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Kambi Group Plc (KAMBI.SE)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Kambi Group Q4 Report 2019. 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 a 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 fourth quarter results presentation. Please turn to slide 2. Today, I'm going to give a brief look at 2019 as a whole, before focusing on Q4, after which, David will take you through the financial performance. I will then speak about the quarter in more detail.

But first, on slide 3, let me give you a brief introduction to Kambi. Kambi is the industry's trusted and independent sports betting supplier. Our multi-channel service is managed through an in-house developed platform, which has been continuously developed over the last decade. The platform, together with more than 850 skilled staff, forms the foundation of our service.

The Kambi Sportsbook consists of multiple elements from front-end user interface and open APIs, through to orders compiling, customer intelligence and risk management, enabling our customers to offer their players the leading sportsbook experience on the market from day one.

On to slide 4. Kambi's business is built up on a revenue share model, with our group linked to our partners' success. The foundation of our strategy is based on scalability, and the majority of our cost base is fixed. At no additional cost to our partners, Kambi continuously invest in products, people, and technology to maintain market leadership. We operate on an experienced in-house trading and risk management team to optimize operate the trading margin, and our business is underpinned by our corporate probity and integrity. We have successfully obtained all licenses we have applied for.

All of these combined, enable us to offer operators the flexibility and scalability required to succeed in today's highly regulated and global market. Our technology has been structured in a way that enables Kambi and its partners to quickly and efficiently comply with regulatory requirements, removing a major barrier to market and allowing them to enter new markets as and when they require.

In total, we power more than 20 operators across six continents, including some of the most recognizable and successful brands in the industry. Together, they create a powerful network of operators. This model enables Kambi to, for instance, aggregate and analyze all data produced across the network, which guides and informs our product development. The network effect also contributes to trading and risk management, with our global coverage feeding into the delivery of sharper and more accurate prices.

In essence, Kambi is a trusted partner behind leading sports betting brands, providing them with everything they need to become a success. This sentiment has been captured in our new in-house developed marketing campaign and brand video. I'd like to play the video for you now. Turning to slide 5.

[Video Presentation] (00:04:03-00:05:39)

Before we get into Q4, let's take a quick look at the highlights of 2019 on slide 6. We signed six new partners, including Penn National Gaming and expanded into multiple new markets, including five US states. As part of this expansion, we created markets first in Pennsylvania, New York, Indiana and New Hampshire. And of course, we continue to invest in product to ensure we provide our partners with the best sportsbook product on the market.

Our success was reflected in the EGR Power 50 list which runs the industry's most powerful and influential operators in the world. A record 11 Kambi partners featured in the list, underlying the Kambi's position as a trusted partner of choice to Tier 1 operators.

Turn to slide 7. Now, on to Q4. We posted revenues of €27.7 million, a 23% year-on-year increase. Q4 operator turnover continued the moment we saw in Q3 and grew 52% at an operator trading margin of 7.4%. For the full year, operator turnover increased by 37%, revenues increased by 21% and profits by 16%, meaning we ended the year with an even stronger balance sheet.

We signed a new customer in Seneca Gaming Corp. who I will speak about in more detail later. And we also continued our impressive rate of partner rollout. In total, we launched across five different states in the US in Q4, including eight retail launches and taking the first legal online sports bet in both New Hampshire and Indiana. We also launched on-property in South Africa for the first time with Sun International. Later, I will touch on our activities so far in Q1, which includes more partner launches.

For now, I'll hand over to David who will talk you through the financial highlights, turning to slide 8.

David Richard Kenyon

Chief Financial Officer, Kambi Group Plc

Thank you, Kristian. Good morning, everyone. In Q4, we had revenue of €26.7 million, up 23% from last year. For the full year, revenue was €92.3 million, up by 21%. Operating costs for the quarter were €20.5 million, giving an operating profit of €6.2 million, or 23%. For the full year, operating costs were €77.6 million and operating profit was €14.7 million, at 16%.

Our cash flow for the quarter, excluding working capital movements, was €4.4 million and €8.6 million for the full year. The net cash position at the end of December was €37.7 million.

So let's now look at the income in more detail, turning to slide 9. This slide sets out the Kambi Turnover Index. The graph shows the aggregated results of Kambi's operators. The turnover is the total stakes placed with the operators by their end users. In Q4, operator turnover was up by 52% from Q4 last year, including underlying growth from our existing operators and from new operators in the US and Sweden in particular. Q4 also benefits from a busy sporting calendar, including the major European football leagues and most of the NFL season.

The margin represents a combined trading margin made by the operators. In Q4, this margin was 7.4%. The operator trading margin fluctuates in the short-term due to the outcome of sports events with the highest betting volumes and value. We have altered our operator trading guidance, the one which was previously based on more general long-term expectation, the one which focuses on the coming 12 month period, based on the company's latest commercial outlook. On this basis for the coming 12 months, we expect the margin in the range of 7% to 8%.

For the first time, we have disclosed a geographical breakdown of where our operator's revenues are generated, as shown on slide 10. We've seen a clear development to the Americas region over the last 18 months, driven by the opening of the US market and the growth of our Central and South American operators. In Q4 2019, 61% of our operator's revenue was from Europe, 37% from the Americas, and only 2% from the rest of the world.

We can see the conversion from operator turnover growth to our revenue growth on slide 11. Operator turnover was up by 52% compared to Q4 2018. The operator trading margin multiplied by the turnover generates the operators' gross gaming revenue, or GGR. The operator trading margin of 7.4% compares to the 8.5% we saw last year. Overall, this led to an operator GGR increase of 32% year-on-year.

Kambi's commission is based on a percentage of the operator's net gaming revenue, which is after the deduction of gaming tax, certain marketing incentives. The tax impact has increased significantly, reflecting the increase in the part of our business coming from locally regulated markets. In total, 78% of our revenues came from locally regulated markets compared to 56% last year.

The impact of the fixed part of our revenues and certain volume-related commission tiers is shown in the other column of the graph. This quarter we've seen the effect from the increased revenues from live events packages, which are fixed and not directly linked to the turnover growth. The net effect of all these factors is our revenue for Q4 2019 is up by 23% from Q4 last year to €26.7 million.

Let's turn to the full income statement on slide 12. Operating expenses for the fourth quarter were €20.5 million. We continued to invest in building the market leading sportsbook as well as the ongoing licensing development of our commercial operations in the US. Our office in Philadelphia which we set up to strengthen our existing US offering, now has around 30 staff handling some of the trading and risk management on US sports, local customer support, and some of the technical development for the US market. For the full year 2020, as we look to capitalize on the commercial opportunities we see ahead of us, we anticipate growth in operating expenditure of 14% to 18%.

Operating profit were €6.2 million for Q4 compared to €4.2 million last year. Operating profit for the full year was €14.7 million, up from €12.7 million last year. In the quarter, we recognized a one-off impairment charge of €0.5 million to fully write-off the investment in Midia Holding Limited. After accounting for this exceptional item, profits after tax is €4.6 million for the quarter and €10.4 million for the full year.

Now let's look at the cash flow on slide 13. Set out on this slide are the major components, which impacted our cash position during the quarter. Our opening cash balance was €41.5 million. Capitalized development costs in the quarter were €4.1 million, whilst the amortization on previously capitalized costs was €2.7 million. Our trade receivables increased by €2.3 million, reflecting the increase in the amount invoiced to operators. There was an inflow of €2.3 million in relation to proceeds from share options exercised in Q4. The net cash inflow for the quarter was €3.5 million and our closing cash balance was €45 million. Our balance sheet is in very healthy position, giving us commercial and strategic flexibility for the future.

So, now, let me pass it back to Kristian, turning to slide 14.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thanks, David. In late December, our partner, DraftKings, announced it had agreed to acquire SBTech, although we expect no impact on our revenues until at least December 2020. While I remain of a view DraftKings would be better served by Kambi, we are firmly focused on the future, which I believe is very bright. Firstly, we have a fantastic set of partners, many of whom are just beginning their sports betting growth story and have a great potential to win market share. Indeed, some partners such as JACK and Mohegan Sun, casino market leader in their respective states, have yet to launch but we are hopeful both Ohio and Connecticut will regulate shortly. In addition, we are partnered with some of the leading gaming operators in states such as Illinois and Michigan, which we are hopeful will open in late Q1 or Q2.

I'm also confident that Kambi as an independent company with a great product will become even more attractive to prospective partners. I know firsthand that the supplier being tied to an operator makes things that much more difficult. It can restrict the actions you would take. For example, our US investment and expansion was made possible due to us being able to take the decision independently. That's one of a few pure B2B sports betting suppliers in the industry, one with an arrival track record of delivery. We are without a doubt the sports betting partner operators can trust.

To give you some idea of the size of our US partners other than DraftKings, when considering the US GGR is generated by our network in Q4, 40% to 50% of the total was derived by our other operators. We have laid out in the report how we arrived at that figure.

Turning to slide 15. Trust was one of the key reasons we were able to partner with Seneca Gaming Corp in Q4. Seneca Gaming is operated by one of the most respected tribes in the US, Seneca Nations of Indians. The US tribal community is one that places great emphasis on trusted long-term relationships. So, I'm delighted they selected Kambi as a sports betting partner.

Seneca owns three casinos in the State of New York, and despite only having signed with us in November, Seneca's three casinos were up and running with Kambi Sportsbook in December. This once again underlines our great record in getting partners to market quickly and with high quality product. This speed is unmatched anywhere else in the market. And this is another competitive advantage we have.

Of course, we continue to wait for online regulation in New York, but are now even better positioned for when this does occur. The partnership also strengthens our appeal within the tribal community. A large target segment in the US, with us having also signed Mohegan Gaming & Entertainment in 2019.

Moving to slide 16. In addition to US launches, we continue to make progress in other markets too. The headline from the quarter was our retail debut in South Africa with Sun International. Sun International is the largest gaming and entertainment company in the country, having already launched online with Sun in 2018. In November, we added a retail sportsbook, launching at its Grand West Casino in Cape Town. We have 40% share of a land-based casino market in South Africa. Sun International plans to launch a Kambi Sportsbook in more of its properties in the future.

Now to slide 17. As David set out earlier, much of our recent growth has been derived from the US, where American football is the number one sport and NFL the top league. When we launched in 2018, Kambi had a good NFL product, one of the best in the market. However, as we set out in the Q2 report, we knew we had to raise the bar higher to ensure the end user receive the best experience as possible.

The work our teams put in to develop the product pay dividends during the recent NFL season. Much of the work went into improving the live trading model, in order to enhance the in-play experience. Due to its speed, skill and complexity involved in offering live [indiscernible] (00:20:13), the quality of an in-play product often separates a good sportsbook from an excellent sportsbook.

A few examples of the strides we've made last season, include significantly improving the availability of a main bet offers in-play. Availability is key. If a market is not available, then end user can't bet and therefore receive a poor u-ex.

The availability on main markets increased from 60% to 90%, enabling our partners to increase their in-play turnover. We also increased availability of cash out, which saw an uplifting in usage of 300% during the season, while our in-play delay times were reduced to a market-leading level. Our research shows that if Kambi had applied a similar in-play delay to those used by some of our main competitors, approximately a third of the in-play bets would have been rejected due to price changes.

As a result of these developments and more, Kambi's NFL revenues increased significantly during Q4 to the extent where it overtook both NBA and the English football leagues to become the number one revenue driver. Kambi's in-play excellence has been key to this and we've continue to improve the products over ahead of the coming season.

And finally with Super Bowl last weekend attracted more than three times higher turnover than the World Cup Final in 2018.

Turn to slide 18. Momentum has continued into Q1, having already launched two on-property sportsbooks with Penn National Gaming, one in West Virginia and one just yesterday in Mississippi, taking the total of on-property launches we've done to seven in as many months. Between those launches, we also have a very successful ice exhibition, which is one of the biggest gaming shows of the year. But the interest in Kambi was as high as ever and we look forward to building on some of the conversations we had during the week.

Turning to slide 19. Some of you may have seen the news last month that Kambi's partner Penn National Gaming had acquired the stake in US multimedia company, Barstool Sports. The investment will give Penn National a very recognizable brand to leverage, not only for its mobile sportsbook due to launch in Q3, but also to drive traffic to its own property books.

Barstool is an edgy brand that connects well with a younger adult demographic, a demographic which has taken quickly to mobile sports betting. Across its media assets, it has 66 million unique monthly users which Barstool

will exclusively promote the Barstool's sportsbook too. Its [ph] podcast (00:23:42) alone attract almost 10 million listeners, including one called, Pardon My Take, which is the top of the US charts. We're excited by our partnership with Penn National and look forward to more on-property launches ahead of a mobile launch later in the year.

Turning to slide 20. In summary, we ended the year in great financial shape led by a 52% year-on-year increase in operator turnover growth in Q4, and 48% increase in operating profits. We also ended the year as the only independent, proven and fully-managed sports betting supplier in the industry, having delivered for our partners time and again throughout the year. We are well-positioned for a great 2020, where we hope to make the most of our partners' untapped potential.

For example, Jack and Mohegan have yet to launch. The Penn National and Barstool Sports betting app is scheduled to be live in Q3, while further regulation will open the door for more states and countries for our operators to enter, such as Illinois and Michigan.

Now, I'll pass over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Christian Hellman from Nordea. Please go ahead, your line is now open.

Christian Hellman

Analyst, Nordea Bank ABP

Q

Hi. Thank you very much. A question on the partners that you haven't launched at the US, you mentioned JACK [indiscernible] (00:25:45). What is timeline for those launches, give us some idea to talk in first couple of quarters of this year or later during this year or...

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. That's a tricky thing. I mean, it's all about regulation here. And it's hard to know when that will happen. I mean, it's easier with states where actually a regulation has passed which is not the case in either Ohio or Connecticut. So, we are hopeful that something will happen during the spring but we will, yeah, have opportunity to get them up and running during the year. But I can't tell you when.

Christian Hellman

Analyst, Nordea Bank ABP

Q

Right. But what is the progress of legislation in those states at the moment? What's your – the best guess?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I mean, Connecticut, we had high hopes for last year as well and then it was halted. So, Christian, it's impossible for me to say. But, I mean, it is progress happening, Ohio even more so at the moment, I would say.

Christian Hellman

Analyst, Nordea Bank ABP

Q

Okay. Okay. And then you mentioned that now with SBTech being sort of – well, at least it's not any independent sports book anymore and what can you do in the future if they will offer B2B or not. But, what do think the opportunities are? You mentioned it just briefly, but can you elaborate a bit more on what you think your sort of opportunities will be in the future as SB takes on, becomes less of a competitor to you. And perhaps if you already had some initial conversations perhaps with the clients that could be thinking of moving over?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. I can't really comment very much on the potential prospects as you know. But of course, I mean, we were in the situation between 2010 and 2014, where we were owned by Kindred. And it was a significant change for us when we were listed in 2014, in the way we could talk to prospects and the trust they could have in us being an independent supplier. So, I definitely foresee that it will be a much tougher proposition for SBTech going forward.

Christian Hellman

Analyst, Nordea Bank ABP

Q

Yeah. It sounds reasonable. And then just another question. Perhaps it's one for the board a bit as well, but on your cash position and sort of what's the thinking strategically with your balance sheet?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. As I said before, I think – first of all, I mean, so for us to win customers, we will need to have a strong balance sheet. And the larger we become, that balance sheet needs to match that as well. So it's a natural growth vary in what we need for everyone to feel safe. Having said that and I have communicated this before, I think as well, I mean, there come a time where, either we need to find a way to invest money in M&A, or we have to start looking at the dividend policy.

Christian Hellman

Analyst, Nordea Bank ABP

Q

Will it make sense to sort of move into other front-loaded [indiscernible] 00:29:50 slots, for example, so delivers on your customer base? Then there are some other examples of that in the industry where you have sort of mostly product suppliers?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I think – I mean, if you look in the industry, I mean, truly great products and successful companies, I think, are very, very focused on what they're doing. And I don't really believe that us going in to do our verticals would be a benefit for either us or our operators for the future. So, unless it's something that is highly tied to our existing technology or highly complementary, I don't foresee us going into our other verticals.

Christian Hellman

Analyst, Nordea Bank ABP

Q

Makes sense. Stick to what you know best. Thank you very much. That was it from me.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thank you.

A

Operator: Thank you. And our next question comes from the line of Viktor Högberg from Danske Bank. Please go ahead. Your line is now open.

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

Hi. Good morning. So, could you specify how much South/Central America was in the Americas in the geographical split that you've provided? I'm trying to learn what the US is amounting to?

Q

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Yeah. I mean, I won't give you an exact figure. But I think, we can give you, yeah, a rough figure. And I think, roughly a quarter of the revenue is coming from Latin America.

A

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

Okay. Well, it's actually more than I expected. So, could you say something about the sports you're coming up and the seasonality and what to expect in terms of turnover growth, and taking into account the comparative numbers here in 2019. Could you say something about what to expect in terms of turnover for this year.

Q

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Sure. So, I think, Q1 is normally a very, very good quarter. Of course, the football season is over after Super Bowl last weekend. Q2, World Cup year is normally a very, very strong. So that should be very nice. Q3 will be by fair margin, but the worst quarter. I think this year actually the European Championships is still moving more in the live and normally. So not that bad seasonality as usual probably. And then, of course, Q4 is again, by far the strongest quarter.

A

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

Okay. And so, when I put out the revenues from the geographical split that you provided, it seems like Europe has been flat the past two years. And in 2019, I can understand that with [indiscernible] (00:33:27) and Sweden, my guess this should turn up again in 2020. But it seems like all of the growth has come from the US, would that be a fair assumption?

Q

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Yeah. That's against the rest of the Americas region, but yeah, certainly, that's been the bulk of the growth is from that general region, yeah.

A

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

Q

Okay. Thank you. That's it from me.

Operator: Thank you. [Operator Instructions] And since we have no more questions registered, I now hand back to our speakers for any closing comments.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thank you for your questions and for listening in. We look forward to updating you on the 2nd of April, 2020, when we publish our first quarter report for 2020.

Operator: This now concludes our conference. Thank you, all, for attending and you may now disconnect.

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