Q4 and FY 2017 Earnings Call Transcript

March 14, 2018

The Stars Group Q42017 Conference Call Transcript

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Operator:
Good morning ladies and gentlemen and thank you for standing by. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. As a reminder, this conference is being recorded today, Wednesday, March 14, 2018. Replay details are included in The Stars Group's earnings press release issued earlier this morning. I will now turn the call over to Tim Foran, The Stars Group's Director of Investor Relations.

Tim Foran

Thank you.

Welcome to The Stars Group's fourth quarter and full year 2017 conference call.

This morning, The Stars Group issued an earnings press release and filed its audited annual consolidated financial statements, annual MD&A and annual information form on EDGAR and SEDAR, and its Form 40-F annual report on EDGAR. These documents and a webcast presentation will also be available on The Stars Group's website at www.starsgroup.com. A link to the presentation is included in the earnings press release.

Some of our comments today will contain forward-looking information and statements under applicable securities laws that reflect management's current views with respect to future events, such as The Stars Group's outlook for future performance. Any such information and statements are subject to risks, uncertainties and assumptions that could cause actual results to differ materially from those projected in the forward-looking information and statements. Undue reliance should not be placed on such information and statements.

Factors that could cause actual results or events to differ materially are set forth in the documents The Stars Group has filed or furnished with applicable securities regulatory authorities or otherwise made publicly available, including, without limitation, today's earnings press release, The Stars Group's 2017 annual information form, annual financial statements and annual MD&A. Except as required by law, The Stars Group undertakes no obligation to update any forward-looking information or statements as a result of new information or future events.

During the call, we will reference non-IFRS and non-U.S. GAAP financial measures. Although The Stars Group believes these measures provide useful supplemental information about its financial performance, they are not recognized measures and do not have standardized meanings under IFRS or U.S. GAAP.

Reconciliations to the nearest IFRS measures are included in today's earnings press release, The Stars Group's 2017 annual MD&A and its earnings presentation, which will all be available on The Stars Group's website.

Unless otherwise noted, all currency figures presented on this call are in US dollars.

I will now turn the call over to Rafi Ashkenazi, The Stars Group's Chief Executive Officer.

Rafi Ashkenazi, Chief Executive Officer

Thank you Tim, and thank you everyone for participating. Joining me on the call this morning are Brian Kyle, our Chief Financial Officer, Marlon Goldstein, our Chief Legal Officer, and Robin Chhabra our Chief Corporate Development Officer

The Stars Group's fourth quarter and year end results illustrate not only the remarkable year our business has enjoyed, but also the progress we have made as we transform from a poker company into a global leader in online gaming.

I'd like to recap some of the accomplishments that defined our business during 2017. I'll then pass the call to Brian to review our financial performance in greater detail, and discuss our outlook for 2018. Finally, I'll conclude with more details of our operational performance in the fourth quarter and provide a brief update on recent developments, including both our investment in Australia's CrownBet online sportsbook and agreement to acquire William Hill Australia.

2017 was a transformative year for The Stars Group:

- We achieved record revenue;
- We introduced our innovative Stars Rewards customer loyalty program;
- We strengthened our financial position and the overall health of the company;
- We welcomed new Board members and executive leadership;
- And we rebranded the company to The Stars Group, further highlighting our new direction;

Our total revenues for 2017 reached a record $1.3 billion, representing a year-over-year increase of roughly 14%. These results underscore our successful transformation into a truly multi-product iGaming company. A key component of this transformation is the increasing shift away from a reliance on poker, which just three years ago accounted for nearly 100% of our revenues. This trend of diversification will be enhanced by our recent acquisitions of CrownBet and William Hill Australia, following which we expect poker to represent less than 60% of our overall revenue base.

Poker revenue increased by 4% for the year, largely as a result of the success of Stars Rewards. We achieved this growth despite regulatory headwinds, including the closing of operations in multiple markets such as Australia and Columbia.

Our ability to grow poker revenue in 2017 is also impressive because it comes alongside our continued successful strategy to cross-sell our existing poker customer base into our new casino and sportsbook verticals. In 2017, we added more than $120 million in non-poker revenue, driven by a 45% increase in casino and sports revenues. This marked the third consecutive year where these verticals' revenues have grown by more than $100 million.

I'm pleased with the improvements in our casino product, as we introduced more than 170 new slots, including our two successful in-house million dollar pay-out progressive jackpot slots games.

These games are exclusive to our casino platform, creating promotional marketing and PR opportunities to engage new customers.

Our BetStars sportsbook also continued to improve in 2017, as betting turnover grew by nearly 85% while revenue grew by nearly 90%. This growth was the result of both an increase in our player base and stronger engagement with our customers.

As we'll discuss later, our sports business will continue to benefit in 2018 from organic and in-organic growth as we accelerate our revenue diversification strategy and make sports betting a second engine for customer acquisition.

Both our record 2017 revenues and our continued high conversion of earnings into cash have allowed us to significantly strengthen our balance sheet. During the year, we repaid high priced second lien debt, completed the repayment of our $400 million deferred payment obligation, and made investments in both marketing and technology infrastructure that we believe will pave the way for future growth. Brian will provide more details on this in a few minutes.

Speaking of Brian, as our new CFO he is one of several new key executives added to our management team since the beginning of 2017. We also welcomed two new members to our fully-independent Board of Directors.

The final key strategic piece in our 2017 transformation was our re-branding to The Stars Group. This rebranding has effectively turned the page on our past, and reflects the transformation our company has undergone in the past few years. It aligns our corporate identity with our celebrated customer-facing brands, most notably PokerStars, and recognizes our expanded vision to become the world's favourite iGaming destination.

I'll now pass the call to Brian, who will review our financial results for both the fourth quarter and full year.

Brian Kyle, Chief Financial Officer

Thank you, Rafi. Having joined Stars midway through the year, it has certainly been a pleasure to be with the company at such an exciting and encouraging time in its evolution.

This morning, I'll review our financial and operational performance for the fourth quarter, provide an update on our balance sheet, and present our expectations for the year ahead.

During the fourth quarter, The Stars Group served 2.2 million quarterly active unique players on our platform. Quarterly uniques were negatively impacted by the loss of certain closed or impaired markets, resulting in a 7.3% decline from the same period for the prior year. When removing the impact of opened, closed or impaired markets, the decrease in unique active players was approximately 2%, which we believe primarily reflects the impact of our previously discussed strategic reduction of promotions and marketing incentives for high-volume in favour of increased incentives for high-value new and recreational players. We believe this strategy creates a more sustainable and healthy ecosystem over the longer term. It not only attracts a greater number of depositing players, who are additive to the environment, but also provides a more enjoyable and engaging experience for our customers overall.

The initial results of this strategy to increase focus on higher value customers are encouraging, as it combined with both the impact of the Stars Rewards program and continued growth in our casino and sportsbook verticals to drive our net yield to $160, an approximately 26% increase when compared to the fourth quarter of the prior year.

On a constant currency basis, quarterly net yield improved to $154, an increase of approximately 21% year-over-year.

To provide you with additional information surrounding our customer behaviour, we have introduced Net Deposits to our key metrics. We believe this metric will be helpful and relevant in light of the changes to our ecosystem over the last two years, and those that we expect to make going forward.

We look at trends in Net Deposits to gauge expected revenue performance across our current online real-money gaming offerings, and to help guide our decision making around product changes. Net Deposits are closely correlated to our reported revenue, as they eventually become revenue when our customers use their funds to play. However, it should be noted that net deposits are not representative of revenue bookings or deferred revenues.

During the fourth quarter Net Deposits increased 15% year-over-year, primarily driven by the implementation of the Stars Rewards loyalty program and our continued focus on high-value customers, as well as the continued development of our casino and sportsbook product offerings.

Turning to our financial performance, The Stars Group generated total revenues of $360 million during the fourth quarter, an increase of approximately 16% when compared to the prior year. This improvement was primarily due to both the introduction of Stars Rewards and the continued improvement and increased geographical reach of our casino and sportsbook verticals. On an annual basis, revenues reached a record $1.3 billion, representing a year-over-year increase of roughly 14%.

Of our total fourth quarter revenues of $360 million, approximately 65% were derived from our poker vertical, while approximately 31% were derived from our combined casino and sportsbook verticals. This compares to 70% and 26%, respectively, during the fourth quarter of the prior year, highlighting our continued progress in the diversification of our revenue base.

For the fourth quarter, revenue from our poker vertical was $234 million, an increase of 8% when compared to the fourth quarter of the prior year. This improvement can be attributed to the implementation of the Stars Rewards loyalty program, the re-launch of online poker in Portugal, and the positive impact of foreign exchange fluctuations.

Fourth quarter revenues for our combined casino and sportsbook verticals increased by 40% to $112.5 million, with casino revenues representing approximately 81% of that amount. Growth in both casino and sportsbook during the quarter was driven by the continued development of these offerings, including the addition of more slot games, the ongoing improvement of our Sportsbook's user experience, the introduction of Stars Rewards, and geographic expansion. Additionally, Sportsbook revenues during the quarter benefitted from a higher than average gross win margin, though the margin for the full year of 2017 was essentially in line with 2016.

As Rafi mentioned earlier, we are very pleased with the progress of our cross-selling strategy, and the fashion in which our customers have received it. As at year end, The Stars Group's casino offering was available to approximately 76% of our poker players, while our sportsbook offering was available to approximately 64% of our poker players.

Currency movements can have a significant impact on our results, particularly the movement in the Euro against the U.S dollar. For the fourth quarter, the strength of the Euro against the U.S. dollar had a positive impact to our results. As a result, our fourth quarter constant currency total revenue growth was 8%, while poker revenue growth was 2%.

On a geographic basis, revenues for the fourth quarter were split approximately as follows: 66% from the 28 countries in the European Union, 19% from the rest of Europe, 12% from the Americas, and 3% from the rest of the world.

Gross gaming revenues from locally licensed or taxed jurisdictions were approximately 57% during the fourth quarter, as compared to 55% during the third quarter. We expect this trend to continue with our Australian acquisitions of Crownbet and William Hill, both of which generate their revenues within the Australian regulated market.

Adjusted EBITDA for the fourth quarter was $147 million. This number was consistent with the prior year, as our margin of 41% declined when compared to approximately 48% in the prior year period. As discussed on our last quarterly call, we anticipated this decline, as we rolled out programs that increased investments in poker and sportsbook marketing, headcount and technology infrastructure to support future growth. We are pleased with the progress we are seeing at this early stage of the expected benefits. These investments, which we believe are creating the foundation for our future growth, are expected to continue moving forward, something I'll discuss further when I outline our guidance for the year ahead.

For the full year, adjusted EBITDA grew to $600 million from $524 million representing an increase of 15% on a year over year basis. The year over year growth was attributable to factors similar to the ones I highlighted on the previous slide for the quarter. Margins of 46% for the year remained in line with prior year.

Net Earnings for the fourth quarter was $47 million, an increase of 5% as compared to last year. The increase was primarily the result of gains from sale of investments and an increase in operating income. These increases were partially offset by a corporate income tax provision relating to an ongoing transfer pricing dispute in Canada.

Our fourth quarter diluted net earnings per common share of $0.23 per share, remained unchanged from the prior year.

Our fourth quarter adjusted net earnings per diluted share were $0.54 per share, an increase of 2% when compared to $0.53 per share during the same period last year.

Full year diluted earnings per common share increased to $1.27 per share, compared to $0.70 per share during 2016. Adjusted net earnings per diluted share increased to $2.25 per share, compared to $1.88 per share during 2016.

From a cash flow standpoint, The Stars Group generated approximately $495 million in net cash inflows from operating activities in 2017. This increase from $350 million during the prior year was primarily due to the strong growth in our net earnings. After removing the movement of customer deposit liabilities, we generated $525 million of adjusted cash flow from operations, compared to $421 million in the prior year, an increase of $104 million.

Free Cash Flow for 2017, which is net of CapEx and required debt servicing costs, was $340 million, compared to $230 million in 2016.

The Stars Group concluded the year with approximately $283 million of operational cash, excluding customer deposit balances. The principal amount of our outstanding debt at year-end was $2.45 billion at a weighted average interest rate of 4.7%.

During 2017, we reduced leverage by prepaying $115 million of high cost second lien debt, and completed the payment of the remainder of our deferred payment obligation, further strengthening our financial position.

I'd like to provide a brief update on some regulatory developments across our various geographies. As you're aware, we faced several regulatory headwinds during 2017, including closures in certain markets, such as Australia and Colombia, and difficult operating conditions in others, such as the Czech Republic and Poland. I'm particularly pleased with how our strong financial results were achieved despite these challenges. Fortunately, recent regulatory developments have been more positive, including the expansion of some new markets for our business.

Early indications from our launch in January of the shared player pools in France and Spain have been encouraging. Portugal and Italy have each made progress in their plans to join France and Spain to create a significant pool of regulated players in Southern Europe. We believe this will greatly improve the customer experience in those markets, which we expect will in turn grow the overall online poker market in Southern Europe.

With pooled liquidity in southern Europe, players can access a larger player base, and we can in turn offer our players bigger prizes, promotions, and game selection. Our hope is that this will result in the growth of our market share, and early indications are encouraging in this regard, as we are seeing benefits from the network effect.

These changes represent a positive step towards improving poker's global presence. Regulators in the handful of markets in Europe and the U.S. that have previously been ring-fenced have indicated a desire to move to shared liquidity, which we believe will promote a healthy, licensed, and appropriately-taxed industry.

In the US, we believe we benefit from strong brand equity that has been maintained through our play money offerings and real money gaming offerings in the regulated market of New Jersey. In 2017, Pennsylvania officially became the fourth state to welcome regulated online gaming. We plan to participate in the launch of this market as soon as it opens. As more states are contemplating online gaming regulation, we believe we are well positioned to take advantage of developments in the U.S. market as opportunities for our offerings become available.

While these regulatory developments are positive, the online gaming industry still remains subject to regulatory risks. Fortunately, we have been proactive and often successful in anticipating and mitigating these risks. We are currently reviewing recent Russian regulations that will likely restrict the number of Russian payment processors who elect to engage with offshore online gaming operators. We are actively monitoring this situation, and proactively developing a strategy to address any potentially negative outcome.

Turning to guidance, I would like to reiterate my previous comments that we look at guidance as a commitment by management.

The Stars Group currently expects the following 2018 full year financial guidance ranges:

- Revenues of between $1.39 and $1.47 Billion,
- Adjusted EBITDA of between $625 and $650 million;
- Adjusted Net Earnings of between $487 and $512 million; and
- Adjusted Net Earnings per Diluted Share of between $2.33 and $2.47

These ranges reflect The Stars Group's existing business and exclude both the recently announced acquisition of a majority interest in CrownBet and the proposed acquisition of William Hill Australia. We will provide additional guidance alongside the disclosure of our first quarter results to reflect the benefit of these acquisitions.

Today's guidance range is based upon management's existing views of our current and future business conditions, and includes assumptions fully detailed within our accompanying earnings press release.

Thank you again for joining us this morning. I will now turn the call back to Rafi, who will provide greater operational details on the fourth quarter and some closing remarks.

Thank you, Brian. I'd like to conclude with some additional colour on our operational performance in the fourth quarter before looking forward to the rest of 2018 and beyond.

Poker remains The Stars Group's primary customer acquisition channel, and in 2017 we began increasing our marketing investment in this segment. We continue to leverage our marketing firepower and poker expertise to acquire customers, and to increase their lifetime value by improving our engagement initiatives and cross-selling them through our casino and sportsbook offerings.

We intend to maintain our global leadership position in poker by continuing to invest in marketing, lobbying to grow the game globally, and increasing the number of regulated online gaming markets. We recently began shared liquidity in France and Spain and anticipate incorporating Portugal in Q2, and hopefully Italy in late 2018 or early 2019. We also continue to see positive momentum for new legislation in several European markets, including Sweden and the Netherlands, to provide clear online regulations.

As Brian mentioned, geographic expansion also remains key to our future growth and we have reason for optimism in 2018 in two key markets: the United States and Asia. In the U.S., we plan to apply for approval to operate in Pennsylvania. Several key states are also currently considering the passage of online gaming regulations, including New York, Michigan and Illinois. We are also monitoring New Jersey's Supreme Court challenge of PASPA and its potential impact on the regulation of sports betting in the U.S.

In India, we have entered into an arrangement with a well-established domestic licensed lottery and gaming operator, which will give our brand access to this highly populated market and the ability to build awareness for both our PokerStars brand and the game itself. We anticipate the brand being launched in the second quarter, initially on the ringfenced basis, but believe it will take a few years for the business to reach profitability and for us to receive noticeable license fees.

PokerStars continues to be the leading promoter of poker globally and we continue to seek new ways to capture the attention of our target market with compelling campaigns and promotions. In December, we announced the PokerStars Players No-Limit Hold'Em Championship, which is expected to be the world's largest-ever $25,000 buy-in poker tournament. The Players Championship will take place in the Bahamas in January 2019, and will serve as the culmination of a year-long campaign of promotions, special events, and marketing initiatives.

Alongside exciting marketing programs, we are increasing the pace of product innovation. While not all new innovations will succeed, our intention is to perpetually experiment. We believe new game variants can not only increase engagement among existing players, but also attract a new audience.

As previously announced, during the fourth quarter we launched a beta version of PokerStars Power Up, which recently proceeded to commercial deployment in the UK. PowerUp is just one example of the innovation pipeline we expect to roll out over the year ahead.

We also intend to continue to refine and improve upon our Stars Rewards loyalty program in 2018 to deliver increasingly targeted and relevant rewards, features and incentives for our most valuable customers, and build upon the positive customer reception received in 2017.

In casino, it is important to note that in just a few years, PokerStars Casino has already become what we believe is one of the largest casinos in terms of active uniques; and we estimate it ended the year among the top five of our public competitors in terms of revenues as well. Going forward, we will continue to improve the customer experience through improved customer journey, greater variety of popular games, and more exclusive games on our platform. Towards that end, we have established an internal casino games studio dedicated to producing proprietary titles like Stars MegaSpin and Millionaires Island, which have been popular with our customers.

As Brian noted, BetStars also is improving its product and continuing its strong turnover growth. We believe this indicates increased engagement by our sports customers who are responding to the product improvements, including our improved mobile app.

During the fourth quarter, BetStars:

- launched digital marketing in key European markets of Italy, France and Spain, and increased focus on localization and local marketing activity;
- became the first international operator licensed for Sportsbook in the Czech Republic;
- invested in CRM personnel and execution, with a particular focus on local European markets;
- and launched a new app in Europe.

As indicated earlier, sportsbetting represents a great opportunity for future growth for the company and in 2018 we are pursuing organic growth for BetStars and inorganic growth opportunities in the consolidating marketplace. We expect BetStars growth will benefit in 2018 from continued improvements in its product and marketing activities to leverage the enormous global betting interest in the World Cup.

We've already taken advantage of M&A opportunities in 2018 by taking a majority interest in Australia's CrownBet and using that foothold to agree to acquire the William Hill Australia business. The acquisitions are consistent with our stated strategies of scaling up our business in sportsbetting and diversifying our revenue base. We anticipate that these acquisitions will significantly increase the percentage of our revenues generated from sportsbetting. They will also diversify our business geographically and increase our percentage of locally taxed revenues.

The Australian market is very attractive, for a number of reasons. Online betting is clearly licensed and has grown in that geography. By acquiring CrownBet and William Hill Australia together, we will become the clear #3 operator in a market where regulatory and taxation changes, in our opinion, provide an advantage to large operators with scale.

The combined business will be operated by the CrownBet management, including the company's CEO, Matt Tripp. Matt and his experienced leadership team have a proven track record of building highly successful businesses in the wagering industry and CrownBet has been no different, being one of the fastest growing sportsbooks in the market. We are excited to partner with Matt and his team and welcome them to The Stars Group.

Matt and his team intend to rebrand the integrated business later this year and will look to leverage the best technology, product, and talent available between the two businesses.

We currently estimate that we will realize gross synergies of at least $50 million Australian dollars beginning in 2019, after a period of expected incremental integration and rebranding costs. For context, the combined businesses recorded $230 million Australian dollars in operating expenses in 2017, including marketing costs of approximately $100 million. We anticipate such synergies and the continued growth in profits in CrownBet this year will exceed the potential impact from expected point of consumption taxes in Australia, along with the negative impact on revenues from the recent ban on credit betting in the market, and typical migration loss related to brand consolidation.

We intend to maintain separate technology platforms for Australia and BetStars, our European sportsbook. However, we do think there are areas our BetStars operation will be able to leverage the expertise of our Australian operation. There are also potential opportunities to leverage this operation in jurisdictions that may see positive regulatory movement in the future.

In conclusion, I'm very pleased with The Stars Group's 2017 performance, and the way we have executed upon our strategies and leveraged our competitive advantages. Our core poker player base remains significantly larger than any of our peers. The size of this player base and the advanced technology we use to support our platform make it difficult for any competitor to challenge our position. This competitive advantage also provides an opportunity for growth, as our poker player base can be cross-sold into our improving casino and sportsbook verticals, and our technology gives us an upper-hand when navigating the regulatory challenges of new markets.

Throughout the year ahead, we will look to invest further in marketing, innovate and improve our product offerings, enhance our customer experience, and explore new geographies. From both a financial and operational perspective, we believe our company is currently in the strongest position in its history.

Finally, I can't close without thanking all of our staff. Our performance and our positive outlook is a direct result of their focus on excellence and their success in bringing winning moments to our customers every single day.

Our vision of being the world's favourite iGaming destination cannot be realized without their passion and commitment.

Thank you.

Operator, please open the line for questions.

Operator:

Thank you. We will now be conducting a question and answer session. In the interest of time, we ask that you please limit yourself to one question, one follow-up, and requeue for any additional. If you'd like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

Our first question comes from the line of Chad Beynon with Macquarie Group. Please proceed with your question.

Chad Beynon:

Good morning and thanks for the commentary, Rafi and Brian. Thanks for taking my question. Just wanted to start with the 2018 revenue guidance. You had a very strong 2H17 and within the presentation you noted the net deposit growth, yet the revenue guidance kind of assumes a little bit of a deceleration in growth. Within one of your slides you did note that the operating conditions could weaken in Russia beginning in May. Just wanted to ask if that is in the 2018 revenue guidance, and then if we should just think about the guide as kind of a tale of two halves given the comps that you're facing, that you will be facing in the back half of 2017. Just a little more color there. Thank you.

Brian Kyle:

Sure. Good morning, Chad. It's Brian. Why don't I start with it and if Rafi has some comments he can jump in after?

I want to start off by highlighting once again, as I mentioned in the prepared remarks that Management looks at guidance as a commitment. It is something that we take very seriously and ensuring that we can manage our business towards those ranges. When we look at the guidance, we are looking at our current and future expectations of our business and the further you go out, Chad, as you can appreciate, the more challenging it is to lock down on our guidance.

To answer your question, I think it might help by just taking a step back and looking at some of the positives that we're seeing right now. At the end of Quarter 4 '17, we had incurred a significant increase in our marketing spend, which we had indicated to the market we would be doing, primarily around Poker and Sports. We're starting to see the benefits of that coming through in Quarter 1 of '18. The Stars Reward program, again, that we launched midway through last year, we've got another half a year of benefits coming through on that, and again, we're seeing positive traction on that. We've talked about the shared liquidity that's in place right now for Spain and France, and again, we're seeing early positive traction on that.

We're also benefiting from some foreign exchange, positive movement in connection with the strengthening of the euro, so that's moving forward on our revenue numbers.

As we mentioned, from a Casino and Sportsbook perspective, we launched 170 new slots and where we're standing right now in terms of our gross win margin on our Sportsbook, it's also looking very encouraging.

There's a number of factors that are setting up for a strong, strong year in 2018 that's reflected in our revenue numbers. However, offsetting that there are a number of offsets. We will continue to invest in marketing. We want to continue to invest in our infrastructure, and we believe those benefits will be real and they will be tangible and we will be able to manage and report those into the future.

We no longer have a couple of markets; the most notable is Australia, so that's impacting our business. We did talk about some challenges that are anticipated in connection with Russia that we factored into our business.

A long-winded way of saying we've got a number of positives that are built into our plan, however at this stage we are cautiously optimistic around a number of other areas in our range level.

Chad Beynon:

Great. Thank you. Very clear. Appreciate that. Then my follow-up is with respect to your debt leverage. Obviously post acquisition, wanted to ask, I guess you would have commented on it if there was something to announce, but if there is any update in the Kentucky situation and kind of how this factored into your thinking of making the acquisition and kind of where your leverage will be post acquisition, I guess, excluding Kentucky? Thank you.

Brian Kyle:

Yes. Let me pass that over to Marlon and then I'll pick up on a couple of comments after that.

Marlon Goldstein:

Sure. Thanks, Brian. Good morning, Chad. I'll give a quick update on the Kentucky appeal and then Brian will take it back on the leverage part of your question.

The case, as we've talked about, is now fully briefed and we are approaching oral arguments which have been set for later next month. A panel of three judges has been assigned to our case. We're quite pleased with the panel. We think there are three very experienced, highly skilled appellate judges that have been assigned to our case.

In terms of when a decision will come, there's no set timeline but it could be summer, into the fall, depending on the actual judges' schedule, briefings, etc.

That's the current update from a timing perspective.

Brian Kyle:

I think to address your question on leverage, I think the way to look at that is, as we've done in 2017 with our surplus cash, we've continued to deleverage the business and I think any outcome on Kentucky, we believe that would be neutral to our leverage level going forward.

Chad Beynon:

Okay, thanks.

Operator:

Thank you. Our next question comes from Matthew Gan with Cormark Securities. Please proceed with your question.

Matthew Gan:

Hi guys. Thanks for taking my questions. Just a couple of questions. First off on Russia, with this kind of change in regulation—potential change in regulation, can you speak to whether this market is actually moving closer towards regulation? Do you have any sort of insight on that matter?

Marlon Goldstein:

Hi Matthew. It's Marlon. Let me see if I can provide some color on that. Generally speaking, I think we view Russia as perhaps an emerging regulatory market. As we've talked about previously, we've been very active on the ground in promoting regulation globally and Russia is one of those jurisdictions in particular where we have been active.

You see the market moving towards regulating sportsbook; there are now licenses available in that market, and we've talked about pursuing and obtaining a license as well. We continue our efforts for promoting regulation with respect to poker in that jurisdiction. Our efforts are quite robust and quite active, and we'll continue to monitor that very closely and certainly update everyone as, when and if we have some progress to report.

Matthew Gan:

Okay. Then a question on Kentucky liability. In the interim, is Management's kind of intentions right now to kind of see through the process or are you potentially considering other alternative courses of action that might clearly handicap? What would that liability could be in the interim?

Marlon Goldstein:

Sure. Fair question. We have been and we continue to remain very bullish, very optimistic on the merits of the appeal and the substantive issues in the case. The oral arguments coming up mid next month, we're actively preparing for, and we would certainly see it through to the extent we get that far.

We are practical and we will look at this and other issues through that lens. To the extent that there is a solution or an option available for us that we think is beneficial to the Company and its shareholders, we certainly will engage and pursue those opportunities.

Matthew Gan:

Jumping over to your marketing and op ex spend, just for modeling purposes, can you give us per the outlook is this expected to be a step change for the rest of the year? Do you expect the momentum from these marketing efforts to build throughout the year and into late 2018?

Brian Kyle:

Hi. I think the way to look at our marketing spend going into 2018 is for the first—for modeling purposes, for the first three quarters you will see a step increase quarter-over-quarter compared to 2017. Then we would get into the later part of Quarter 4 where we would actually either see it stabilizing or slightly decline from a Quarter 4 year-over-year perspective.

Matthew Gan:

Just on this increase in marketing spend, can you speak to just give us some color on what those efforts are so far?

Brian Kyle:

I think the way to look at our marketing spend is, as Rafi mentioned in his prepared remarks, a large portion of that is around product enhancement, new product development, feature functionality in terms of new products that we would be bringing out, and most of it would be around the incremental spend in Poker and Betstars marketing areas.

I'm not sure if Rafi has another comment.

Rafael (Rafi) Ashkenazi:

I will just complement it very quickly. I mean we are continuing to invest into Poker and there is an increase in marketing budget going to Poker. Obviously we are supporting Betstars. We see positive outcome of our marketing efforts for Betstars so we do want to continue reinforcing it, especially in a year, in a World Cup year. We are gradually also increasing marketing budget for PokerStars Casino and we are planning to do more in the second half of the year.

It's essentially really reinforcing our current verticals.

Matthew Gan:

Okay. Thank you.

Operator:

Thank you. Our next question comes from Simon Davies with Canaccord Genuity. Please proceed with your question.

Simon Davies:

Yes, good morning guys. Just on Australia, you talked about cost synergies and the target of $50 million. You haven't talked about revenue synergies. Certainly in other consolidation deals we've seen in the industry revenue synergy numbers have been material. Can you talk about areas in which you might see upside to those numbers, and do you think in aggregate that the synergies you can generate in combining the two businesses can offset the impact of both credit betting and the introduction of gross profit tax (inaudible)?

Robin Chhabra:

Sure. It's Robin Chhabra here. Good to speak to you, Simon. As you said, we expect cost synergies in excess of, or at least $50 million. We've got continued growth in CrownBet as well. You'll have seen from the numbers that it's on a steep profit trajectory, and those factors should offset what we expect to come from the point of consumption tax, credit betting and other factors that you mentioned.

We're not guiding on revenue synergies but I think the assets we have have some particular qualities which should lead to better customer engagement. If you just look at the CrownBet platform versus the William Hill platform, the customers there are generating sort of higher bet frequency, more bets per active. The margins that the CrownBet trading team are generating for a given set of customers is higher than what William Hill was achieving, and again, Matt Tripp and his team have got some other benefits in their operations. They've got this unique partnership, this exclusive partnership with the AFL which you'll know is the most popular sport in Australia. They've got exclusive access to racing streaming across the PC and mobile, and they have easily the most, I guess the richest loyalty scheme in Australia.

So, we do expect the acquired customers from William Hill to respond positively to the CrownBet offering, but again, we're cautiously optimistic but we're not putting any numbers against that as yet.

Simon Davies:

Okay, thanks. Just a quick follow-up. The $182 million potential earnout payment, can you give us any sense of the terms behind that? Is this an incredibly stretched target? Is it one that you think that there's a realistic chance you might pay out?

Robin Chhabra:

We hope to pay out in that. We would welcome paying out that, yes. We hope that they do pay it and it's well within the scope of expectations. Again, time will tell. There's quite a few moving pieces, as you can imagine.

Simon Davies:

Okay. Many thanks.

Operator:

Thank you. Our next question comes from Suthan Sukumar with Eight Capital. Please proceed with your question.

Suthan Sukumar:

Good morning. The first question for me is on the casino and sports betting side. Obviously we're seeing continued trends with strong growth here. How should we think about some of the ongoing investments that you expect to make over the course of Fiscal 2018, I guess with respect to product and direct marketing efforts? Also, as part of guidance, are you able to share any targets for Sportsbook in Fiscal '18 in terms of percentage of total revenues?

Rafael (Rafi) Ashkenazi:

There are ongoing investments going into Casino and Sportsbook. As I mentioned on the call, a lot of it is really—if I'm looking at Casino specifically, a lot of it is really designed to increase the share of wallet and yield of our existing players. Most of it will come through new content that we are introducing on an ongoing basis: the whole treatment to VIPs, which is already yielding very positive results. We are adding new marketing tools. This is across Casino and Sportsbook, and we do see an increase of engagement which is driven by CRM activities and the Stars Rewards.

On top of that, we are also investing a bit more in localization and having specific content for specific markets. That's what we are planning to do for Casino.

When it comes to Sportsbook, the strategy hasn't changed. Again, it's really investing into the product and getting to product parity. We are investing more into localization. This is something which we believe is very important. The Sportsbook markets are very different from Casino. Casino is more of a commodity; you can have largely similar games across multiple markets. With Sportsbook, we see localization being quite a significant feature to have.

We do have a World Cup year, so I would say for the first time in the Company's history, we're actually moving from a defense strategy into an offense strategy and we are expecting to increase marketing activity around Sportsbook before the World Cup.

Brian Kyle:

Maybe just to continue on your next part of the question around guidance, I think the way to look at guidance is we don't, as you know, provide guidance based on our individual verticals. But that being said, one of our objectives is around improving the transparency, so as our Sportsbook continues to grow, as the Casino continues to grow, we will be providing enhanced transparency around that, so we should be able to address some of those questions in future quarters.

Rafael (Rafi) Ashkenazi:

I will also add if you look at the revenues from Casino and Sportsbook and you compare them to last year, if I remember correctly, last year Casino represented something along the lines of 92% of Casino and Sports, and this year Casino represents only 81% of Casino and Sports revenue—this quarter, sorry, the last quarter of 2017. I think this is something that you also need to take into account. Sportsbook is growing faster in terms of percentage compared to Casino, so we do think it will take a greater portion of our revenues in 2018.

Suthan Sukumar:

Okay, great. That's quite helpful, guys. Thank you. On the Poker side, it's quite evident the base ecosystem continues to improve. Can you speak to some of the trends you are seeing with the Stars Rewards program and how that's kind of impacted your tenure of retention and engagement? And if you can comment on lifetime value as well, that would be appreciated.

Rafael (Rafi) Ashkenazi:

Stars Rewards has a brilliant impact on the Poker business and we can see it also going into the first quarter with quite positive trading so far. The whole Stars Rewards program was really designed to increase engagement, to increase and optimize engagement, and it's working out quite well. We are now regarding the Stars Rewards as a platform. There will be what we are referring as the Stars Rewards 2.0 rollout in 2018, and overall, I think we are very pleased with the performance and the engagement of our players.

It also allows us, what we have, which is quite positive with Stars Rewards is the fact that it's very flexible. We can really ensure that when we are investing back into the ecosystem and back into the ecology and back into our players, we are really optimizing our spend and investing in the high value players. Again, as I mentioned, it's been yielding positive results so far.

Suthan Sukumar:

Great. Thanks for the color, guys. Thanks for taking my questions and I'll pass the line.

Operator:

Thank you. Our next question comes from Ralph Garcea with Echelon Wealth Partners. Please proceed with your question.

Ralph Garcea:

Good morning gentlemen. A couple of questions if I may. First, is there any way you can quantify the impact of the shared liquidity so far with France and Spain, either from an increased percentage in growth or from a dollar value? Just to give us a feel on what could happen once Portugal and Italy join.

Rafael (Rafi) Ashkenazi:

Shared liquidity has been very successful for the Company. I would say that it's approximately—I mean the combined shared liquidity is approximately 30% more versus the two markets operating separately or independently. So, quite positive for the Company.

Ralph Garcea:

Perfect. Then on the Sportsbook, can you give a percentage of how much of the handle was on mobile and where you think that can go once the full mobile product is rolled out?

Rafael (Rafi) Ashkenazi:

I don't have the exact breakdown for the mobile, but overall mobile for the Company is growing, and especially on Sportsbook, but I don't have the exact breakdown in front of me. Sorry.

Ralph Garcea:

Longer term, would you merge the three platforms on the Sportsbook side, let's say once you're into 2019, 2020? Or do you keep the brand, Betstars, CrownBet and the William Hill product separate? What's the plan sort of going into 2019, 2020 for the book?

Rafael (Rafi) Ashkenazi:

The Australian operation is planned to be managed separately as an independent business. We have a lot to do in 2018 merging the two businesses, and this would be the main focus. Moreso, CrownBet has been experiencing in the past three years very nice growth and we want to ensure that this growth trajectory continues into 2019 as well. So, for now, we have no intention to integrate between the product. We also believe, as I mentioned, before, localization for Sportsbook specifically is very important and the Australian market is a highly competitive market and we need to also ensure agility. There are no plans to integrate technologies or brands.

However, there are expertise in the Australian market and the Australian market management team that we believe that we can bring over to Europe and those expertise will be utilized for our Betstars operation.

In terms of the brand, we do have plans for the brand. This is quite a significant project which is undergoing at this stage and we probably will have some news to the market in the future, in the near future.

Ralph Garcea:

Okay. Just lastly on Russia, do you think they'll postpone any changes until after the World Cup? I mean why would they implement anything on the licensing side in May when you've got the World Cup starting mid June to mid July?

Rafael (Rafi) Ashkenazi:

We really don't know when this will come into force. They still have to draft the ordinance and we really don't know what will be the impact, and it may be delayed. We simply don't know at this stage and we are monitoring. But regardless to us monitoring the situation, we've developed also a mitigation plan which is quite a robust mitigation plan and we hope that whether this will be implemented or not, we will be ready.

Ralph Garcea:

Okay. Thank you.

Operator:

Thank you. Our next question comes from Maher Yaghi with Desjardins Capital Markets. Please proceed with your question.

Maher Yaghi:

Thank you for taking my question. I wanted to thank you for the improved disclosure that you have in your reporting and presentation slides. It's very helpful.

I wanted to ask you is Russia one of your six countries that is between 5% and 12% of gross gaming revenues?

Rafael (Rafi) Ashkenazi:

Yes, Russia is within our top countries. That's correct.

Maher Yaghi:

Okay. Can you tell us how much? What percentage it represents?

Rafael (Rafi) Ashkenazi:

No, we do not disclose this information.

Maher Yaghi:

Okay. Now, when—you've given us a lot of information on Russia, but I wanted to just understand what's built into your guidance when it pertains to Russia. You say that you have some reduced revenue expectations starting in May. Can you quantify what you built into your guidance, so that if there is any delays like you kind of mentioned potentially, we can get understanding of what extra revenue you could have beyond what you guided for?

Brian Kyle:

On that question, we don't specifically highlight what the individual element from a quantification perspective are in our guidance. I think, again, as more information around it becomes available, we will certainly be as transparent as we can moving forward on that.

Maher Yaghi:

Okay.

Rafael (Rafi) Ashkenazi:

Just to add one more comment here. We have assumed the potential impact from the financial blocking in Russia in our guidance. I think Brian mentioned it before but I just wanted to make it clear.

Maher Yaghi:

Yes. No, that was clear. Thank you. Wanted to just—when you said, Rafi, that you have put in place implementing—some kind of procedures to mitigate the impact, can you describe what those are and how much mitigation can you do in terms of protecting your revenue and your business profits from Russia?

Rafael (Rafi) Ashkenazi:

I can't really disclose the plans because they are confidential for primarily competitive reasons, and the level of impact of Russia is really currently unknown. We have Plan A and Plan B and Plan Cs for every type of scenario that may happen in the market.

So, we are monitoring, we are assessing, and we are ready with our mitigation plans, which unfortunately I can't disclose.

Marlon Goldstein:

The one thing I would add to that, just to give you some color and some content, this isn't the first European country to implement measures along these lines. We've dealt with it several times previously, so when we say we've developed mitigation strategies, that's based on our experience and the know-how and knowledge we've gained with those prior.

Maher Yaghi:

Okay. On leverage, can you tell us what was your calculated debt to EBITDA ratio at the end of the year? If you can, what would that ratio be after the closing of the transactions in Australia?

Brian Kyle:

Hi. Yes, so at the end of the year it was at about 3.6 and after the acquisition of the Australian acquisition it will be about the same, in that range. You should be thinking of it in the 3.5 to 3.8 kind of range.

Maher Yaghi:

Okay. Great. My last question on Kentucky. You discussed that some proceedings are going to start soon. Can you talk about when do you expect some form of decision on that front to happen, excluding any potential agreements you might have, but let's say that if you think about the legal aspect of it and what potentially it could take time to get a final decision?

Marlon Goldstein:

Sure. The case is currently pending before the appellate court in Kentucky. Oral arguments are set for mid April. In terms of a decision from that panel, our best guess at this point is perhaps late summer, maybe into the fall. Unfortunately, there's not a required deadline that the court has to issue a decision by. It depends on the judges and their docket and all sorts of other intangible factors, but our best guess right now is perhaps late summer, into the fall.

Maher Yaghi:

Okay, great. Thank you, guys.

Operator:

Thank you. There are no further questions at this time. I would like to turn the call back over to Mr. Ashkenazi for any closing remarks.

Rafael (Rafi) Ashkenazi:

I'd like to thank everyone for participating on today's call. We appreciate your ongoing interest and support of The Stars Group. Thank you and good-bye.

Operator:

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.