GAN Limited
Q1 2022 Earnings Conference Call
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Presenters
Dermot Smurfit, President and CEO
Karen Flores, EVP and CFO
Robert Shore, Head of IR & Capital Markets

Q&A Participants
Chad Beynon - Macquarie
David Katz - Jefferies LLC
Ryan Sigdahl - Craig-Hallum Capital Group

Operator
Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to GAN's Q1 2022 Earnings Conference Call. At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. Should you require operator assistance during the conference, please press star zero to signal an operator. Please note, this conference is being recorded.

I will now turn the conference over to your host, Robert Shore, Head of Investor Relations for GAN. Thank you. You may begin.

Robert Shore
Thanks, David, and good afternoon, everyone. GAN's first quarter 2022 earnings release was issued today after market close and is posted on the company's website at gan.com. With me today are Dermot Smurfit, President and CEO, and Karen Flores, CFO. Please note that we have posted -- provided a set of PowerPoint slides that will accompany prepared remarks. You may access these slides on the Investor Relations section of our website.

I'd like to direct you the second slide of the presentation we have posted on the IR portion of our website that talks to our forward looking statement and legal disclosures. Along those lines, I'd like to remind our audience today that we may make forward looking statements on the call under Safe Harbor and Federal Securities laws, which in each case are qualified by the forward looking disclaimers contained in our earnings release, the risk factors contained in our SEC filings from time to time, and those statements may or may not come true.
We also reference non-GAAP financial measures to adjusted EBITDA, which are intended to supplement and not substitute for comparable GAAP measures. Reconciliations with certain non-GAAP financial measures are provided in appendix of the presentation.

With that, I'll turn the call over to our CEO, Dermot Smurfit. Dermot, go ahead please.

Dermot Smurfit

Thank you, Bobby, and good afternoon, everyone. Please join me on the fourth slide of the presentation to discuss our first quarter 2022 financial performance and operating segment results encompassing both our B2B enterprise software segment and our international B2C internet gaming segment.

The first quarter was a record quarter in nearly all aspects of our business with 38% growth in revenue, driven by both our B2C segment and the performance of our recurring B2B revenues with underlying B2B real money internet gaming revenues growing 50% year-on-year. The better scale achieved from this revenue growth coupled with our cost rationalization delivered $3 million of adjusted EBITDA in the quarter, which sets the scene for the remainder of 2022 and continued delivery of profitable growth.

Our B2C revenues and KPIs remain very strong indeed. We saw a 71% increase in top line revenue, driven by a 57% increase in handle or turnover and our active customers were up 106% from the prior year. Sports margin was 7.2% for the quarter or essentially in line with our normalized margin of approximately 7%. Importantly, our marketing spend as a percentage of GGR was 17%, which is about one-third of what domestic U.S. B2C operators are currently spending.

This is driven by our unique in-house setting of lines, our local approach to sports related sponsorships, and market leading features offered within our sports product experience favored by both recreational and veteran sports gamblers alike. Coupled of course to the growing strength of our increasingly recognized B2C brand Coolbet.com represented by our trade marked unruly polar bear character. Collectively, this enables a profitable cash generative business.

On the B2B side, in the first quarter, we delivered a 39% increase in gross operating revenue year-over-year with the recurring revenue portion of the business that we refer to as platform and content fees growing by 17% from the prior year, driven by an all-time record of $300 million in gross operating revenue delivered to our clients through our B2B platform.

Turning now to the operational highlights. It's been an incredibly busy few months for the B2B division. I'll take the opportunity to express my thanks to divisional President Mr. Don Ryan, and extreme admiration for our entire B2B team for their tireless efforts to launch our leading B2B technology platform in Ontario, early last month, and then just over one week later, launching PlayEagle.com for Soaring Eagle Casino in Michigan, the state's largest private casino operator, as well as our fourth B2B client in Michigan, a state which continues to demonstrate not just growth, but also the online profit opportunity available to our client B2C operators when iGaming is legislatively permitted to complement online sports betting.

With the domestic online profit opportunities still limited to just five states equipped with full iGaming, or six if you include Ontario, we believe we will see many more states implement iGaming legislation over time, as licensed B2C operators, who are our B2B clients increasingly direct their lobbying efforts towards passing incremental iGaming legislation, which most industry analysts acknowledge is critical to generating significant indirect profit from online sports betting.

I'll also of course congratulate Mr. Anders Karlsen and his B2C division for delivering solid sports marking performance during the first quarter, driving continued, efficient marketing performance and securing a prestigious industry award from the International Gaming Awards Organization, which acknowledged Coolbet.com as the international mobile operator of the year. All of us at GAN couldn't be more excited to bring the highly compelling Coolbet Mobile sports betting experience to the newly regulated Ontario market, which is comparable in size to the population of Pennsylvania.

We've already seen an impressive ramp in active end user players with many transitioned successfully from .com to .country. And with the native app waiting in the wings, we believe there are many years of profitable operations available to our B2C division on the northern doorstep of America, armed with one of the most exciting mobile sports betting experiences available online in any market.

Now, jumping to our outlook for the full year 2022. We are reiterating our full year revenue and adjusted EBITDA guidance. Currently, despite the uncertainty in the macroeconomic environment, we aren't seeing any signs of a pullback in gross operator revenue trends, which remain robust. Historically, gaming has been extremely resilient to changes in the broader economy. And with 20 years of experience under our belt, we know firsthand that Internet gaming tends to be recession resistant, as consumers elect to stay at home and engage more often online.

That said, we continue to refine our cost structure and will proactively adapt as necessary to the environment with an overarching focus to generate increased levels of adjusted EBITDA, profitability and free cash flow. We expect this focus to continue to yield positive adjusted EBITDA in every quarter of 2022 as profitable growth is our number one priority.

Our continuing focus on optimizing our cost structure has caused us to reevaluate the timing of pursuing select international B2C market expansion opportunities, particularly in light of the foreign currency headwind already created by the U.S. dollar strength during these uncertain times. Accordingly, we now view our prior 2023 revenue target of $225 million as more aspirational and contingent on certain material B2B market opportunities, such as California Regulating Sports Gambling later this year and a successful B2C launch in Mexico anticipated well before year's end. That said, our expectation of continued profitability improvements, as the business achieves better scale, coupled with our cost rationalization efforts, and our expectation for improved adjusted EBITDA generation going forward, remains unchanged.

Focusing on the continuing domestic B2B opportunity, particularly with our one stop shop capability as validated recently by Red Rock resorts continues to sit at the heart of our investment thesis. Remaining B2B in the U.S. is still the right path to follow here and remains an unshakeable central tenet of our industrial strategy aligned with our value creation strategy for continued implementation of efficiencies, margin expansion, and delivering continued profitability.

Profitable growth is now our primary agenda. And we remain highly confident in our existing full year guidance for 2022. But with regards to 2023, we will take a more opportunistic and measured approach consistent with our current priorities while keeping a close watch on California, which may create substantial B2B opportunities for our B2B platform, and of course, our GAN Sports omnichannel solutions.

Moving on to the next slide, please, slide five. Those strategic priorities for this year are focused on three key disciplines. I'm pleased with the progress we've made executing against them in the first quarter and the momentum we now have to make meaningful additional progress.

Our first priority is centered squarely on profitable growth. This past quarter, we reduced our largest expense line, adjusted G&A, by 16% year-over-year, while growing revenue nearly 40%. This demonstrates the inherent potential in our operating model with the appropriate level of scale.

We continue to see opportunity to achieve meaningful efficiencies, including the creation of what we call GameSTACK 2.0 prepared for operational launch in early 2023, and bringing together the best elements of Coolbet's B2C technology with the best parts of our B2B offering under the clear leadership of our Global CTO, Mr. Jan Roos, and his new technology management structure now firmly in place.

This drive towards GameSTACK 2.0 has two outcomes. Firstly, this ensures we will continue delivering a best-in-market offering for our domestic B2B clients and our B2C end user customers. And then secondly, this means we will benefit from $10 million in real and identifiable cost savings over the next year, reducing our expense structure to further drive positive adjusted EBITDA growth.

The second key initiative playing out through the balance of this year is the rollout of our prior year investment strategy including GAN Sports and the Super RGS. This summer, we will launch GANSports in Mississippi which will be followed by Red Rock resorts to operate their entire omnichannel sports offering throughout the Las Vegas locals' market with a technical trial kicking off in the fourth quarter.

Finally, our third priority is organic growth across both B2B and B2C divisions. In the coming months, we'll launch B2B in two additional states, Mississippi and Arkansas, the latter of which will have a very limited number of operators and we therefore reasonably expect to garner our fair share of the sports betting opportunity there. We're also planning to launch in Mexico in the fourth quarter, a new regulated B2C opportunity for Coolbet coming relatively hot on the heels of a regulated B2C launch of internet gambling in Ontario, Canada.

Moving on to slide six, and here, I'll conclude my remarks which recaps the flurry of activity we had last month in Ontario, and just across the border in Michigan. Starting with Ontario, we launched our B2B technology platform for a leading sports first B2C operator, leveraging our entire game site platform to enable both online sports and of course, iGaming.

While we wouldn't want to extrapolate too much from what is essentially one month's worth of data so far, but we are happy to say that we're seeing initial customer signups and deposits on a similar ramp to the initial launch results from the state of New Jersey back in early fall of 2018, which appears highly encouraging. Concurrently in Ontario, we brought our award winning B2C offering live via the website coolbet.ca, which transitioned the existing player activity successfully from .com to .country.

Coolbet.ca has certain specific advantages in market specifically around ice hockey, where a sports trading team members have been setting ice hockey odds for more than 20 years. We've also been leaning into our strategy of local sports sponsorships and are thrilled to announced as our Canadian ambassador, the Olympics Gold Medalist Mr. Andre De Grasse, otherwise referred to as Canada's fastest man. Our marketing efforts in ONTARIO remain strategic and laser focused to generate day one profitability.

And so, just 10 days after launching in Ontario, we launched PlayEagle.com for Soaring Eagle Casino and Resort in Michigan, the state's largest tribal casino operator. This launch represents the very best of GAN's B2B division, delivering not only the enabling platform technology, but also supporting our Native American client with operational marketing services, led by Mr. Mayor Deutsch and his capable team in Tel Aviv, who are now delivering efficient user acquisition, digital marketing, and deploying our clients marketing capital responsibly.

Marketing services is an increasingly important aspect of our B2B divisional services. And we now service three separate B2B clients in three separate states for user acquisition and retention marketing of real money gamblers. Marketing services represents the lucrative cross sell opportunity, and our Israeli team now has a harder and compelling track record right here in the U.S.

As I mentioned last quarter, the U.S. B2B opportunity is taking longer than we originally forecast given some near-term headwinds, although we remain bullish in the mid to longer term. We also remain in the very early innings of Native American retail casino operators getting involved in online gambling of any kind. Collectively, Native American casino operators represent nearly half of all land-based casino gaming revenues here in the U.S. And so it's not unreasonable to assume they're all being equally major part of the U.S. online gambling opportunity as the market develops, and we're seeing them increasingly as participants in our B2B sales pipeline. We are well-positioned for this wave given our success in Michigan, and other relationships with some of the largest tribes including those in my home state of California, many of whom are long standing simulator gaming clients of ours.

Before turning the call over to Karen, I note that while I'm pleased with this quarter's results, and the start to our year, we're still in the very early innings of a massive opportunity in both domestic B2B and our international B2C markets. While the timing of new market openings and the general macro environments are uncertain, we continue to focus on what we can control and find additional ways to run the business more efficiently, and ultimately, more profitably.

The results will be accelerated adjusted EBITDA, strong top line growth, a great product for our clients that I'm confident will drive increased stakeholder value.

And with that, I'll pass the discussion to our CFO, Karen Flores. Karen?

Karen Flores
Thank you, Dermot, and good afternoon, everyone. Some brief housekeeping items first. My comments today around our consolidated results will focus on year-over-year comparisons, given the effects of the Coolbet acquisition on January 1, 2021, as both periods now include the acquisitions.

Starting with our consolidated financial results on slide eight. Record first quarter revenue of $37.5 million increased 38% from the prior year. Our revenue performance was driven by organic growth in both our B2C and B2B segments. I'll note this comparison includes $3 million in onetime patent licensing revenue in the prior year quarter and excluding this revenue was up 55% year-over-year.

Q1 B2C segment revenue increased with organic growth across most of our operating markets. OSB hold returned to a normalized level this quarter of 7.2%, which is modestly above our historic normal hold of 7%. Active customers of 230,000 were up over 100% from 112,000 in the prior year, which drove 584 million in handle, up 57% from the prior year. Overall, Q1 B2C segment revenue of $24.4 million increased 71% versus prior year based primarily on expansion of the customer base in existing markets. Q1 B2B segment revenue of $13.1 million increased 2% versus the prior year, which again includes 3 million in patent licensing revenue.

Recurring revenue represented 82% of segment revenue and increased to 17% to $10.7 million. The increase was driven by 39% growth in gross operator revenue, with the strongest growth coming from U.S. real money gaming, which increased 49% year-over-year, with a corresponding increase in net revenue. We observed strong organic growth in Michigan, New Jersey, and Pennsylvania, along with our new states of Connecticut and West Virginia. Our Italian and simulated businesses were down 4% and 1%, respectively.

Adjusted operating expenses were $22.8 million in the first quarter versus $17.9 million in the prior year quarter. Looking at adjusted OpEx as a percent of revenue, expenses were 61% of revenue, which is down 500 basis points from 66% in the prior year. In this quarter, we also incurred $1.1 million of restructuring charges.

Our biggest operating expense G&A was $8.3 million adjusted or 22% of revenue, which was down materially from 36% in the prior year quarter. The growth in our revenues in conjunction with our cost rationalization efforts resulted in $3 million of adjusted EBITDA as compared to $500,000 in the prior year quarter. Though the current quarter includes a significant foreign currency impact of $900,000 versus an immaterial number in the prior year quarter, our net loss was also reduced as a result of our scaling and cost discipline to $4.5 million versus $5.6 million in the prior year quarter.

This April, we successfully completed a $30 million term loan. The new loan provides us additional flexibility to execute our balanced capital allocation plan centered around investing in our B2B offering and growing Coolbet in our B2C presence.

We will opportunistically consider share repurchases given we believe our share price currently does not reflect the long-term opportunities we see ahead of us. However, we are still in hyper growth mode as a company and given the broader macro uncertainty, all capital allocation decisions will be appropriately contemplated.

We are reiterating our full year revenue guidance of $155 million to $165 million and adjusted EBITDA of $15 million to $20 million. We expect international seasonality in the second quarter, and our strongest quarter this year will be the World Cup occurring in Q4 over the months of November and December. As such, we expect a stronger second half of the year. That said, we continue to expect to be adjusted EBITDA positive in every quarter this year, driven by our profitable B2C business, scaling of our B2B business that is largely recurring, and cost controls we are implementing throughout the company. Our focus remains squarely on execution and cost control to drive near-term profitability, while strategically investing in new market opportunities, GAN Sports and Super RGS.

Moving on to the next slide, slide nice. We have been implementing cost controls along with other strategic initiatives that are expected to accelerate adjusted EBITDA generation and improved profitability. The early signs of this were evident this quarter. Looking at our three functional OpEx areas. We see an opportunity to improve both the short-term cost structure and the longer-term scalability while still meaningfully growing our top line.

First, I'll touch on our sales and marketing expense. The cost of B2B trade shows such as Global Gaming Expo or G2E, are largely fixed in nature. On the marketing front, Coolbet's local sponsorships generate high ROI, are carefully contemplated, and are a fraction of what a similar cost would be in the U.S.

The second item is product and technology. As Dermot already touched upon, we are developing GameSTACK 2.0, which will result in considerable operational efficiencies in the organization without impacting the pace of client deployments. The outcome is an anticipated $10 million in annualized cost savings. Finally, looking at G&A, we continue to bring more corporate functions in-house including tax, legal, and accounting, which is resulting in notable cost savings. This line item is highly fixed and scalable.

Moving on to slide 10 and to wrap up my remarks, we delivered strong growth this quarter, scaled down our OpEx, and delivered $3 million of adjusted EBITDA. Operationally, we recently launched our fourth client in Michigan, our first B2B client in Ontario, and brought Coolbet into Ontario as well. That said, we still have a lot of work to do as we focus on launching GAN Sports and continue to improve the cost structure to drive accelerated adjusted EBITDA and ultimately free cash flow.

I'll now turn the line over to the operator to open it up for questions. David, back to you.

Operator
Thank you. At this time, we will be conducting a question and answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. If at any time you wish to remove your question from the queue, please press star two. For participants using speaker equipment it may be necessary to pick up your handset before pressing the star keys. Once again to ask a question, please press star one. And we'll pause for one moment to pull for questions.

Our first question is from Chad Beynon with Macquarie.

Chad Beynon
Hi. Good afternoon and thanks for taking my question. Wanted to talk about Ontario for a second. You spoke about the transition from .com to .country. Wondering if you could expand a little bit in terms of what the near-term impact could be for Coolbet in the second quarter? It sounds like

the .country, you're acquiring customers or transitioning customers pretty well. But just wondering if there's a near-term impact? And then just from a competitive standpoint, is the market kind of as expected, or more or less operators in the market? Thanks.

Dermot Smurfit
Thanks, Chad. I'll take the last part of the question first, and then invite Karen to comment on the first. But no, the market is pretty much as expected. Our client appears to be ranked around third place in the market and we're very happy with initial ramp up. It's been eerily similar to the September 2018 ramp up when we launched online sports betting and iGaming in the state of New Jersey. So that's all very positive and we're happy with the competitive position of both our B2B clients and Coolbet. I mean, Coolbet has a native app that they're waiting on, which is waiting in the wings ph currently will be out at some point in the second quarter. And I think the operational marketing has been very, very efficient and very conservative.

Karen, any other comments on that?

Karen Flores
No. I mean, I think it's the rollout so far, we're very early innings into it, but we haven't seen any notable differences otherwise from what we were expecting. So I think we're off to a great start on both sides.

Chad Beynon
Great. Thanks. And then on the revenue guidance, last quarter I think you've mentioned $50 million to $55 million of the revenue guidance would come from B2B. Just wanted to confirm that the split between B2C and B2B is the same. And then the second part of that is, can you talk about the take rate on the B2B business kind of where that's gone? And given the additional content that you have with Silverback and Ainsworth, if you can -- if we should expect to see that pick up in the back half of the year? Thank you.

Karen Flores
Sure. So we have not seen the effects of the B2B take rate increasing as of yet. So you'll notice that when we're comparing it to the first quarter last year, we have the effect of course of patent licensing revenue. We're still in this range of 4% to 5%. We believe that the take rate will increase as we move towards the second half of the year as more content is coming out, as we start to scale sports, Super RGS, but we're really not going to see the full effects of that until really next year, where we expect the take rate to be above 5%.

Chad Beynon
Okay. And then just in terms of the split between B2C and B2B on the revenue guide?

Karen Flores

There's no change to the split in the guidance.

Chad Beynon
Perfect. Thank you very much. Appreciate it.

Operator
Our next question comes from the line of David Katz with Jefferies.

David Katz
Hi. Afternoon, everyone. Thanks for taking my questions. Can we just delve a little farther with California and what you may be able to know there? It seems there maybe you two competing efforts. The one that's more tribal, one that's more commercially driven. Can you just share your thoughts on both of those and sort of how you are positioned within each of those or how you see your chances within each of those or preference, et cetera?

Dermot Smurfit
Yes, David, thanks for the question. I mean, you're right. There are two competing proposals out there for California towards the back end of this year. And thankfully, it appears that the third proposal which may have led to significant voter confusion has been benched at least for now. So there will be two proposals going on to the ballots. I mean, as a general statement, I think if either win we will still have a hand to play in the poker game of California sports betting. We're particularly positive on the tribal initiatives. The tribal initiatives, we've obviously been here active with simulated gaming in California for many, many years, since 2014. And we have a very strong track record of converting simulated gaming operator clients into real money gambling B2B clients. So we lean in favor of the native American initiative on the basis of those fully developed long-term relationships that we have and enjoy right here in California.

David Katz
Understood. I do have a couple other details, but I'm going to jump back into queue. Thanks very much.

Operator
Our next question is from Ryan Sigdahl with Craig-Hallum.

Ryan Sigdahl
Good afternoon. Curious if you could elaborate on why GameSTACK 2.0 will be more efficient and save $10 million annually versus 1.0? And just maybe some additional details and qualitatively what improvements are coming there?

Dermot Smurfit

Yes, Ryan. I'm happy to take that. I mean, you're really talking about one leadership group in software engineering globally moving to one technology system, which is competent to hybrid of GAN existing tech and Coolbet existing tech. One of the most interesting technical efficiencies is certain aspects of the Coolbet software, which allow, instead of three software engineers to work on a project, one software engineer can work and complete that exact same project. And that's really at the core of the critical engineering efficiency that we're moving towards for launch in very early 2023. Hopefully, that's helpful.

Ryan Sigdahl
So launches in early 2023 and then the $10 million could be incremental beyond that starting once this launches. Is that correct?

Karen Flores
No, the $10 million is starting to take effect this quarter. But we'll see that unfold over the course of the year as we have moved through periods of restructuring. So most of that will be identified through this year, I would say about 70% of it this year, with the remainder coming in next year.

Ryan Sigdahl
And of that 70%, Karen, is that within guidance, or is that incremental?

Karen Flores
It is within guidance.

Ryan Sigdahl
Great. Then just one on the 2023 outlook. You talked some about California. But did I catch you right in the prepared marks? So you were previously assuming California and now you aren't? I guess, can you walk through the puts and takes on 2023 of what assumptions have changed?

Karen Flores
Well, as Dermot was alluding to, a lot of it is also just around the cadence of our international launches. So in the original guidance, we had assumed effectively two new territories per year for Coolbet as an example, where between now and the end of next year, it really is primarily around Mexico, that's going to be our focus. So we're really only expecting one launch. So it's really again, as you can sort of compare it to the U.S. opportunity there's a slight delay there. But the point that I would highlight around 2023 is, while it may be aspirational, as we say for the 225, we are really focused on bottom line profit. And so we don't think that there is going to have a delay in achieving long-term margins that we're pacing towards, that 30% to 35% range that we previously guided to. We will be on track to achieve that even with the revenue number for 225 being aspirational because the focus really is profit.

Ryan Sigdahl

Helpful. One more for me. So $34 million in cash, good balance, there. Seems like with the guidance is here, and even the profitability and cost efficiencies for next, you would have enough cash to inflict free cash flow positive on an organic basis. I guess, one, is that true. And then two, you look at a $30 million notes that you just offered, I guess what's the rationale for that specifically, given the core business comments? Thanks.

Karen Flores
We're still expecting to be free cashflow positive in the fourth quarter as we originally guided too. We are not quite there yet because of the level of investment. We're still in hyper growth. And so while we could get there organically if we weren't investing as heavily in GameSTACK 2.0, for example, and again, the Mexico launch, that could have been a possibility, but we are expecting to be generative by the fourth quarter. The closing of the term loan was ultimately -- we're looking at the uncertainty in the macro environment. It's good corporate hygiene. We want to make sure that we are well capitalized and in the event that other opportunities are coming away, it just allows us to be that much more flexible. So very prudent all around.

Ryan Sigdahl
Great for my end on that last statement. That's it for me. Thanks. Good luck, guys.

Karen Flores
Thanks.

Operator
As a reminder, if you'd like to ask a question, please press star one on your telephone keypad.

We are not receiving any further questions at this time. I would like to turn the floor back to Dermot Smurfit for closing remarks.

Dermot Smurfit
Okay. Thank you, everyone for joining us today and for your continued support. We're off to a strong start to the year with numerous catalysts upcoming in the third and fourth quarters across GAN Sports, Super RGS, and a more active international sports calendar. We've now transitioned the business to generating positive EBITDA in the first quarter and 2022 will be a full year of continued profitable growth as we execute each of our three main priorities. I look forward to updating you all on our progress as we go throughout the year. Thank you again.

Operator
Thank you, ladies and gentlemen. This concludes today's conference. You may disconnect your lines at this time.