The Stars Group Inc. Q2 2019 Transcript
August 12, 2019

CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

SLIDE 1: 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 12, 2019.

Replay details are included in The Stars Group's earnings press release issued earlier this morning. I will now turn the call over to Vaughan Lewis, SVP Communications.

SLIDE 2: VAUGHAN LEWIS

Thank you and good morning.

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. 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. Please refer to today's press release and the webcast presentation for more information.

During the presentation, we will reference non-IFRS financial measures. For more information about these measures and reconciliations to the nearest IFRS measures, please refer to the appendix of the presentation.

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Today's earnings press release and presentation will both be available on our website.

I will now turn it over to our Chief Executive Office Rafi Ashkenazi

RAFI ASHKENAZI

SLIDE 4

Good morning and thank you for joining us on the call today. With me is Brian Kyle, our CFO, who will provide further details about our second quarter financial results and 2019 outlook, and Robin Chhabra, the CEO of FOX Bet, who will expand on our plans for the launch of FOX Bet in the U.S.

Turning to slide 4, I would like to start with an overview of our second quarter 2019 highlights.

Over the past few years we have built a leading company in the online gaming industry through a combined strategy of organic and inorganic growth. Importantly, we have de-risked and diversified our revenue base as we have transformed from a poker-only company with less than half of our revenues generated from locally regulated or taxed jurisdictions to a balanced and highly diversified betting and gaming company with nearly 80% of revenues regulated or taxed, with the prospect to increase that figure to over 90% over the next 18 months.

In line with this strategy, we continued to execute against our top 3 strategic priorities for 2019 during the second quarter, as we continue to position the business for strong, long-term sustainable growth:

1. First, Integration. The Sky Betting and Gaming acquisition has already benefitted the company in multiple ways, and we are now beginning to realize even more significant revenue synergies. After migrating the SkyBet Italy player base to our PokerStars platform, we are pleased to

report that Sky Bet by Stars in Italy had a great quarter, with betting revenue growth of over 25%. We are expecting further revenue synergies as we reinforce the partnership with Sky Italia. I'm also delighted to confirm that we just launched Sky Bet in Germany, and we'll begin cross-selling players from sports betting to poker and casino in the near term. In addition, to further accelerate revenue synergies, we are working on what we refer to internally as the 'UK Eco-System.' Beginning in early 2020, customers in the UK will have their accounts paired across our brands available in the market, enabling quick and easy fund transfers between wallets, with Sky Poker being relaunched as Sky Poker by PokerStars, and providing UK customers with access to the some of the best poker, casino and sportsbook product offerings in the world.

2. Second, we remain focused on execution and are encouraged by the strong momentum we are seeing in our business. We reached a number of key milestones during the quarter: SBG reported record quarterly revenues in local currency, with impressive adjusted EBITDA growth of over 50%, PokerStars hosted a new record online poker tournament with over $100 million in prizes, we cemented our very exciting launch plans for FOX Bet in Pennsylvania and New Jersey and secured further market access, and BetEasy signed a strategic partnership with Kayo Sports, an Australian multi-sport streaming service.
3. Third, as we remain focused on rapid debt repayment, we have repaid $350 million of our first lien term loans so far this year, and have repaid over $500 million since completing the SBG acquisition last year. We are on track to reduce leverage towards our target ratio of net debt to adjusted EBITDA of under 3.5x in the medium term.

SLIDE 5

Moving on to slide 5, I'll recap our financial results for the quarter.

The second quarter of 2019 was a busy quarter for the core Stars International business, with growth in most markets offset by certain market closures, and disruption in some other markets. Overall, constant currency revenues were down just 2.5% despite these headwinds, which I'll explain further in a moment.

Sky Betting & Gaming was a key driver of our overall performance this quarter. The investments in promotions that we made in the first quarter are paying off, as the UK segment added $253 million of revenue, with Quarterly Active Uniques, revenues and adjusted EBITDA hitting all-time highs for the business, all while our betting net win margin was 9.7%, just slightly above our historical long-term average. Our Q2 results reflect the underlying strength of the business, and we remain on track to see low double-digit growth in revenues for the full year. We believe this has been an exceptional acquisition for the company, and given the strong future growth prospects for the business, as well as our unique ability to replicate the proven SkyBet model with FOX Bet in the U.S., I'm very confident that this acquisition will drive strong shareholder returns.

SLIDE 6

Moving on to our second quarter highlights on Slide 6, we continued to drive innovation and product leadership in all key geographies.

Within our international segment, we hosted the world's first online tournament series that paid out over $100 million with our Spring Championship of Online Poker, and we continue to cement our leadership in poker tournaments. Casino had another great quarter, with underlying growth of around 20% as we continued to roll out new casino games and further improved cross-sell rates.

Within SBG in the UK, as previously mentioned, the business saw a record performance. We were very pleased to see the strong and immediate return on investment from our Cheltenham Festival promotion during the first quarter, while the Grand National in April was the biggest single event in Sky Bet history, with Stakes up by more than a third from last year. In addition to racing, we saw record soccer Stakes on the Champions League final, which even exceeded the levels we saw during last year's World Cup games.

BetEasy also had another solid quarter, with 13% growth in stakes and an Adjusted EBITDA margin of 11%, in-line with our expectations. We signed an exciting strategic partnership deal with Kayo Sports during the quarter that we believe positions us well to expand further into the recreational market in Australia going forward, leveraging the media integration strategy from our SBG business to drive effective customer acquisition and retention through sports media.

SLIDE 7

Turning to slide 7, I'd like to expand on some of the factors that are impacting the reported performance of our international segment, and why the strength of our underlying operations is not being fully reflected in our reported results.

As you can see in the chart on the left, our Rest of World or top tier markets which now represent 83% of international revenue are seeing organic growth, with 4% growth in constant currency. This growth rate is relatively consistent with the 6% rate that we saw in Q1 2019, and we believe it broadly reflects the current underlying growth profile of the segment.

We then have a group of disrupted markets, where our products, marketing or payments have been disrupted, or where we have had to suspend or otherwise adjust our offerings as part of the regulatory or licensing process. These markets now only represent around 15% of our international revenue compared to 20% in Q2 2018. The main markets within this segment are Russia, Norway, the Netherlands, Switzerland and Slovakia.

On the top right, you can see the impact of the trends that we experienced in these markets over the last few quarters. Within these markets in the aggregate, constant currency revenues were down 27% in both Q1 and Q2 2019. That being said, we have seen encouraging signs of recovery in these markets, most of which are largely stabilizing, and we are optimistic about our prospects for the future, with encouraging trends in Russia, strong potential in the Netherlands as we move towards a full local license, and our plan to relaunch our Swiss poker business on a local licensed basis in the second half of 2019.

The recovery in these markets has been a little slower than expected, and the launch of our licensed poker business in Switzerland is slightly delayed. As a result, we now expect our international segment revenues for the full year to be lower by a mid-single digit percentage. Nonetheless, we have taken rapid action to reassess and optimize our cost base in this segment in order to mitigate the adjusted EBITDA impact and free up funds to invest in product and marketing in our top tier markets, supporting our mid-term growth targets.

There are many exciting opportunities emerging in this segment, including newly regulated markets, and our plans to increase marketing spend on direct customer acquisition for casino and betting. These initiatives give us confidence that our revenue growth will accelerate as we begin to lap the majority of the disruption in certain markets from the beginning of 2020.

SLIDE 8

As we move to slide 8, I would like to take a moment to reiterate our confidence in our strategy to deliver strong, sustainable future growth.

We are operating in large and high-growth markets, with encouraging regulatory progress in the US and Latin America.

We are a diversified global leader in this industry, and I am pleased with the progress we made during the quarter to leverage the capabilities across the group, as evidenced by the operating momentum we saw with Sky Bet in Italy, and the development of our plans for our UK ecosystem integration, that will enable our UK customer base to benefit from our leading PokerStars products.

We believe we have significant, sustainable competitive advantages, and we continue to leverage these to grow market share in our attractive end markets. We further strengthened our market share in key markets in the second quarter, and continued to launch further innovative, proprietary products and content.

Our business is uniquely set up for scale benefits. With our strong brands, proprietary technology, and operating expertise, we have the ability to replicate our products in new markets. These competitive advantages also provide us with an immediate head start in new markets, and I am really excited about the forthcoming launch of FOX Bet in the U.S., which Robin will expand on shortly.

Finally, we believe we have a highly attractive financial model, and continue to generate strong cash flow, which we currently intend to use for debt reduction while investing for future growth.

With that, I'll turn the call over to Robin, who will provide additional detail on our plans to launch FOX Bet in the second half of 2019.

ROBIN CHHABRA

SLIDE 10

Thanks Rafi, and good morning.

The U.S. betting market is the largest and most exciting medium-term growth opportunity for our company. We believe our proprietary technology, operating expertise in sports betting, and our unique FOX Sports brand partnership positions us ideally to become a leader in this market.

SLIDE 11

You can see a couple of examples of how our FOX Bet products and odds will be seamlessly integrated into the FOX Sports broadcast on slide 11.

This provides us with huge, sustainable competitive advantages – significantly broader access to recreational sports fans as potential customers, a trusted, authentic and credible brand, and a series of free to play games that will become part of the day-to-day sporting and entertainment narrative for sports viewers in the US, in turn driving ongoing engagement with our products.

The scale of FOX Sports is impressive, and will create a wide funnel of potential customers for both our free to play games, and in relevant states, our real money betting products.

Our partnership with FOX Sports also provides us with direct access to nearly all U.S. households. In fact, The FOX Broadcast Network is the leader in live sports viewing, broadcasting more events – with viewership over 20 million more than any other sports network – and is available in 99% of U.S. households. FOX Sports 1 is one of the leading cable sports networks and is available in over 80 million U.S. households, featuring more than 800 live sporting events annually.

SLIDE 12

Since we last spoke in May, we have been focused on securing the plans for our launch, as highlighted on slide 12.

We have built a strong, experienced team including great operators from Sky Bet, BetStars and from other leading sports operators. We have also transferred some fantastic creative talent from FOX Sports over to FOX Bet and signed up many FOX Sports presenters, all household names, to be brand ambassadors for FOX Bet, which will increase our alignment with this great brand. Eric Shank's team at FOX Sports have been incredibly engaged and we believe we have the operational plans in place to begin replicating the success of the Sky Bet model in the US.

We have most of our market access partnerships in place, with potential access in up to 20 states, including recent deals with the Mohawk Casino Resort in New York and Penn National Gaming.

With our plans in place I would like to provide some additional colour on our expected investment. We currently expect to invest approximately $40 million in the second half 2019 primarily focusing on customer acquisition, launching the FoxBet brand in Pennsylvania, relaunching our betting product in New Jersey with FoxBet, building strong and talented operational and marketing teams, and product development across the real money and Free To Play apps.

We currently expect to continue investing in the business next year, and based on our expectations of the regulatory environment, state openings, skin availability, and expected addressable market size, we anticipate the US business to break even by the end of 2022

To put this investment into context – as previously discussed, we see an addressable market opportunity of around $9 billion of revenue by 2025. We are not planning to sit at the sidelines now that we have one of the strongest media partners in the world and a strong strategy in this emerging market. Rather we are planning to ensure that we become one of the market leaders in this industry across all product verticals and free to play games.

I couldn't be more excited about the launch of FOX Bet. With our world-class proprietary technology and strong operating expertise, and with the FOX Sports brand partnership, we are poised for an effective launch.

With that, I will hand over to Brian for more details about the Q2 results.

BRIAN KYLE

<u>SLIDE 14</u>

Thanks Robin, and good morning. As you've heard from Rafi, we have continued to make significant strategic progress during the quarter, and it is really exciting to outline our plans for Fox Bet in the US.

I'll now provide a bit more context on the second quarter, starting on Slide 14 with a summary of our financial results. As reported, net earnings for Q1 was $5 million. After adjustments including removing the amortisation relating to purchase price allocations, adjusted net earnings was $138 million, giving us adjusted diluted net earnings per share of 48c.

On a proforma basis, revenue declined by 2% year-over-year. However, we saw constant currency growth of 4%, as most of our major currencies were weaker year-over-year compared to the US Dollar. As we lapped the World Cup, and were impacted by disruption and closures in certain markets, this underlying growth of 4% was in-line with our expectations.

As highlighted on the slides, the acquisitions we made last year have significantly improved our mix of revenue from regulated and taxed markets and de-risked our business, with 79% of revenue now from regulated or taxed markets, and a further 12% from markets that are in the process of potentially regulating.

Lastly, we continue to rapidly pay down debt and ended the quarter with net debt of $4.75 billion, down from $5.06 billion at the end of March 2019.

Over the next few slides, I'll provide an overview of our quarterly performance by segment.

SLIDE 15

Turning to slide 15, I would like to start with additional details about our performance in the International segment.

As you heard from Rafi, encouraging trends in most markets were offset by headwinds in certain disrupted markets. Despite these headwinds, as reported revenues were down 8% with constant currency revenues down only 2.5%.

Within poker, revenues were down 12% in the second quarter, or down 7% in constant currency. In line with last quarter, we are experiencing low single digit poker growth in most markets offset by headwinds in certain disrupted markets. As a reminder, we will begin to lap the majority of the disruption from Q4 2019 onwards in poker, and continue to believe we will see low single digit growth in constant currency over the medium-term.

Our casino revenues were up 2%, which represented 9% growth in constant currency, despite the impact from certain disrupted markets and some closures. The strong underlying performance reflected the continued success of our product and content roll-out, with new game launches continuing at about 30 per month, as well as continued progress in cross-sell which reached new record levels during the quarter. Excluding the markets where we have seen disruption, on a like-for-like and constant currency basis, underlying casino revenue growth was approximately 20% year-over-year.

Betting revenue was down 7% as reported, with stakes flat as we lapped the World Cup in the prior year period, and faced the impact of certain market closures. We also continued to rollout new products, including virtual racing and more Request-A-Bet variants from Sky Bet. During 2020, we plan to ramp up direct acquisition through our international Sports business, and currently expect to see strong growth rates follow suit in the upcoming years.

Our adjusted EBITDA margin was down 2.5 percentage points at 44.5% during Q2. The gross margin was 3.7 percentage points lower, as we continue to increase the mix of revenues from regulated and taxed markets and saw higher taxes in certain markets. This gross margin decline was partially offset by our continued efficiency gains and the delivery of acquisition synergies.

SLIDE 16

Turning to the UK segment financials on slide 16, which currently comprises the SBG business and are presented in pounds sterling.

The second quarter was an exceptional period, setting new record levels in local currency for financial and operational performance for the business. Stakes grew 15% to new record levels, a strong performance against tough comparatives which were boosted by the World Cup in the prior year. We saw strong engagement from new customers that were acquired during the Cheltenham Festival in Q1 2019, and with a new record level of Quarterly Active Uniques, we continue to see strong returns from this investment. Gaming revenue was up 20%, also a strong performance that reflected the growth in actives and the continued rollout of premier product, content and promotions.

The betting net win margin was 9.7%, which was broadly in-line with our long-term historical average of around 9%, but slightly below the same period last year, resulting in betting revenue growth of 9%.

Overall revenues were up 13% to an all-time-high in pounds sterling of £196 million. The Adjusted EBITDA margin was up 11 percentage points during the period, benefitting from the phased investment in marketing and customer acquisition in Q1 2019. With that said, we believe that the year-to-date adjusted EBITDA margin of 33% is a fairer reflection of the ongoing profitability of this segment, after a focus on efficiency and streamlining of the cost base to mitigate the higher gaming duties that came into effect during Q2 in the UK.

The SBG business reported impressive adjusted EBITDA during the quarter, and remains on track with our cash flow and adjusted EBITDA expectations from the time of the acquisition.

SLIDE 17

Turning to slide 17 we provide an overview of the financial results for the Australian segment. As a reminder, this is in local currency to provide increased clarity about the underlying operating trends.

Stakes growth in the quarter was 13% to 1.1 billion, with continued solid trends driven by the roll out of our personalisation plan and successful player management. The prior year period includes the acquisition of William Hill Australia from April 2018, with 3 weeks at the start of the period that only relate to Crown Bet. If we included the full contribution from William Hill

Australia in Q2 2018, staking growth on that basis would be 5%, a strong performance considering the trends in the William Hill Australia business prior to acquisition and migration of its customer base to the BetEasy platform.

The betting net win margin of 8.5% in the period was broadly in-line with our expectations, with adjusted EBITDA of 10 million Australian Dollars at a margin of 11%, consistent with the range of 10% to 20% that we previously outlined and reflecting the impact of the new point of consumption taxes that were all in place in the first quarter.

Looking at the rest of 2019, we expect to capitalize on the personalization of our products to increase customer engagement and satisfaction, and drive profitability through our focus on high-value, recreational customers. We therefore expect a slightly higher betting net win margin in the second half of the year, assuming normal sporting results, and we are on track to continue to achieve an Adjusted EBITDA margin within the range of 10% to 20% in 2019.

SLIDE 18

Turning to slide 18, I'd like reiterate the strength of our cash generation.

Our adjusted EBITDA in the period was $237 million. After working capital and adjustments, this covered our cash interest costs of $51 million and tax of $39 million, of which $18 million reflected one-time tax payments related to pre-acquisition periods in Australia.

Capex was $37 million, and we had integration costs of $5 million. Overall, this meant that we saw free cash flow of $85 million in the period. Excluding the items that are more one-time in nature, including integration costs and historical tax settlements, and adjusting for the pre-payment of debt, this would have been around $120 million available for debt paydown.

We have already repaid $350 million of debt this year, following a $100 million repayment in Q4 2018. As we prioritise debt reduction with our strong cash flow, we continue to monitor debt capital markets in order to optimize our capital structure given prevailing market conditions.

SLIDE 19

Turning to slide 19, I'd like to provide an update on our 2019 guidance.

We now expect revenues in the range of $2.5 to $2.575 billion. This represents growth of 5-8% on a constant currency proforma basis. The change in our revenue guidance reflects the impact of updated FX rates, a historically low betting net win margin in the first quarter in the UK, the slower than planned recovery in our disrupted markets, and some delays in launching our newly licensed operations in certain jurisdictions, such as Switzerland.

We previously indicated that we would likely be at the low end of our adjusted EBITDA guidance range of around $960 million, and we are now updating this to reflect the following main factors:

(1) First and as Robin outlined here, we plan to invest around $40 million into our very exciting US opportunity, as we look to build a leading and prominent presence with the launch of FOX Bet. With our proprietary technology, sportsbook operating expertise and leading brand, we are excited for the tremendous opportunities this investment brings.

(2) and second, a $15 million increase in FX headwinds compared to previous assumptions, with the US Dollar further strengthening against our major currencies.

Taking these factors into consideration, we now expect adjusted EBITDA in the range of $905 and $930 million. Excluding the impact of the change in FX and investment in the USA, our adjusted EBITDA guidance range would be $960-985 million, relatively consistent with our prior guidance.

After taking into account our expected depreciation, interest and tax, this amounts to adjusted EPS of $1.68 to $1.83, based on 283 million diluted shares. For a detailed discussion of the factors and assumptions underlying our guidance and the changes to the same, please refer to this morning's earnings release and the appendix of the webcast slides.

We now expect total capital expenditure this year of about $150 million, at the higher end of our previous guidance range due to our investments in the U.S.

Importantly, during 2019, we remain focused on our strategic priorities of integration, execution, and debt reduction, and we are laying the foundation for strong future growth.

With that, I'll now hand over to Rafi to conclude.

RAFI ASHKENAZI

SLIDE 20

Thanks, Brian. To conclude and recap the quarter:

- We continued to build our US plans with further market access deals and preparation for our FOX Bet launch, and we are ready to build FOX Bet into a market leader.
- We saw all-time-highs in our UK segment, with strong returns from our Q1 investment in player acquisition; and
- We saw over 25% growth in Sky Bet in Italy, and just relaunched Sky Bet in Germany.

We believe the transformation of our business is paying off and we are confident that we have built a strong platform to deliver our medium-term growth plans.

And with that, I would like to hand the call over to the operator to begin the Q&A session. As usual, Marlon Goldstein our Chief Legal Officer is joining us for questions.

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Operator:

Thank you. We will now begin the question and answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. We ask that you limit yourself to one question and re-queue should you have a follow-up. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. Once again, to join the question queue, please press star, then one. We will pause for a moment as callers join the queue.

Our first question comes from the line of Thomas Allen with Morgan Stanley. Please proceed with your question.

Thomas Allen:

Hey, good morning, everyone, well, depending on where you are. Just touching on FOX Bet first, how should we think about kind of the 2020 and 2021, how this business is going to trend? If it's $40 million of losses in the second half of this year, does that mean $80 million next year, or should that go down? I know you said that breakeven target is late 2022, but just wanted to think how we should think about our models. Also, are you going to report it as a separate segment? Thank you.

Robin Chhabra:

Hi, Thomas. This is Robin Chhabra speaking. Yes, so look, as I said in my prepared remarks, we're going to invest heavily in this opportunity. We are talking about the biggest opportunity this industry has seen for a generation. Given the assets that we've amassed, we're certainly not going to sit on the sidelines. Following the partnership with FOX, we have a strong brand, amazing market access, great technology, great operating expertise. You've seen the market access that we have with Eldorado, with Penn, Mohawk, Mount Airy and Resorts, and of course, we've got funds to invest from the cash generation from the rest of the group.

What I would also say is that we will invest in a disciplined manner. We have natural benefits here. With the brand, with the marketing integrations, we can attract a lot of customers at competitive CPAs; with the product that we have, with the operating expertise that will drive player values, and we will be taking advantage of the scalable global platform, so that FOX Bet will have an efficient cost structure. So, yes, we will invest, but the ROIs should be very, very good.

Now, when it comes to 2020, I wouldn't necessarily extrapolate the $40 million and annualize that, especially if we're only looking at just Pennsylvania and New Jersey. We are setting up the business, so some certain costs won't repeat. Revenues this year will be low because we're investing to build a customer base rapidly, and that involves quite a lot of cost in terms of bonuses and offsets and that will dissipate over time.

That said, look, if there are a couple of big states opening in the back end of next year, then we're going to want to launch strongly, and we will do so. That will lead to short-term cash outflows, but that will be the right thing to do for the business. So, we're not sitting on the sidelines, we are going to invest in this opportunity, and we expect to drive strong returns. As a result of all the assets and capabilities that we have.

Brian Kyle:

Thomas, this is Brian. Just to answer your second question on reporting it as a separate segment, definitely this is going to be one of our most strategic business opportunities that we're going to be focused on. We are aligning it to be structured as a separate segment. We expect to report it as a separate segment beginning in 2020.

Thomas Allen:

Thank you both. Then in the quarter SBG's U.K. business really stood out with really strong margins, and appreciate the commentary that we can kind of extrapolate first half margins going forward, but can you just talk about the sustainability of the strength here, and should it continue to be this kind of a lumpy one period of investment then you reap the rewards as we go forward? Thank you.

Rafi Ashkenazi:

Hi, Thomas. Yes, we do expect sustainability in this business. This business is a strategic asset that we have in the U.K. We will continue investing exactly in the same way that we are investing, that we have invested so far, we just had the beginning of the season, this last weekend, and we've been doing quite a lot of investments for the beginning of the season because we want to ensure that we are set up well for the start of the season and for the rest of the year.

I would say, yes, we do believe that there will be sustainability in this business. We're not planning to operate on those high-level margins going forward. Exactly as we said, we are seeing this business operating at approximately 33% margin, but in terms of the investment profile, this will continue going forward, and we still expect this business to grow. It's, in our belief, the best asset in the U.K. There is no reason in the world not to continue investing and not to continue taking market share and not to continue to build our customer base.

Thomas Allen:

All helpful. Thank you.

Operator:

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

Chad Beynon:

Hi. Good morning. Thanks for taking my question. On the disrupted markets that you parsed out in one of your slides, you noted that the business has stabilized from a loss standpoint, reflecting kind of a similar type of loss as we saw in the first quarter. As we think about the algorithm, particularly for international going forward, is the goal to really stabilize this, or is there hope that given some of the things that you're doing internally in those markets, that these markets could eventually grow off of where they are? Just trying to figure out how this kind of plays into the medium-term outlook. Thanks.

Rafi Ashkenazi:

Not a problem. We are planning to grow this business. I mean, we have been in the same situation before where we have FX impact versus the headwinds. We have demonstrated quite a great recovery over the past three years, '16, '17 and '18. This business, in my view, has the biggest opportunity outside of the U.S. simply because the business is so global. Markets are opening up all the time. There are opportunities in Brazil; we're about to launch in Argentina; we're still working and lobbying for the Italy shared liquidity; we're going to launch Poker in the U.S., even though it's going to be reported, obviously, in the U.S. segment; the Netherlands is now in the process of regulating, and we see the Netherlands as a great opportunity; and we're doing some work around rebranding within the International business.

Essentially, the concept that we have is really to promote two master brands, if you wish, one is the PokerStars brand and the other one would be the Sky Bet. In markets where we operate PokerStars, and we don't have great brand equity in Sky Bet. We are likely to move away from BetStars and start promoting PokerStars Sports and also PokerStars Casino, and then have PokerStars as the master brand. We believe through that we can get more marketing efficiencies in those markets. Obviously, markets where we do have Sky Bet as the brand, and it's available, and we do believe that we have good relationships that we can build with the local Sky broadcaster, like Sky Italia and Sky Deutschland, then obviously we will start investing in those brands.

We are not looking at this business on a basis of stabilizing it, we are looking at this business on the basis of what do we do in order to continue growing this business, and we do believe we will continue growing this business.

Chad Beynon:

Okay. Thanks, Rafi. Then my follow-up is just back on the U.S. market, some of your competitors have given very broad targets in terms of market share. Are you willing to provide some goalposts on what your internal expectations could be a few years out after the programming and the integration is fully launched, and we're at a better steady-state?

Robin Chhabra:

Sure. Look, with the assets and capabilities that we've amassed, we expect to do very well in this market. We're not going to give our market share targets right now. Let's see how we evolve. But we are planning to invest in the market, $40 million this year, $40 million is the starting point for next year, and, as I said, with the brand, with the technology, with the marketing integrations that we have, we expect to do very well in this market, but at this stage we're not giving out target market shares.

Chad Beynon:

Okay. Thank you very much.

Operator:

Thank you. Our next question comes from the line of Omer Sander with JP Morgan. Please proceed with your question.

Omer Sander:

Hi, guys. Thanks for taking the question. Can you help us understand your 2019 guidance, how much of this reduction has to do with disrupted markets? Then what's included in that Other cost bucket that looks like it was up $65 million from prior? Then just on top of that, how do these moving pieces flow into those medium targets you've provided previously?

Brian Kyle:

Yes. Hi. I think the way to look at our guidance going into the balance of the year, starting with where we landed in Quarter 2. Basically, the Quarter 2 results were in line with our expectations. These were reflecting record results in SBG, not only from a financial perspective, but also from an underlying operational perspective, so we were very, very pleased with that. The other point I want to highlight is the cash flow and the free cash flow generation. Again, this was at exceptionally strong levels coming in on an adjusted basis at about $120 million, and we continue to execute on our debt reduction strategy paying off about $250 million in the quarter and making this our third consecutive debt repayment quarter since we closed on SBG.

Looking at specifically Adjusted EBITDA, we were tracking at the lower end of the guidance range in Quarter 1 after reflecting the low net win margin that was realized in the quarter coming in at about 6.1%. Quarter 2 we were back in line with our 9% average. Again, all we're doing is adjusting from that low-end average to reflect FX impact, which is about $15 million based on current spot rates, and the investment that Robin outlined in the U.S. which is about $40 million. Adjusting for those two items only, we're going from the low-end of our range, the historic, the original guidance range, down to our new range of $905 million to $930 million.

Omer Sander:

Thank you. That's helpful. Then second, on the U.S., has it become easier—I know it's early—but has it become easier to find partnerships given the relationship with FOX Sports, and how has the rollout proceeded relative to your expectations, both on the regulatory and on the partnership side?

Robin Chhabra:

Sure. I think we're very happy with where we are in terms of access. We've got access to potentially 20 states, and you would've seen the recent announcements on Mohawk in the key state of New York and obviously Penn National Gaming. We are absolutely confident we will get all the access we require and, as you correctly said, life becomes even easier now we have FOX as a partner, so no issues there.

I think I would agree with a number of my peers in the sector when I say that the pace of legislation has been more rapid than we thought, which is obviously very good news for the entire market. We are seeing more states go live faster than we anticipated. We are seeing more bills pending than we anticipated, which is all very good news for us.

Rafi Ashkenazi:

I just want to add one quick comment here. It's been only three months since we signed the deal with FOX, only three months. We need to consider that in the big picture. Since we signed FOX, we're going to roll out very soon a range of free-to-play games, and we're were going to launch FOX Bet in Pennsylvania ahead of the NFL season and relaunch BetStars as FOX Bet in New Jersey. Obviously, we've already built up further market access positions in more markets, and it's been only three months since we signed this deal, so, yes, we are expecting still a lot to happen in these markets, obviously.

Omer Sander:

All right. Thank you.

Operator:

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

Tim Casey:

Thanks. Sticking with the U.S. opportunity, you've got a line in the slide where you talk about breakeven in 2022. Can you talk to us about what is in that assumption? Also, Robin, you mentioned $40 million as the starting point for 2020. Reasonably, how many states should we expect you'll light up in addition to Pennsylvania and New Jersey in 2020? Thanks.

Robin Chhabra:

There are number of factors. We've obviously run a number of scenarios. There are number of factors which you will appreciate—the pace of legislation, the size of the markets that legalize, tax rates, the number of verticals which are legalized that obviously influences cross-sell rates and also the number of skins that are available because that influences competitive intensity in those states. It's based on a reasonable assumption on each of those that we get to a breakeven position in the back end of 2022. Clearly, a material change in those factors could lead to a change of outlook. There are positive reasons why that may be pushed back because we're gaining lots and lots of market share, the unit economics are very positive, the returns on investment are very strong. But, based on what we see today, that's our best estimate.

In terms of state rollouts, I would imagine that we're looking anywhere between, say, two to four states every year. We are going to prioritize those states which are the largest which present the best opportunities for us. Also, where FOX are particularly strong, as well there are a number of factors. So, again, we will prioritize based on potential economic returns.

Tim Casey:

Thank you.

Operator:

Thank you. Our next question comes from the line of Joe Stauff with Susquehanna. Please proceed with your question.

Joe Stauff:

Thank you. Good morning. I wanted to ask about Sky Bet and the stakes growth that you had in the second quarter and how to think about that. You had mentioned the newer subscribers and customers that you had achieved basically at the horse race. It certainly contributed to that, but I was wondering if you can help us understand other drivers that really help generate that type of stakes growth in the quarter.

Rafi Ashkenazi:

Sure. I would say it's going back to all the basics that Sky Bet is doing so well, first of all and above everything, the retention level, I think I mentioned it several times, when we looked at the Company before acquiring Sky Betting & Gaming, we were highly impressed by the retention level of their customers. It's not something that we see in the gambling industry. It's something that you can see in other industries, not very frequently in the gaming industry. As a matter of fact, I've never seen that degree of retention level in any company in the gambling industry. The ability to continue to retain customers and obviously monetize those and increase the ARPU of those customers will continue to contribute to the stakes level that we have.

Secondly, Sky Bet in general is a category builder. We are investing in promoting sports book, and we are investing in making the market bigger. We've been quite successful doing so. When we look at the market share in terms of the customers, we do have the largest market share in the U.K. from a customer base perspective, and that's, obviously, another area where we believe that we are going to continue to generate or increase stakes levels.

Other than that, I mean, it will be all the usual tactics that every gambling company is doing in terms of promotions and CRM and bonuses etc.

Joe Stauff:

Okay. Thank you. My follow-up is on the disrupted markets. Russia is, correct me if I'm wrong, a large contributor just in terms of that aggregate disrupted markets. I know in past quarterly conference calls, you had provided some update in terms of trends. Can you provide that for your Russian business in the second quarter on a sequential basis?

Rafi Ashkenazi:

Sure. We do see sequential improvement in the Russian market, and it is improving. You can't really compare Q1 to Q2 because in Q1, even though we said it's stabilizing nearly 20%, 27% lower in those both quarters, there were some other impacts that happened in Q1 that happened later. Just as an example, we still had Switzerland for a period of time in Q1 with Casino; we still had Slovakia until the end of Q1. We do see sequential improvements in Russia, and I'm quite excited about this market because there are more opportunities that we're seeing in this market. First of all, we just signed the UFC deal; we're going to launch the UFC TV campaign in Russia very soon. On top of that, we are planning to apply for a sports book license in Russia under the PokerStars Sports brand, and we are seeing, again as I mentioned, sequential improvement in the market. We added more and more payment methods, so as time goes by, I do expect Russia to continue growing.

Joe Stauff:

Thank you.

Operator:

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

Simon Davies:

Good morning, guys. Can I kick off asking about Germany? You've launched your Sports product in German market. Obviously, they're planning to launch a licensing process for sports in the new year. Can we assume that you're planning to apply for a license and, if so, do you see any risk that that might impact on your ability to offer a Casino and Poker product in the German market?

Marlon D. Goldstein:

Simon, hi. It's Marlon. How are you?

Simon Davies:

Very good, thank you.

Marlon D. Goldstein:

I can tackle this one for you. Look, if we look at Germany, I think for the foreseeable future we anticipate the status quo to continue for quite some time. We've talked previously that we have a license from Schleswig-Holstein, and that permits us to operate all verticals in the market, not just sports. In terms of the current State Treaty, as you know, that expires in June of '21, and we're hopeful that as things progress, the next State Treaty is going to include a broad commercial framework similar to what Schleswig-Holstein has already adopted that's going to allow the operation of all products, not just sports. So, we are hopeful looking forward, but, currently, we expect the status quo to continue.

Simon Davies:

If there is a licensing round over the next three, four months, would you expect to participate in that for sports licenses?

Marlon D. Goldstein:

I think that's something we would take a good look at, and certainly we will evaluate it as it comes.

Simon Davies:

Great. Then just, secondly, in terms of your target breakeven in the U.S., can you give us some kind of indication of what kind of revenue run rate you need to achieve that breakeven level?

Robin Chhabra:

We're not providing that information at this time, as I've said. Once we launch, as we get some data through, we'll share more about our plans in the future, but nothing for now.

Rafi Ashkenazi:

I'm going to add one more quick comment around Germany. As I mentioned on the call, we have launched Sky Bet in Germany under the PokerStars ecosystem, so now Sky Bet is fully integrated into the PokerStars ecosystem, and we have signed a relationship or a partnership with Sky Deutschland, and we're going to be integrated and obviously continue to develop this business in the market, so we're quite excited about this market overall.

Simon Davies:

Great. Thank you.

Operator:

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

David McFadgen:

Hi. Thanks for taking my questions. Let me first of all just start off with the International business. You talk about—actually, you didn't talk about it, but

Apple has said that starting, I think, in early September, all the betting apps or all of the apps have to be completely native iOS apps, can't have any HTML 5 components. I'm just wondering if you're going to be compliant there. I'm just wondering about the risk to the International business, I guess specifically Poker. Maybe you can address that and then I'll follow up.

Rafi Ashkenazi:

Sure. The answer, when it comes to Poker and PokerStars, is very simple. This is all native, so there's essentially no risk. By the way, the same goes for BetEasy and same goes for some of the other features that we have within the PokerStars business, and all the rest of the business is taking whatever preparation and adjustments in order to make sure we are in compliance with the iOS policies.

David McFadgen:

Okay. Great. Then just a question on Fox Bet. I was kind of surprised at the level of investment. I guess it's for customer acquisition, so I was kind of surprised given the PokerStars database, the U.S. database that you guys can use, and then FOX's U.S. digital database that you can obviously use as well. I was just kind of surprised. What is really the factor driving those EBITDA losses in the short-term?

Rafi Ashkenazi:

I wasn't sure if you're asking if you're surprised because it's too low or it's too high, but I guess you mean it's potentially too high in your view.

David McFadgen:

I thought it was a little high, but anyways, if you could talk about it.

Robin Chhabra:

Look, we wanted to take full advantage of this opportunity, and we want to take market share and build substantial customer bases on top of the ones we have access to. Yes, poker is a very important vertical in U.S., but sports betting is far more mainstream, far more widespread, and will attract a wider number of people, so we need to look beyond our poker database if we want to become one of the leaders in this market. As I said, I think we will deliver very good returns on investments as a result of the FOX brand, as a result of marketing integrations in some of the exclusives we have with them, so I feel confident that we will generate positive returns for shareholders from that investment. But as I said, we need to look beyond those existing databases if we want to become a leading player in this market, and that is clearly our intention.

David McFadgen:

Okay. All right. Thank you.

Operator:

Thank you. Our next question comes from the line of James Rowland-Clark with Barclays. Please proceed with your question.

James Rowland-Clark:

Hi. I've got a couple, please. First one is just a point of confirmation on the U.S. losses. I think you said earlier that $40 million loss is a good starting point for next year. I just wanted to double check that. Does that mean to say that the $40 million of losses this year have about $20 million of certain nonrecurring or accelerated costs in that number? Then, secondly, in the past you've given us a flavor of how the quarter is progressing so far for Sky Bet, so I wondered if you could just give us a flavor of how Sky Bet is performing so far in Q3.

Then, finally, on the guidance you've had a fairly regular stream of downgrades in the last 12 months, so is it fair to say that your new guidance is a little bit more conservative than usual? Thank you.

Robin Chhabra:

I'll take the question on the U.S. losses. So, $40 million for this calendar year, that's 2019, $40 million is a starting point for next year, but what I said was that I wouldn't necessarily annualize that if we're just looking at New Jersey and Pennsylvania and obviously the free-to-play. What could change that would be launches, particularly in the second half of next year in large new states where there could be significant investments to build customer bases. That's the position as far as the losses, the investment is concerned.

Rafi Ashkenazi:

When it comes to Sky Bet in Q3, we started Q3 in a very positive way, and we actually had the start of the season which kicked off this last weekend, and we had a very good start. Sky Bet or Sky Betting & Gaming is doing well in Q3 so far, and I'm expecting them to continue to do well throughout the year and going forward in general. I mean, I do genuinely believe it's the best asset in the U.K.

When it comes to the guidance, I wouldn't say that we're too conservative here. I would say that we are realistic with our estimations for the year.

James Rowland-Clark:

Okay. Great. Thank you.

Operator:

Thank you. Our final question comes from the line of Gianluca Tucci with Echelon Partners. Please proceed with your question.

Gianluca Tucci:

Yes. Hi. Good morning, guys. Just a question on your efforts in Italy on the rebranding. What are some of the takeaways there that you can apply to your other jurisdictions in integrating your existing platforms?

Rafi Ashkenazi:

Yes. We're actually very happy with the way that we rolled out Sky Bet in Italy as part of the PokerStars ecosystem. The same thing happened just now in Germany. We launched only a few days ago, and we've signed a partnership with Sky Deutschland, and we're expecting to see essentially the same type of trend also happening in Germany. In terms of the other markets, I think I mentioned it before, we're planning to use Sky Bet where available and obviously where Sky has brand equity, and there are a few considerations around those markets. They operate in five key markets, and we are exploring those. Some of the other considerations that we have around the brand is, again, something that I mentioned before; we are looking to move into Poker Stars as the master brand, and in markets where we don't have Sky or Sky Bet or Sky doesn't have strong brand equity, we are going to start using PokerStars Sports, and for that matter also we're going to use PokerStars Casino. That's the plan going forward.

We are looking to ensure that we are as efficient as we can in terms of the marketing, and we are really extracting the value from the assets that we've managed to build and acquire over the course of the years.

Gianluca Tucci:

Okay. Great. Thanks, Rafi. Just a follow-up to that question is can you give us an update, I guess, Brian, on how the synergies across your assets that you acquired last year are advancing and how much are supposed to be generated for the balance of '19? Thanks, guys.

Rafi Ashkenazi:

Sorry. Before Brian answers, I just want add one more comment. I think maybe it was lost in what we said previously, but we are planning also to have the U.K. ecosystem rolled out towards the beginning of next year, and we also believe that this will actually drive very meaningful revenue synergies over time.

The U.K. ecosystem, just to maybe add a little bit of substance to what this project actually means, it means that we're going to put PokerStars and the Sky Betting & Gaming customer bases into one ecosystem and allow customers to transfer funds between one ecosystem and the other ecosystem, essentially allowing the customers on Sky Betting & Gaming access to the best poker business in the world, the best poker offering, the best poker product in the world, and obviously allowing PokerStars access to millions of customers on the Sky Betting & Gaming business, which they've acquired over the course of the years in the U.K. That's another quite exciting opportunity that we see. This is something that we're hoping to roll out at the beginning of next year. There will be follow-up projects relating to, obviously, the extract of the value of the revenue synergies as time goes by and as we tighten the integration between the two ecosystems.

That's just a follow-up remark on your previous question. Sorry, Brian, go ahead.

Brian Kyle:

Then just answering the question on synergies, synergies are tracking very well. The only point that I would add is that the large proportion of those will be realized through H2, so, again, from a phasing perspective, they were heavily weighted into the back half of 2019. We continue to look at other cost optimization opportunities. Again, the whole objective here is to ensure that we are operating effectively and allowing us to free up funds to continue to invest back into our business through marketing efforts. Overall, synergies are tracking exceptionally well.

Gianluca Tucci:

Thanks, guys.

Operator:

Thank you. This concludes time allocated for questions on today's call. I would like to turn the conference back over to Mr. Ashkenazi for any closing remarks.

Rafi Ashkenazi:

Okay. Thank you everyone for participating on today's call and the ongoing support and interest in The Stars Group. Thank you and goodbye.