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Q2 2019 JPJ Group PLC Earnings Call

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## CORPORATE PARTICIPANTS

**Keith Laslop** *JPJ Group plc - CFO & Director*

**Neil Geoffrey Goulden** *JPJ Group plc - Executive Chairman*

## CONFERENCE CALL PARTICIPANTS

**David Brohan** *Goodbody Stockbrokers, Research Division - Analyst*

**Richard Paul Stuber** *Numis Securities Limited, Research Division - Analyst*

**Simon John Davies** *Deutsche Bank AG, Research Division - Head of UK Midcap & Online Gaming Research*

**Victoria Elaine Pease** *Edison Investment Research Limited - Analyst*

## PRESENTATION

### Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the JPJ Group plc's H1 2019 Results Conference Call. (Operator Instructions) Please note that this call is being recorded today, Tuesday, the 13th of August 2019 at 1 p.m. London time.

If you have not received a copy of JPJ Group plc's H1 2019 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](http://www.jpjgroup.com).

Please be aware that we will be discussing some information about the business that is forward-looking and which is based on the 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 29th of March 2019 and our management information circular dated 3rd of May 2019, which you can find on the SEDAR website under the 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 law. 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 6 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.

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### **Neil Geoffrey Goulden** *JPJ Group plc - Executive Chairman*

Thank you, Molly, and good afternoon, everyone, and welcome to JPJ's results call for H1 2019. And with me today is Keith Laslop, our CFO. Simon Wykes, CEO of Jackpotjoy Operations, is taking a well-earned vacation. So Keith and I will cover any operational detail normally covered by Simon.

I will briefly cover the highlights of the 6 months ending the 30th of June 2019, touching on our completion timetable for the Gamesys acquisition/merger and also update you on the outlook for the full year to end December. We will then open up the call for questions, which will be facilitated by the operator, Molly. A transcript of the call will be on our website within 48 hours, and a replay option will also be available. Copies of our investor presentation are also on the website.

So moving on to the highlights for H1 performance. I think it's fair to say that JPJ delivered a strong and robust financial performance in the first half year. Revenue was up 14% year-on-year driven by strong organic growth at Vera&John, notably from Germany, Japan and the Far East, and also from Botemania in Spain. The U.K. remains a challenging market following the introduction of new regulations in H1 of 2018. However, we are seeing signs of improving trends, and hope this will deliver a return to mature growth in the U.K. in Q4.

Adjusted EBITDA was up 2% year-on-year driven by strong revenue growth being partially offset by the impact of regulation and the higher Point of Consumption tax in the U.K. and the introduction of Point of Consumption tax in Sweden.

We delivered a free cash flow worth GBP 30.8 million, reducing net debt to GBP 270 million and leverage to 2.47x. Active customers grew 7%, and ARPU was up 5%, driving a 12% revenue -- growth in revenue per month.

We are seeing improving trends in our JPJ U.K. brand and anticipate to return to mature growth in Q4 once the regulatory changes in



2018 have fully annualized. Spain also delivered a strong performance in Q2. And we continue to grow in a number of territories across the rest of the world, most notably in our B2C and B2B businesses in the Far East.

In the face of increased taxation, both JPJ and Gamesys have invested heavily to grow both active customers and first-time depositors. Our brands are in rigorous good health and well-positioned to grow market share.

We announced the acquisition of Gamesys on the 13th of June. This is a transformational, strategic step in the group's forward strategy. It should provide significant benefits to shareholders, employees and customers. We intend to drive double-digit accretion and create a world-class online gaming business of scale. We remain on track to complete the acquisition in September 2019, and we announced an oversubscribed syndication of our additional debt facility in July.

In today's presentation, we outlined the continued strong performance of the Gamesys business despite the regulatory and tax headwinds in the U.K. The strong trading performance in H1 was consistent with Q2 performance and has continued into the first weeks of Q3. Jackpotjoy will pass the anniversary of the introduction of the enhanced responsible gambling measures introduced in 2018 during Q3, and our international markets are well-placed to continue to deliver strong growth. As a result, the Board remains confident in the full year outlook.

I'll now hand over to Keith to give some more color on our operational and financial performance in H1.

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**Keith Laslop JPJ Group plc - CFO & Director**

Thanks, Neil, and hello, everyone. As Neil mentioned, I'll dive into some further detail on the performance highlights.

With respect to the P&L, we were very pleased with the performance of our overall group in H1 with revenue up 14% to GBP 169.5 million, and adjusted EBITDA up 2% to GBP 54 million, notwithstanding a 6% increase in remote gaming duty in the U.K.

Vera&John was, again, our standout segment in H1 2019, and Vera&John revenues increased 58% to GBP 71.8 million in H1. Adjusted EBITDA was GBP 25.8 million, which is 109% increase year-over-year. In euro terms, revenue and EBITDA growth was a bit higher.

As always, we expect Vera&John to continue to be our fastest-growing segment. However, it will always be more volatile than the Jackpotjoy segment, and therefore, we feel is a great complement to our Jackpotjoy segment.

Now on to the Jackpotjoy segment. H1 revenues were GBP 97.7 million, which is a 6% decline year-over-year, and adjusted EBITDA was GBP 34.1 million, which is a 26% decline year-over-year. The revenue decline year-over-year within the JPJ segment is mainly the result of added responsible gaming measures we introduced in 2018 and the impact of those measures on many of our U.K. cohorts. The adjusted EBITDA decline of the JPJ segment is due to the decreased revenue, the increase in remote gaming duty in Q2 2019 as well as increased marketing spend in this period versus the previous period.

We continue to see improvements in various KPI metrics within the segment. And within the segment, actives grew over 6% whether looking at JPJ U.K. itself, all U.K. actives or the entire JPJ segment.

Simon has spoken previously about our decision to invest more in above-the-line activity for our Jackpotjoy brand in the U.K. in 2019. This includes the new Paddy McGuinness adverts and the sponsorship of Loose Women. This led to a growth of first-time depositors, or FTDs, of 45% for the Jackpotjoy U.K. brand in H1 2019 over H1 2018. And what's more, the revenues from that cohort grew 33% for Jackpotjoy U.K. over the same period. So we're very comfortable with the results of our marketing efforts.

We have been saying that we foresee a return to growth in the JPJ segment following the annualization of additional responsible gambling measures put in place in 2018. And given these stats as well as the promising start to Q3, we continue to believe that the Jackpotjoy segment will return to growth in the second half.

Moving to the balance sheet and cash flow statement. We generated GBP 36.1 million of operating cash flow in H1 2019, which equates

to 48.4p per share of operating cash flow.

There are some additional uses of our cash, especially in the last quarter, including Maltese tax. During every Q2 since our inception, we paid income taxes to the Maltese government at 35% of our Maltese profits, and some weeks later, we receive 6/7 of the tax back in accordance with Maltese tax regulations. As of the end of June, we had GBP 2.9 million tax receivable amount due, which we hope to receive in the following weeks.

Another area which affected cash was PSP reserves in the first half of 2019. As our business continues its high-growth trajectory in certain jurisdictions, payment service provider contractual reserves have had an increasing impact on the cash balances. These reserves tend to be on a rolling basis on deposits, and we reclassify them as restricted cash. As the business becomes more mature in these markets, the increased use of cash will slow, and we will also be in a better position to negotiate better terms from our payment providers.

Lastly, transaction costs impacted cash flow significantly in Q2 and will also impact Q3's cash. As Neil said previously, even though the Gamesys transaction will be a relatively easy transaction to execute, it was more complicated to paper, and there were significant transaction costs, which we list within our financial statements.

On the positive side, the oversubscription on the debt meant there was no OID or original issue discount to be paid, which was of significant savings for us. The details of our cash flow conversion bridge can be seen within our corporate presentation, which is live now on [www.jpjgroup.com](http://www.jpjgroup.com).

As of the end of June, we had GBP 114 million of unrestricted cash on our balance sheet. [Excepting that] reduced to GBP 270 million. However, given the cash requirements I just mentioned, adjusted net leverage increased slightly from 2.44x to 2.47x. The leverage will increase, again, post-completion of the Gamesys acquisition. However, as previously discussed, we believe the Gamesys transaction enhances our deleveraging capabilities, and getting our net leverage below 2.5x remains a key mandate from the Board.

Although this call is to talk about JPJ Group's H1 results, it's worth also taking this opportunity to update investors on the Gamesys transaction and to share some information on Gamesys' H1 results.

Firstly, about the transaction, we issued a prospectus at the end of June. The transaction had a positive in-favor vote at the end of July. We have obtained commitments for EUR 196 million of debt at Euribor plus 425 basis points. The commitments for which were circa 50% oversubscribed and have entered into swaps to match our debt with our projected cash flows. We've also completed interest rate swaps to move the majority of the U.K.-related debt from floating into fixed interest rate payments.

We are currently proceeding on clear and conditioned precedents, and we still expect the deal to complete this Q3.

Now with respect to Gamesys brand's results in H1 2019, H1 revenues were GBP 96 million, which is an 8% increase year-over-year. And adjusted EBITDA was GBP 30 million, which is a 15% decline year-over-year. These results met our expectations for this period. Growth accelerated during the 6-month period. Q1 revenues increased 5% year-over-year, whereas Q2 revenues were 10% above the prior period. So far, in Q3, we're seeing this momentum continue.

The decline in EBITDA was expected due to the increase in remote gaming duty in the U.K. from 15% to 21%. Similar to our own brands, the majority of the decline was due to this increased RGD. However, similar to our JPJ segment, there was an opportunity to get additional customer acquisition spend away, and Gamesys took the opportunity to do so. This additional spend will benefit the business in the current as well as future quarters.

I will now pass the call back to Neil.

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**Neil Geoffrey Goulden JPJ Group plc - Executive Chairman**

Thank you, Keith. Molly, we are now open for questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) The first question comes from the line of Richard Stuber calling from Numis.

### Richard Paul Stuber *Numis Securities Limited, Research Division - Analyst*

Just a quick question, please, on your exposure to Japan. It's now sort of 27%, I think, of the group. Could you -- in terms of revenue. Could you give us an idea of how much contribution that has? Obviously, there doesn't -- you don't pay taxes on that part, but presumably, the cost of payments are more in that territory. And secondly, sort of post your sort of Gamesys acquisition, do you expect sort of a slightly change in view on Japan and unregulated markets more generally?

### Keith Laslop *JPJ Group plc - CFO & Director*

I'll cover the first one. So Japan margin, it is slightly higher given that there's no gaming taxes, but there are significant other expenses such as payment processing costs. So it's -- I wouldn't call it materially different from the rest of our group.

### Neil Geoffrey Goulden *JPJ Group plc - Executive Chairman*

And then into the second, Richard, it's Neil, the second point. No. We want to have a balanced portfolio of brands and balanced geographies. So there are, quite frankly, if you look at the U.K., there are as many risks in a regulated market as there are in an unregulated market. So we will look at each market by its shape, by its size, by its opportunity and also its emerging regulations. So our strategy will remain the same. We want to be a diversified global brand of scale.

### Operator

The next question comes from the line of Victoria Pease calling from Edison.

### Victoria Elaine Pease *Edison Investment Research Limited - Analyst*

I had a couple questions, the first on marketing. With the Gamesys, you mentioned that you're spending more marketing in the first half, particularly in the second quarter. And just wondering if you could let us know how much more than usual that was, and if that's to continue through the rest of the year? And also the Jackpotjoy U.K., is the level of marketing we're seeing in Q2 also continuing into Q3? And the second question on your restricted cash related to the payment processes. I can see that restricted cash is going about GBP 3 million a quarter. I mean is that a decent level to assume over the next couple quarters going forward? And I also assume it's mostly related to Japan. So can we correlate the growth in Japan with the growth in restricted cash?

### Keith Laslop *JPJ Group plc - CFO & Director*

I'll take the second question first on restricted cash. And yes, the answer is yes, that the restricted cash is directly related to growth, not only in Japan but B2B and Asia. But yes, that will continue into the future as long as the growth rates continue the same amount. Now I don't think anyone should expect that the growth rates continue along these lines into perpetuity. So over time, the increased use of cash will slow. And also, as we are -- develop better relationships with payment providers, we hope to negotiate better terms as well. So instead of, let's say, a 6 months rolling, if we can move that to 3 months, that makes a significant difference.

In terms of marketing, you are right that you can see, on the JPJ segment, that distribution costs were 60% of revenues versus sub-50% in Q2 2018. One of the benefits of our business is that we can change marketing spend on the fly. I don't think you should expect that we will be spending these levels for a predictable amount of time, so for the next 6 months. But if we see the opportunity, so if cost per acquisition is at the right level, then we absolutely will. So it's much more down to -- it is very dynamic. So it's down to the opportunities that we see in the market.

### Victoria Elaine Pease *Edison Investment Research Limited - Analyst*

Okay. And on Gamesys, how much more than normal was the marketing spend in the first half?

### Keith Laslop *JPJ Group plc - CFO & Director*

It was roughly 2%, 3% of revenues more. And again, that is dynamic. So it depends how much we can all get away.



**Operator**

The next question comes from the line of Simon Davies calling from Deutsche Bank.

**Simon John Davies Deutsche Bank AG, Research Division - Head of UK Midcap & Online Gaming Research**

Yes. A couple from me. Firstly, you talked about significant B2B growth in Asia. Can you discuss which markets in Asia in particular you're targeting? I'm assuming this is beyond just Japan. And what is the business model? Is this high-visibility platform deals or just content sales?

**Keith Laslop JPJ Group plc - CFO & Director**

It is content sales, but more so B2B partnerships that we have with operators where we supply the private platform as well as content to those operators. That is largely throughout Southeast Asia to varying degrees.

**Simon John Davies Deutsche Bank AG, Research Division - Head of UK Midcap & Online Gaming Research**

And any particularly significant markets there?

**Keith Laslop JPJ Group plc - CFO & Director**

I would say higher up on the list would be Thailand and Vietnam.

**Simon John Davies Deutsche Bank AG, Research Division - Head of UK Midcap & Online Gaming Research**

Okay. (technical difficulty) you talked a potential advertising ban in Spain. What are you hearing on that front? When do you think it might be introduced? And what do you think the impact could be on your Spanish business?

**Keith Laslop JPJ Group plc - CFO & Director**

That's been in discussions for a very long time. I see it being challenged in Italy right now. There's different ways to advertise in Spain. It's definitely a look-and-see approach right now, but we're seeing good results in Spain right now. So I don't know. It's, I think, too early to really comment on whether that's likely or not.

**Simon John Davies Deutsche Bank AG, Research Division - Head of UK Midcap & Online Gaming Research**

And lastly, can you talk a bit about your view of the U.K. bingo-led market? Is it -- has it been growing over the last 12 months? And do you think you've been losing market share?

**Keith Laslop JPJ Group plc - CFO & Director**

Well, you can see in the Gamesys brands, that grew 8% in H1 2019 versus H1 2018, and hard bingo was part of that. I think that Jackpotjoy U.K. itself, being such a long-running mature brand, probably suffered more than others just given the high -- relatively higher number of VIPs within the Jackpotjoy U.K. brand versus some other brands out there. I think that we are seeing some operators that took advantage of advertising more in H2 2018 that they have grown faster. And I think that is one of the things we should have done, and you'll see the advertising spend we're doing now. We probably should have spent more in the latter half of last year, and some other operators took advantage of that. But believe me, there's plenty of operators that are struggling and that are -- their decline is much more than we've seen.

**Neil Geoffrey Goulden JPJ Group plc - Executive Chairman**

And Simon, it's Neil. Just adding to that. The investment that Gamesys had made in the first half of the year and Jackpotjoy's made in the first half of the year have seen first-time depositors rise by 45% in Jackpotjoy and 48% in Gamesys. So that -- you don't get an immediate return from first-time depositors, but that is a really strong brand position going into the second half of the year.

**Keith Laslop JPJ Group plc - CFO & Director**

And then I'll tell you also, what I mentioned before in terms of the Gamesys brands grew 5% in Q1, 10% Q2. We're seeing the momentum continue in Q3. So both figure -- accelerating there.

**Operator**

(Operator Instructions) The next question comes from the line of David Brohan calling from Goodbody.

**David Brohan Goodbody Stockbrokers, Research Division - Analyst**

Just a few questions for me. And just on Germany, has there been any change in your view in Germany in terms of your basis for operation there? And just given the kind of the noise in the background? And then on Sweden, can you give like any update on how -- on what you're seeing in terms of performance there? And is there any sign they're starting to stabilize even month on month? And then just in Spain, seems like it was a pretty good performance in Spain in H1. And kind of what's driving that performance? Or kind of is there any change there that's going to drive them to good performance there?

**Keith Laslop JPJ Group plc - CFO & Director**

Okay. I can cover those. So Germany, the regulatory landscape continues to evolve on a monthly basis. Extremely difficult to make predictions, David. I think we'll need to see how regulations play out. Germany has grown strongly for us in the first half of this year, but it is still only low single digits of the current group. And then, of course, once you combine us with Gamesys, it will be even lower.

On Sweden, Sweden, yes, without a doubt, it's been a very tough market for everyone involved. We just did launch with BankID and Swish virtually in the last week. So that will be a benefit to our Swedish players, and that should help. But I think Sweden is -- it's a tough market.

Spain, on the flip side, did grow quite strongly in Q2. Now I think you should probably look at the Spain growth in the first half more in the comp side. So the comps in -- we grew amazingly in Q1 2018. So therefore, it was a very difficult comp, less so in Q2 2018. So I -- But I think double-digit growth in Spain we are seeing, and I think we see that continuing.

**Operator**

(Operator Instructions) The next question comes from the line of [Quillan Buitin] calling from Investcorp.

**Unidentified Analyst**

I just wanted to know if you could maybe comment on the EBITDA impact of the U.K. if you see it increase in Q2? And also, there was a show yesterday on the BBC about the gambling addiction, and I think that JPJ was mentioned like one of your customer, he or she lost GBP 600,000. And yes, I just wondered if you could, like, comment on this specific case, and if you expect any impact of this show on your performance in terms of complaints or reputation damage?

**Keith Laslop JPJ Group plc - CFO & Director**

I'll cover the first one. So in terms of POC impact in the U.K., we've always said that our -- it's roughly GBP 1 million per month pre-mitigation. And we have been able to mitigate tax impacts over time, and lo and behold, in Q2, it was a little bit on the GBP 3 million.

**Neil Geoffrey Goulden JPJ Group plc - Executive Chairman**

And picking up on your second point. Yes, the Panorama program went out in the U.K. last night. These sorts of investigated programs are never easy watching for the target companies, be they banks, estate agents, gambling companies, or indeed, the National Health Service have appeared on Panorama. So it's always good to keep things in perspective and to keep balance. The first thing to say is the lady concerned ended up bankrupt, and we have a huge amount of personal sympathy for the problems that she found herself in. However, from our point of view, we are -- have a lot of interaction with the customer concerned. It didn't probably come across in the program that what we had checked her source of funds. We had asked on numerous occasions, in recorded calls, as to whether she was comfortable with her level of spend, and we complied with all regulatory requirements enforced at the time. But the most important thing to remember is that, and the program did not mention it, that this customer gambling happened in 2014. That was over 5 years ago now, and the regulations have changed significantly since then.

Hence, you've seen our numbers for the last year where we said consistently that bringing in the new regulatory impact has seen a 5%, 6%, 7% change in our sales performance, revenue performance. We're going to lap that at the end of this year as that it's all coming in into -- going over annualization. But it did have an impact on our business. We closed 25,000 accounts to comply with the new



regulations. So no, it won't have any impact on our business because it was in 2014, and we've adapted to the new regulations. It's not balanced because it didn't give both sides of the story with the customer or indeed, when it took place.

And then yes, I mean, I'm sure we're going to get a lot of questions about the program over the next few days. But we, Jackpotjoy, JPJ, buying Gamesys who manage the customer and the platform, we did extensive checks the way we were doing the acquisition merger. We think that their responsible gambling infrastructure at Gamesys is, firstly, fit for purpose and, secondly, one of the best in the industry. So we are not concerned around it. We could have done without the publicity.

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**Operator**

That concludes today's Q&A session. I'll now hand the call back over to you, Mr. Goulden.

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**Neil Geoffrey Goulden *JPJ Group plc - Executive Chairman***

Thank you, and thank you all for joining us on today's call. We have a series of conference calls and meetings with various shareholders over the rest of this week. If you would like any further information or detail, please do contact our Investor Relations Director, Jason Holden. For now, from London, thank you very much, indeed.

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**Keith Laslop *JPJ Group plc - CFO & Director***

Thank you, everyone.

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**Operator**

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

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