Department for Culture, Media & Sport

Review of Gaming Machines and Social Responsibility Measures:
Call for Evidence dated 24th October 2016

Written evidence submitted by Satellite Information Services Limited in response to Question 8 in the Call for Evidence:

"Any other relevant issues, supported by evidence that you would like to raise as part of this review but that has not been covered by question 1-7 above?"

1. Executive summary

1.1. SIS is the largest and most technologically advanced supplier of television and data coverage of British thoroughbred horseracing and greyhound racing to the British betting industry. As such, it provides the conduit through which millions of pounds of media rights income annually flows from the betting industry to various stakeholders, principally (but not exclusively) those involved in the equine and canine bloodstock industries.

1.2. Since it does not operate licensed betting offices ("LBOs"), SIS takes no position on the regulation of gaming machines. Its concern lies with the potential unintended economic consequences of any regulatory measures on the number of LBOs in the UK, since a significant reduction in LBO numbers is expected to have a detrimental impact on the media rights revenues currently enjoyed by the racing industries, and on SIS itself.

1.3. A reduction of the UK's LBO estate by 2,000 LBOs would represent a loss to UK racecourses of c. £12 million p.a. (c.15% of their media rights revenue from SIS). It could also put SIS with its high fixed operating costs into a loss-making position, a consequence of which could be a cessation of business and the loss of £30.8 p.a. to the greyhound industry and £3.5m p.a.to digital content suppliers. Although other operators would almost certainly emerge to replace SIS at some point, the racing and betting industries would lose the benefit of SIS's efficient, low-margin business model which maximises the value of media rights to rights holders and customers alike. It would also compromise SIS's activities as an innovative technology company that re-invests the value generated by its core business in the creation of new products and services for the benefit of the racing and betting industries.

1. About SIS

<u>History and ownership</u>

2.1 Following a de-regulatory initiative in 1985 that allowed live television coverage of horseracing to be shown in LBOs, SIS was established in 1986 by the then four major bookmakers (Ladbrokes, Coral, William Hill and Mecca) to provide a satellite-delivered television service comprising live coverage of (initially) British horseracing and greyhound racing to LBOs in the United Kingdom and Ireland.

2.2 In 1987-88, the Racecourse Association ("RCA"), representing all 59 British racecourses at the time, and the Horserace Totalisator Board ("the Tote") took shareholdings of 10% and 6% respectively as part consideration for the grant of a non-exclusive media rights licence to SIS for the LBO market. The RCA and the Tote also had the right to nominate a director each to the board.

2.3 In 1991, the founding bookmaker shareholders were joined by two financial investors, MAI plc (the then holder of a number of independent television franchises) and Racal Electronics plc (the firm that launched Vodafone). These shareholders were replaced in 2005 by Caledonia Investments plc and Catalyst Media Group plc, who holds shares through its wholly-owned subsidiary, Alternateport Limited. At about the same time, the RCA relinquished its shareholding, but six racecourses retained their interest.

2.4 In 1987, Coral transferred its shares to Bass plc. Although in formal terms Bass plc became the shareholder, its nominated director to the board was from Coral and for all practical purposes Coral continued to be regarded as the shareholder. In 1998, Bass plc ceased to be a shareholder following the sale of the Coral business to Ladbrokes, at which point Coral ceased to have any corporate connection with the business. Upon completion of the merger between Ladbrokes and Coral in November 2016, Coral once again acquired an interest in SISH via its shareholding in the combined entity, Ladbrokes Coral Group plc

2.5 In 2007, Mr. Fred Done (the founder of the Betfred bookmaking brand) took a personal shareholding of 7.5%.

Structure

2.6 The SIS group comprises an ultimate parent company, Satellite Information Services (Holdings) Limited ("SISH") and a number of wholly-owned operating subsidiaries. The largest of these is Satellite Information Services Limited ("SIS"), the author of this submission. The interests of the shareholders referred to above are in SISH, the parent company. The current shareholdings in SISH are set out in Annex 1 to this document.

Current operations

2.7 With industry connections developed over 30 years, SIS is a leading supplier of products and services to online and retail betting operators in the UK. It was innovative from its inception: after the then three public telecommunications operators (BT, Mercury and Kingston-upon-Thames), SIS was the first private company to be issued with a satellite service operator licence and launched its satellite service for licensed bookmakers in May 1987, even before the advent of BSB and Sky TV.

2.8 SIS has two principal business activities: SIS Betting, which provides content services to bookmakers worldwide, and SIS Live.

2.9 SIS Betting now delivers content to bookmakers via 28 television channels to c.10,000 LBO sites in the UK and Ireland (of which 9,103 are in the UK), c.6,000 sites in the rest of the EU and a further c.1,000 sites internationally. Its content comprises television coverage of live racing, data and commentary from racecourses and greyhound tracks in the UK, Ireland and other territories, as well as "virtual racing" (computer-generated animation) to its customers via its own satellite uplink facilities. It also delivers content to online bookmakers via its recently-developed proprietary streaming platform. Further details may be found at www.sis.tv

2.10 SIS Live provides outside broadcast and connectivity services to customers such as broadcasters (e.g., BBC, ITV, BSkyB and SIS itself) and sporting event rights holders (e.g., the organisers of the Commonwealth and Olympic Games and Arena Racing Company). See www.sislive.tv for further details.

SIS financial position and contribution to the British economy

2.11 SIS's group turnover for the financial year 2014/15 was £229 million[1]. It operates television production, satellite uplinking and internet streaming facilities in Milton Keynes and in MediaCityUK, and has c.475 employees. Its audited accounts for the year ended 31st March 2016 report group turnover at £228 million. [2]

[1] 2015 SISH audited accounts, see Annex 2
[2] 2016 SISH Audited accounts, see Annex 3

2.12 In the year 2015-16, SIS contributed £[…] to HM Treasury, split between £ […] in PAYE and NI contributions and £4.7 m in corporation tax. Its products and services are considered to be an essential raw material input by virtually all licensed bookmakers in the UK, a sector which generated an estimated economic footprint of 100,300 FTE jobs and £5 billion of GVA in 2011.[3] It currently pays £84.3 million per year in media rights fees to the UK horseracing industry, which in 2012 generated a GVA of £3.45 billion.[4]

Diversification and innovation

2.13 In 2013 SIS started to diversify into the digital market, and now has a portfolio of digital game products that includes 2D and 3D horseracing, greyhounds, cycling and themed novelty variations. SIS is also the official data partner of Spanish football, delivering to betting markets worldwide live data from more than 2,500 matches covering three leagues, plus two cup competitions per season.

2.14 SIS has also developed two innovative technologies for which it has applied for patents. One of these is a dual-use electronic racehorse tracking technology that can be used for both driving in-running betting products and for integrity purposes[5]. The other covers automated television programme production[6], which enables television programmes to be produced at lower cost.

2.15 In keeping with its position of one of the most technologically advanced suppliers to the betting industry, it has entered into a partnership with the University of Salford to offer undergraduate placements in its television and production facilities at MediaCity UK. A number of placement students have been taken on in permanent positions after graduating.

3. Economic impact of a reduction in LBO numbers

3.1. SIS is concerned that a change to the regulatory regime for gaming machines in LBOs could have unintended knock-on effects that adversely affect the betting and racing industries, and indeed SIS itself. This section of the submission sets out SIS's concerns about the potential financial impacts.

3.2. In the current year (2015-16), SIS's payments to UK-based rights holders are as follows:

Rightsholder	Annual payment (£m)
Racecourses[7]	52.2
Greyhound tracks[8]	28.7
Virtual games suppliers	3.4

[3] Deloitte/ABB report, "The full picture – 2nd edition: Measuring the economic contribution of the British Betting Industry", March 2013
[4] Deloitte/BHA report, "Economic Impact of British Racing 2013"
[5] UK patent application number 1421676.6, International patent application number PCT/GB2015/053656).
[6] UK patent application number 1616588.8.
[7] These comprise racecourses owned or operated by Arena Racing Company Limited (Bath, Brighton, Chepstow, Doncaster, Ffos Las, Fontwell Park, Great Yarmouth, Hereford, Lingfield Park, Newcastle, Royal Windsor, Sedgefield, Southwell, Uttoxeter, Wolverhampton and Worcester), a number independent racecourses (Chelmsford City, Fakenham, Hexham, Leicester, Newton Abbot, Plumpton, Ripon, Stratford-upon-Avon, Taunton and Towcester) and two racecourses in Northern Ireland (Downpatrick and Down Royal). These two latter are comprised within a media rights deal with the Association of Irish Racecourses which for historical reasons owns the media rights to all 26 racecourses in Ireland and Northern Ireland.
[8] These comprise 18 tracks of which six are owned by bookmakers (Coral, Ladbrokes and William Hill owning two tracks each).

Total	**84.3**

These payments are expected to remain relatively stable (apart from fluctuations to reflect additional scheduled races or abandonments due to bad weather) through to December 2017, when SIS's media rights from all but three racecourses in Great Britain expire.

During this period, the level of SIS's payments to rights holders is unlikely to be affected by changes to LBO numbers. Its current business model is based on acquiring rights on a per event basis, and creating various packages of content for customers. In this model, the risk of changes to LBO numbers lies with SIS. If shop numbers decline, SIS's payment obligations to its rights holders remain unaltered, as does its prices to customers. Although the long-term trend is for a decline in the number of LBO sites (from […] in October 2014 to […] in October 2016[9] - a movement driven largely by the shift to remote betting) SIS is able to generate sufficient margin to accommodate this gradual decline.

3.3 From April 2018, however, this situation will change as a new set of media rights comes into effect which reflect the new business model SIS developed in response to the economic pressures facing the betting industry. It involves three elements:

- Media rights are differentiated into "core" rights that are acquired on the basis that they will be sold to all customers, and "non-core" rights which are acquired on the basis that they will be offered to customers as optional extras.
- The adoption of a low-margin, low-cost model, in which core rights are acquired by SIS and passed through to customers at cost, with non-core rights and other ancillary services (e.g., television and data production and distribution) subject only to a 7.5% margin – SIS effectively becoming a low-cost utility for the UK and Ireland betting industry.
- Risk sharing with rights holders, whereby the amount paid to core content rights holders will be linked to LBO numbers – effectively shifting market risk from SIS and its customers to the rights holder.

3.4 In the year 2018-19, SIS's annual payments to UK rights holders are expected to be as follows:

Rightsholder	£m
Racecourses[10]	[…]
Greyhound tracks	[…]
Virtual games suppliers	[…]
Total	**[…]**

Of these rights, horseracing rights are core rights subject to risk-sharing arrangements. By way of illustration, the table below sets out the reduction in media rights fees payable to the racecourses listed in note 10 below as LBO numbers decline.

[Table redacted]

[9] Source: SIS subscriber records

[10] Contracted rights as at December 2016 include the RMG racecourses (Aintree, Ascot, Ayr, Bangor, Beverley, Carlisle, Cartmel, Catterick Bridge, Cheltenham, Chester, Epsom Downs, Exeter, Goodwood, Hamilton Park, Haydock Park, Huntingdon, Kelso, Kempton Park, Leicester, Ludlow, Market Rasen, Musselburgh, Newbury, Newmarket, Nottingham, Perth, Pontefract, Redcar, Salisbury, Sandown Park, Stratford-upon-Avon, Taunton, Thirsk, Warwick, Wetherby, Wincanton and York), Chelmsford City, and Downpatrick and Down Royal in Northern Ireland.

3.5 If changes to the regulation of gaming machines result in LBO closures, there are a number of potential unintended consequences which could be felt in one of two ways. Provided that overall LBO numbers in the UK and Ireland are maintained at or above c. […] (which currently equates to c. […] in the UK), the adverse effects will be limited to a reduction of payments to the horseracing and greyhound racing industries. Although this would inevitably create a degree of pain for those industries, it is unlikely to be terminal.

3.6 The position would be significantly worse, however, if the total number of LBOs in the UK and Ireland were to decrease below this level. At that point, SIS's low-cost, low margin model would not generate sufficient margin to prevent the business as a whole from going into loss. Revenues from that number of LBOs, together with expected revenues from the SIS Live business and the diversification into digital products referred to above would be insufficient to cover SIS's costs. In essence, if UK LBO numbers were to fall below c. […], on current assumptions SIS would be forced to cease operations. This in turn could give rise to a number of wider economic detriments:

- The loss of jobs in the media and digital sectors.
- Loss of tax revenues to the Treasury.
- The loss of a business that is not only a supplier of essential revenue generating content, but is one of the most technologically advanced suppliers to the betting industry.
- Loss of significant media rights revenues to UK horseracing and greyhound industries and suppliers of digital content. The losses would amount to c.£ […] p.a. (or c. [ ]% of media rights revenue for horseracing, £[ ] million p.a. for greyhounds and £[ ] million for digital content suppliers.
- Loss of the only distributor of British racing coverage to the international betting industry.
- Loss of the SIS Live business which provides connectivity services to the sports and broadcasting industries in competition to large incumbent operators such as BT and Vodafone.

3.7 Although it is to be expected that SIS's media rights would soon be re-sold to other operators if SIS were to close, there would inevitably be a period of delay until new services come on stream, a period that could run for several months while new facilities for television and data production and delivery are built. It is also possible that other operators would not be prepared to adopt SIS's low-cost, low-margin model and would seek higher returns, with the inevitable increase in costs for betting industry customers. Meanwhile, it is foreseeable that the suspension of cash flows could put the greyhound and horseracing industries under stress with the possibility of real financial hardship being caused to less financially robust operators. On the betting side, an interruption of even a few months in the supply of content could be enough to force some LBOs to close, thus further compounding the closures resulting from changes to gaming machine regulation.

4 Potential Risk of adverse impacts on LBO numbers

4.1 The risk of LBOs being forced to close down as a direct result of an increase in Machine Games Duty is not easy to identify with much accuracy. An unpublished study of the impact of changes to betting shop tax commissioned by SIS in 2014 suggested that some […] % of UK LBOs were vulnerable. These sites were described as "over-competed", characterised by low revenues and earnings but high "machine mix" ratios. It concluded that although there was a strong core LBO estate of 5-6,000 LBOs, the base case-scenario was a reduction of the estate to c. 8,000 LBO, while the bear-case scenario saw the total estate falling to 7,000 LBOs.

4.2 Recent reports by investment bank analysts into listed companies in the sector give some support to the predictions in the SIS study. Morgan Stanley estimates that up to 500 William Hill sites may close if increases in betting duty result in a 30%

reduction in gaming machine revenues.[11] (This prediction is similar in numerical terms to the bear-case scenario identified in the SIS study. It may, however, actually be worse as the proportion of William Hill sites that were identified as "over-competed" and vulnerable to closure accounted for only [ ]% of their estate before closures). HSBC also estimate a 30% reduction in machine revenues for the whole sector, and have forecast the EBITDA reductions for Ladbrokes/Coral, William Hill and Paddy Power, but have not sought to convert this into shop numbers,[12] Barclays believes that "it is fair to assume that a significant number of the company's 2.4k shops may close if taxes increase or if there is a major change in machine regulation".[13] Finally, Shore Capital notes in relation to Ladbrokes that "any further Draconian regulations could materially impact profitability".[14]

5. Conclusion

5.1 SIS is neither a licensed betting operator nor a supplier of gaming machines and has no views on the social responsibility measures that might be desirable, nor on the level of Machine Games Duty payable. Nevertheless, its position as an intermediary between the racing and betting industries places it in an almost unique position to be able to comment on the potentially adverse impact that over-regulation of gaming machines could have on the funding of the racing industry if LBO closures were to result. Indeed, the adverse effects may not be limited to racing rights holders if SIS were no longer able to continue in business. The low-cost, low-margin business model devised by SIS is unlikely to be adopted by any replacement operator. Any successor would almost certainly seek to maximise its returns which, in turn, would inevitably mean higher prices for the betting industry and lower returns to racing. SIS's concern is submitting this response is merely to alert the DCMS to the risk of unintended consequences as the Triennial Review progresses.

5.2 Since some of these consequences have a bearing on the wider economic picture, a copy of this submission will also be made available to H M Treasury.

Satellite Information Services Limited

4th December 2016

[11] Morgan Stanley Research, Leisure and Hotels update, 28th October 2016 (page 17). Attached as Annex 3.
[12] HSBC Global Research, UK Bookmakers: Risks now crystallising, 31st October 2016 (pages 6-7). Attached as Annex 4.
[13] Barclays Equity Research, William Hill plc, 24th October 2016 (page 4). Attached as Annex 5
[14] Shore Capital, Ladbrokes, Citius, Fortius…Altius? 21st October 2016 (page 3). Attached as Annex 6.

Annex 1

SISH shareholders

£ 0.10 Ordinary shares

Name	Shares Held	Overall %
Ladbroke Coral Group PLC	46,709	23.41%
Caledonia Investments plc	44,993	22.55%
Alternateport Limited (1)	40,977	20.54%
William Hill Organization Limited	38,925	19.51%
Fred Done	14,983	7.51%
Tote (Successor Company) Limited	11,968	6%
Leicester Racecourse Holdings Limited	411	0.2060%
The Bibury Club Limited (Salisbury)	212	0.1063%
Stratford-on-Avon Racecourse Company Limited	154	0.0772%
Thirsk Racecourse Limited	109	0.0546%
The Catterick Racecourse Company Limited	77	0.0386%
Frontrelay Limited (2)	11	0.0055%
Total issued	**199,529**	100%

Notes:

1. Alternateport Limited is a wholly-owned subsidiary of Catalyst Media Group plc.
2. Frontrelay Limited is the trustee of a defunct Inland Revenue-approved Employee Share Option Scheme.

Annex 2

SISH audited accounts 2015-16

Annex 3

Morgan Stanley Research, Leisure and Hotels update, 28th October 2016

Annex 4

HSBC Global Research, UK Bookmakers: Risks now crystallising, 31st October 2016

Annex 5

Barclays Equity Research, William Hill plc, 24th October 2016

Annex 6

Shore Capital, Ladbrokes: Citius, Fortius…Altius? 21st October 2016