JPJ Group PLC H1 Results MT 1232300694 14th Aug 1300 RM

Speaker Key:

NG	Neil Goulden
KL	Keith Laslop
SW	Simon Wykes
SD	Simon Davies
FM	Freda Marmari
VP	Victoria Peat
OP	Operator
RS	Richard Stuber
TT	Terence Te
JB	Jack Barrett

OP Thank you for standing by and welcome to JPJ Group PLC's H1 2018 results conference call. At this time all lines 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 the call is being recorded today, Tuesday 14 August, 2018 at 1pm London time. If you have not received a copy of JPJ Group PLC's H1 2018 earnings release that was issued before market opened today you can find it under JPJ Group PLC's profile on the [unclear] 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 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 dated 2 April, 2018 and our management information circular dated 27 April, 2018 which you can find on the [unclear] 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.

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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 six in the RNS 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 Good afternoon from London, good morning if you're phoning in from North America welcome to JPJ's H1 results call. With me today are Keith Laslop our CFO and Simon Wykes CEO Jackpotjoy Operations. I will cover the financial and strategic highlights for the first half of 2018 ending 30 June 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 priorities.

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

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The first six months of 2018 saw the group pass some important milestones. Firstly, in July we transferred to the premium list on the London Stock Exchange which gives us a platform for future growth and also exposure to a wider investor base and a resultant enhanced liquidity in our shares. We are already seeing the impact of the move. The premium listing was achieved six months ahead of our initial schedule.

Secondly, in June we made our final earn-out payment of £58.5 million to Gamesys this was in relation to our Botemania brand in Spain. The payment was comfortably met from existing cash balances and we still retain close to £30 million of cash on our balance sheet.

Our strong and growing cash flow will now be used to accelerate our deleveraging of the business. Leverage at the half year stood at 3.4 times and we expect to continue to deleverage at 0.1 of a turn per month getting us to our initial target of 2.5 sometime in the first half of 2019, assuming no acquisitions or other calls on the cash. Our initial leverage target of 2.5 times is an important milestone as it is the level at which we can consider returning cash to shareholders.

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Fourthly, and subsequent to the half year end I'm pleased to confirm that we have reached agreement for the disposal of our social gaming business for £18.1 million. This is an attractive price for a business which has clearly gone ex-growth and leaves us solely focused on our core real money gaming offer. Cash proceeds from the sale will go to reduce debt.

In terms of our first half financial performance we are reporting that group revenues grew by 10%, our customer base grew by 7% to circa 260,000 actives per month, operating cash flow increased by 7% and represented an adjusted EBITDA to cash conversion rate of 86%. As already stated leverage was 3.4 times at the half year and is now set to quickly reduce to our initial target of 2.5 times.

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. The last of these three core values is not purely altruistic as we believe that proactively going above and beyond legal requirements will enable us to build a sustainable business model. Several of our competitors have referred to the impact of tightening regulation on revenues in the first half of 2018 and others have flagged pending regulatory sanctions.

To be clear JPJ is not aware of any regulatory action aimed at our gaming brands. However, we have been proactively introducing new responsible gaming measures across 2018 and despite a 7% growth in active players there's obviously been some impact on spend per head in Q2 as these measures take full effect.

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We will continue to strive to represent the highest standards of consumer protection in our industry; this involves highly proactive play monitoring and the use of behaviour insight tools to identify players who may be gambling irresponsibly. All of our key managers have responsible gambling objectives including me and whole heartedly support our ethos. We also provide customers with the tools to enable them to manage their gambling and to play responsibly whilst enjoying the benefits, the fun, excitement and social interaction that gaming brings to millions of people across the globe.

Finally JPJ remains well-positioned for future growth. The JPJ Group continues to trade in line with expectations and we are comfortable with the forecast by analysts, the consensus forecast. We expect to see an improvement I adjusted EBITDA growth in H2 following the conclusion of the successful TV advertising campaigns in H1 and the introduction of point of consumption tax on bonuses passes its first anniversary.

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We continue to focus on driving profitable growth and diversifying into new markets outside of the UK. I will now hand you over to Keith who will walk you through the company's financial highlights.

KL As per usual I'll add a few more details to Neil's highlights starting with premium listing; for those of our shareholders who are not aware of the structure of the London Stock Exchange the main market on the LSE has two lists, the standard list and the premium list. A premium listing has a number of benefits to shareholders over and above the standard list including a commitment by the company to the highest standards of corporate governance through adherence to premium listing standards.

Secondly, an exposure to a wider investor base; there are a number of investors that prefer to invest in premium listed companies which will enhance the liquidity in our shares. And lastly enabling the company's ordinary shares to be considered for inclusion in the FTSE UK indices whether it's through access to passively managed assets or by being added to benchmarks, index inclusion will benefit all JPJ shareholders through buy and demand and improved liquidity.

One of the rules to qualify for a premium listing can be summed up as owning 75% of your business for a minimum of three years. As we purchased the

Jackpotjoy businesses in April 2015 we qualified to move up to the premium list post April of this year. We officially joined the premium list on July 26 and index inclusion should take place later next month.

As Neil mentioned we signed an SPA for the sale of the social business. Our social business had revenue of £5.7 million and generated £1.7 million as EBITDA in the first six months of 2018. We aim to complete the transaction within the next month. It isn't a significant transaction for us given the size of the social business but it will be positive with respect to reducing our net leverage levels.

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On to the financial statements, I'm proud to show that post-payment of the Botemania earn-out we're able to provide further clarity to shareholders regarding balance sheet items, leverage levels and future cash flows. The payment of this earn-out enables us to record a few adjustments to our numbers and makes future cash flows much more predictable. We paid 58.5 million for the Botemania earn-out and five million for the first milestone payment and post this earn-out payment there are only two remaining milestone payments each for a maximum £5 million or £10 million total.

These milestone payments are payable based on the Jackpotjoy segment excluding EBITDA targets for the 12 month ending March 2019 and March 2020 and are currently valued on our balance sheet at £8.6 million. The end of the earn-out meant a lack of contingent consideration adjustments in Q2 which meant that we lifted record IRFS profitability in Q2. It's another important milestone for the company although given that we still have more than £250 million of unadvertised purchase price intangibles on our balance sheet our IRFS profitability will be impacted for years to come.

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The fact that these intangibles have no cash impact on our business at all is one reason why cash flow is an important part of our story. So on to cash flow, we generated £49 million of operating cash flow in H1 an increase of 7% year-over-year equating to 65 pence of operating cash flow per share. Free cash flow to the firm also known as [unclear] cash flow was £47.8 million. Normally our operating cash flow conversion is about 90% however during every Q2 since our inception we've paid income taxes to the Maltese Government at 35% of our Maltese profits and some weeks later we receive 6/7ths of the tax back in accordance with the Maltese tax regulations.

This year as of the end of June we had a 2.7 million tax receivable amount from Malta and we received this amount in July so our Q3 cash flows will be positively impacted. The details of our cash flow conversion bridge can be seen within our corporate presentation which should be live now on www.jpjgroup.com.

Our net leverage calculations are tied to our cash on hand and although Q2 saw an improvement in leverage reduction down to 3.41 times from 3.57 times at the end of Q1 leverage reduction will accelerate in the second half of the year with the Malta tax receivable as well as future EBIDA growth. Reducing net leverage to at least 2.5 times the level which we become unrestricted as to what we do with our excess cash remains a fundamental mandate of our Board.

Moving on to the P&L with respect to overall headline figures total revenues were £161.1 million an increase of 10% in H1 or excluding our social business the revenue increase was 12%. Adjusted EBITDA declined £2.3 million or 4% year-over-year due to planned marketing investment in H1 vis-à-vis H1 2017. Distribution costs increased 24% year-over-year an increase of over £50 million and a significant portion of these costs relate to marketing.

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There was a meaningful difference between the performance of our segments; revenues for the JPJ segment in H1 were £115.8 million which is 2% growth year-over-year or 5% excluding social and adjusted EBITDA of £49.8 million which is a 9% decline year-over-year. The slower than historic revenue growth was causes principally from underperformance in our social and Mandalay brands.

With respect to our major brand, Jackpotjoy UK we're quite happy with player levels as H1 2018 activists increased 7% over H1 2017. However a focus on responsible gaming initiatives and the resulting ARPU decrease meant that that brand only grew low single digits in H1.

The EBITDA decline year-over-year was due to POC2 as well as marketing investment into TV campaigns in the first six months of the year. We remain comfortable with market expectations for the full year of 2018. Our Vera&John segments grew both top line and bottom line significantly in 2018. H1 2018 revenues were £45.4 million which is 37% growth year-over-year and adjusted EBITDA was £12.4 million which is an increase of 31% year-over-year.

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In euro terms revenue growth was 34% growth year-over-year and adjusted EBITDA growth was 27% year-over-year. I will now pass the call to Simon.

SW At JPJ we continue to focus on our key operational priorities namely putting the customer first, adding capability and diversifying geographically. Firstly, putting the customer first building long-term sustainable relationships with customers still sits at the very heart of our business model. This focus has enabled us to continue to grow both our active customers and their spend over the last half. Relationship management necessitates thinking of responsible gaming as a source of long-term competitive advantage rather than short-term profit maximisation.

We want our customers to have fun not problems. As we better understand our customers and develop both proactive and reactive mechanics to help them such as cool off periods there is inevitable a small drop off in spend. We remain confident that these changes will support both our active customer growth and our high retention business model in the longer term.

Secondly, adding capability; 2018 is also a year of adding to our operational capability as planned and previously reported particularly on marketing and technology. We continue to invest in our brands in terms of additional marketing funds supported by additional personnel with an emphasis on digital marketing and relationship management. This investment has underpinned H1's active customer growth of 7%.

We are also developing our proprietary technology and content to provide both differentiation and margin optimisation. The LTM proportion of revenue being taken through our proprietary technology grew to 27% in the quarter which vindicates that strategy.

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Thirdly, geographical diversification, as highlighted at our last update JPJ is UK centric and we aim to diversify internationally to provide a better balance to our revenue stream. In H1 our non-UK share of LTM revenue grew to 40% with Germany and Denmark our fastest growing territories. I'll now pass the call back to Neil.

NG Thank you, Keith thank you, Simon, if we can now, operator if you could take us to questions?

OP If you would like to ask a question please press *1 on your telephone keypad. If you change your mind and wish to withdraw your question please press *2. You will be advised when to ask your question. So again if you do have any questions please press *1 now.

00:17:07

Our first question comes from the line of Simon Davies from Cannacord; please go ahead.

SD Hi guys firstly in terms of Vera&John a very strong performance can you talk a bit about the growth markets that have driven that; which were the core markets there? To what degree is this reflecting further recovery in Japan from the weakness we saw a year ago? And, secondly, on Vera&John can you talk a bit about your plans for the Swedish market once it regulates in the New Year?

SW Okay thank you Simon, in terms of the performance in Vera&John it's very much driving our geographical diversification strategy and as I mentioned in my question before our fastest growing territories in H1 are Germany and Denmark. If you look at the split of revenue by territory you'll see that Europe is driving that acceleration.

In terms of Asia in particular I think we'll see that the rest of the world is 14% of our overall revenue and Asia or the Far East represents the large proportion of it so that is performing strongly.

SD And plans for Sweden?

SW Sorry yes plans for Sweden in terms of Sweden, Sweden is expected to regulate 1 January next year, we are assessing our strategy for going into that market.

Unlike most unregulated markets TV advertising is allowed in Sweden currently so there is unlikely to be a significant growth in marketing spend in our view from current levels. What Swedish regulation will enable is more effective marketing so an increase PPC and Facebook in particular and also probably a reduction in payment processing costs which will help mitigate any increase in tax as a result of the regulation.

SD Thanks and lastly you were talking about strategic review looking at potential options in terms of returning cash to shareholders can you flesh out those comments a little in terms of what we might see?

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NG Could you repeat that question exactly Simon?

SD Yes can you just flesh out your comments about the strategic review of balance sheet and what your options might be; what we might expect to see in March?

NG At the moment our plans are to use our free cash flow to deleverage as quickly as possible, 0.1 per month on a multiple. On that basis if we're at 3.4 now, if that continues sometime in the first half of next year we should get down to around 2.5 times multiple. At that level we have the ability to return money to shareholders. The Board is in the process of taking advice and considering how best to use that cash flow because assuming it continues we will have a fairly significant free cash flow coming into the business.

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We, firstly, will be looking at what are the market opportunities to drive the business forward in terms of cash-based acquisitions. Beyond that we will then be looking at what is our target leverage. Keith and I remain comfortable with leverage at just over two times, just under two times and we will then also be looking at how we can return money to shareholders either in the form of a dividend or share buybacks or a combination of the two. So in answer to your question the key at the moment is to use the cash to deleverage as quickly as possible, to get to the 2.5 times leverage which creates options for us then to return money to shareholders and actually use our free cash flow for acquisitions going forward that don't stop us returning money to shareholders by inflating the leverage.

Hopefully that answers your question, Simon.

SD Yes many thanks.

OP The next question comes from the line of Freda Marmari from McQuarrie [?]; please go ahead.

FM A few questions if I may just around Jackpotjoy segment to start with. You've explained responsible gaming initiatives, the introduction of those; if you're able to actually flesh them out a little bit more when do these actually kick in, when do we annualise them and is it purely a question of annualising them? Clearly there was a difference in the trajectory in Q2 versus Q1 of the gaming revenues in the segment.

And also if you're able to give us a sense of current trading either in the segment or overall? And then finally just on Vera&John just to go back to the previous question, I understand it's a bit more volatile in some of the various markets but clearly growth has been very robust for several quarters now are you able to talk to a run rate of what you think is a sustainable level of growth here?

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NG Okay I shall kick off with just discussing responsible gaming and then Keith will cover the current trading and the V&J growth run rates. So, firstly, in terms of responsible gaming it's worth just reiterating our business model. So we are a bingo and casino operator and so therefore our relationships with our customers is about mathematics. So they spend their money with us, we take a small percentage margin and really they look on playing with us as entertainment so it's a very different model to a sports betting where there is an adversarial relationship between customer and operator.

So our business is all about providing entertainment and our business is also about generating long-term relationships with our customers and we have a very high retention business model. So because of that we intend to be at the very, very forefront of responsible gaming initiatives so we want long-term relationships with our customers; the last thing we want to do is to lose any of our customers because they have problems.

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And we are prepared to sacrifice some short-term revenue on the basis that we believe we will win the long-term both in terms of those long-term relationships but also gaining market share as we become more reputable. We are constantly introducing new responsible gaming initiatives. What we see with any initiative is once we introduce it there is an impact on our business which begins to erode over time and also we are continuously developing and refining them to make sure the customer's welfare stays at the heart of our business and we minimise harm there becomes less of an impact over time.

So it's less about annualisation I think you can always expect us to be at the very forefront of responsible gaming but I will just reiterate we grew our customer base in Jackpotjoy UK by 7% year-over-year. We did see a reduction in ARPU so therefore the spend of those customers but we were still in revenue growth in H1. So a business at the forefront of responsible gaming, growing the customer base with the customer spending a little less but still in revenue growth we feel is a very good place to be.

KL So current trading I would say that July looked a lot like Q2, so stable consistent trends and we remain comfortable with market expectations definitely for the full year of 2018. And that's a bit of an answer I guess for Vera&John as well; Vera&John we don't want to start giving growth targets for but historically what I've always said is that you should expect for our Vera&John segment to grow faster it's in higher growth markets than the Jackpotjoy segment. But it will always be more volatile so you'll always have bigger swings.

And again on that side in terms of any estimate I can give you what I'll say is we're again comfortable with market expectations for full year 2018.

FM Okay thank you.

OP The next question comes from the line of Victoria Peat [?] from Edison [?]; please go ahead.

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VP Hello good afternoon I had a couple of questions the main one really being on the market in general in the UK and what your feeling is on general market growth given all the regulatory hurdles that everyone's had to go through. And aligned to that how are you finding your market share is it therefore going to increase given the pressures on the smaller competitors and if you could just give an overall view of the market and growth?

NG In terms of the UK market I think there are a range of responsible gaming measures being introduced into the market, some voluntarily by operators, some by regulators. As I mentioned right at the very beginning we've been at the forefront of those we tend to introduce them immediately rather than the last possible time. But we probably see a bit of a slowing down in the market as a result of those regulatory pressures.

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I think it's too early to see any market fallout yet but I can explain what we're seeing in our business. So what we are seeing is Jackpotjoy UK is growing market share as we can see by the growth in active customers in H1 18 versus H1 17. What we do see in the Mandalay segment is the challenge of the changing market on smaller brands. So I think we have 30 brands in our portfolio under Mandalay, we have Costa which is our hero brand which is undoubtedly performing the best out of all of our brands in that segment, in the Mandalay business but some of the small brands are finding it very tough going.

We have closed down one brand over the course of H1 just to really see what happens, see how many of those customers migrate to our other brands. But I think I would expect over the fullness of time that the small brands in the other section on our market share slide slowly diminish and that share gets distributed between the bigger brands.

VP Thanks and just one more question on Botemania do you have a figure on how much came from Botemania in H1 versus Starspins I know you lump them together?

KL Yes we lump them together we haven't spread them out in terms of our shareholders but they grew at similar levels in Q2.

VP Okay thanks.

OP The next question comes from the line of Richard Stuber from Numis; please go ahead.

RS Hi good afternoon just a quick one on Jackpotjoy segment growth, I know you said that it grew in the first half but it looks like, as you say quite a sharp slowdown Q2 versus Q1 on my numbers it's flattish. Do you expect that to return into revenue growth in Q3 and Q4?

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And the second question is actually just on Sweden, before January are you planning to apply for a licence and what sort of [unclear] can we see ahead of January?

SW Okay so if I deal with the H2 yes I think whenever we look at the calendar year month by month, quarter by quarter the business can be… it has slight ups and downs so you see a broad trend. We have seen a slowdown in revenue in the Jackpotjoy segment Q2 versus Q1. As I mentioned I would be concerned if we'd been seeing a slowdown in customer growth that would have made me more nervous. What we've seen is continued customer growth and we've seen a dip in the spend per customer.

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I can't think of any reason why that trend will change significantly in H2 so I would expect us to see continued customer growth. I'd expect customer spend levels probably to stay at their current level maybe a little bit of growth over time as the responsible gaming measures that we've introduced into the business begin to settle down.

In terms of the licence question is that regarding Sweden?

RS Yes.

SW So we have both Vera&John and Jackpotjoy operate in Sweden and we will be getting licences for those brands in 2019. As I mentioned before it will be different to a normal regulated market because there is already TV advertising there but we see a real focus about leveraging the marketing skills that we've developed in the UK and applying those to the Swedish market going forward.

RS Thank you.

OP The next question comes from the line of Terence Te [?] from [unclear]; please go ahead.

TT Hi guys just a couple of questions on my side the first one is just clarification on when you talk about deleveraging is it actual repayment of debt or is it holding cash on balance sheet which then reduces net debt? And then the second one is do you have an update on the project to transfer employees from the Gamesys platform to Jackpotjoy; I remember you guys mentioned that a year ago? And are there any changes to cost expectations that may change your margin expectations [unclear]?

KL So on the leverage side what I mention in my notes is the social sale that reduces net leverage so increases our cash obviously. In terms of exactly what we'll do with that cash or other cash that comes in that's something that the management team will decide. However as Neil and I both stated reducing leverage to minimum 2.5 times is a fundamental mandate of our Board so whether we do it now or in a few months I think you will see us de-lever and pay down some of the debt.

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TT So it is actual repayment of debt itself at some stage in the future but not the near-term?

KL Yes I think you will see it, it could be near-term as well you will start to see us pay down some of that debt.

TT Okay thanks.

NG And in terms of Gamesys we have a very, very good working relationship with Gamesys and we're always discussing how we best organise ourselves to maximise the future performance of both of those businesses. You are quite correct that in 2019 a number of contractual changes take place so we would have the option to internalise staff. We could change platform. They have the end of a no-compete so there's a whole range of things that may happen. We are in discussions with them and next year is the day that we can implement some changes.

We will look at the pros and cons of them and make a decision a bit closer to the time. But whatever we do we are very aligned as businesses and we will do whatever we need to do to make sure that any disruption caused by any change has the minimal impact on both businesses' performance.

TT Thank you.

OP The next question comes from the line of Jack Barrett from Man Group; please go ahead.

JB Good afternoon guys thank you for taking my question, just one from me it looks like Vera&John margins went from around 19% to almost 35% Q1 on Q2 sequentially is there anything that's driving that specifically and is that 35% margin run rate that we saw, EBITDA run rate that we saw in the second quarter "the new normal" for this business going forward?

KL What you saw in Q2 was I think a focus on profitable growth. I think Q1 was more, I was going to say rampant growth but that's probably the wrong term, I would think that going forward you should probably expect somewhere in between.

JB Okay so H1 as a whole is a sensible guide point the margins going forward and there's nothing in particular we should look at from a cost-saving perspective that meant that H1 was any different?

KL I think if you took an average of H1 that would be reasonable.

JB Perfect thank you.

OP As a reminder if you would like to ask a question please press *1 on your keypads now. We have no further questions coming through so I will hand the call back to Neil for any concluding remarks.

00:35:40

NG Thank you Operator and thank you everyone for joining today's call. We are visiting a number of you or talking to you individually over the coming days but if you require anything you can obviously contact us through either Cannacord or [unclear] but in the meantime thank you very much for your time and that ends today's call.

OP Thank you for joining today's conference you may now replace your handsets.

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