THOMSON REUTERS

EDITED TRANSCRIPT

Q1 2018 Jackpotjoy PLC Earnings Call

EVENT DATE/TIME: MAY 15, 2018 / 12:00PM GMT

CORPORATE PARTICIPANTS

Keith Laslop *Jackpotjoy plc - CFO and Director*
Neil Geoffrey Goulden *Jackpotjoy plc - Executive Chairman*
Simon Michael Wykes *Jackpotjoy plc - Group MD & Director*

CONFERENCE CALL PARTICIPANTS

Sreedhar Mahamkali *Macquarie Research - Analyst*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to Jackpotjoy's plc Q1 2018 Results Conference Call. (Operator Instructions) Please note that this call is being recorded today, Tuesday, the 15th of May 2018 at 1 p.m. London time.

If you have not received a copy of Jackpotjoy's plc's Q1 2018 earnings release that was issued before market open today, you can find it under Jackpotjoy's profile on the SEDAR website or on the Jackpotjoy plc website at www.jackpotjoyplc.com.

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 form is dated the 2nd of April 2018 and our management information circular is dated 27th of April 2018, which you can find on the SEDAR website under Jackpotjoy plc's profile discuss many of these assumptions and risks. Jackpotjoy plc does not intend to publicly update any forward-looking information, except as required by applicable security 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 4 in the RNS we issued earlier today.

I will now turn the conference over to Mr. Neil Goulden, Executive Chairman of Jackpotjoy plc. Please go ahead.

Neil Geoffrey Goulden ***Jackpotjoy plc - Executive Chairman***

Thank you, and good afternoon, everyone, or good morning if you're dialing in from North America. Welcome to Jackpotjoy's Q1 results call.

And with me today are our CFO, Keith Laslop; and Simon Wykes, CEO of Jackpotjoy Operations Limited.

I'll briefly cover the headlines for Q1 and the outlook for 2018. Keith will then review the financial headlines and key data points and Simon will then give an operational update. Finally, we will then take questions, and if we get a recording, we'll then go on to our website.

Quarter 1 represented another period of sustained operating momentum across the group. At our 2017 year-end call in March, I said the revenue had grown by 12% in January and February. Today, I can report the revenue growth for the quarter, Q1, was up 13%. Adjusted EBITDA decreased by 7%, reflecting the planned increase in marketing spend and the impact of point-of-consumption taxes in the U.K. from Q4 of 2017. This was well flagged to the market.

Cash flows remained consistent, with strong cash conversion at over 90%. Adjusted net leverage at the quarter-end was 3.56x. Post the Botemania earnout in June, we will deleverage at circa 0.1 of a turn of multiple per month. And that free cash flow will open up strategic options as we deleverage.

Looking forward, we remain well positioned for future growth. Trading in Q1 has begun in line with expectations -- has been in line with expectations. We expect that momentum to continue across the rest of the year.

Strong positive cash flows, post Botemania earnout, will significantly and quickly reduce leverage. We have a strong and experienced management team in place across the business. We have very strong brands. We have 250,000-plus active customers per month. And TV advertising will continue into quarter 2, both in the U.K. and in Spain. I remain confident, therefore, that we will continue to drive strong growth and attractive returns for our shareholders over the remainder of 2018 and into 2019.

I will now hand over to Keith and then Simon.

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Thank you.

The first thing I'll point out that I'm sure many of you have noticed is that we did what I've been talking about for around the year. We've provided Mandalay with our Jackpotjoy's revenue. This makes logical sense for a number of reasons and reflects how the segment operates today. And Simon and his team continue to review our operations and assess the optimal way to both maximize overall brand value and as well as player entertainment. There may be other logical ways to present our results, although it is unlikely that we'd consider further reporting changes for the rest of 2018.

With respect to overall performance, as I mentioned in March, we were planning to and have invested much more in marketing this quarter than in Q1 2017. Distribution costs increased 33% during the year, an increase of over GBP 10 million, and a significant portion of these costs relate to marketing. I mentioned that in H1 2018, the weighting of marketing spend will impact EBITDA growth on a year-over-year basis, and we still believe this to be the case. However, as also mentioned in March, we remain comfortable with market consensus expectations for the full year of 2018.

Overall, cash flow performance continued to be our favorite metric in Q1 2018, with GBP 24.4 million of operating cash flow, 5% higher than in Q1 2017 and notwithstanding POC2 and increased marketing spend. This equates to 33p per share of operating cash flow. Our claimed EBITDA converted to operating cash flow at 90% in Q1 2018. Given our business model, we always have low CapEx. However, at Q1, you'll see at our cash flow statement that our purchases of intangible assets were more than offset by sales of intangible assets. Therefore, our free cash flow, or operating cash flow less CapEx, was GBP 24.7 million, also 33p per share. The details of our cash flow conversion bridge can be seen within our corporate presentation, which should now be live on www.jackpotjoyplc.com.

Looking at other impacts on our bottom line. Interest expense was GBP 4.9 million in the quarter, which is GBP 3 million less than in Q1 2017, leading to a 3% increase in adjusted net income year-over-year or GBP 21.4 million. A large item which will impact cash in Q2 2018 is the main and final payment of the Botemania earnout, the Spanish asset that we purchased from Gamesys, which earnout ended at the end of March this year. Botemania continues to be one of our fastest-growing brands within the group, has consistently exceeded our expectations, including a record margin this year, and the overall EBIT grew close to 200% over the last 12 months. This does mean that we increased the share value of contingent consideration one last time outside of probability weight increases that we detailed in the notes to our year-end financial statements. Botemania outperformance resulted in a fair value adjustment on contingent consideration of circa GBP 7.5 million.

Although there will be a significant outlay of cash, circa GBP 65 million in June of this year to satisfy the Botemania earnout and the first milestone earnout payment, we are very excited for the continued growth of this business as well as being able to provide further clarity to shareholders regarding balance sheet items, leveraged levels and future cash flows. Post this earnout payment, there are only 2 remaining milestone payment, each for a maximum of GBP 5 million for a GBP 10 million total. These milestone payments are payable based on the Jackpotjoy segment, excluding Mandalay, EBITDA targets for the 12 months ending March 2019 and March 2020 and are currently valued on our balance sheet at GBP 8.3 million. The combination of reduced EBITDA year-over-year, an increase in contingent consideration and the net present value of the 5-year interest rate swap means that in March 2018 our net leverage ratio remained flat from December 2017. However, given the end of any significant earnouts means that future leverage should come down in a much more linear manner and reducing leverage at least to the level where we become unrestricted as to what we do with our excess cash remains a fundamental mandate from our board.

Moving now to operations. On these calls, I also like to provide some data points on the underlying subsidiaries. For the Jackpotjoy segment, Q1 revenues were GBP 59.5 million, which is a 7% growth year-over-year; and adjusted EBITDA was GBP 26.1 million, which is a 6% decline year-over-year. Distribution costs were 23% higher year-over-year, GBP 5.3 million higher than in Q1 2017. And this increase was largely made up of increased marketing and increased premium taxes from the introduction of POC2.

Across the subsegments, Q1 2018 as a whole was pretty consistent with previous quarters. Steady, consistent growth in JPJ U.K., our flagship brand. Overall revenues continued to grow as expected. In Q1, mobile gross gaming revenue, or GGR, was 69% of total GGR for JPJ U.K., up from 66% in Q4. Starspins and Botemania were our fastest-growing subsegments this quarter, consistent with previous quarters, and together were responsible for 24% of our revenue under the JPJ segment in Q1. Mobile share of revenue in Q1 for Starspins was 75%, up

from 74% last quarter; whereas Botemania was 70%, up from 69% last quarter. We launched a TV campaign in Spain in April, and we look forward to showing up Boteman and his powers to create fun more in the future. Mandalay and Social were our underperforming brands in Q1, and together made up circa 11% of our revenue under the JPJ segment in Q1.

Moving on to the Vera&John segment. Gaming revenues were GBP 21.2 million in Q1 2018, which is 35% growth year-over-year. And adjusted EBITDA was GBP 4 million, which is a 9% decrease year-over-year. In euro terms, revenue growth was a 31% growth year-over-year and adjusted EBITDA growth was negative 11% year-over-year. We invested heavily in marketing in Q1 2018. And distribution costs increased 67% year-over-year, mainly due to increased marketing spend.

I'll now pass the call to Simon.

Simon Michael Wykes ***Jackpotjoy plc - Group MD & Director***

Thanks, Keith.

So there are 3 main focuses for Jackpotjoy operationally at the current time. Firstly, ensuring that we put the customer first by building long-term customer relationships; secondly, adding capability to our existing business; and thirdly, geographical diversification.

Taking each one of those in turn. Firstly, putting the customer first. The world of online gaming is typically focused on acquisition marketing, which has often been designed to limit bonus abuse, resulting in a noncustomer-centric operational decision-making. Winning in the future will be about ensuring the customers know we are putting them first and building long-term relationships with them. This is already one of our strengths, as demonstrated by our growing customer base and our impressive retention statistics and something that we will continue to develop and leverage going forwards. Our second key focus area is on adding capability, particularly with regards to marketing and technology. As we've already mentioned, we are investing significantly, as planned and previously communicated, in our brands this year in terms of additional marketing funds, and this will be supported by additional personnel and a significant focus on both digital marketing and VIP management. We are also building our technology teams to increase our speed to market and to add further features to our own proprietary technology and to create our own content, providing both exclusivity and margin optimization going forwards. Finally, geographical diversification. The business today is U.K.-centric, with over 60% of our revenue coming from the U.K. Our aim is to continue to build on our strong U.K. base by adding more international business to provide a better balance to our revenue streams going forwards. Those are the 3 main focuses operationally for Jackpotjoy over the remainder of 2018.

I'll now hand you back to Neil to sum up.

Neil Geoffrey Goulden ***Jackpotjoy plc - Executive Chairman***

Thank you, Simon. Thank you, Keith. Operator, if we can now see if there are any questions for us.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Okay. We do have a question coming through from the line of Sreedhar Mahamkali.

Sreedhar Mahamkali ***Macquarie Research - Analyst***

Sreedhar Mahamkali from Macquarie. I've got 3 questions and probably just one short follow-up, please. First one, in terms of top line, clearly accelerating into the end of the quarter, given you've talked about Jan, Feb run rate earlier in the year. I'm curious as to why you think the consensus expectations of circa 9% are right. Why shouldn't they a bit faster? Why shouldn't they be looking for a bit faster growth for the year? That's the first one. The second one, you've talked about, I think at the -- again, at the full year results call, margin being hit about 400 basis points as a result of POC and marketing costs, but, clearly, it's running a bit higher than that in Q1. Is it just a function of phasing? Are you still happy with the 400 bps roundabout mark in terms of margin or at least in terms of the consensus EBITDA, 111? If you could talk about those 2 aspects, that will be great. And finally, just a question in terms of any comments on current trading. That would be helpful, please.

Keith Laslop ***Jackpotjoy plc - CFO and Director***

So unfortunately on your -- started coming -- cutting in and out of there for us. What's your first question with respect to revenue growth?

Sreedhar Mahamkali ***Macquarie Research - Analyst***

Yes.

Keith Laslop ***Jackpotjoy plc - CFO and Director***

(inaudible) Sorry. (inaudible) Can you repeat the first one?

Sreedhar Mahamkali ***Macquarie Research - Analyst***

Absolutely. So the growth of 13% seems to have accelerated at the end of the quarter in Q1. Consensus seems to be expecting about 9% growth in revenue.

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Yes. Oh, got you, got you, got you.

Sreedhar Mahamkali ***Macquarie Research - Analyst***

Why shouldn't that be greater? It...

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Well, I think that, in general, we're quite happy with consensus. We're comfortable with consensus. We always spoke to improving cost consensus. But on that side, all we can say is that we're comfortable with consensus. Our fastest-growing segment is Vera&John. And as I've said many times in the past, that will always be our most volatile segment. It should be our fastest-growing segment, but always the most volatile. So I think we're happy with consensus estimates on that. And then, sorry, the...

Sreedhar Mahamkali ***Macquarie Research - Analyst***

The second one was the margin. I think in the full year results you talked about potential 400 bps. Yes.

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Yes, yes. Got you. So margin -- yes, full year was 36%. Consolidated we're at around 33.5%. I think what I would have mentioned was a 3% to 4% margin hit this year depending on marketing. We always will keep marketing quite dynamic. So we're not going to set in stone how much we spend on marketing just because if there's good ROI opportunities that we see in marketing, we're going to cease them. We were not on TV in Q1 and Q2 2017. We are on TV in the first half of this year, so that will have a margin impact, as I've said a couple of times. But in terms of overall marketing spend, we're going to -- we'll spend as we see good ROI opportunities. But I apologize...

Sreedhar Mahamkali ***Macquarie Research - Analyst***

So just to ask because I know that the 300 to 400 basis points, is the delta to more on the marketing as opposed to POC2?

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Yes. I think POC2, as I've said in the past, it's 3% to 4% of our U.K. business. Our U.K. business is roughly 2/3 of the group, so 2% to 3% across the group. And on POC, we were around 3% in the U.K. So I think that we will continue to optimize both of them in the future, but we're pretty comfortable that we're at the lower end of what we mentioned to the markets previously.

Sreedhar Mahamkali ***Macquarie Research - Analyst***

Okay. Any comment on current trading, please?

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Yes. Current trading remains as we predicted for the year, and we continue to be comfortable with the market cost estimates for the year.

Sreedhar Mahamkali ***Macquarie Research - Analyst***

Last one, just trying to -- this is a follow-up as mentioned. The increase in the earnout over the past few quarters is quite significant. And you'd referred to 200% increase in EBIT or EBITDA. Is there a number you could share with us, please?

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Yes, so as I mentioned, we'll be paying circa GBP 65 million in June, GBP 5 million of that is due to the first milestone payment. So, that means GBP 60 million roughly for the balance of the year. We paid GBP 30 million for Botemania in the earnout last year, GBP 6 million this year. So the earnouts possibly is based on...

(technical difficulty)

Keith Laslop ***Jackpotjoy plc - CFO and Director***

Okay. It is interesting that's happened. Can people still hear me?

Operator

Yes. Your line is still connected and (inaudible)

(technical difficulty)

Keith Laslop ***Jackpotjoy plc - CFO and Director***

I'm sorry, it was just to inform you that we're in (inaudible) the city of London and that clearly something happened in the...

(technical difficulty)

Keith Laslop ***Jackpotjoy plc - CFO and Director***

So we're still live. We're going to try and continue. We may have to...

(technical difficulty)

Keith Laslop ***Jackpotjoy plc - CFO and Director***

I think we'll just keep going --

(technical difficulty)

Unidentified Company Representative

(inaudible)

Neil Geoffrey Goulden ***Jackpotjoy plc - Executive Chairman***

And you could do the call and we could just risk it before one of you -- it's a big gamble. We'd rather wait until we get this out (inaudible)

(technical difficulty)

Operator

Ladies and gentlemen, thank you for joining today's call. Unfortunately, the call has had to come to an end. Please await further instructions. Thank you. You may now disconnect your handsets.