J.P. Morgan Gaming, Lodging, Restaurant & Leisure Management Access Forum

Aristocrat Leisure Ltd - Australia

Don: We're conscious that we only have about 30 minutes, would love to get started here. Ladies and gentlemen, we have Trevor Croker, the CEO of Aristocrat. Trevor, thank you very much for joining us.

Your business has changed a lot in the past couple of years, a land-based operator who's now generating over a billion dollars in revenue from a sneaky little digital business. You've obviously transitioned into a different company today. Would love to hear that quick summary of the past two to three years and how you've transitioned into someone making so much money in digital.

Trevor Croker: Thanks, Don. Good afternoon, everybody. Thanks for your time. Aristocrat's been a very strong core content company in the gaming industry for a number of years, particular based out of Australia.

We went on a trajectory in 2010, 2011 to create a great business. Part of that was getting a strong gaming ops business in North America, a strong land-based business in Australia, and building a great talent pool of game design and creative talent for the organization.

We executed on that through in about 2014, '15 with the acquisition of VGT. We immediately bought scale into the business with the Oklahoma tribal business but also mechanical reels. That was the platform to say, "Our core business is now robust. We're in most of the major segments that we want to play in in that marketplace."

Then we started to say, "What are the adjacencies to that?" Those adjacencies started off with products like Product Madness where it was taking land-based content and putting it through a digital engine, where the Product Madness team were very, very good at monetization, CRM, and backend and they were able then to commercialize our land-based content into the digital world.

Over that progress, we started to get a real appreciation for digital. At the same time, we see that there is an emerging market for digital direct to the consumer. The ability to produce a number of apps or applications to an ecosystem of players that are not dissimilar to our core business come from a content-driven strategy.

What we did is we looked at both. We looked at a number of acquisitions over the last three or so years. We looked at the type of business model and acquisition that suited the type of business we are. We looked at, "Has cash created a new one? Can we run the business culturally?" and then what this would do from a product and content point of view.

That's where we landed with buying both Plarium and Big Fish. Both of those assets bring a content and capability to us. They also bring a scale play to us.

Those three buckets have given us the capacity now to build a portfolio of digital applications not dissimilar to the portfolio of land-based applications that we've made or portfolio of products that we've made through our land-based business both against the core for-sale and the gaming ops business point of view.

This is our year of transition. We are investing, in this year, to launch a number of apps to create that pipeline that you need in digital. We're launching a number of apps this year. We just launched Raid two weeks ago, which was a worldwide launch on Google and Apple iStore.

We had featuring on that. We've ended up with over a million downloads in a week from that. We've launched Decurse, which is another game from Big Fish, only yesterday. Later in this year, towards May, we'll be launching Toy Story Drop!, which is in conjunction with Disney Pixar.

We're bringing Toy Story to a match 3 story game, which we think will be another add to the portfolio, and that's on top of refreshing some of our core apps as well. It is about building a portfolio of applications, not just about one hit wonders. That's the way we'll play this, just like we play our land-based business, is a portfolio of solutions that are well-targeted and segmented.

Don: Part of that portfolio that you build, it takes a lot of money to invest in that. I think there are two buckets that you have. One is the D&D or the design and development. Can you elaborate on what that is, and what that is relative to perhaps User Acquisition, the UA spend that you use in the digital business?

Trevor: Yeah, sure. D&D is the first investment we make every year. It's the first investment. We fund it fully from the P&L. We take our D&D investment, which is somewhere in the vicinity of 11. I think it was around 11.5% last year. We had 11, 11.5 percent of our revenues.

That's our first investment. That buys us talent, it buys us technology, it buys us game capability. That is really about how we differentiate our core business. We continue to invest in D&D, and that's our number one priority. That leverage that we create in that capacity of games, has been what's been underpinning and continues to underpin the strong growth.

At the same time, we're moving to adjacencies. We have a number of markets where we have low or no share, that it's a large addressable market, which we think we can attack. We've got the capability to do that.

Markets examples of that would be Class III Stepper, Washington CDS, VLT in Canada, Ovation which is Class II video, and we're moving into Poker Bar Top later this year. That's really where we spend our D&D dollars, and as I said, spent 11 - 11.5% of revenue.

We see that's the important differentiator for us, to continue to invest in the content, breadth and depth that is required to take share on the floor with our customers and continue to give them the support behind not just the game content, but the hardware and the technologies that supports it.

When you talk to UA, UA is the biggest lever you have in the digital business. User acquisition, it's around 25 to 28 percent of the revenue. It is the key cost driver (behind platform fees at 30%). It's the way you buy traffic for applications. It's an important lever, and it's also a very rigorous lever.

The good thing about a digital business is you have complete and absolute facts in the decisions you're making (via data). We know what the retention is. We know what the monetization is. We're able to then look at the lifetime value of players. Then we're able to work out what we can afford to buy them for.

Cost or CPI is really what we work on. We have rigorous (predictive) models with that. You can look at it effectively by the minute as to how you do that. That rigor is there.

That's part of the fundamentals of who we are as a company, is we have strong investment rigor, whether it's around the D&D dollars spent, and how we're attacking a market, and what our returns and expectations are or whether it's around the way we apply UA to drive growth in the digital business.

Don: Are there any opportunities that if you're developing great land-based content, obviously you have an online casino? What are those opportunities to take land-based content into digital? What are the lessons that you're learning from growing this digital business and these two acquisitions that you just made?

Trevor: We can start to take content. Today, we are now making games as what we call "Digital first". They're being made for the digital market as a first market as opposed to our land-based market.

Our land-based business, for those who don't know, it can take us up to about 9 to 12 months to make a game. A fair chunk of that, probably up to about four months of that, is in just regulatory approval.

We can stand up games from a casino point of view a lot quicker in the digital world and it allows us to put more games into the market and allow them to perform in that marketplace. We are starting to do more digital-first content. That allows the cadence of content release to keep the games fresh for our players and also to test new themes as they come through at the same time.

Don: Some people might be a bit skeptical of your ability to compete in a social casual space. Can you talk a little bit about what you're learning and what you're taking from your current digital business, and how you're developing that segment?

Trevor: Yeah. Thanks, Don. First of all, social casino is just over 50 percent of our digital business from a revenues point of view. It's a pretty predictable curve. It's got I wouldn't call it evergreen but it's close to (characteristics). It's very predictable. It's very structured in the way it operates and what we need to do. We understand that category.

The other just under 50 percent (of total Digital revenue) is casual games. The difference in that casual games is that's a completely different demographic to the whole rest of our business. Our business is largely in casinos. It's a 50-year-old plus female.

In the casual world, it's 40-year-old males predominantly when you think about RPG, strategy, and that sort of games. Yes, there's matching games in there, but it's a different skew.

What that gives us as a business is it gives us these great development paths. Then when we get into the casino piece, we're number two now. With the acquisition of Big Fish, we're the number two casino publisher in the casino business. We're continuing to pursue growing that and continue to grow ahead of the category growth rates on that basis (long term).

When it comes to casual games, we have strong positions in a number of genres. We have a strong position in Match 3 with Gummy Drop!. We have a strong position in time management with Cooking Craze. We have a strong position in cards with Fairway Solitaire and Vikings from a strategy point of view.

We're going to continue to build on those franchises and keep them fresh and evergreen through live ops and new brand extensions.

Then there'll also be new apps coming through with the new genres. RAID is actually RPG with the collections, which is a new trend coming through. That's a new game methodology. Decurse is a builder, which is another game, FarmVille-type builder context. That's another new area.

We are slowly moving up to the genres. The way that we think about the genres is we know the size of the total addressable marketplace for mobile games is about $50 plus billion, growing at 10 to 12 percent per annum.

We look at all the sub-segments in that. We have our own comparatory data that we look at when we subsegment that. Then we look at,

- "What are the addressable markets that we like?
- What's the size of those markets and the growth in those markets?" and then,
- "Do we have the capability to compete and be successful in there?"

That's why we're starting to branch into a few more of these genres using assets which we picked up through the acquisition.

One is the low-cost jurisdictional development that we've bought through Plarium in Eastern Europe and got a lot of low-cost, very high-caliber people that we can work with there. They're able to pivot quickly and work on new games, new genres. RAID was actually built from that studio from ground up. They did that themselves.

The Big Fish model which is working with third-party development studios who are coming to us either pitching ideas or they're currently working with us exclusively and we're looking to extend apps.

A good example of that is Gummy Drop! Moving to Toy Story Drop, which is both a brand extension with a license on. The people that did Gummy Drop! have evolved the game, have evolved the mechanics on the game, and they've added the license on top.

Don: Not to take anything away from the secret sauce of the land-based business, you've mentioned some of the adjacencies that you're looking at. Can you elaborate on what that market opportunity might look like?

Trevor: In the land-based business?

Don: Please.

Trevor: If I just go through in hierarchy what they look like, Washington Class II CDS is a big opportunity, from our perspective. It's a market of over 30-odd-thousand machines. It has quite a high churn, so we see that as a great opportunity to enter. We've only just ended that market in October 2018.

Don: Yeah.

Trevor: The years are getting away from me. If I then go away and you start to say, "What about Class II video," which is Ovation? It's about a 23,000, 25,000 machine market, predominately outside of Oklahoma. VGT has a very strong position in mechanical reels in Oklahoma.

We're seeing the majority of the growth coming in Ovation, outside of Oklahoma. We've placed about 4,200 units at the end of 2018 into that Class II video market, of which the majority are outside of Oklahoma. The next one after that is the VLT market. They're a little bit more choppy.

VLT markets, the first two that we're in is we're in ALC, which is the Atlantic Lottery Corporation and Manitoba. Both of those markets we're currently in trial, and then we've got another two markets coming through this year where we'll enter.

On top of that, and I will get to the end of this quickly, is the poker market, so Bar Top Poker. A big market in our opinion, has a very much an entrenched install base. We're bringing up both the new mechanical solution, also gameplay methodology to enter that category. That's quite a big market when you think about the route type businesses that it's in. It's a big market that we think we'll be able to penetrate over time as well.

Don: Do you see the market changing, that you're currently competing in the core Class III or gaming ops? What's your outlook for maybe this year, as you see it?

Trevor: In this core Class III business, we've got to keep on winning in there. That's where we have these great game designers, and we focus on these great game designers making new content and continuing to evolve our games. You'll continue to see evolution of our great games coming through in our core business.

You'll see new games and innovation in the way that we make games, based off what we call customer...not customer, but player feedback. We actually go out and have a look at the market, and see what the customers are wanting, and seeing what they're making, so we do more in that space.

From a gaming ops point of view, continuing, we've got some licenses coming through this year. We've got licenses coming through. We still see runway in Dragon Link. Dragon Link and Lightning Link are proprietary brands. They've been a great growth engine for us in the gaming ops business and will continue to be a growth engine for us.

We also got some licensing and some game forms coming through. There's a small market opportunity in what we call Class III Stepper. We've got some very good results out of an early placement of some of those games. We expect to place more of those over the balance of the year.

What do I think the year is going to look like? I think there's nowhere near as many expansions this year. The churn is pretty robust. We're in a very good place to get a much greater share of churn because we're entering categories where we haven't placed machines at all.

We'll be taking share in those new markets. That's where we expect to gain share, and also to be aggressive in maintaining our position in the for-sale video market. We're sitting in the 30s from a share point of view, and we expect to continue to be very competitive there as well.

Don: You mentioned that you're in the 30s for the share point there. When I look at the talent that you have in the business, it seems like you've hired more than your fair share of talent in the market. Could you talk a little bit about that? It seems like it's almost the who's who in Aristocrat for game, design, and development.

Trevor: We've really believed that having the best talent is part of. The best talent is to start off with the best creative talent, but it's working into the best digital talent. We've been able to check and keep talent there. We believe talent is a real differentiator, hence the important part of what we do.

We do have a great suite of game designers in our portfolio, and that's great to have. Not every game designer is running at 100 percent each time, so we've added two game designers this year. Two new names have come into our organization. That will take them about 12 or so months before their portfolio are coming out.

At the same time, we've got good ideas coming out of gaming ops studio, when you think about some of the Buffalo Grand, 5 Dragon, and those great looking products. Like I said, you've still got evolution from Scott Olive over at HRG against the Dragon Link, and the next evolution of that game.

I feel comfortable that, yes, we've got the right talent. They've got the right incentives and motivations to drive, and it's creating great games for our customers. Ultimately, I think that you'll see that people will be up and down sometimes because not every game you make is a success.

We've got a great portfolio of guys that are our main core teams, and that are making great games. I think you'll find over time, we'll continue to deliver great games, and keep the floor average going the way we need it to.

Don: To be balanced, what are some of the challenges that you're looking at? What keeps you up at night, as you think about this next year, and the competitive landscape in both digital and land-based?

Trevor: It's an interesting time. The last couple of years, there has been a lot of consolidation going on, from an operator's point of view. We're just interested to map through that. We feel very comfortable with the position we have with the tribal markets. We feel that there's good opportunity with the regional casinos.

We can do better with the corporates, but they're not as big a part of our business as the regionals and the tribals (customers). We still see opportunity in those marketplaces, see opportunity to continue to pursue new markets. As I said, we're entering some of these new categories, and it's important that we enter and execute those very well.

From a Digital point of view, we have got some apps that are long in the tooth, and we don't have to keep working hard to keep them fresh. The early signs from the portfolio that's coming through now is very good.

We expect to continue to be able to launch apps through the balance of this year, which will build out our portfolio towards the end of this year and let us run into (20)20 with a broader portfolio, which is more along the portfolio that we're looking for.

I think our key focus now is really delivering on our plan. We're investing adequately, we're providing the right level of content and outfit, and that's where we're delivering on.

Don: You mentioned that some of your digital titles are bit long in the tooth. When you think about that UA spend and your investment in it, can you talk about what the timeline to their terms are, or how you think about that incremental dollar that you may or may not spend? What's the process to think about spending $100 million in digital?

Trevor: Thanks. From a UA point of view, really when you think about the investment in launching an app, there's very little upfront cost. There's a little bit of D&D. It's an iterative process. Whilst you're even going through soft launch, it's very iterative. It's nowhere near our land-based business, where a lot of the costs from a design point of view is right at the front of the curve.

As you get closer and closer to release, it diminishes, whereas in digital it's the complete opposite. It's very light up front. As you get closer and closer to launch, and you're running through soft launches, and tech launches, where you're refining the metrics...and those metrics that we look at are retention and monetization metrics.

Once we get to the point where those retention and monetization metrics are above what we want from a target point of view, that's then when we go to launch. At that point, you start to scale your UA. UA then scales basically offer...it's just a very simple formula between lifetime value and cost per install.

You just work on what the cost per install is going to be. That can be calculated by each day, by hours within each day, to make sure that you're buying at the right rate and you're buying the right target.

It's a pretty rigorous process and it's all data-based from that point of view. The good thing is there are times in soft launch where apps just won't make it to the target, and then you don't spend the money and you may even cut them, or you may take longer to refine the app for monetization and retention before you take it to market and really spend the UA dollar.

When you do push go with UA dollar, you know what your returns are. We understand that the earlier you spend the UA dollar, the better the return. That's when your when CPIs are cheapest, and that's when you get the best players in general terms.

Don: Being mindful of time, I wanted to see if the crowd had any questions. If not I can, of course, go back to it. Do we have any questions out there?

[pause]

Don: OK. You'd mentioned some of the launches, RAID being one of them, and it's been featured in the Google Store, in iTunes as well as a featured game. What does that mean for you in terms of downloads, virality? What happens there?

Trevor: You get basically a week of featuring. It ended up being featured by Google and it was in the top five apps with iOS. That is very valuable when it comes to launching. You get virality, and the virality of these change depending on the type of game.

The genre that it's in is a smaller genre than say a Match 3 game, but we've been able to achieve over one and a half million downloads in that period of time. There is a multiple factor there. It's over $10 million of (equivalent) UA value as a consequence of getting that virality and driving that through the business.

What that allows us to do is have critical scale that we can now buy UA and target users on top of that. It's been a very helpful message. Through the algorithms and the systems that the app stores use means it gets prompted more quickly to people as they're searching.

That's a good thing from a virality point of view, let alone what happens with the blogs and the influencers now that people have started writing it up and talking about it.

Don: Is there any seasonality to either the UA spend or game launches that you're being mindful of or you should think about?

Trevor: UA spend, there is seasonality in UA spend. UA gets expensive around Christmas time. Usually, around holidays, it gets a bit more expensive, so you phase your UA depending on what you want to buy, and this is where the CPI number comes in. How much are you willing to pay for new users?

You do have some seasonality in that, but you run the UA and you launch the apps according to both the release schedule and how they're progressing through the soft launch plan. We look at all of those components as we're going into when we spike UA and how we actually drive it up.

Don: When you think about the future of the business, you guys are generating almost a billion in free cash flow, under two times levered. Where do you go to from here?

Trevor: Well, we're in a transition year at the moment. Really, we've got a very, very strong core business and that's what's driving a lot of those metrics when you really think about it. We've got a wonderful gaming operations business that's still got strong growth. For-sale business which is continuing to show good momentum in investment.

That's really what underpins a lot of that core business and that drives a lot of that. The digital business, as I said, this is a transition year, and this is really framing it up so that we have this broad portfolio of apps that we're able to invest in as we go into the next couple of years.

Where we see ourselves is investing heavily in D&D. Continuing to invest in D&D which is our most important investment. We have to pull in some capital to support the install base, the greater install base of gaming ops. Then making sure we've got the UA spend to scale the apps that we've got coming through the pipeline.

We stay focused on driving cash. It's an important part of what we do. Then, obviously, we want to drive down some debt at the same time.

Don: How do you think about mitigating the risks of maybe the margins as people become more competitive and as the digital space continues to become more competitive? How are you competing there and how are you thinking about the risks associated with them?

Trevor: We've learned a lot over the last couple of acquisitions. One of the great acquisitions is a backend UA (marketing) tool that we've acquired through Plarium which we're rolling out across our business, which is going to give us a much more efficient and effective UA management.

We've already started rolling out across the three businesses. That's part of the way that we mitigate that.

The other part to this is that we are playing a portfolio game, so if for instance, I don't know, cards become super competitive and hard to buy, that's not the only thing we need to make our numbers. We've got a portfolio of apps and we can invest in other apps.

Also, by launching apps like Toy Story, which I expect to see good results from because it's a simple Match 3 game with a great license, that should give us good virality as well.

Don: You guys reported your results late last year. What were the highlights for you coming out of that result in 2018?

Trevor: 34 percent growth wasn't too bad in a market that's growing at about 5% (reference t Australian listed market) and (around) $1bn in free cash flow, as you mentioned. A couple of very, very strong results from my perspective. More importantly, the 34 percent is half of that growth, 17 percent of it, came from our core business. It wasn't coming from just acquisitions.

Actually, our core business grew well ahead of category and well ahead of market. 12 percent of that came from digital business and some of that was acquisition. Then the five percent came from tax. I was really proud at our core business growing at 17 percent. We've come off years of 60 and 70 percent growth and we're still growing very, very well.

We're taking share in all markets in which we participate, and we have opportunity to expand share further, particularly in North America, which is our core focus at the moment, to grow our business further.

Don: What should be appreciated about the land-based business across the globe? You've mentioned the US. What about Australia and Asia as well?

Trevor: The way I would think about Australia is Australia is effectively a churn market. It has a very fixed churn rate. It doesn't have any expansions, but it churns at about the same number of machines, give or take a thousand every year.

Our job is to make sure we get our share of that churn every year, and we're well positioned to do that through good customer relationships, long-term buying programs, and good commercial structures we've put in place. From that perspective, Australia is a tough market, but it's a fair market and there is good churn in that space.

Asia is a little bit different. Asia has been through a period of expansion over the last couple of years. Last year we had a lot from Philippines and Macau. This year there won't be anything material from either of those jurisdictions with really the last casino to open probably at the end of this calendar year in Macau.

The Asian business for us now is about taking it through the maturity events that we take the rest of our business through and working harder to optimize the flaws with the operators and continue to make great games and launching new games for that market to continue to grow it.

Europe, it's a pretty small market for us. It's not insignificant, it's a small market but it has good opportunities. We're still seeing out recurring revenue business in Europe grow significantly. A very, very small base and starting to enter into the Spanish arcade market and the South African bingo market. There is some small expansion going into adjacency across their jurisdictions as well.

Don: Everyone is focusing on real money gambling and gaming, how are you guys positioning yourselves? Also, what do you think about what the risks associated with using real money inside of your apps, buying coins and tokens, and the risk around any maybe litigation or risks around regulation in that space?

Trevor: Real money gaming, that's the hot dollar around at the moment. There are definitely conversations going on around that. We've made our play on social at this stage, and we continue to make that play. We think the portfolio of social apps we've got are the right portfolio and we can continue to grow it ahead of category, and that's our objective.

Real money gaming is something we continue to monitor. It's certainly a market opportunity. There are a lot of challenges from us as a company because of our high regulatory compliance piece where a lot of the real money, not a lot, there are components to real money gambling which are in markets in which we wouldn't necessarily want to be participating.

We've got to continue to monitor that market and look for what is the right solution for us longer term. When you talk about regulation, from our perspective, we've come from a highly regulated environment. Believe it or not, we enjoy the high regulation and compliance and we take that very seriously.

Don: As we have time for probably one more question, were there any from the crowd? No? Great. Oh, please.

[off-mic question]

Trevor: Thanks for that question. The way to think about it is, we are...I'll just talk about North American for-sale for just this moment. North American for-sale, market estimate is putting it somewhere between 66,000 and 72,000 units of churn each year.

We basically only participate at this point in time in a meaningful way in the for-sale video, and that's roughly about half of that number. In that, we have about 30 percent share. We expect to continue to hold and grow that share by continuing to invest in that core.

You then start to step down from that, you get into Stepper. Stepper is about 10,000 units, which we're only just entering the Stepper category. We've been in it nearly two years now.

We're just going to keep getting into that churn, but we're probably low double-digit share from that perspective.

When you get to places like Washington CDS, quite a big market, large market with large churn and frequent churn. That market's probably in the vicinity of about 30-odd-thousand (maybe 33-odd-thousand) with a high churn rate, probably one of the fastest churn rates around the market.

We've only just entered that category effectively in October, and we expect to continue to take a strong share position in that as well.

Class II video, again, it's probably about a 30,000-35,000-unit market. Since launching two years ago we've put (about) 4,000 units into that market. I still see runway to move into that space given that we haven't really aggressively moved out of Oklahoma. We've been growing outside of Oklahoma, but there is still a lot of opportunity outside Oklahoma for Class II video.

Then you've got bar-top, which is possibly about 100,000 units large churn. Pretty institutionalized business, but we feel we've got a solution into that category.

Again, we've got zero share there. You can work out the numbers, it's high double-digits, sorry, high single-digits, low double-digits for both Stepper, Ovation, and Class II CDS. We expect to see good growth in those numbers. We would like to see a much more aggressive number.

I see all of that is markets that we haven't participated in historically, and that's what's going to drive our share growth in the North American for-sale. Plus, VLT, but VLT is about up and down. We're already in two provinces, and we expect to enter another two this year.

Don: Ladies and gentlemen, I think that wraps us up for time. Trevor, thank you very much for your time. If you can hang around for a few minutes and answer any other questions, I really appreciate your time.

Trevor: Thank you, Don. Thanks, everybody for your time. Thank you.

Don: Thank you.