

24-Apr-2020

Kambi Group Plc (KAMBI.SE)

Q1 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Kambi Group Q1 Report 2020. 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 first quarter result presentation. Please turn to slide 2. I'll begin with a brief overview of Q1. After which, David will take you through our financial performance. I will then speak about the quarter in a little bit more depth including our response to the pandemic.

But first on slide 3, let me give you a brief introduction to Kambi. Kambi is 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. That platform together with more than 850 highly skilled staff, forms the foundation of our service.

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

Onto slide 4. Kambi's business is built up on revenue share model, [ph] with our growth (00:01:48) linked to our partners' success. The foundation of our study is based on scalability. We've no additional costs to our partners, Kambi continuously invest in product, people, and technology to maintain market leadership. We operate an experienced in-house trading and risk management team to optimize, operate the trading margin. And our business is underpinned by our corporate's probity and integrity. And we have successfully obtained all licenses we have applied for. All of these combined enable us to offer our partners 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 requirement, removing a major barrier to market and allowing them to enter new markets as and when they require.

Kambi is the trusted partner to 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 which combined to generate powerful data insights that we use to inform and continuously trade our product and services.

Let's look at the Q1 highlights on slide 5. Despite the absence of many sports and leagues, in the second half of March, we still managed to post a strong Q1 performance which operated – we've operator turnover up 27% year-on-year at a trading margin on 9.3%. This led to Kambi revenue of €27.9 million, an increase of 33%.

Without the impact of the coronavirus on the sporting calendar, I'm confident we would have been looking at another record quarter of performance. We've operator Turnover Index in the region of 600.

To give you some idea of our momentum, average daily operator turnover for the quarter up to the 12th of March when the sports began to be impacted was up 47% year-on-year and 7% sequentially. And that means we were at very high margin, which suppressed the turnover.

Our business continue to grow from [indiscernible] (00:04:47). During the quarter, we processed the first legal sports betting with states of Illinois and Michigan, clocking up our 10th US state in the process. Our fantastic record in the US often goes under radar. But we have proven ourselves to be the partner, to be trusted online and on property. And I'll give you some more color on these later.

Added to these, in the event of the Q1, the combination of DraftKings and SBTech received shareholder approval yesterday. We don't really have anything to add at this point, only to say Kambi remains well-positioned for a long-term growth and we will continue to serve DraftKings with the same technology and services that has enabled it to take a leading position in multiple US states.

For now, I will hand over to David who will talk you through the financial highlights. Turning to slide 6.

David Richard Kenyon

Chief Financial Officer, Kambi Group Plc

Thank you, Kristian. Good morning, everyone. In Q1, we had revenue of €27.9 million, up 33% on last year. Operating costs for the quarter were €21.1 million giving an operating profit of €6.8 million or 25%. The cash flow for the quarter excluding working capital movements was plus €4.1 million. The net cash position at the end of March was €39 million.

Let's look at the income in more detail. Turning to slide 7. 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 Q1, operator turnover was up by 27% on Q1 last year. Until the 12th of March, when the impacts of COVID-19 on the sporting calendar took most effect, the average daily operator turnover was actually up by 47%, compared to equivalent period in Q1 2019 before falling significantly in the last few weeks of the quarter. The margin represents the combined trading margin made by the operators. In Q1, this margin was 9.3%, buoyed by favorable results in some of the major European football leagues. It's worth noting that this high margin is also likely to have suppressed the level of turnover in the quarter.

You can see the conversion from operator turnover growth to our revenue growth on slide 8. Operator turnover was up by 27% compared to Q1 2019. The operator trading margin multiplied by the turnover generates the operators' gross gaming revenue or GGR. The operator trading margin of 9.3% compared to the 7.8% we saw last year, overall has led to an operator GGR increase of 51% 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 and certain marketing incentives. This tax impact has increased reflecting the increase in the parts of our business coming from locally regulated markets, in particular, the US. In total, 79% of our revenues came in from locally regulated markets, compared to 71% last year.

The impacts of the fixed part of our revenues and certain volume-related commissions tiers is shown in the other column of the graph. This quarter we've seen the effects from the significant increased level of operator NGR which has reduced the effects of commission rates charged to our operators due to the tiered structures in some contracts. The net effects of [ph] all these factors is (00:08:58) revenue for Q1 2020 is up by 33% on Q1 last year to €27.9 million.

Let's turn to the full income statement on slide 9. Operating expenses for the first quarter were €21.1 million. We continue to invest in building a market-leading sportsbook, as well as the ongoing licensing and development of our commercial operations in the US. Operating profit were €6.8 million for Q1, compared to €2.6 million last year.

In accordance with IFRS 9, we recognized a one-off bad debt expense of €0.6 million to fully writes off the amounts owed by National Lottery AD in Bulgaria. This operating license was suspended in Q1. After accounting for this exceptional item, profit after tax was €4.8 million for the quarter.

Now, let's turn to the cash flow on slide 10. [indiscernible] (00:10:07) this slide are major components, which impacted our cash position during the quarter. Our opening cash balance was €45 million. Capitalized development costs in the quarter were €4.7 million, whilst the amortization charge on previously capitalized costs was €2.9 million.

Our trade receivables increased by €3.3 million, reflecting the increase in the amounts invoiced to operators following particularly strong revenues in February. Most of these February invoices have subsequently been settled in April. The net cash inflow for the quarter was €1.3 million, and our closing cash balance was €46.3 million.

With this very healthy balance sheet in mind, let's consider our financial situation in the current environment, turning to slide 11. The sporting calendar has been severely impacted by COVID-19 since mid-March. We've seen a level of sporting activity driving operator turnover of 25% to 30% from where it was earlier in Q1. As soon as the impacts on our revenues became clear, we implemented a comprehensive cost saving program, resulting in savings across the whole business, including significantly reduced travel and marketing costs, freeze on staff recruitments, and a substantial reduction in pass-through data costs due to fewer sporting events.

We also applied for the financial support packages announced by the Swedish and UK governments. As a result, total expenses are anticipated to decrease during Q2 by 20% to 25%, compared to Q1. With capitalized development costs falling by 20% to 30% and remaining at similar levels whilst the current situation continues. Once the sporting calendar resumes and restrictions are lifted, the business will be able to ramp up instantly to ensure that full offering is available from day one with the associated costs.

In the unlikely event that the sporting calendar that does not increase from its current level, and based on the cost saving measures taken so far, we would expect the average quarterly cash outflow to be in the range of €7 million to €9 million. Although we anticipate the figure in Q2 to be significantly more favorable for Kambi due to the working capital movements I mentioned previously.

With our strong balance sheet and the cost savings we've been able to implement, we believe we are very well placed to weather the current storm and immediately gear up to normal levels of activity as soon as sports resume.

So now, let me pass it out to Kristian, turning to slide 12.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Thanks, David. Although the whole industry is going through a tough period at the moment, we certainly see the light at the end of the tunnel, and there are many reasons to feel positive about the future. The sporting calendar will [indiscernible] (00:13:30) and many postponed events may be rescheduled for a later date potentially creating a busiest sporting calendar than usual.

We have also seen increased appetite from regulators to consider, and in some cases, expedite online regulation. Many restrictions have seen the retail sector badly impacted, and therefore, the prospect of online betting has moved up the agenda. Pure retail businesses are also taking more interest in the potential of online. So we expect to see increased regulatory movement over the next 12 months, which, of course, we welcome.

I also believe the current challenging period will remind people of the benefits of outsourcing. The costs associated with running, maintaining and continuously developing a high-quality sportsbook continue to rise and are only sustainable for a few companies that could possess sufficient scale. Therefore, the situation may well prompt those operating a sportsbook without that scale to think carefully about the pros and cons.

Turning to slide 13. As I mentioned previously, the quarter began very well for us, both in terms of the numbers and how we continue to increase our footprint in the United States. In January, we launched in West Virginia with Penn National. In February, we launched five retail sportsbooks in Mississippi also with Penn. And in March, just before coronavirus took effect, we took the first legal sports bet in the states of Illinois and Michigan with Rush Street and Penn National, respectively. We also launched with Penn in Illinois.

These are two large and important states, both with passion for sports. So we look forward to seeing how business develops. We have many more launches in the pipeline and are looking forward to completing these as soon as it's safe to do so.

Our record of delivering in the US is unmatched, as I will show you on slide 14. There can be no doubt Kambi has been setting the pace in the US. We are active in more states than any other end-to-end sports betting supplier. As you can see on the map, we are now active in 10 states, with Colorado to follow shortly. Within these states, we are online everywhere it is currently possible to be and operate more than 30 on-property sportsbooks with approximately 600 betting kiosks in operation.

Since our first US retail launch in Q4 2018, we have been opening retail sportsbook at a rate of around five per quarter. And among these 10 states, we have created eight markets for us through a mixture of first legal bets and first legal online bets, including taking the first legal online bet in the US post-PASPA. This speaks to our operational excellence and reliability to deliver for multiple partners simultaneously. It also reaffirms our strength

in regulatory compliance and corporate probity, which enables us to get license quickly, not only is Kambi the trusted partners for operators, but we are highly trusted by regulators, too.

Moving to slide 15. Due to the impact on sports, we have had to be flexible to ensure we continue to provide a good service to our customers. On this index graph, you can see the change in which sports have been driving turnover. The impact on sports and our turnover really began to take effect on March 13 at which point football and a collection of other sports were generating almost all turnover.

However, as these leagues and sports were gradually postponed, you can see our focus shifted to table tennis and eSports, which by the end of the quarter were responsible for a large proportion of the turnover. You can also see from 16th onwards, our turnover remained relatively stable for the rest of the month, which highlights the great work we've done to provide a good service to our partners and their players during this time. Since the end of the quarter, we have also seen darts emerge as a key contributor to turnover.

Turning to slide 16. We see some positive signs that some leagues and tours could return without spectators. While a small number of European football leagues have been cut short, the German league is expected to return behind closed doors within a matter of weeks with May 9, the current target date. All eyes will be on how we handle this. And if successful, you could see many other football leagues following their footsteps. For example, the English Premier League plans to finish its season before the end of July, potentially with some games screened on a free-to-air. Elsewhere, the PGA recently announced its tour would resume in June, and plans are in progress to get the Major League Baseball season underway as soon as possible. So there is certainly some cause for optimism.

Turn to slide 17. So in summary, Q1 saw Kambi begin the year in the same fashion as we ended the last, with a strong financial performance. Without the impact of the pandemic, it would have been yet another record quarter. Meanwhile, we have taken steps, we think, leads us in a very good position for when sports do return, reducing costs while protecting staff and the long-term interest of the business.

Of course, things are not ideal right now. But we're in a good financial shape and [indiscernible] (00:20:40) more partner launches, we have a lot to look forward to as we look to regain the momentum shown recently.

Now I will pass over to the operator for questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Viktor Högberg from Danske Bank. Please go ahead.

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

Q

Hey, good morning. So I have a question on – you said the end of March or April revenues were [ph] 25% to 30% in Q1 (00:21:20). We saw the development here in end of March, at least, with Ping-Pong. Could you elaborate the trajectory during April versus March? Have you seen the same levels in the beginning of April as you saw in the last two weeks of March or could you elaborate a bit on that?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yes. As I said from March 16 and up until now, more or less, we have seen quite stable turnover figures throughout the period. I think we have seen a little bit different mix in sports. As I said, the Dutch has become more of a popular sports than it's – yeah, it didn't really exist in the first couple of weeks of this pandemic. But that was down a little bit. We have lost a few [indiscernible] (00:22:16) on the other hand. So it's kind of stable at the moment. And I expect it to be so until we see some major development on some big leagues.

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

Q

Okay. Can you say something about the margins for the sports events that you are currently having odds on? Is there anything special to note there?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

No. We haven't – I don't really want to glide on the margin. It's very early into the quarter as well. But [indiscernible] (00:22:57) more live betting proportionately than it was before. So on that reason, we would expect a slightly lower margin.

Viktor Högberg

Analyst, Danske Bank A/S (Sweden)

(

Okay. And in the report you said that in the event of – events not returning, you see costs down 5% to 10% year-over-year in 2020. And I assume that would be in the worst case scenario. So what is the base case for cost development? You've guided for Q2. But should we expect flat costs for 2020 over 2019 if we would have Bundesliga returning in May and the events that you mentioned if that materializes? Is flat OpEx or OpEx up, OpEx down? What do you expect for base case for this year?

David Richard Kenyon

Chief Financial Officer, Kambi Group Plc

A

It's David here. I think we really have to play that one by ear as and when we get some facts about when things are coming back. We know what OpEx would have been if this hadn't happened. We know what OpEx will be

given the current assumptions. So I think anything else is just pure speculation. So I think we just need to wait till we see some resumption and then we can give some further guidance gotten at that point.

Viktor Högborg

Analyst, Danske Bank A/S (Sweden)

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

Operator: And the next question comes from the line of Marlon Värnik from Pareto Securities. Please go ahead.

Marlon Värnik

Analyst, Pareto Securities AB

Hi. Good morning. Marlon here. Question regarding the market, you mentioned in the report that America share of the group revenue is 37%. What part of the America is the US revenue?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

We didn't really guide on that that much last time, but it is still the same as in Q1. Majority is coming from the US, but we have a strong foothold in Latin America and especially Colombia as well. So that's a large chunk of the revenues well.

Marlon Värnik

Analyst, Pareto Securities AB

Okay. And you mentioned also in the Q4 report the DraftKings of the US figure is roughly [ph] 60%. (00:25:15) What was the number for Q1?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

Yeah. So roughly the same ballpark.

Marlon Värnik

Analyst, Pareto Securities AB

All right. And regarding coronavirus and the legalization process in US sportsbetting, have you noticed any impacts from coronavirus in terms the legalization process in sportsbetting in the US? If it's less prioritized or more given the tax revenue income?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

I think we hear voices that it's becoming higher up on the agenda. We have already seen a few states actually are talking about it. But, at the same time, I will say, with the current situation, the regulators are also working [indiscernible] (00:26:07) first, of course, it is to run with the day-to-day business. So I think you will see some states expedite before the end of the summer. But so far, I can't give you any concrete examples. [indiscernible] (00:26:34).

Marlon Värnik

Analyst, Pareto Securities AB

All right. And as you mentioned already, yesterday [indiscernible] (00:26:38) technology was approved by the shareholders. Given the severe cybersecurity attack on [indiscernible] (00:26:45) a few weeks ago, can we expect or is it reasonable to assume some delay in the timeline of integration of DraftKings. Can you give a comment here, please?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I mean it's probably something you should ask DraftKings rather than us, to be honest. So, I can't really comment on that.

Marlon Värnik

Analyst, Pareto Securities AB

Q

All right. And the last question regarding the competition in the markets, I mean that one is now having a B2B offering and Pinnacle Sports, probably one of the sportsbooks with most [indiscernible] (00:27:30) B2B solution about 1 and 1.5 year ago. What can you say of the competition in the market? How are you dealing with it now and going forward?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

I think if anything, I mean, the very examples you mentioned, it will probably take some time before they can be considered a competitor to us. On the other hand and more importantly, I would expect SBTech's competitiveness to be severely weakened by being owned by DraftKings. So, if anything, I will say it looks more positive now than it has done historically.

Marlon Värnik

Analyst, Pareto Securities AB

Q

Right. So, you would say that Pinnacle Sports B2B solution is not fully ready for the market. That's what I've heard, that they have quite few clients earlier and quite good flexibility in the offering.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yes. I can't tell you. I haven't seen them in any of the competitive bids where we have been involved so far.

Marlon Värnik

Analyst, Pareto Securities AB

Q

All right. All right. Thank you.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Welcome, Marlon.

Operator: And the next question comes from the line of Erik Moberg from ABG. Please go ahead.

Erik Moberg

Analyst, ABG Sundal Collier AB

Q

Hi, guys. If some of the soccer leagues were to start up again in late May, beginning of June such as Bundesliga and Premier League, how much ballpark numbers do you think that this would add to the current sportsbook activity?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

To be honest, Erik, it's impossible to say. I mean, as you can see on how big table tennis become from being virtually nothing for us. Yeah, yes, I think a few big leagues it can be enormously big. But you need some frequency as well to get the turnover up. So I mean you need more than – more than one league, I would say, to really get some big movement of the turnover. But yeah, what can I guess, I mean, I think you would struggle even in lower term to see a lot of international tournaments. I mean I struggle to see that traveling can return to normal. So, Champions League, the Tennis Tour may be heavily impacted by that. But I think it's – yeah, a reasonable guess for [indiscernible] (00:30:33) probably somewhere but we will be back to 50% to 75% of normal turnover.

Erik Moberg

Analyst, ABG Sundal Collier AB

Q

Okay. Thank you. Fair enough. And in terms of Penn Gaming, has the COVID-19 outbreak changed the planned rollout for their mobile brand or is it – is the timeframe still the same?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

From what we know, it's definitely the same timeframe.

Erik Moberg

Analyst, ABG Sundal Collier AB

Q

Thank you. And in regards of the pipeline of new customers, if you compare your situation right now versus one year ago, would you perceive the – perceive you to be in a better position as of right now even though you have the headwinds from COVID-19?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

It's pretty much the same. I mean obviously, some of really big opportunities like Penn, we have signed already, so that's off the table now. But, yeah, I think we have some really good leads at the moment. So, even now if we can't meet the prospects basically, I think sales is actually going on pretty much as usual.

Erik Moberg

Analyst, ABG Sundal Collier AB

Q

Got you. And in regards of Argentina and Buenos Aires, if I recall correctly, Sun International, if I recall correctly, they purchased a casino property in Argentina [indiscernible] (00:32:11) ago. Could they in theory launch a mobile brand there?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Yeah. In theory, I think everyone can come – can launch. But, I mean, yeah, they need to acquire one of the licenses of course.

Erik Moberg

Analyst, ABG Sundal Collier AB

Q

It's not something that you have discussed with them a roll out in Argentina?

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Not at the moment. No.

Erik Moberg

Analyst, ABG Sundal Collier AB

Q

Okay. Thank you very much, guys. That's all for me.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

A

Thank you.

Operator: As there are no further questions, I'll hand it back to the speakers.

Kristian Nylén

Chief Executive Officer, Kambi Group Plc

All right. So, thank you for your questions and for listening in. We will look forward to updating you on the 24th of July 2020 when we publish the second quarter report. Thank you.

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

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