Q2 2018 Earnings 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 for analysts will follow the formal presentation.

As a reminder, this conference is being recorded today, Monday, August 13, 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.

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TIM FORAN

Thank you Operator.

Welcome to The Stars Group's second quarter 2018 conference call.

This morning, The Stars Group issued an earnings press release and filed its second quarter 2018 MD&A and consolidated financial statements on SEDAR and 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 or 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, financial statements, and MD&A for the second quarter of 2018.

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 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.

Reconciliations to the nearest IFRS measures are included in today's earnings press release, earnings presentation, and MD&A for the second quarter of 2018, which will all be available on our 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.

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RAFI ASHKENAZI

Thank you, Tim, and thank you everyone for joining us. With me on the call this morning are Brian Kyle, our Chief Financial Officer, and Marlon Goldstein, our Chief Legal Officer.

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Maintaining Strong Momentum

I am very pleased with The Stars Group's second quarter results, which were driven by exceptional performance and organic growth across our core business. Our quarterly revenues of $412 million represented a 35% increase from the prior year. Excluding the impact of acquisitions, our quarterly revenues of $350 million represented organic growth of 15%. As a result of this organic growth, our quarterly adjusted EBITDA increased by 15%, to $168 million.

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Transformative Acquisitions

Beyond our strong financial performance, the second quarter also witnessed a second major highlight: Our announced acquisition of Sky Betting & Gaming and the completion of our Australian acquisitions.

The first impacts of these acquisitions are visible in today's results, which reflect a full quarter of CrownBet's performance and roughly two months of contributions from William Hill Australia. This week, these two businesses will migrate onto one platform and into one brand, BetEasy. Our third and largest acquisition, Sky Betting and Gaming, reached completion on July 10, and its contributions will be reflected in our third quarter results.

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An Evolution in Structure

To optimize the management of The Stars Group's expanded business, we have started to restructure our business within geographic segments, and beginning with this quarter, we will also utilize these segments to report our financial results. Currently, these include an International segment, which is comprised of our existing Stars Interactive operations; an Australian segment, which is comprised of our two Australian acquisitions; and a distinct Corporate cost center. In the third quarter, we anticipate introducing a UK segment, which will include Sky Betting and Gaming. In the future, as our investments and operations in other jurisdictions develop, new geographies – such as the United States - may be reported as additional segments. Within each of these segments, our revenues will be presented within three verticals – poker, betting, and gaming, the last of which will include casino, bingo and other house-banked products.

These geographic segments reflect how we will manage our combined operations, and will ensure that our diverse global offerings are best-aligned to their respective customers' preferences. They will also offer an enhanced degree of transparency into our performance. Ultimately, this new structure reflects both the needs and the vision of our expanded business.

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Acquisitions Create Opportunity

This new structure will also guide us as we commence the integration of our acquisitions. Managing integration successfully is always challenging, and this process will require a period of measured transition.

However, upon completion of this transition, The Stars Group will be a transformed business, and possess several significant advantages.

Notable among these are:

- Superior poker and betting offerings, which will provide us with both two large, low-cost customer acquisition channels and the ability to cross-sell customers across all verticals; and

- Revenue security, as roughly 75% of our consolidated revenues will be generated by locally regulated or taxed jurisdictions. This security will be further enhanced by the greatly increased product diversity of our revenue base.

Perhaps the greatest advantage of The Stars Group's transformation is simply scale. We enjoy remarkable brand loyalty and customer awareness across our global markets. We are among the world's largest gaming businesses. And we are the world's largest online gaming business, as measured by enterprise value. We must seize the significant opportunity presented by that position.

I'll now pass the call to Brian, who will review our financial results for the second quarter and our revised outlook for fiscal 2018.

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BRIAN KYLE

Thank you, Rafi.

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Consolidated Revenue

And as you mentioned, The Stars Group's second quarter results were highlighted by the growth of our legacy business, which continues to build a track record of exceptional and consistent performance.

Our consolidated quarterly revenues increased by 35%, or 15% when excluding our recent acquisitions. Organic growth was driven by improvements across our gaming, poker and betting verticals. These improvements were partially offset by certain market changes, notably the cessation of our online poker operations in Australia and Colombia in the third quarter of 2017.

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Q2/18 Revenue Diversity

Our second quarter revenues underscore the growing geographic and product diversity of our business. 85% of our consolidated quarterly revenues were generated by our International segment, with the remaining 15% generated by our Australian segment. Roughly 53% of our revenues were generated by our poker offerings, 25% by our gaming offerings, and 20% by our betting offerings. Both product diversity and the percentage of revenues generated within regulated or taxed markets will improve further in the third quarter, upon inclusion of Sky Betting & Gaming's results.

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Consolidated Adjusted EBITDA

The Stars Group's revenue growth resulted in Adjusted EBITDA of $168 million for the second quarter, a 15% improvement from the prior year. Excluding the $13 million Adjusted EBITDA impact of our Australian acquisitions, our Adjusted EBITDA represents organic growth of 6%, primarily due to increased gross profit in our International segment. This benefit was partially offset by greater G&A expenses, as well as increased marketing expenses related to the World Cup.

Our margin contraction was primarily due to greater contribution from our Betting vertical in both the International and Australian segments. And as I noted last quarter, betting traditionally generates lower margins than our historical poker business.

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Consolidated Adjusted Net Earnings

Adjusted Net Earnings for the second quarter were $131 million, an increase of 15% when compared to the prior year. This improvement can primarily be attributed to the increase in our Adjusted EBITDA, as well as lower financing costs related to our April 6 amendment and extension of our existing long-term debt. These factors were partially offset by increased depreciation and amortization, primarily related to our Australian acquisitions. Adjusted Diluted Net Earnings per Share for the second quarter were $0.60, an increase of 7% when compared to $0.56 for the same period in 2017, with the increase in Adjusted Net Earnings partially offset by a higher share count.

On an IFRS basis, net earnings decreased from $70 million during the second quarter of 2017 to a loss of $155 million for the second quarter of 2018. This change was primarily due to a number of one-time acquisition related costs. For similar reasons, Basic EPS decreased from $0.48 per share in the prior period to a loss of $1.01 per share in the second quarter of 2018.

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Second Quarter Free Cash Flow

Cash flow from operating activities increased by 26% to $164M from $130M in Q2 2017, or approximately 7% to $150 million from $139 million excluding movements in customer deposit liabilities. Free Cash Flow for the second quarter was $85 million, an 11% decline from the same period in 2017, primarily due to increases in capital expenditures related to our investments in future product improvements.

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International Revenues

Our International segment generated revenues of $350 million during the second quarter, a 15% increase when compared to the prior year. This improvement was driven by organic growth within each of the segment's verticals. International revenues grew by approximately 11% on a constant currency basis.

Poker revenues increased by 7%, primarily as a result of the impact of our Stars Rewards program and the introduction of shared liquidity in Southern Europe. Poker revenues grew by approximately 4% on a constant currency basis.

Gaming revenues, which currently include our online casino business, increased by 26% for the second quarter, primarily as a result of our continued focus on improving this vertical's products and user experience. Gaming revenues grew by approximately 21% on a constant currency basis.

Finally, betting revenues, which currently include our BetStars brand, increased by 122%, primarily as a result of effective cross-selling and the significant impact of the World Cup, with a 72% increase in betting stakes. This vertical also benefited from a 1.8 percentage point improvement in its net win margin. Betting revenues grew by 106% on a constant currency basis.

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International Adjusted EBITDA

These revenue increases drove Adjusted EBITDA for the International segment to $164 million during the second quarter, a 13% increase from the prior year. Adjusted EBITDA margin for the quarter was 47%, an approximately 1 percentage point decrease from the prior period, due primarily to a decrease in gross profit margin, reflecting expanded operations in existing taxed markets and an increase in the proportion of lower margin Betting revenues as well as increased marketing costs related to the World Cup and other initiatives.

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International KPIs –QAUs

Turning to key metrics, the International segment hosted 2.02 million active unique players during the second quarter, a decline of roughly 5% when compared to the prior year, driven by the cessation of online poker operations in Australia and Colombia and continued negative operating conditions in Poland. Excluding these market changes, QAUs decreased by approximately 2%.

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International KPIs –QNY

Quarterly net yield within the International segment increased to $167 in the second quarter, a 22% improvement when compared to the prior year. This improvement was primarily due to the continued success of our cross-selling strategy. Betting yield also benefited from a higher win margin. On a constant currency basis, quarterly net yield increased approximately 18%.

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International KPIs –Net Deposits

Second quarter Net Deposits within the International segment increased by 19% when compared to the prior year driven by the same factors impacting revenues and QNY.

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Australia

Our Australian segment encompasses the acquisitions we have made in that country. During the second quarter, revenues for this segment were $61 million, with stakes of $710 million and a net win margin of approximately 8.6%. Adjusted EBITDA and Adjusted EBITDA margin were $13 million and 22%, respectively. We anticipate providing additional key metrics for this segment following further progress in their integration and migration efforts.

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Corporate Cost Center

As part of our new reporting structure, we will begin reporting a Corporate Cost Centre to encompass costs not directly associated with any of our operating segments. Looking at the impact these costs had upon our Adjusted EBITDA reflects the underlying corporate costs of our consolidated businesses.

Adjusted EBITDA for our Corporate Cost Centre was a loss of $10 million during the second quarter, compared to earnings of $1 million in the prior year period. This decrease was primarily due to a gain on a sale of an equity investment recognized last year. Excluding the impact of this gain, Adjusted EBITDA for our Corporate Cost centre decreased by $3 million due to both higher professional costs associated with our public company structure and lobby costs incurred to support our emerging market opportunities.

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Current Capital Structure

The company’s capital structure has also changed significantly following the issuance of equity and debt particularly related to financing of the acquisition of Sky Betting & Gaming and the conversion of our preferred shares into common shares, which removed a very dilutive security from our structure.

Following these changes, The Stars Group currently has approximately 272 million basic shares outstanding, plus approximately six million exercisable shares of other equity based awards.

Subsequent to the quarter, The Stars Group issued new debt to repay our existing debt and that of SBG, and to fund a portion of the cash consideration for that acquisition. As a result, pro forma of completion of the acquisition on July 10, The Stars Group had long-term debt of approximately $5.7 billion. Inclusive of our operational cash, net debt was approximately $5.3 billion.

Subsequent to the quarter, we also entered into cross currency interest rate swaps to fix our interest rates and hedge currency risk. Therefore, we anticipate total annualized debt servicing payments of approximately $340 million, which includes required amortization of principal. Our current cost of debt is approximately 5.4%.

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Future Capital Structure

Based on our cash flow conversion and minimal capex obligations, we currently anticipate that we will have the ability to delever on an orderly basis while investing for future growth opportunities, including expansion within the United States.

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Regulatory Updates

Beyond our results, I'd like to provide a brief update on some of the more notable ongoing regulatory matters across our primary markets.

- In the UK, the government recently announced that it was exploring an increase to the gaming duty charged on poker, casino, and bingo products. Currently, gaming duty within the UK is charged at a rate of 15% of gross gaming revenues generated by these products. Details on the quantum and timing of this possible change are as yet unknown, as the government stated that it will provide further details following a period of engagement with the gaming industry. It should be noted that sportsbetting is excluded from this review.

- In Australia, most state governments have recently introduced or passed anticipated legislation related to the introduction of point-of-consumption taxes on sports betting revenues. Rates and implementation dates have generally fallen in line with our expectations.

Such taxes have been in place in South Australia since July 2017. Similar taxes have been announced in almost all other Australian states, with anticipated implementation in late 2018 and early 2019. Victoria and New South Wales, which account for approximately two thirds of our Australian customers, have imposed rates of 8% and 10% respectively. As we have previously stated, we believe our scale in Australia will help us navigate these changes. We anticipate that their impact, as well as the impacts of both a credit betting ban introduced in 2018 and typical migration loss related to our upcoming brand consolidation, will be offset by the benefits of our Australian strategy of combining our two acquisitions into a single business. These benefits include both profit growth and our targeted A$50M in gross cost synergies, savings that we believe we will begin to realize during 2019. Rafi will speak further to this consolidation in a moment.

- This month, the Italian government enacted a law that restricts all gambling advertising and sponsorships. Any arrangements currently in place are permitted to continue for a year. There is still a lack of clarity how this decree will be interpreted, and whether the proposal will face legal challenges at either the domestic or EU level. In general, we do not support restrictions that may inadvertently assist the unregulated black market to thrive at the expense of regulated entities. However, we are a leading online brand across verticals in the market, and will look to take advantage of any opportunity to secure more market share if such restrictions end up negatively impacting the profitability of smaller, less-recognized operators.

- In Spain, the government has reduced online gaming duties to 20% from 25%. While this change will result in a minor financial benefit, it reflects the government's understanding of how a tax rate above 20% overly restricts the growth of licensed and taxed operators. Across the globe, we continue to lobby in favour of strong regulation that protects customers while maximising tax revenues.

- Elsewhere in southern Europe, Portugal joined France and Spain in PokerStars' Southern European shared liquidity player pool. We are hopeful that Italy will follow suit in 2019, as we believe this pool has proven to be a success for players, governments, and regulated operators.

- In Russia, we continue to monitor the development of recent regulations that may restrict the number of Russian payment processors for gambling transactions. Certain banks and processors have begun to block payments . However, many appear to be awaiting further clarification on ordinances related to the government's financial blocking bill.

- Finally, the most notable regulatory change of this quarter took place in the United States. In May, the Supreme Court struck down the country's nearly 30-year ban on sports betting. Since that point, multiple states have passed or proposed legislation that would allow for both land-based, online, and mobile sportsbetting. We have recently announced our intentions to offer betting in both New Jersey and Pennsylvania, alongside our poker and casino products. Rafi will speak further to this significant opportunity in a moment.

As it relates to our pending litigation in Kentucky, we await a decision on our appeal from the Kentucky Court of Appeals, and hope to provide further update within the second half of this year.

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Outlook

As I turn to our revised guidance for 2018, I'd like to reiterate how encouraged we are by the strong results of our legacy operations during the first half of this year. Their consistent performance is the foundation for our positive outlook on the second half, when we will begin to recognize the benefits of our acquisitions.

The Stars Group's updated guidance reflects contributions from these acquisitions as of their respective completion dates, as well as related changes to our capital structure. These changes include increases to both our long-term debt outstanding and number of common shares issued and outstanding.

Our updated 2018 full year guidance ranges are as follows:

- Revenues of between $1.995 and $2.145 billion, as compared to between $1.390 and $1.470 billion;
- Adjusted EBITDA of between $755 and $810 million, as compared to between $625 and $650 million;

- Adjusted Net Earnings of between $485 and $545 million, as compared to between $487 and $512 million;
- Adjusted Diluted Net Earnings per Share of between $1.99 and $2.22, as compared to between $2.33 and $2.47; and
- To provide visibility on the combined business, we are also introducing guidance on anticipated annual capital expenditures, which we anticipate to be between $110 million and $150 million.

This guidance 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, including net win margin percentages related to our betting verticals. You will notice that the guidance range is wider than we have previously given, and this reflects the inclusion of Sky Bet, the Australian acquisitions, and the growth in BetStars, where short-term swings in sports results mean that a wider guidance range is now appropriate.

Notable changes in assumptions from previous guidance include a reduction in the assumed rate of various currencies, notably the Euro, against the US dollar, which is now assumed at an average 1.17 to 1.00 for the full year of 2018 versus the 1.20 to 1.00 average that was assumed in previous guidance, and also a diluted share count of between 241 to 243 million versus the range of 207 to 209 million anticipated in previous guidance.

I will now turn the call back to Rafi.

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RAFI ASHKENAZI

Thank you, Brian.

As I stated at the outset of the call, we're very pleased with the organic growth demonstrated by each of our verticals during the second quarter.

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Growth and Challenges in Poker

Our poker offering generated yet another quarter of encouraging organic growth. This vertical continues to recognize the benefits of not only our focus on high-value players and the Stars Rewards program, but also the shared liquidity pool in Southern Europe, where Portugal recently joined France and Spain. We also witnessed our Indian partner's launch of PokerStars.IN in April, and introduced multiple innovative new online cash game poker variants.

These positives were somewhat offset by the impact of the World Cup. As we witnessed during the 2016 Euros, our poker business traditionally experiences a slowdown during major global sports events, and this World Cup was no different. In fact, its impact was slightly compounded by how effectively we cross-sold our gaming and betting offerings into our poker player base.

For the balance of the year, we anticipate that poker will encounter some short-term headwinds. Notable among these are the ongoing impact of the World Cup during the third quarter, the absence of recent forex tailwinds, and a potential slowdown in the Southern European shared liquidity market due to the entrance of new competitors. Furthermore, we have now lapped the July 2017 introduction of the Stars Rewards program that has served as a key growth driver for this vertical.

We will confront these challenges and aim to drive growth in future years by continuing to offer the world's most compelling poker product, introducing new game variants, developing an enhanced version of our loyalty program, entering new markets, encouraging shared liquidity in remaining ringfenced markets, and promoting the game globally through our live events. These events will be highlighted by our live PokerStars Players No-Limit Hold'Em Championship in the Bahamas early next year.

All of these strategic initiatives give me great confidence that poker will continue not only to provide a foundation for our expanded business, but also to strive for further organic growth in 2019 and beyond.

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Improving Gaming Offering

We are likewise confident in the future of our gaming business, which once again produced outstanding organic growth during the second quarter.

This growth has been driven by our successful focus on product improvement. We continue to roll out new and innovative games at a record pace. In total, we launched more than 150 new titles during the first half of 2018, including both our first multi-tiered in-house jackpot and the first game produced via our Game Developer's Kit, a tool set and API for external studios to develop unique content for us.

As a result of these product and content improvements, PokerStars Casino is beginning to emerge as an industry leader. Moving forward, we will seek to accelerate this emergence by improving the other elements of our customer experience, including our CRM execution. We expect that these product, content, and marketing capabilities will be further enhanced by our acquisition of SBG, and we are excited to integrate their capabilities following CMA approval.

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A Victorious World Cup

The success of our product improvement strategy is also clearly evident within our betting vertical. BetStars had an exceptional second quarter, with revenues more than doubling as a result of both a 70% increase in stakes and a higher net win margin.

This performance can be attributed to the great strides our betting product has made over the past year. BetStars continued this evolution during the second quarter, implementing multiple improvements to its user experience and features and introducing a ‘Bet at the Table’ option for our poker players.

BetStars’ product improvement enabled it to take full advantage of its first significant involvement with the World Cup. Effective cross-selling and the global awareness associated with this event resulted in record player participation for the brand. During the first quarter, BetStars exceeded 100,000 bettors for the first time. We nearly doubled this number during the first week of the World Cup alone, and hosted roughly 70,000 unique players on the tournament’s opening day. We also witnessed greater mobile app performance in several of our top tier markets.

We anticipate maintaining this positive momentum during the second half of 2018. However, the fourth quarter will represent a difficult comparable for the European sports betting industry as bookmakers recorded an unusually high win margin during the fourth quarter of 2017. To put this into perspective, if sports results are normal in Q4, SBG would need to see nearly 50% stakes growth to hold betting revenue flat. While sports results ebb and flow over time, Q4 2017 was an unprecedented period of house-friendly results.

While we are again very pleased by the second quarter performance of our legacy businesses, we are at the same time excited by the current and upcoming integration of our acquisitions.

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Integration: Australia

In Australia, we are in the process of combining our two businesses. We will migrate William Hill Australia's accounts onto the CrownBet platform, and operate the consolidated businesses as a single brand, "BetEasy." This change, which will be effective as of this month, will increase our visibility, allow for both cost synergies and far greater marketing efficiency, and accelerate our pursuit of the leadership position within this geography.

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Integration: SBG

Our acquisition of Sky Betting and Gaming reached completion a month ago. Our integration efforts are in the planning stages and will proceed once we receive approval from the UK's Competition and Markets Authority. This review is common and was fully expected, specifically within a sector where there has been previous and will be continued consolidation. We have proactively taken steps to comply with CMA guidelines, and submitted our pre-notification filing with the CMA prior to the transaction's closing. We are working closely with the CMA, and will operate The Stars Group and Sky Betting & Gaming independently until we receive their formal approval.

Following CMA approval, our focus for integration will be on international opportunities and driving improvements across our betting and gaming verticals.

Given SBG's strong track record within the United Kingdom, we intend to minimize disruption to their operations within that market. This track record continued in the first calendar quarter of 2018, when SBG grew revenues by 18% on a British Pound basis.

SBG is currently preparing its audited annual financial statements for its fiscal year ending June 30, which we expect to file with our Business Acquisition Report by early October. At this point, we anticipate Q2 revenue growth of mid to high teens on a British Pound basis.

Beyond the business's financials, it is notable that Sky Bet established itself as the UK's most popular bookmaker during the World Cup. According to research firm YouGov, Sky Bet claimed the largest percentage of UK sports bettors during the event. This achievement reflects SBG's 100% online, mobile-focused business, as YouGov further detailed that online betting was roughly three times as popular as its retail counterpart. Data points like this serve as encouraging evidence of SBG's ability to continue growing its market share.

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Near-Term Priorities

The integration of these acquisitions represents our immediate focus. As I mentioned in my opening remarks, we intend to adopt a measured approach towards this integration, moving forward in phases so as to accommodate the magnitude of our combined business.

The successful integration of our acquisitions will allow The Stars Group to further expand our leading positions within the world's largest markets. It will also allow us to establish leading positions within emerging markets – most notably the United States.

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US Opportunity

The magnitude of the opportunity represented by the United States cannot be overstated. However, we believe this opportunity will evolve slowly, and that a deliberate, strategic approach will best position us for long-term success. To that end, we are methodically evaluating all opportunities to partner with land-based operators, including large multi-state gaming companies, leading casinos in defined geographic areas, tribal gaming operators, and media companies. We will update you as this process continues, and are pleased with both of our announced initial expansions into this market.

In New Jersey, we have extended our existing partnership with Resorts Casino to include online and mobile sports wagering, which we anticipate launching under our BetStars brand in the near future subject to regulatory approvals. BetStars will be available alongside our existing poker and casino offerings in New Jersey and we will focus on cross-sell initially as we incrementally improve the mobile product and offering – including after we integrate SBG - before considering significant marketing spend in the future.

In Pennsylvania, we announced a partnership with Mount Airy Casino Resort to enter the Commonwealth's online gaming market, which we currently anticipate will launch in 2019 following licensing by the Pennsylvania Gaming Control Board. Pursuant to our agreement with Mount Airy, we will offer all three verticals in Pennsylvania – poker, casino and sports betting.

In both states, we intend to secure leading market positions by leveraging our online and mobile-led betting and gaming expertise, customer trust and loyalty. We will be using our proprietary technology and player account management platforms to provide customers with a seamless offering of gaming and betting options through a single account, common wallet, and supported by various online and mobile depositing and cashout options.

Beyond New Jersey and Pennsylvania, we intend to continue to execute on our strategy to expand our offering in the United States, which will focus on:

(1) selectively partnering with land based gaming operators and/or lotteries in key U.S. States, with a focus on densely populated geographies;
(2) providing a multi-vertical offering of poker, casino and sports betting, which we believe will provide a quicker path to profitability allowing for reinvestments to continue to take market share; and,
(3) following approval of the CMA, exporting to the U.S. market our deep expertise with respect to the integration of media and sports that was developed through the Sky Betting and Gaming business in the U.K.

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Looking Forward

Again, we have a long-term view of the US opportunity, and have adopted a disciplined approach to this evolving landscape. However, there can be no doubt that this opportunity will represent a major step towards our vision of becoming the world's favourite online gaming destination.

Today, I am proud to state that I have more confidence than ever in our ability to realize this vision. The Stars Group's core business continues to demonstrate remarkable organic growth. Our recent acquisitions provide us with a global footprint, greater diversity, product improvements, and exceptional brand awareness. As a result, we are ideally positioned to both expand our existing markets and capitalise on new opportunities.

More importantly, my confidence is driven by the quality of our now more than 4,000 employees, whose dedication and talent never fail to inspire me. The Stars Group is emerging as an industry leader in many ways, but we have no greater advantage than the quality of our people. I look forward to sharing the results of their hard work.

Thank you. Operator, we may now turn to questions.

Operator:

Thank you. We will now be conducting a question and answer session for analysts. In the interest of time, we ask that you please limit yourself to one question, one follow-up question, and re-queue for any additional. If you would 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 would 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 is from Chad Beynon with Macquarie Group. Please proceed with your question.

Chad Beynon:

Hi, good morning everyone. Thanks for taking my question. Nice quarter and thanks for all the detail there. Just wanted to go into the 2018 guidance a little bit more. It sounds like on the Poker side you have obviously some tough comps and some near-term headwinds that you called out given the World Cup and the shared liquidity. Then on the Sports side, really the only thing is the tough 4Q on Sky Bet, given higher expected margins. Within your revenue guidance, are you able to provide some type of same-store basis, kind of what this looks like, and is that kind of a fair assessment that you have some tough comps here and that's why the guide is where it is? Then, secondarily on the guidance, just to confirm, you're not really assuming any synergy costs within your EBITDA guide. Thanks.

Brian Kyle:

Hi, Chad. It's Brian. Thanks for the question. Let me just take a step back for everyone on the call to reiterate what we said before about guidance, that management does look at guidance as a commitment, and I think that's the starting point for people to understand.

If we look at our second quarter results, we were pleased with where those results came in, and they are tracking to our expectations. The updated guidance that we have provided does reflect on a consolidated basis the legacy Stars Group business, the Australian acquisitions, and Sky Betting & Gaming. So, we are looking at a consolidated guidance number and moving forward into 2019 we will continue with that approach.

In preparing the revised guidance, there were a number of issues and factors that we looked at and we needed to consider. I think it's important for people to recognize that we did acquire three businesses; with that comes an awful lot of complexity. The operational complexity internally with the management teams focused on integrating those businesses, but there's also a number of accounting complexities through various purchase price accounting, valuations, and some of those issues also flow into the results that we need some time to get a handle on.

But I think if we move to answer your question, Chad, if we look at the underlying businesses, I think the first point I want to make is that our legacy business is expected to continue to perform well and we believe that we've got a very solid foundation that will allow us to continue to grow that into the future. There are a number of issues that we will be addressing: one, our Stars Reward Program, the benefit of that will be reduced significantly as it's now phased in and in our run rate; the shared liquidity in Southern Europe is being accessed by our competitors and they're may be some impact to that moving into the second half of the year. We've talked previously about some concerns around payment blocking in Russia and that continues to be on our watch list, and potentially, with the continued weakening of the Euro, we could have some headwinds with respect to foreign exchange.

That's really how we looked at the legacy business.

Our Australia business run by Matt Tripp and his team, they're focused on the integration and migration of the two businesses and they're making very good progress, but it is early, and like the other operators in Australia, the environment is becoming more and more competitive from a pricing perspective.

So, again, they have some issues there but Matt and team are doing a great job on the integration and the migration of those two companies. But again, it is early.

If we look at Sky Betting & Gaming, again, we are very excited about this opportunity. We believe we've got a great business. We're looking forward to executing on our integration plan and to begin realizing our cost synergies and revenue synergies. However, as Rafi mentioned in his prepared remarks, we do need to wait to get approval from the CMA before we can actually start moving forward and integrating those businesses.

So, we do have a few challenges that we're working through, a few uncertainties specifically around the CMA timing on that, and we feel that the guidance again that we presented is a very attainable level and certainly a commitment that Management is focused on.

Rafael (Rafi) Ashkenazi:

I would add one more comment here. You guys probably need to look at 2018 as a year of transition as we merge as a new company towards 2019, and in regards to your synergies question, we are assuming synergies in Australia but almost nothing meaningful in the U.K. as we are waiting for the CMA approval.

Chad Beynon:

Okay, great. Thank you very much. Yes, I understand that there's a lot of moving parts in 2018 and it's more about 2019, but thanks for the commentary.

Then just on the cap ex, the guidance that you provided, are you able to parse out if there is a U.S. cap ex number here that resulted in this to be a little bit more elevated? Just maybe some more color on kind of how this looks, given that it's slightly higher than the combined cap ex from I believe the legacy, the Sky Betting and the Australian legacy business. Thank you.

Brian Kyle:

On the cap ex front, we felt it would be appropriate to begin providing some guidance on cap ex as it's critical to understanding our free cash flow analysis. It is higher. The guidance is higher. The range is a little broader. It factors in a number of potential opportunities which could include U.S.

opportunities as well as some additional organic growth activities that we would look at in terms of building some development costs.

There's also an opportunity where we may want to invest further in capex in terms of capital equipment for infrastructure, so there's a number of initiatives that are on our roadmap and we felt that we would provide that range to give some clarity as to where it could go.

Chad Beynon:

Okay, great. Thank you both very much.

Operator:

Thank you. Our next question comes from the line of Tim Casey from BMO. Please proceed with your question.

Tim Casey:

Yes, thanks. Could you flesh out your initial impressions of the U.S. landscape, how it's evolving? Obviously understand it's early days but how are you reacting to what some of the competitive developments have been? Just in general, could you talk about how you're approaching the potential partnerships?

Just as a clarification on that cap ex number, should we assume that as kind of a—I know you're not giving guidance for '19, but should we assume that that is a run rate going forward, or is there some one-time items in that $110 million to $150 million? Thanks.

Brian Kyle:

Hi Tim, it's Brian. Yes, there could be some one-time number additions in there, but again, I would look at it that is a good indication right now of our run rate range for cap ex.

Marlon Goldstein:

Hi Tim, it's Marlon. On your question about the U.S., I'll try and give a little bit of color on that.

As you've seen in our prepared remarks and in our announcements, we have entered into an agreement to expand our offering in New Jersey to include sports betting. We have also entered into an arrangement to launch all three of our verticals - Poker, Casino and Sports - in the Commonwealth of Pennsylvania; two markets that we think will be very strong and very competitive for us as we're able to launch and operate all three of our verticals.

We continue to evaluate opportunities to partner with other land-based operators across the country, but we're being very selective and we're being very strategic in the way in which we evaluate those opportunities.

We are talking to multi-state operators, one-off casinos in select jurisdictions, tribal operators and media companies where we look to leverage our unique expertise through Sky Betting & Gaming in partnering and collaborating with media that we've gained in the U.K., which we think we can export to the U.S. in a very meaningful way.

We will keep a very watchful eye; we're very active here, but we do think it's going to be an evolution over a number of years in this marketplace. We intend to be active in all aspects of the U.S. market as it evolves, and we will certainly make announcements and update everyone as that happens.

Tim Casey:

Thank you.

Operator:

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

Simon Davies:

Good morning, guys. Just returning to the U.S., do you expect to launch in almost all states under your own brand Stars Bets and sports betting? Also, can you give us a first feel for the likely level of marketing spend in the U.S.? Do you have any sense of likely start-up losses as you're going into 2019?

Rafael (Rafi) Ashkenazi:

We are planning to launch surely with Poker Stars. This is a very significant brand. It has a lot of equity in the U.S. so Poker Stars will surely be part of our brand strategy for the U.S.

As it comes to Casino Stars and Bet Stars, this is something that we will need to deal with tactically on case-by-case or state-by-state basis as we move forward with our operations in the U.S.

In terms of the marketing investment, I think it's too early to determine what would be the marketing investment in those states. We need to understand better the competitive landscape. We need to understand what is the equity that we currently have within our existing customer base. There are also some different strategies that we need to consider, obviously cooperating with the land-based casinos that we are working with and potentially utilizing some of their customer base, land-based customer base. There are a lot of different activities and a lot of different strategies that we are considering, so it's too soon for us to determine what would be the marketing investment for the U.S. We will take, though, a measured approach, as we said.

Simon Davies:

Just as a follow-up, you've talked previously about ramping up marketing spend in the fourth quarter to start to launch into recruiting customers directly into the Casino product. Is that still your expectation or is that going to get pushed back alongside the Sky Betting acquisition?

Rafael (Rafi) Ashkenazi:

This is still our expectation to move forward with Q4 acquisition on Casino, on Casino Stars. I believe we have a very strong product today. Previously we wanted to bring the product into a position that we feel comfortable to start marketing and acquiring customers. We've made very significant progress with our Casino offering, and Casino is doing really extremely well. We've launched more than 150 games only in the first six months of the year. We are launching now a very nice, new website for Casino Stars. We are going to launch the new brand in Q4, so yes, everything is essentially focused on starting the acquisition strategy for Casino Stars in Q4 of this year.

Simon Davies:

Should we expect a ramp up in marketing spend in the fourth quarter?

Rafael (Rafi) Ashkenazi:

Yes, gradually.

Simon Davies:

Thank you.

Operator:

Thank you. Our next question comes from David McFadgen with Cormark Securities. Please proceed with your question.

David McFadgen:

Thank you. Yes, I have a couple of questions on the guidance. The previous guidance of 625 to 650, that didn't include any of the acquisitions. I'm just wondering on that legacy business, is the guidance still the same or is it down a bit given all the headwinds that you've identified here?

Rafael (Rafi) Ashkenazi:

The guidance for the core or legacy business is essentially the same despite the impact of currency, but guidance remains the same.

David McFadgen:

Okay. So it doesn't seem like Russia is having much of—it doesn't seem like Russia had any impact on Q2 and it doesn't seem like Russia is expected to have much of an impact going forward then on the legacy side. Is that correct?

Rafael (Rafi) Ashkenazi:

Russia didn't have a lot of impact in Q2. There is a slight impact on acquisition in Russia as we remain relatively silent in the market, waiting to see how our strategies evolve. Yes, we are expecting and hoping that we will continue these operations in Russia for the remaining of the year, and any impact would be hopefully margin on the business.

In September, we are also launching the Sochi Live event, and we are going to ramp up marketing around this event.

David McFadgen:

Okay. If I can just squeeze one more question in, on New Jersey, I know you're partners with Resorts. Resorts also announced a deal with one of the other, like DraftKings or FanDuel.

Rafael (Rafi) Ashkenazi:

Yes, Draft Kings.

David McFadgen:

I was just wondering how does that impact you on the sports betting side because they are also going to offer sports betting with DraftKings.

Rafael (Rafi) Ashkenazi:

Every operator has, to my recollection, three schemes, three sports schemes in the market. We expect to have quite a few different operators launching in New Jersey and potentially quite tough competition for the market.

It's not something that we can deal with it. The fact that Resorts has also signed with DraftKings is basically just optimizing, or maximizing their commercial opportunity in the market. It's not affecting us. All we needed ourselves is to have access to the market. We already have a player base in the market. We already operate in the market. DraftKings is new to the market. To my knowledge they are going to operate only sports betting, which will probably be a little bit tougher to operate. But from our perspective again, if I'm just thinking about the Stars Group, we just did it to have access and we've got the access and we are satisfied.

David McFadgen:

Okay. Thank you.

Rafael (Rafi) Ashkenazi:

You're welcome.

Operator:

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

Suthan Sukumar:

Good morning, guys. Just kind of looking ahead, given the cap ex guidance, how should we think about de-leveraging going forward? Are you able to share any targets or goals for the full year?

Brian Kyle:

Yes. No targets but continuing in the theme that we've presented before, we're looking at focusing our free cash flow generated over the next couple of years into aggressively de-levering the business. Our underlying business, as I mentioned, the foundation is strong, we've got the acquisitions that are lining up that will continue to drive very strong free cash flow. Think of it as to the extent that we don't utilize our free cash flow for incremental organic growth initiatives, the vast majority of it will be used for de-levering.

Suthan Sukumar:

Okay. Thank you. Just kind of quickly from me on India, just was curious to know if you guys were able to share any update on any progress that you're making in that market, any player KPIs that you guys have been observing recently?

Rafael (Rafi) Ashkenazi:

It's very early days for India. To an extent I can say that the product is not really ready in full for the market. There are a few elements that we still need to—a few gaps that we still need to close before we start our marketing campaign, probably in Q4, more towards Q4 of this year.

You can refer to India currently as a soft launch where we'll increase focus on this market probably starting in Q4.

Suthan Sukumar:

Great. That's helpful. Thank you guys.

Rafael (Rafi) Ashkenazi:

No problem.

Operator:

Thank you. Our next question is a follow-up from David McFadgen with Cormark Securities. Please proceed with your question.

David McFadgen:

Great, thank you. Just two more questions. Is there any update on Kentucky? Then on Pennsylvania, when do you expect this market to actually go live?

Marlon Goldstein:

No update on Kentucky at this point. We are still waiting for the decision from the appellate court in Kentucky. There's no set timeline on when that could come, so we are in waiting mode at this point.

In terms of the Pennsylvania market will be fully operational, we have applied for a license in Pennsylvania. We're going through the process right now. Our best guess is probably Q1 at this point, but we'll continue to update as that progresses.

David McFadgen:

Okay. Then just one other one. Do you expect the ad ban in Italy to have much of an impact?

Rafael (Rafi) Ashkenazi:

It will have an impact. It's not something that we are very happy with. Fortunately for us, we have a very significant base in Italy. We are the largest operator in Italy, and we have been given, as the rest of the industry, a year to approximately start revising and adjusting our strategies to continue acquiring customers in Italy. We just need to find different and more creative ways to do that.

Yes, it will have an impact. If you're asking can I quantify this impact, no, I can't really quantify this impact. We have a year of transition where we need to really think outside of the box how to operate in the market and how to continue pushing for acquisition in this market. But again, fortunately for us, we are the largest operator. We do have the largest player base and hopefully we'll get the CMA approval very soon and we will be able to bring Sky Betting & Gaming into this market in a more active way. That's currently our thought process in regards to Italy.

David McFadgen:

Okay. Thank you.

Operator:

Our next question comes from the line of Daria Fomina with Goldman Sachs. Please proceed with your question.

Daria Fomina:

Hi. Thank you. I have two questions. One is very basic and (inaudible). Given you are still waiting for CMA approval, from which dates you consolidate SBG for your guidance? Then my second question is also on SBG. Can you provide a bit more color on how the second quarter was evolving? It was a bit more competitive on the marketing side in the U.K. judging by what SBG (inaudible) are reporting.

Then related to or maybe a follow-up to your previous answer on Italy, anything changed in your view on the announcement of acquisition in terms of the SBG prospect in Italy? Again, in relation to the ban on advertising. Thank you.

Brian Kyle:

Hi. Your question were—you went through those very quickly so I hope we have them correct here. The first one was, when we did we consolidate the results for Sky Betting & Gaming? On the acquisition date, July 10. Effective July 10 forward, into our guidance we included those results for the balance of the year.

Rafael (Rafi) Ashkenazi:

Sorry, I'll just jump in for a second, just to make it clear. We basically, from July 10, own the company, so the results are consolidated from July 10. The CMA approval is a different, separated, independent process that runs by the anti-trust authorities in the U.K. and it's a standard procedure in which we are pending for their approval, so these are not related.

Brian Kyle:

I'm sorry, could you repeat your second question?

Daria Fomina:

Thank you for your answer. The second question was on the performance trends of the second quarter at SBG, and especially on their marketing spend. It seems that it's a bit more competitive with a number of brands trying to increase their share of voice in marketing spend in the U.K. Can you give us a bit more color how the second quarter was trending for SBG?

Rafael (Rafi) Ashkenazi:

I would say that the trends for SBG were good for the second quarter. There was an obviously enhanced marketing spend as everyone else, all the operators, the rest of the industry invested during the World Cup. It's something that happens every four years and marketing investment is growing.

Our estimation is mid to high teens in terms of revenue for growth for SBG in the second quarter.

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:

Thank you everyone for participating on today's call and the ongoing interest in the Company. Thank you and good-bye.

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.