian Hellman

Analyst, Nordea Bank AB

Q

Okay. Thanks. Thanks. And 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 and since then you've signed with the Bulgarian National Lottery. And yeah, what's your feeling right now?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah, [indiscernible] (20:38) the same feeling, it feels very, very solid at the moment.

Christian Hellman

Analyst, Nordea Bank AB

Q

Okay. Fair enough. Thanks. That was it from me.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Thank you.

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

Mathias Lundberg

Analyst, Skandinaviska Enskilda Banken AB

Q

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 some price reduction and that the new contract is for a longer period than the last contracts?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

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 other contracts. But I can't tell you this that it's different in the timing of signing. So, I think the later one was probably more in line with where we thought the market should be.

Mathias Lundberg

Analyst, Skandinaviska Enskilda Banken AB

Q

Okay. Thank you. And I think – I'm thinking a bit about the effect of commission tiers on your revenue bridge from operator turnover to Kambi revenue growth report in the other segment in that growth, is that effect the largest in the end of the year and it's more or less in the beginning or how should we think there?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

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

Mathias Lundberg

Analyst, Skandinaviska Enskilda Banken AB

Q

Great. Thank you for clarifying. And then I have a third question, I noticed that [indiscernible] (23:10) 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? Thank you.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. I mean we are not a supplier of [indiscernible] (23:30) It's not our business model. We are an end-to-end supplier. So this is not at all in line with our business model. So, I can't comment on who is answering on that tender. But it's surely not us.

Mathias Lundberg

Analyst, Skandinaviska Enskilda Banken AB

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Thank you.

Operator: Thank you. [Operator Instructions] And our next question comes from the line of Rasmus Engberg from Handelsbanken. Please go ahead. Your line is open.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I can't comment on that. And – I mean obviously, we hope that it will happen well in advance of the end of 2018, but I can't comment on it, and on what impact it will have, I can't comment on either.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Okay. Thanks. I think in the previous con-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 all towards the end of this year?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I mean, we don't see the first time we forecast OpEx. I mean this – when we hit those targets, there will be a 16% growth in OpEx 2017 versus 2016. So, I mean it's a fair working assumption for the years ahead.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Is that for 2018 I mean, sorry?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. I mean that 16% is on this year, but you can add that...

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Okay.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

...the total will going to be give or take...

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

Correct. Right.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

...what will be next year.

Rasmus Engberg

Analyst, Svenska Handelsbanken AB

Q

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

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Okay.

Operator: Thank you. And as there are no further questions at this time, I will hand back to you speakers.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

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

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