William Hill PLC

Q3 Interim Management Statement

21 October 2010

Operator

Welcome to the William Hill Q3 IMS conference call. At this time, all participants are in a listen-only mode. I would now like to turn the call over to your host, Ralph Topping. You may begin.

Ralph Topping

Thanks, everybody. And good afternoon. I'd like to thank you for joining us for what will be a brief conference call at relatively short notice. Neil, our Group Finance Director, is here with me. I'll make a few opening remarks, then I'm going to hand over to Neil to take us through the numbers, before we open up for questions.

We all knew the third quarter would benefit from being compared to a weak performance last year, this time last year, when we were all obsessing with the lack of draws in football. But I think it's fair to say none of us would have predicted such strong results this year. We've clearly benefited from football results, particularly in the World Cup and the Premier League, going in our favor, with our football margin up from 5% last year to around 40% this year.

Let's turn to the two divisions. I continue to look at Retail [in the round], recognizing that our customer base is changing, as has our product base. Football and machines, the two products particularly attracting a wider customer base, have both done well in the period, with horse racing actually holding its own.

Taking into account machine plays, transactions are still growing; they're up 17%. And that indicates to me that customers' appetite for betting remains, even while their capacity is a bit constrained.

Online remains a big story for us, and we're continuing to get good momentum from our improvements to our product offering. Sportsbook continues to lead the way. And, yes, we've benefited from the second half of the World Cup, but we're also delivering strong underlying growth from new accounts; increased share of wallet; and very importantly, margin improvements.

Overall, and given we're only 10 weeks away from the end of the year, we feel it's unlikely that all the recent outperformance related to sporting results will average out.

On current projections, we believe our 2010 outturn is likely to be around the top of the consensus range you're currently projecting. 2011 is still an open question. But we're well placed for the fourth quarter of this year, and hence the reason for bringing today's statement forward by a week.

Now, I'm going to hand over to Neil to take us through the numbers in a little bit more detail.

Neil Cooper

Thanks, Ralph. The combination of the strong football results Ralph highlighted, together with the weak comparative period in Q3 2009, has led to a very good quarter in terms of year-over-year growth. Group net revenue was in year-over-year growth by 22% in the quarter, leading to a 64% growth in operating profit.

Within Retail, OTC net revenue was up 18%, comprising a 0.6% fall in turnover, but benefitting from an increase in gross win margin of 2.8 percentage points, taking us from 15.4% in the comparable period last year to 18.2% this year. This is obviously above our normalized 17% to 18% range, and reflects the positive impact of the strong football results.

Horse racing gross win margin was broadly in line with the comparable period last year.

Within OTC turnover, which I'd remind you was down around 0.5%, slip volumes were off 1% and pence per slip was up by around 0.5%, which reflects the benefit of the World Cup. Underlying trends were similar to those seen earlier in 2010. Ignoring the favorable impact of any World Cup substitution, e.g., just stripping out the World Cup in weeks 27 and 28, the turnover trend ex-World Cup was down around 3% year over year for the third quarter.

Machine gross win was up 16% in the period, with gross win per machine per week now up to GBP844, versus GBP736 in Q3 last year. Inspired store machines continue to perform well. But the shops with Global Draw cabinets are also doing well, benefiting from our overall approach to managing machines. Retail operating benefiting from the operating leverage was up 41% in the period.

Moving to William Hill Online, which delivered a 35% increase in net revenues year-over-year for the quarter. The Sportsbook continues to benefit from a combination of increased turnover and structural margin improvement, as well as from the football results themselves, increasing net revenue by an outstanding 287%. Turnover was up 45%, with in-play up 88% and pre-match up 29%.

The gross win margin for the Sportsbook was around 9%, which includes pre-match at 11%, reflective of the favorable results we've seen, both in the World Cup and as a result of the string of Premier League draws we've seen this year.

In-play is now consistently delivering an increased margin; 5% in the period. In-play betting was around 36% of turnover; up from 28% in the comparable period last year.

Overall gaming net revenue was down 2% in the period following our withdrawal from France; Casino net revenue was off 9%; but Poker was up 6%, which is the second consecutive quarter of growth we've seen in this category; and Bingo and skill games were up 58%.

The trends in Online costs were unchanged from the first half, bringing us to an 80% increase in operating profit.

Overall, as Ralph has said, this gross win margin performance in the period means we now expect our full year results to be at the top of the analysts' consensus range for operating profit, which ranges on our consensus tracker from around GBP251 million to around GBP265 million.

As a result of this improved profit performance seen in the quarter, it is likely that associated costs, such as improvements in Retail bonus accruals, will push out our cost guidance by a further 1% on previous comments made.

Notwithstanding this favorable run of results in Q3 2010, we remain cautious about 2011, not least because margins will tend to revert to the norm.

Knowing that we've got a VAT increase coming down the line, together with austerity measures from the government that are likely to have an impact on consumer confidence, government spending certainly, and potentially on discretionary spending by consumers, all give us pause for thought. That said, we are clearly well placed against expectations for the rest of this year.

That's the overall picture. Now, if I can hand over to the call moderator for questions, please.

QUESTION AND ANSWER

Operator

Thank you. We will now begin the question and answer session. (Operator Instructions). Our first question is from Ed Birkin from Barclays Capital.

Ed Birkin

Afternoon, guys. I've just got three quick questions. First one, I don't really understand why it's been bought forward a week. On Friday, we were told it's on the 28th, which means that something materially must have happened over the weekend for you to feel that you need to bring forward the numbers. And I know there's a couple of good draws in the Premiership with United and Chelsea, but I don't really see how one weekend's made a difference from your view last Friday.

Ralph Topping

Neil, do you want to cover that?

Neil Cooper

Sure. The simple answer is that there is always a trade off when you're looking at how your numbers are projecting to the end of the year. At a particular point in time, you will have a view based on what you think is going to happen looking forward and what you've got in the bag to date. There will come a point, and clearly we've reached that point, where we felt it was appropriate to update the market at the most sensible opportunity, regardless of the fact that it may have been out of the strict timing that we previously guided to you.

Clearly, the two big draws at the weekend on Saturday were a factor in us firstly forming the view that we were making continued very good profit; and secondly, it was a further week beyond which we were not going to see margins revert back and put us in a position where we were losing profit against trend. So it's simply a judgment about at what point is it appropriate to update the market.

Ed Birkin

Okay. And secondly, you said in the Sportsbook you've got structural margin increases, as well as the benefit from football. You give OTC margin guidance as 17% to 18%, obviously Sportsbook's gone up by 5 percentage points, can you give any kind of guidance of what you think a long term Sportsbook margin should be?

Ralph Topping

Sportsbook? Sportsbook, you mean Online?

Ed Birkin

Online.

Ralph Topping

Yes, it's round about 7% overall.

Ed Birkin

So we'd expect long term it should be around 7%?

Ralph Topping

Yes. So I think the margin we're seeing at the minute's probably [depressing] turnover, so you should expect to see turnover rise and margin drop back to about 7% would be my -- if the world works the way it normally works.

Ed Birkin - Barclays Capital - Analyst

Okay, thanks. And then finally, I know it's only an update, but can you give any idea as to 2011 cost guidance? You've increased this year's by 1%, so following on next year we should be looking at nearer 4%/5% cost increases?

Ralph Topping

Well, we're going through our budget preparations at the minute and we're meeting with management teams, so it's a bit early for us to give that guidance I'm afraid.

Neil Cooper

We gave some guidance at the interim management statement about 2011 costs and, to be fair, we're not changing from that at the moment.

Ed Birkin

Okay, that was 3%, was it, from memory?

Neil Cooper

Plus. Yes, 3%, plus the impact of any estate growth that will drive through the cost base naturally.

Ed Birkin

Okay. All right, thanks very much.

Ralph Topping

Okay, Ed, cheers. Next?

Operator

Our next question is from Sanjeet Aujla from Credit Suisse.

Sanjeet Aujla

Hi, guys. A couple of questions from me. First of all, on the Online gaming net revenue, down 2%, are you able to X that out before France?

Neil Cooper

Yes, I think if you strip out the impact of France, we would have seen a modest Casino growth. I'd remind you, we commented that our Casino was down 9%. Excluding the impact of France from both sets of numbers, we would have seen a modest circa 2% growth in the quarter.

Sanjeet Aujla

Sure. I know machines are 16% gross win, was that consistent throughout the quarter on a monthly basis?

Ralph Topping

I've not got that figure in front of me, but you could -- it'll have a peak in it, and it'll have a -- it won't be consistently across the quarter, but it won't be far away from that 16% in terms of any deviation. So 16% is a good increase, and it isn't because of one phenomenal spike, if that's where you're coming from.

Sanjeet Aujla

Sure. Okay, thanks.

Ralph Topping

Cheers.

Operator

(Operator Instructions). We now have a question from Nigel Hicks from Liberum Capital.

Nigel Hicks

Afternoon, guys. I just wondered if you can talk through what Q4 was like last year in terms of results and margins and underlying? And then, if you can talk through maybe what you've got to face certainly the first quarter of next year in terms of how football results went margin-wise, or obviously there's the snow impact of January?

Ralph Topping

I can do the second part for you, Nigel. The first couple of months this year we lost about GBP24 million worth of turnover, from memory. January was worse than February. So with that to take into account, and if you look at I think again on football, this year the first three months of the year on football we were substantially behind 2009.

And from memory, I think it was about period one, a lot of fixtures canceled, but not bad results; we were still down on our gross wins by about 15%. Periods two and three were down roughly the same in percentage terms; around about 40%. So the first quarter of the year wasn't at all kind to us in football terms, but you do expect things to average out.

So maybe the Gods of football were bad to us in the first quarter, but they've smiled upon us in August and September. But everything comes back to an average at some point, and I think that's what you're seeing to an extent with the first quarter [and, secondly,] certainly the third quarter.

Nigel Hicks

And those Grand National and Ascot were adverse and Cheltenham was good?

Ralph Topping

We're about -- I think, again from memory, about Grand National week, I think we were down -- off about maybe GBP7 million or GBP8 million, but you may get those figures from Lindsay later on, on the previous year.

Nigel Hicks

And can I just -- everyone's obviously concerned about the consumer, and underlying trends, and what have you, there's so many moving parts here. But when you're seeing this rate of growth in machines, the consumer is obviously spending on machines, and that's maybe product led, but also -- well, I'm not quite sure what the other thing is, unless it's feeling reasonably happy to spend the money, and also Online, so a good chunk of your customer base is actually in reasonable health or improving; I don't know whether you can see any trends in that.

Ralph Topping

Well, I think -- I've always been a big fan of Retail in terms of what's happening in Retail. My consistent mantra for the last three years, you've got to remember, it's three years we've been through this, is that if I saw my slips or transactions falling off a cliff, I'd get really worried. But we've seen good growth in overall transactions right throughout this year.

And if you look to the year as a whole in terms of gross win performance, it knocked out the first two periods then because of the bad weather impact and we're seeing positives in overall gross wins in Retail right through three through nine. Neil will not like me for doing this, but if you normalize the Grand National in four, then you have seen that as a positive right through.

So, I agree with you; there's lots of positives in the business at this point. But there's no doubt about it, the working man is under a bit of pressure, and you're seeing that in pence per slip or pence per transaction. And of course, we don't know where that's going to go next year.

Neil Cooper

No, I would also just flag that clearly we've had the World Cup in June and July this year, which will be certainly above and beyond the normal year. Now there will be -- some of that will be substitution; that's a matter of judgment.

But actually, by far the bulk of the profit will be one-off, if you can refer to a one-off as something you get every four years. So we do need to take that into account when we're looking at underlying trends as well, which is one of the reasons why we've been keen to ensure that we continue to try and give you a sense for what underlying Retail OTC turnover looks like ex-World Cup.

Nigel Hicks

Okay. Can you just say what you're doing with marketing in Online? Are you stepping that up? Have you stepped that up? Will you step that up?

Neil Cooper

Well, the first thing to say is that I'd remind you of the comments that we made at the interim, which is that we were on TV for the first time this year.

Ralph Topping

Not you and I; it was William Hill were on TV.

Neil Cooper

I wonder what a sight that would be; no comments please, gentlemen. We were on TV earlier on in the year with both brand building and fairly specific call to action media for Online; that has continued and will continue in the second half. That obviously is predominantly around encouraging trial and usage for Online on TV.

You will have seen, if you watch Sky TV, our advertizing, or ITV Champions League, you'll see our advertizing, talking about the 100-plus in-play markets in the game that's on. And we think that's a pretty credible offer in in-play betting at the moment on a per match basis. We're going to look to continue to do that because, frankly, given our brand proposition and our brand strength in the UK, you could argue that we should be dominating online too. And I don't think anybody here would make that suggestion. And, therefore, we think we got people to aim at, and we think we've got a fair amount of room to still go, frankly.

Nigel Hicks

Okay, thank you.

Ralph Topping

Thank you.

Operator

Our next question is from James Hollins from Evolution.

James Hollins

Hi ya. Just three quick questions, following on from earlier questions, actually. The first one on marketing, is that mainly Sportsbook focused? Or have you focused on Poker and, hence, is that behind the uplift in Poker, I think it's plus 6%, which I think is probably better than expected?

The second one; following on to I think it was Ed's question in terms of the Online margin, would you expect the in-play margin to actually improve from where it is? I think you said around about 5%, would you expect that structurally to improve as you get better at it?

And the third one was on machines. You said on the 16% obviously it varies month by month; in October, would you expect it to be up something like 16% as well?

Ralph Topping

Okay, I'll deal with the first two, I think. The Sportsbook, yes, that's where most of the marketing has gone, but we haven't ignored other products. Done a fair bit on Bingo, for instance, this year.

And on Poker, we've been really working our Poker base and we've seen -- well, I suppose you could call it a CRM regarding the Poker base has been excellent for us. So we've put a lot of work into Poker, and we see maybe growing that and bucking a trend in the marketplace, but more details on that. Is it a blip; I don't think it is, but I won't be able to say that clearly until we see how we do this quarter and into the first quarter next year.

Online margin, it's nice of you say as we get better at doing what we're good at, which is actually being bookmakers. I think that's -- there's always hope for us that we can improve. Would I expect to see the Online margin tickle up; I think we have seen it grow this year. I think there's a wee bit more room for it, but it would only be, pardon the pun, at the margin, I think. It wouldn't be -- you wouldn't expect it to be around 5%.

And on the other question, the machines and growth in October, Neil's got an answer for that one.

Neil Cooper

Yes, I would just remind you that we will certainly have seen some pre-match margin benefit in Sportsbook from the run of exceptional results we've had with it, and it's also clearly benefited Retail in Q3. So there is a little bit of positive halo there, which you do need to think through as not necessarily being repeatable every quarter; we'd love it if it was.

In terms of machines, look, as we've clearly indicated, we're seeing growth in both Storm and in terms of the Global Draw Cabinets, but the Storm growth is very good. Now, eventually we will start rolling over the full completion of the Storm rollout, and then I would expect to see growth rates fall back a little bit.

It is probably early days, given that our launch started in August. So we're just starting now to get into a period where there's a meaningful comparison, and I would expect that rate of growth to dissipate. I think that's what analysts are expecting, and there's every reason to believe that'll be the case.

Ralph Topping

I think looking at if, if there are no disrupters to our business in the last eight weeks, I would expect to still see good growth in machines up until the turn of the year, whether or not it'll be at the 16% mark I think time alone will tell.

Neil Cooper

Okay, thanks.

Ralph Topping

Okay.

Operator

Our next question is from Tej Randhawa from Citi.

Tej Randhawa

Hi. Afternoon. It's Tej Randhawa from Citi. Just a couple of questions. Firstly, I just wanted to know whether a decision has been reached on the tax treatment of your Sheffield call center? I think when you announced that you were moving offshore your cost savings would be between GBP4 million to GBP7 million, and much of that would depend on how the tax is treated there; I just want to know whether there's been a decision there so far?

And the second question is just simply where do you expect your net new openings in Retail to be at the end of the year? And, I suppose similarly related to that, CapEx guidance as well.

Ralph Topping

Well, the very brief answer to the first part is, no.

Tej Randhawa

Right. Can I just ask, when do you expect a decision to be made? Didn't you say previously at the end of Q3; has that changed or --?

Neil Cooper

No, we are moving the business directionally at the end of Q3. In reality, we're obviously looking at a move time now some time in November just in terms of getting all our operational ducks in a row.

The specific aspects around tax is something that we need to progress in due course. We're not going to hurry at that one, we'll get it right. There is some dialog to have with the Revenue. I wouldn't want to get ahead of myself in commenting at it at this stage other than we intend to be conservative and not take undue tax risk; I think that should be clear.

Ralph Topping

I think the net new openings will be around 50. And I don't want to be any more specific than that because it depends on -- because it involves buildings, workmen, Christmas period, etc., etc., I can't be more specific than that but we'd expect around about 50.

Neil Cooper

We've opened about 32 so far this year and closed around 15, so we've got a net circa 20 openings. We do have a quite a bulge of openings to come. We guided, I think, on 70 gross adds, and at this stage our property colleagues keep assuring me those may be the case. Santa Claus might be busy this year, running around opening a whole bunch of William Hills in the last week of the year.

I think the one thing that is clear, and I should give you guidance on this, is that as a result of the timing of these now we're likely to spend a little less CapEx in the 2010 fiscal year. I think our previous guidance was 65; we're probably likely to be between 55 to 60 now, so just a little bit of a cash flow improvement. That will largely be timing, assuming we get to the number of openings that we anticipate.

Ralph Topping

At this time of the year, our builders are always optimistic. There's a long way to go, but we think we'll get to around about the plus 50.

Tej Randhawa

Okay. And just coming back to the telephone issue and the tax treatment there, do you expect a decision by the end of the year? It sounds like you're being quite cautious, and if you're not willing to give details should we just be assuming that lower end of cost savings, that GBP4 million?

Neil Cooper

I think for the time being I would assume the lower end until you hear otherwise. But we will update you as soon as we're in a position to do that, and certainly at the prelim reporting we'll come back and have a conversation with you.

Tej Randhawa

Okay. All right, thank you.

Ralph Topping

In the round, it's non-material.

Neil Cooper

[It's not] a big number.

Tej Randhawa

All right, okay. Cheers, thank you.

Ralph Topping

Cheers.

Operator

Our next question is from Roohi Siddiqui from Bank of America Merrill Lynch.

Roohi Siddiqui

Good afternoon, guys. I just had a question on the cost increase for the remainder of this year. Could you just run me through what's going on, and where that -- why we're seeing that increase?

Neil Cooper

Yes, fundamentally, it's just that if you make a hell of a lot more money you've got to pay people more bonus. So we've got to account for that bonus as we go through the rest of the year; that's the main driver, if I'm honest.

You should be, I think you are, to be fair, from conversations we've had, aware of the SIS cost increase. We have a pay increase rolling through now in October. Just to update everyone, we have made a decision to increase shop staff by 1% in October and then another 1% in March to give effectively a year over year 2% salary increase for shop staff next year. And we are holding the line at present on non-shop staff above a certain level outside of the administrative Group while we wait to see how next year pans out.

Roohi Siddiqui

Okay. And so the 1%, is that on a full year basis?

Neil Cooper

Well, yes, I'm disclosing to you full year guidance. It will push up a bit. Look, I wouldn't -- is it 1.0% or 0.9%; I'm just giving you the directional view that we're likely to see our year-over-year cost guidance push up a bit. But it is -- needs to be taken in with the wider profit guidance that we've been disclosing today.

Roohi Siddiqui

Absolutely. Thank you.

Operator

There are no further questions at this time. (Operator Instructions). We have Ed Birkin back on line with a question, from Barclays Capital.

Ed Birkin

Just one follow-up. For your marketing spend, is that all going through the Online business?

Ralph Topping

Generally speaking, yes.

Ed Birkin

Okay. All right, thanks.

Nigel Hicks

Sorry, yes, there is an allocation into Retail.

Ralph Topping; The bulk of it's in --

Neil Cooper

As well because obviously it will have a -- advertizing the William Hill brand name on UK TV will have saliency for Retail consumers as well.

Ed Birkin

But you're largely putting it through the Online stuff, which Playtech are taking a share of the cost on, am I right?

Neil Cooper

Yes.

Ed Birkin

Okay. Okay, thanks.

Ralph Topping

All right. If there's no more questions --

Operator

We have no further questions.

Ralph Topping

I think we'll call it as the end of the call at a minute, if you don't mind. Thank you very much for joining us, and see you next time. And Lyndsay and Neil will be available during the rest of the day should you want to come back and ask any more questions. Thank you very much.

Operator

Thank you, ladies and gentlemen. This concludes today's conferencing. Thank you for participating. You may now disconnect.