

# **MECN's 2005 review and 2006 outlook of the gambling and gaming industry**

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We have been tracking the media and entertainment industry for quite a while now, and we have seldom seen any industry sector moving and shaking as much as today's gambling and gaming sectors. Therefore, we would like to review the highlights of 2005 and look ahead to what is in store in the coming year. Let's begin with our review of an exciting year.

## **2005 – The year that was**

We saw the gambling industry coming out of the shadows of the economy and becoming one of the rising stars of the stock markets. We witnessed private operators attacking state monopolies – sometimes successfully and sometimes not – and we saw state operators reacting to this threat. We realized that cross-border gambling will slowly become a reality, and more state operators will more and more hand over operative responsibilities for their businesses to private companies. All in all, 2005 was full of groundbreaking developments shaping the industry – we will highlight some of the most important ones.

## **Online poker – IPOs and Svenska Spel**

Online poker is a phenomenon that has been closely watched by many industry experts for quite a while now. But it was not until Party Gaming's IPO, one of the biggest ever in London, that the world took notice. Suddenly online gambling was THE topic at stock markets all over the world. Many other IPOs followed, and stock prices of almost all online operators rose to P/E ratios previously known only from the good old Internet

boom times. But as in all booms, many investors are on tenterhooks and anxiously wait for signs of decline and market saturation – but until now there has not been much to worry about.

What came as a surprise was the quick reaction of one of the forerunners of the state-controlled operators to the new threat of online gambling. As Scandinavia is one of the key regions for online poker, the Swedish state lottery Svenska Spel just recently announced its plans to launch its own online poker offer, which is expected to bring about USD 40 million annually to the Swedish state coffers. The question now is whether other state operators will follow this strategy.

### **Gambelli, Gambelli, and no end in sight**

What started in November 2003 with the advocate general of the European Court of Justice outlining his opinion in the Gambelli case seems to have become a never-ending story. Almost every month each side (state vs. private operators) can celebrate some kind of small victory.

On the one hand, several European supreme courts (e.g., Italy, Netherlands, ...) decided in favor of the state monopolies and gambling was once again excluded from the EU-wide service directive. On the other hand, many national decisions are still pending (e.g., Germany), and the EU commission continues to be concerned about pursuing a common gambling market and regularly calls on countries to justify their regulations. At the moment the conflict seems undecided with no conclusive decision in sight.

### **Privatization – staying competitive**

It seems to happen quietly and without wide public notice – privatization of state-controlled gambling operators. The reasons are manifold and range from filling empty state budgets to trying to stay competitive in an increasingly tough

market. More and more state operators are now owned and operated by private companies and shareholders. The list is already quite long and includes the Who-is-Who of state-controlled gambling (e.g., UK National Lottery / Camelot, OPAP, Asian Berjaya, ...).

More privatizations are expected. In fact, more than 70% of gambling experts questioned in a recent survey anticipate an increase of privatizations in the gambling industry in the near future. Among the privatization prospects mentioned were Milli Piyango, the UK Tote, and a large number of casinos in Germany as well as many state operations in developing countries.

### **Macau – where Asia beats Las Vegas**

What poker is for online gambling Macau is for land-based casinos. Macau has long had a flourishing entertainment and casino industry, and with more than USD 4 billion in gambling revenue it will unseat Las Vegas as the Mecca of gambling. Three gambling licenses were signed with private operators, and more and more US large players (e.g., Wynn) open new mega-casinos in what is believed to be Asia's gambling hub.

### **More to come next year – looking ahead to 2006**

#### **The carefully thought out revenge of the state operators**

For a long time the state monopolies were slow in reacting to threats such as online gambling. Many private operators would like to see state monopolies minimizing their marketing efforts in order to focus solely on curbing the passion for gambling. But the truth is quite different – state monopolies have to advertise and have to expand their portfolio. Particularly in the Internet sector, an expansive strategy is in some cases a must and not just an option.

In order to curb the passion for gambling and bring it under the control of state authorities, jurisdictions have to

prevent that more and more customers turn to hard-to-control Internet offers, which are sometimes operated in hidden and small jurisdictions. However, this does not mean that state operators themselves should begin to develop and launch new products before even private operators do so; three rules should apply:

1) Only react and do not initiate action – only launch a product if competitors have already introduced something similar.

2) But react much faster – it is not acceptable that it takes even forerunners among state operators 3-5 years to launch products after private operators have already done so (e.g., online poker).

3) Always analyze the legitimacy of expansive strategies – some expansions are necessary while others are only intended to fill state coffers.

### **Private companies will take over sales for state operators**

Sales for state lotteries have long since been handled by private companies. Most of these were little shops, which in return for 5%-8% commission sold the entire product portfolio of the state lottery – a system implemented around the globe. But this arrangement is changing rapidly, and large companies are increasingly taking control of entire retail channels. Sometimes they develop new sales channels, as Tipp24 did for the Internet; sometimes they develop and sell new product bundles, and sometimes they just use their massive retail network (e.g., Lottomatica). This trend will continue as state lotteries are seldom sales experts and competition forces them to look for private companies whose key competence is sales, sales, and sales.

### **Casual Gaming**

With other growth sectors in the gambling industry maturing,

the search is on for other, as yet unpolished gambling gems. According to many experts, casual gamblers and gamers are the ones who will trigger the next growth spurt in the industry. The casual gambling and gaming sector includes many offerings ranging from bingo and skill-based games, such as Solitaire, to the „Betfair Light Version“ on Yahoo. Although some of the casual gambling and gaming offers have already been in existence for several years, the industry has only recently begun to focus on them.

### **Betting and the soccer world championship**

The betting market will continue to grow, pushed by online offers and the soccer world championship in 2006. Before the start of the championship in summer many operators will launch new offers (e.g., live betting), and advertising and media coverage will be reaching new heights. New players probably will successfully enter the betting market, and others will likely fall by the wayside because they cannot not live up to what their share prices promise.

### **Consolidation in P2P pushed by investors**

Liquidity is everything when it comes to the p2p business, and the two major gambling p2p models – betting exchanges and online poker – are no exception. That’s why in both markets there are dominant market players, Betfair for betting exchanges and Party Poker for online poker.

Most of the other offers make a decent living but nothing that thrills big-time investors such as private equity companies. And these investors make their money by buying several companies offering the same product, consolidating to realize synergies, and then selling the company again. If you think betting exchanges and online poker would be of interest to such investors, you’re absolutely right.

### **More IPOs to come?**

It would be nice if there were an endless supply of investment money for the gambling industry. But the reality is that hardly any other industry has to fight as many objections as the gambling industry: no oil money can be invested due to sharia-compliant investment rules, and there is little money from „politically correct“ US investors.

While that leaves more profit to be divided among fewer investors, it limits the total amount of money available from institutional investors. Traditional gambling companies such as Harrah's take a big chunk of that money, and rising stars such as Party Gaming and Sportingbet take most of the rest. So will there be enough investment money for many future IPOs to come? We doubt it and so did probably Betfair, which cancelled its IPO a few weeks ago and lost its CEO and CFO in the process.

So we can expect a lot for the months to come. MECN wishes you and your family a merry Christmas and prosperous new year.

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About MECN: MECN is a network of experts in the media and entertainment industry that offers its clients detailed expertise and analyses regarding business strategies.

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