

ACTTAB

Future Options Feasibility Study

July 2013



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Glossary

ACT	Australian Capital Territory
Associate	As defined in the Corporations Act 2001 (Cth)
ASX	Australian Stock Exchange
ATO	Australian Tax Office
AUD	Australian Dollar
Business	The business of ACTTAB Limited
c.	Circa, approximately
CAGR	Compound Annual Growth Rate
Capex	Capital Expenditure
EBIT	Earnings Before Interest and Tax
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortisation
EUR	Euro
Federal Government	The government of the Commonwealth of Australia
FTE	Full Time Equivalent
FTSE	Financial Times and the London Stock Exchange
FY	Financial Year
FY11	Financial year ended 30 June 2011
FY12	Financial year ended 30 June 2012
FY13	Financial year ending 30 June 2013
FY14	Financial year ending 30 June 2014
GOE	Government Owned Enterprise
JV	Joint Venture
KPI	Key Performance Indicator
LTM	Last Twelve Months
Management	Management of ACTTAB Limited
MSA	Management Services Agreement
NSW	New South Wales, Australia
NT	Northern Territory, Australia
PMU	Pari Mutuel Urbain
PPE	Property, Plant & Equipment
PwC	PricewaterhouseCoopers Securities Limited
QLD	Queensland, Australia
Racing Industry	The Canberra Racing Club, The Canberra Harness Racing Club, The Canberra Greyhound Racing Club
SA	South Australia, Australia
TAB	State totalisator agency board
Tabcorp	Tabcorp Group Limited
TAS	Tasmania, Australia
Tatts	Tatts Group Limited
Territory	The Government of the Australian Capital Territory

UK	United Kingdom
USU	United Services Union
VIC	Victoria, Australia
WA	Western Australia, Australia
\$	Australian dollars unless otherwise stated

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¹ Part of this section has been redacted for commercial in confidence purposes.

² This section has been redacted for commercial in confidence purposes.

1 Executive Summary

1.1 Terms of Reference

Pricewaterhousecoopers Securities Ltd (“PwC”) has been retained by the ACT Government (“Territory”) in response to RFT No 18504.110. The terms of reference are summarised below.

1. The ACTTAB Future Options Feasibility Study Report (“the Report”) will provide a balanced analysis of the risks and opportunities with respect to the Territory’s ownership of ACTTAB.
2. In order to gauge the approach which maximises and protects the Territory’s longer term interest the feasibility study is required to evaluate a range of alternatives including each of the following:
 - maintain the status quo;
 - forming a joint venture with a suitable private sector organisation;
 - retaining Government ownership and contracting out the management of ACTTAB; and
 - a trade sale.
3. The Report is required to provide advice about:
 - market appetite for a trade sale or alternative divestment or change in future arrangements;
 - a preliminary indication of the potential value of ACTTAB (retention value and sale value) under particular scenarios;
 - identification of racing industry issues and preliminary advice on how these can be addressed;
 - identification and assessment of issues to be addressed on divestment;
 - a preliminary assessment of any related transaction fees under the identified alternatives; and
 - identification of the contribution ACTTAB makes to the local community.

1.2 Key Conclusions & Recommendations

The ACT wagering market is under threat from interstate wagering operators. Consequently, ACTTAB’s financial performance is in a state of decline, with Management forecasting a 3.6% compound annual decrease in EBITDA (pre government fees) over the next four years. As a result the value of ACTTAB to the Territory is also in decline.

It is PwC’s view that a strategic trade buyer will attribute relatively more value than the status quo value. The Trade Sale Value of ACTTAB is higher than the Retention Value because of synergies and other operational improvements a strategic trade buyer may generate from integrating ACTTAB into their business.

PwC’s key recommendations are as follows:

- The ACT Government should not retain ownership of ACTTAB; and
- A trade sale of 100% of ACTTAB is the preferred method of sale.

1.3 Discussion of Key Recommendations

The rationale for PwC recommending that ACTTAB be sold by way of a trade sale is as follows:

The industry is rapidly changing and ACTTAB's relative market position is in decline

- Australia has one of the strongest and most active wagering markets in the world. The national wagering market has grown at a CAGR of 4.7% in the 15 years to FY10.
- In the period FY03 to FY10 the ACT share of the national wagering market has decreased from 5.0% to 1.2%. During the same period the ACT share of the national gambling market decreased from 2.3% to 1.6%.
- In recent years numerous large international wagering operators have entered the Australian market driving innovation, an increased product offering, easier access to wagering and therefore creating a strong competitive landscape. There has been a leakage of ACT residents from ACTTAB to the online bookmakers.

ACTTAB's commercial focus is constrained

- ACTTAB's ownership structure limits its ability to operate in a profit maximising manner.
- ACTTAB's relatively inferior market position constrains its ability to attract industry leading management resources.

ACTTAB's financial performance is in decline

- ACTTAB's EBITDA (pre Government fees) has declined c.10-18% each year over the period FY10 to FY13B.
- FY13 EBITDA (pre Government fees) is forecast to reduce a further 13.6%.
- The decline has been driven by decreasing turnover and a relatively fixed cost base.
- ACTTAB will need to spend significant catch up and ongoing capex to improve their technology and product innovation.

The risk profile of the Territory's investment is increasing

- ACTTAB is one of only two remaining state owned and operated totalisator operators in Australia. The emergence of international on line operators and continued consolidation of the Australian wagering market is increasing the pressure on ACTTAB to remain competitive.
- ACTTAB is not well positioned within its market to be able to provide stable returns to its shareholder. If ACTTAB's financial results continue to decline so will the returns to the shareholder.
- As the national wagering market continues to develop it is likely that ACTTAB's shareholder will need to continue to invest in ACTTAB to keep the business viable and relevant within the competitive landscape. In this competitive environment it is likely that any incremental investment in the business by the shareholder will provide relatively low investment returns.
- ACTTAB's annual capex investment has been low relative to other industry participants. Over the last three years ACTTAB

The potential funding gap is material

ACTTAB's value is reducing

The trade sale option has relative merit

A sale creates issues to be managed

expended \$5.5 million to maintain its relative competitive position, reflecting an average ratio of 7.0% of wagering revenue. For the same period Tabcorp's capital expenditure averaged 16% of wagering revenue.

- Despite ACTTAB's investment in capital expenditure over the period from FY08 to FY12 the business lacks the size and scale to be able to translate this investment into revenue growth at a comparable rate to the other industry participants.
- The Territory provides a majority of the ACT racing industry funding. The current funding regime commenced in FY12 (\$7.5 million), as a fixed amount paid from the ACT Government budget and is indexed for inflation each year.
- There is an estimated shortfall of ACTTAB payments to the Territory and funding to be paid to the racing industry totalling \$24.1 million over the next five years, at an average of \$4.8 million per year.
- Given ACTTAB's relatively weak market position and deteriorating financial outlook it is difficult to define a reasonable scenario whereby its valuation increases over time.
- The trade sale option provides the best approach to realise value due to the following reasons:
 - Valuation will be maximised, particularly if the purchaser is able to realise synergies.
 - There is a relatively larger universe of potential purchasers for this option.
 - Complete risk transfer.
 - The business will have access to a larger pool of resources which should benefit services to punters.
- The Territory will no longer be able to exert shareholder control over ACTTAB, however the Government will still be able to regulate ACTTAB through the ACT Gambling and Racing Commission.
- Depending on the business plan to be adopted for ACTTAB by the new owner, there may be a loss of some or all of the community funding and sponsorships that ACTTAB currently provides. This risk could potentially be mitigated through mandating community service obligations on the purchaser in the transaction documents.
- The racing industry will need clarity of the ongoing funding models. A sale process could potentially incorporate a structure that links industry funding to the financial performance of the operator.
- Depending on the business plan to be adopted for ACTTAB by the new owner, there may be a reduction in the number of existing employees. If the Territory decides to adopt the Trade Sale approach then consideration should be given to including into the transaction documents a government objective and/or

tender evaluation criteria that evaluates the extent to which tender participants treat ACTTAB employees in a fair and equitable manner.

- A sale process could take 6 to 12 months to complete. During this period the ACTTAB business will be disrupted by the sale process requirements.

1.4 Indicative value range²

² This section has been redacted for commercial in confidence purposes.

2 Market Overview

2.1 The Australian Gambling market

The total gambling market in Australia consists of all gaming (including casinos, electronic gaming machines and lotteries), racing and sports wagering expenditure across the nation. For the 2009-10 year total gambling turnover equated to \$160.4 billion³. The concentration within each state as well as the composition by gambling sub sector is shown below.

Figure 1 – National gambling turnover (\$billion) and market share (%) by state and territory 2009-10

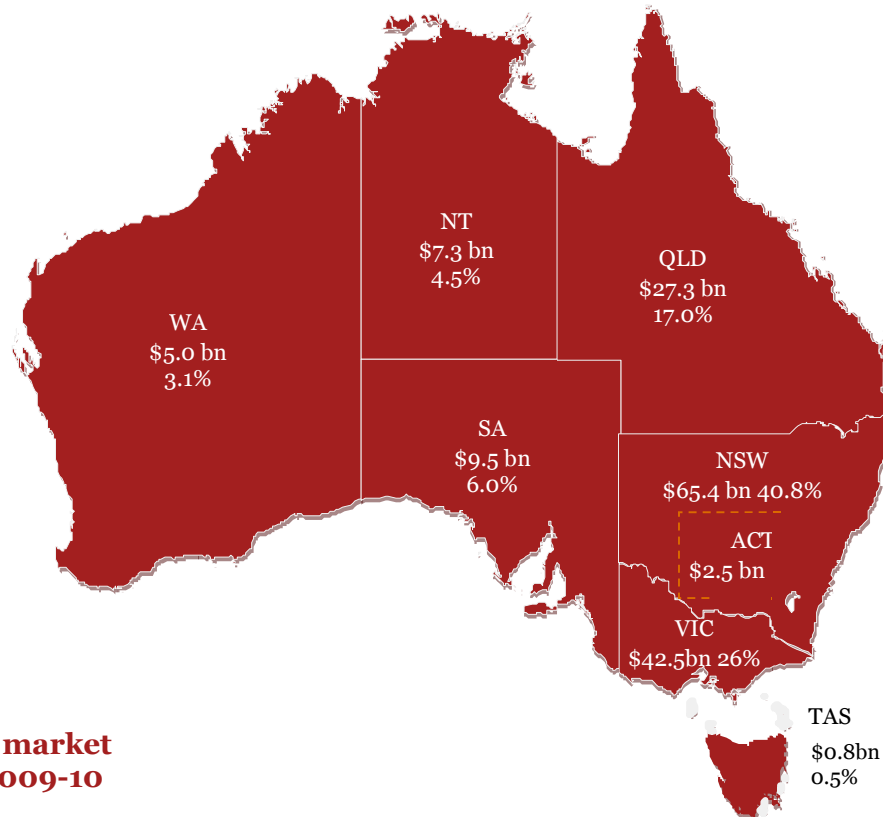
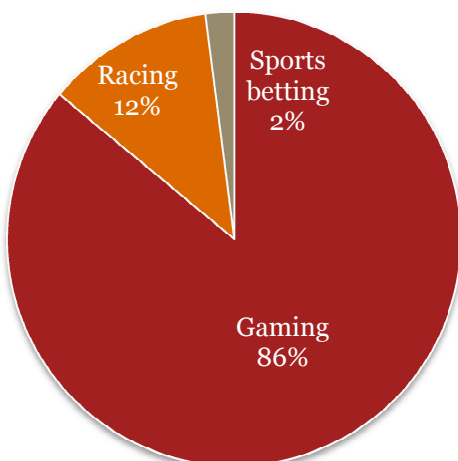


Figure 2 - Gambling market segments 2009-10



Source: Australian Gambling Statistics, 28th edition, December 2012

Gaming comprises the majority of gambling in Australia and primarily comprises electronic gaming machines, casinos and lotteries.

The Australian wagering market includes all racing (thoroughbreds, harness and greyhounds) as well as sports events. Other forms of wagering exist, such as wagering on outcomes of elections or reality television shows. Sports betting is a relatively new form of wagering that has been in operation in Australia for c.15 years and has been the fastest growing segment with a compound annual growth rate (CAGR) of 26% p.a. over the 15 years to 2010.⁴

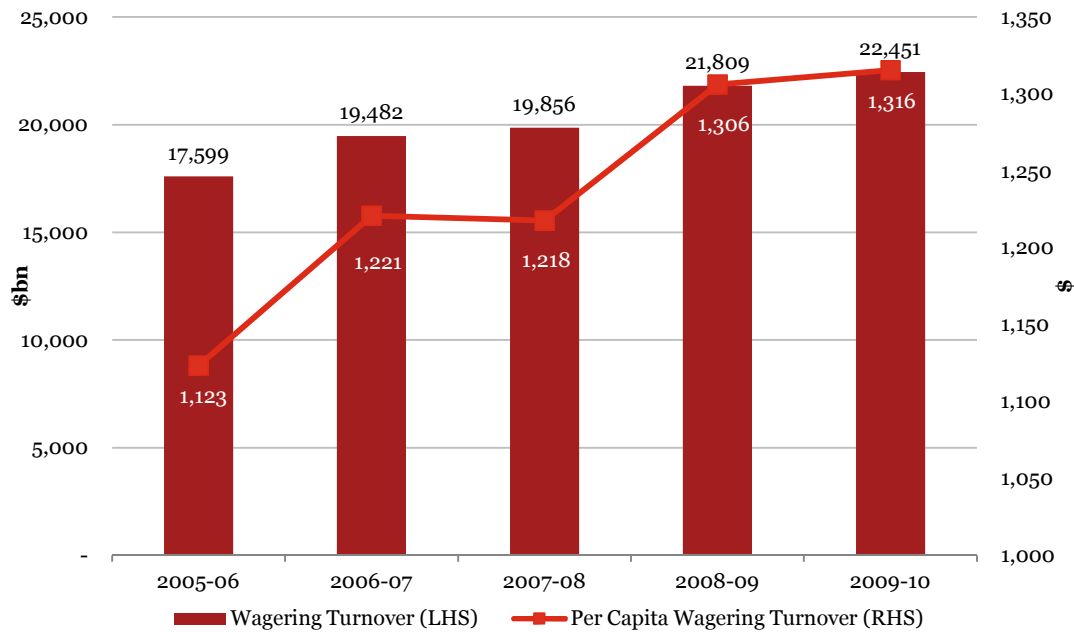
Source: Australian Gambling Statistics, 28th edition, December 2012

³ Australian Gambling statistics, 1984 to 2009-10, 28th edition

⁴ Australian Gambling statistics, 1984 to 2009-10, 28th edition

Racing and sports betting combined accounted for 14% of total gambling expenditure in 2009-10 and over the period from 1984-85 to 2009-10 grew at a CAGR of 4.7% p.a. to \$22.5 billion⁵. The chart below presents the consistent growth in both total wagering turnover and per capita wagering turnover across Australia. This growth in wagering can be attributed to increased accessibility to wagering operators through technological advances, the growth in fixed odds sports betting and a more diverse racing and sports betting product offering.

Figure 3 - National total and per capita wagering turnover 2009-10



Source: Australian Gambling Statistics, 28th edition, December 2012

2.2 The Australian wagering market

Racing totalisator wagering is where punters purchase ‘units’ in an increasing pool for a specified event and receive winnings in proportion to the units wagered, less deductions for costs, fees and taxes. The odds constantly vary as a result of changes to the pool up to the completion of the event. The dividend paid to punters is legislated by the regulator in each state or territory.

Fixed odds betting is where a punter receives the odds quoted at the time the wager was placed, regardless of any subsequent change in odds.

The following table provides a breakdown of the Australian wagering market by channel.

⁵ Australian Gambling statistics, 1984 to 2009-10, 28th edition

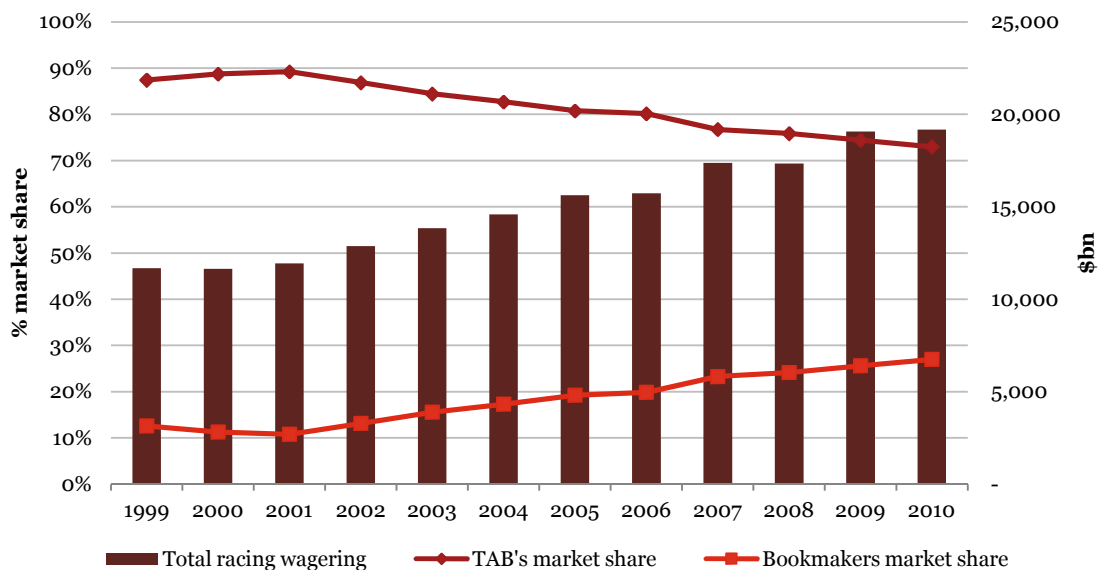
Table 1 - National wagering turnover by channel

\$ millions	2009-10			2010-11		
	Racing	Sports	Total	Racing	Sports	Total
TAB						
Tab on course	1,230	n/a	1,230	1,170	n/a	1,170
Retail	9,231	932	10,163	8,717	1,009	9,726
Phone	1,265	143	1,408	1,069	167	1,235
Internet	2,210	398	2,608	2,674	468	3,143
fixed odds)	13,936	1,473	15,409	13,630	1,644	15,274
Fixed odds (racing)	615	-	615	1,299	-	1,299
Total TAB	14,551	1,473	16,024	14,929	1,644	16,573
Bookmaker						
Face to face	648	1	649	597	13	610
Phone	2,055	577	2,632	1,757	578	2,334
Internet	2,829	856	3,685	2,864	1,082	3,946
Total bookmakers	5,532	1,434	6,966	5,218	1,673	6,890
Total wagering	20,083	2,907	22,990	20,147	3,317	23,464

Source: Australian Racing Board Fact Book 2010 and 2011

Australia has one of the strongest and most active wagering markets in the world and has the highest number of horse races on a weekly basis in the world. Wagering services are provided by the state totalisators (TAB's), online corporate bookmakers and Betfair (Australia's only online betting exchange). By 2011 corporate bookmakers had grown to a 29% share of the market while the TAB's accounted for the remaining 71%, down from 90% in 1999.⁶

Figure 4 - Share of Australian racing wagering market



Source: Australian gambling statistics, 1984 to 2009-10, 28th edition

Note: We have not included sports in the above figure as the data is not available historically on a consistent basis, however, when we compared the split for sports in recent years the trend was not materially different to racing.

⁶ Australian Racing Board Factbook 2010-11

The Australian wagering market has changed significantly over the past ten years primarily driven by the following market trends.

1. Retail wagering

Wagering has historically been conducted through the retail networks of state/territory run totalisators and included on-course, in retail shops and over the phone wagering. In recent years online wagering has become a significant distribution channel. There are two major state based exclusive retail wagering operators in Australia, Tabcorp (New South Wales and Victoria) and Tatts Group (Queensland, South Australia, Northern Territory and Tasmania). There are also two state owned retail operators, ACTTAB and the Western Australian TAB that pool their turnover with Tabcorp's SuperTab pool.

2. Online Wagering

Over the last 10 years the emergence of online wagering has been a significant driver of market growth and now a large proportion of total wagering is conducted online through the state based TAB's and online corporate bookmakers.

The majority of online growth has been driven by Northern Territory based corporate bookmakers (accounting for 23.8% of the national market in 2009-10⁷) who only operate online and benefit from the freedom to advertise nationally. The emergence of the corporate bookmakers in the Northern Territory has been primarily at the expense of all other state and territory TAB's who over the period 2002-03 to 2009-10 have either lost market share or only held market share⁵. The Northern territory has attracted the corporate bookmakers to their favourable tax regime whereby only a flat fee of \$250,000 is charged in tax per year and there is no requirement for the corporate bookmakers to fund the industry outside of the race field's fees which are levied on all wagering operators in Australia.

3. Fixed Odds Sports Betting

Fixed odds sports betting, which became legal in Australia in 1994-95, is the fastest growing segment of the wagering industry. The table below shows sports betting turnover by state and the CAGR for each state's sports betting turnover from 1994-95 to 2009-10.

Table 2 - Sports betting turnover growth 1994-95 to 2009-10

State	Turnover 2009 10 A\$ millions	% of total	CAGR
NT	\$1,275	39%	23%
NSW	\$760	23%	26%
VIC	\$738	22%	26%
WA	\$170	5%	30%
QLD	\$150	5%	30%
ACT ⁽¹⁾	\$104	3%	15%
SA	\$52	2%	20%
TAS	\$34	1%	50%
Total	\$3,282	100%	26%

(1) ACT growth in fixed odds sports betting is the lowest across all states and territories

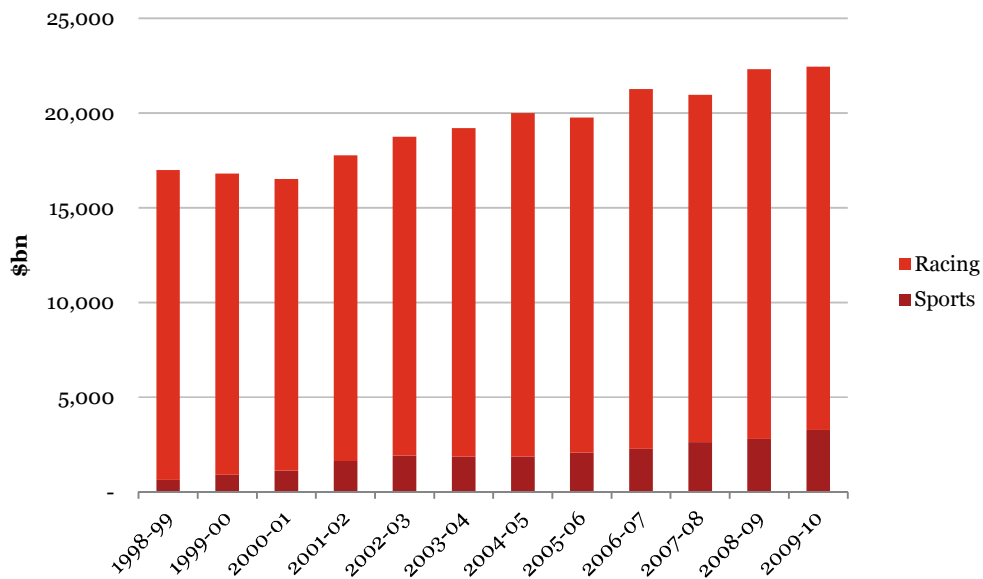
Source: Australian Gambling Statistics, 28th edition, December 2012

⁷ Australian Gambling statistics, 1984 to 2009-10, 28th edition

The table above demonstrates the growth in fixed odds sports betting across all Australian states and territories generating between 15% and 50% annual growth over the 15 year period. This growth has been driven by the high number of sporting events in Australia and its attractiveness to punters who do not have an interest in racing.

Despite the strong growth fixed odds sports betting has achieved over the past 15 years, as at 2009-10 it only represented 15% of the total wagering market⁸, considerably less than other developed overseas wagering markets. As a result, strong growth in fixed sports betting is expected to continue.

Figure 5 - Total racing and sports wagering



Source: Australian gambling statistics, 1984 to 2009-10, 28th edition

4. Corporate Bookmakers

Corporate bookmakers have used the telephone and internet to break down the traditional state based barriers to wagering to service the national wagering market. Most large corporate bookmakers are headquartered in the NT (currently 10) because of the favourable tax regime offered by the Northern Territory.

As a result of the rapid growth of corporate bookmakers and their considerable penetration of the national wagering market, there is a significant proportion of national wagering turnover that has been transferred into these businesses from state based operators. This has resulted in both lost revenue for the state governments as well as decreases in funding for the racing bodies around Australia.

The table below presents independent research commissioned by Tabcorp that was provided to the productivity commission. It estimates Tabcorp’s revenue that was lost to the Northern Territory, foregone Government revenue, and lost funding to the racing industries in 2008. Whilst this analysis does not include other states and territories, leakages have also occurred in other jurisdictions because of the emergence of Northern Territory based corporate bookmakers.

⁸ Australian Gambling statistics, 1984 to 2009-10, 28th edition

Table 3 - Tabcorp-NSW & VIC leakage estimates, 2008 (A\$ millions)

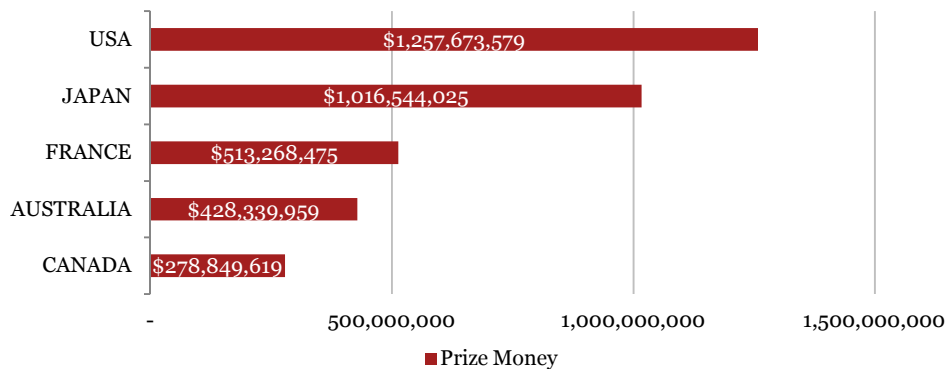
State	Revenue lost to Northern Territory	Government revenue lost	Racing industry funding lost
NSW	\$987	\$30	\$58
VIC	\$592	\$19	\$45
Total	\$1,579	\$49	\$103

Source: “Call for a national approach to the regulation of the Australian wagering industry”, Tabcorp submission to the Productivity Commission’s inquiry into Gambling, April 2009

2.3 Industry consolidation and international competition

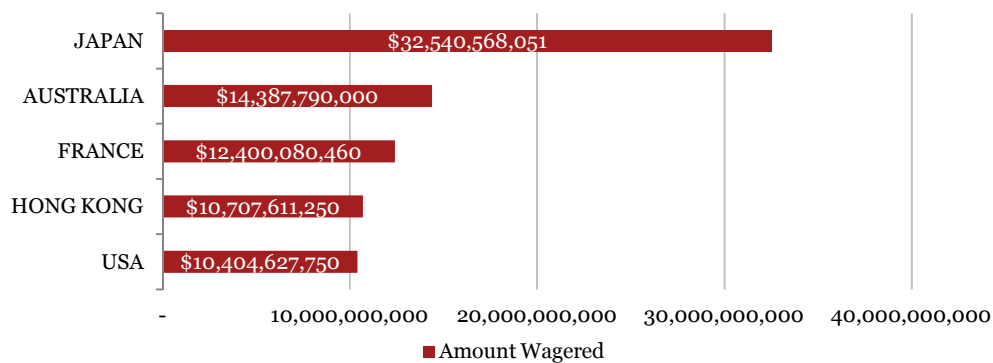
Australia is placed among the top five countries in the world for racing prize money and total money wagered⁹. The charts below show the top five countries for both racing prize money and total amount wagered on racing in 2012.

Figure 6 - International racing prize money, top 5 countries 2012



Source: Australian Racing Board Fact Book 2010 and 2011

Figure 7 - International amounts wagered, top 5 countries 2012

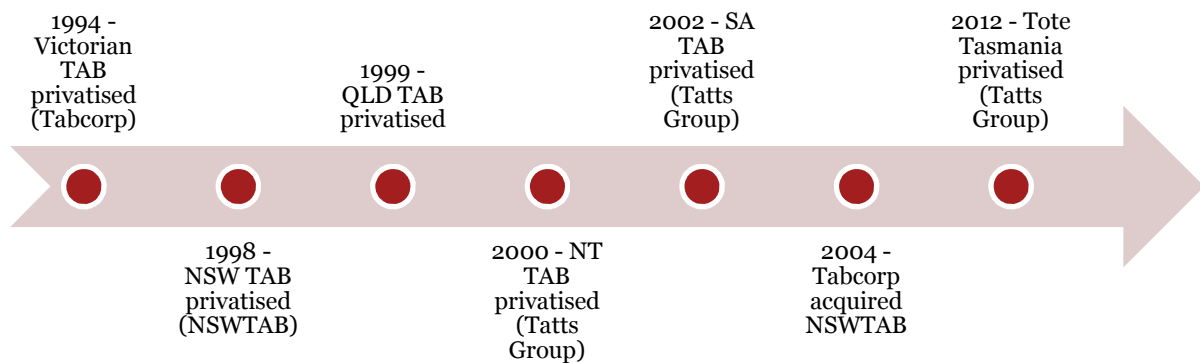


Source: Australian Racing Board Fact Book 2010 and 2011

⁹ Australian Racing Board Factbook 2010-11

Since the first privatisation of a state owned TAB, the Victorian TAB in 1994, the wagering industry in Australia has undergone a period of steady privatisation and consolidation. The chart below presents the privatisation timeline of the wagering industry in Australia over the last 20 years. The last remaining state owned TAB's are ACTTAB and WA TAB.

Figure 8 - State owned TAB privatisations



Source: Company websites and announcements

The Australian market has been targeted by a number of international gambling organisations to gain access to a regulated market with growth and geographical diversification. There have been a number of major transactions involving international operators acquiring Australian wagering businesses over the last five years. The table below provides a summary of each transaction.

Table 4 - Major Australian wagering transactions

Major Acquisitions of Australian Wagering businesses				
Target	Acquirer	Acquirer Location	Enterprise Value	Date
Sportingbet plc (including Australian operations)	William Hill plc	United Kingdom	\$584 million	Mar 2013
Betchoice	Unibet Group plc	United Kingdom	\$22 million	Feb 2012
Centrebet International	Sportingbet Australia	Australia	\$237 million	Jun 2011
Sportsbet	Paddy Power plc	United Kingdom	\$106 million	Oct 2009

Source: Capital IQ

In addition to the above, there have been a number of international operators that have commenced operations in Australia, most notably Bet365 and Betfair.

The above transaction activity highlights both the attractiveness of the Australian market for large experienced international operators, the level of globalisation that is occurring in the international wagering market and industry consolidation in the Australian wagering market. The consolidation activity means that competitive advantages of scale, diversification and access to international content are becoming increasingly necessary for wagering businesses in Australia to compete.

Product Innovation

The increased competition in the Australian wagering market has led to an increase in both the variety of products offered by operators and the services available to punters. The table below presents the services and products offered by ACTTAB, Tabcorp, Tatts Group and corporate bookmakers.

Table 5 - Service and products offered

	ACTTAB	Tabcorp	Tatts Group	Bookmakers
Service				
Retail (on and off course)	√	√	√	√
Phone	√	√	√	√
Internet	√	√	√	√
Mobile website	×	√	√	√
Iphone/Android app	×	√	√	√
Deposit (Bpay, cash & credit card)	√	√	√	√
Withdrawals - cash	√	√	√	√
Withdrawals - any bank account	×	√	√	√
Incentive scheme	×	√	√	√
Racing product				
Win/Place	√	√	√	√
Flexi betting	√	√	√	√
Quaddie	√	√	√	√
Big 6	×	√	×	×
Fixed odds win/place	√	√	√	√
Pre post fixed odds	×	√	√	√
Sports Product				
Standard bet types	√	√	√	√
Exotic bet types	×	√	√	√
Live betting	√	√	√	√

Source: Company websites and presentations

Tabcorp and Tatts Group have diversified their accessibility from retail and phone to now offer easy to access internet websites and smart phone applications. Product offerings have also increased significantly with a multitude of exotic racing and sports betting options now available.

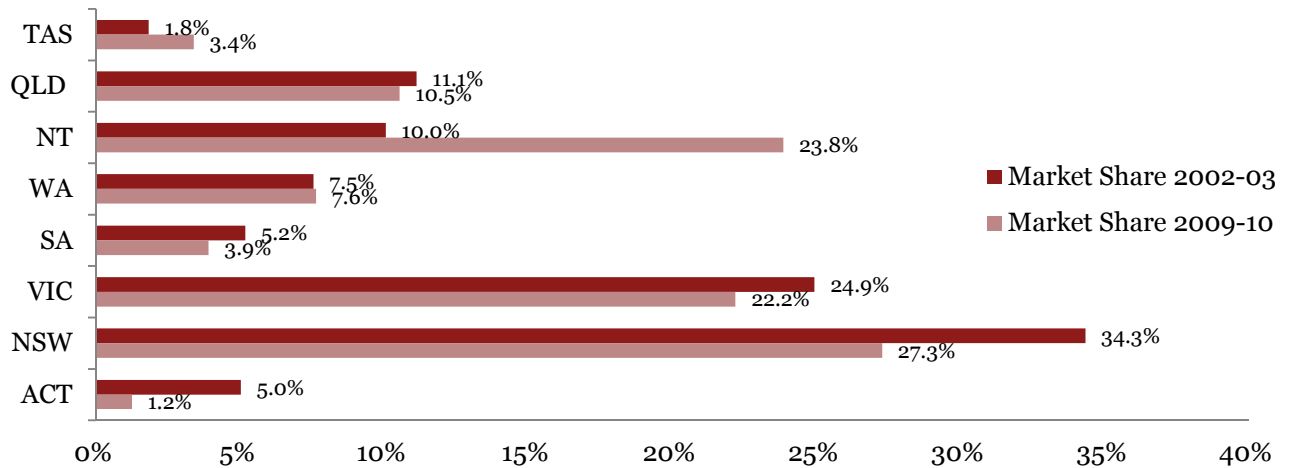
Due to its lack of scale, ACTTAB has not been able to gain access to several significant products now offered by the other interstate TAB's. This has contributed to ACTTAB's loss of market share to operators who are able to offer full product suites. We note that ACTTAB is currently undertaking an upgrade of its website which will include a mobile offering and improved functionality, however the new website is not expected to be launched until June 2013.

2.4 Wagering market share by state and territory

As depicted in Figure 9 below the ACT wagering market represents a small segment of the national market, notably 1.2% in 2009-10¹⁰. The historical trend for the ACT region has been one of declining market share and its market share has declined at a faster rate relative to other states and territories in Australia.

¹⁰ Australian Gambling statistics, 1984 to 2009-10, 28th edition

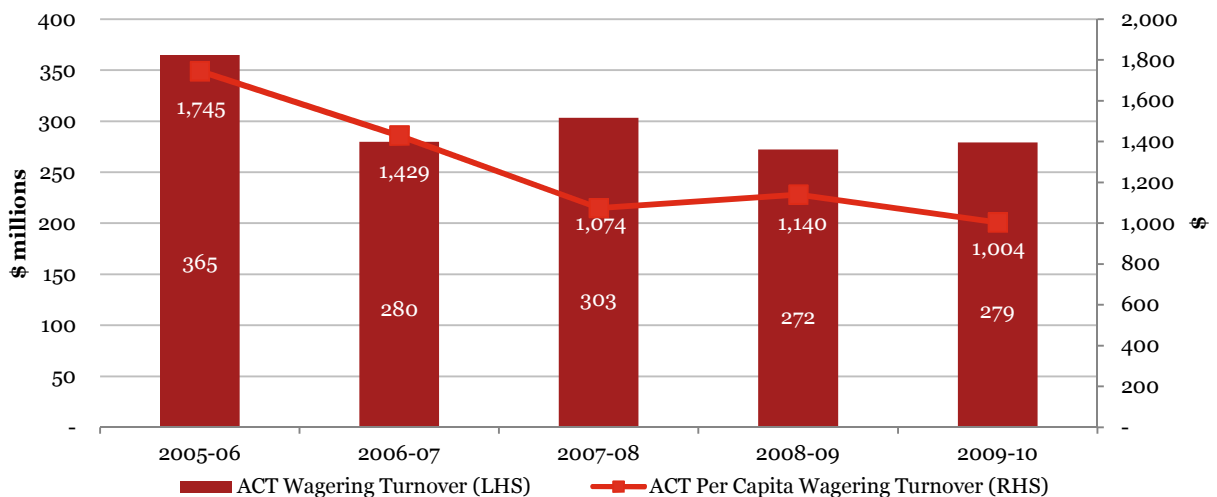
Figure 9 - State market share change from 2002-03 to 2009-10



Source: Australian Gambling Statistics, 28th edition, December 2012

Similar to the above market share trends the ACT wagering market over the five year period to 2009-10 has declined both in terms of total turnover and per capita turnover.

Figure 10 - Total per capita wagering turnover for the ACT



Source: Australian Gambling Statistics, 28th edition, December 2012

The data shows that ACT wagering turnover has been in decline, falling by 12.9% p.a. over the five years to 2009-10. The decline in the ACT market is related to both industry wide trends such as the emergence of corporate bookmakers, as well as specific issues identified with ACTTAB, its product offering and scale discussed in section 3. Wagering per capita in the ACT is \$1k per annum, c.24% less than the national average.

2.5 Regulatory regime

Each state and territory in Australia has its own independent gambling regulator. In the ACT the regulator is the ACT Gambling and Racing Commission. PwC has not noted any significant differences in the regulatory regime in the ACT compared to other states and territories. The ACT Gambling and Racing Commission monitors the social effects of gambling, regulates all gambling activities in the ACT and approves all gaming and racing activities. PwC has not noted any material benefits for either the ACT or ACTTAB arising from a common owner of ACTTAB and its regulator.

2.6 Competition issues

There are two major groups of wagering operators in the Australian market, the exclusive state TAB's and online corporate bookmakers. A majority of these industry participants are either large publicly listed companies (located in the UK or in Australia) operating in multiple states and online or large international privately owned companies. These operators' key competitive advantages are listed below along with the current barriers to entry to the Australian market.

Sources of competitive advantages

- **Economies of scale** – Wagering operations benefit considerably from scale and many successful established players in the industry are able to spread fixed costs across large revenue streams. Whilst fixed odds wagering is taking up an increasing share of total wagering pari-mutuel wagering still occupies the majority of wagering throughout Australia. The operation of a pool is the core concept of a pari-mutuel wagering and a pool is most efficient when it has size and diversification, providing less risk for the operator and less volatility in odds for the punter.
- **Product innovation** – Product innovation is a key to attracting and retaining customers. Developments in technology have allowed alternative bet types to emerge and the modern punter is well aware of the vast array of products available due to extensive media advertising.
- **Diversified operations** – Many of the major wagering operators have been able to successfully diversify their operations geographically. Both Tatts Group and Tabcorp generate wagering business in different states within Australia and, as stated above, there has been a significant increase in the number of multinational wagering businesses entering Australia. Product diversification has also been achieved through the development of alternatives to pari-mutuel wagering, specifically fixed odds sports betting and a variety of different bet types.
- **Expertise of established operators** – There is a risk in the provision of wagering services, particularly with respect to the setting of odds and the management of a pool of bets. Established operators have substantial experience in managing this risk.
- **Ease of access to products** – Wagering operators are able to use key locations to generate large amounts of betting activity and attract customers through prime locations. The provision of self service terminals also enhances customer experience but more importantly reduces personnel costs. The development of a significant online presence through web sites and mobile applications is essential for the success of wagering operators in the current market.

Barriers to entry

- **Legislative requirements** – All Australian states and territories have legislated exclusive licenses to operate totalisator wagering operations in that state.
- **Capital outlay** – There is significant capital required to set up a new wagering operation of scale in the form of technology infrastructure, access to venues, contractual arrangements and other general business expenses.
- **Mature industry with established participants** – Wagering in Australia is a mature industry with established participants. It would be difficult for a new entrant to compete with the established participants and gain market share due to the concentration of industry participants and the exclusive structure across Australia.

2.7 Problem gambling

It is prudent to note that the prevalence of problem gambling is low in relation to wagering. The Productivity Commission's Inquiry Report on gambling (2010) states that problem gambling among the Australian adult population has been in decline since the 1990s and is most identified with gaming machine spending and not racing wagering. The ACT Government should continue to monitor and regulate the wagering industry in the ACT through the ACT Gambling and Racing Commission.

3 Business Description

3.1 Introduction

ACTTAB is a wholly owned subsidiary of the ACT government established in 1964 to provide a legal offcourse betting system. ACTTAB has the exclusive right in the ACT to provide totalisator and fixed odds retail betting services for racing and other sports events.

ACTTAB's principal activity is to provide totalisator wagering services and fixed odds wagering in the ACT on sport, racing and other approved events. ACTTAB also provides gaming services in relation to Keno and Trackside. ACTTAB operates on race meetings in Australia and overseas combining betting pools with its SuperTAB partners in Victoria and Western Australia. This pooling partnership provides access to pools in excess of \$4.5 billion per annum¹¹.

Over the past 49 years, ACTTAB has expanded its network of gambling services to the ACT, whereby as at 30 June 2012 there were 58 retail outlets consisting of 15 branches and agencies and 43 sub agencies. Sub agencies are located in venues such as clubs, hotels, taverns and Casino Canberra. ACTTAB retail facilities are also located at 3 ACT race courses, Canberra stadium and Manuka (Star Track) oval. In addition to the retail facilities ACTTAB has in excess of 5,000 individual account holders utilising telephone and internet services.

3.2 Financial Profile

The financial performance of ACTTAB over the last 3 financial years (financial year ending June 30) and ACTTAB management's FY13 budget is presented in the table below.

Table 6 - ACTTAB historical & budgeted statement of financial performance

\$'000	FY10	FY11	FY12	FY13B
Racing turnover	160,135	155,845	152,803	151,450
Sports & other turnover	19,504	20,461	23,764	21,969
Total turnover	179,639	176,306	176,567	173,419
Racing revenue	22,993	22,228	22,299	22,241
Sports & other revenue	4,675	4,550	5,228	4,527
Total revenue	27,668	26,778	27,527	26,768
Processing fees	2,872	3,216	2,805	3,543
Other operating expenses (excl. D&A)	17,071	17,258	19,016	18,295
EBITDA (pre Government fees)	7,725	6,304	5,706	4,930
Racing Development Fund	7,206	-	-	-
Government licence fees	1,457	1,326	1,464	1,519
Total Government fees	8,663	1,326	1,464	1,519
EBITDA (post Government fees)	(938)	4,978	4,242	3,411
D&A	1,394	1,373	1,523	1,701
EBIT	(2,332)	3,605	2,719	1,710
Interest	305	376	442	368
Profit before tax	(2,027)	3,981	3,161	2,078
Income Tax	-	2,015	1,041	624
Net profit after tax	(2,027)	1,966	2,120	1,454

Source: ACTTAB financial reports and ACTTAB management. PwC has presented the P&L in a different format to show EBITDA pre payments to the Government. PwC has restated revenue and Government license fees by removing GST from the balances.

¹¹ ACTTAB Annual Report 2012

Racing turnover

Racing turnover declined at 2.3% per annum over the period from FY10 to FY12. During this period considerable competition from online bookmakers has negatively impacted ACTTAB's market share. In addition, significant rebates paid to large volume VIP customers by interstate operators have lured ACTTAB VIP customers away, again negatively impacting racing turnover. ACTTAB management is currently investing in improving the ACTTAB website quality and functionality. Despite this investment, racing turnover is forecast by management to decline 0.8% in FY13B.

Sports and other turnover

Sports and other turnover grew at 10.4% per annum over the period from FY10 to FY12. This growth was almost entirely attributable to growth in fixed odds sports betting. ACTTAB, through strategic agreements with Tabcorp (fixed odds sports provider) has been able to take advantage of the industry wide increase in sports betting turnover. Sports and other turnover is forecast by management to decrease 7.6% in FY13.

Revenue

Total revenue is directly proportional to turnover and represents turnover less the payout ratio paid to the punter less GST collected. ACTTAB retains c.16 cents of every dollar of racing turnover, and c.23-25 cents of every dollar of sports and other turnover.

Operating costs

Processing fees are linked to turnover and attract fees based on volumes bet on sports and racing wagering, Trackside and Keno. The mix of these betting products impacts the processing fees paid to the providers, namely Tabcorp and SA Keno. Included in processing fees are rebates paid to VIP customers.

Other operating expenses include salaries and wages, property costs, information technology, agents fees, marketing and race fields fees. Other operating expenses have increased as a percentage of revenue from 56% in FY10 to 62% in FY13B because the relatively fixed cost base of the business is unable to adjust sufficiently to decreasing turnover to maintain margins.

EBITDA (pre Government fees)

EBITDA (pre Government fees) has declined c.10-18% each year over the period FY10 to FY13B. This has been driven by decreasing turnover and a relatively fixed cost base that is unable to react accordingly. ACTTAB management is currently investing in technology by improving ACTTAB's website quality and functionality in an attempt to increase turnover and EBITDA, albeit FY13 EBITDA is forecast by management to reduce 13.6% to \$4.9 million.

Government fees

Total payments from ACTTAB to the ACT Government comprise the following items.

Table 7 - Payments to the ACT Government

AUD in thousands	FY10	FY11	FY12	FY13B	Timing of Payment
ACT Government licence fees	4,071	4,249	3,990	4,215	
less net GST paid to ATO	2,614	2,923	2,526	2,696	
Net licence fee paid to ACT Government	1,457	1,326	1,464	1,519	Monthly in arrears
Income tax paid to ACT Government	-	2,015	1,040	623	Quarterly in arrears
Net profit after tax paid to ACT Government	-	1,476	2,120	1,454	Annually deferred for 12 months
Special dividend	-	-	3,000	-	Annually deferred for 12 months
Racing Development Fund payment	7,206	-	-	-	
Total payments to ACT Government	8,663	4,817	7,624	3,596	

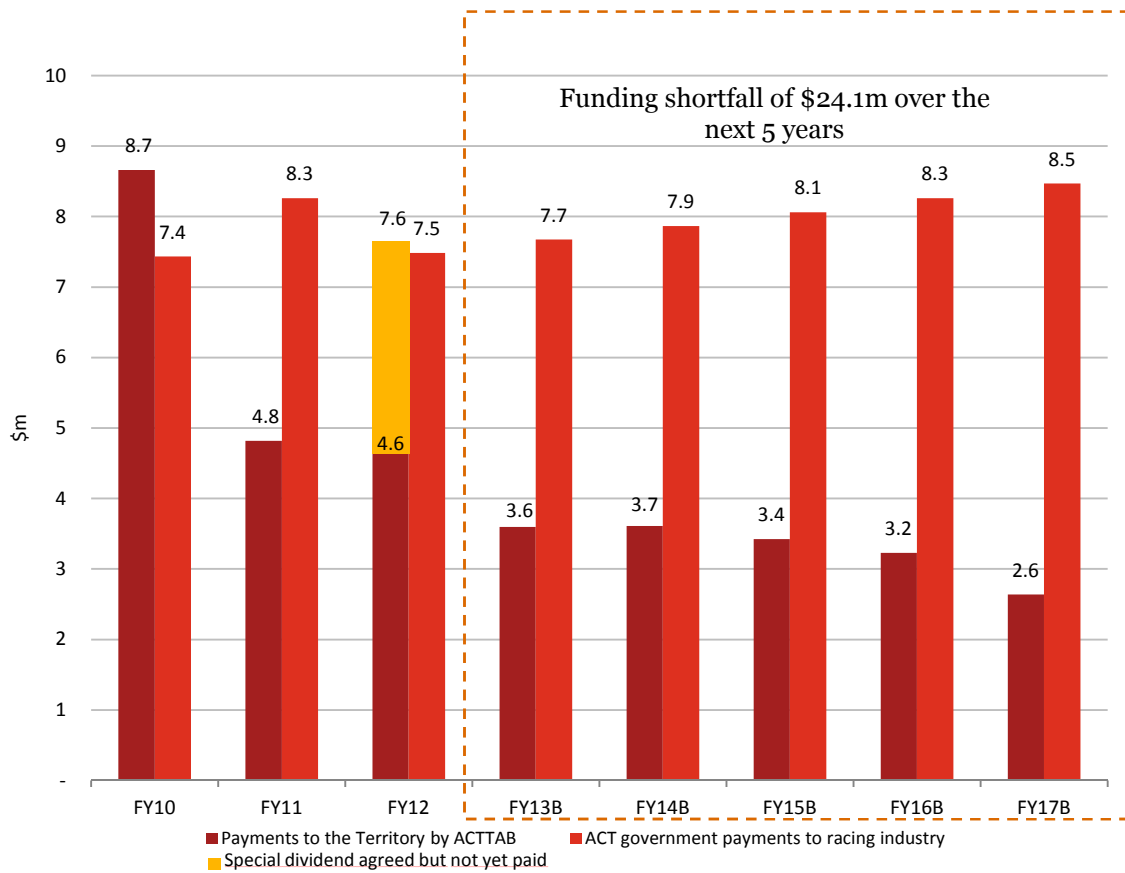
Source: ACTTAB financial reports and ACTTAB management

The ACT Government licence fee is calculated at 10% of the value of the licence (which is assessed annually) plus 5% of Keno and Trackside turnover and a Sportsbet licence fee. The total licence fee is then reduced by net GST paid by ACTTAB to the ATO. ACTTAB also pay a corporate income tax equivalent of 30% of profit before tax. From FY12, ACTTAB is required to pay 100% of net profit after tax to the ACT Government via a dividend. In previous years the dividend proportion was 75% (FY11) and 50% (pre FY11) of net profit after tax. In FY12 a special dividend of \$3 million was agreed to be paid from excess cash at the end of FY13.

Prior to FY11 ACTTAB paid a Racing Development Fund fee to the ACT Government which was used to fund the racing industry. This fee was based on 4.5% of turnover. The Racing Development Fund fee ceased from FY11 as the ACT Government instead set a fixed payment from the budget to the racing industry, and introduced the current tax, fees and dividend regime set out above.

The historical and forecast payments to the ACT Government by ACTTAB, and from the ACT Government to the racing industry are shown in the chart below. The payments to the ACT Government are based on the ACTTAB management forecast. ACTTAB disburse the dividend payments 12 months following the end of the financial year. i.e. the FY12 dividend will be paid to the ACT Government in June 2013. Net licence fees and income tax paid to the ACT government are disbursed monthly and quarterly in arrears, respectively.

Figure 11 - Payments to the ACT government & budget funding to the racing industry



Source: ACTTAB financial reports and ACTTAB management

Note: Payments to the Territory by ACTTAB are presented in the financial period ACTTAB records the expense. We note the dividend (forms part of total payments) is actually paid during the following financial period. This has been taken into account in the valuation analysis in Section 5.

ACT racing only contributes c.2% of ACTTAB’s turnover ¹², therefore, there is no nexus between ACT racing and the performance of ACTTAB.

The racing industry receives a fixed amount paid from the ACT Government budget (commenced at \$7.5 million in 2012) indexed for inflation each year. As can be seen from the chart above the proceeds from ACTTAB were sufficient to fund the payment to the racing industry in FY10 and FY12 but not in FY11. Management are forecasting a decrease in Government payments in FY13B and beyond due to the declining financial performance of the business.

¹² Australian Gambling statistics, 1984 to 2009-10, 28th edition

Balance sheet

The financial position of ACTTAB, as at 30 June 2012 and 28 February 2013, is shown in the table below

Table 8 - ACTTAB balance sheet

\$'000	Jun-12	Feb-13
Current Assets		
Cash	4,752	5,478
Receivables	353	415
Other	309	405
Total Current Assets	5,414	6,298
Non Current Assets		
Property, plant and equipment	8,792	8,058
Land and buildings	4,487	4,479
Long term investments	6,000	6,000
Other	1,884	2,053
Total Non Current Assets	21,163	20,590
Total Assets	26,577	26,888
Liabilities		
Creditors	3,967	3,774
Employee entitlement provisions	1,252	1,147
Other provisions	5,120	5,120
Other liabilities	809	493
Non current employee entitlement provisions	140	140
Total Liabilities	11,288	10,674
Net Assets	15,289	16,214

Source: ACTTAB financial reports and ACTTAB management

Current assets consist of cash held in trading accounts and term deposits. The term deposits retain excess cash until it is used to make payments to the ACT Government.

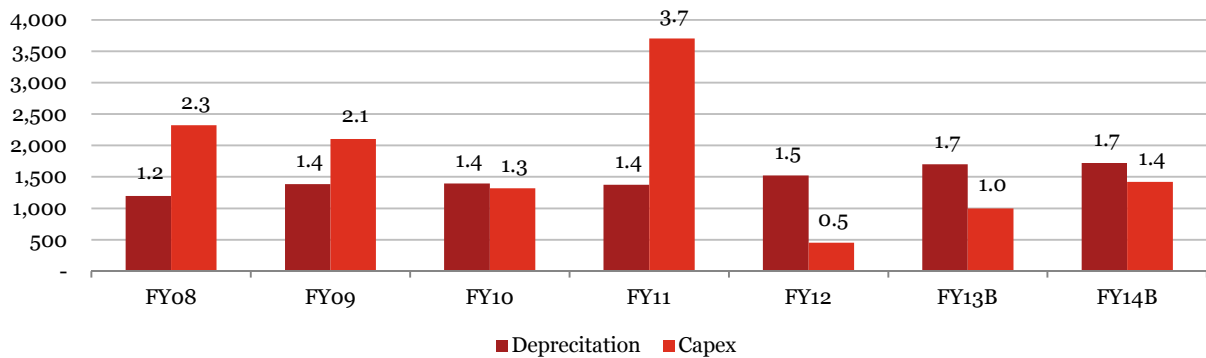
Non-current assets predominantly consist of land (\$4.0 million), buildings (\$0.5 million), and property plant & equipment (\$8.1 million). Land and buildings relate to a number of ACTTAB's retail shops. Investments relate solely to a cash term deposit that will be used to fund the dividend payment of \$5.1 million to the ACT Government for FY12 dividend.

Liabilities predominantly consist of creditors, customer accounts & other provisions. Creditors comprise processing fees payable to Tabcorp for the provision of totalisator, sports, Keno and Trackside services (\$2.4 million). Creditors also include amounts owed to sundry creditors (\$1.4 million). Other provisions relate to the FY12 ACT Government fees. Other liabilities include income tax payable and deferred tax liabilities.

Capital Expenditure

ACTTAB has historically not invested significant amounts in capital expenditure on the business. During the period FY08 to FY13B ACTTAB invested \$10.9 million in capital expenditure. During the same period the annual depreciation charge was \$8.6 million, representing only a marginal increase in the fixed asset base of the business. In FY11 an amount of \$3.7 million was invested primarily in IT system upgrades and digital marketing improvements. Despite this investment total turnover is forecast to decrease 1.6% over the 24 month period to FY13B.

Figure 12 - Historical and forecast capex and depreciation



Source: ACTTAB financial reports and ACTTAB management

Management’s estimate for FY13 capital expenditure is \$1.0 million (revised down from their original forecast of \$2.1 million). For the ten month period ended April 2013 ACTTAB incurred \$0.6 million. Key planned capital expenditure items forecast for the final two months of FY13 include the website finalisation and purchase of additional customer information display units.

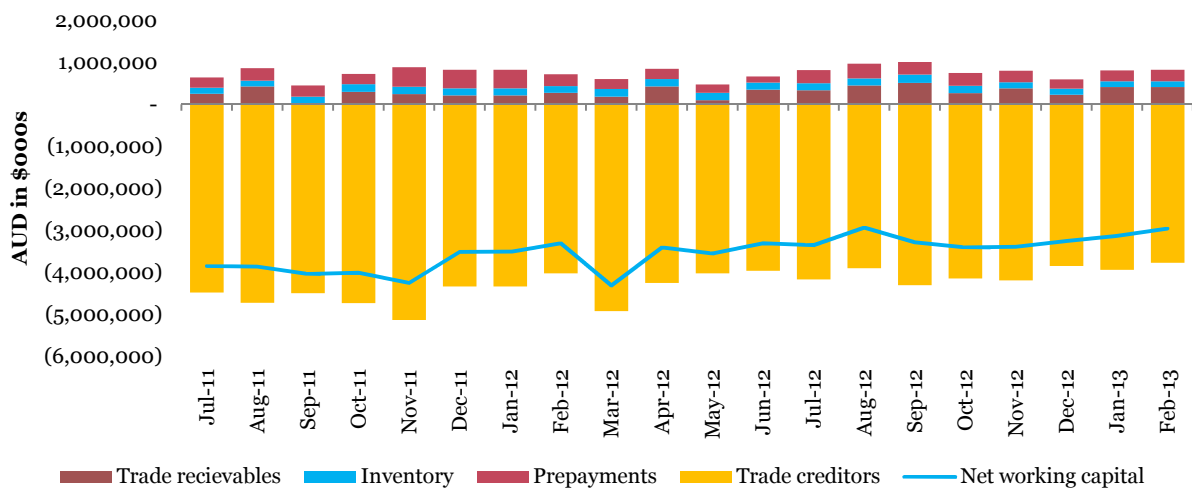
ACTTAB’s annual capex investment has been low relative to other industry participants. Over the last three years ACTTAB expended \$5.5 million to improve its relative competitive position, reflecting an average ratio of 7.0% of wagering revenue. For the same period Tabcorp’s capital expenditure averaged 16% of wagering revenue.

The Australian wagering market is highly dynamic and is characterised by a technical service delivery model through various online, mobile device and self service terminals. Key Australian wagering competitors in Australia are well placed to respond to these trends as a result of their considerable size and scale advantages. Despite ACTTAB’s investment in capital expenditure over the period from FY08 to FY12 the business lacks the size and scale to be able to translate this investment into revenue growth at a comparable rate to the other industry participants.

Working capital

Outlined below is ACTTAB’s monthly net working capital balances from July 2011 to February 2013.

Figure 13 - Monthly net working capital



Source: ACTTAB financial reports and ACTTAB management

ACTTAB’s net working capital consists of the following:

- Trade creditors: Consisting of payments owing to Tabcorp, SA Lotteries and Sky racing for both fees for use and settlements depending on the win/loss rate of ACTTAB clients;
- Trade receivables - Comprises the amounts owing from Tabcorp and SA lotteries as part of the settlement process depending on the win/loss rate of ACTTAB clients;
- Inventory - Primarily comprises of the tickets for use in the full service and self service machines; and
- Prepayments - Primarily comprises prepaid sponsorships

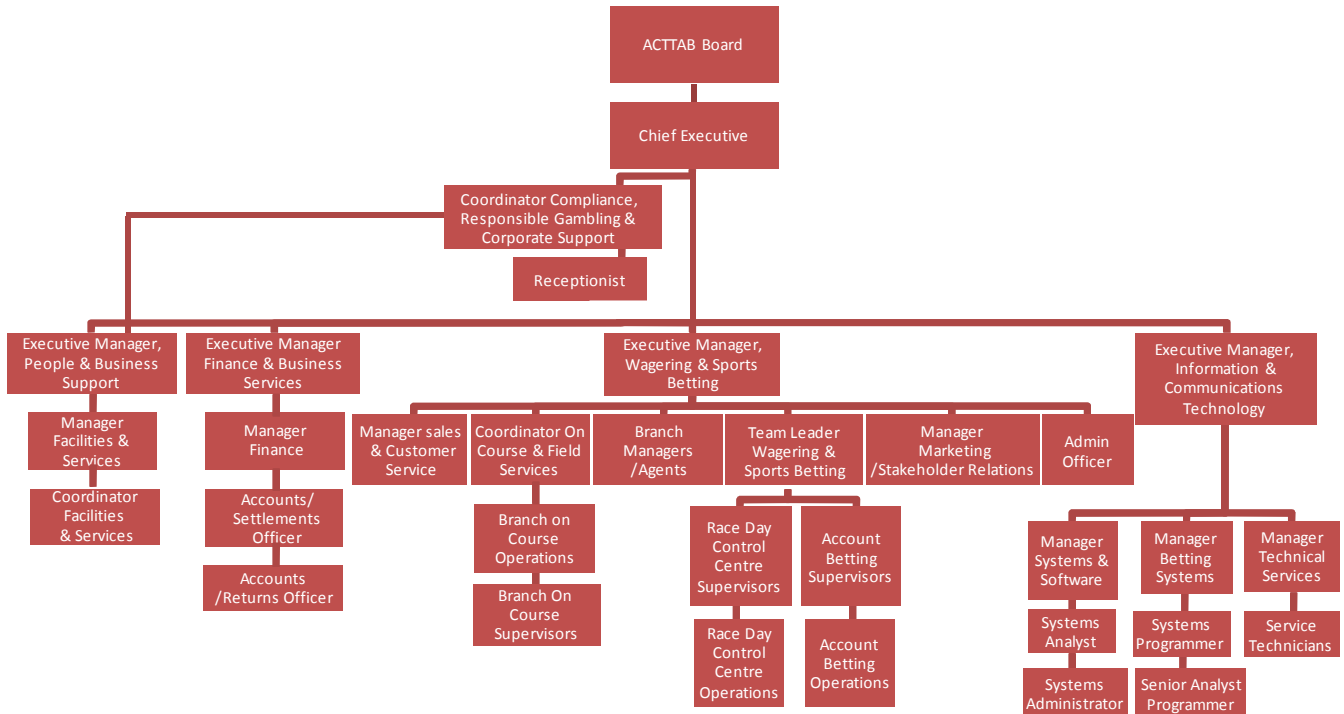
ACTTAB’s net working capital is largely driven by the win/loss rate of ACTTAB clients which drives the settlements to/from Tabcorp and SA lotteries.

We note that ACTTAB as a retail service provider has a negative net working capital balance, which is effectively a source of cash funding for the business.

Management and Employees

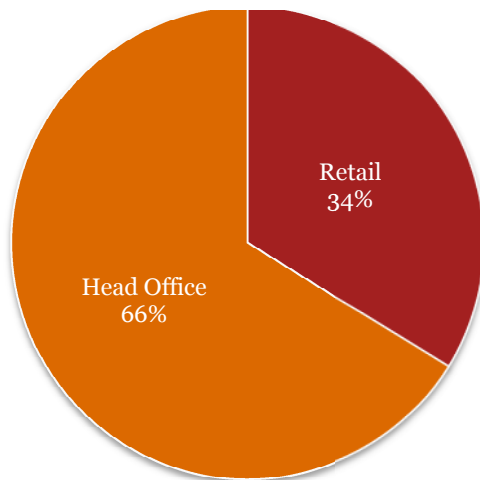
Outlined below is ACTTAB’s current organisational chart, the current split of full time equivalent employees (FTE) between head office and retail and the total number of employees segregated by type of employment contract.

Figure 14 - ACTTAB organisational chart



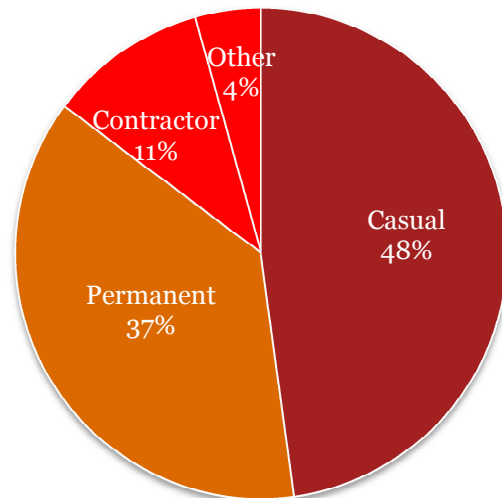
Source: ACTTAB Management
Employee information is current as at February 2013

Figure 15 – FTE split by function



Source: ACTTAB Management
Employee information is current as at February 2013

Figure 16 - Total employees split by type



Source: ACTTAB Management
Employee information is current as at February 2013

There are currently 115 employees, of which 66% are classified as head office staff and 34% retail staff. ACTTAB’s casual workforce almost entirely consists of employees involved in the retail operations, whereas the permanent employees are predominantly part of the head office function.

We also note that for permanent and casual employees the average length of service is 10.7 and 4.4 years respectively.

3.3 ACTTAB’s contribution to the community

ACTTAB has been a long term supporter of the Canberra community through the sponsorship of events, sporting organisations and charitable organisations. The table below lists ACTTAB’s current sponsorship commitments.

Table 9 - ACTTAB sponsorships

\$	Annual commitment	Expiry Date
National multicultural festival	10,000	31-Dec-13
Problem Gambling Assistance Fund	50,000	30-Jun-14
ACT Racing Club		
- Melbourne Cup (year 1)	26,520	31-Dec-13
- Melbourne Cup (year 2)	27,050	31-Dec-14
- Tony Campbell Cup	30,000	31-Oct-13
- Canberra Centenary Cup	125,000	31-Mar-13
Canberra Raiders	75,000	31-Oct-13
Western Sydney Football Club (year1)	90,000	31-Oct-13
Western Sydney Football Club (year2)	90,000	31-Oct-14
Brumbies	65,000	31-Oct-13
Clubs ACT Chefs on Show	25,000	31-Dec-13
Active Kids Sponsorship	15,000	31-Dec-13
Canberra Capitals	15,000	31-Dec-13
Ronald McDonald House	10,000	31-Dec-13
Canberra Harness Racing Club	10,000	31-Dec-13
National Multicultural Festival	10,000	31-Dec-13
PMs XI Cricket	5,000	31-Dec-13
Canberra Greyhound Club	5,000	31-Dec-13
Live in Canberra	5,000	31-Dec-13
Canberra Stadium Sponsorship and Signage	71,291	31-Dec-13
ACTAADS	10,000	31-Dec-13
Cerebral palsy	7,500	31-Dec-13
Blind Society	7,800	31-Dec-13
Heart Foundation	5,000	31-Dec-13
Total	790,161	

Source: ACTTAB financial reports and ACTTAB management

ACTTAB previously had a long standing sponsorship arrangement for “Celebrate in the Park” to which they contributed c.\$400,000 per year. This sponsorship was not undertaken in the current FY13 period due to reasons beyond management’s control. ACTTAB has entered into a new sponsorship arrangement with the Canberra Racing Club and provided \$125,000 to support the running of The Centenary Cup and intend to provide a similar level of support for the Canberra Cup in 2014.

3.4 ACTTAB’s Competitive Position and Outlook

ACTTAB has a number of competitive strengths, namely:

- **Exclusivity rights within the ACT** - ACTTAB has been legislated with the exclusive right to conduct totalisator wagering operations in the ACT. This allows ACTTAB to act as the sole retail wagering services operator for the ACT, a structure that is mirrored in other states and territories in Australia. This exclusivity structure is unlikely to be challenged by other operators seeking entry to the ACT market (i.e. similar to the Sportsbet ‘Betbox’ case in Victoria) as the ACT market is relatively small and therefore unattractive to a second entrant;
- **Established customer base** – ACTTAB has a large customer base, established distribution network and brand loyalty among its customers. ACTTAB has been an integral part of the ACT community for almost 50 years. ACTTAB has forward sponsorship commitments of over \$0.8 million per annum with various organisations within the ACT, which contribute to the recognition of its brand and its continued local customer support; and
- **Relationship with Tabcorp** - ACTTAB has a contractual relationship with Tabcorp to provide pooling services for pari-mutuel wagering and fixed odds for sports betting and Trackside. This pooling arrangement enables ACTTAB to decrease the volatility in the odds it provides to its customers compared to if it ran its own pool. The relationship with Tabcorp also provides ACTTAB with access to the majority of Tabcorp’s products eliminating the need to develop these capabilities in house.

ACTTAB also has a number of competitive weaknesses, namely:

- **Ownership structure** – ACTTAB’s ownership structure limits its ability to operate in a profit maximising manner;
- **Declining financial performance** – ACTTAB’s wagering turnover is declining with a relatively fixed cost base. As a result its cash flow and EBITDA generation has been declining over recent years and management expect this trend to continue;
- **Market position** – ACTTAB is one of only two remaining state owned and operated totalisator operators in Australia. The emergence of international on line operators and continued consolidation of the Australian wagering market is increasing the pressure on ACTTAB to remain competitive;
- **Access to resources:** - ACTTAB’s relatively inferior market position constrains its ability to attract industry leading management resources;
- **Reliance on Tabcorp** – ACTTAB is reliant on pooling its turnover with Tabcorp. If Tabcorp terminated this relationship ACTTAB would need to either pool with another operator or create and manage its own pool that would be highly unattractive to its customers due to the volatility of odds;

- **Product and technological innovation** - ACTTAB has invested in its IT systems in recent years with the objective of enabling the business to keep pace with the broader market offering to punters in Australia. ACTTAB however does not currently have a mobile device application for its customers and is reliant on Tabcorp for much of its product innovation, however, ACTTAB does not currently have access to some of Tabcorp’s more popular products such as the ‘Big 6’; and
- **Significant capital expenditure required** – Significant capex is required for the development of an enhanced IT platform, online website and smart phone applications.

The competitive weaknesses of ACTTAB are relatively stronger than its competitive strengths, which will negatively impact the financial outlook for the business. The ACT wagering market is mature and under threat from interstate wagering operators. ACTTAB’s competitors are larger, less restricted and have greater access to capital. This competitive environment is likely to significantly limit investment returns for ACTTAB.

Consequently management are forecasting a continued decline in the financial performance of ACTTAB. The table below shows EBITDA (pre government fees) decreasing at 2.1% per annum over FY13 to FY17.

Table 10 Management forecast financial performance

AUD in thousands	FY13B	FY14F	FY15F	FY16F	FY17F	CAGR
Total turnover (1)	173,419	176,925				
Total revenue	26,768	27,153	27,832	27,947	27,944	1.1%
EBITDA (pre government fees)	4,930	5,049	5,271	5,096	4,525	-2.1%
Government fees	(1,519)	(1,353)	(1,371)	(1,389)	(1,424)	
EBITDA post government fees	3,411	3,696	3,900	3,707	3,101	-2.4%
Depreciation & amortisation	(1,701)	(1,719)	(1,747)	(1,768)	(1,785)	
EBIT	1,710	1,977	2,153	1,939	1,316	-6.3%
Interest	368	347	100	100	103	
Profit before tax	2,078	2,324	2,253	2,039	1,419	-9.1%
Tax	(624)	(697)	(616)	(551)	(364)	
Net profit after tax	1,454	1,627	1,637	1,488	1,055	-7.7%

Note: (1) Total turnover has not been estimated by the Territory in the outer years of the forecast.

Source: ACTTAB Management

4 Ownership Options

4.1 Introduction

PwC has assessed the following options in relation to the Territory's ownership of ACTTAB:

- Maintaining the status quo;
- Forming a joint venture with a suitable private sector organisation;
- Retaining Government ownership and contracting out the management of ACTTAB; and
- A trade sale.

PwC's assessment of the options has taken into consideration;

- Execution issues.
- Racing industry issues.
- Market demand for the option.

4.2 Status Quo

The Status Quo Option is defined as the Territory continuing to own all of the shares in ACTTAB, with a board and management structure similar to the present situation.

4.2.1 Execution Issues

The Status Quo option will allow the Territory to continue to share in the risks and rewards of ownership of ACTTAB.

Sections 2 and 3 of this Report describe the market in which ACTTAB operates and its relative market position.

The opportunities for the Territory from continued ownership of ACTTAB include the following:

Control	<ul style="list-style-type: none">• As sole shareholder of ACTTAB the Territory has control of the activities of the business.• ACTTAB does not have funding facilities with external parties. For significant expenditures it is most likely that Treasury will become involved.• The Territory also has regulatory controls over ACTTAB that would continue if the Territory no longer had ownership control.
Annual Payments	<ul style="list-style-type: none">• The ACT Government has received total payments from ACTTAB in the past 3 years of between \$4.8 million and \$8.7 million and is forecast to receive annual payments from ACTTAB of between \$2.6 million and \$3.7 million over the next 5 years.

Community Involvement	<ul style="list-style-type: none"> • ACTTAB has been a part of the ACT community since its establishment in 1964. • During FY13 ACTTAB are forecasting to contribute \$0.8 million in sponsorship arrangements with various ACT organisations such as the Canberra Raiders, ACT Racing Club and various charitable organisations. They also have a long standing sponsorship arrangement for “Celebrate in the Park” to which they contribute \$0.4 million per year.
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The risks for the Territory from continued ownership of ACTTAB include the following:

Marginal Market Position	<ul style="list-style-type: none"> • ACTTAB provides gambling services to a relatively small market and is losing market share in national wagering turnover. From 2002-03 to 2009-10 ACTTAB’s market share decreased from 5.0% to 1.2%¹³. • The majority of ACTTAB’s competitors are larger non-government owned businesses with relatively greater access to capital and management resources. Some competitors are less regulated and many have invested in a larger portfolio of products for punters.
Constrained Commercial Focus	<ul style="list-style-type: none"> • ACTTAB’s ownership structure limits its ability to operate in a profit maximising manner. • ACTTAB’s market position constrains its ability to attract industry leading management resources.
Declining Financial Performance	<ul style="list-style-type: none"> • ACTTAB’s EBITDA (pre Government fees) has declined 18% and 9% over the period FY10 to FY12 respectively. • FY13 EBITDA (pre Government fees) is forecast to reduce a further 13.6%.
Increasing Capital Expenditure Requirements	<ul style="list-style-type: none"> • Capital expenditure is an ongoing requirement for participants in the wagering sector. • Over the last three years ACTTAB expended \$5.5 million to maintain its competitive position, reflecting an average ratio of 7% of revenue. For the same period Tabcorp’s capital expenditure averaged 16% of sales. • Future capital expenditure requirements will likely include investments in securing additional products, improving internet and smart device access, IT upgrades and continued self service terminal roll out.

¹³ Australian Gambling statistics, 1984 to 2009-10, 28th edition

Funding Shortfall	<ul style="list-style-type: none"> • The Territory utilises payments from ACTTAB to partly fund the ACT racing industry. • ACTTAB management estimate a shortfall between ACTTAB payments to the ACT Government and funding to be paid to the racing industry totalling \$24.0 million over the next five years, at an average of \$4.8 million per year. • If ACTTAB’s market position continues to decline, so too will its profitability and ability to provide meaningful payments to the shareholder.
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4.2.2 Market Precedents

Throughout international gambling markets the trend is for reduced government ownership of operators:

- Governments in the UK, Germany, France, Italy, Netherlands and Spain have undertaken reforms to facilitate the market entry of online gambling operators;
- In the United States wagering operations are undertaken by private and listed businesses; and
- In Australia, the only other state owned gambling operator is Racing & Wagering Western Australia, which generates revenues of approximately \$320 million¹⁴.

4.3 Joint venture

The term joint venture can describe a range of different commercial arrangements between two or more separate entities. Each party contributes resources to the venture and a new business is created in which the parties collaborate together and share the risks and benefits associated with the venture.

A joint venture should be distinguished from a purely contractual arrangement whereby a public sector body gives a third party the right to provide management services to an entity in consideration for a service fee. An example of a pure contractual arrangement would be ACTTAB’s Pooling Agreement with Tabcorp, whereby ACTTAB makes payment to Tabcorp for use of its SuperTAB tote pool over a specified contract period.

For the purposes of this Report it has been assumed that for the Joint Venture Option, 50% of the shares in ACTTAB are sold to a single suitable private sector party for cash consideration. Under this option, each partner would have equal exposure to the risks and rewards associated with the venture.

4.3.1 Execution issues

A number of structural considerations will arise for ACTTAB in undertaking the Joint Venture Option, including:

¹⁴ Australian Racing Board Factbook 2010-11

- The board of directors of ACTTAB will need to be restructured to include an equal number of representatives from the two shareholder groups
- A Shareholders' Agreement will need to be signed by both shareholder groups and cover topics such as:
 - Purpose & Objectives;
 - Business Plan;
 - Key commercial terms such as:
 - Obligation of the parties to execute any subsidiary contracts;
 - IP and ownership rights;
 - Non compete/conflict of interest provisions and obligations of confidentiality;
 - Funding obligations including each parties intention for future funding commitments;
 - Guarantees, warranties and indemnities;
 - Distribution policy;
 - Termination and dispute resolution; and
 - Management and operational issues.
 - Board composition;
 - Staffing; and
 - Exit strategies and valuation methodology.

The opportunities for the Territory from the Joint Venture Option include the following:

Upfront Payment	<ul style="list-style-type: none"> • The Territory will receive a cash payment for the 50% shareholding that is sold.
Management Expertise	<ul style="list-style-type: none"> • The joint venture partner will need to satisfy a selection criteria designed to import expertise and resources to ACTTAB that would otherwise not be available to the business. This may promote improved earnings and risk management.
Risk Sharing	<ul style="list-style-type: none"> • Shareholders will each share 50% of the potential risks, rewards, dividends and capital outlays of the business.
Flexibility	<ul style="list-style-type: none"> • A joint venture structure is a relatively flexible mechanism for the introduction of new equity and or transfers of equity.

The risks for the Territory from the Joint Venture Option include the following:

<p>Conflicting Shareholder Objectives</p>	<ul style="list-style-type: none"> • There is an increased risk for conflict of objectives between shareholders to emerge when the JV is a combination of a GOE and “for – profit” corporation. • A dysfunctional JV will have cash flow impacts to shareholders and the racing industry.
<p>Limited Market Demand</p>	<ul style="list-style-type: none"> • The universe of third parties interested in entering a Joint Venture Agreement with the Territory will be significantly smaller than for a trade sale.
<p>Future Sale Constraint</p>	<ul style="list-style-type: none"> • The Shareholders’ Agreement will likely constrain the ability of shareholders to sell their stakes to third parties.
<p>Reduced Sale Proceeds</p>	<ul style="list-style-type: none"> • The expected sale proceeds from the sale of a 50% stake will not include a strategic control premium, as in the case of a trade sale, and will be negatively impacted by a relatively small bidder universe.

4.3.2 Market Precedents

There have been several examples of Australian GOEs establishing joint venture arrangements with private sector companies. Examples include:

- Australia Postal Corporation entered a 50:50 joint venture with Qantas in 1992 to establish Australian Air Express. In 2012 Qantas sold its stake to Australia Post;
- In 2000, the ACT’s ACTEW Corporation established ActewAGL with AGL; and
- The Federal Government owned Comland and entered into a 50:50 joint venture with Lend Lease for several residential development projects in Victoria and NSW. The Government sold its stake in 2004 to Lend Lease.

PwC is not aware of any similar government joint venture arrangements in the Australian or international wagering markets (where each shareholder has 50% ownership).

- Wagering services in most Australian states have been privatised, with the two main licensed operators being Tatt’s Group Ltd and Tabcorp Ltd. Tatt’s Group offers totalisator and fixed price betting in Queensland, South Australia, the Northern Territory and Tasmania. Tabcorp offers services in Victoria and New South Wales;
- In Western Australia and the ACT, wagering services remain government owned, however these organisations both currently have contractual arrangements with private operators to provide tote pooling services and fixed odds services; and
- Internationally, there is a mixture of government owned and privatised wagering markets, but no evidence of 50:50 joint venture arrangements. Most notably, the French government owned betting business Pari Mutuel Urbain (PMU) entered into a five year contractual arrangement with Paddy Power plc in 2010. These two businesses have a

profit-sharing arrangement, whereby Paddy Power contributes its pricing and risk management expertise to PMU.

Of the major gambling markets that PwC has reviewed, the counties have either government-owned or fully privatised wagering markets.

4.4 *Outsource*

The Outsource option is defined as a contractual arrangement between ACTTAB and a third party provider for the provision of management services for a defined period and payment regime.

4.4.1 *Execution issues*

Structural considerations for ACTTAB in undertaking the Outsource Option include:

- A Management Services Agreement (MSA) will need to be developed. The scope of these services will likely include topics such as:
 - The scope of services;
 - The quantum of fees for service; and
 - Incentive and penalty regime.
- The Territory will need to ensure that it has the appropriate contract management infrastructure in place in order to monitor performance of the contract.

The opportunities for the Territory from the Outsource Option include the following:

Management Expertise	<ul style="list-style-type: none"> • ACTTAB business practices will likely benefit from the expertise of the outsourced operator.
Risk Sharing	<ul style="list-style-type: none"> • Contracted business operating risks will be transferred to the outsourced operator. Importantly, not all operating risks can be outsourced and the shareholder retains ultimate risk if the business deteriorates during the contract period.
Incentive Regime and Performance	<ul style="list-style-type: none"> • The payment incentive regime will be designed to promote improved operating performance.

The risks for the Territory from the Outsource Option include the following:

Complex Contract Management	<ul style="list-style-type: none"> • This structure is best suited to situations that are clearly defined and limited in scope and with little or no potential for growth and diversification or where risk transfer rather than risk sharing is sought. • The industry in which ACTTAB operates does not fit this profile. As a result it will be difficult to define in the MSA contract all
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	<p>possible commercial eventualities. In such an environment there is heightened risk of contract disputes.</p> <ul style="list-style-type: none"> • Parties to the contract tend to work less closely, relying more on the contract as the basis for commercial decision making.
Reliance on Provider	<ul style="list-style-type: none"> • ACTTAB will become reliant on the service provider for management and technological expertise. • At the time of contract renewal this reliance could create succession issues for ACTTAB.
Capital Requirements	<ul style="list-style-type: none"> • The Territory will retain all shareholder risks and capital requirements that are not defined in the contract as the responsibility of the service provider.

4.4.2 Market Precedents

Concessional outsourcing arrangements are commonly implemented by the Federal and State Governments for large infrastructure projects, whereby the government engages a skilled contractor to deliver the project on time and within budget and operate the project within defined KPI's. Features of these types of arrangements include:

- Long term contract of 20 – 25 years;
- Fixed price and term for contract delivery;
- Management operating contract with a defined scope of works, KPI's, incentives and penalties; and
- Transfer mechanism at contract maturity date.

These types of arrangements have been utilised for infrastructure projects and social assets such as hospitals and prisons.

There is no evidence of similar government outsourcing arrangements in the Australian or international wagering markets

4.5 Trade sale

The Trade Sale Option is defined as the sale of 100% of the shares in ACTTAB and an exclusive licence to operate to a single suitable private sector party for cash consideration.

4.5.1 Execution Issues

The Trade Sale Option execution requirements will include:

- A Purchase & Sale Agreement that will define the terms and conditions of sale, warranty regime and any service obligations to be imposed on the new owner;

- An exclusive licence to operate pari-mutuel wagering, fixed odds wagering, sports betting, trackside and Keno for a period of at least 15 years;
- Definition of any tax regime to be imposed on the new operator. In other jurisdictions the wagering tax regime is calculated as a percentage of revenue or charged as a flat annual fee;
- Definition of any regulation requiring a percentage of revenue and profit to be paid by the new operator to the Territory for distribution to the local racing industry; and
- The Trade Sale execution process will require consideration of the following matters:
 - **Sale Structure:** Sale of shares or sale of assets. The effect of a sale of shares would be to transfer ownership of the entire legal entity of ACTTAB, which will include all of the assets and liabilities of the business. A sale of assets involves the transfer of the operating assets and liabilities of ACTTAB to be sold to the purchaser. This would include tangible and intangible assets required for the operation of the business.

Trade buyers generally prefer the sale of assets alternative, in situations where the entity to be sold includes other subsidiary entities that may have their own risk profile. Whether a sale of shares or assets is adopted;

- Consent from third party contract parties should be undertaken; and
- Completion will require ACT Legislative Assembly approval.
- **Vendor Due Diligence:** An important part of the preparation for sale will be the completion of a comprehensive vendor due diligence program. This program provides a review of the underlying quality of ACTTAB's financial performance and a review of the assets and liabilities that will form part of the sale.
- **Tender Process Format:** The Trade Sale tender process will typically involve the following stages;
 - Presentation and drafting of marketing materials
 - Expression of Interest
 - Request for Tender
 - Receipt of Indicative Offers
 - Purchaser Due Diligence
 - Binding Offers
 - Preferred Purchaser Selection
 - Final Negotiations & Completion

The Trade Sale process could take between 6 to 12 months to complete.

The opportunities for the Territory from the Trade Sale Option include the following:

<p>Maximum Upfront Proceeds</p>	<ul style="list-style-type: none"> • The trade sale option will generate the greatest investor interest. • Potential investors will apply a control premium to their valuation of ACTTAB. • Some investors will have synergy savings with existing businesses that should enhance valuations.
<p>Risk Transfer</p>	<ul style="list-style-type: none"> • The Purchase & Sale Agreement will define for a complete transfer of risks to the new owner, qualified by any warranties that are offered.
<p>Industry Funding Regime</p>	<ul style="list-style-type: none"> • Presents an opportunity to potentially negotiate other sale conditions such as future industry funding and community sponsorship obligations.
<p>Management Expertise</p>	<ul style="list-style-type: none"> • ACTTAB could benefit from being part of a larger specialised wagering business. The outcome could be improved service to punters.

The risks to the Territory from the Trade Sale Option include the following:

<p>Reduced Control</p>	<ul style="list-style-type: none"> • The Territory will no longer be able to exert shareholder control over ACTTAB and will no longer be entitled to the annual payments, subject to the negotiation of a new tax regime. However, the Territory does have regulatory controls over ACTTAB that would continue if the Territory no longer had ownership control.
<p>Community Contribution</p>	<ul style="list-style-type: none"> • Depending on the business plan to be adopted for ACTTAB by the new owner, there may be a loss of some or all of the community funding and sponsorships that ACTTAB currently provides. • This risk could potentially be mitigated through mandating community service obligations in the transaction documents.
<p>Staff Redundancies</p>	<ul style="list-style-type: none"> • Depending on the business plan to be adopted for ACTTAB by the new owner, there may be a loss of some duplicated employment positions.

4.5.2 Market Precedents

Trade sales and privatisations are common in the gaming and wagering sector globally.

- The Australian ownership structure has been described in previous sections; and
- Recent European activity has included:
 - A recent international privatisation involved UK monopoly wagering business The Tote, which was acquired by UK bookmaker Betfred for £265 million in July 2011. As part of this purchase, Betfred committed to paying the racing industry £11 million in 2012 and £9 million for the remaining six years of its licence¹⁵; and
 - In Greece, the government is divesting a 33% stake in the country's only licensed gambling operator, OPAP, as part of its plan to raise EUR 2.3 billion from the privatisation programme. As at March 2013, seven parties have expressed interest in acquiring the stake in OPAP, which recorded revenue of EUR 4.0 billion in 2012¹⁶.

4.6 Racing industry issues

The issues facing the ACT racing industry are as follows:

- Funding levels – The majority of ACT racing industry funding is provided by the ACT Government under an agreement that was reached with the racing industry in FY12. The minimum level of annual funding is \$7.5 million in FY12 indexed to inflation;
- Prize money – ACT racing prize money per race has fallen below NSW provincial prize money per race therefore limiting the ACT's ability to attract better quality racing, and in turn higher turnover on their races; and
- Self reliant and sustainable in the long term – The ACT racing industry is reliant on the ACT Government for funding. Their preference is to operate under a direct funding model with the TAB operator similar to Victoria and NSW where the racing industry is funded by Tabcorp under a "Racing Distribution Agreement". The rationale being that the racing industry and the operator's interest are aligned in terms of growing turnover for the benefit of both parties. The ACT racing industry believes they require c.\$10 million of annual funding to increase prize money to levels comparable with NSW and ensure the sustainability of the industry¹⁷.

The above issues are unlikely to be resolved under the status quo, joint venture or outsourced management options, however, under the trade sale option there is an opportunity to negotiate a direct funding model between the purchaser of ACTTAB and the ACT racing industry. We note however, that unlike other states TAB/racing industry relationships, total profits generated from ACTTAB are unlikely to be sufficient to fund all the racing industry's requirements.

¹⁵ Capital IQ & Company announcements

¹⁶ Capital IQ & Company announcements

¹⁷ Based on consultations with ACT Racing Industry

4.7 Potential interested Parties¹

The Australian wagering market has undergone significant merger and acquisition activity in recent years by both local and overseas operators. Interest in the Trade Sale Option is expected from both local totalisator operators and corporate bookmakers, particularly those with overseas retail operations.

¹ Part of this section has been redacted for commercial in confidence purposes.

5 Indicative Valuation²

² This section has been redacted for commercial in confidence purposes.

Appendices

Appendix A Stakeholder Meetings

As part of the study PwC representatives met with the following parties to discuss various topics relating to the terms of reference.

- ACTTAB board of directors and senior management;
- ACT Racing Industry including; Canberra Racing Club, Canberra Greyhounds Club and Canberra Harness Racing Club;
- United Services Union;
- ACT Gambling and Racing Commission;
- Australian Hotels Association; and
- Clubs ACT.

Appendix B Valuation Materials²

² This section has been redacted for commercial in confidence purposes.

