Playtech Acquisition of CFH Call

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Acquisition Highlights

Ron Hoffman

CFO and CEO of Financial Division, Playtech

Introduction

Good morning, everybody, and thank you for joining us on this call to discuss Playtech's acquisition of CFH, which we were delighted to be able to announce this morning. I am Ron Hoffman, Playtech's CFO and Chief Executive Officer of Playtech's Financial Division. With me is Neil Offord, CFO for Financial Division, who some of you will already be familiar with. I will take you through the key highlights of the deal before handing over to Neil to discuss the financial. We will both be then happy to take questions.

Highlights

CFH is a technology company with products including a leading STP brokerage, which stands for straight-through-processing, which provides retail brokers with multi-asset execution, prime brokerage services, liquidity and complementary risk management tools. The acquisition of CFH will strengthen Playtech's entry into the B2B market of financial trading, and provide the foundation and the platform for future acquisitions as well as to become one of the only businesses to offer proprietary dedicated B2C and B2B platform to clients.

CFH has proven technological capabilities, and generates revenue primarily from trading volume processed through its brokerage platform, either as clearing fees or technology services. The vast majority of CFH customers or retail brokers licensed in different jurisdictions, including some of the most lucrative markets worldwide such as the UK, Japan, all throughout mainland Europe, Asia and more. It currently has over 400 customers and partners in more than 80 countries, of which over 250 are active monthly, which service thousands of retail customers worldwide and is considered one of the largest and most reputable B2B providers for technology and clearing in the industry.

CFH technology services today offer $100 billion in monthly trading volumes across its very diverse customer base, with very few customers representing over 5% of revenue and the remainder significantly below.

CFH Clearing is one of the top STP venues in the world, with award-winning liquidity services and $1.5 billion in direct interbank credit lines with tier 1 banks, liquidity providers and prime brokers such as Barclays, Goldman Sachs, UBS, Jefferies, BNP Paribas and more. Through its relationship with the liquidity providers and prime brokers, CFH is currently able to offer liquidity on approximately 110 instruments.

The acquisition will significantly enhance Playtech's position as it continues to build the B2B offering within its financial division. There are multiple benefits in CFH becoming part of Playtech's financial division. First, although CFH will remain a provider of STP processing, due to Playtech's strong financial profile it will be able to offer its customers improved financial terms through revised credit options and more attractive margins.

CFH customers will have access to a deeper pool of liquidity through the addition of intra-Group liquidity arrangements, enabling more competitive prices and faster executions. Over time, CFH's customer base will be able to offer its customers a wide range of CFD instruments on its clearing system, as Playtech's financial division currently offers over 2,000 instruments compared to approximately 110 that CFH offers today.

CFH will have access to offer Playtech's propriety retail trading platform and CRM technology to its customer base, mirroring Playtech's B2B offering in the gaming vertical, creating stickiness for both the liquidity part of the business and technology side of the business. In addition, CFH will benefit from Playtech's leading technological capabilities and resources to further develop its offering and improve client experience.

Finally from me: CFH's wholly owned subsidiary, CFH Clearing, is regulated by the Financial Conduct Authority, the FCA, and I am delighted to confirm that the FCA has given change of controller approval for the acquisition.

With that, I will hand over to Neil for the financials.

Financial Review

Neil Offord

Chief Financial Officer for Financial Division, Playtech

Thank you, Ron, and good morning, everyone. For the year ended 31st December 2015, CFH reported revenue and adjusted EBITDA of $19.2 million and $5.7 million respectively. Recent trading reflected a revenue run rate of approximately $29 million, achieved on the back of an uplift in volume from further organic growth of the business and new customers being onboarded.

Over 70% of CFH's revenue is generated through commissions and mark-ups on the straight through processing it offers customers. The remainder of its revenues are volume-based, and are generated through offering technology such as liquidity, control and customisation capabilities, real-time risk management tools and cloud-based back-office tools.

To help with modelling the acquisition, on a full-year basis in 2016 CFH's depreciation and amortisation charge is expected to be approximately $1.1 million, with the business paying a headline corporation tax rate of 20%.

For 2016, CFH will only be consolidated for December, and so will simply be included within the financial division line item in the Group's 2016 segmental analysis.

Under the terms of the acquisition, which is immediately earnings accretive and is expected to complete on 30th November 2016, Playtech will initially acquire 70% of CFH for consideration of $43.4 million on a cash free, debt free basis, representing a multiple of approximately seven times the current EBITDA run rate. The remaining 30% of CFH is being retained by the management team, and can be acquired by Playtech pursuant to put and call option arrangements exercisable in 2019 at a multiple of six times the CFH Group's adjusted EBITDA for the year ending 31st December 2018, subject to a maximum aggregated consideration of $120 million for the entire business.

With that, I will hand back to Ron.

Summary

Ron Hoffman

CFO and CEO of Financial Division, Playtech

Thank you, Neil. To summarise, CFH's leading technology will significantly improve Playtech's B2B offering within its financial division. CFH has proven technological capabilities, and has developed not only a leading platform in the STP brokerage industry, but also relationships with an impressive database of retail brokers operating in a variety of jurisdictions worldwide, alongside long-term relationships with a suite of tier 1 banks, prime brokers and liquidity providers.

We believe this industry is in its infancy, and there are a lot of growth opportunities out there. We aim to become a significant player in the space in the same way we managed to do in the gaming industry throughout the years. We have core competencies, the technological superiority, the resources and the drive.

With that, we would now be pleased to take any questions.

Q&A

Brian Devitt (Goodbody Stockbrokers): Good morning, guys, just one question for me: will CFH be integrated with Markets.com? If so, how will that affect the earn-out of both businesses?

Ron Hoffman: Yeah. From a technological perspective, Markets.com is a customer of CFH today. In essence, we are already pretty much integrated with our trading platform to the CFH systems, given that today, when we hedge, we actually hedge with CFH. There is further integration for this, I would say it is small in size; integration between the system in order for us to cater for being another liquidity provider in the mix, and also obviously for providing liquidity for other instruments which they do not offer today at a later stage in time. There is further integration. It is not significant, it is not a game changer and it is something that we will do over the short term.

In terms of how it will affect the markets business, we look at that as a combined business at the end of the day. We see those as revenue synergies; whether those will be presented in CFH or in the existing financial division of Playtech today, these are merely revenue synergies generated from the acquisition itself.

Brian Devitt: Okay. How will it impact the earn-out of the two acquisitions?

Ron Hoffman: Basically, the earn-out for CFH will be calculated on the incremental EBITDA generated by the additional CFH, including some of the revenue synergies that will be generated. Although, there is a certain mechanism on how it is accounted for, so they will enjoy some of the upside generated from those revenue synergies.

On the Markets side, obviously there is an earn-out on the existing transaction, which is based on the 2017 numbers, so not aligned to the same year: 2018 for CFH and 2017 for Markets. Even if it will enjoy certain revenue synergies, it will also take into account the appropriate cost attributed to that from the acquisition of CFH, so the cost as well as the revenue synergies that it will enjoy.

Brian Devitt: Okay. Thanks, guys.

Vaughan Lewis (Morgan Stanley): Hi. You said that 70% of revenues are from these STP fees, where it sounds like very high volumes and a tiny basis points charge on that volume. Is that the right way to think about it? Who else offers that product?

Neil Offord: Thanks, Vaughan. When we say over 70% of the revenue is generated from the straight through processing, the revenue is charged on the basis of the dollar per billion, or a value per billion dollars of volume that is processed through the system. Now, that is with the traditional A-Book straight through process and arrangements. As we indicated, the business also provides technology in its propriety systems. The amounts per billion charged on the technology side are obviously less than what is charged on the straight through processing side.

Vaughan Lewis: Who else offers that product, the STP product?

Neil Offord: There are a few other businesses in the industry who offer it, although none of them are really specific, other than if you go to a mainstream, investment bank. They all offer liquidity. For example, Saxo Bank offers liquidity and processing. However, in terms of direct competitors, we see very few in the market.

Vaughan Lewis: Okay. Then just on the trading update on Markets.com: can you be any clearer about the revenue trends so far in the second half?

Ron Hoffman: Yeah. I think we cannot go beyond what we indicated in the announcement that was following the investor day. Basically, the KPIs are quite strong. We are very confident about the future, given the growth of the number of FDs and actives. With that being said, we were obviously affected by market volatility in the second half up until the point of certain macroeconomic events – so you can imagine the US elections, et cetera – was not so volatile. The translation to that volatility, and therefore revenues, was less than what we would have like it to be. However, definitely the core fundamentals of the business are growing and in line with our expectations, and we are quite excited about where it is going. The transition period for H1 is now behind us, and we see growth going forward.

Vaughan Lewis: Got it. Thank you.

Richard Stuber (Numis Securities): Hi. Good morning, guys. Just three questions, please. The first one is on margins. It looks like margins have remained roughly 30% last year and this year. Could you just tell me how much operating leverage is in the business, and whether you expect any cost synergies with Markets.com?

The second question is on the FCA approval. I guess the FCA did not give you approval when you tried to buy Plus500. Could you tell me what has changed in the intermediary period?

The third question is on customer concentration. You said there are only a few which have got more than 5%. Can I take that to mean there is not a single one, say, more than 10%? Or are there any very large customers within the mix? Thank you.

Neil Offord: Okay. Thanks, Richard. I will take the first and third questions. I will start with margins. You are right, the EBITDA margin somewhere between 25% and 30% at the moment. In terms of operating leverage going forward, absolutely: for each dollar that comes onto the revenue line, we expect a greater improvement on the margin level. It is not a case of, for every dollar onto revenue, 30 cents goes to margin; there is definitely a leverage in being able to grow that margin with greater revenue.

Richard Stuber: Should that get to 40% over time, in line with your main core business?

Neil Offord: I think it is too early to say at the moment, but clearly we would be looking to increase the top line and grow the margin as well.

Ron Hoffman: I think it is safe to say that the business model supports increased margins. However, we want to be conservative at this point, and therefore we do not want to come up with any projections going forward yet, at this point.

Neil Offord: Okay, turning to the customer concentration. As you rightly say, there are very few customers who account for more than 5% of revenue. On a month-on-month basis, there may be individual customers who breach 10%, but over a course of time there will not be any customers who continuously account for more than 10% of revenue.

Richard Stuber: That is great. Thank you.

Ron Hoffman: In terms of the question related to the FCA approval, and that compared to the Plus500 transaction: I think we always reiterated the fact that the Plus500 was a very different transaction, and there were issues which were related to that transaction. Definitely the circumstances were quite different. Remember, Plus500 at that point in time had its own regulatory issues and special circumstances, and we were new entrants into the industry; only two weeks after, we completed the transaction to acquire Markets.com. So, I think they were very aggressive circumstances for the FCA to approve that. With that being said, this transaction was very straightforward, and I think it only reiterates the fact that we always said we do not believe we have any barriers in terms of acquiring an FCA-regulated business.

Simon Davies (Canaccord Genuity): Good morning, guys. Just a few from me. Firstly, can you confirm that the market exposure is 100% regulated, and can you give us the geographic splits across the business?

Ron Hoffman: Yes. In terms of market exposure, 100% of the revenues are regulated revenues. The vast majority of their customers, of the CFH customers, are retail brokers. There is a very small percentage of elective professionals. The entire revenue stream is a regulated revenue stream. All of the retail brokers have licences throughout the world, and they are all regulated.

In terms of the market, it is quite diverse. There is no specific market where you see a dramatic uplift. I mean, you will see customers across the UK, all throughout Europe and all throughout Asia as well, even in the States, in Hong Kong, in Japan where it is a very lucrative FX market. There is no specific market which is above and beyond, or taking the majority of the activity.

Simon Davies: Great. Secondly, you are pointing to 50% revenue growth in 2016. Can you give us a bit more colour in terms of what is driving that? The balance between underlying markets and new customers and new products?

Ron Hoffman: Are you talking about the growth that CFH experienced within 2016?

Simon Davies: You are talking about something like 50%-plus revenue growth year-on-year in 2016. Where is that coming from?

Ron Hoffman: Yeah. It is basically organic growth of the business; a combination of more volumes being driven by existing customers and new customers being onboarded. I think in the last ten months or so, the level of new customers being onboarded onto CFH has been accelerated, and we see that as a positive sign for growth going forward.

Simon Davies: Lastly, you pointed to a number of synergies, including improved terms with suppliers. Can you quantify at all the level of synergies you see, both revenue and cost?

Ron Hoffman: On the cost side, we do not believe there are; at least, not significant cost synergies. We believe this deal is about the organic growth of the business, the B2B offering and the revenue synergies and the growth opportunities going forward. I think it is too early to quantify those revenue synergies. I think it is yet to be seen how it will evolve in the next few months, and in terms of quantification we will know much better.

However, we do believe there is a very significant opportunity, on the back of getting access to over 400 retail brokers, that we can empower them with our trading platform where they can create key differentiation from others. Because this industry is very much driven by everybody using the same trading platform of MT4, and the same way of doing business. We believe that by providing them with better tools, CRM capabilities, better technology and a unique trading platform and marketing capabilities, we will empower them and actually grow their business, and it creates a stickiness factor. We believe that, by way of expanding their instruments to what they offer today, it is a significant revenue synergy.

It will not be an immediate one; it will take time to do that and properly expand that and grow that across the customer base. However, we believe that it is a significant offering and, again, a key differentiator between others. It creates further stickiness with the brokers that will enjoy getting liquidity not just for the main FX pairs that they get today, plus some commodities, but the really long tail of assets where they can enjoy further growth and volumes going up and trades going up. I think it is a big opportunity all together.

Simon Davies: That is great. Thanks a lot.

Tal Grant (UBS): Thanks very much for taking my call, and congratulations on the deal. I have three questions, and maybe one more if we have time at the end. First question, just on the first benefit of the acquisition that you mentioned. You talk about, due to basic scale and financial strength, you will be able to provide customers with better trading terms and more attractive margins. Can you tell us what will be the cash requirements for running this business going forward, for this and Markets.com really? If we think about next year onwards, how much cash is segregated for this financials business?

Second question is on the second benefit of the acquisition, where you talk about a deeper pool of liquidity through intra-Group liquidity arrangements. I am just wondering why that is something that Playtech can provide, and why could CFH not have done that by themselves?

Then finally, just something that you mentioned on the call now, you said there are more than 250 active monthly customers out of 400 in total. I am just wondering, because I can understand an individual end customer of these products not being active every month, but how can a whole FX brokerage or CFD brokerage not be active in an entire month? Thanks.

Ron Hoffman: Of course. Okay, let me start with the first one. In terms of being able to offer better commercial terms to customers on the back of the financial profile of Playtech:

basically, the terms that CFH gets today from the banks is aligned to the financial strength and backbone of CFH today; meaning they are of a certain size, they have a certain balance sheet behind them, and therefore the banks have their own risk analysis when they provide them certain liquidity and credits and credit facilities. They offer them the commercial terms, the margin that they are willing to offer them and the credit facilities that are willing to offer them, on the back of the financial profile of the business.

Now, simply by the mere fact that it is under a bigger umbrella without injecting capital, without further securing capital into the business, we believe that CFH can get immediate access to better terms to improve the margins, which means that they can offer their customers improved margins and therefore grow the business on the back of that. This does not mean that there is further capital injection required in order to accommodate that.

In terms of the deeper pool of liquidity, CFH is an STP broker. It has a licence of an STP broker, meaning it cannot be the counterparty for the transactions, for the trades coming from its customers. Its model is a neutral STP broker that provides best execution, provides the best price out there, the lowest price possible that it can get from the different liquidity providers. We simply see us joining as a liquidity provider, another one in the mix; not instead of anyone, but simply getting a deeper pool of liquidity, giving them the ability to have a wider liquidity pool and therefore to offer better prices and potentially faster execution on the back of us joining into that liquidity pool.

In terms of the active customers, I would say the market in terms of retail brokers is divided into two types of brokers. Brokers who are always STPing, meaning hedging each and every position, each and every position the counterparty is with the liquidity provider, so they have to hedge each and every position. Then there is the long tail of customers, retail brokers, who actually do want to be the counterparty for their positions – what we call B-Booking – and therefore, they only use the liquidity of CFH to some extent when they need to hedge, or when their capital adequacy ratio has reached its limit and their exposures are such that they have to hedge at a certain point. Remember that some of them have a licence to B-Book on, then they have their own capital requirements. Most of them do not have a significant big-sized balance sheet to accommodate high exposures, therefore at a certain point in time they have to hedge it.

When the market is very volatile and there are a lot of volumes, you would see more trades coming over to CFH. Where the market is quieter, you would see a bit less, but you will see certain cases where a customer will be more active in one month and less active in another, dependent on where he is in his own exposure book. On top of that, some of them can also use other liquidity providers, although we believe that CFH has positioned itself as being a leader in its space.

Tal Grant: Thank you very much, that is a very clear answer. If I could just have one final follow-up. You talked about MetaTrader 4 a second ago: does Playtech have a competitive solution to MT4, and is the plan try to displace that in some of these 400 customers?

Ron Hoffman: No, it is not about replacing MT4. MT4 is a very well known, well respected system by MetaQuotes. We are not aiming to replace MT4 in the offering to retail brokers. We believe that we have a technology offering which is more tailored for retail brokers specifically, for the retail industry. MT4 is a generic, very complicated and diverse trading platform, which is fit for mostly professional traders. I would say it fits all. It is a very complicated system and a big system, and it is not really tailored for the retail customers.

Our own trading platforms, which come together with CRM systems and tools which are embedding, I would say, the best methodologies of online marketing as part of the system, provide retail brokers the ability to have a tailored solution for the retail market. So, a trading platform which is more intuitive, easy to use, combined with CRM systems all integrated as one; sort of a holistic system that they can use to drive more traffic into their business and grow their business, and offer a system which is not instead of MT4 but in addition to MT4. Some of the customers will always want to use MT4 because they are used to it, and we do not see any issues with that. However, we do believe that there is a market, a big market, for offering retail technology or a retail trading platform tailored for the retail customer, and not just a generic one.

Tal Grant: Got it. Thanks very much. Very clear.

James Wheatcroft (Deutsche Bank): Morning. Just one really. I guess I picked up from the capital markets day, and maybe from the acquisition this morning, that there is an increasing emphasis on the B2B business. What should we be thinking about the B2C business in the longer term?

Ron Hoffman: We always wanted access to B2C, and we wanted to do that even back when we did the Markets.com acquisition. We also indicated that we wanted access to the B2C arena without jeopardising our B2B position in the gaming division, and therefore we saw that door being opened in the financial vertical. This market, we do not see the same conflicts as we have in the gaming B2B arena. Given the fact that, first of all, the market is very fragmented, it is in its infancy, we do not believe it will create a conflict between our B2C business and the B2B offering that we want to drive further. It provides us the ability to extend our offering to markets where we do not have any footprint for our B2C business.

We obviously see value naturally, given the fact that we managed to succeed on the B2B front for the gaming vertical. We see a big, big opportunity to replicate that success in the financial vertical. Given the fact that we have the core expertise on the technological side, and the marketing expertise and the CRM capabilities, we believe that we can expand the growth and accelerate the growth through B2B offering, and replicate what we did in the B2B arena on the gaming side also in the financial vertical.

James Wheatcroft: Great, thank you. Very clear.

Alistair Ross (Investec): Morning, guys. Just one from me. I am just a little bit concerned about blockchain technology, and whether you think that is a risk going forward.

Ron Hoffman: Apologies, about…?

Alistair Ross: About blockchain technology, and the risk of clearing fees going forward.

Ron Hoffman: I am not sure I follow the concern. Perhaps we can take that offline after the call?

Alistair Ross: Sure, no problem.

Klaus Kehl (Nykredit Markets): Yes, hello. Perhaps this is a more strategic question, but what is it that really makes this industry interesting for you to participate in? Is it basically your ability to handle a lot of transactions, whether it is within gaming or within the financial sector? What is it?

Ron Hoffman: Hi, Klaus. I would say that we believe we have the core expertise to succeed in both arenas. Meaning, these businesses are driven by online capabilities, by technologies and by CRM capabilities and competencies. We believe we are experts in all of these fields. We already proved ourselves in the gaming sector. This industry, while it is a completely different industry and regulated in a completely different way, the core fundamentals of the business are still driven by the same core competencies. So, technology is a key factor in this industry; it is a young industry and it just started, and other than a very few brokers out there which have their own technology, there is no big B2B provider in the space which provides technology all across the business which is tailored for the online retail market. So, technology is a key factor for growth.

Also, online marketing is a key factor for growth. We see the market growing significantly on the back of more and more online penetration, and more and more traffic coming into brokers through online marketing channels. This is what we excel at. We excel at providing technology and CRM tools and online tools and capabilities to drive that traffic to operators on the gaming side and brokers on the financial side. This is where the opportunity comes from, for us.

Klaus Kehl: Okay, thank you.

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