JPJ Group PLC Base Q3 - 14.11.18 - 6608240 - 13.00 - JH

<u>Speaker Key</u>:

NG	Neil Goulden
KL	Keith Laslop
SW	Simon Wykes
SD	Simon Davies
SM	Sreedhar Mahamkali
OP	Operator
VP	Victoria Pease
TE	Terrence
IA	Ildas Abdu-Allah

00:00:04

OP Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to JPJ Group PLC Q3 2018 results conference call. At this time, all participants are in a listen only mode. Following the presentation, we will conduct a question and answer session and instructions will be provided at that time for you to queue up for questions.

Please note that this call is being recorded today, Wednesday 14th November 2018 at 1:00 pm London time. If you have not yet received a copy of JPJ Group PLC's Q3 2018 earnings release that was issued before market opened today, you can find it under JPJ Group PLC's profile on the SEDAR website or on the JPJ Group PLC website at www.jpjgroup.com.

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Please be aware that we will be discussing some information about the business that is forward looking and which is based on management assumptions and subject to a number of risks that could cause actual results to differ materially from current expectations.

Our annual information forum, dated 2nd April 2018 and our management information circular, dated 27th April 2018, which you can find on the SEDAR website under JPJ Group PLC's profile, discuss many of these assumptions and risks. JPJ Group PLC does not intend to publicly update any forward-looking information except as required by applicable securities laws.

Please note that we will also be discussing some non-IFRS measures on today's call. For the definitions and reconciliations of these non-IFRS measures, please refer to page four in the RNF we issued earlier today. I will now turn the conference over to Mr Neil Goulden, Executive Chairman of JPJ Group PLC. Please go ahead.

NG Thank you, Operator, and good afternoon to those of you who are joining us here in London. Good morning if you are phoning in from North America. Welcome to

JPJ's Q3 results call. With me today are Keith Laslop, our CFO, and Simon Wykes, CEO of Jackpotjoy Operations.

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I will cover the financial and strategic highlights for the three months ended 30th September 2018, and also touch on the outlook for the full year. Keith will then review the financial headlines and key data points in more detail and Simon will update on operational policies.

We can then open up for questions, facilitated by the operator. A transcript of the call will be on your website within 48 hours, and also, a replay option will be available. Copies of today's presentation are also on our website. So onto the results.

Financial results of the third quarter included robust top line growth with revenue up 8%, and double-digit EBITDA growth of 13%. This profitable growth reflects a very strong performance from international markets, as evidenced by the 14% constant currency revenue growth at Vera&John.

We continue to be highly cash generative. EBITDA to cash conversion rate of over 100%, and including the proceeds of our social business means our leverage ratio reduced from 3.4 at the end of June to three times at the end of September, with £71 million in cash on our balance sheet.

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We expect to continue to deleverage at approximately 0.1 of a term per month, getting us to our strategic target of 2.5 times leverage sometime in the first half of 2019, assuming no acquisitions or other calls on that cash. Our initial leverage target of 2.5 times is an important milestone for the company as it is the level at which we can consider returning cash to shareholders. We've said frequently that our intention is to update the market with more detailed plans in that respect, when we report our full year results in March next year.

In terms of other aspects of our Q3 performance, we are reporting that our customer base grew by 3% to circa 260,000 active per month, and that average monthly ARPU, average revenue per user, has grown by circa 10%.

The theme of responsible gambling has dominated the UK gambling industry during 2019. And the impact of tightening regulation has been a feature which we, and many of our competitors have referred to in results announcements. To reiterate, JPJ is based around three core values – putting the customer at the centre of everything we do, making JPJ a fun and rewarding place to work, and actively encouraging our customers to gamble responsibly.

With respect to the last of those three core values, our recent sponsorship and support of responsible gambling week highlights our commitment and we were a first mover during the first half of 2018 in introducing new responsible gaming measures.

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Inevitably, revenues at Jackpotjoy UK have been impacted by those measures, in particular, the sorts of wealth checks which have led to the closure of a number of high value accounts. We expect that the impact of closed accounts will begin to annualise during the second half of 2019. And provided there are no further regulated challenges, the Jackpotjoy segment will return to revenue growth thereafter.

Our ongoing ethos to promote responsible gambling and protect customers includes highly proactive play monitoring and the use of behaviour insight tools to identify players who may be at risk. Responsible gambling objectives are performance criteria for all of our key managers, and we're also providing our 250,000 plus customer base with in tools to enable them to manage their gambling responsibly and to play responsibly whilst enjoying the benefits of gambling – the fun, the excitement and the social interaction that our products bring.

Finally, in terms of outlook, JPJ remains well positioned for future growth. The group continues to trade in line with expectations and we are comfortable with the EBITDA forecast and consensus for 2018. Strategically, we will continue to focus on driving profitable growth and diversifying into new markets outside of the UK. I will now hand over to Keith, who will walk you through the company's financial highlights.

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KL Thanks Neil, and hello everyone. I'll start off by elaborating a bit on our cash flow generation as that is always a focus area in our business. We generated £33 million of operating cash flow in Q3, 1% higher year over year, and over the first three quarters of 2018, we've generated £82.2 million of operating cash flow, a 5% increase over the same period in 2017. In this one quarter, we generated 44 pence per share of operating cash flow, and in the first three quarters, we've generated £1.10p of operating cash flow per share.

Free cash flow to the firm, also known as unlevered free cash flow, and it's calculated by deducting our capital expenditures from our operating cash flow, was £31.4 million or 42 pence per share this quarter. Unlevered free cash flow for the first three quarters of 2018 was £79.5 million or £1.06p per share. The details of our cash flow conversion bridges can be seen within our corporate presentation, which should be live now or shortly will be on www.jpjgroup.com.

Our net leverage calculations are tied to our cash flow generation as well as cash on hand and we are very pleased to report that our net leverage ratio decreased from 3.41 times at the end of June to 3.03 times at the end of Q3. Reducing net leverage to at least 2.5 times, the level where we become unrestricted as to what we can do with our excess cash, remains a fundamental mandate from our board and you can see from our current leverage multiple, that we are getting much closer.

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Moving onto the P and L, and these numbers will be excluding the social business that we sold in August of this year. With respect to overall headline figures, total revenues in Q3 were £77.8 million, an increase of 8% year over year, and adjusted EBITDA was £28.8 million, an increase of 13% year over year.

Refinancing of the debt in 2017 had a significant impact on interest expense, and therefore, played a significant role in our adjusted net income increasing 36% to £23.3 million. There is a meaningful difference between the performance of our segments.

Revenues for the JPJ segment in Q3 were £52.1 million, which is a 3% decline year over year, and adjusted EBITDA was £22.9 million, which is a 4% decline year over year. The slower than historic revenue growth was caused principally by underperformance in our Mandalay brands.

Our Vera&John segment grew both top line and bottom line significantly in Q3 2018. Revenues were £25.7 million, which is 40% growth year over year, and adjusted EBITDA was £8.4 million, which is an increase of 71% year over year. In Euro terms, our constant currency revenue growth was 41% year over year, and adjusted EBITDA growth was 72% year over year. With respect to the rest of the year, we remain comfortable with market expectations for the full year of 2018. I will now pass the call to Simon.

00:09:58

SW Thanks Keith, and hello to everyone. We have three key operational priorities at JPJ, and we continue to make good progress in all three areas. They are one, putting the customer first, two, adding capability, and three, diversifying geographically.

To start with the customers, JPJ differentiates itself within the online gaming market by our customer retention business model which demands adopting a very customer centric approach to running the business. The current regulatory focus on knowing our customers, for us is not just about responsible gaming, but lies at the heart of our business strategy of building long-term, sustainable relationships with all of our customers.

Our LTM active customer base grew again 3% year over year during quarter three. This represented a slight slowdown on quarter two for two principle reasons. Firstly, as Keith alluded to, Mandalay continues to struggle as a collection of small brands with a bonus hungry business model, facing significant regulatory and fiscal headwinds. The LTM active customer base grew by 10% for the group if we exclude Mandalay from those numbers.

Secondly, last September, we launched the Paddy McGuiness TV campaign, supported by a significant reactivation initiative across JPJ UK, generating our second highest ever monthly active total. This year, we have not been on TV and the reactivation campaign was run under the post-GDPR regime, which reduced the volume of customers but increased revenue.

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Whilst we continue to grow our customer base, as we implement RG measures, the drop off in the spend from our highest spending customers in the UK has continued in quarter three. The quarter three performance is very similar to quarter two, with JPJ UK down low single digit. We anticipate the RG impact annualising in H2 2019, when we fully expect JPJ UK to return to growth.

Secondly, adding capability, investment in adding operational capability is also a theme for 2018. We continue to invest in our proprietary platform and have also established a product function to ensure our development efforts are geared around improving the customer experience.

The proportion of our revenue from proprietary technology continues to grow, and 30% of our LTM revenue is now generated through our own technology. We have also launched our own slots content, both on our own website, but also through our games aggregation business. Whilst it's very early days, this content has been well received by our customers.

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And thirdly, geographical diversification. We continue to diversify the business away from the UK to provide a better balance to our revenue streams. As highlighted at our last update, the business is UK centric, and we aim to diversify internationally to provide a better balance to our revenue streams. In the quarter, non-UK revenue grew to 44% of the total.

To summarise, we have made good progress on our strategic objectives, whilst delivering high single digit revenue and double-digit operating profit growth in the quarter. I'll now pass the call back to Neil.

NG Thank you, Simon. Thank you, Keith. We are now open for questions. Operator, could you handle the questions and let us know the first question?

OP Of course. So if you would like to ask a question, please press star one on your telephone keypad. If you change your mind and want to withdraw your question, please press star two. Please ensure your line remains unmuted locally, and you will be prompted when to ask your question. So one again, that's star one to ask a question. And we do have a couple of questions in the queue. So the first one comes from the line of Simon Davies from Canaccord. Please go ahead.

SD Yes, hi. Can I ask three, please? First off, can you give us some colour around JPJ UK's active customer performance in the third quarter, and are you seeing some signs of stabilisation in terms of the IP revenues following the stepdown with tighter due diligence requirements?

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Secondly, Sweden was a very weak market, down close to 20%, I think, in the first nine months. Can you talk us through what's happening there and how confident you are in terms of a bounce back in that business, post regulation, in 2019? And finally, Mandalay obviously remains very weak. It's been impacted by revision to the point of consumption tax. Are you seeing any signs of stabilisation there, and what are the medium-term objectives in terms of Mandalay? Is there scope for rationalisation or, indeed, exit?

NG Simon, thank you for those. We will take them one at a time, I think, rather than try and answer all three in one go. So the first question was about Jackpot UK customer numbers and the IPs, Simon.

SD Yes.

SW Okay, thanks Simon. So if I was to give you a view, across the group, customer growth has been very solid. As I mentioned earlier, we had a 3% growth on our monthly actives over the last 12 months, and that would be 10% excluding Mandalay.

With reference to Jackpotjoy UK, the actives are up 2% over that timeframe. In quarter three, the absence of TV advertising and the impact of a large reactivation campaign in September 2017 has reduced the number of reactivated customers we generated year on year.

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If you were to take September out of the numbers, our active customers grew in the rest of the quarter at the same rate as the LTM. So overall, the trends are very, very similar to Q2. The impact of RG measures has impacted on high value VIPs, which has led to a slow single digit decline in revenues in Q3, but it's very much along the same lines, so it does feel like it's flattening.

So we consider JPJ UK to have an encouraging performance in the quarter. We're very pleased to see growth in our FTD, our first time depositors, despite the absence of any TV advertising this year, and our strategy remains focused on building and maintaining long-term relationships.

KL I'll touch on the revenue side. So the JPJ segment and JPJ UK did experience revenue decline of roughly around 3% in Q3. The segment was largely driven by Mandalay, as we've spoken about. But JPJ UK did also decline a bit. That's driven by VIPs and VIP revenues.

Worth mentioning that we are now self-reliant, that we're now less reliant on VIPs than we were. And in September, revenues from VIPs were around the mid-20s mark of NGR, compared to 40% historically. This in itself is not a bad thing. It does make our business more stable and robust and it is where the industry is going.

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NG Thank you Simon. And Simon, at our end, could you also touch base on the weakness in the Sweden market?

SW Yes. Thanks Neil. In terms of Sweden, I think we've seen a bit of a changing dynamic in Sweden, particularly over the past 12 months, which has seen the rise of no-account casinos, which appear to have created a distinct customer advantage over the non-nonregistration casinos out there in Sweden. As Sweden regulates, we will have similar payment methods to everyone else, and therefore, we expect our performance to improve. So our suspicion is that our challenges in Sweden have been more about payments than about marketing the product.

NG And lastly, in the questions, was the ones on Mandalay. If you could touch on that, and then maybe I'll ask Keith if he can talk a bit about future strategy.

SW Okay. In terms of Mandalay, it appears to be stabilising at the current time. Clearly, we haven't seen a significant growth in numbers. That whole business model of providing high bonuses and then selling customers across other brands was the right strategy for pre-POC2 and GDPR, but is far harder to execute going forward. And so that continued to be a challenge. The year on year variances are a little painful but it does show some signs of we're pretty predictable on the revenue figures we're getting month by month.

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KL And with respect to Mandalay and its future, we are exploring various alternatives with that. Definitely, we're not sitting around doing nothing with that. Simon, just one thing that I should have mentioned as well, as I'm sure you'd have a follow up question with that, sequentially, we have seen a stabilisation of revenues in JPJ UK through the end of Q3 and into Q4, and continued growth in FTD. So from our side, that does provide meaningful evidence that these responsible gaming measures will annualise next year.

SD And that sequential improvement, that's driven by a sequential improvement in VIP, or at least stabilisation in VIPs?

KL Yes, stabilisation in VIPs and growth in the other segments.

SD Yes, perfect, thank you.

NG Thank you, Simon. Operator, the next question.

OP Certainly. Next question comes from the line of Sreedhar Mahamkali from Macquarie. Please go ahead.

SM Yes, hi. Good afternoon. Three questions from me as well, please. Firstly, do you have any market share data at all that could help us in terms of the UK, for JP UK segment? Secondly, on Vera&John, could you perhaps talk through trends in the top three markets? In terms of growth and profitability, clearly, a very impressive performance. Just curious to understand how variable they are across the top three markets.

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And finally, just in terms of debt, how should we think about… you're clearly now deleveraging, as per the plan, but the gross debt number is still quite a big number. How should we think about how that will look and how much will you be looking to pay down, just in terms of shape versus what you will preserve for a shareholder reward, as in terms of either a dividend or a buyback? Just trying to understand the balance between the debt paydown versus what you will hold onto.

NG So thank you, Sreedhar. I'll deal with one and three there and then I'll hand over to Simon and Keith to deal with the Vera&John. In terms of market share, that is all contained in the presentation that's on our website, on page ten. And that is the latest data we have. It's quite hard to get hold of the data.

But the latest data we have, which is provided by Regulus Partners, shows that JPJ Group PLC has a stable market share, around 23.6%. The second biggest in the market is actually a group of others at 17.2%, and that's the market that we think is quite challenged. The nearest major competitor to us is GVC, with 16%. And I think, as most people know, they have the Foxy brand, the Cozy brand and Gala Bingo.

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Stride Gaming at 10.6% with a multitude of brands. Metro, part of their own group, 7%. BGO, about 7%. Tombola, which has a lot of customers at a low stake, about 6%. And then there are a number of others such as LeoVegas, Sun Bingo, 888, all in the 3% to 4%. But all of that is contained on page ten of the presentation on our website.

SM There isn't any more recent data? I suppose that's what I was hoping for.

NG No. We are very reliant on the data that can be put together by people like Regulus. We don't…

SM Understood.

NG There's no other source you can go to, really.

SM Understood.

NG The final question or the third question you asked about debt levels, yes, we said at the half year that now that we've paid the last [unclear] business, that we expected to deleverage fast, at about 0.1 turnover multiple of debt per month. We've delivered on that. Leverage in the quarter is down from 3.4 to three. We think it will be down at around about 2.7 at the year end and will go below the 2.5

threshold where we can return money to shareholders some time in the first half of next year.

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We've consistently said to shareholders that the use of that money can be to further deleverage and pay down debt, could be to do small acquisitions. We're not likely to do large acquisitions in that way with a lowly rated stock and a fairly highly leveraged business, but there are small acquisition opportunities. We have shareholder approval to do share buybacks, and analysts have pencilled in the possibility of us paying a dividend next year. So that is the uses of it.

It's quite a dynamic market out there. We are quite happy, sitting on 71 million of cash at the moment, because that demonstrates very clearly to our shareholders, this is not just some watery promise – there's 70 million of cash on the balance sheet [unclear] deleveraging.

And cash on the balance sheet gives us flexibility. So we're quite happy sitting on a bit of cash at the moment. We promised we will report when we come back with our full year results in March, and we will be giving a very clear statement into our intentions as to that cash and future cash flows. Does that answer your question on that one, Sreedhar?

SM Yes, absolutely. Just curious, where do you hold the cash? Is there any FX exposure in there?

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KL We tend to hold the cash mainly in Sterling. Yes, we do have some Euros as well, but mainly in Sterling.

SM Got it. And…

KL With respect to Vera&John, our fastest growing market in Q3 was Germany. Fastest growing in H1 was Germany and Denmark. Asia is also growing quite strongly as well. And I think that, not in the Vera&John segment but obviously outside of the UK, Spain is growing quite strongly as well. I think I've always mentioned in the past, and it will continue to be true, that you should expect that the Vera&John segment grows faster than other segments. It's in faster growing jurisdictions mainly. It will be more volatile. We love the fact that our fastest growing segment is also in our own proprietary technology as well.

SM And in terms of profitability, which markets are the three most important markets perhaps? Germany…?1

KL In terms of profitability, our JPJ segment is much more profitable.

SM No, sorry, within Vera&John.

KL Yes, within the Vera&John, it's hard to say specifically because payment processing costs vary widely across segments. It depends on marketing plans that we do in any specific quarter. I wouldn't want to give a specific data point for Q3, just because that would be misleading for future quarters because it does depend on marketing that we do in any specific quarter.

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SM Okay.

NG Thanks Sreedhar.

SM Thank you.

NG Operator, next question.

OP Yes. So the next question comes from the line of Victoria Pease from Edison. Please go ahead.

VP Hi. Good afternoon. Actually, I just had a follow up on a Vera&John question, really just in terms of if you could elaborate a little bit about where you are in Asia. And are you able to tell us how much, for example, you have in Japan, and also, in Germany, how much of revenues that is? Are you able to break that out a little bit? And also in terms of marketing, are there any big campaigns planned for early next year or is it on hold at the moment? Thanks.

KL Yes. I'll cover the first bit. So Japan, I think we might have reached double digits at this point. Germany, mid-single digits, or mid to low single digits, so it's still quite small.

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NG And I'll hand over to Simon Wykes who will talk about the marketing one.

SW Yes. I think on marketing, probably the area we're focused most on is the UK. Clearly, we see some regulatory change, we see POC3 coming in as well, and so we see the potential to disrupt the markets there. So there is a threat on one side that clearly there's some challenges to our future revenue.

But we also see an opportunity to benefit as more and more smaller brands begin to struggle. So as they get another regulatory wave and POC3, we think that will push the other section that Neil was alluding to earlier further down, as we're seeing with our own Mandalay section.

So we are assessing our marketing very closely towards next year, to see whether there is an opportunity for us to leverage our size and gain in the long-term within those markets.

NG Is that okay, Victoria?

VP Yes, perfect, thanks.

NG Operator, another call?

OP Next question comes from the line of Terrence [unclear]. Please go ahead.

TE Hi guys. Just a couple of questions on my side. Just the first one in relation to POC3, and I guess the market share, the structure of the market itself. Ahead of the implementation of POC3, where do you see the market moving towards?

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Meaning do you see more consolidation in the market as opposed to [unclear] opportunity that you guys may benefit from small players going out? But if the small players start to consolidate, would that create a bigger competitive threat to you guys, because they have to consolidate?

And my next question is just on the Gamesys internalisation plans. As you're well advanced in those plans, as you mentioned, can you give us an idea on the overall cost impact, versus what you initially expected, whether that has changed since?

KL Sure. So yes, I'll cover the POC3. So any increase in tax over the mid to long term we believe will be a benefit to us in that any tax impact will further entrench the market leadership positions of the market leaders. So that doesn't happen immediately, but I do think that growth within our group from December 2014 was partly due to the introduction of POC to start.

We have been approached by a number of companies to potentially buy them, in the UK, I think that that's the first step. And then, I think smaller businesses will continue to struggle with the new tax as well as regulatory environment in the UK. So in the long term, I don't see it being a threat; I see it being a potential opportunity for us.

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NG And Simon, would you like to touch on internalisation?

SW Yes. In terms of internalisation, we have a very good working relationship with Gamesys. We continue to explore the functions and how we might absorb those within the organisation. Clearly, in 2020, there is a step up in cost, contractually, with our in direct costs, so those are costs that [unclear] by Gamesys, which I think you could probably take at circa £5 million.

The internalisation cost at the moment, we pay for everything, all costs associated with running our business. And so therefore, if we absorb any of those functions within our organisation, it should come at a relatively similar cost, although presumably there may be some dyssynergias from going from big to smaller. But against that, we'll be adding on our other businesses as well. So there'll be a bit of a mixture between. So in 2019, I imagine it might step backwards a little bit, but in 2020, we will see significant savings.

TE Thank you.

NG Thanks Terrence. Operator, are there any further questions?

OP Yes, of course, we do have another question in the queue. But as another reminder for those on the phone, if you would like to ask a question, please press star one on your telephone keypad. And your next question comes from the line of Ildas Abdu-Allah [?] from Res Privata. Please go ahead.

00:32:07

IA Okay, yes. I had a question about the drivers behind not continuing with the no compete. If you could give a bit more background as to how you came to that decision.

NG Yes. Sure. Well, I think that most people know that we made a comment in our Q3 results because April 2019 has always been a date in people's diary because it is the date at which we can internalise, it is the date at which we can consider moving platforms, should we want to. We don't have any intention of doing that, but it gives that opportunity. And it's when the non-compete ends. So we felt we should make a statement around those things.

We had a non-compete in place for the last three years. We don't believe that there is any benefit in extending the non-compete. It's a highly dynamic bingo market out there. There are new competitors such as Buzz Bingo, which has launched on the Playtech site recently. And we don't think that there's any difference to Gamesys opening another bingo site to anyone else opening a bingo site.

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So we don't believe that we need any special protection. We have an excellent relationship with Gamesys, as Simon's referred to. And we move forward on that basis. It's a dynamic market. There will be competitors that will come and go and consolidate across the whole sector.

IA And thank you for that. When you say you are on friendly terms, that means that you still share your liquidity with Gamesys, even though the non-compete goes away and you still have that, as I understood, as a tool, so to speak, later down the line?

KL Correct.

NG Yes. We own our customer, we own our customer data. Our customers are protected, they are our customers. And we share liquidity with the other bingo sites on the Gamesys platform. We think that's advantageous to us and to them. We have the ability to ringfence that and take our liquidity away if we wish to do so. But at the moment, we believe that it's beneficial to us and to the whole platform.

KL It's not dissimilar to how Playtech operates either.

IA Okay, thank you. Just one last one, sorry, just to drop in. Because you guys obviously referred to the consensus as your guidance. Could you tell me what you see as the consensus? And obviously, you can put a range on it, not trying to get you to give guidance. But I think things are moving today, but 105, 110, is that what you see as the EBITDA?

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KL I see consensus as of this morning at 107.6.

IA Okay, thank you. That's it from my end.

NG Thank you. Operator, any further questions.

OP There are no further questions in the queue, so I'll hand back over to your host to conclude the call.

NG Thank you very much, Operator, and thank you everyone for joining today's call. We have a number of one-to-one meetings and calls set up over the next few days. If anyone else would like any further information, they can contact Jason Holden in our office. But thank you. We are pleased with the results that we're putting out today. Hopefully, they reassure the market that we're on track with all the things that we said at the half year. And we look forward to talking to you and meeting with many of you over the coming days. So at that point, I'm going to call an end to the call. And thank you all very much indeed.

OP Thank you for joining today's call. You may now disconnect your handsets.

00:35:45