Q1 2015 Results

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Strategic Update

James Henderson

Chief Executive Officer, William Hill

Opening remarks

Thank you, good morning everyone. I will go through a strategic update, and then as usual, Neil will cover off the numbers. Although we are no longer required to publish quarterly updates, I am sure you will agree with me that these short updates are useful, particularly given the recent volatility of the business.

Today's update is a case in point, as we have seen a number of trends improve since we last updated you, but as yet we have not had enough of a margin swing to offset our loss in Week 3.

Key highlights

The good news is that wagering was much better in February and March after a quiet January. Online, Sportsbook wagering was up 20% across those two months. On the flip side, results have been below expectations during the quarter, not just because of a tough Week 3 but also due to, amongst other things, a paucity of draws in the Premier League during March. With the season coming to an end, and with Cheltenham and the Grand National under our belt, we have not as yet recovered the Week 3 shortfall. In gaming terms, at the end of Q1, we are broadly back in line with internal expectations for both retail and online.

Looking at the early trends in UK online under the Point of Consumption regime, net revenue, the number of unique actives and new accounts for the quarter were well up on last year. From a results perspective, Cheltenham was below the prior year. Staking was up 29%, new accounts was significantly up, and we had a 20% share rise[?] on UK TV. Italy performance has been strong, with net revenue up 30% and good growth in both gaming and sports. Spain's net revenue declined due to unfavourable sporting results offsetting wagering growth. However, we believe further gaming deregulation, which is due in the summer, will be positive for market growth.

One further point to note on the scale of the online business now: for the very first time, we broke £100 million weekly wagering barrier in this quarter.

I am also pleased to update you on the outcome of our recent bidding on the UK TV rights for the 2015/16 football season. We have secured the top bookmaker package on BBC Sports, and one of the leading packages with Sky, demonstrating our commitment to retaining a leading presence on key media platforms.

Year-to-date progress on key projects

Looking beyond short-term trends, we are making good progress on some of our key projects for the year. In retail, Eclipse is now in 95% of the shops and we will have the rollout complete by the end of Q2. We implemented the £50 journey as planned by 2nd April 2015 after a great deal of training and preparation with the shop teams. Obviously it is far too early to say if we are seeing a sustained impact, particularly as Easter and the Grand National have switched weeks, but we will update you on that as soon as we can.

For the online team, it is a big year for a couple of their technology projects. We are on-track to deliver both Project Trafalgar, which will put our front-end user interface in our own hands and give us a responsive design, and a bonus engine for our proprietary Vegas platform and Live Casino product. These are already very competitive products, and this will take them to the next level. We will update you on both of those at the half year.

In Australia, we have successfully moved the Sportingbet client base over to William Hill. It is still early days, but encouragingly pretty much all the KPIs, such as first-time depositors, actives and [inaudible] are showing good growth since then versus last year. Our work to reshape the business continues following the increase of race-field fees, so we will be looking for cleaner trends in the second half to see the benefit of all the changes we have made.

A big factor, of course, is the additional tax burden on the business this year. Point of Consumption and the MGD rate increase have cost us £20 million in the quarter, and without that we would have seen profit growth. On the regulatory front, we have seen what the manifestos have to say, so let us see what the election brings and we will be looking forward to further developing our relationships with whichever party, or parties, occupies Number 10 after 7th May 2015.

So now, let me hand over to Neil to run through the numbers.

Financials

Neil Cooper

Group Finance Director, William Hill

Wagering

Thank you James, and good morning to you all. Providing more colour on the numbers for the quarter, online wagering was up in February and March on average 20% after being up only 5% in January, with the quarter as a whole up 16%. The standout has been the 44% growth in the Tennis category, driven both by increased content and improved mobile presentation, which is largely why in-play wagering grew so much faster than pre-match, up 26% and 8% respectively. We saw 12% growth in Football staking, with 7% fewer UK League fixtures in the quarter.

Over-the-counter wagering fell 7% in January but recovered to an average 3% decline in February and March, which is a 4% decline on average for the quarter as a whole. The average number of retail units fell 3% on the comparable quarter given the exceptional closure programme in the second half of 2014, so the underlying wagering decline in February and March, adjusting for these exceptional closures, was only 1%. Of the reported quarterly decline, Horse Racing fell 2%, with Greyhounds and Football falling further.

Gross win

Gross win from gaming machines in retail grew by 1%, or 4% after adjusting for the exceptional closures. January was slightly softer than February and March. The only outlier from this general pattern across the quarter has been gaming net revenue in online, with 8% growth in the comparable quarter, but with January being stronger than February or March. Within the gaming category, Bingo grew 8% and Poker, reflecting the ongoing tough market, fell 32%. Casino grew 10%, with the stronger performance of the mobile driven Vegas suite of products more than offsetting a decline in the standalone Playtech Casino products.

Moving to focus on sports gross win margin, both retail and online saw similar trends. Over-the-counter gross win margin was in line with the comparable at 17.6%, and online sports gross win margin fell by 0.1 percentage points, from 7.1% in the prior year to 7% this year. As James has already mentioned, we regard this performance as below expectation, as Q1 should be higher than the average, given the levels of National Hunt racing and football content. To illustrate this, over the last five years OTC has seen an average margin of 18.7% in Q1 versus 18.1% full year and online has seen an average margin of 8.3% in Q1 versus a full year 7.7%.

Football margin in online grew by only 0.2 percentage points from a very low base in the comparable period, which you will recall was impacted by two major loss-making weeks. This year, whilst we only saw one major loss-making week, we have also been impacted by some unusual trends. For example, March saw only three Premier League draws, which reflected 9% of the fixtures. This would typically be over 20%. Partly as a result, we lost money on Premier League betting in both retail and online in March.

Horse Racing margin also grew in online, with the main driver of the overall modest margin decline being the performance of Tennis betting margin, which fell from 4.3% to 3.2%.

Revenues

With online sports betting net revenue growth of 11% largely driven by the wagering growth, and with gaming net revenue growth of 8%, total online net revenue grew 9%. The major single factor impacting cost growth was the imposition of the Point of Consumption tax, which drove an additional £17 million of costing online. Overheads grew £8 million, or 11%, driven by increased staffing costs, IT-related depreciation and £2 million of additional marketing. Given the growth in the indirect tax burden the business saw profits fall as a result by 38% in the quarter. Retail net revenue fell by 2% reflecting the fall in OTC net revenue.

Despite this, and an increase in Machine Games Duty of £2 million arising from the change in rates, strong cost control has enabled the business to deliver operating profit in line with the comparable period. The business benefitted from the final quarter of lower labour costs arising from the extension of single-manning, and also saw the cost base fall as a result of the exceptional shop closure programme.

Ex-UK territories

Following the rebranding of Sportingbet to William Hill in the quarter in Australia and the plans to rebrand Centrebet later in the year, I will remind you that this will give rise to the second and final portion of the accelerated brand amortisation exceptional item. We estimate that this will be £61 million for the full year. Trading-wise, Australia saw wagering decline 20% in local currency terms. We think that the majority of this decline has been driven by the client management changes we have introduced as a result of race-field fees. We expect that the benefit of up-weighted and single-brand-focused marketing, together with ongoing products and systems improvements that James has touched on, will see the business top line move forward by the end of this year.

The US continues to make good progress, with strong wagering growth helping to offset a results-driven margin swing against us.

Tax

Finally, I would note that while we retain our existing guidance on effective tax rates, this is contingent on there being no changes to the existing and active rates. In particular, an increase in corporation tax rates would lead not only to an increase in effective tax rates going forward, but also in a one-off deferred tax charge in the year of introduction.

Q&A

Vaughan Lewis (Morgan Stanley): James, in your comments you said that in online, unique actives and sign-ups were well up. Can you give us a rough figure on how much growth you are seeing?

In retail, for machines the rate of growth obviously lags behind Ladbrokes quite a lot, and there is now a very big gap in absolute terms. Do you have any plans to close that gap, and why do you think you are losing market share there to Ladbrokes?

Finally, for Australia that 20% drop in stakes looks very disappointing in a market that is growing quite strongly. Has anything changed in terms of your medium-term outlook there, and is that a bigger setback than you were expecting? Thanks.

James Henderson: Morning Vaughan. Yes, in regards to actives for the UK, they are well up on last year. I am not going to give you the precise number, but they are good double digits, both actives and new accounts.

In regards to the machines I am obviously not going to comment specifically on Ladbrokes, but if you strip out the closures then we are up 4% year on year. You have to remember that we are still rolling out the Eclipse terminals; we are in the second tranche of doing that, and as we know, there is a bit of an adoption curve there. However, I do not think it is about losing market share; it is about being able to roll out. We are at 95%, we will complete the rollout by May, and then we will have a clean run of a full estate of Eclipse terminals.

In regards to Australia, we are certainly not looking to change the end-of-year guidance. We have done a lot of work on the current client base, which we have previously communicated. That continues, and you can see the benefit of that in the margin, which is up significantly on the previous year. That will obviously suppress turnover slightly, but the guidance will not change. I am very comfortable with where we are with all the work we have done, and we will get cleaner trends by mid-year.

Patrick Coffey (Barclays): Hi guys, I have a few questions. Firstly, on recycling, gross win margins in Q4 last year and Q1 this year have been lower than normal in both online and retail, but I am keen to hear a bit more about the recycling trends. It seems as if perhaps recycling has not been as high as usual when you have those low gross win margin quarters, so I am keen to hear what you are seeing there and maybe what is driving that.

Secondly, on competition, thinking about Betfair and their Q1 statement where they said their Sportsbook unique actives were up 50%, I was just wondering if you feel that they are taking customers from the bigger operators.

On Australia, the migration of Tom Waterhouse in 2016 seems to pose a potentially decent risk in terms of customer migration. I was thinking about what your expectations are for that transition, and how you are preparing for that?

Finally, Neil, did you say that online gaming growth was stronger in January than in February and March? That seems a bit strange, given that Sports Book wagering increased in February and March, so I was wondering what the discrepancy was there. Thanks.

James Henderson: In regards to recycling and the margins, it is actually within our expected range of between 17–18 for Q4 and Q1. I suppose that volatility has become the new norm, and therefore maybe recycling is slightly less than it was last year. Certainly from a retail point of view, the business has stood up very well and has been incredibly resilient. We have maintained the same profit from previous years, so it certainly does not cause me concern in regards to the wagering levels at that rate. Online over the quarter was up 16% against very tough comps, so that is a good number.

In regards to the Betfair number that you quoted, in that their actives are up 50%, our new accounts and actives are still very strong. So they may well be gaining market share, but I do not think that it is at our expense.

In regards to the Tom Waterhouse transition, we have done Sportingbet and the signs are very positive in regards to the FTDs and the new accounts. We are going to have the opportunity to spend 40% more on that brand. Centrebet will be the next transition, which we will be doing before the Spring Carnival, and in terms of Tom Waterhouse we will make sure everything is in place so that we are able to migrate that as best we can at that time.

Neil Cooper: Patrick, just to follow up your point about online gaming, I think that unlike those others, the area where we are seeing particular stress in online casino gaming is in the standalone casino brands, rather than the Vegas-style stuff. I think you are seeing different drivers of performance there which may lead to slightly different patterns. I would not want to overplay this; gaming is relatively volatile, at least in terms of online casino, so the fact that it is slightly higher in January than in February or March does not give me too much pause for thought, other than to say that the drivers of less-good performance across the casino categories are more about what is happening in standalone than the UK Vegas product.

James Henderson: The actives are very strong in gaming as well.

Patrick Coffey: Okay, thanks. James, just coming back to the point on recycling: you mentioned that recycling retail has been good, however, in terms of online recycling, has that been disappointing? If so, what has been driving that?

James Henderson: As I said, the comps are very strong: over the quarter we were at 16%, and over February and March it was at 20% in regards to year-on-year growth. I am comfortable with that, bearing in mind it was 30% the year before.

Neil Cooper: There is one thing I would say, which we are watching with interest: we saw very strong recycling after the first black swan back in 2014. We don’t seem to be seeing the immediate strength of recycling after the black swan as the year went on in 2014 and into 2015. It may just be that consumers are now starting to recognise that if they lump on immediately after a big win, they are as likely as not to lose it.

James Henderson: I think Boxing Day was a prime example of that, where we did have a very bad set of results, but the next day we had probably the best set of results we could ever have had. That does leave its mark for a recreational customer, and maybe that had a slight impact in Q1 this year.

Patrick Coffey: That is really clear, thanks a lot.

Chris Stephens (UBS): Good morning guys, a few from me please. The first one is on the TV advertising deals you mentioned. Could you comment on how the competitiveness there has changed versus last year, and possibly in terms of cost?

Secondly, could you tell us what proportion of your sports book is now coming from accumulators, and how that has evolved over the recent years?

Finally, the volatility in sports results seems to be becoming a normal part of your business. You have talked about acquisitions and potential shareholder returns; if you don't find any acquisitions, do you think it would be prudent to allow the balance sheet to de-lever instead of increasing leverage to do either of those two things? Thanks.

James Henderson: In regards to the TV deals, it was as competitive as ever. In regards to the Point of Consumption environment, it will probably take 12–18 months to unwind. I am very pleased that we were able to secure a top bookmaker package with BT, not least because they will have 150 Champions League games in 2015–16, as well as 200 European league games, and obviously they have got the English Premier League and the FA Cup. I am really pleased to secure that package, and obviously we have a top package with Sky as well.

We are not looking to change the guidance in regards to marketing spend for the full year, so that will be kept at that level. We probably paid a little bit more to get those two packages, but it is what we wanted because we believe they are key media packages that will help promote our brand. So yes, as competitive as ever, but we got what we wanted.

In regards to the percentage of accumulators, I do not actually have that number to hand. What I can say, unless Neil wants to comment, is that obviously by Acca Insurance, which has been really positive, we have seen a lot more at the sort of five and six level than we have historically. Obviously, when you get bad results then that hits you, but you would much rather have acca business that single business because historically you get a much better margin.

Neil Cooper: I have nothing further to comment.

In terms of the balance sheet, look: I think it is clearly premature to be forming a view on what the long-term shape of the balance sheet is for Hill's. There are a number of factors: you have mentioned M&A, and clearly we see M&A as a tool to help us deliver strategy, and if the right opportunity comes up we want to be able to consider it. There is clearly regulatory uncertainty surrounding the election, and we need to see where that goes. I therefore think we are not in a position now to be formulating long-term views about the shape of the balance sheet.

Richard Carter (Deutsche Bank): Hi, good morning; a couple of questions from me. Firstly, on the casino growth number of 8%, you are talking about very strong, double-digit active player growth. I do not quite understand why that is not feeding through into underlying growth. So are there some issues with FX or have certain markets been much weaker, and is it possible to give us an underlying feel for what the casino growth rate is in the UK market, if possible?

Then secondly, in terms of Project Trafalgar, in terms of the delivery, is there any lumpiness in this on the cost side? How should we be thinking about how the costs build as Project Trafalgar is delivered through this year, please?

Neil Cooper: Let me just take the casino question. The casino growth was 10% not 8%; that is the overall online gaming growth. The UK casino is running about 16% up. I know we have talked about strong customer acquisition, which I think we are seeing, but I think one of the things that Mobile Vegas is doing is driving slightly more recreational punters in, which are arguably lower spend-per-head than a classic, bonus-led, download casino-type customer.

So we are getting lots more customers in, though probably a slightly lower net revenue per customer. However, as I have said, the UK performance is ticking along nicely at 16% versus the 10% which the overall casino category is seeing.

Richard Carter: So, Neil, is there quite a bit of an FX impact, then?

Neil Cooper: There is an FX impact. I would not describe it as material to the Group numbers in the first quarter, but yes, for sure; I mean, the euro has obviously struggled a little bit.

Richard Carter: So why is the overseas casino business performing less well?

Neil Cooper: There are a number of factors. It is not just FX.

Richard Carter: Okay. You do not want to elaborate on them?

James Henderson: Poker is down 32%, which obviously drags on the whole gaming number.

Richard Carter: Okay. And then just on Project Trafalgar?

Neil Cooper: Yeah, again, let me just take that. In terms of the cost, Trafalgar per se is largely a capital project, so the costs will start to come in depreciation as the project goes live. Now, the project is being phased in a number of rollout elements because, given the scale of it, whilst we are very confident that we have done a lot of testing, you can never be too cautious, in my view. So we are rolling it out in increments, so you will see the phased, incremental impact of the increased depreciation come in over the second half and into next year.

Richard Carter: Okay. If I can, one final question. In terms of UK market growth rate, you obviously grew wagering at 20% in February and March. That sounds to me like it is quite materially above UK market growth rate; would you agree with that, and do you have a view on where you think the market is growing?

James Henderson: Yeah, I think the last UK market growth statistics was around about 14%, so we are above that and the encouraging thing for me is that, albeit 16% over the quarter, February and March were better and we will obviously see how that runs forward.

Ed Birkin (Credit Suisse): Hi, morning. Just a couple from me, please. First of all, on the online casino, Neil, you said that Vegas growth was offsetting the Playtech decline; just clarify that. And also, what percentage of your casino products are now Vegas rather than Playtech?

Secondly, in the sports betting, there seems to be a differential between net revenue and amount wagered which is more than the margin change. Has there been another step up in free bets in order to try and gain market share from the Point of Consumption, and do you have any guidance on what that will be for the full year?

Finally, I was just wondering if you could maybe comment a little bit further on the horse racing betting right. I know you had it briefly in the statement. Would it be fair to say that if you voluntarily paid the levy online, perhaps this whole discussion of horse racing betting right would go away, and that may be a better thing to do in the medium-term rather than having this drag on and I suppose the potential going across to other sports?

Neil Cooper: Just in terms of the casino, we are moving I think to a position where the Vegas vertical, which includes other non-Playtech products like Live Casino, is going to be more like 60/40, two-thirds/one-third Vegas/Playtech, so we are definitely seeing the up-weighted Vegas growth. Now, to be clear, a lot of that has been driven by the successful developments we have made around mobile, which have largely come to bear on the Vegas category as opposed to the Playtech casino category. So that is what is materially driving that differential growth, in terms of the overall casino performance.

We have seen a bit of a blip in Q1 in free bets, so well spotted; you are obviously on top of your numbers. I do not think it is a sustained thing, and we are still happy with our full-year guidance of around 0.8% of wagering around the free bets. It was more about a particular promotion we were doing which we structured in a way that meant it was in a free bet category as opposed to a marketing category in the first quarter, but it is not a sustained or strategic response and I do not anticipate the full-year numbers moving materially away from our guidance.

James Henderson: Yeah, in regards to your betting right question, just to remind you that there are three consultations out there at the moment, one in regards to the offshore, one in regards to the mechanic itself and the betting. I think there are a number of hurdles that need to be jumped before any of those can be considered; we are waiting for a response. However, I think the thing that runs through all three is essentially in regards to potential state aid and competition laws. So there are legal hurdles to be overcome, and as I said, there are three out there and we are waiting for feedback on all three of those.

Gavin Kelleher (Goodbody): Neil, can you just confirm, did you say marketing costs were up £2 million in Q1?

Neil Cooper: Yeah, I can confirm that.

Gavin Kelleher: Okay, sorry. You said the guidance for the full year remains the same. The Sky contract appears to be more costly than you would have thought; is it? Given that, and given that ITV is no longer involved in football as much, has the cost per number of people you reach reduced? So, what is actually happening to the marketing mix in general? Is there anything you can say?

James Henderson: Yeah, I would just flag that one of the reasons the shape looks like it does is because we had a lot of money around the middle of the year last year, around the World Cup.

Gavin Kelleher: Okay.

James Henderson: Now, clearly we are not going to be advertising football in July this year, where there is not any football on, so you will see a mix shift. From that perspective, whilst clearly we have said that we expect our overall marketing spend to be broadly the same this year on last, if you strip out the World Cup, the implication is the spend outside of the World Cup period should be slightly more. So that is, I think, what you are seeing.

Gavin Kelleher: Okay, that is fair enough. Just on Australia, just on the amounts wagered, when do we actually lap the race-field fee and customer management changes? Did you implement them in July last year, when they came in, or was there any bit delayed? When do we start lapping that?

James Henderson: We actually started the process around about June/July of last year, but it is an ongoing process. We will get much cleaner trends obviously come June/July of this year.

Gavin Kelleher: Should we expect all the race-field fee management to pretty much end in June or July? Is there any spill-over into the Spring Carnival this year?

James Henderson: I think in our business certainly you are forever reviewing the client base, and obviously the heavy lifting has been done in regards to making sure that we have the right set of clients, but it is ongoing and it is regularly reviewed. However, as I said, the trends will be much clearer now with regards to June/July of this year.

Gavin Kelleher: When is Centrebet migration? Is it August/September?

James Henderson: Yeah, clearly we have just done Sportingbet and we will let that run through. However, the plan at the present time is to do this before the Spring Carnival.

Joe Thomas (HSBC): Neil, I think you said that the majority of the decline in Australia was because of transition, or weeding out the unprofitable customers. Can you just talk about, if we put that to one side, what the trends would have looked like?

Secondly, on Point of Consumption tax, are we seeing any mitigation at all yet, including from your suppliers? If so, is there any sort of quantification that you can give?

Finally, can you give an update on the uplift that you are seeing on the like-for-like machine revenue from the new Eclipse terminals? Thanks.

Neil Cooper: Just in terms of Australia, if you strip out the client management impact we have seen a modest decline in wagering. That is evident from what we have said. Let’s face it: we would not be single-branding and focusing our marketing on a single brand if we did not think we could do a little bit better. As James has already echoed, we want to get through this client-management period, we want to see the fruits being borne from the up-weighted and single-brand marketing effort, and we hope to be in a position to be able to see that in the second half of this year.

Just to answer your POC mitigation question, what we said in terms of our plans for this year was that we would seek to mitigate around £15 million–20 million of it, versus what we would have otherwise spent. Some of that is coming from marketing in the sense that we have historically raised marketing on a revenue-to-ratio basis, and we have cut that link and we are holding the marketing in absolute terms so some of that saving is coming from the opportunity cost of otherwise-inflated marketing. Some of it will come from contributions from individual suppliers and on specific deals, however all of that is effectively I think wrapped up in our existing plans.

Joe Thomas: Has any of it shown through in Q1 at all?

Neil Cooper: Well, in terms of the fact that we have spent what we were expecting to spend in marketing and the marketing number reflects an element of that mitigation, I guess you could say yes. However, it is always difficult to say it will be visible in that way, because frankly it is stuff that we may have spent without the tax and we have not spent, so you do not have a baseline to compare it to.

James Henderson: Just to your question around Eclipse, as I said, we are 95% through the rollout of the second tranche, which makes it very, very difficult to be able to compare how those Eclipse terminals are doing, not least because we also closed a number of shops as well, which has further confused the matter. However, I would just remind you that when we had a clean comparator group when we rolled out the first branch of Eclipse, they were performing around about 1% better than the old terminal, so there is no reason to believe that that will not run through once the full rollout is complete. Having said that, the London regions have had the Eclipse terminals for the longest period and are the best-performing within the Group.

Nick Edelman (Goldman Sachs): On machines, can you just talk about any difference in performance between B2 and B3? Also, are you actively trying to improve your proportion of B3, just from a regulatory perspective?

James Henderson: We are not giving a split from a Q1 in regards to B2/B3, but historically it has been around about the 70/30 mark. In regards to whether we are actively promoting B3 above B2 because of the regulatory position, B2 is pretty much a standard product, whereas B3 we are looking to introduce a number of new games which hopefully will increase that percentage. We have not released a few games in the last two or three months, but we are looking now to continue that rollout over the next four or five months with regards to the games which should drive B3.

Thank you all very much. Lyndsay and Neil are around all day if you have any further questions, but thank you very much for dialling in.

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