

Date: 27th October 2008

Subject: SIS/Turf TV

At the Levy Board meeting on 22nd October Sir Philip Otton indicated that the Bookmakers' Committee (BC) had provided him with a range of values between £29 million and £77 million pa. At the meeting Chris Bell referred to a figure of £40 million pa. Racing considers this figure to be wildly over-estimated.

VAT

There is no reason why the BC should incorporate any irrecoverable VAT in their estimate. Their taxation profile is purely a matter for them. For example they benefit by not having to charge customers VAT on most of their products. As Racing receives Levy on the basis of gross winnings not turnover, VAT is even less relevant to this exercise.

The headline costs

There are approximately 8,500 licensed betting offices (LBOs) in mainland Britain. The publicised cost for Turf TV is £6,500 per LBO. On this basis the maximum total charge for Turf TV would be £55,250,000. However we know that the charges to the big 3 are significantly below this figure. Similarly the independent LBOs were offered an early adopter first year discount of 25%.

We know that SIS reduced their charge by £1,900. This would equate to a reduction of £12,350,000.

Consequently the difference can't be higher than £42,900,000 even if everyone was charged the full rate. We know this is not the case. We would expect the headline cost to be up by between £30 million and £40 million pa. However, within this figure there a number of items which should be excluded from "capacity". They are dealt with below.

Increases in right fees

There have been periodic rights fee increases over the past 30 years, notwithstanding that there was only one service provider before 2007. For example in 2002, when the contract changed from between SIS and the RCA to between individual racecourses and BAGS (or SIS), the income increased from £12 million to about £30 million pa. The BC forecasted, in May 2008, that in 2007 the combined payments to all British racecourses were about £35 million.

In May the BC estimated that SIS/BAGS is now paying £25.5 million pa for approximately half the rights. If one assumes that the Turf TV rights fees are at the same level, then the increase in rights fees is approximately £16 million pa. The BC has never in the past 20 years contended that LBOs should receive any relief from the Levy for the operation of these market mechanisms. Appropriately, it should be deducted from the headline difference in costs. This reduces the difference highlighted above to the range of £14 - 24 million.

Overseas rights fees

Similarly we understand that there have been increases in other rights fees that make up the Turf TV and SIS service. SIS retained its exclusive rights to Irish horseracing. If one conservatively assumes a similar rate of growth to British horseracing then the costs would have increased by approximately £3 million pa. There are also rights for other overseas horseracing and greyhound racing. We would put the estimated increase in costs at £5 - 10 million pa. This further reduces the difference between the previous monopsony and the current regime to a range of £4 to £19 million.

It is worth noting here that Turf TV now broadcasts South African racing, which was previously part of SIS programme, and the cost of South African racing has been absorbed into the standard Turf TV licence fee. SIS's costs have actually **reduced** in this area, though we note that SIS is not proposing a rebate for this cost reduction.

The loss in value of service

BAGS did not react to the potential introduction of competition of Turf TV in a normal market manner. BAGS objective is (or should be) to acquire access to rights at the best economic value. The introduction of competition had the potential to put downward pressure on SIS's charges. This would have been an objective of all independent LBOs and at least Coral. The position of Ladbrokes and William Hill is interesting because they are the two largest shareholders in SIS. Like Coral they will pay a significantly lower cost per LBO than the independents for both the SIS and Turf TV services. However, they also benefit from significant dividends from SIS. This relationship has in our view prevented to date the normal downward pressure on SIS's charges one would have expected, and indeed SIS has in fact increased its charges.

BAGS announced, when faced with the introduction of Turf TV, its support for SIS. It acquired exclusive rights which it then made available only to SIS, despite a request from Turf TV for access to these rights at the same price that SIS offered to pay. Why did it act this way? It was suggested in the High Court that their objective was to prevent the launch of Turf TV, and the only contradiction to this view was offered by BAGS' then CEO who said that the reason was that BAGS did not believe that Turf TV would be able to operate a credible service, a position which has since been proven wrong.

BAGS and SIS are, in our view, in large part responsible for the overall increase in costs to the industry. The BC can't, in our view, justifiably ask for Levy relief from the consequences of its own actions.

SIS should have reduced its prices to reflect the loss of value in its service. This far exceeded the £1,900 per shop referred to above. That reduction merely passed on some or all of the direct cost savings reduced by the increases in British rights fees, about 15% of the SIS cost. The loss in value was over 40% of the value generated by the previous service.

The cost of the SIS service prior to the launch of Turf TV was approximately £13,000 pa. Horseracing accounted for about 46% of the gross profit generated by LBOs from the content in the SIS service. The content lost to Turf TV is about 57% of the British

horseracing content (based on gross margin). The loss in value is therefore equivalent to $\text{£}13,000 \times 46\% \times 57\%$ ie $\text{£}3,400$. We contend that SIS should have reduced its charges by a further $\text{£}1,500$. This accounts for a further $\text{£}12.75$ million pa.

This accounts therefore for practically the whole of the alleged "impact of Turf TV".