Q3 Interim Management Statement

Tuesday, 21st October 2014

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James Henderson

Chief Executive, William Hill PLC

Preamble

Thank you. Good morning to everyone in the UK and good afternoon to those here with us in Sydney. I know some of you have other companies reporting today, so I will try and keep this call short.

Strong margins are the biggest factor this quarter

In terms of this quarter, the biggest factor has been the margins; we have seen a big swing from poor results in Q3 last year to above-average results this quarter. That has driven strong Q3 gross win and profit growth in both retail and online. In my view the strong margin has affected turnover; notwithstanding this improved margin, turnover for online was still up 18%, with pre-match up 6% and in-play up 35%. This result was also against a tough comparator in 2013, so double-digit growth is pleasing.

Gaming

Gaming is also growing strongly, both in online and in the shops. Mobile gaming is up 116% and, as stated at the interims, Eclipse continues to perform better than Storm cabinets, so we have started the second half of the Eclipse rollout which will complete at some point in H1 next year.

International overview

Internationally, we have moved ahead again in market share terms in Italy and Spain, achieving the number one position for sports in Italy during the quarter. The US has had another great period and Australia's performance continues to improve. The KPIs for Australia are still moving forward, with the gross win margin improving after significant work on our client base. Furthermore, lower costs mean the drop through the profit is very good and obviously we are very excited to be showing you the business tomorrow.

Financial outlook

That clearly leaves the group in a good position for the full year. As usual we will not get too far ahead of ourselves because we have all seen how results can fluctuate, but if we see normalised results in Q4 we should exit the year towards the top end of the current consensus range for operating profit.

Regulatory outlook

In terms of regulation, we are ready for UK licensing to start on 1st November, and for the point-of-consumption tax on 1st December. We have seen one or two small operators disappear in recent weeks but everyone else is now at the starting line. I am confident we have done everything we can to be both competitive and compliant as the market, inevitably, changes.

RGT

We now expect to see the RGT[?] data around late November or early December and the legislation for the £50 journey on the gaming machines should be coming shortly and we are moving ahead with preparations for that to come in around April next year.

With the ABB code introduced in the early part of the year and technical changes to gaming machines due in April 2015, coupled with the new research by RGT, I believe that a robust data set will be developed that will assist with future decision-making.

Senate Group

At an industry level we have announced the formation of the Senate Group[?] and we are very pleased to be a founder member. There is a lot of work still to do, not least to encourage other LAN-based and online operators to join, but we will have an independent industry body that can hold us to account, which is definitely an important step in the right direction.

Now let me hand over to Neil to run through the numbers.

Q3 IMS Key Numbers

Neil Cooper

Chief Financial Officer, William Hill PLC

Preamble

Thanks James. I will focus on the key numbers from the statement; unless otherwise indicated any comparison will be to the comparable period in 2013.

Overview of the quarter

Quarter three has been strong for us, with net revenue up by 23% and operating profit up by 89%. To remind you, the quarter opened with the final two weeks of the World Cup; a number of high-profile draws, including the final, led to a strong World Cup gross win margin for that two-week period: 45% in retail and 19% in online.

These channels then benefited from a favourable run of football results through August and September. This was particularly favourable when compared against what was a disappointing margin in the comparable period.

Online

Online gross win margin was 9.4% for the quarter, ahead of our normalised expectation and well ahead of the 6.3% in the prior period. OTC gross win margin was 19.7%, again ahead of both normalised expectation and the prior-year 17.7% margin.

Retail

Over-the-counter

Turning to focus on retail, over-the-counter wagering was down slightly, by 0.8%. This obviously benefited from the World Cup; stripping these weeks out wagering was down around 3%, or less than 2% when you adjust for the impact of the 82 exceptional sites closed during the quarter. On that same closure-adjusted basis August was down 3% but September was flat year-over-year.

Over-the-counter net revenue grew by 10%, benefitting from the year-over-year margin improvement, as well as the presence of the World Cup.

Machine

Machine's gross win was up 8%. July trading benefitted from some additional World-Cup-related footfall and gross win growth for August and September was around 6%, or 8% after adjusting for closures. Gross win for machine per week for the quarter was £921. The combination of the favourable margin swing, the World Cup benefit and these strengthened gaming trends left retail net revenue up 9%.

Operating costs

Operating costs grew by 4%, which showed the impact of increased staff incentive provisions during the quarter. However, costs were helped by the extent of single-manning, which we introduced at the end of the first quarter. This enabled operating profit to grow strongly, up 31% in the quarter and now up 3% on a year-to-date basis. There were 14 shop openings and four closures plus 82 exceptional closures, with a closing shop count of 2,371.

Net revenue growth

Online

As retail benefited from the year-over-year swing in gross win margins, so did online, with Sportsbook net revenue doubling, driven by a circa-50% gross win margin improvement from 6.3 percentage points last year to 9.4 percentage points this year. Pre-match football results were the main driven of an improved performance, with pre-match margin moving from 7.2% to 12.6%. In-play, margins were more stable, at 5.8% this year versus 5.1% last year. As James said, sports wagering grew 18% in the quarter, or 11% if the two World Cup weeks were removed. In-play wagering grew by 35%, with pre-match growth slowing to 6%.

Gaming

Gaming net revenue growth accelerated in the quarter to 23%. As well as underlying growth, which we think was somewhere between 15–20%, the quarter also saw some cross-sale benefit in July from World Cup traffic and we additionally rolled over a circa-£2.5 million high-roller hit in August 2013.

Mobile

Mobile remains the driver of activity, with mobile gaming net revenue up strongly versus the prior year, by 116%. It now makes up 31% of total gaming net revenue. With the combination of 23% net revenue growth in gaming and 100% in Sportsbook, overall net revenue grew strongly, up 55%. Operating cost growth was in line with internal expectations, 30% growth reflected in part the year-over-year movements in staff incentive provisions; underlying growth was less than 20% excluding this line item.

Marketing

The marketing to net revenue ratio fell to 20% for the quarter, or 25% on a year-to-date basis. This strong growth in net revenue led to strong operating profit growth, up 126% in the quarter and now up 31% on a year-to-date basis.

Australia

Moving to Australia, operating profit grew 384% on a statutory basis, with margins growing from 8.3% to 10.2% and with operating costs falling. Wagering fell 3%, in part reflecting the impact of decisions taken to help mitigate the impact of the increases in rental[?] fees suffered during the quarter.

Furthermore, underlying progression continues positively, with unique actives continuing to grow by 18%, new accounts up 2% and with the average cost per acquisition continuing to fall by 26%.

United States

Finally, William Hill US continues to make good progress, with wagering up 21%, gross win up 73% and with a modest operating profit versus the loss posted in Q3 2013. In regard to exceptional items, the group previously announced the planned closure of 109 shops following the government's announcement of an expected MGD hike in early 2015. Of these, 82 were closed in July and August and a 16.6 million provision was taken at the half-year in relation to these. The remaining 27 will be closed in the final quarter; accordingly, we have recognised a further 4 million of exceptional provisions.

Concluding recap

To recap, quarter three has been a good quarter for William Hill and this has helped the group move from a position at the half-year of a modest operating profit decline to a position at the end of Q3 with operating profit up 19%.

That is everything I wanted to cover; I would now like to hand back to James.

Q&A

James Henderson: Thank you Neil. Let me now hand over to the operator for some Q&A.

Vaughan Lewis (Morgan Stanley): Hi there. I have a few questions, if that is alright? Can you give us the active customer growth for online that is driving that 55% net revenue growth, please? Secondly, Neil, you said the marketing ratio is 25% year-to-date; should we still expect that for the full year or do you think you might invest a bit more in Q4, given the strong returns you are seeing? Then, thirdly, I have a quick question on New Jersey; do you think you might open the Sports Bar for real-money betting at the end of this month or, if not, when do you think that could be open? Thanks.

James Henderson: Hi Vaughan. I will just take the New Jersey one very quickly. The sporting bodies are going for a temporary injunction, which they put in yesterday, so we have to wait to see how that pans out before deciding whether we are going to take any bets. However, we are obviously watching the situation very, very closely.

Neil Cooper: Vaughan, the detail you have asked for on active customers we do not normally do in an IMS so, if you will permit me, I am not going to get drawn on that. In terms of the net revenue, we are still happy with our guidance for the full year of around 25% margin-to-net-revenue ratio.

Vaughan Lewis: Okay. Thanks.

Neil Cooper: Alright. Cheers.

Patrick Coffey (Barclays): Morning guys, there are just three from me, please. Firstly, should we expect marketing costs to be flat, year-on-year, next year, or should we still expect marketing costs in 2015 to increase as a percentage of net revenue? Secondly, on free bets, 0.7% of amounts wagered in Q3 seems a bit lower than usual; is that something that we should read into or does your guidance remain on the free bets? Finally, just on

Australia, I know we are going to be talking about this a lot more tomorrow, but in terms of the gross win margin there, have you any sense of what a normalised gross win margin is for the Australian business? Thanks a lot.

Neil Cooper: Okay, if I can take those? Marketing costs, in regard to next year's spends, will be staying the same at absolute terms; I think we spend about 130 so I think it will be consistent with next year.

In regards to free bets as 0.7% of amounts wagered, there is nothing to read into that at all. And with regard to gross win margin, as we have said, we have done a lot of work on the client base and it is probably too early to gauge what a normalised margin is, other than it is probably going to be better than the historical one over the last two or three years. We are still trying to find out what the margin is; however it is pleasing to see that already the work that we have done has improved it quite significantly.

Patrick Coffey: Thanks a lot. Can I just ask one final question on the competitive pressures you are seeing at the moment? Can you just talk us through what you are seeing? Are competitors spending more or getting more aggressive with odds? What is happening in the run up to the point-of-consumption tax? Thanks.

James Henderson: I think we saw a competitive approach earlier on in the year; it seems to have settled down now and we have not noticed anything in particular from our competition leading up to the point-of-consumption. Furthermore, we have secured all the marketing packages that we want so we are in a good position and certainly from a pricing point of view I have not seen anybody act any differently in the last three or four months in the lead-up.

Patrick Coffey: Brilliant. Cheers guys.

Gavin Kelleher (Goodbody): Good afternoon guys. Can you give a feel for what is driving the +8% Machine performance? Is it the new Eclipse machines, and how are Storm improving on a like-for-like basis? Also, is the level of online gross win margin in play sustainable at 5.8%, going forward?

James Henderson: In regard to Machines, I think there are a number of factors that have led to the growth that we have recorded. Eclipse is one factor, and as you said they continue to outperform the Storm cabinets. We have also had soft comparators against last year because of the hot weather; we have also had a shorter off-season in regards to football and of course there is a little bit of World-Cup benefit in there as well. I think, therefore, it is a number of factors that have seen the machines get to where they have.

In regard to the in-play, which I think was 5.1 versus 5.8 this year, we are doing a lot of work in regard to the margins. I do not know if 5.8 is sustainable, however it will be around about 5%.

Neil Cooper: Yes, our normalised guidance on in-play is, I think, 4–5 so obviously we are well above that. As James has said, I think we have had a good quarter and you should not assume we run forward at that rate.

James Henderson: A supplement to that is, obviously, that as more is done on Mobile we expect to get a better margin from that. It is still above our normalised range so we need to be cautious about that, but as we progress we will put more onto Mobile and that will improve the margin on in-play.

Gavin Kelleher: Sorry, the margin on Retail was obviously results-driven in this quarter; can you just reiterate what your expectation there is? Is it still 17–18% because we have not hit that level for a number of periods now?

James Henderson: I take your point.

Neil Cooper: Do not jinx us, Gavin.

James Henderson: I think you are right: our normalised range is 17–18 and we are not looking to change it but it is something we need to consider going forward because, you are right, we have not hit it for a while.

Gavin Kelleher: Thanks a million, guys.

James Henderson: Thanks.

Nick Edelman (Goldman Sachs): Hi everyone. I just have three short ones, please. My first is on Retail: in terms of the shop closures, do you think you are capturing any of that revenue in other shops in the locations of those shop closures? Are they near other retail shops you have?

Secondly, can you just give a bit of colour on the £50 journey in the first half of next year? Is that going to involve some promoting and should we expect that to impact what drops down to net revenue?

Then thirdly, in Italy and Spain how would you split market share gains there between product and marketing? What is the bigger driver for you there? Thank you.

James Henderson: Okay, if I can just take the shop closures then, first off? You would expect we would be able to get some of the business from the shop closures. To give you an idea, we redeployed pretty much 90–95% of the staff because there were shops within the vicinity; you would therefore expect the same principle apply to, maybe, some of the lost business. However, I would not be able to gauge exactly how much we are going to get.

In regard to the £50 Journey, I have not modelled what the impact might be; we have only just agreed what the solutions are. I will just quickly go through them: it can be through a loyalty card, or the Bonus Club as we call it; it can be through a verification of an account through a PIN; or you can load cash at the counter. The legislation is imminent and the introduction will be around about April, however I am not in a position to really gauge what the actual impact might be. If we get it right and we execute it right, then we will see. It should be okay.

Nick Edelman: Can I just ask one follow-up on that? Are you able to give us any idea what those higher-staking customers would typically load on to a machine?

James Henderson: Other than money?

Nick Edelman: Yeah, someone who is staking £50–£100.

James Henderson: I think what I can do is point to industry data that would suggest that around 8% of sessions are at those higher levels; a much higher percentage of profits is made off those higher-level staking customers. That does not answer your question directly; however, to be fair, we have never commented on that level of detail.

Nick Edelman: Okay. I will watch you play one time; see what you put in.

James Henderson: I am a 20p merchant, me. Do you want to answer on Italy and Spain?

Neil Cooper: Yeah. I think we are spending a competitive amount of marketing in Italy and Spain. However, I think it is also true that, in particular with sports, we would see our products as being superior to the domestic incumbents. They are not necessarily superior to our British Isles competitors, like Paddy's or 365, but certainly in Italy I think we have a better product and frankly the pace of deregulation is probably the thing that is hindering us from really showing our wares. The deregulation is going quite slowly on Palinsesto, although it is progressing. I think the answer is therefore that it is, as ever, about a number of things: It is about getting your marketing competitive and it is about having a great product. However, trying to ascribe value to each of those is exceptionally difficult; it would only be a guess.

Nick Edelman: Thanks very much.

Victoria Greer (J.P. Morgan): Evening, thank you. I just have one on regional[?] please. Now that you have a bit more clarity over the £50 restriction coming in next year, are you in a position to talk about whether you think you might need more shop closures for FY 2015, or are you happy with the 109 that you will do this year?

Neil Cooper: Well, the 109 was based on increasing the MGD from 20 to 25, so as long as it stays at that level I would not expect to see any further closures for the time being.

Victoria Greer: Okay. Thanks. However, that is presumably assuming, as you said, that you can execute on the £50 change and do not see any downside there on the revenue number.

James Henderson: Absolutely.

Neil Cooper: Yeah, we are not planning to do a bad job of execution at this stage, I think.

Richard Stuber (Nomura): Hi, good evening. I just have a quick question on the machines. I understand it was up 8% year-on-year but I think quarter-on-quarter it is down a little bit. It was 931 in the first half and I think 921 just now; is there some sort of a quarterly trend in there or is the slow down due to the disturbances –

Neil Cooper: Richard, sorry, Neil, let me answer the question. It is seasonality; you have obviously got the summer holidays through the middle of Q3 and people are away. You can see that from the year-over-year growth; clearly last year was equally impacted by that same seasonal effect.

James Henderson: It was -5%.

Richard Stuber: It was not impacted too much by putting through the Storm machines or anything like that? I was wondering if you had any sort of idea what the run rate was [inaudible] –

Neil Cooper: We finished the Storm roll out in late 2011, I think, so there might have been a little bit of Eclipse roll out impact the other way but no, I do not think you can read too much into the natural seasonality for the H1 Q3. We do not believe it is an unusual shape for us.

Richard Stuber: Okay, thanks.

Jeffrey Harwood (Oriel): Good morning. Where are we on the road map in Italy and Spain in terms of getting to a break-even situation in 2015?

James Henderson: We are still expecting to, by the end of [inaudible], to be in profit. We are not updating on Italy and Spain specifically at this IMS, however we are still on target to be, as I said, profitable by the end of next year.

Ed Birkin (Credit Suisse): Hi, there are just a couple of quick ones from me, please. Can you give us a bit more colour on when you expect the RGT report to come out? Secondly, on the Online staff pay provisions you have talked about, is this something that is a change of timing from Q4 and you should expect a headwind in Q4? Perhaps you can actually quantify that roughly in actual monetary terms? Thank you.

Neil Cooper: Sorry Ed, can you repeat that last question; I think we missed a bit at this end?

Ed Birkin: The online staff pay provision you talked about, which flattened the EBIT number this quarter, is that a timing issue that is going to be a headwind in Q4? Can you perhaps also quantify what it is in actual terms?

Neil Cooper: We are not going to give you any more detail than we have given you on the breakdown of the cost basis. It is, I remind you, an Interim Management Statement; not a full set of results. It is basically a reflection of the fact that Q3 was terrible last year and we were releasing bonus provision; Q3 has obviously been exceptionally strong this year and as a result we have had to upgrade our bonus provision, so that is what is driving it. However, we have given the market some guidance for this year and any impact of that is clearly built into that guidance.

James Henderson: And in regard to the RGT research, that is due on 1st December, the latest intelligence tells us.

Ed Birkin: Okay, great. Thank you very much.

James Henderson: Okay. Thank you very much and I will look forward to seeing a lot of you at dinner a little bit later. Thank you all.

[END OF TRANSCRIPT]