

ZEAL Network SE
Analysts Earnings Call Q3 2023
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O **Operator**

SB **Sebastian Bielski**

HB **Helmut Becker**

HV **Henry Wendisch**

O Hello, ladies and gentlemen, and welcome to the Q3 results 2023 of the ZEAL Network SE. At this time, all participants have been placed on a listen only mode. The floor will be open for questions following the presentation. Let me now turn the floor over to Sebastian Bielski. Please go ahead.

SB Morning to everybody. Welcome to the Q3 earnings call of ZEAL Network. I hope you can all see the presentation, but if you can't see it, you can also access it through the investor relations section on our homepage. Let me now walk you through the agenda for this morning's call. First, Helmut will give a short summary of the first nine months as well as give a business update. Then I will walk you through a financial update and will also reconfirm our guidance for this year, and then Helmut will end with the key takeaways [01:00] of this call. Over to you, Helmut.

HB Thank you, Sebastian. Welcome, everybody. In summary of the first nine months of 2023, we maintained our strong growth momentum of the first six months and once again improved our profitability. Although the jackpot situation was largely similar to that of the previous year, we were also able to raise billings from lotteries and revenue by 16%. In line with our marketing strategy, we've accelerated customer acquisition during high jackpot phases in June and September. We've also started to invest more at the top of the funnel in brand building. We expect this to unlock further customer and business growth. Following our launch in the second quarter, we were able to [02:00] successfully expand our games portfolio. Back to you, Sebastian.

SB As all of you probably know, the jackpot environment is very important for us.

HB Sorry, Sebastian, I gave back to you too early. There's one more slide on the business update. We jump now to page six and let us talk about games because it's a business that we've recently launched. As mentioned before, we were able to launch our games business in a very short period of time after having received the licence already in June. With our brands, Lotto24 and Tipp24, we are still the front runners in the lottery segment. To date, no state lottery company has launched a comparable [03:00] games business. Starting with a very low number of games, currently we have 28 games online. We expect in the fourth quarter of the year to continuously expand our games portfolio. Now with that special update on games, I hand back to Sebastian to take us through the financial update.

SB

Now I've already spoiled the headline of this slide. Yes, the jackpot environment is really very important for us actually for both billings and revenue growth as well as for the acquisition of new customers. As you can see on the slide, the jackpot environment in this year was very comparable to last year with five peaks in each year across Lotto 6/49 and Eurojackpot. In terms of the average jackpot sizes, it was stable at 15 million for Lotto 6/49, while for Eurojackpot, [04:00] it slightly increased from 39 million to 42 million. Even though the jackpot environment was very comparable, we still grew our top line very, very strongly this year. We grew our revenues by 15.5% compared to the last year, and that was driven by growth in underlying billings of 16% as Helmut has already mentioned.

The third quarter of 2023 also saw the first meaningful revenue contribution from our newly launched games business, which came in at 1.2 million. While revenues grew very strongly by 15.5%, as you can see, our EBITDA only increased by 5.3% compared to the last year. The main reason for the lower growth of EBITDA compared to revenue was an increase of marketing investment of 27.4% year on year. This large increase in investment into marketing was a very deliberate management decision [05:00] and consisted of firstly, a large push for new customer acquisition in the second quarter during two consecutive Eurojackpot picks. And secondly, the launch of our biggest brand campaign ever for Lotto24 in the third quarter. Overall, about half of the circa 6.6 million increase in marketing investment came from our investment into the brand campaign in the third quarter.

We can already see the first very positive effects of our brand campaign and that our aided brand awareness has increased to 47% after the start of the campaign compared to 40% before the launch of the campaign. We believe that this increased brand awareness will enable us to gain additional new customers in future hi jackpot phases, which will lead to further revenue and growth down the lane. All other expenses, except for marketing, increased less than revenue with personnel costs growing 9%, direct operating expenses growing 11% [06:00] and indirect operating expenses also growing 11%. Since Q3 2023 was the first quarter with a meaningful revenue contribution from our newly launched games business, we have decided to include a few new KPIs, which we believe will help investors to better understand and track the progress of our games business.

The most important new KPI is called pay in, and it's defined as money which our customers deposit into their wallets for playing the lottery or playing games. As you can see on this slide, in the first nine months, our customers have deposited 503 million euros to play lotteries while they have deposited 3,000,000 to play games. The reason why we believe that this is an important KPI is that it allows a different view of revenue margins when you compare lotteries with games. When comparing the gross margin, which is defined as the ratio of revenue to billings, our games business shows a lower margin of 7.3% [07:00] compared with the gross margin of 12.5% for all lotteries.

However, we believe that this comparison does not provide a complete picture due to the difference in the underlying mechanics of the games business and the lottery businesses respectively. As you can see on this page, the multiplier of payments to billings is circa 1.3 for lotteries, whilst it is 4.9 for games. The reason for this difference is that our games business has an average return to player of 88% compared with 50% for our most important lotteries, which means that in our games business, a much higher share of the bets our customers placed are returned to them in the form of winnings. Our games customers usually use these winnings to

play additional games. That is why we believe that looking at the pay in margin, which is designed as the ratio of revenue to pay ins, provides a better comparison between those two businesses. When looking at this metric, you can see that the pay in margin for games stands at 35.3%, and it's actually materially higher than for lotteries [08:00] where it stands as 15.8%. This difference is also reflected in the significantly higher monthly average revenue per active user of 19.52 euros for games compared with seven euros and 65 games for lotteries.

As you know, our games business is still very young and is in startup phase, but seeing these early metrics makes us highly confident that the games businesses will be able to contribute a very significant share to both revenue and profit in the midterm. We will now look at a few other metrics. As Helmut and I have already mentioned, our lottery billings have grown by 16%. This very strong growth was driven by an increase of the number of monthly active users of 12% and an increase in the average billings per active user of 4%. We're especially happy to see the strong increase in our monthly active users because it was not only driven by an increase of our customer base, [09:00] but also by a higher level of activity of our customers. Our gross margin for lotteries has declined slightly from 12.8% to 12.5%.

The underlying driver was slightly different product mix in the first nine months of this year compared to last year. We have been able to grow the number of new customers by 3%, and this is, again, a very good result because it is growth from an already very high level. Lastly, you can see that the cost per lead has grown by 29%. Driver of the increase in the cost per lead was, number one, the overall media cost inflation, which does not just affect us, but everybody. Number two, an increased level of competition, especially in the second quarter in search engine marketing.

And thirdly, our strong brand investment in the last quarter. When investing into brand, a company always faces a timing gap. What that means is that [10:00] we have incurred the cost for the branding campaign in the third quarter, but the benefits we expect to derive from this investment will only accrue to us in the coming quarters and years in the form of higher numbers of new customers, which will then transform into higher revenue and growth. Based on the very good performance in Q3, we're also happy to reconfirm our previous guidance for this financial year, we expect billings to come in the range of 800 to 830 million revenue in the range of 110 to 120 million, and EBITDA in the range of 30 to 35 million. With that, I'll hand back to Helmut.

- HB Thank you, Sebastian. So what are the key takeaways from the first nine months? We have successfully maintained our strong growth momentum and once again improved our profitability. We've successfully launched our games business already in June and are in the process [11:00] of ramping up and broadening our games portfolio. We've accelerated our customer acquisition with significant marketing investments in high jackpot phases, and also broadened our marketing investments. We further expanded our brand building measures. Thank you. Now we will start the Q&A session please.
- O Thank you very much. Ladies and gentlemen, if you would like to ask a question, please press nine and the star key on your telephone keypad. In case you wish to cancel your question, press nine and the star key again. Please press nine and the star key now to state your question. And the first question comes from Henry Wendisch from NuWays. Please go ahead.

HV Hi. Good morning, everybody, and welcome Sebastian to our quarterly calls. [12:00] I'm happy to have you here. I have a couple of questions. The first one is I thought that the instant win game gross margin was at 7% when I talked to you back in a few weeks ago or a few months ago. I expected actually 20% to 25%. I also saw that you increased the return to player to 88%. Is that basically the case that you pay out more at the beginning of the launch of instant win game in order to attract and keep players, embodied with the instant win games? And do you plan to raise that to the 2025 percentage gross margin in future? Is that a figure we can calculate with for the next quarters to come?

HB Let me take that question. It's still very early days. Right now, we are in the process of ramping up our games portfolio, [13:00] and we depend on the approvals and the approval rate of the regulator. We have 28 games live right now, which is not very much, not very many. We are looking to launch a much, much bigger portfolio of games. And the standard games in the market are slot games that come with a very high return to player which means a low margin and a lot of cycling through the same money again, which is the dynamic that Sebastian explained. Those standard games are the games that the regulator is approving first because that's the standard in the market, that's what they're most familiar with. We are looking to broaden our portfolio going forward and we will add some lower RTP games.

We've actually just gotten approved a first slightly lower or lower RTP [14:00] game called Bingo, and that will change the average RTP and the average margin again. We may not get to that number that you just quoted which we thought we would get to with a very balanced portfolio from the start with, but we are probably getting closer to that number because there's a difference between what we thought we would launch, and again, we will get there over time. And what we have now launched dependent on the regulator, we felt that it is important to explain the economics and the unique economics of the games and especially point out that also these high RTP games are a very great source of growth and profitability if you look at the right metrics.

HV Okay, thanks very much. Also, on regarding on the instant win games, [15:00] the impact in Q3 was quite better than I expected. I think you were happier with that as well regarding that it's only 28 games so far launched. How do you expect Q4 to develop more on a similar level to Q3 or even better than Q3 already?

SB Yeah. We expect the games to grow actually in Q4, so we expect a higher revenue contribution from those games. Given that we are, as Helmut explained, building up the games portfolio over time and we launched with a few games, we added some games, we are actually today adding a few more games because we've got some more games approved by the regulators. So yes, we are expecting it to contribute more to revenue.

HV Perfect. Thanks. That's already been my part of the questions. Thank you.

O Okay. So, at the moment there seem to be no further questions, so if you would like to [16:00] state another question, please press nine and the star key on your telephone keypad. We'll leave the line open for a couple more seconds. Okay. And we have a follow-up question from Henry. Please go ahead.

HV Yeah, quick follow-up. Thanks. I saw the cost per lead was also quite on the level that on the Q3 level was quite on the level of Q2. I expect actually a bit of a decrease because they really pushed marketing in Q2. Do you expect the cost per lead to stay on these heightened levels going forward, or can you give an indication that it's really the market driven pushes that also pushes the cost per lead ratio that it's basically led to increase in this number? Or do you feel that it's going to go away on a statistical average jackpot quarter that it's going [17:00] to be below the 40 euros again?

SB I don't think we're in a position to provide specific guidance on specific numbers at the moment. What we can say is that the experience that we've made with the brand investment in the third quarter was very positive for us. We saw that increase in the aided brand awareness going to 47%. And as such, we currently plan to continue to invest into brand channels, especially into TV in the next year. We will sculpt this a little bit to TV pricing across the year. But yeah, so we continue to believe that this is a good investment, but we cannot guide you to specific numbers at the moment. [18:00].

HV Okay, thanks.

O Okay. Since we didn't receive any further questions, in the meantime, I will hand back over to the host.

HB Thank you very much. If you have no further questions, then we would like to finish the call. Thank you very much for the participation and our next regular call will be the Q4 earnings call in March next year. Thank you very much. Have a nice day.