The Stars Group Inc. Q1 2019 Transcript
May 15, 2019

CORPORATE PARTICIPANTS

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Brian Kyle, *Chief Financial Officer*

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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, Wednesday, May 15, 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, Group Director of Investor Relations and Corporate 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.

Today's earnings press release and presentation will both be available on our website. I will now turn it over to our Chief Executive Officer Rafi Ashkenazi.

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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 first quarter financial results and our outlook for 2019.

Before that, I will provide an update on Q1 performance highlights and progress against our strategy.

Overall revenues in Q1 were $580 million, and adjusted EBITDA was $195 million. As you can see in the charts on the left, the main driver of this was a historic low Betting Net Win margin. With a normal 9% margin, we would generally have seen revenue of around $650 million and adjusted EBITDA of around $240 million.

While the reported results were adversely impacted by the volatility in net win margin in the short-term, this was an exciting quarter from a business development perspective.

As you heard last week, we announced a landmark partnership with Fox Sports to launch FOX Bet into the U.S. betting market, creating the platform to build a leading operator in this exciting market.

We continued to execute against our top 3 strategic priorities for 2019:

1. First Integration. We have made great progress on integration, and increased our synergy target from $70 million to $100 million.
2. From an execution standpoint, we hosted record online and land-based poker tournaments, and Sky Bet saw record new customer acquisition during the quarter.
3. And, so far this year we have repaid $350 million of our loans.

SLIDE 5

Moving onto slide 5, let me recap our financial results for the quarter.

The first 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%, despite these headwinds.

Our UK business added $179 million of revenue, with a really strong operational performance, that was simply masked by a net win margin significantly lower than our long-term average of 9%.

The Australian business added $51 million of revenue in the quarter, as the team continued to execute well and build the BetEasy brand in the market.

Overall, we are pleased with the operational trends and think that they lay a strong foundation for the rest of the year and beyond. Revenues of $580 million were a little below our expectations, as the strong operational progress was not fully reflected in our reported results.

Our Adjusted EBITDA was $195 million in Q1, with the margin of 34% being a little below the 36% implied by our full year guidance. This simply reflects the lower net win margin during the period, and is otherwise in-line with our expectation.

With encouraging trading trends in April, a deep pipeline of product launches, an expectation of normal win margins and improved trends in some of the markets that have been disrupted, we are confident about seeing improved quarterly results in the rest of the year.

SLIDE 6

Slide 6 shows the key highlights by segment for the first quarter as we continued to drive operational excellence, innovation and product leadership in all key geographies.

Within our international segment, we hosted a record live tournament with our PSPC in January, which provided a real boost to customer acquisition. We continued to roll out new casino games, supporting growth in quarterly net yield in our gaming products. We also launched our fully regulated business in Sweden.

Within SBG in the UK, Q1 was a fantastic quarter from a business growth perspective, with record customer acquisition, and an acceleration in the growth rate in gaming revenue and betting stakes.

BetEasy had a good quarter, using its proprietary tech platform to launch a highly differentiated loyalty plan called My Rewards. This helped to drive over 80% year-over-year growth in stakes and revenue, reflecting strong engagement from the players that we migrated from the William Hill Australia brand beginning in August 2018.

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 underlying operations is not being fully reflected in our reported results.

As you can see in the chart, our Rest of World markets which now represent 82% of international revenue are seeing organic growth, with 6% growth in constant currency.

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 licensing process. These markets represented around 21% of our international business in Q1 2018, but are now around 16%. The main markets within this segment are Russia, Norway, the Netherlands, Switzerland and Slovakia. While it is disappointing that our customers in these markets are not able to enjoy our products as seamlessly as before, we are working to ensure that disruption is minimised. One of the benefits of our diversification is that these disrupted markets are less than 10% of our enlarged business overall.

The right-hand side demonstrates the strength of the fundamentals underpinning the business.

On the top, poker continued to charge towards an amazing milestone of 200 billion hands, which was reached on May 4th. To commemorate this, we ran a series of marketing campaigns and the six players who were playing on the table each won $10,000.

Below that, you can see that we are enjoying really strong growth in casino actives. Part of this reflects the benefit of PokerStars Casino *Spin of the Day* campaign, which leverages the learnings from the Sky Vegas *Prize Machine* offer. This is one of the benefits of our acquisitions – sharing best practices across some of the best operators in the market, with a deep understanding of techniques and offers to drive customer engagement.

SLIDE 8

Turning to slide 8, let me expand on the strategic progress in our UK segment during the first quarter.

This was an excellent quarter for SBG from an operational perspective, with an acceleration in growth rates in QAUs, betting stakes and gaming revenue, as we continued to drive market share gains in the UK market.

The Cheltenham Festival is the biggest horse racing event of the year in the UK. Our historical data, and consumer research highlighted that this is an opportunity to acquire high-value, high-frequency bettors, more so than other major volume events such as the Grand National or World Cup. We had planned a strong promotion this year, and I'm pleased to say that we had by far our most successful Cheltenham ever in terms of customer engagement and betting stakes, with active customers up by more than a third, and stakes up by more than 60% during the four-day Festival. The outperformance of our new sign-up offer meant that we signed up around a quarter of our normal annual customer acquisition during these four days; however, the success of the offer increased the short-term costs for the segment.

We are already seeing really encouraging results from this cohort of high-value customers. Our targeted investments are paying off as the customer acquisition costs have already been almost fully repaid. We are also seeing strong engagement from reactivated customers. Overall, nearly 90% of customers who took part in the promotion have been active with Sky Bet since Cheltenham. The strong performance of this offer underpins our confidence in the remainder of the year.

As you can see in the charts, the success of this offer contributed to improving growth rates in both betting stakes and gaming revenues – these are the key drivers of the business, and the strong customer recruitment during this period gives us confidence in double-digit revenue growth and continued market share gains in 2019 overall.

Lastly, the integration of SBG has progressed really well, enabling us to increase our target for synergies from $70 million to $100 million with the incremental savings being invested to support ongoing organic growth. With the business now on a strong path as part of The Stars Group, Richard Flint, who served part-time as SBG's Executive Chairman since October, has decided to take this opportunity to move on and pursue other opportunities. I'd like to thank him for his great work, and for the assistance with the transition of the business. Richard leaves SBG in great shape in its new home, under the management of Ian Proctor and Conor Grant, who were both promoted from within following CMA approval in October 2018, and I am confident that this will allow us to maintain our unique culture that has delivered success over the years.

SLIDE 9

Turning to slide 9, we were delighted to announce our media partnership with FOX Sports last week.

We have been working on this for a long time, and working to create a structure and team that is set up to build the leading betting business in the market. The partnership is based on creating a winning ecosystem, leveraging the proven media partnership strategy that our Sky Bet business has executed in the U.K. More specifically, the agreement provides us with exclusive use of the FOX brand for sports betting, giving us immediate access to an iconic brand, that is embedded in U.S. sports culture. It therefore gives us a large and low-cost customer acquisition channel for sports betting in the U.S.

We're not just planning for the near term; we are building a business for the next 25 years and beyond. Given the unique opportunity at hand, we had to ensure that each party has the right incentives, the right people and the right approach to build a successful business.

I couldn't be more pleased to have FOX as a partner. As you heard last week, FOX has fantastic sports assets, and you can see here some of the early designs that we will be launching into the market.

Our launch plans for FOX Bet are commercially sensitive, and we currently expect to provide an update on FOX Bet and its financial impact with our Q2 results in August.

I was also delighted to welcome FOX as a shareholder. As part of the deal, FOX made a strategic investment in The Stars Group shares to participate in the value creation for The Stars Group shareholders. This further underpins the aligned incentives between our businesses, and their confidence in our plans.

With that, I'll turn the call over to Brian, who will provide additional detail on our financial performance and full year outlook for 2019.

BRIAN KYLE SLIDE 11

Thanks Rafi, and good morning everyone.

Slide 11 provides a summary of our overall results for the first quarter. As reported, net earnings for Q1 was $28 million. After adjustments including removing the amortisation relating to purchase price allocations, adjusted net earnings was $106 million, giving us adjusted diluted net earnings per share of $0.38.

As you've heard from Rafi, these results are impacted by short-term swings in the win margin in our betting businesses, which impacted our results in the short-term, but have no impact on the fundamentals of the business, and only a temporary impact on cashflow.

We ended the quarter with net debt of $5.1 billion, broadly stable compared to the end of December, with a temporary impact to cashflow from the low win margins in the period.

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

SLIDE 12

Turning to slide 12, 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 certain disrupted markets, and despite this, constant currency revenues were only down 2%.

Within poker, constant currency revenues were down 4.5% in Q1, with low single digit growth in most markets offset by certain disrupted markets. It is also important to note that revenues for Q1 were sequentially higher than Q4 2018, and with further product launches, our tournament schedule and recently launched promotions, we are confident that trends will improve as the year progresses. We believe our competitive strategies are working well, and that our global market share improved by 1 percentage point this quarter compared to Q4 2018.

Our casino revenues were up 1% in constant currency, despite the impact from disrupted markets and some closures. There was also an impact from some major jackpot wins, and other one-time adjustments relating to payouts. Excluding these items, we estimate underlying growth in casino was around 20%. In reported terms, revenue was down 7%, reflecting a significant FX headwind, in addition to the other factors mentioned.

Betting revenue was up 20% as reported, with 23% growth in stakes slightly offset by a lower net win margin. We continued to launch new products during the quarter, including the popular Request-A-Bet that was pioneered by Sky Bet, onto BetStars, as well as virtual games, and other new products that increased engagement.

Other revenue declined 40% year-over-year, with the majority of the decline being offset by a corresponding increase in the UK segment Other revenues as we realign certain activities across the group, as well as optimizing our live events including the removal of some less profitable ones.

Our adjusted EBITDA margin was down 2 percentage points at 46.8% during Q1, reflecting mainly a lower gross profit margin, as we continue to increase the mix of revenues from regulated and taxed markets.

SLIDE 13

Turning to the UK segment financials on slide 13, which currently comprises the SBG business, with figures presented in pounds sterling.

Staking grew 16% during the period, an acceleration from the 10% rate in Q4 2018 as we benefitted from record customer acquisition during the Cheltenham Festival, with overall quarterly active uniques growth of 18%. The betting net win margin was 5%, which was well below our long-term average of around 9%. This was also below the 6-7% range that we expected at the investor day, as sports results were particularly unfavourable during the final week of the quarter, with most of the top soccer teams winning. As a result, betting revenue was down 37% year-over-year. Gaming revenue was up 23%, an acceleration from the 17% growth in Q4 2018, as we benefitted from a strong period of customer acquisition, and successful product and content roll-outs.

Overall revenues were down 12% as a result of the lower betting net win margin, but we estimate revenue growth of around 19%, assuming a betting net win margin of 9%. The Adjusted EBITDA margin was down 70 basis points during the period, slightly worse than the improvement we had expected due to the adverse sporting results in the final week of the quarter. Overall, however, we were encouraged with the operational efficiency in the business, and assuming normal betting net win margins for the balance of the year, we continue to expect double-digit revenue growth, and the adjusted EBITDA margin to be significantly higher for 2019 as a whole.

Looking at the rest of 2019, we enter Q2 with very strong momentum, having seen an acceleration of growth in quarterly active uniques, betting stakes and gaming revenue. Betting net win margins in April were well above our normal long-term range of 9%, and we continue to expect a win margin a little above 9% for the UK segment in the medium-term. The retention and engagement of players from our Cheltenham promotion has been really encouraging, and our EBITDA and cashflow expectations for 2019 remain consistent with our prior targets.

SLIDE 14

Turning to slide 14 we provide an overview of the financial results for the Australian segment. As with SBG, this is in local currency, and on the basis that we owned the existing business in both periods, to provide increased clarity about the underlying operating trends.

Staking growth in the quarter was 86% to 1.1 billion Australian Dollars, driven primarily by the impact of the migration of the William Hill Australia player base to BetEasy. The historical figures relate to the CrownBet business on a standalone basis up until the completion of the acquisition of William Hill Australia in April 2018. If we included the full contribution from William Hill Australia in Q1 2018, revenue growth on that basis would be 10%, a strong performance considering the trends in the William Hill Australia business prior to acquisition.

The betting net win margin of 8.1% in the period was a little below the historical average of 8.5%, largely due to unfavourable sporting results in the period. However, despite this, we delivered satisfactory profitability, with adjusted EBITDA of 12 million Australian Dollars, at a margin of 14%, consistent with the range of 10% to 20% that we outlined previously, and reflecting the impact of the new point of consumption taxes that were in place in Q1 19. Looking into the rest of 2019, we expect continued double-digit growth, with an Adjusted EBITDA margin within the range of 10% to 20%.

SLIDE 15

Moving onto slide 15, we believe we have one of the strongest betting businesses in the world. Over time this generates predictable and stable win margins, reflecting our scale, pricing expertise, risk management and the increasing diversification of our betting business.

I would like to remind you that, while we generate a stable and predictable win margin in the long-term, we do see quarter-to-quarter volatility, reflecting the swings and natural unpredictability of sporting results. To that end, and because of the low betting net win margin seen in Q1 2019, I thought it worth re-iterating one of the slides from our investor day, and outlining a few key statistics to give some context to the results.

The red line on the top chart here shows the long-term trend of our win margin, on a proforma basis, across the group, with the bottom chart showing where actual betting revenue came out, with the red boxes being a range of 8% to 10%.

We have called out a couple of other key stats from Q1 on the page to highlight how sporting results can vary quarter to quarter. Q1 2019 saw unusually unfavourable results, with a couple of the worst weekends of football results that we have ever seen.

It is important to note that periods of strong or weak margins do not mean we have been particularly effective or ineffective at managing our risk, they simply reflect the random nature of sporting results.

While these short-term variances in win margin do impact our reported financials in any given quarter, they tend to even out over a year, and they do not impact the fundamental value of the business, which is driven by our acquisition and retention of customers, the activity of these customers, and the value that these customers generate over time.

SLIDE 16

Turning to slide 16, I'd like to highlight the strength of our cash generation.

Our adjusted EBITDA in the period was $195 million, which was around $40 to $50 million below where it would be with normal betting net win margins, so this has been a temporary negative impact on our cashflow.

We also had an unusually large working capital outflow of $62 million, reflecting the timing of certain year-end related payments.

Our cash interest cost of $92 million was higher than Q4 2018, reflecting the first semi-annual payment for our senior notes.

Capex was $29 million, including continued investment in expansion in the period, and we paid our debt amortisation of $12 million. We also incurred $8 million of one-time costs relating to the integration activities.

Overall, this meant that we saw a free cash outflow of $38 million in the period. The negative cashflow reflected the temporary impact of a low betting net win margin in the period, as well as significant timing differences in certain payments as compared to prior periods.

We currently expect free cash flow to be around the lower end of the range outlined at our investor day, reflecting our expectations for Adjusted EBITDA for the full year.

As Rafi said, we have already voluntarily repaid $350 million of debt this year in addition to mandatory amortization, following a $100 million repayment in Q4 2018. As we prioritise debt reduction with this cashflow, we continue to monitor debt capital markets in order to optimize our capital structure given prevailing market conditions.

Assuming normal sports margins, and a reduced impact from restructuring costs and working capital movements, we expect strong free cash flow generation for the balance of the year.

SLIDE 17

Turning to slide 17, given the low win margin in the first quarter, we are currently trending towards the lower end of our previously issued guidance range.

Following the announcement of our partnership with Fox Sports, our total share count will increase by around 5%. Given the benefit of lower interest cost, and the timing of the issuance of new shares, the net impact on adjusted diluted net earnings per share for 2019 is relatively negligible.

As outlined by Rafi, our launch plans for FOX Bet are commercially sensitive, so we currently expect to provide an update on FOX Bet and its financial impact with our Q2 results in August.

SLIDE 18

Turning to slide 18, I'd like to finish with a reminder of our medium-term growth framework that we outlined at our investor day in March.

During 2019, we are laying the foundation for strong future growth. Our focus this year is on integration, execution and deleveraging, as well as establishing the platform to launch our FOX Bet business in the U.S. later in the year. We are building a platform for sustainable, long-term growth, to capitalise on the opportunities ahead of us in the long-term structural growth markets in which we have a leading position.

Looking to future years, we are committed to delivering annual adjusted earnings per share growth of at least 10% per year. To be clear - this is not a CAGR - but rather a minimum annual growth target.

With 8-12% constant currency revenue growth, and broadly stable adjusted EBITDA margins, there is upside potential for higher annual adjusted diluted EPS growth in the later years as we capture the benefit of our strong cash generation and new country launches.

I'll now the call over to Rafi to conclude.

RAFI ASHKENAZI

SLIDE 20

Turning to slide 20, this is a reminder of our overall strategy, and how we are building a business to deliver sustainable long-term growth.

We are operating in large and high-growth markets, with encouraging regulatory progress in the U.S. and Latin America last year and so far this year.

We are a diversified global leader in this industry, and I was pleased with the progress we made during the quarter to leverage the capabilities across the group and improve the cross-pollination among our segments.

We have significant, sustainable competitive advantages, and we continue to leverage these to grow share in our end markets. We are further excited about our partnership with Fox Sports, which we believe greatly enhances our competitive advantages in what we expect to ultimately be the largest betting market in the world.

Our business is uniquely set up for scale benefits and the ability to replicate our products in new markets. For example, our expansion into the U.S. will leverage the technology, licensing, payments and operating expertise that we have developed across the group – this is the power of The Stars Group business model.

Finally, we have a highly attractive financial model, and continue to generate strong cashflow, which we intend to use for expansion and deleveraging.

SLIDE 21

Finally, to conclude on slide 21, I am pleased with the significant strategic progress that we have made in Q1:

- We laid the foundations to build a leading U.S. betting business with our FOX partnership.
- We continued to integrate our recent acquisitions, increasing our expected cost synergies from $70 million to $100 million.
- We migrated the Sky Bet Italy player base to our PokerStars platform, and put plans in place for a similar transition in Germany, beginning to generate revenue synergies.
- We increased revenue synergies among the segments, with internally created content and product launches expanded across our betting and gaming brands.
- And, we continued to reduce debt, paying off an additional $350 million of our term loans, and have confidence in strong cash generation in the rest of the year.

Our reported results for the quarter do not fully reflect the strong operational progress we made, primarily due to the short-term volatility of betting net win margins.

However, we are seeing encouraging trading in April and into May, and with a deep pipeline of new product and content launches, new country launches, and improved trends in our disrupted markets, I am confident that we will see improved reported results in Q2 and the remainder of the year.

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DAVE GADHIA, EXECUTIVE CHAIRMAN

Good morning, I'm Dave Gadhia Executive Chairman. We're looking forward to our AGM later this morning.

Before we go to questions, I just want to let everyone know that today's prepared remarks were pre-recorded. Rafi Ashkenazi, our CEO, was able to prerecord his remarks but unfortunately won't be participating in the Q&A today.

I was up last night arranging a doctor for him but for those of you who know the Canadian medical system, you know how challenging that can be. He has a severe bout of the flu after a long day of travel but can't speak right now.

We're looking forward to his speedy recovery. Joining me today for the Q&A are Brian Kyle, our CFO, Marlon Goldstein, our Chief Legal Officer, Robin Chhabra, our CEO of FOX Bet and Vaughan Lewis our SVP Communications.

Before I hand the call over to the operator for analyst Q&A, while you are registering your questions, I'd just like to play a short video with clips from FOX Sports shows last week, when we announced FOX Bet.

I'm sure you will agree, our partners at FOX Sport are every bit as excited as we are about the potential for this business, and it really shows how powerful our integrations can become.

VIDEO

We can now move to Q&A.

Operator:

Thank you. We will now begin the question-and-answer session for our analysts. 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 Chad Beynon with Macquarie Group. Please state your question.

Chad Beynon:

Hi, good morning. Thanks for taking my question. Brian, I know you mentioned that you're maintaining 2019 EBITDA guidance and you're kind of coming in closer to the lower end of the range, but could you maybe just help us understand your decision to maintain guidance just because of the one-time kind of temporary negative outcome in the first quarter with the low bet margin. Obviously, it's a tough start given that, but could you just kind of explain your decision there and if this should be more 4Q weighted than we were originally thinking? Any color on that would be helpful.

Brian Kyle:

Good morning, Chad. Thanks for the question. I think it's important to recognize and just reiterate some of the challenges that we had in Quarter 1, that were really around the noncontrollable factors that we encountered. We talked about FX being about $32 million. We had the impact from the disrupted markets and the exited markets, and really impacted by the low sports net win margin that came in around 6.1% compared to a 9% normalized level, and again, the volatility we will continue to experience but over a long term we remain confident that our historical average of 9% will be there.

I think a couple of things. If we look at the underlying businesses, on the International business we are really seeing some improvement on a sequential basis within the disrupted markets, and again, if you look at the casino revenue that we reported in Quarter 1 it was impacted by a number of items that if you exclude we would have been tracking closer to 20% on an underlying business.

We're very encouraged from the promotional activity resulting from the Cheltenham offer that was undertaken in Quarter 1. The engagement level is just tremendous right now and we're seeing almost 90% of customers who had enrolled in the Cheltenham offer being active into the second quarter.

We're starting to see some very strong, encouraging, underlying momentum in the business. Also, within the April timeframe we are tracking higher than our average in the sports win margin category, so we're starting to see some momentum on that front, and again, to answer your question on the back-end loaded element, synergies as well as some product and enhancements are much more heavily weighted towards the second half of the year, so that gives us a lot of confidence that we'll be able to maintain the guidance range, but again, we will be trending towards the lower end of that guidance range right now.

Operator:

Thank you. Our next question comes from Ed Young with Morgan Stanley. Please state your question.

Ed Young:

Hi. Thanks for taking the question. Could you help me understand? You mentioned two areas of underlying growth looking very positive; this Sky Bet Cheltenham offer you already talked about and the same with Gaming actives. Can you help us break down those a little bit, just so we can understand the underlying and then (inaudible) going forward? If I look at your quarterly actives, they look like they're—you've disclosed them up 18%. You've got a chart there on a sort of three-week (inaudible) basis with them looking much more impressive than that. That's sort of in line with William Hill and Paddy Powers

22%, I guess. If this is all new acquisition at Cheltenham, is there a reason why that number wasn't a bit higher than the market? And on the Gaming side, again, very strong Casino daily actives trend but then the constant currency growth is light at sort of 1%. You said it's 20% underlying. Can you help us bridge towards that number to give us comfort on what that number looks like going through Q2 and onwards? Thanks.

Vaughan Lewis:

Thanks, Ed. It's Vaughan here. On the Cheltenham offer, this was a very targeted and specific offer at particular cohorts where we were either under-represented in terms of our racing share, or with new cohorts of customers where we, for a variety of reasons, were under our market share. That offer worked extremely well. We saw record customer acquisition at record low CPAs, and as Brian just said, 90% of those have been active since so we're seeing pretty good quality indications of that customer acquisition.

If we look at current trading, we said we're sort of confident on the current position. One of the sort of quirks of quarterly reporting is it just captures that volatility in terms of win margins and how that impacts the quarters themselves, but starts to smooth out over the passage of time. If we look to the first 17 weeks, so included April, we'd be looking at mid single digit growth for the U.K. segment in terms of revenues.

In terms of the actives, in terms of the Gaming growth, we're seeing both strong customer acquisition through Gaming. We're leveraging the Sky brand. We're leveraging the unique customer acquisition channels that we have there, and we're leveraging the capabilities from the Stars business in terms of cross-sell mechanics and improved revenue from cross-sell. We're really pleased with the momentum in terms of actives. We're really pleased with the momentum in terms of stakes. We're very confident that we're growing share in the U.K. market and that gives us confidence in that double-digit growth for the year overall.

In terms of the TSGI business, in terms of Casino, as Brian mentioned, that was impacted by some one-off factors towards the end of the period and some large jackpots. The underlying momentum there is extremely good. We're leveraging some of the capabilities from the Sky Bet business in terms of the Prize Machine which has been ported over to the PokerStars Casino and that's driving really strong engagement in terms of actives, and now we're just starting to tweak that product and drive the monetization. If we X out the uncontrollable impacts, the growth in that Casino product is more like the sort of 20% level that Brian mentioned. Again, really strong momentum and pleased with the business there.

Ed Young:

Still on the Casino one, in terms of understanding, the actives obviously has been very strong. Is another way of reading that that maybe Casino is more sort of overrepresented in disrupted markets, or that the actives are coming on in a kind of lower yield because you're involved in things like the Daily Spin? Is that a fair way or reading it? Or is just simply jackpots was 10% and something else is a large number and net-net it doesn't make much difference?

Brian Kyle:

Yes, Ed. I think the way to look at it are that there were the jackpot wins that came through in the quarter and then we had some other adjustments, one-time in nature that we do not expect to incur going into the remaining part of the year. If you exclude those, you get back to that 20%-ish range and I think that's the way to look at that category.

Ed Young:

Okay. Thanks very much.

Operator:

Our next question comes from Patrick Coffey with Barclays. Please state your question.

Patrick Coffey:

Hi. One question on the cash flow with two parts if this is okay? One is on working capital. Can you just talk us through the changes there year-over-year, and then secondly, just Part B, there's a big step up in exceptional items year-on-year? What should we be expecting in terms of exceptionals for the full year? For example, a bit confused by the lobbying costs. I would have thought that would be in the normal cost of doing business, but they always go down as an exceptional. Thanks.

Brian Kyle:

Hi Patrick, it's Brian. I'll take the first one. With respect to the working capital adjustments, the seasonality of our business drives a lot of increase in accruals throughout the year that are settled in Quarter 1. If you look at the net working capital and other component, there are a number of timing differences also included in that in connection with, as an example, some payment processing elements. That net working capital movement is really a seasonal element of our business that is higher than traditionally throughout the balance of the year as a result of those adjustments.

The other item is the interest, the semi-annual interest that we are starting to incur on the bonds. This was the first quarter where we actually had that payment. That amount also is reflected in the movement on the free cash flow.

I think the way to look at the free cash flow is, again, as a result of the win margin coming in lower than the average, we would have generated in the neighborhood of $40 million to $45 million more of cash based on that normalized win margin level, and if you reflect that through our free cash flow we would have been slightly positive for the quarter, which would have been more in line with our expectation on the timing of that.

The other part of the question in connection with your comment on adjustments, I think the real component there that is impacting it is the result of the restructuring expenses, and the largest item of that is in connection with one of our operations out of Costa Rica where we closed that business. We announced that last year. We’ve gone through the restructuring, the closing, the termination of staff and are relocating those people and those functions into a more optimized lower cost jurisdiction.

Patrick Coffey:

Okay, thank you. And lobbying costs, just for my knowledge, going forward do they typically go in as an exceptional?

Vaughan Lewis:

Hi Patrick, it’s Vaughan. I mean in terms of the lobbying costs, we’ve been pretty clear that we support regulation. We work hard with local authorities, local governments to further the case for the regulation of the industry and the benefits that that brings in terms of both consumer benefits but also tax. Those lobbying costs relate to markets that we’re not in at the moment. They’re similar in sort of nature to preopening costs that you’d see for land-based casino companies or hotel companies, and that’s the reason why we adjust those out of the financials.

Brian Kyle:

Just one other point. Once the jurisdiction becomes regulated, any further lobbying costs associated with that are treated as regular expenses and not adjusted out.

Operator:

Thank you. Our next question comes from Daria Fomina with Goldman Sachs. Please state your question.

Daria Fomina:

Thank you so much. I have two questions. (Inaudible) and I'm sorry if I missed it through the presentation, your corporate costs went up. How should we think about it going forward? Are there any one-offs we should expect, comparable growth through the remaining three quarters of the year? The second question is on your win margin. I'm not sure if I got it wrong but it feels like the (inaudible) market, the numbers came a bit lower even though the guidance was given on the quarter close to the end of the period. Was there something particular that happened towards the end of the quarter? If you can help on that because I think the actual win margins came a bit lower than what you were guiding back then.

Then also, in terms of the improvement at the beginning of the second quarter, if you can give a bit more color on what portion or what revenues is affected by that, or it's across the board average above 9% number that you're giving. Thank you.

Brian Kyle:

Hi. So on the first question in connection with the corporate costs, I think the way to look at our corporate costs going into 2019, there is going to be some movement in there between the International business and our corporate segment as a result of identifying incremental costs that are associated with driving our corporate business. For Quarter 1 there were a couple of one-time items that impacted that to the tune of almost the full variance. Excluding those adjustments, you should think of the normalized run rate on the basis of excluding that variance, and that would be a good starting point for corporate, but I would caution you as we move forward, especially with our U.S. business and we start identifying what incremental costs we want to reflect in the corporate category, there could be some movement out of the other segments in connection with that.

Vaughan Lewis:

In terms of the question on win margins, the nature of the sports betting business is that we are subject to those variations in the short term and we are impacted by short-term volatility and the unpredictable nature of sporting results. That particularly is the case around accumulators of the top soccer teams, and what happened at the end of the quarter, that final week after the Investor Day is that we saw one of the record low weeks in terms of margin where most of the top football teams in the U.K. won their matches, so a lot of our customers enjoyed a very profitable week.

You can see over time that win margin evens out. The short-term volatility has no impact on the fundamental value of the business. We're in the business of acquiring customers cost-effectively and then monetizing those customers over a long period of time as we retain and engage those customers and they bet with us on a range of options.

As you've heard today, that's worked extremely well for the customer acquisition during Q1. We're really pleased with the momentum.

In terms of those win margins into April, across the board we're seeing improved win margins. That is contributing to much stronger revenue growth in the start of Q2. Some of that is simply driven by win margin. In the same way that the low win margin in Q1 doesn't really reflect anything that we've done operationally, the higher win margin in Q2 doesn't reflect much that we've done operationally, it's just the swings of sport results.

If you take the first 17 weeks for the U.K. segment with mid single digit revenue growth overall, that gives you a pretty strong indication about how strong trading has been so far in Q2, and if we look at the underlying drivers of the business in terms of customer volumes, staking growth and gaming growth, you can see the underlying trends are ahead of that.

Operator:

Thank you. Our next question comes from Tim Casey with BMO Capital Markets. Please state your question.

Tim Casey:

Yes, hi. Could you talk a little bit about the outlook for the poker business? You mentioned that you're encouraged by the tournaments and whatnot you've had, but could you talk about what, if any, of those disrupted markets you expect to normalize or come back in this year and just your view of the underlying trends of poker for the rest of the year and beyond and over the medium term? Thank you.

Brian Kyle:

Hey Tim, it's Brian. Let me start with a couple of comments and then Vaughan will jump in and share some additional thoughts. I think the starting point with our poker business is and continues to be that we believe that over the long term we are going to be able to grow that on a low single-digit basis, on an annual basis. The disrupted markets and the exited markets that we encountered so far in to 2019 have had an impact on the business, but again, if you look through the financial results and try to understand the operational element, on a constant currency basis we're down about 2% of the category, and if you look at the rest of the world it's up 6%, so that's very in line with what our expectations would be.

From the disrupted market in particular around some payment blocking countries that we've spoken about in the past, we are seeing some stabilization and some recovery in those categories that should provide some increased momentum into the balance of the year.

Vaughan Lewis:

Just to add to that in terms of the operational progress, we've launched a new Six Plus game which has seen really strong take-up. It's a great new product. We've got some great new marketing plans coming, particularly around the UFC partnership and new game variants rolling out with that which we'll capitalize on the massive audience base that they've got, and we've got our next generation app starting to roll out across more countries.

With that sort of combination of new marketing plans, new product and content rollouts and the sort of stabilization and improvement that we're seeing in the disrupted markets, we do expect to see a better year-on-year performance across the balance of this year.

Operator:

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

David McFadgen:

Hi, two questions. First of all, I was wondering if you expect on the International side the Gaming revenue to grow potentially in Q2 or will it take a few more quarters? Then, secondly, on your guidance, when I look at the EBITDA build-up from 2018 to 2019 to get your range of $118 million negative impact from regulatory changes and FX, and the U.S. dollar keeps gaining on the euro, and I was just wondering if that's provide a (inaudible) for the constant strength of the U.S. dollar where we stand right now?

Brian Kyle:

Dave, I think on your first question in connection with the International revenue, again, we've talked about it. We're starting to see more encouraging sequential growth. We believe that revenue for the balance of the year is going to be stable. That being said, it could be a slight decline on a year-over-year basis in the International business.

With respect to the guidance for 2019 for the balance of the year, again, we are guiding towards the lower end of that range on a number of factors that we've spoken about. We've remained very encouraged on the momentum that we're seeing, the new product launches that are occurring and the fact that in the second half of the year we've got a number of synergies being realized which will drive EBITDA growth as well as the back end loaded with products and enhancements. I think that's what we can say right now on guidance.

Vaughan Lewis:

Specifically on your question on Gaming or Casino revenue, we would expect that to be in positive growth for the year.

David McFadgen:

Okay. Would we start to see that in Q2 or it's more a Q3/Q4 thing to have a full-year growth target?

Brian Kyle:

I think the way to look at that is we believe that throughout the year we're going to see sequential growth occurring. To give you an exact time on that is something we're just not prepared to do right now.

David McFadgen:

Okay. All right, thank you.

Operator:

Our next question comes from Joseph Stauff with Susquehanna Investment Group. Please state your question.

Joe Stauff:

Thank you. Good morning. Most of my questions have been answered but just a couple of clarifications. On the International segment, in particular for Gaming, the impact that you saw clearly from exited markets, I just wanted to confirm kind of the timing of when that started to negatively affect you guys last year, just simply based on comps. Is it fair to say that starting in third quarter that the negative effect from those tougher comps start to alleviate, or 100% alleviate?

Brian Kyle:

Hi Joe. Yes, you’re right. It started in Quarter 3, accelerated into Quarter 4, and as we move into Quarter 1 we’re still seeing some of that effect as the regulatory market changes started to occur.

Joe Stauff:

In the Poker segment as well, did the Russian business grow? I think you used the word stability. Did it grow sequentially from those fourth quarter levels? I think you had indicated that at least intraquarter and I just wanted to figure out if that in fact happened, that it had grown sequentially.

Brian Kyle:

We don’t provide on a country basis the growth. Again, if you collectively look at all of those disrupted markets and exited markets, we are seeing a stabilization almost of a trough where we’re starting to show some stability and some acceleration out of that. I think that’s the way to look at it, Joe, that on a collective basis we’re seeing positive trending out of that.

Vaughan Lewis:

Just to put that into context, Joe, that collection of markets where we have seen operational challenges, that amounts to 16% of revenue for the International segment, so the impact of that is much reduced, and obviously as part of the group it’s significantly lower than that.

Joe Stauff:

Fair enough. One last question, please. What is the right way to think about the synergy bucket or the synergy number that you guys had guided to, $100 million, some of it drops and occurs in 2020, but you have to spend about $85 million, if I'm correct, to get there. Those cash restructuring payments, what is the right way to think about the timing at which they occur? On a quarterly basis, that is.

Brian Kyle:

I think if we break them down into the benefit, we're tracking towards $60 million in-year synergy cost savings that will be more heavily skewed to H2. With respect to the timing on the costs to incur those, more costs will be incurred in connection with probably Quarter 2 and Quarter 3 on those as a result of timing and payments related to people, and then as we move into the back half of 2014, we should start seeing on a percentage basis that amount being reduced, and also, we'd given indication that 85 was the target off of the $70 million synergy number. We believe that that 85 will still remain off of the $100 million target.

Operator:

Thank you. Our next question comes from John Tucci with Echelon Wealth. Please state your question.

John Tucci:

Hi guys, good morning. Just a question on your debt schedule. If we think about the balance of this year, how should we think about debt repayments? As a second question, pertaining to the FOX Sports deal, does that include the potential of a DFS offering? Thank you.

Brian Kyle:

On your first question with respect to the debt schedule, again, our business model is very strong cash flow positive, cash flow generative. Cash flow conversion strength is very strong in our business. We've commented before that we are very committed to using surplus cash to focus on deleveraging. To date, we've paid down about $350 million in debt which includes the recently issued equity raise in connection with the FOX deal. We are committed to repaying debt going forward, all of our surplus cash, or a large portion of that surplus cash for deleveraging. We expect, again, given the guidance range that we're working towards and the fact that we will be moving towards the lower end of that range, we expect to have somewhere in the neighborhood of $350 million of free cash flow for 2019.

Robin Chhabra:

It's Robin here. I'll take the second question on DFS. Look, the partnership will include a range of immersive games to achieve both parties' objectives, but the immediate focus is on the release of a range of free-to-play games, which we can do so nationally, and of course the FOX BET [Sports] betting app. Within the U.S. business, we actually do have a team of DFS specialists led by Matt Primeaux, the President of our US business and very much my partner in this initiative. They were an acquisition that my business made a few years ago called Victiv, so there's a lot of deep capability in DFS but that's certainly not part of the immediate roadmap. The focus is on those free-to-play games and the real money betting app.

Operator:

Our next question comes from Suthan Sukumar with Eight Capital. Please state your question.

Suthan Sukumar:

Good morning, guys. Just a question on the Casino and the sports betting side within the International business. You guys noted strong underlying performance (inaudible). Can you speak to—actually, I'm not sure if I heard correctly on an earlier question, but you guys did note you seeing encouraging sequential growth, but I think Brian mentioned you're expecting to see a slight decline on the full-year basis, if you can clarify that. Secondly, could you speak to the marketing plans and new market rollout for both the Casino and sports betting segments over the balance of the year?

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Brian Kyle:

Hi. It's Brian again. I think on the International business we expect to have stable revenue or slightly decline against 2018 as a whole. With connection with Casino, we expect that to be growing.

Suthan Sukumar:

Okay, great.

Vaughan Lewis:

In terms of that momentum on Casino, yeah, we're seeing great product rollout. We continue to roll out more content we think than any other operator. In terms of products, we've rolled out Spin of the Day, which is sort of leveraging the capabilities and the knowledge from the Sky Vegas business in terms of driving activity there, which is working really well, as you can see.

On the BetStars side, the performance there was really strong, as you can see. That's a combination of good new product launches using some of the capabilities from SkyBet like launching RequestAbet that you heard about. Some really innovative new markets that BetStars has launched first, and just some really, really strong execution as well. We're pleased with the underlying momentum in both the Casino and the BetStars business on the International segment, and we do think that that underlying strength will be more fully reflected in the reported numbers as the year progresses.

Operator:

Thank you. Our next question comes from Simon Davis with Deutsche Bank. Please state your question.

Simon Davis:

Hi guys. Can I just return to the subject of the shift in gross win margin at SkyBet? How much of that was explained a step-up in promotional activity, and is this in any way a reflection of pricing? By taking a more aggressive stance on pricing. Secondly, you mentioned specifically Premier League activity in the dying weeks of the quarter. Can you give some sense of how concentrated betting activity is around the U.K. Premier League football?

Vaughan Lewis:

Yes. Hi Simon. It's Vaughan here. In terms of the betting, that win margin, yes, as we've outlined it is volatile on a week-to-week basis. It is hard to predict where any individual week will come out. Over time that does very much smooth out. There's no change at all in terms of the long-term margin expectation of around 9%. There's no change, no significant change in terms of promotional activity with the exception of the Cheltenham promotion that we've talked about quite extensively and that very targeted promotion at those high value, high frequency horse racing customers.

In terms of the specific question around football, the SkyBet business is slightly overindexed in terms of football share versus the market, but not significant. The penetration of football and horse racing, which the vast majority of revenue for U.K. online betting is broadly similar, so nothing specifically to call out there. We'd expect other operators to have seen pretty similar results in that final week of the quarter where all of the big teams won.

Simon Davis:

So, even within the football mix you don't think you are particularly heavily exposed to Premier League relative to the peer group.

Vaughan Lewis:

I mean we have a slightly different business mix in terms of the player base being more recreational, lower staking on average, more linked to the Sky Sports channels and small incremental bets, essentially, as an upsell from the sports viewership experience. That does give us a slightly different mix in terms of in-play, in particular, and as you know in-play margins are lower but are more stable and predictable. That sort of lower mix of in-play and that mix of business does contribute to that slightly higher volatility of win margin versus the peer group that we see over time, but it also contributes to that structurally higher win margin that SkyBet enjoys versus the rest of the market.

Simon Davis:

Perfect. Thank you very much.

Operator:

Ladies and gentlemen, this concludes the time allotted for questions on today's call. All parties may now disconnect. Have a great day.