50TH HORSERACE BETTING LEVY SCHEME
RACING'S CRITIQUE OF THE ERNST & YOUNG REPORT FOR THE BOOKMAKERS' COMMITTEE

This note summarises Racing's comments on the Ernst & Young ("E&Y") Report for the Bookmakers' Committee ("BC") (dated 3 August 2010) (the "Report"). Where possible we have avoided repeating points made in Racing's Initial Critique of the BC's Recommendations which related to E&Y's work, but in a number of places they are necessary to provide context. Similarly, we have restricted our comments to the following material points and issues, plus our commentary on the Report's Executive Summary.

1. Despite being commissioned by BC, the Report is written as if E&Y were on 'the outside', with limited information provided by betting operators and no recognition of the complex multi-platform nature of the betting market, specifically betting exchanges. The E&Y engagement letter listed on the Report's content page was not in fact provided hence have not seen their agreed scope. Given the narrow focus of the Report we are unable to determine whether E&Y's agreed terms with the BC prevented them from carrying out a much wider review of the betting industry's capacity to pay, which should in our opinion have been performed.

2. The Report purports to focus on capacity to pay issues, but makes no written statement of, or commentary on, the quantum of the profits earned by the betting industry. However, based on the estimated gross win from betting products (as set out in Figure 2) and overall EBITDA percentage (as set out in Figure 8) we have calculated using the E&Y assumptions the overall EBITDA of the betting industry in the table below.

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Gross win (£m) (Figure 2)	1,800	1,950	2,050	2,550	3,100	3,250	3,750	4,200	4,400	4,250
EBITDA % (Figure 8)	23.2%	23.8%	28.8%	34.3%	30.1%	29.5%	29.1%	27.1%	27.3%	24.7%
Calculated EBITDA (£m)	**418**	**464**	**590**	**875**	**933**	**959**	**1,091**	**1,138**	**1,201**	**1,050**

The table above illustrates the huge growth in profits of the betting industry since 2000, driven by the deregulation of the market. Whilst the market experienced a decline in 2009 due to the recession, profits have remained above 2005 levels. The combined depreciation and amortisation of the Big Three in 2009 was £133m hence if c.£175m is assumed for the total market, EBIT of £875m was earned by the industry in 2009.

3. The makeup of the "Other Betting" category in Fig 2 on page 5 is unclear, yet represents c.£1bn of gross win by 2009 and we cannot understand why no further information is given.

4. The Report assumes that the structure of the 50th Scheme is unchanged, but gives no supporting argument as to why.

5. The Executive Summary of the Report gives the E&Y view of a reasonable yield for the 50th Scheme which is not only unsupported, but completely ignores the proper

consideration of all relevant factors (needs of Racing, capacity to pay and taking account of all fiscal, economic and social circumstances).

6. The Executive Summary claims that a higher level of levy would damage the industry's ability to invest and pay the levy in future years. There is no analysis in the Report that supports such a sweeping statement and it should be rejected. The EBITDA levels set out above provide an illustration of the profit levels in the betting industry that make that statement misleading.

7. Such is the level of unsupported assertion within the Report, we hope that the Report, and the elements of the BC Recommendations that draw from the Report, will be disregarded.

The table below summarises the Report's executive summary and our main responses.

E&Y Comment	**Racing's response**
Share of British Racing's gross win as a proportion of total gross win has declined from 55% in 2000 to 20.7% in 2009	• It is assumed that revenue equals gross win, but is an example of unclear use of terminology. • It is accepted that British Racing's proportion of total betting has decreased, but it is not clear if the underlying gross win has declined in absolute terms. • Leakage of gross win to betting exchanges and offshore operators will also exaggerate the size of the real decline. • However, as previously noted in our critique of the BC's Recommendation there are a number of serious question marks over the reliability of the information used to calculate the size of the fall
Betting on overseas racing has increased but represents *"a very small share of horseracing"*	• In 2008 LBO gross win of overseas racing was £133m compared to £741m from British Racing equating to over 15% of racing betting (Source: The full picture – An Economic Impact of the British Betting Industry) • Furthermore rapid growth in virtual racing which is designed to closely resemble real racing, and hence is intended to act as a substitute for racing.
"*The revenues achieved from machines and other betting products seem to be independent of British Horseracing betting revenues*".	• The Report offers no meaningful evidence on which to base such a sweeping statement.
Bookmakers' cost base has increased significantly	• Costs relating to racing, other products and general overseas have increased (in common with Racing) but rapid growth in revenue has resulted in increased profits.
EBITDA as share of revenue	• The movements in EBITDA over revenue will be a

has declined since 2003	function of changing product mix and are much less relevant that overall EBITDA levels which as we show later has increased significantly over the period. • We have particular concerns of the reliability of the information and methodology used in this area.
Inclusion of TV rights leads to larger contribution of bookmakers to British Racing, especially in the last 2 years	• It is assumed "TV Rights" relates to "Total Media Payments", as inclusion of all TV costs would incorporate the significant costs of all other non British Racing costs. • Racing's Initial Critique of the BC's Recommendations clearly demonstrated that this statement was incorrect, as the sum of media rights and levy in 2008/09 and 2009/10 was less that in 2007/08. • We note the E&Y document has higher estimates of media rights paid to racing in 2008 and 2009, but even allowing for this (which we will need to understand the reasoning for) the Report's statement remains incorrect.
Proposed scheme that yielded between £65-70m "*would be reasonable to recommend*".	• The methodology used by E&Y to arrive at this range is: o Extremely simplistic - with no meaningful arguments presented; and o Inappropriate as it completely ignores the proper consideration of levy scheme determination (needs of Racing, capacity to pay and taking account of all fiscal, economic and social circumstances). • Their implied assumptions are also fundamentally flawed as the stated £881m gross win for 50th scheme is likely to overstate gross win due to the structural issues, such as further moves offshore, discussed in Racing's Submission and Racing's Response to the BC's Recommendation. • Even allowing for these weaknesses at arriving at the proposed range, the scheme in the BC's Recommendation would be expected to result in a lower yield than E&Y suggest.
A higher level of levy would damage the industry's ability to invest and pay the levy in future years	• There is no analysis in the Report that supports such a sweeping statement. The EBITDA levels set out above provide an illustration of the profit levels in the betting industry that make that statement misleading.

3 September 2010