

Simon Holliday

Director H2 Gambling Capital (H2)

H2 Gambling Capital (H2) has become one of the most respected resources for information about how the gaming industry is evolving. In addition to advising over 500 organizations, H2's projections have been influential in shaping legislators' views of the gambling sector in both Europe and the United States.

Paul Jason, Public Gaming: *What is the primary focus of H2 Gambling Capital?*

Simon Holliday: H2 has two sides to its business off the shelf gambling industry data products, covering regulated markets, interactive gambling and daily Internet poker data, and bespoke work on behalf of clients. In the case of the latter corporate clients generally hire H2 to assist in the understand where the sector is headed, evaluate specific market opportunities, advise on how business models should be adapted and help identify potential partners. Financial institutions hire us to review gambling related factors which might impact investment opportunities in the sector. The commonality to everything H2 does is that we utilise deep understanding of the gambling sector together with a data-driven approach to provide the best market intelligence.

Do you produce source data yourself or rely on data that is public information?

S. Holliday: It's both. We collect all of the publicly available data but most of resource is allocated to modeling this and making projections regarding the sector based on developing an understanding of the more qualitative factors that impact the sector. We typically combine all the publicly available data with personal interviews and investigative fact-finding. We also have developed bespoke software which tracks the value and volume of activity on Internet poker sites (international and dot fr sites thus far). This has been a valuable tool to our clients and so we are looking at developing means of tracking other sectors of the gaming industry in a similar way. Much of this information is analysed on a daily basis and reported to our subscribers on a weekly basis.

I'm thinking that the wave of corporate mergers in the Internet gaming space has important implications for operators everywhere. For instance, one of your

reports indicated that the market share of Poker Stars and Full Tilt Poker has increased from 30% to 60% over the past three years. What's driving that extraordinary consolidation?

S. Holliday: First, Internet gaming is a very large space encompassing a lot more than Internet poker. Poker Stars and Full Tilt have come to dominate the poker space, with these figures relating to volume of real money players though the impact on revenues is believed to have been fairly similar. It is, as you say, a quite interesting development. This is a phenomenon that one can expect to see in all P2P (Peer-to-peer) gaming. Larger community of players generates greater liquidity, more game options and larger lottery style jackpots. At any point in time there can be as many as 85,000 real money players playing on either Stars or Tilt across as many as 16,000 tables. It is impossible for a smaller platform to offer the variety of playing experience and the guaranteed prize pools to compete with that. It just shows how liquidity breeds liquidity and that people want to play where the money is. It's all about attracting the largest number of players.

Once these operators get beyond a critical mass, the player experience is really defined by the single attribute of how many players there are. Other product features become less important or even irrelevant. Liquidity is king in all P2P business models. In Bingo, the amount on the prize boards, the amount you have in jackpots is the most important driver. And from the point of view of a betting exchange, liquidity is crucial and that's why, Betfair dominates this space. Even in house games such as slots aggressive jackpots drive increased player engagement and so that too is a function of volume of players.

Explain Betfair's model.

S. Holliday: It's a sports betting exchange. It's based on a P2P model and the rationale of a financial markets as opposed to traditional



fixed odds bookmaking which involves the customer betting against the operator and the latter managing its risk. Players bet against each other with Betfair taking up to a 5% commission on the winnings. They are the dominant betting exchange where as in fixed odds sports betting, there are lots of operators such as Ladbrokes, William Hill, Bet365, PaddyPower, Bwin, Unibet etc. These conventional bookmaking operators set the odds against which they take bets.

The exchange model seems more fun.

S. Holliday: Many people feel you get a better value with the exchange. P2P models are capturing the interest of the players and happen to work particularly well on the internet.

Since liquidity breeds liquidity, it would seem important to scale up as quickly as possible. Poker Stars and Full Tilt are unlikely to lose market share unless they make a major blunder, right?

S. Holliday: It is very hard to claw back market share from the dominant player/players under any P2P model once a market has matured. It is not quite the same in a new market or restricted market. Here there will be new race for liquidity with perhaps a few more players able to have a significant share of the market unless one or two succeed in dominating in the early days for whatever reason. Canadian operators are creating a multi-provincial poker network that will have the potential develop massive scale that will challenge the position of any offshore players that decide to continue in the market. The extent of its success will depend on the type of

offer and the ability to attract and retain more serious players. In Sweden the National Lottery, Svenska Spel, has an Internet poker platform that appeals mainly to the mass market player. As a result they have secured only 30% of the nation's market and in fact have become kind of a feeder ground for the off shore sites. In the case of the U.S. It would make sense for the states to collaborate and create a multi-state platform to create maximum liquidity. They already do this with lottery games now so I would think many will seek to do this with Internet gaming at some point. The advantages to that kind of collaboration are evident in any kind of jackpot-driven game, like lottery or progressive slots. But it becomes even more compelling when the jackpots are derived in a peer-to-peer format.

There are provisions in the U.S. legislation that threaten to prohibit licenses to operators who have offered Internet poker illegally in the past. Given that's exactly what they have done, are Poker Stars and Full Tilt nervous about legislation that might prevent them from getting licensed to operate in the U.S.?

S. Holliday: It is our understanding that PokerStars and FullTilt would contend that they have not knowingly broken any U.S. law. The decision regarding the licensing of these entities is for the relevant authorities in the U.S. It would appear that many U.S. organisations would not be in favour of Stars or Tilt being licensed. Ultimately it depends on the regulators and we have recently sensed in other progressive Internet gambling jurisdictions that there is a desire to make the 'black or grey' market 'white'.

Will legislators look at how the Internet gaming industry has evolved in Europe when deciding what to do in the U.S.?

S. Holliday: I think they already have and it would make sense to continue this process. Though European states are looking at each other it appears that the majority are conservative and so end up announcing they will start from a similar position including just sportsbetting and poker with relatively high tax rates rather than moving straight to a more operator and consumer friendly environment with lower taxes and more products which is the direction that Italy has ultimately taken.

Europe seems to finally be rationalizing the regulatory framework of the markets.

S. Holliday: Yes. The interesting paradox is that a regulated market can be a much more fertile ground for the expansion of our industry than an unregulated market. The EC is supporting the right of operators to establish themselves on-shore anywhere a local monopolies are promoting playing their gam-

bling products. The vast majority of operators, including Stars and Tilt, desire the increased legitimacy of being official licensed in all the jurisdictions in which they are present though they do not relish the thought of numerous sets of regulations to comply with. As onshore regulated alternatives develop offshore operators will find it increasingly difficult. Survey work by Poker Players' Research has shown that given a credible alternative the vast majority of players would rather play on regulated sites. Their findings suggest that this is particularly the case in the U.S. where strong patriotism means that the majority of players would like to support operations that are paying taxes and creating jobs in the nation.

Capital markets also tend to gravitate towards the predictability and stability that a regulated market affords. The financial community is much more comfortable with businesses that are in stable and predictable political and regulatory environments. Higher taxes impinge on profits, but knowledge that the businesses are premised on legitimate government licenses is important to them. Taxes do tend to decrease as markets grow and governments realize the way to optimize the return is to improve the value proposition to the player and not to burden the operator with extreme taxation. However, generally investors are a fairly impatient breed that do appear a little concerned regarding the initial licensing and compliance costs and the level of marketing spend that will be required to ensure success in a regulated market. It may take as long as three to five years for even the larger players to turn a profit in the majority of onshore regulated markets.

Responsible gaming will always be a high priority for governments, but that is a good thing. It's good not just for the protection of the players and the public. It also is integral to the long-term growth and sustainability of the gaming industry. The status as a legitimately licensed onshore operator is clearly an objective that will be even more important in the future. I think that once the U.S. has a clear regulatory system in place for Internet gaming, you will see PokerStars and FullTilt make every effort to be compliant or drop out of the market. It probably won't be worth it to them to try to fight the system at this stage. They have worked hard to be licensed everywhere in the past 12 months or so and will want to protect that status. We believe that together they still generate as much as a third of their combined revenues from the U.S.

The EU Commission and the ECJ have been deciding in favor of the member states in disputes over whether they have the right to prohibit unlicensed operators from entering their

markets. What is the future? Is it possible the EU Commission may change direction?

S. Holliday: Infringement cases continue worked on by the Commission and the issues are still being debated. A Green Paper is expected next month which may clarify some issues. However, in the meantime it appears that the nationally regulated ring fenced model is gaining in popularity with EU member states. Of course, they are still required to comply with laws prohibiting anti-competitive controls and so it is likely there will continue to be some debate over exactly what that means in actual practice. There are now hopes that in the next couple of years the likes of Germany, Spain, Belgium, Poland and Greece will all join the United Kingdom, France and Italy with a regulated Internet gambling market open to all operators that can meet the licensing conditions. These developments are set to be the key drivers of growth in the sector in the short to medium term.

As an industry, gambling has a unique capacity to both stimulate the economy and generate tremendous tax receipts which is a great motivator in the current economic climate in which we find ourselves. National governments are highly focused on the preservation of public order and high responsible gaming standards and so are the best ones to oversee the healthy growth of the industry.

Charles McCreevy was fanatically devoted to deregulating the gaming market. He was just replaced as the Commissioner for Internal Markets with Michel Barnier. Do you have any read on the sentiment of the current Commission for Internal Markets?

S. Holliday: Commissioner Barnier stated back in February that these issues should be clarified once and for all. But to date, at least publicly, he is not being nearly as aggressive as McCreevy was and so it is not clear to what extent the moment will continue. The general view is that the infringement cases remain and that the majority of the nine Member States still involved (the case against Italy has now been dropped) will seek to comply. Ultimately all 27 EU members are required to comply with the basic laws requiring free competition across the region. It is very doubtful that the EC would try to impose a pan-European regulatory framework for gambling so it is expected that member states will move forward with their own regulatory and tax structures initially and then will seek to establish a more efficient regulatory and operational framework across national boundaries.. Once governments have resorted some measure of control, they won't be in the business of prohibiting gambling but expanding it. ♦