

Julie Thompson

From: David Curry <david.curry@alhgroup.com.au>
Sent: Wednesday, 5 October 2016 8:48 AM
To: fgm
Subject: Submission to the Joint Select Committee on Future Gaming Markets
Attachments: Tasmanian Gaming Machine Arrangements 5 October 2016.doc

Dear Sir/Madam,

ALH Group is pleased to provide this submission to the Joint Select Committee on Future Gaming Markets.

If you wish to discuss this submission please contact:

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Yours Sincerely,

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Response to the Joint Select Committee on Future Gaming Markets

Prepared by:

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Submitted to:

The Secretary
Joint Select Committee on Future Gaming Markets
Legislative Council
Parliament House
Hobart TAS 7000

5 October 2016

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Tasmanian Gaming Machine Arrangements

ALH note Government policy position is that the rights to operate EGMs post 2023 will be allocated and priced by a market-based mechanism, such as a tender.

Alternative structural options for the ownership of EGMs in hotels and clubs post 2023 – the current single network model could continue, with the rights to own and operate that network put to the market, or alternative models such as individual venue ownership under a common network control platform could also be considered.

The finalisation of a policy position on this will be informed by a public consultation process concluding in 2019

Hotel and Club EGMs:

- The right to operate EGMs in clubs/hotels post 2023 will be allocated and priced by a market-based mechanism (such as a tender) with the model for possible structural options (i.e.: the current single network model or an individual venue ownership model under a common network control platform) to be informed by a public consultation process.
- State wide EGM numbers to be capped from 2023 at 3,530 machines (a reduction of 150 machines from the current cap of 3,680).
- The tax rate and licence fees for EGMs in hotels/clubs to be reviewed against the broader Australian market.
- The Community Support Levy applicable to EGM activity in hotels/clubs to be reviewed.
- A new public interest test to be applied by the Tasmanian Liquor and Gaming Commission to the re-location of EGMs in new hotel/club venues with immediate effect (but without any requirement for retrospective approvals).

Public Process to Inform Structural Arrangements:

- Establishment of a Joint Select Committee of both Houses of the Tasmanian Parliament to undertake a public consultation process and report by the end of 2016.
- Possible terms of reference for the Committee (yet to be finalised and to be decided by both houses) would, in the Government's view, include:
 - Consideration of the Government's policy position as outlined;
 - Assessment of options on how market based mechanisms to operate EGMs in hotels/clubs could be framed;
 - Consideration of future taxation and licensing arrangement (informed by those in other jurisdictions);
 - A review of harm minimisation measures and their effectiveness, including the Community Support Levy;
 - Consideration of the duration and term of licences for the various gambling activities post 2023; and
 - Any other matters incidental thereto.

ALH Group

ALH operate 330 licensed venues and over 550 retail liquor outlets across Australia employing almost 16,000 people. These venues offer a diverse hospitality experience including, sports bars, bistros, restaurants, cafes, electronic gaming, retail liquor, accommodation, nightclubs and wagering. ALH venues are located in capital cities and urban and regional centres across Australia.

Our hotels

- Serve over 57,000 meals each day
- Offer over 1,800 accommodation rooms
- Spend over \$28 Million per annum on bands acts and DJ's
- At a local (hotel) level ALH sponsor over 1,000 clubs nationally and our hotels provide a meeting place for many local community groups.

Responsible Gambling

The ALH Group is committed to providing responsible gaming in our venues. We have devised and introduced some very unique and innovative responsible gambling initiatives of which we are very proud.

For the last seven years, the ALH Group has worked with David Schwarz, a well-known former professional footballer and reformed problem gambler, as its Responsible Gambling Ambassador. David provides employee education and customer awareness about the importance of "asking for help if your gambling becomes a problem" Most importantly, David is available for our staff to discuss any gambling problems they or their families and friends may be experiencing.

We want to ensure our hotels provide a safe and supportive environment where our customers make informed decisions about gambling and provide timely appropriate assistance and information. We have developed and distributed a responsible gambling pocket guide to every one of our gaming staff

ALH have a hotel and gaming charter that clearly demonstrates our commitment to responsible gambling.

ALH complies with all applicable responsible gambling legislative requirements in each state and participates in many state and local government gambling working groups to assist in identifying and developing appropriate responsible gambling initiatives

ALH hotels operating standards are well in excess of legislative requirements.

We are focusing on staff education and training and partnerships as well as setting voluntary pre-commitment limits.

As part of our commitment to delivering Responsible Gambling, ALH has partnered with Bally Technologies as the preferred system provider across our Australian hotels to facilitate this strategy.

Bally Technologies is a market leader in gaming systems and has the ability to deliver Voluntary Pre commitment functionality that assists our customers stick to their limits by nominating spend and, or time limits on the electronic gaming machine at kiosk or at the cashier.

We have pre-commitment functionality on every gaming machine in all states except Tasmania. Federal Group has advised us in writing that they cannot facilitate or assist with implementation of pre-commitment.

ALH are very keen to install the Bally in machine hardware technology and external card readers (secured to the side of the EGMs) across the 150 gaming machines we operate in Tasmania in order to facilitate the Voluntary Pre commitment capabilities to our customers.

Economic drivers and EGM market environment

Gambling is a common recreational pursuit in Australia. It takes many forms, including lotteries and 'scratchies', electronic gaming machines, table games (e.g. roulette, blackjack), wagering and online gaming.¹

Gambling is now a 'mature' industry, particularly gaming in clubs and hotels and wagering on racing. Over the five years to 2014, the market grew 11% in total, to \$21.1 billion. This equates to a 1% growth in spending on all forms of gambling on a per capita basis.

Underlying these figures are several distinct trends:

- Gaming machine spending per capita is in decline – falling by 4.0% over the period from 2009 to 2014
- Casino revenues are growing – up by 16% per capita. This is driven by a significant increase in VIP revenues
- Within wagering, there is an on-going migration of pari-mutuel to fixed odds and sports betting, facilitated by increased access to betting accounts via mobile devices over recent years. Race wagering per capita fell by 2.0% but sports betting grew by 158%.

Trends in the EGM market in Australia

Gaming machines market share relative to other forms of gambling has decreased. This decline has primarily been driven by the following factors:

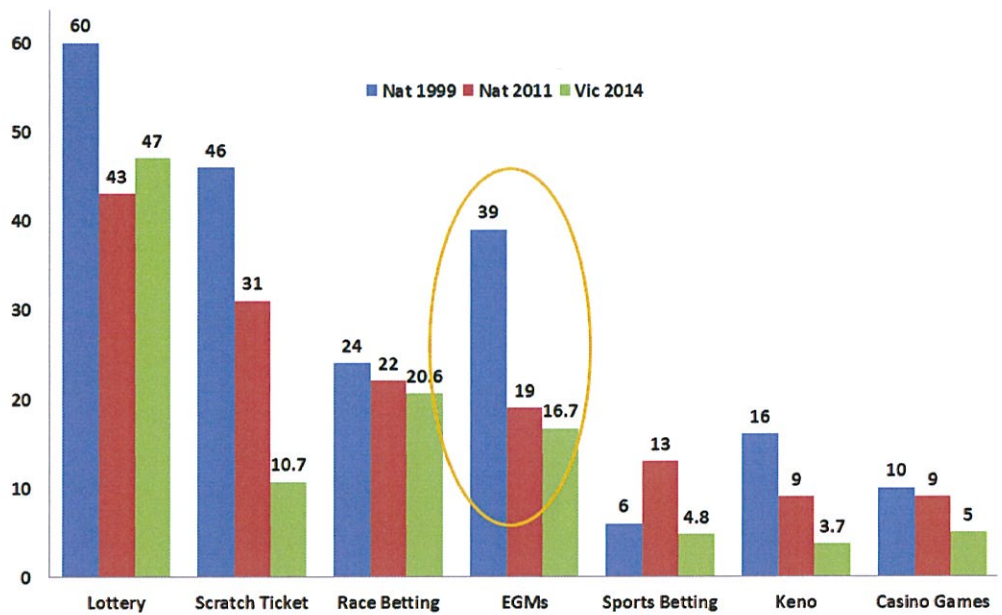
- A decline in the overall size of the gambling market in real terms. A recent study conducted by researchers at New South Wales' Southern Cross University, found 64 per cent of adults gambled in the past year, compared with 82 per cent back in 1999
- An increase in spending on other forms of gaming, particularly casinos, interactive gaming, and lotteries. This trend is shown in Figure 2.
- The explosion in popularity of sports betting. Between 2009 and 2014, sports betting increased by approximately 158%. While this increase was off a small base, the above mentioned study indicates that sports betting has doubled in popularity over the last five years.
- The impact of on-line gambling – A recent study indicated about 1.8 million Australians had gambled online in the past 12 months.²

The decline in EGM market share is not driven only by growth in other products – it also reflects a significant decline in rates of participation in EGM gaming itself. EGM participation (measured as the proportion of the population that spent any money on EGMs in the last 12 months) has fallen nationwide from 39% in 1999 to 19% in 2011.

¹ Productivity Commission, Inquiry Report – Gambling, No 50, 26 February 2010, p. 5.

² Hing, N., Gainsbury S., Blaszczynski, A., Wood, R., Lubman, D. and Russell, A. (2014) *Interactive Gambling*. Gambling Research Australia March 2014)

Figure 2: Changes in gambling participation rates, 1999-2014



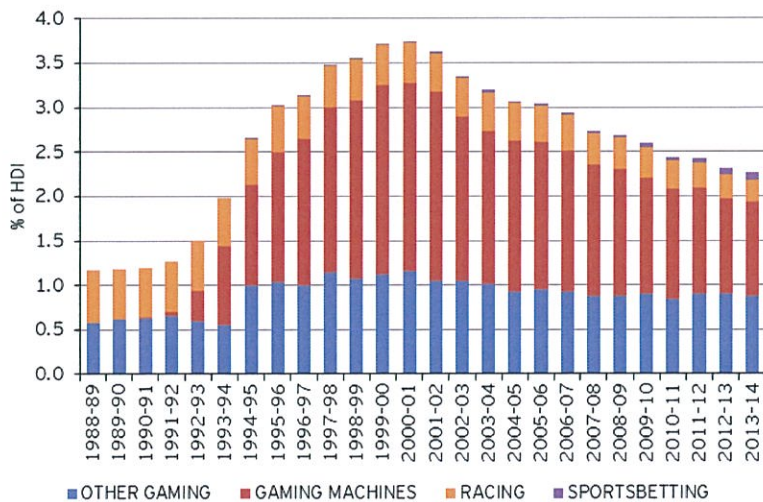
Source: Gainsbury (2013) "Interactive Gambling in Australia", and Hare (2015) "Study of Gambling and Health in Victoria"

Declining share of disposable income

As shown in Figure 3. Expenditure on gambling as a percentage of household disposable income peaked in 2000-01 and has since been on the decline. More specifically, expenditure on gaming machines as a percentage of household income has experienced the most notable decline - it declined from a peak of 2.14% in 2001-02 to 1.06% in 2013-14.

Consistent with the trends in sports betting noted in our analysis of gambling expenditure in the previous section, expenditure on sports betting increased as a percentage of HDI.

Figure 3: Expenditure on gambling as a % of household disposable income



Source: Queensland Government, Australian Gambling Statistics, 31st Edition, 1988-89 to 2013-14

Competition from other forms of entertainment

While electronic gaming machines compete for the gaming and wagering dollar they also compete more broadly in the entertainment market. That is, they are competing with going to the cinema, the theatre, a sporting event, etc. Over the last decade and more specifically over the last five years the level of competition within the entertainment industry has intensified.

The following table shows that the average weekly household expenditure on gaming machines has declined compared to spending on other recreational / entertainment services. The significant increase in other recreational spending is largely driven by internet and pay TV related services. The gaming machine product offering needs to be regularly updated and refreshed to make the product relevant and attractive in this highly competitive environment. This requires capital investment, which is being stifled by the current term of the entitlements. This will be particularly relevant towards the later period of the 10 year entitlement.

Table 1: Average weekly household expenditure on recreational / entertainment services

	2009-10		1998-99	
	\$	%	\$	%
Gaming machines	1.61	3.9%	1.21	5.2%
Other gambling	3.44	8.3%	4.68	20.3%
Sports	10.05	24.1%	5.27	22.8%
Cultural	7.31	17.5%	5.50	23.8%
Other recreational spending (excl holidays)	19.29	46.3%	6.41	27.8%
TOTAL	41.70	100.0%	23.07	100.0%

Source: ABS Cat No. 6535.0 Household Expenditure Survey, Australia: Detailed Expenditure Items

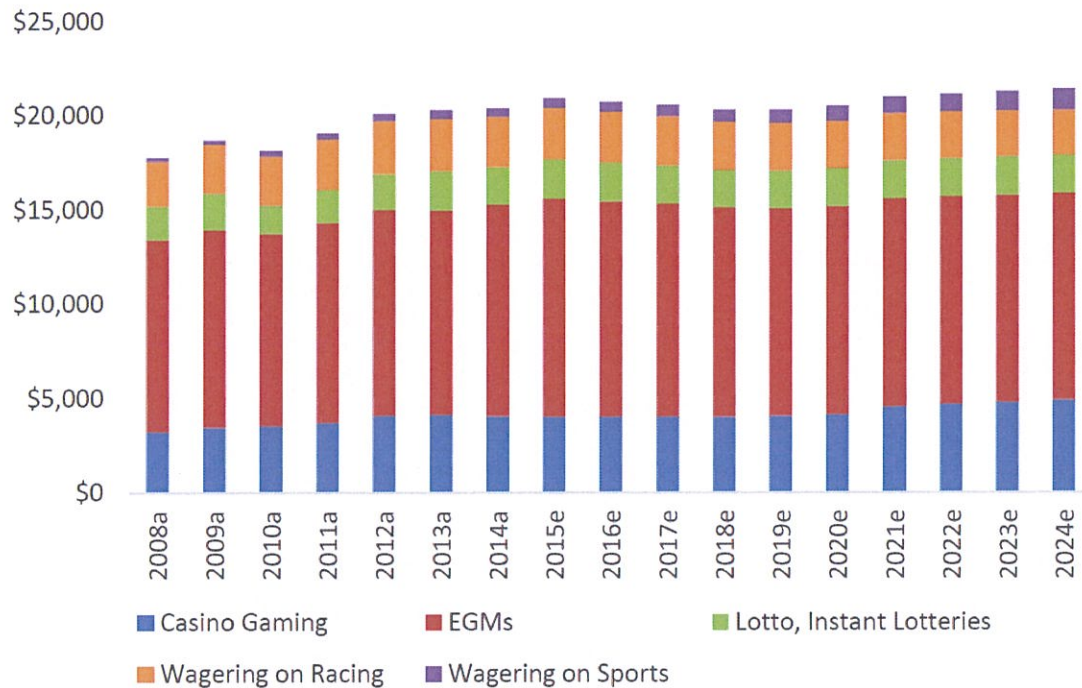
Forecasts

Spending on gambling is clearly linked to households' disposable incomes. Owen Gaming Research forecast overall spending on gambling in Australia to increase by 4% (in nominal terms) from 2013 to 2024 (to \$21.6bn). Within this, there are significant differences in the growth outlook of different segments of the industry:

- Gaming Machine spending is likely to increase by 1.1% (nominal)
- Spending on Lotteries and Race Wagering is likely to fall (Lotteries by 3.9% and Race Wagering by 13.2%)
- Sports betting and casino play are forecast to deliver strong growth (Casino Gaming to grow by 19.0% and Sports betting to grow by 136.3%)³

³ Owen Gaming Research, Australasian Gambling Market – A Review, Updated for National Data to 30 June 2014.

Figure 1: Historical data and forecasts of gambling spending (national), \$m



Source: Owen Gaming Research, *Australasian Gambling Market – A Review, Updated for National Data to 30 June 2014*.

Key drivers underpinning the forecasts of spending on gambling are:

- Disposable income growth – the Productivity Commission has forecast longer term household income growth to be 1.1%, about half of what was seen on average from 1993 to 2012
- Household growth – household numbers are expected to grow from 8.7 m in 2013 to 10.6 m by 2014, based on ABS projections.
- Gambling’s share of disposable income is expected to continue to decline in the absence of regulatory change or new form of gambling or licenses being approved.

A greater emphasis on economic efficiency in entitlement allocation and on supporting the investment environment for venues will be important to ensure the EGM industry delivers continued growth, investment and employment as well as a fair financial return to the State.

Competition between venues

Venue operators effectively compete within a price-regulated industry. The minimum Return-to-Player rate (the closest thing to a ‘price’ of gaming) is set in legislation, removing the key avenue by which concentration in a market causes consumer detriment – higher prices.

Venues can compete for EGM players by their location, by the quality of the environment and machines, and by the quality of their complementary businesses (e.g. bistros and bars).

Gaming venues are increasingly subject to competition from other forms of gambling. They are also subject to competition for EGM players from the casino, which sits outside the entitlement system and receives preferential treatment in many regulations (e.g. opening hours). These forces discipline all gaming venues into providing a better product, regardless of ownership.

Venues also compete within a broader hospitality and entertainment market – competing for recreational gamblers means competing with non-gambling food and beverage venues as well as other gaming venues. The EGM gaming share of entertainment expenditure has fallen by a quarter since 1999, while the share of other recreational expenditure has grown by two-thirds – with far more varied consumer options available now, gaming competes in a broader entertainment market.

In summary, gaming entitlement owners are:

- legislatively restricted from significantly raising prices
- practically unable to improve the consumer offering by increasing availability in prime locations, and
- subject to increasing competitive tension from other gambling forms, casino EGMs, and the broader hospitality and entertainment industry.

Product Innovation

Under the current arrangements, venue operators have no ability to determine the price (return to player) and quality (type of game and denomination) of the product they offer to consumers.

These aspects of the business are licensed to the Federal Hotel Group who is responsible for sourcing and distributing product to venue operators.

The licensees choose the source manufacturer, the product, denomination and return to player for all EGMs in all other Australian states.

Whilst under these arrangements some competition exists at a “network” level between the licensees there is more potential for vigorous venue to venue competition on the basis of product quality, price and marketing.

Bill note acceptors should be able to be fitted to all club and hotel machines in Tasmania as per all Australian mainland states (except South Australia). This would also ensure regulatory neutrality with Tasmanian Casinos.

Distribution of benefits

A key rationale for moving to a venue operator model is to ensure that “the financial benefits of gaming are fairly and more broadly distributed”.

A venue operator model would break the monopoly where a single operator, by law, is entitled to a revenue share that provided them extensive profits (at the expense of venues and taxpayers). A new owner operator model ensures venues benefit directly from operating EGMs, and pay the wider community for the right to do so via taxation and competitively-determined premium payments.

The financial benefits of gaming machines are understood to be distributed to the community through four channels: taxation revenue, direct community benefits provided by venues, economic activity created by venue operators in their local community, and broader economic activity arising from the gaming machine industry.

ALH supports the existing tax structure, while emphasising the need for certainty over tax rates in order to encourage investment in venues and products.

Licences should be issued in-perpetuity which will ensure an environment of investment confidence and offset increased levels of revenue risk and perceived tax and regulatory risk in the industry.

Gaming venues face stronger competition from other forms of gaming – e.g. mobile sports betting – than in the past, and are seeing declining participation rates and average spending.

More intense competition for consumer dollars raises the level of on-going investment required to provide an innovative product (e.g. via new machines and games) and a quality venue environment. The declining revenue outlook also lengthens the payback period on venue and machine investments, because investment costs remain fixed while annual incremental revenue from the investment declines.

The replacement cycle for gaming machines in Australia is trending between 9-10 years, down from the 15-year average seen up until about 2010.⁴ The shortening of the cycle illustrates the heightened need for investment in new product to remain competitive. However the overall replacement cycle remains relatively long compared to the current 10-year term, making machine acquisitions later in the entitlement term riskier investments.

Both of these factors raise the importance of an in-perpetuity licence to permit investments to be recovered and to give financiers confidence that venues will not be left with stranded venue assets but no entitlements from which to generate income.

Without confidence over investment returns, venue operators with interstate operations such as ALH may prioritise allocation of investments to jurisdictions where licences are issued in-perpetuity and thus investment risk is seen as lower.

The licences also cannot be seen in isolation from the riskiness associated with income streams, both from the point of view of venues considering entitlement purchases and asset investments, and from the point of view of financiers considering supplying capital for one or both of these.

Without strong guarantees of tax and regulatory certainty, venue operators and financiers will apply a much larger risk premium to expectations about future revenues and apply a higher hurdle rate to investments.

This means venue operators' willingness to pay for entitlements upfront will be lower, reducing premium revenue to the State. For asset purchases that have a fixed cost (i.e. machines and venue investments), this higher hurdle rate may deter investment entirely unless the licence term is issued in-perpetuity.

The following table below provides comparison of recently traded gaming machine entitlements in other states. The price in other States reflects the perpetuity of the term along with consideration on the tax rates.

⁴ Bank of America Merrill Lynch "Primer: Australian Gaming 2016".

State	Term of entitlement	Last trade price paid for entitlement
<i>Victoria</i>		
Club (PACO and auction))	10 years	\$39,710 ⁽¹⁾
Hotel (auction only)	10 years	\$32,030 ⁽¹⁾
Market traded	8 years remaining	\$80,000
New South Wales	Perpetuity	\$135,000
South Australia	Perpetuity	\$37,250
Northern Territory	Perpetuity	\$55,000
Tasmania	Licences held by Federal Hotel Group	
Queensland	Perpetuity	
South East Queensland		\$87,058
Coastal		\$72,678

(1) Average price paid for 13,750 and 13,550 entitlement respectively Victorian government allocation process

ALH believe that the licences should be issued in perpetuity which would;

- Be in line with the other Australian States and also mirror the period for which liquor licences are issued
- Create an environment of investment certainty which has the flow on effect of capital investment in our properties and job certainty for our staff

ALH will focus its capital investment in the Australian states based on both return and where GME licences are issued in perpetuity

ALH will consider a variety of options for the allocation process, noting that there are numerous variations of each model which can be developed. A lot of the decisions around the structure of the allocation process, be it competitive or administrative (or some hybrid), will influence the effectiveness of the process. For example:

- The timing of the process
- Whether it is open to current holders only
- When the changes apply from
- The term applying to the new entitlements
- Certainty provided around tax and regulatory settings

It will be important that an administrative process, or any reserve-setting as part of a competitive process, recognises other policy settings around the future entitlements. For example, if certainty over tax rates and key regulatory settings can be provided for a minimum period, the appropriate discount rate to use in valuing entitlements should be lower. Equally, a longer licence term lessens risk of stranded machine or venue investments which can be reflected in any administrative (or reserve-setting) formula.

ALH would consider a variety of payment terms. An option for discounted up-front payments should be provided.

The Government should not perceive any value in introducing 'friction' into the transfer market by imposing taxes on transfers or on profits made on sale of entitlements.

Doing so may ultimately cost taxpayers foregone revenue as the transfer market fails to facilitate redistribution of entitlements towards venues where they generate more revenue. The upfront price venue operators are prepared to pay for entitlements will also be reduced if it is perceived that, in the event of wishing to divest venues or entitlements, the proceeds will be suppressed by a sales tax.

In addition, unless a costly administrative regime was devised to implement the tax, the State would run the risk of venue operators finding loopholes. A transfer market tax might therefore produce little revenue while venues end up incurring additional costs to minimise tax payable.

For example, if a venue is sold with EGM entitlements included there would be no incentive to record the value of the entitlements transferred above their book value (i.e. price paid), even if the market value is higher. Policing the varied ways in which venues might structure transactions and payments to avoid a transfer tax would be difficult and costly.

The industry should be provided more certainty over future taxes and levies, and over other major regulatory settings.

The EGM industry has been subject to increasing regulatory restrictions, and exists under a constant threat of regulatory change that raises risk perceptions amongst venues and investors and reduces the market value of EGM entitlements. Major regulatory changes over the last 15 years are shown below.

Regulatory changes can also impose significant costs; deterring investment and reducing the value the industry are prepared to pay for entitlements. Without strong guarantees of tax and regulatory certainty over the future licence term, venue operators and financiers will apply a much larger risk premium to expectations about future revenues, which will reduce venue operators' willingness to pay for entitlements upfront. If the State is unable to institute arrangements to provide as much certainty as is legislatively possible, it faces the real risk of receiving far lower price per GME.

That is, taxpayers have a clear interest in providing industry with sufficient certainty to purchase entitlements and undertake investments with confidence around key tax and regulatory settings affecting revenues and costs.

Without greater confidence around future regulatory and tax settings, venue operators with interstate operations such as ALH may prioritise allocation of investments to jurisdictions where investment risk is seen as lower.

A key metric for ALH is return on investment and therefore value to shareholders. If the rate of return on investment in the gaming machine sector diminishes due to the factors discussed in this paper, ALH may find it increasingly difficult to justify further investment. A reduction in capital investment in the gaming machine business is likely to have flow on effects such as:

- Downward pressure on ALH's gaming machine revenue
- Downward pressure on gaming machine tax receipts to government.
- Impact on industry employment.

Although Governments cannot truly bind future Parliaments (except via constitutional change), they are able to legislate strong signals to future Parliaments. Governments should provide strong protections against regulatory risk where this generates certainty, investment, employment, and licence revenue to the state.

Guaranteeing tax rates will lead to more certainty amongst entitlement purchasers and may ultimately increase total revenue (licence premiums plus tax) to the state. Where the entitlement term is perpetual, a reasonable model would be to recognise that more is being staked upfront by entitlement purchasers and a fixed period of tax certainty (e.g. 10 years) is required to reduce this risk and hence increase purchasers' willingness to pay upfront.