Entain

Q2 Trading Update

7th July 2022

Transcript

Host: Good morning and welcome to Entain's Q2 trading update and investor call. I will now pass you over to CEO, Jette Nygaard-Anderson, to open today's call.

Jette Nygaard-Anderson: Good morning everyone. And thank you for dialing in today. As usual, I'm joined on this call by Rob Wood, CFO, and deputy CEO, as well as the IR team. And I'll start with a brief performance overview, and then Rob will take you through our Q2 trading in greater detail. And then we'll open up to Q&A. So I'm pleased to say that Entain continues to deliver on our strategy of focusing on our customers. We continue to attract broader, more recreational audiences with great products, engaging content and exciting experiences. In fact, in Q2, we had our highest ever actives, up 60% versus Q2, 2019, i.e. versus pre-COVID. Our retail operations continue to see customers engaged with the richer experience our shops provide with volumes back to pre-COVID levels, and in some cases, ahead. However, while we grew revenues quarter on quarter, we did face some headwinds in Q2, including tough comparables year on year as we lapped last year's COVID enhanced performance and pressures on consumers from the weaker macro environment.

Jette Nygaard-Anderson: As a business, we are relatively resilient to cyclical macro-economic effects. However, no business is completely immune. We've seen some moderation in the rate of spend by customers resulting in lower underlying growth across many of our markets versus our expectations earlier in the year. We also continue to enhance protections for customers with more stringent affordability checks in the UK. Also, competition in Brazil is intensifying ahead of regulation, which has slowed the rate of growth we are seeing there. That said, in Brazil, we still grew NGR by 26% in the quarter. We continue to lead that market and we remain very excited by the long term prospects of the country.

Jette Nygaard-Anderson: Meanwhile, over in the US, BetMGM continues to deliver, reinforcing its leadership in North America. As you heard from Adam and his team at the BetMGM capital markets event in May, we have exciting plans for second half of the year, particularly with further enhancements to our sports product. Following a successful launch in Ontario, BetMGM went down to announce two exciting innovative partnerships, one with Carnival Cruises to provide on ship betting and gaming under the BetMGM brand, and an exclusive agreement with Sony to provide a unique Wheel of Fortune experience, bringing together a range of Wheel of Fortune games including ones we specifically develop in ours Entain studios.

Jette Nygaard-Anderson: These types of partnerships really highlight that we think differently and more broadly about our customer acquisition opportunities, M&A continues to be a key part of our growth. Our recent announcement of the BetCity acquisition in the Netherlands, marks the fourth transaction so far this year, and the pipeline of opportunities remains exciting. Sustainability and responsibility remain at the heart of our strategy, alongside growth. We continue to make progress on our sustainability agenda. And it was notable that we were awarded advanced safer gambling status by GamCare, recognising how we are leading the industry in this important area. We also continue to make progress on ARC with trials continuing across many of our international markets.

Jette Nygaard-Anderson: So before I pass to Rob, I just want to stand back from the short term headwinds and remind everyone that the long term fundamentals and health of the business are strong. We continue to deliver our strategy of growth and sustainability. We have a diversified business across both geographies and product, providing relative resilience and also long term growth. Our track record on M&A is strong, and we continue to grow through acquisition. The underlying growth dynamics of our markets remain compelling with an ever growing and broadening audience, engaging with online betting and gaming. New markets are regulating opening up further new opportunities. So we look at a potential total addressable market of over $160 billion as we grow in existing markets, into new geographies and into new verticals, creating a market opportunity three times larger than we operate in today. And, of course, all this growth potential is underpinned by our Entain platform that enables us to outperform our markets. So I remain extremely confident that as we continue to execute on our strategy, we can deliver significant upside to our shareholders. Now, over to you, Rob.

Rob Wood: Thanks, Jette, and good morning, everyone. As a group, our NGR was up 6% in constant currency in Q2 and up 18% for the half. Before I get into online, I'm going to kick off with retail today. Because our shops were the star performers this quarter, delivering ahead of expectations. We're delighted to see that customer volumes in shops were ahead of pre-COVID levels. So, if we compare Q2 of 2019 to the quarter just gone. So pre-COVID, NGR was up around 2% per annum on a CAGR basis. Of course, year on year growth percentages for retail are very large due to lockdown restricted trading in the prior year. Those figures for retail are a blend of all of our territories, with the UK and Italy, our largest businesses, showing the strongest performance. In the UK, the strong results are driven by continued digitalisation of our estate with gaming machines and self-service betting terminals, both seeing fantastic out performance.

Rob Wood: Now onto online. Online NGR growth in Q2 came in at minus 8% in constant currency or minus 7% for the half. Now we expected to be down versus last year as we lapped lockdowns and the euros in the prior year, we wait for Netherlands licensing, and the tighter affordability measures play through the UK ahead of the UK gambling act review. However, the outturn was ultimately behind our expectations from earlier in the year, due to a couple of headwinds. Firstly, whilst our business is resilient to weakening consumer sentiment, we're not immune from it. So given the headlines over the last few months, it's not surprising we are seeing some moderation in spending by customers. Our active numbers remain strong, but we estimate that spend per head is down around four to five percentage points versus our expectations for Q2, due to the macro environment. Let me put that another way. In spite of the gloomy economic headlines and backdrop, our strong actives show that our customers are still playing with us -

Rob Wood: They're just spending around 95% of what we had expected them to. So, still spending at 95% is why we see our business as relatively resilient to macro conditions. Secondly, in Brazil, we always expected there to be increased competition ahead of regulation, but the intensity has arrived a little earlier than anticipated. And while our NGR growth in Brazil in Q2 was still an impressive 26%, that was nevertheless lower than we had been expecting. Which results in approximately a one to two percentage point drag versus our previous expectations. You'll remember, we have previously talked about Q2 year on year growth being down low single digits, largely as a result of the COVID impact unwind. So, those two factors together should help you bridge from that expectation to what we're reporting today. As we plan ahead, whilst macroeconomic impacts are cyclical, we think it prudent to assume they persist across the balance of the year.

Rob Wood: Additionally, we need to digest the delay in Netherlands licensing and therefore we now expect the second half to deliver mid to high single digit NGR growth leaving online NGR for the year around flat. What I find particularly encouraging is that the underlying performance of the business remains strong. We saw positive underlying momentum across the first half with Q2 NGR ahead of Q1 NGR. As Jette highlighted already, we continue to deliver on our strategy of broadening our customer base with further growth in actives, up 60% versus the same period in 2019. And in fact, Q2 is our highest level of actives on record. Our business in Australia continues to grow from strength to strength with NGR up 21% in Q2, and as already outlined, Brazil continues to grow strongly up 26%. And when looking through the COVID variables, we continue to deliver double digit online NGR growth with a three year CAGR up 13% in constant currency for the first half

Rob Wood: Moving on, M&A continues to be a key part of our growth. I'm delighted to recently announce the BetCity acquisition, which once we receive licenses for our existing brands provides us with a leadership opportunity in that market. Completion is expected later this year with the real benefit being seen in FY23. And last but not least, BetMGM and the US. As Jette said, we are firmly number two across online sports betting and iGaming markets, where we're active, with a 24% market share for the rolling three months to April. This excludes New York, where our strategy is different due to the high tax rates.

Rob Wood: In iGaming, we continue to lead the market with 29% market share in our states. Customer engagement remains as strong as ever, and on a same state basis BetMGM continues to deliver growth of over 30%. In Ontario, it's still relatively early days, but despite it being highly competitive, in June, BetMGM saw over 80 million transactions in the month. With BetMGM, continuing to deliver, we remain on track with our ambition of over 1.3 billion of NGR this year and reaching positive EBITDA during 2023. With that, I'd like to hand the call over for Q&A.

Call Operator: Thank you, sir. If you would like to ask a question, please signal by pressing star one on your telephone keypad. We will now take our first question Ed Young from Morgan Stanley. Please go ahead.

Ed Young: Good morning. Can you hear me?

Jette Nygaard-Anderson: Yes Ed. Go ahead.

Ed Young: Great. Thank you. So my first question, obviously you gave the original guidance in March. It's now quite a significant update you are giving now. Can you just talk about when you started to see this impact during Q2, just so we can think about exit rates versus entry rates in Q2? And perhaps connected to that, your thinking on the cadence of what growth might look like in Q3 and Q4, if that's possible. Obviously you've given an overall expectation for each one.

Ed Young: The second question, I wonder if you might be able to give a little bit more geographic colour. I didn't hear a UK growth number. I may have missed it. But the reason I say that is you are saying, you're putting through the full macroeconomic impact that you've seen the sort of spend the heads coming down 4% or 5%. Are there any geographies that were particularly weak or particularly strong or you feel you've seen that more or less than in other places, or is it a fairly uniform effect across your geographies?

Ed Young: And the third is, retail is obviously a very strong, frankly a very impressive number there. But, if you are seeing a macroeconomic impact across online, is there a reason to think that wouldn't hit at some point in retail as well? Or do you think that's cushioned by COVID offline reversion or whatever else it might be. How should we think about maybe a slightly phased risk? But risk nonetheless to retail growth for H2 onwards.

Jette Nygaard-Anderson: Thanks. Good morning. I suspect many of this morning's question will be for Rob on the trading, so Rob handing over to you. Guidance, exit rates, and Q3, Q4, geographical differences, and retail. Whether we expect to see any macro impact, you want to take those?

Rob Wood: Sure. Thank you. Jette. Good morning, Ed. So let's start with, when did we first start seeing an impact? Really, spend per head started to dip in April. So, realistically into May before observing it as a trend and watching it closely. May continued, and likewise into June, albeit when you lap a tournament, there's a bit more noise in that mix of actives and spend per head.

Rob Wood: So really the step-down beginning in April. When you think about when, across the globe, the headlines really started hitting and consumer confidence levels dip, it was around that sort of time so that clearly prompted us to investigate. You can clearly see that progression in spend-per-head decline from Q1 to Q2, both in absolute terms and on a year-on-year basis and nothing else was really changing so it started to become clear to us, I guess, during May that this is a trend that we need to watch closely, drilled into the detail.

Rob Wood: We talked to all our businesses. I spent the last couple of weeks doing quarterly updates with all our MDs and some territories are feeling it much more than others. Australia, for instance, is going fantastically well. It's sort of being flagged as a risk, but we don't think we're seeing a macro impact in Australia yet.

Rob Wood: But other parts of the world, this is really moving on to another one of your questions, but in other parts of the world, particularly Europe, I'd suggest it's clear there's an impact. In the Baltics, for instance, inflation is nearing 20% and you'd be mad to think that you're not seeing an impact as a result of those kind of conditions.

Rob Wood: When you bring it back to group level, sort of on a weighted basis, we get to around four or five points of being the sort of unexplained, if you like, drop in spend per head, which we absolutely attribute to being the macro environment. But it is cyclical. We're not forming a view on when it comes back and we felt it was sensible to assume that it continues through the rest of this year.

Rob Wood: To your question around Q3 into Q4, now, I expect Q3 to be better than Q2 and then I expect Q4 to be better again. There are some fairly material movements between Q3 and Q4, just to note, when you're thinking about that progression. One is football tournaments. So obviously in Q4, we have one, whereas we didn't in the prior year, and in Q3, we don't have one, whereas we had the end of the Euros in the prior year. There's also Netherlands relicensing. I think it's Q4 is our assumption going forward. We don't know that, but it's our best view. Also you remember margins were a little tough in October last year and, hence, there's a bit more of a margin movement helping Q4. So I think the quarters from a year-on-year perspective get progressively better.

Rob Wood: Your second question was all about territories and, really, I think I've hit the headlines already. There absolutely are some strong territories out there, such as Australia and Brazil, that we've mentioned. The ones that are struggling the most are, I would say, it's really concentrated around Europe.

Rob Wood: Then your last question was around macro impact on retail. It seems that, unlikely that there's no impact at all on retail. What we are benefiting from right now, though, is outcompeting on the High Street. We're really confident we're taking share. You can see it in the comparators. Our revenue per shop is looking very strong.

Rob Wood: How are we doing it? It's primarily through a stronger gaming machines offering and stronger bet stations and I can dig into the detail on that, if you'd like. But we're really confident we're outperforming and, hopefully, that will continue and market share gains are really the best way to offset any potential impact from macro conditions.

Rob Wood: Let me pause there.

Ed Young: Thanks, Rob. Thanks, Rob. Could I just follow up? Are you able to give a UK number or are you not giving that today?

Ed Young: I guess the other sort of thing that comes out of it is that if you've got some geographies that appear to be wearing the macro impact much more than others, is there a chance that you end up with a higher blended impact than the four to five points you're looking at now, if other geographies also start showing some of that weakness?

Ed Young: I guess what people want to understand is how conservative do you think the macro impact you've swept into the H2 guidance is? Or do you think there's a chance that we could be looking at Q3 and having to bring it down more because countries that, maybe Australia, as you mentioned, is a risk, some countries like that, start showing more than we've seen previously. Just your thoughts on that in general.

Rob Wood: Really tough one to call, Ed. I think we're doing the sensible thing, which is assuming current levels continue and that some territories could start improving, while others go the other way.

Rob Wood: We're such a globally diversified business. You might hope that the blend stays broadly where it is, but clearly, we'll be keeping a close eye on it. There are some territories that consider their economy to be really quite insulated from global conditions and, therefore, are not expecting an impact at all so one for us to keep a close eye on.

Rob Wood: And UK is down 15% for the half, very similar numbers, Q1 and Q2, clearly with a significant impact from the UK affordability measures that we've been taking as is everybody else, as you know.

Call Operator: We will now take our next question from Simon Davies from Deutsche Bank. Please go ahead.

Simon Davies: Yeah. Morning, can you hear me?

Jette Nygaard-Anderson: Yes, Simon, loud and clear.

Simon Davies: Perfect. First, can you give us a bit more detail around affordability? You talked about the impact in the first half broadly, but can you put any numbers on that? Of what percentage of the weakness in the UK is coming through from tighter affordability checks and where do you think you are relative to the rest of the market?

Simon Davies: Then secondly, we've seen Australian tax hikes in New South Wales and Queensland. Do you think it's reasonable to expect that we'll see other states following suit and what impact could that have?

Simon Davies: Thirdly, M&A. Is that still on the agenda? Or given the weaker macro backdrop, are you looking to conserve balance sheet and hold back for the time being?

Jette Nygaard-Anderson: Got it. Thanks, Simon.

Jette Nygaard-Anderson: Let me start from the back. I'll comment on M&A and also start off on affordability. Then, Rob, if you will continue affordability and then tax in Australia.

Jette Nygaard-Anderson: Listen, on M&A, we are as active as ever, very happy with the BetCity acquisition that we did recently closing later this year. So that's our fourth transaction this year and our pipeline is as exciting as ever. And, really, when you look at the BetCity acquisition, I look at this as a classic Entain deal, which is complementary, attractive in price, synergies in the outer years and it gives us a strong foothold before re-entry of our brands, Bwin and Party. It also basically leaves our leverage in a good place so there's still room to invest. So, we are as active as ever on M&A and remain really excited about our pipeline.

Jette Nygaard-Anderson: On affordability, really, maybe where I wanted to just kick off is just to take us back a little bit. We've talked about affordability has really been a journey for us since the GCs came out with guidelines back in late 2020 so we have through 2021 implemented a number of things around affordability.

Jette Nygaard-Anderson: I think we've said this before so let me reiterate it. I think all operators have worked through the last year, 18 months in implementing tighter measures here, like thresholds and different affordability checks so at least when it comes to the licensed operators, this is across the industry.

Jette Nygaard-Anderson: Operators have different approaches, but we're all addressing the same things. So for our side, we've included three times more behavioural markers than others. We are capturing real-time data here, meaning that we can do bespoke or hyper-personalised customer protection, which is enabling us also to impose variable staking limits for some player cohorts and we are doing self-certification and questionnaires and working on the customer journey.

Jette Nygaard-Anderson: The reason why I say this is that it's been a process. So what we are trying to do is really bake this in to our forecast as we go along, because it's really part of our industry and part of doing business.

Jette Nygaard-Anderson: So I'll pause there, happy to talk more about our measures, but why don't I hand over to Rob, if you want to say anything more on affordability, and then turning to Australia and taxes.

Rob Wood: Thanks, Jette. Morning, Simon.

Rob Wood: To the question of the impact of affordability, look, it is hard to unpick the competing drivers. For example, we're seeing spend per head fall in the UK. That's the driver of the 15% decline that I mentioned. How much of that is affordability measures versus other measures versus ARC, but also versus macro conditions? It is hard to separate with confidence.

Rob Wood: What I would say is we do see macro impacts in the UK as well, because if you look at spend per head on the lower spending cohorts, then you can see a fall-off as well. So it's not just driven by less top-end activity, but really hard to unpick the two so I wouldn't attempt to do that.

Rob Wood: Interesting to see that the recreational mix in the UK continues to improve at pace. Now, clearly that is partly due to UK affordability having an impact so you know it's having an impact, also the pivot towards that audience from a brand and product and customer proposition perspective. But if you look at the contribution from the top cohorts of spenders in the UK, it's fallen by just over half since the start of last year so very material movement in the customer base in the UK.

Rob Wood: On to Australia, is there a risk of further tax rises? There's always a risk. What you would say in Australia, though, is that the blended tax rate now, once you roll forward the proposed changes, is comfortably over 20% so it's on the high side. That is on top of high product fees so the gross profit margin in Australia was already one of the lowest globally and this now puts further pressure on that.

Rob Wood: In other words, there's not a lot of room you would've thought for further movement in Australia, but if it does happen, then we move into mitigation mode, as we always do. We think actions internally can typically mitigate around half, something like that.

Rob Wood: Then, of course, you get the knock-on benefit of smaller operators, just simply can't make it work anymore in these kind of conditions. So unless you've got a decent market share, you're going to be loss-making as a result of these changes and, ultimately, that will play through to higher market share for ourselves.

Rob Wood: So is there a risk of further tax rises? Same as everywhere, yes. But then you can mitigate, you can flex through the marketing line. There's other measures and, ultimately, the scale operators are the ones that win in that sort of situation.

Simon Davies: Great. Thank you.

Call Operator: We will now take our next question from David Brohan from Goodbody. Please go ahead.

David Brohan: Morning, guys. Just a couple of questions from me.

David Brohan: Firstly, can you give any colour around sports wins margin, either at a group level or in terms of some of the key geographies you call out. Then in Australia, a very strong outcome in Q2. Is this volume-driven or margin-driven? Then just kind of finally on the affordability side of things, have you guys made any changes to your slot stakes across the UK stakes, or is that something you're willing to disclose? Thanks.

Jette Nygaard-Anderson: Thanks, David, and good morning. Let me just start from the back and then I'll hand you back to Rob.

Jette Nygaard-Anderson: On affordability, we are constantly working with different thresholds, with different customer segments. But when it comes to any specific, let's say implementations, we are waiting for the GAR to see what they come up with when, and if, hopefully soon, that we see the white paper there. But through 2021 and 2022, we are working with the different levels for different thresholds, but on specific slots, we'll wait and see what comes with the white paper.

Jette Nygaard-Anderson: Rob, over to you on sports margins and Australia.

Rob Wood: Thanks. Morning, David.

Rob Wood: Sports margin in the quarter was a very solid 12.6% however, we have this every quarter, I sort of get asked whether our expectation is ticking up. I think it is ticking up, particularly due to that recreational mix point that I was referring to earlier. It feels like numbers starting with a 12 are more normal than 11 now so a decent quarter for margin.

Rob Wood: No particular stories. I have to say on a geographic basis everywhere broadly in line with expectation, broadly down a little year-on-year, but broadly, consistently. So unusually no real stories by geography for the quarter.

Rob Wood: Then onto Australia, not margin-driven. I wouldn't say that the 20% growth is volume-driven and it's really a mix of both spend per head and actives, so, healthy growth rates, volume driven, at least half actives and other half spend per head.

David Brohan: Perfect. Thanks guys.

Call Operator: We'll now take our next question from Monique Pollard from Citi. Please go ahead.

Monique Pollard: Oh, hi morning, everyone. Just a few from me, please. The first is on the GAR, obviously Jette you mentioned, waiting for that before giving further guidance. But I'm just trying to understand, even if it comes out before Boris leaves office with the gambling minister resigning today, but saying that the paper is with number 10, can we have confidence that it isn't later amended? So would that be a clearing event? Then the second question on M&A, I just wanted to understand given you've got that strong pipeline and the BetCity acquisition, as you say, completely falls into your criteria. What are you seeing in terms of valuations and expectations from the acquisition targets in your pipeline? Are they coming down, I guess in line with how your valuation has been coming down? And then finally, on Brazil, is it reasonable now to no longer expect the sports betting market there to regulate before the October elections? And how do we think about that in terms of 2H growth expectations, would regulation have been a drag on growth or a benefit to growth?

Jette Nygaard-Anderson: Good morning, Monique. Yeah, I'll start out with GAR and Brazil regulation and then maybe Rob, you can continue. So I think on the GAR listen, I've adjusted my notes on the white paper on the GAR the last 24 hours for this call. And we don't know when it will come out. It's probably unlikely that it comes out before the summer recess, but as you mentioned and as Chris Phillip said this morning, it is with number 10. So we know that the process is working and it's going through the commentaries and so forth. And yes, it can still be amended and it will also be consulted on once it's published.

Jette Nygaard-Anderson: However, we are quite confident that the process is working. So number 10 and treasury are taking the different comments in and they still are. So I suspect that there is still ongoing work around that, but they will see when it comes out, whether it can still come out before the summer recess process, probably unlikely, but then after the summer and before potentially Boris steps down, whatever is out this morning, just when we started the call. So that's on the white paper and the GAR, but when it comes to Brazil, so we expect that regulation would be published just after the election here. But I think probably looking at it right now, it's probably unlikely that it will come up before the world cup. And then we move into sports betting licenses by mid 2023.

Jette Nygaard-Anderson: That doesn't really change our excitement about the region. But we are seeing right now that competition is heating up in the market ahead of regulation coming out. And therefore for us, we are looking forward to regulation actually happening because us being number one in the market, that obviously is a benefit for us when it comes to market growth and marketing, and so forth. So yeah, signing probably after the elections now and that means licensing into 2023 so we are seeing a bit of a delay there. Rob, do you want to say anything more about Brazil? And I don't know if you want to comment on M&A or I can do it?

Rob Wood: Yeah. Let me do both of those things. So just to add a little bit more on Brazil. One of the benefits of licensing actually will be to clean up the market. So it's interesting looking at the competitive intensity over there. It's not just some of the larger operators positioning themselves ahead of regulation. It's also a very large number of smaller unlicensed or lower quality operators. I've seen reports that they're over 2000 operators right now in Brazil. So clearly a licensing regime will help tidy that up. The marketing point is a big one as Jette’s just mentioned, but also being able to give customers better journeys through more popular payment service providers, that sort of thing. These are all reasons why we expect the market to grow very well, and in particular for the likes of ourselves, albeit new taxes being introduced leads to pull back in EBITDA a little bit versus where otherwise it would have been.

Rob Wood: But most definitely we're expecting growth. And to the question on M&A valuations in particular, so clearly public companies, valuations adjusted, private, not by as much, that's for sure. If owners of businesses have no reason to sell, they're not forced to sell, then they're more than happy to ride out difficult macro periods. So private does make it a little harder, but clearly there's sympathy for things like cost of debt going up and needing to make sure that's reflected in acquisition prices and so on. So some movement, but clearly much less in the private environment.

Call Operator: Thanks so much. We'll take our next question from Joe Thomas from HSBC. Please go ahead.

Joe Thomas: Good morning. Yes. So good morning. Rob, if I could ask my question, please. First one would be, in the UK are you seeing any market share issues? And the reason I ask that is because I think it was well understood that bet365 were making a bit of a land grab earlier on in the year. And I just wondered to what extent that might have influenced the revenues that you're seeing over the course of the most recent period. That’s the first question. The second thing is on Australia. Can you remind me of the scale of the impact to EBITDA of the tax increases in New South Wales and Queensland, and also importantly, would you plan to mitigate that by higher overrounds, which I think is what you did in the past? And the final thing I'd just like to ask you about please, is cost inflation in the business. I mean, developers, etc. are not getting any cheaper. And I just wonder to what extent that is going to impact your SG&A line? Thank you.

Jette Nygaard-Anderson: Thank you, Joe. Good morning to you. Why don't I take the first one and then I'll hand over to Rob for Australia and inflation. So on UK market share, no, we are not seeing impact on market share. So when we look at the data that we have, the data that's published 2021, and also into the year, when we look at our biggest competitors, we have grown our NGR ahead of the data that we are seeing from competitors. And when you look at a 3 year CAGR basis, we are also very happy with how we are growing overall market shares there. So a little different from the different brands, but overall, we are holding on to our share. So we are not seeing that as an impact.

Jette Nygaard-Anderson: And maybe I should just comment a little bit about the recreational audience and actions there, as Rob mentioned earlier on, it's really difficult to dissect which are the different impacts and on growth on the recreational base, but outside of any impact from affordability and regulation, the team has also worked extremely hard in terms of engaging recreational audiences.

Jette Nygaard-Anderson: It is a key cornerstone of Australian mature markets to increase that base. So we are doing things and Rob mentioned earlier, both around brand and product, but driving low stake, low risk promotions, expanding our free play games, looking at gamification, new experiences that make products easier and more fun to play. Live casino is something that we've doubled down on. It's also something that attracts a bigger base. So both when you look at the NGR but when we look at the actives, we are pleased with what we are seeing there in terms of share and actives drive. Rob, Australia, Queensland NSW, and inflation pressures?

Rob Wood: Yep. Let me take those. So if we look at the 2023 impact of the two movements in tax rates, we make it some somewhere around 35 million Sterling EBITDA impacts pre mitigation, and then the team are confident of mitigating broadly around half that. So that should give you a steer for the economic impact. How do the team mitigate? There is some activity to be done around GGR margin through overrounds, but you have to be super careful with that. It's quite skillful, but there'll be some of that, I imagine. We also talking about clearly more efficient marketing is a must. There's also ways to redirect customer activity to the higher gross profit margin products.

Rob Wood: So, simple example, things like the next-to-go promotions on the carousel. You can choose which activity you choose to promote. You can choose which activity your free bets are redeemable against. You can focus your different marketing promotions, whether above the line or below the line, you can focus on certain products with margin in mind. So that's all before thinking about fringe operators struggling as well. That's further opportunity, but the single best mitigation actually is just continued market share growth. And all the while that we continue to take share in that market. That's the best protection we can have against bottom line. Then there was a question about cost inflation. I mean, absolutely it's a watch out. The guidance for online is mid to high single digit. I don't think we're in a position to need to change that in retail, particularly the UK, obviously European is more of a franchise model.

Rob Wood: In the UK, the watch-outs really are energy prices and potentially salaries. I think I spoke on the last call about how the bulk of the rest of the cost base is either on a rev-share basis. Things like content deals or it's of a fixed or more longer term nature, like the rent-roll, for instance. So energy undoubtedly is under pressure and salaries, we'll have to wait and see. Right now, we lifted our pay earlier this year to

10 pounds an hour, which is ahead of the national living wage and the real living wage. So almost some natural protection there, but to be determined later this year what 2023 might look like. So there is a watch out there. The good news in retail there is, all the while, that the revenue numbers are outperforming then that's creating a buffer to absorb any cost inflationary type pressures.

Joe Thomas: Thanks very much.

Call Operator: We will now take our next question from Kiranjot Grewal from Bank of America. Please go ahead.

Kiranjot Grewal: Hey, morning guys. Just a couple of questions from me. Firstly, how should we think about your leverage level when we are thinking about M&A, is there a cap you're assuming, especially given the macro backdrop? On the affordability measures in the UK, you mentioned tightening of the measures for Q2. When did you start making these changes? I know you've said you've been working on it for the last year or two, but it's the first time you've called it out. And lastly on Australia, a really good performance there, are you winning market share? Thank you.

Jette Nygaard-Anderson: Hey, good morning to you as well. Let me take the second one around affordability first, and then I can hand you over to Rob. So you're absolutely right that affordability is something that we worked on through 2021 and into 2022. And I think some of the things that we are putting in place now is also in preparation for the latest guidance from the GC that's coming out after the summer. So it's an iterative process that we've gone through and we constantly put it into our business model because it is part of doing business in this industry. So I wouldn't say that it's... You could say that it's something specific we've done in Q2, but we are constantly upgrading those measures as we follow the guidelines that is put forward from the GC.

Jette Nygaard-A...: It comes back a little bit to Rob's point around how we see the impact now on spend per head that we are talking to today, so I don't know if Rob wanted talk more about it, but he said earlier on this call that it's really difficult to point to what is the specific [impact] from affordability and macro, but that's what we tried to do today when we split out the different impacts for the impact on Q2. Rob, do you want to start with leverage? And if we have any cap on that due to the macro.

Rob Wood: Yes, very happy to. Morning Kiranjot, so no hard cap, but no change either to the position that I've been communicating probably for three years now, which is that three times feels like the level that we'd like to stay below. But as I've said before, we would go beyond that, so long as there's a path to getting back under in short order, but that continues to be the level at which we are happy and we prefer to stay below, so no particular change on that position. In terms of Australia, that was the last question I think. So are we taking share? Yes. It's been clear that we've been taking share for some time, obviously there's the large operator in Tabcorp, which is not so strong online and that's benefiting us, but also taking share from the number one operator as well, I'm just looking at a market share chart in front of me right now and it's a very healthy picture over the last few years, really. And it continued to accelerate through 2021 and we believe first half of 2022 as well.

Rob Wood: And I think we've talked on these calls, why is that? What are the guys doing? And it really is about having a leading customer proposition, so a ton of work in the products, but also some more innovative developments around things like content, we've spoken about the horse video content that the team produced there and the engagement that we have via that, we launched something called Mates Mode earlier this year, which is seeing great adoption. I think Dean told me there's been 250,000 chats using that feature since it launched a few months ago, so this is a way of creating an account for a group of people with their own chat functionality, private chat functionality within it, that we're working on more social experiences that are exciting and also building a new racing channel, which hopefully will be going live in due course. So it's nonstop development of the customer proposition in a really interesting and innovative way.

Call Operator: Perfect, thank you. Thank you so much. We will now take a question from Andrew Tam from Redburn, please go ahead.

Andrew Tam: Hi Jette, hi Rob, just a quick one for me. Just following on from Rob's query about the retail portfolio with respect to the macro, retail obviously cycling the COVID recovery, obviously that looks like it's largely over, does this prompt a reexamining of the size of that portfolio or given that you're still winning market share does that mean that there's opportunities to potentially grow that? And how does that work from, I suppose, from a capital allocation perspective versus your online business? So that's probably the first. The second is just on Australia, you mentioned you've got some market share gains there, you have a higher tax rates as well, but is that likely to change just in terms of the competitive dynamics, potentially with the reinvigoration of Tabcorp there and then potentially with new entrants as well? How do you think that will factor in? And sorry, just going back to the retail, you mentioned the rent-roll in terms of the SG&A earlier, do you not have CTI increases factored in on your leases? Just wanted to clarify that particular point as well, thanks.

Jette Nygaard-Anderson: Hey, good morning. Why don't I let Rob continue on the retail, two questions, whether we are reviewing the portfolio, SG&A lease agreements and back to Australia competitive environments.

Rob Wood: Okay. Thanks Jette, morning. So in terms of capital allocation, so yes, we're pleased with how retail's progressing, are we looking to open materially more shops? I think that the guy said to me that we're already in 119 out of 124 postcodes in the UK, so for us, I don't think there's a lot of opportunity to open more shops, so no. But is there opportunity to invest? Yes. We have already and continue to invest in the digitalisation of the estate, we think we have over 40% of the market share in the UK, and we think there's a lot more to go at. The ones who are investing in the best quality product, particularly when it comes to the gaming machines and the self service betting terminals, they're the ones that are going to win over the next period of time.

Rob Wood: The average age of users of these gaming terminals, it's similar to online, it's a similar profile and the combination of SSBTs and gaming machines is now around two thirds of a shop revenue. So you have two thirds of the revenue with a good demographic and good growth prospects as well, so we invest in the technology in particular in shops, as opposed to looking at opening new shops. In terms of the lease structures, yes, it is a mix, but it's not something that's when you compare to energy inflation, for instance, it's also worth noting that for our betting shops, the rent bill is quite a low mix of the cost base compared to other retailers because our units tend to be smaller, very often in secondary locations and so on, so we are less exposed to rent than many others.

Rob Wood: Australia, I think we've spoken quite a lot about market share change, is there a threat from new entrants with one in particular? Absolutely we'll be keeping a close eye on that, do we have a reinvigorated competitor in Tabcorp? Let's see what changes with their product proposition, as we all know in this sector, we really compete on product and so if they bring out new, improved technology and products, then that will be interesting, that will be the catalyst for change if there is going to be any.

Andrew Tam: Yeah, sure. Just to follow up on that, I guess the reason for asking the question is more along the lines of you spoke about the mitigants earlier on, and I just wondered how successful that would be in light of that changing competitive dynamic, I suppose.

Rob Wood: Not much more to add. I think as we always see in these kind of environments is the scaled operators tend to improve, so if you're thinking about a new entrance business plan, the path to profitability looks materially worse now than it did before, right? And that goes to how much you can spend on marketing and so on, so it's really important to be on the podium in these kind of situations and continue to deliver for your customers. So nothing really new to say, it's clearly a market that we like, we're interested in. Remembering as well that it's only for online, it's only pre-match sports betting, that's the only product available. It continues to be a market that we want to invest in and grow.

Andrew Tam: Got it, many thanks.

Call Operator: We will now take our last question from Ivor Jones from Peel Hunt, please go ahead.

Ivor Jones: Morning. Could I ask about contribution margin online? How do you respond to reduction in customer value? Do you cut what you're prepared to pay as a CPA to try to protect the contribution margin, or do you keep spending at the same marketing level to try and grow share even though customers are less valuable? And secondly, you said that the top two cohorts in the UK, it had revenue halved as a result of affordability measures, was that to do with reduction in their spend per head or is that a large proportion of those customers simply churning off when challenged on affordability? Thank you.

Jette Nygaard-Anderson: And good morning, Ivor. Rob, do you want to take those two?

Rob Wood: Yeah, yeah, I can have a go. So in the UK, so the highest spending cohort, not top two, the top spending cohort has halved in terms of its contribution to the total mix. It's a combination of moderating spend plus losing customers who inevitably some don't want to go through the kind of processes that are in place, so I would say a combination. And then to the contribution margin question, a great question, the way that we operate our digital P&Ls with the MDs is the more revenue you make, the more you can spend on marketing. If you miss your numbers, you need to pull back. So we have that natural protection in the model. How that's done, it is a variety of things. You point to one really good measure, which is the comparison of CPAs to value.

Rob Wood: So if you're in a state situation where the tax rate has gone up, therefore player value's gone down, therefore CPA needs to moderate so that the unit economics are preserved, and that's clearly therefore something that we pay a lot of attention to, and you would expect a rational market to go through that process, and that is ordinarily what comes. But sometimes you just have to be more efficient and you have to cut out that last 5% of marketing, which you can't prove that there's a return against it and so on. But the key message is that we try to keep that rate of marketing spend consistent as revenue goes up or down.

Ivor Jones: Just to be clear, Rob, does that mean that you tried... You were implying you tried to protect the contribution margin, because obviously you could still have healthy revenue growth and a 20% contribution margin. But it's the contribution margin you're targeting because you are targeting the marketing ratio.

Rob Wood: Correct. That's right, so I think what I consistently said over the last couple of years is try to keep contribution margin flat in your models over time because inevitably taxes will go up, meaning there's pressure on the GP margin, but equally inevitably the marketing rate will tick down over time, partly in compensation for any movement in tax, but also because we just get better at marketing, more efficient with performance marketing gets better, the digital marketing, marketing technology improves. And also of course, many territories are introducing restrictions on marketing, which naturally gives protection as well. And for the larger established brands, it doesn't hurt the top line in the same proportion. So for all those reasons, preserving contribution margin, where it is, is an important metric for us to monitor.

Ivor Jones: And just to be clear, does that apply to the implied revenue change for the second half of this year? You would expect that to drop through at the contribution margin? There's no funnies I should be thinking about, that would imply-

Rob Wood: That absolutely is the intention, yes.

Ivor Jones: Great, really helpful. Thank you very much both.

Rob Wood: Okay.

Jette Nygaard-Anderson: Thanks, Ivor.

Call Operator: This concludes the question and answer session, I would now like to turn the call back to Jette Nygaard-Andersen for any additional or closing remarks.

Jette Nygaard-Anderson: Thank you operator, and thank you to all of you for your time today. Our group performance continues to demonstrate that customers are choosing to play with us, both online and in our shops, reflecting our focus on more recreational players and of putting the customer at the heart of everything we do. Our customer focus, our diversification and proven ability to grow both organically and through M&A means we remain well positioned to deliver on our strategic opportunities for the rest of 2022 and beyond. So I look forward to updating you on this progress at our interim results on the 11th of August, and as always, if you have any other questions, do get in touch with David and the IR team. Thank you and goodbye.