

SNAI SpA

“First Quarter 2014 Results Conference Call”

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MODERATORS: **GIORGIO SANDI, CHIEF EXECUTIVE OFFICER**
MARCO CODELLA, CHIEF FINANCIAL OFFICER

OPERATOR: Good morning. This is the Chorus Call conference operator. Welcome and thank you for joining the SNAI First Quarter 2014 Results Conference Call. After the presentation, there will be an opportunity to ask questions.

At this time, I would like to turn the conference over to Mr. Marco Codella, CFO of SNAI. Please go ahead, sir.

MARCO CODELLA: Hi, good morning everybody. This is Marco Codella speaking. We are here today to report on our Q1 results, but before going in detail on our presentation, I would leave the floor to Mr. Giorgio Sandi, our CEO, for an introductory speech. Unfortunately, Mr. Sandi will not be able to attend all of the call, but he is here to give you his welcome. Please, Mr. Sandi.

GEORGIO SANDI: Good morning, everybody, good morning, ladies and gentlemen. Thanks for coming to our meeting this morning. I apologize for not being able to attend all this call, but I am sure that Marco will be able to express and give you all the information and details that you would require to understand the current situation of our activities.

I must say that I am very satisfied by the first quarter of 2014. We had a very important and strong result in the launch of the virtual events. And we have been able to follow on all the areas of business...and our plan that we presented to you just a few days ago. So please Marco, go ahead with your presentation, and you please ask whatever you would need to have a better and clear view of the Company's situation. Thanks very much.

MARCO CODELLA: Thank you, and thank you all for attending this call. Last time we met, for the plan presentation, we committed to report on progress on our strategic plan and results, and we are here today to give you an update on our Q1 results, as well as business updates.

First of all, we have to say that Q1 was a very good quarter and it was in line with the extremely good performance we did in Q1 2013. And it was also beyond our budget expectations. It is worth mentioning that the Q1 2013 was one of the best ever in SNAI's history. We were able to achieve results which are at least in line with Q1 2013, and sometimes better than 2013. So this is a very important achievement for us in this new fiscal year. We will give you details on our performance during the presentation, but I would like to give you now a quick view on our main achievements and events that affected Q1 2014.

As Mr. Sandi was saying just a few minutes ago, we had very good results from launch of virtual events. As you know, virtual events were launched late December 2013. So this is the first quarter that we were able to enjoy the effect of having this new kind of activity in our portfolio. And results were quite good since we collected some €93 million in terms of wagers and wagers generated €11.8 million in terms of revenues, an extremely good result. We have no official figure coming from AAMS, but our estimate is that our market share in virtual events is in the range of 34%, 35%, but this is our estimate.

Second achievement is that we had a very good and solid performance in sports betting. Our payout in Q1 2014 was 74.3% as compared to 73.7% in Q1 2013. There were some, you know, reductions in terms of wagers collected, and most of them are coming from the strong competition that we had to face coming from illegal, you know, sports shops.

But just to give you an idea, the Guardia di Finanza, the tax police in Italy are, you know, starting a stricter policy of control on illegal sports betting shops. And we have news in the paper saying that they had been

controlling in the last few weeks some 1,000 shops and more than 200 of them were closed because of, you know, irregularities.

Third topic and third update we want to give you on our business operation is related to machines gaming. The performance in machines gaming was positive for what VLTs are concerned, as compared to last year because of the completion of the roll outs. At the end of March, we had some 4,850 machines collecting money in the territory as compared to 3,400 in Q1 2013. We had at the end of March, some 200 machines which were not operational because they were under re-location. As you know, we have a plan in place under which we are, you know, moving some 1,000 VLTs terminals in total, from the existing locations to more performing premises.

The good performance in VLTs was partially counterbalanced by a reduction in AWP's collection, but this is due mainly I would say 95% to the reduced number of machine as compared to Q1 2013 since as you know, one of our clients left our AWP network at the end of March 2013 taking out of it some 3,500 machines.

In terms of performance, we were able to reduce volatility of our performance since fixed payout games were 49% of contribution margin versus 39% in Q1 2013. And last but not least, we had some very effective cost saving activities and you will see them when we go in detail, but we had some slight reduction in contribution margins, but we were able to increase our EBITDA. And this was mainly based on cost saving activities.

Going to Page 7 of the presentation, we are trying...we have been trying here to give you a very quick view on our financial KPI. As I was saying before, most of them...all of them are in line with Q1 2013, but again, it is

worth reminding that Q1 2013 was one of the best quarters ever in SNAI's history.

The only KPI which is down as compared to last year is net income because of the increased interest expense charges which were related mostly to the new financial structure we have in place after the high yield bond that we issued late November...early December.

Then we can move to Page 8, where we reported changes in terms of you know, revenues, contribution and so on. And we also highlighted the percentage of change. Total revenues were down by 1% as compared to Q1 2014. Contribution margin was down some 2% while EBITDA was up 2%. The adjusted EBITDA which is the...which is, you know, the EBITDA plus the recurring part of the allowance for bad debts, was in line with last year. As well as the EBIT that was reduced by 9% mainly due to the increased depreciation charge that is related mainly to the new concessions on sports betting, 278 rights that became effective July 2013. And also because of the full deployment of VLT rights that started to generate depreciation charges.

In terms of pre-tax profit, we were significantly down because of the combined effect of increased depreciation and increased interest charge. CAPEX is, you know, lower than Q1 2013, but this is , you know, something that will be somehow recovered in the near future because in Q1 2013, we did not spend any money on, you know, concessions related CAPEX.

For what cash flow is concerned, we had some significant decrease in terms of cash flow generated, but this is due to some changes in payables. So some working capital changes as a result of payments we did in Q1 2014 related to some significant costs associated to the high yield bond

issuance that we did in December. As you probably remember, the cash flow at the end of December was positively affected by a positive change in working capital. This is exactly the other way around; I mean the payables that were increased at the end of 2013 because of the high-yield bond costs are now reduced because we paid them.

In terms of net financial position, last year we had €356 million, this year we have €439 million because of the new structure and because of the settlement of the you know litigation with Corte dei Conti that we paid late November last year.

Moving to Page 9, we have been trying here to give you a view of how our EBITDA evolved from Q1 2013 to Q1 2014. In terms of sports betting; sports betting contribution decreased because of low wagers and higher payout. We can estimate that there are...the decrease generated by increased payout is some €1.6 million, and wagers that were down quite significantly because of the reasons I already explained were affecting the contribution margin and the EBITDA by some €2.5 million.

In terms of gaming machines, AWP's were down because of the number of machines. Again, since one of our...one of our customers left our network on March 2013. VLT increase because of number of machines, but in this figure, we did not fully enjoy the effect of lower payout games because of delays from Spielo in obtaining the authorization for this new lower payout games from AAMS.

As you probably remember, we had in our plan the...we had foreseen the possibility to enjoy the availability of lower payout games in both our platform...VLT platforms Novomatic and Spielo, since January the 01, 2014. Actually, we were only able to enjoy the reduction in Novomatic, because Spielo was quite late in obtaining the authorization from AAMS.

They only obtained the authorization late March, and we...therefore we started the technical updates on...in the first days of April, and we are able to update some 150 machines per day. So we are close to the end of this process.

In terms of, you know, the performance we did in Q1, it is worth mentioning the effect of virtual events. Again, we collected some €93 million. We estimate some 35% in terms of market share, the effects on the EBITDA as compared to last year is in the range of €6 million.

Just to give you another...some other information on virtual event. As you probably remember, we estimated in our plan presentation, the market of virtual events to be in the range of 1 billion per year, and based on the first evidences of the first quarter in 2014, we are confident that it is a good estimate for year end.

Moving to Page 10, we reported here the payout trend in the last three years. As you can see, we achieved 74.3% in Q1 2013, and this 74.3% is made of 73.4% in the offline sports betting and 78.4% in online sports betting. As you know, there is a significant difference in terms of distribution costs between offline and online, which is not completely offset by the higher payout that we normally pay in the online betting.

Last year, the 73.7% performance was made of 72.8% in the offline business, and 77.8% in the online. So it's quite normal to have a difference that is in the range from 4 to 5 percentage points between the offline payout and the online payout. So at the end of the day, we had a very good performance in terms of payout, and this performance is replicating the very good performance in Q1 last year, and it was also made...this was also made possible by the new contract we have in place

with some 85% of our shops, and also by the automatic controls we put in place in our IT systems.

In Page 11, you can find a very quick recap of our cash flow. As I was saying before, moving from the EBITDA, which is 36.4 and considering some non-recurring costs which were not, you know, cash related costs, and considering the working capital variation and the financial expenses, we go down to a total cash flow of €3.4 million in the period as compared to €13 million last year. But cash flow that we achieved at the end of Q1 2014 is in line with our forecast.

So just to give you some more information about our performance; in terms of comparison with last year, we are in line in most of our...the...our financial KPIs. And as compared to budget, we are above the expectations in most of our business areas, mainly in the virtual events and sports betting, since they are contributing to our Q1 2014 results quite significantly. All of the other, you know, business areas are quite steady with a partial exception of the so-called on line skill games which were below the expectations we included in our Q1 2014, budget.

I think I covered most of the areas I wanted to report on. So I think we could then move to the Q&A session, provided that you have questions you want to put. So please go ahead with Q&A.

Q&A

OPERATOR: Excuse me. This is the Chorus Call conference operator. We will now begin the question and answer session. The first question is from Gary Amit (Ph) of Barclays. Please go ahead.

ANALYST: Yes, hi there. The question on behalf of [indiscernible] Barclays. Can you give us an update on current trading? Are you seeing continuing benefits from the roll out of the VLT for example? And secondly, will you strength in AWP front in Q2, given the easier comp (Ph) is Q2 '13 from the annualization of the loss of the clients?

MARCO CODELLA: Okay, for what the VLT's are concerned, we will still be enjoying some effects of the completion of the roll out, since as you probably remember in Q2 2013 we were not enjoying the full range of VLT's right, we would have been theoretically able to enjoy. So there will be an affect of the completion of roll outs also in Q2. It is quite likely. Although, this will probably reduced as compared to Q1 because we had, you know, the possibility to increase the number of machines in Q2 2013. For what the AWP's are concerned, we see the AWP...our AWP market quite steady after the effect of the, you know, the missing 3,500 machine is not existing anymore, since they left our networking on March 20, 2013. So for what Q2 is concerned, we do not expect AWP to be significantly lower than last year. They are likely to be in line with last year.

ANALYST: So, you reckon the trend is going to be better versus Q1?

MARCO CODELLA: I'm saying that what the...if you compare Q1 2013 and Q1 2014, you can see a significant reduction because of number of machines. Taking out the effect of number of machines, we do not expect in Q2, the AWP to be significantly lower than Q2 2013.

ANALYST: That's fine. Thank you very much.

OPERATOR: The next question is from Katie Rucie of J.P. Morgan. Please go ahead.

KATIE GOLDICH: Hi, Marco.

MARCO CODELLA: Hi, Katie.

KATIE GOLDICH: Hi, thank you for the presentation. I have two questions actually, one is on the cost savings activities, you guys have had quite a bit of good track record so far. So I was wondering whether you can give us a little bit more color as to how that is going to play out for the remainder of the year, particularly in the context of the longer term operational guidelines that you shared with us during the fiscal year presentation. And then, the other one, I don't know whether I have missed this anywhere, but can you remind me what your second quarter 2013 adjusted EBITDA number was. So I have sort of a better idea in terms of, you know, that the 2014 numbers for modeling reasons. And then one last one, on the sports betting performance, a pretty good performance. Some of the initiatives that you talked about during the road show seemed to have been successful. So I was wondering whether there is, you know, more focus I guess going into summer and the World Cup? Thank you?

MARCO CODELLA: Okay. I will try to give you answers to your questions. So first of all, cost savings activities. As you probably remember, we were able to actually sell the outbound parts of our call center business because it was not productive. So by doing this, we've been reducing the cost of labor, the cost of personal by €1.5 million on a yearly basis. Also, we have some significant activities in terms of cost savings on consultancy. We are you know, trying to actually reduce the cost of consultancy by increasing our, you know, internal workforce which is not meant in terms of number, but in terms of skills in order to have some of the activities that were performed by consultants to be performed internally.

And third area in terms of cost saving actions is in the costs which are associated to the horse race track. So these are the three main areas that

we are actually addressing in terms of cost savings activities. For what the Q2 figures 2013, I will let, you know, because unfortunately I don't have with me, the figures for Q2 last year, but I will let you know, I will send you an email on that.

KATIE GOLDICH: Yes, now, that's great, that's fine. I just wanted to make sure that, you know, because they were not available in the IM (Ph) and I was wondering if I missed it somewhere, so...

MARCO CODELLA: No, but as far as I remember, Q2 last year was not a very good quarter actually. For what the sport betting activities are concerned, again, we are focusing on, you know, the management of payout and the management of quality of betting acceptance. For what the World Cup is concerned, we've a specific plan for, you know, taking all the benefit and all the opportunities that could derive from this very important event. And we will be launching in the next week some, you know, special plan for the World Cup that will involve our shops and corners.

KATIE GOLDICH: Okay, that's great. You are not going to tell me who you guys are internally saying is going to win the World Cup, and don't say, Azzurri.

MARCO CODELLA: Most of our results in the World Cup depends on the Azzurri, you know, results. So, if they will be successful doing a big [technical difficulty], but with...I'm not so sure they will successful. And we do not see a significant possibility for them in the World Cup, Katie.

KATIE GOLDICH: Thank you, Marco.

OPERATOR: The next question is from Alan Yesner of Morgan Stanley. Please go ahead.

ALAN YESNER: Hi, and thanks for taking my question. First one is just bookkeeping; can you let me know are you going to be posting an interim report for Q1 2014 on your website in English?

MARCO CODELLA: Yes.

ALAN YESNER: Okay. I appreciate that. And you mentioned that the delays in the authorization for lowering the payout ratio, I just...can you just go back, you mentioned, you are updating 150...I think you said 150 machines per...and then I missed it, they are per day?

MARCO CODELLA: Yes, I will clarify the point. last year, the Italian Government increased the taxation on VLTs [multiple speakers].

ALAN YESNER: Yes.

MARCO CODELLA: All of the concessionaires decided that it would have been possible to actually reduce the payout which is, you know, the money which is paid back to the players because the lower...the legal limit for payout in VLTs is 85%. So the concessionaires asked the suppliers of the technical platform, in our case Novomatic and Spielo to actually have some new games approved by AAMs with a lower payout. And Novomatic did it by moving some of their, you know, the most important games which are mainly 3 or 4, from 88.5% to 86.5%. Of course, this is partially affecting the figures in VLTs because they were not able to actually change all of the games they are providing the VLTs with, but just some of them. For what Spielo is concerned, they were not so, you know, timely, they were not so quick in updating their main games and they were not so quick in obtaining the authorization from AAMs.

they were supposed to provide us with new games by the end of last year and that we included in our budget that the positive effect of the lower payout games would have been effective since January the 1st. But this was not true because they were late; they only obtained the authorization from AAMs at the end of March. So we were able to able to start the technical update of the terminals in early April.

ALAN YESNER: Right.

MARCO CODELLA: Technical reasons, we are able to update maximum 150 machines per day.

ALAN YESNER: I see. And can you tell me what it the positive impact on an annual basis or on monthly basis [multiple speakers] ratio?

MARCO CODELLA: You know, the theoretical payout for Spielo machines is moving from 90.1% to 88.7%. So its 1.4 points on the games which are affected by this reduction, which is not 100% of Spielo games, but say 50%.

ALAN YESNER: I see.

MARCO CODELLA: And this is already included in our budget.

ALAN YESNER: I see, I see. Okay, that's helpful. Thank you very much.

OPERATOR: The next question is from Domenico Ghilotti of Equita. Please go ahead.

DOMENICO GHILOTTI: Hi, Marco.

MARCO CODELLA: Hi, Domenico.

DOMENICO GHILOTTI: I have three questions; the first is related to your statement that you are above budget in Q1. I would like to understand it is related mostly to different assumption in your budget on payouts, so if at comparable payout, if you are still ahead of budget or you are more in line? The second question is on the virtual events, you have mentioned in your estimated market share. So if you can give us your estimated size of the market in Q1? And the third question is related to gaming machines, and I was interested in having the split between AWP and VLT revenues, if possible.

MARCO CODELLA: Okay. For what the budget is concerned in terms of payout, we had some...our forecast was including a payout which was in the range of 78% in Q1 2014. So we had some positive effects coming from the payout that was counterbalanced by some negative effect on wagers because [technical difficulty] but the virtual events market share is concerned, we estimate, we have the collection in Q1 in the range of €93 million. We estimate our market share to be 35%...34%. So, the market in Italy for Q1 was in the range of €280 million. And for the whole year we then estimate the market to be in the range of €1 billion, in line with what we reported during the plan presentation.

DOMENICO GHILOTTI: And is the profitability in Q1 so strong, but is structure so strong. So is the business so profitable or there is any special...?

MARCO CODELLA: No, it is profitable...it is profitable because we normally get, you know, these are fixed payout games. So the risk associated is very low, and you just have to manage collection at the end of the day. And in average, our contribution margin is some 6% of total wagers. And there is nothing special in Q1, it is worth reminding that we have a contract in place with Inspired which is the main supplier of this kind of games under which we also get some money out of the collection, which is generated by other

concessionaires, using the Inspired platform. Okay, this was included in budget anyway.

DOMENICO GHILOTTI: Okay. And then I had the question on sales?

MARCO CODELLA: The question was, on VLTs and AWP's revenues in...just let me...here it is, revenues in AWP's talking about revenues.

DOMENICO GHILOTTI: Yes.

MARCO CODELLA: Revenues were some €43 million for AWP's and €22 million for VLTs.

DOMENICO GHILOTTI: Okay, and just a follow-up on the sport betting, could you give us also the year-to-date payout because probably, we are moving in a less profitable part of the year, seasonally speaking?

MARCO CODELLA: Yes, April was not a good month.

DOMENICO GHILOTTI: Okay. But it was probably expected so, nothing strange.

MARCO CODELLA: It was expected because on a statistical basis, April and May are normally quite poor in terms of payout performance.

DOMENICO GHILOTTI: Okay, thank you.

OPERATOR: The next question is from Ronan Clarke of Deutsche Bank. Please go ahead.

RONAN CLARKE: Hi, there. First of all, I was wondering if you could give us a bit more detail on the under performance in online games, is it a market issue or is

there something that you could do to, you think to address that going forward?

MARCO CODELLA: The performance on the online skill games is mostly affected by one specific area of activity, which is Poker .Poker is going down dramatically. So most of the poor performance is coming from that, but this is true at market level.

RONAN CLARKE: And...but you think it will be offset by any other factors, like mobiles and penetration or anything like that?

MARCO CODELLA: There is a partial counterbalancing by the effect of our mobile applications. But in terms of comparison with last year...with Q1 last year, the performance was a bit lower...overall bit lower.

RONAN CLARKE: Okay, and then secondly, and maybe related. But I'm just wondering that...given the growth and the size you expect from virtual games. Is there any cannibalization elsewhere or where is...is that just incremental, is it first of all incremental foothold through your shops. And where is the extra spend coming from do you think?

MARCO CODELLA: We have been, you know, going through some analysis, shop by shop. And, of course, there is some cannibalization mostly in the VLT area. This is the...you know, are the very first figures we got from our shops giving us a view that there is a partial...actually not very significant cannibalization on VLTs because at the end of the day, it's quite a similar game because, you know, it is totally randomic and it's just made on, you know, luck. But the net effect is significantly positive. So the cannibalization is quite poor and the positive effect of virtual events is very high.

RONAN CLARKE: Okay, I understood. All right, thank you very much.

MARCO CODELLA: Thank you.

OPERATOR: The next question is a follow up from Alan Yesner of Morgan Stanley. Please go ahead. Mr. Yesner, your line is open.

ALAN YESNER: Hi, I apologize; my question has been answered since I could [indiscernible]. Thank you.

OPERATOR: The next question is a follow up from Domenico Ghilotti of Equita. Please go ahead.

DOMENICO GHILOTTI: And the last question is related to AWP's, if you give us the number of terminals at the end of March. And for me, it's not clear; if you have the room to improve, to increase the number of AWP's going forward. So to recover the terminal that you lost basically with the...?

MARCO CODELLA: Yes, at the end March, we had 23,000 machines, which is compared to 25,000 at the end of Q1, 2013. So we already recovered part of the, you know, 3,500 machines we missed.

DOMENICO GHILOTTI: Do you have room to go ahead in expanded a number of AWP's?

MARCO CODELLA: Yes, on two main directions; first one is that, we have a plan to buy 1,000 machines that we will be directly be managing and owing. And also we have plans to actually introduce new customers in our network.

DOMENICO GHILOTTI: Okay.

MARCO CODELLA: So we plan to recover the effect of the 3,500 machines.

DOMENICO GHILOTTI: Very clear. Thank you.

OPERATOR: The next question is from [indiscernible]. Please go ahead.

ANALYST: Yes, could you give us a bit of guidance or, you know, what you have seen from the past, on the affect of World Cup on your sports books, and on your payouts? And also, maybe a bit of, you know, how much it improves your revenues and what affect is on the actual payouts of this big sporting event?

MARCO CODELLA: We have not elaborated a specific analysis on that. What we know is the, you know, statistical series that we have been experiencing since years. So we do expect an increase in terms of collection which is in the range of 2%. For what the payout is concerned. As, you know, payout associated to the World Cup normally is a bit higher than the average payout that we are able to achieve because of the special characteristics of that event. So we expect, especially for the second part of the World Cup, the payout to be higher than the average.

ANALYST: Thank you.

MARCO CODELLA: Okay. I think that time is running out. So if there are no other questions, then we could probably close our call. I would like to thank you all for attending and we will be reporting Q2 figures, I don't remember, it's late July or very early August. Thank you everybody.