

CryptoLogic, Inc.
2002 4th Quarter & Year End Conference Call
February 11, 2003

Operator: Good morning ladies and gentlemen. Welcome to the CryptoLogic 2002 fourth quarter and year-end results conference call. I would now like to turn the meeting over to Mr. Lewis Rose, Interim President and Chief Executive Officer. Please go ahead Mr. Rose.

Lewis Rose: Good morning everybody. Welcome to CryptoLogic's 2002 fourth quarter and year-end financial results conference call from an exceptionally cold Toronto ... on a day when everybody should be at home playing online casino games. My name is Lewis Rose and I am Interim President and CEO of CryptoLogic. With me today is Jim Ryan, our Chief Financial Officer and Nancy Chan-Palmateer, our Director of Communications.

This is the third conference call I have hosted since joining CryptoLogic in July 2002 as Interim President and CEO. In our previous two calls, we spoke of CryptoLogic's fundamental strengths as well as the sizeable challenges to our 2002 financial performance.

During the past six months, I carefully reviewed CryptoLogic's business and operations. CryptoLogic's business remains sound and continues to have significant potential. We have a solid business model and one of the strongest balance sheets in the business.

We lead the industry in promoting safe, secure and responsible Internet gaming in markets around the world. And we provide our customers with among the most comprehensive, reliable and advanced suites of products in the industry today.

In reaching this conclusion, I identified three strategic imperatives for this Company which we've already begun to act upon.

The first imperative is to ensure sustainability of our key sources of revenue and to maximize profitability. In my view, the near-term future of Internet gaming is outside of North America. To this end, we are focused on top-tier customers in international markets like Europe and Asia, successful, reputable gaming brands that are looking to leverage their brand equity on the Internet.

I have visited our key customers in Europe on four occasions since joining CryptoLogic to identify and respond to their concerns, and to continue to develop opportunities for growth from existing and new games.

Looking at our new European customers, the early results from Littlewoods - whose well recognized sports pools and lotteries are enjoyed by over two million players each week - and The Ritz Club London, one of the most elegant and sophisticated names in UK gaming, continue to be encouraging. This validates CryptoLogic's ongoing focus on international, brand name gaming organizations. These two customers are our fastest growing revenue contributors since their launch in September 2002, and have contributed to the fact that by December 2002, overall licensees' revenue derived from international markets increased to approximately 45% up from 40% in Q3.

Our second objective is to lead the way in regulatory compliance. I will ensure that our business operates with the highest standards of integrity under the scrutiny of the most exacting regulation. I firmly believe that the key to the Internet gaming industry succeeding is to embrace regulation --- to bring the industry into the sunlight. I am pleased that in Q3 of 2002 we achieved certification of our gaming software in the Isle of Man and we are now actively seeking certification in Alderney this year.

Regulatory compliance is no small task. It requires the commitment of substantial time, resources and millions of dollars. But it's critical to our strategy. These rigorous standards are comparable to the tough requirements in the land-based gaming world and provide CryptoLogic with significant competitive advantage.

The third objective is to build on our suite of products. To develop a broader range of products across the gaming spectrum that allows our licensee customers to enter new revenue generating markets and drive organic growth. To this end, we have delivered exciting new games such as bingo and poker.

For example, our multi-player poker game creates a critical mass of players where different WagerLogic licensees feed into a single poker room. This liquidity is key to building a large and successful poker community which ensures that players can always find a game at the stake they want.

Players can also bet in their currency of choice - US dollars, British pounds sterling and euros. It's all at the same table, and it's all seamless.

CryptoLogic poker is more than exciting and unique technology, it's also about making money for our licensees. Our central poker room is gaining solid momentum and it's on track to be a meaningful source of new income for our licensees and for CryptoLogic. This site is already ranked among the top ten poker rooms on the World Wide Web.

Indeed, bingo and poker are expected to grow from under 1% of total CryptoLogic's revenues in 2002 to over 10% by the end of 2003. As well, the integration of all CryptoLogic products means that players can play casino

games, bingo and poker using a single ECash account. That's a decisive advantage for our customers, for their players and for us.

In a year that was one of the most challenging in our Company's history, CryptoLogic continues to make money and generate cash. As a regulated Internet gaming company with a strong roster of blue chip international customers and a new leadership team, our prospects remain strong.

I'm pleased with the advancements made in the past six months, which saw 2002 close on a positive note. We added to our balance sheet strength and met expectations. Both our base business and our new products and customers showed encouraging progress in the fourth quarter and we are determined to make our operations as efficient as possible. To this end, we have eliminated certain positions and reduced our headcount by 8%. We have made certain key hires, implemented measurements and targets, emphasized customer responsiveness, and adjusted the compensation model of certain senior employees to be more closely linked to corporate performance. And we have started to see results. This puts us on solid ground as we now enter 2003 with positive momentum.

While everybody agrees that online gaming is growing, opinions are divided about how governments should respond. In Europe, the prevailing attitude is "regulate it, and then prosper from it". In the United States, the two predominant views are licensing and regulation versus prohibition. 2003 marks the start of a new Congressional term and we expect further proposals from both sides of the Internet gaming debate. Until the issue is definitively resolved, growth prospects will be tempered in North America for the short term.

Against this background, our investment in broadening the range of payment options for our licensees' players remains a tough priority. And it's paying off. We've integrated six new cash-funded payment methods in 2002 and more will follow throughout the year.

Our 2003 strategy turns the challenges of this maturing marketplace into opportunities to strengthen our leadership worldwide. We will emphasize international expansion with brand name customers. We will extend our regulatory leadership. We will capitalize on new consumer-driven products and leverage opportunities for organic growth. We will also consider selective acquisitions to advance growth. With US\$3.61 per share in cash, we will use our balance sheet strength to capitalize on our industry's potential now and in the years ahead, particularly as we see increasing consolidation.

And we have the talented people to do it. CryptoLogic's new management team has instilled a new corporate culture of discipline, accountability, and a re-energized commitment to long-term growth.

Jim Ryan, our Chief Financial Officer will now speak specifically to our financial results and performance.

Jim Ryan: Good morning. It's my pleasure today to present our fourth quarter and fiscal 2002 financial results. My presentation will consist of a commentary on the main components of our income statement and key financial indicators. As a reminder, all figures are in US dollars.

Details on the company's revenue performance is as follows. Fourth quarter revenue of \$8.9 million was ahead of analyst estimates and in line with our published guidance. For fiscal 2002, revenue was \$34.4 million compared to \$43.5 million in the prior year. Lower year-over-year revenue reflects the challenges in the US market being faced by the entire Internet gaming industry.

CryptoLogic continues to experience positive momentum towards its objective of increasing our international revenue base. On a run rate basis, revenues generated by our licensees from international players was approximately 45%, up from approximately 30% in fiscal 2001.

The company continues to focus on enabling its licensees to add non-credit card based payment solutions. We are committed to providing the broadest possible range of payment alternatives and have implemented six new payment options in the last half of 2002. We will continue to treat payment solutions as top priority and will introduce a number of new solutions in 2003.

Software development and support costs include all personnel, licensee support, customer service and compliance related expenditures. These costs declined by 12% to \$19.4 million for 2002. Software development projects included in these costs are the development of our new Java, bingo and poker games as well as the ongoing development of our core technology. It is important to note that we expense 100% of software development costs as incurred.

General and administration expenses were \$5.9 million for fiscal 2002 as compared to \$3.8 million in the previous year. The primary factors contributing to this increase relate to business development efforts as the company pursues international licensee opportunities, infrastructure costs associated with the establishment of UK-based operations, legal costs associated with regulatory compliance and expenses associated with defending various legal actions.

The company posted a fourth quarter net income of \$2.2 million or \$0.18 per diluted share. The performance for the quarter was in line with management's guidance and ahead of analyst estimates. For fiscal 2002, net income before non-recurring items was \$7.7 million or \$0.60 per diluted share compared with \$18.1 million or \$1.21 diluted earnings per share for fiscal 2001. Including the one-time \$9.9 million special charge which was net of tax taken in the second quarter, the net loss for fiscal 2002 was \$2.1 million or \$0.17 per diluted share.

The primary reason for the profit decline excluding the impact of the special charge relates to the revenue challenges associated with the US market and the reduction of interest revenue.

Given the current business environment, our near term focus will remain squarely on the implementation and execution of existing initiatives. While profitability will continue, we are keeping a close eye on costs with a view to ensuring our expenditures are producing an appropriate return.

During fiscal 2002, we have reduced headcount, completed the consolidation of our customer support organization to the United Kingdom, implemented a headcount freeze and capital asset freeze and we continue to explore additional cost saving opportunities and efficiency programs.

During our fourth quarter and on a year-to-date basis, the company has generated \$3.5 million and \$10.0 million of cash from operations respectively. Our cash and cash equivalents position as at December 31st, 2002 is \$44.1 million. The company has no debt and expects foreseeable cash needs to be funded through existing cash resources and operating cash-flow. I will now turn the call back to Lewis.

Lewis Rose: Thanks Jim. We are now pleased to open the call to any questions you may have.

Operator: Thank you very much Mr. Rose. Thank you Mr. Ryan. We will now take questions from the telephone lines. If you have a question, please press one on your telephone keypad. If you are using a speaker phone, please lift the handset and then press one. If at any time you wish to cancel your question, please press the pound sign. Please press one at this time if you have a question. Our first question will come from Mr. Scott Preston from Research Capital. Please go ahead sir.

Scott Preston: Good morning and congratulations. What percentage of the revenues came from the land-based casinos such as Ritz, Littlewoods?

Jim Ryan: Scott, with regards to individual licensees revenues, we're not at liberty to disclose that related to confidentiality provisions in each of our license agreements.

Scott Preston: On an overall basis, can you give us the number for the land-based casino percentage of revenue?

Lewis Rose: Scott, what we can do is get that information and give it to you later today. We don't have that information handy right at this moment.

Scott Preston: The other question I wanted to touch on, as far as going forward, the weakness in your business, that's solely coming from North America. Would you expect the European business to be up quarter to quarter or where is that expected to come in versus the total?

Lewis Rose: We are showing exceptional growth in Europe both from existing customers and from new licensees and we continue to be excited about the prospects of our European opportunities. You're correct in saying that the prospects resulting from our licensees' players business in North America has short term challenges. So we do expect the growth to continue in Europe quarter-over-quarter and year-over-year.

Scott Preston: Okay, excellent. And then as far as acquisitions, what areas are you currently focusing on?

Lewis Rose: Well, if we were to make any acquisitions, we would leverage our existing strengths. We have three core strengths internally, obviously gaming software, our ECash business and operation and then also our customer management and data processing business. So our first choice would be to leverage one of those three areas.

To ensure that we had some competitive advantage as a result of the acquisition, opportunities may actually be in an alternative distribution channel. Internally we are working on opportunities in the wireless area for example and a logical extension of the casino gaming versus from the Internet. At this point the marketplace is on to wireless devices and also interactive TV.

So on the one hand we may actually consolidate our business by developing and growing our core operations. On the other hand we're also looking at incremental and alternative distribution channels. But it's safe to say there's nothing that is pending today. We're obviously looking at a number of different alternatives. We're absolutely committed and focused on building and strengthening our core business first.

Scott Preston: Okay excellent and last question, what's the goal this year for new licensees?

Lewis Rose: We've said in the past that we anticipate as an objective, four new licensees each year. We've seen the market fragment and what we're finding is that many of the strong land-based customers are looking, not necessarily for a complete range of product offerings as we are fortunate enough to be able to offer, for example casino, bingo and poker. But we are seeing some land-based and indeed some Internet-based brands looking for specific niches. For example, poker offering only or a bingo offering only. And so while our traditional model has been to look at growth of four licensees per annum, what we may find going forward is that they may not constitute a full

range of product offerings but it may be specialist offerings for specific customers.

Scott Preston: Okay, thanks a lot guys.

Operator: Thank you very much Mr. Preston. Once again if you do have a question, please press one at this time. Our next question will come from David Shore from Desjardins Securities. Please go ahead sir.

David Shore: Thanks. Good morning and congratulations on a good quarter. Jim, some financial questions first. Tax rate in the quarter is a little lower than I was looking for. Can you talk about that?

Jim Ryan: Again, our tax rate is dependent upon the jurisdiction where the income is earned. In our fourth quarter, we certainly saw a portion of our income being earned in foreign markets and hence a lower tax rate.

David Shore: Okay, so as a target for next year, what kind of rate should we be modeling?

Jim Ryan: I think if you went with a 9 to 10% rate that would be appropriate.

David Shore: Okay, operating expenses for the quarter, G&A was down a little bit as a percentage but your R&D was down as a percent of revenue pretty significantly. Are you looking for those kind of rates to go forward?

Jim Ryan: Certainly in terms of software development and support costs, we anticipate operating in the same range. We're hopeful that we will be able to manage our G&A costs downward in the coming year. The intention is to redirect expense savings into marketing efforts and revenue generating efforts with regards to the European and UK-based sales and marketing focus.

David Shore: Okay, and as far as capital expenditure plans for the year?

Jim Ryan: \$1.1 million.

David Shore: Okay. And accounts payable in the quarter was up again sequentially.

Jim Ryan: We saw two primary factors affecting payables. First and foremost there is a component of our special charge that still resides in our accounts payable. That's approximately \$2 million and then payables are

affected by the timing of our licensee payments. At December 31st, we had a larger component of licensee payments sitting in our accounts payable balance.

David Shore: Lewis, can you talk about the competitive front, a little bit more about what you're seeing people are doing as far as product offerings or alternative cash payment, things like that versus what you guys are doing?

Lewis Rose: The competitive environment continues to be intense. We continue to develop and implement new product solutions for customers both in terms of new games and in terms of payment offerings. Poker for example which we've spoken about at length is a significant advantage to us because it's a multi-player game, it's offered in multi currencies and it's in a central poker room environment so it encourages critical mass. Liquidity is a key success factor in an online poker room offering. Our bingo product is being updated and our cash payment alternatives have now been broadened to allow our licensee players to play using the broadest available options. So we believe that by continuing to enhance our product suite and our new games that we will be able to continue to lead in this area. In terms of the revenue, the revenue is split at a scalable rate structure. That continues to be competitive too. What we have done is moved to a volume-based structure which rewards our customers for incremental volume. So as we encourage them to improve their profitability, they will be rewarded by having lower royalty rates.

David Shore: Okay and just finally as far as talking to the large Vegas casinos and Atlantic City casinos and deals with them going forward. Any update on that?

Lewis Rose: Well, we continue to work towards establishing relationships. We in Toronto recently engaged a Vice President of Business Development, a gentleman by the name of A.J. Slivinski who has tremendous experience in both sales and marketing and one of his roles is to ensure that we continue to develop relationships in Las Vegas and Nevada specifically. In the short term, we're not optimistic about the opportunities. However, having said that, if the United States were to regulate the online gaming business, the opportunities would be huge and we want to ensure that we are there. One of our most significant competitive advantages as we speak to US land-based casinos, as we do on an ongoing basis, is the fact that we are one of the few gaming software companies in the world that has our gaming software certified to the high standards of the Isle of Man, which is similar to the land-based gaming standards. And so to the extent that the US market does eventually regulate the online gaming business, we obviously will be ready, willing and able to accommodate the land-based casinos.

David Shore: Okay, thank you.

Operator: Thank you very much Mr. Shore. Once again if you do have a question, please press one at this time. And at this time Mr. Rose there are no further questions registered. I would now like to turn the meeting back over to you.

Lewis Rose: Thank you. Internet gaming is a vast international market that is here to stay. It continues to grow regardless of efforts to curb its development. The worldwide online gaming industry was \$3.5 billion last year up from \$2.5 billion. The market size is respectable but only a mere 1½% of the total global revenue generated from land-based gaming. Advancements on the regulatory front will create a credible marketplace. This is encouraging land-based, brand name organizations to move online. CryptoLogic is well positioned to own a larger share of the broad, leisure and entertainment market emerging on the Internet working closely with the biggest and the most profitable names in the business.

I am confident that our professional and committed management team will deliver superior, long-term returns to shareholders. We continue to achieve positive results in a difficult market. We will continue to position ourselves as the front-runner in an industry with many newcomers, but few survivors.

It's about leadership, it's about innovation, it's about integrity. Most importantly, it's about performance. We're off to a good start. We will execute our strategy and as market conditions improve, we will deliver the performance expected of a market leader in one of the fastest growing industries in the world.

I look forward to sharing our progress with you at our next quarterly conference call. Thank you.