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Governments all around the globe are exploring ways to expand into all sectors of the gaming industry. All different kinds of public policy questions need to be addressed as part of the process of expansion. There is much discussion about “distributed venues” versus destination resort casinos. And how to strike the best balance between revenue generation, economic development and social responsibility.

Italy has undergone the most massive transformation of a gaming market in history. Not only is it grand in scope, it's also progressive in its attempt to formulate a regulatory policy that effectively accomplishes a broad set of public policy objectives. Their commercial partners who are responsible for the record-time build-out of this market have a special insight into how public and regulatory policy may finally be catching up to technology and the markets. That is why all eyes are on the unprecedented implementation of 56,000 VLTs throughout Italy.

Paul Jason, Public Gaming: *Michael, can you briefly summarize what is happening in Italy, how you approached this market and what it means for ACE?*

Michael Koch: Currently the Italian gaming machine market is covered by approximately 350,000 AWP (amusement with prize) machines with low stakes and low maximum wins. These kinds of machines are regulated under the so-called ‘comma 6A’ legislation.

The VLT bill passed in July of 2009 and suppliers and concessionaires began to apply for VLT certifications just a few months later. There were initially around 20 suppliers from all around the globe that applied to have their VLT systems certified under this newly formed regulation. After a rigorous certification process, only four were able to get this certification. ACE/Aristocrat is pleased and honored to be one of those four and to be given the advantage of being among the first to market.

We are currently in the process of installing initially 2,000 iVTs (interactive Video Terminals) over the next few months. We are partnering with Italian service provider COGETECH to ensure that performance and reliability at all locations throughout Italy are optimized. Bostjan Torkar, a high-caliber casino executive, has been appointed to the newly created post of Account Manager Italy, effective October 1.

Please explain what is meant by ‘distributed venues’ and the different basic models for meeting the customer demand for gaming and wagering.

M. Koch: This is the VLT model in which there are many different gaming venues, each having a limited number of machines. For instance, it could be bars and taverns located over a very large geography, each with just five or 10 machines. All these machines are connected to a central server that controls all aspects of game implementation and operation. It can be likened to the traditional online lottery systems where many retailer terminals throughout the jurisdiction are connected to one central data center. Of course, processing lottery transactions is not as complex as controlling a gaming machine, but the logistical and networking model is similar. This is opposed to a ‘venue-based’ model that has large casinos, like in Las Vegas and will also be in Maryland. You have many options for how to manage the various business functions like data collection, jackpot calculation, monitoring, player loyalty programs and accounting in the venue-based model. The logistical challenges are much different when the machines are spread out over a large geography as in the distributed model.

Is the distributed model likely to be the wave of the future?

M. Koch: That depends on the public policy objectives of the legislation. It would appear that at this stage in the evolution of the European gaming market, the ‘distributed models’ have a lot going for them. There will, for instance, be 56,000 VLTs installed in thousands of locations throughout Italy, each one having less than 15 VLTs, although there are

exceptions that allow for some larger size venues as well. It's really the best of both worlds. You have a limited number of mini-casinos that have larger minimums and larger jackpots (up to € 500,000) and a wider variety of games. And you have the distributed model which brings gaming much closer to the consumer no matter where they live, albeit in a slightly tuned down fashion.

To what extent is the distributed model going to eventually displace the destination casino resort model? Will the market expand so that both models will co-exist to grow and prosper?

M. Koch: We don't really believe these models are mutually exclusive. Making the games more accessible to the consumer is an obvious next step in the development of the market. By bringing the games closer to the players no matter where they live, the distributed gaming model is meeting a need and will clearly thrive. But destination resorts meet a different need, and deliver a whole different kind of value to the consumer. Even if the distributed model were to provide the same player experience as do the large casinos, you still have a completely different overall vacation lifestyle and entertainment experience at the destination resorts that will not likely ever be quite replicated in the local venues. In the short-term, there's obviously more growth potential in the distributed model because it has not been built out yet. But you'll always have the destination casino resort customer,

so in the long-term the two models will co-exist and succeed.

What about the younger economies of Eastern Europe? Are they more likely to adopt the distributed model?

M. Koch: You certainly have a point here. Just look at the markets east of Italy. The casinos in Slovenia that bordered Italy have derived a lot of their revenues from Italians coming across the border to play. Those revenues will almost certainly be negatively impacted by the roll-out of VLTs in Italy. I don't have any special insight into what the Slovenian government is planning, but I would think they are exploring the option of a distributed model which makes gaming more available to a larger portion of their own market in Slovenia. That would seem to be one way to make up for the revenue dip likely to occur at the border casinos. I think a similar evolutionary dynamic will occur elsewhere. Jurisdictions whose residents are going across the border and supporting casinos in other countries will decide to take action to capture the revenues for the benefit of their own people. Instead of the capital intensive and riskier proposition of a large casino, they could go with the lower cost and broader reach of the distributed model. And when revenues dip at some of the large casinos, do you think they'll try to make up those shortfalls by building even more destination resort casinos? I think they'll be more likely to augment the existing large casinos with a distributed model that would result in bringing in new players and expanding the market. We'll see what happens.

Many markets have a large population of illegal "gray" machines. Isn't the 'distributed model' the obvious way to convert that into a taxable and regulated market.

M. Koch: The distributed model does have the benefits of converting an underground economy into a taxable revenue base. The government regulated model would also have more integrity and security for the players. While that is true, it is not so much a question of 'distributed model' or 'destination-based venues'. It is more a question of how the regulations are implemented and, even more importantly, how they're enforced. There are significant differences in approach. Oregon, for instance, is a well established VLT market and yet you would have a hard time finding gray machines there. That's because the police work very closely with the lottery to ensure that no gray machines exist. A zero tolerance policy is in place and being enforced. In Sweden on the

other hand, a VLT market also works under a 'distributed model' with a size of about 7,500 VLTs. There are regulations that prohibit "gray machines" in Sweden just as there are in Oregon. But those regulations are not enforced as aggressively in Sweden, so you have a gray market of electronic games there. The difference isn't in the regulatory framework. It's in the mechanisms to enforce the regulations.

In Italy, the newly enforced VLT legislation, called 'comma 6b', will effectively minimize the gray market machines. Gaming machines are all required to be connected to a central server. It is relatively easy to inspect and identify those that aren't connected. The Italian regulator and tax police have asserted that the rules will be enforced, the illegal machines shut down, and violators will incur heavy penalties.

How is the development of the Italian VLT market different than other markets?

M. Koch: The Italian approach is certainly different from any other market. Among other things, the government set out to create a regulatory framework that ensures that taxes are collected. And just as importantly, they provide the tools and mechanisms for law enforcement to go after any form of tax fraud and tax evasion. From the very beginning, there was a will on the part of the Italian Government to create a comprehensive system that works on all levels: eliminate gray market machines, implement responsible gaming tools for the protection of the player, enforce the collection of taxes, block unlicensed offshore operators from doing business in Italy, and most importantly, generate revenues to fund disaster relief and other public service causes.

Additionally, the Italian model called for all of this to be implemented in record time. It was an ambitious agenda for everyone. ACE Interactive, along with a small number of other elite commercial suppliers, are proud to play a role in this exciting project. The efforts are just beginning to show results, and it is apparent that there is much to recommend about the Italian approach to implementing a large scale project of this type.

From a supplier's point of view, there is a difference between the multiple licensee model and the monopolistic model. In both, the key performance indicators remain the same: deliver the best games at the most cost-effective price, create a truly entertaining experience for players on a platform that performs reliably and meets the needs of all constituents, and does all that in a responsible manner to minimize social costs and problem gambling. The major difference between those models, though, is that time-to-

market is typically accelerated in the multiple licensee model.

With inter-operability and the ability to implement all games over all cabinets, how relevant is the cabinet to the success of the overall VLT program?

M. Koch: We believe we are just about to enter a paradigm shift. The point you raise is a good one, but we're not quite there yet. It's mostly a matter of player education. As the players come to understand the full meaning of true server-based gaming, they will learn to demand the games that are most appealing to them. At that point, the commercial suppliers will evolve to deliver the games the player wants, regardless of whether the game content was built in-house or provided by a third party. That's the promise of "open source – open systems." Of course, it will continue to be the goal of the terminal manufacturer to produce the games that appeal most to the players. But if the hottest games happen to be produced by someone else, the player will demand it and the operators will want to meet that demand, so their commercial partners will have to provide it. That will be the next most important paradigm shift – when the player actually takes control and determines the games they want to play. At that point, the provision of game content will be separated from the business of terminal, hardware, and network support. The player can play any game, at any time, and on any cabinet. That is the promise of open systems and true server-based gaming. But we are not there yet and we should not believe that this educational process can be accomplished overnight.

Earlier, you talked about there being a limited number of "mini-casinos." Is TruServ, your VLT product, installed in those mini-casinos as well as the small venue served in the distributed market? Is TruServ a casino product for the VLT sector or a VLT product from a casino company? Or has this become an irrelevant distinction?

M. Koch: TruServ is deployed in Italy as a distributed market true server-based gaming solution. ACE Interactive is, however, a wholly owned subsidiary of Aristocrat. So our cabinets are designed to meet the needs of both the large casinos and the small venues in the route markets.

What exactly does ACE Interactive do that's different from Aristocrat? Why have two brands?

M. Koch: The reason we have two different brands is that we've each developed world-class competencies in two different areas of the business. TruServ™ is the server-based gaming platform developed by ACE Interactive. This

is the central server, networking and infrastructure that enables all the game mathematics, including the random number generator, to be controlled by the central server. The gaming terminal itself (in our case Aristocrat's proven VIRIDIAN™ cabinet) only carries sound and graphics. In the sense that there are no other functions performed at the cabinet itself, it's all done by the central server, TruServ™, the only 'true' server-based gaming platform in operation in Italy. That's an ACE product. Aristocrat, of course, is one of the top video games providers to state authorized casinos in the world. The end result is best-in-class Aristocrat games on ACE's market proven server-based gaming platform called TruServ™.

Games can be made available at the cabinet level with the click of a button at the central server location. Hardware changes at the iVT are not required. For example, if the specification of a EURO bill is changed, we just download the necessary firmware into the iVT. This one-step process lowers operating costs and simultaneously provides maximum security against fraud. Unplugging the machine from the central server renders the machine inoperable. You cannot play, it's as simple as that.

In addition, we provide two different kinds of jackpots which are ideal for our true server-based gaming platform. Not only will CO-GETECH players benefit from a four level mystery jackpot, soon they will also be able to play Aristocrat's '50 Dragons' game – a jackpot dedicated game which will cater for a fixed top prize, called the 'The Million\$er™', that can be won from day one of operation. There is no need to wait for the jackpot to grow organically.

TruServ™ has been in operation in Norway for more than two years where the operator, Norsk Tipping, has enjoyed very high levels of availability. This is one of the reasons CO-GETECH chose Aristocrat and ACE to become its prime flagship partners.

Historically, the record shows that people below a certain age are easily prevented from playing in a casino. What are some of the different venue options and age-restriction mechanisms used in a distributed model? Bars and taverns would seem an obvious option. What are some others?

M. Koch: This is an important issue. One of the most carefully considered questions is: Where do you put the gaming machines to ensure that no under-age gaming takes place and how do you enforce it? Many jurisdictions chose to resolve this matter by proper retail selection where it is a given that no minors will access the gaming machines, like bars, pubs or purpose

built gaming locations. However, the other approach is to resolve this by using technology. Here one needs to be very careful not to create a patchwork solution. It's vital to create and implement a holistic approach, otherwise you dig yourself one hole after the other. Such a holistic approach has been chosen and implemented quite successfully in Norway where game play is 100% 'carded'. That means that only Norsk Tipping player card holders, by definition above legal age, are permitted to access the gaming machines. This way the question of locations and local supervision becomes irrelevant.

What is the difference between an interactive video terminal (iVT) and a video lottery terminal (VLT)?

M. Koch: An iVT is a VLT but a VLT is not automatically an iVT. A VLT comes in many different flavors:

A standalone gaming machine, also referred to as EGM (Electronic Gaming Machine), has the game logic, sound and graphics residing on the EGM itself.

Related to that model is the EGM that is connected to the central server for certain monitoring and accounting purposes. The cabinet is connected to a central server so that some data is shared. But, game logic, sound and graphics still reside on the EGM itself. A variation on that model is a fully online connected EGM which operates under full control from a central system with downloading capability. Game logic, sound and graphics still reside on the EGM itself, however the central system has major control capabilities including game enabling, switching of games, etc.

An iVT is also called a "thin" terminal, in which all game logic remains on the central system, not on the terminal. Game sounds and graphics reside on the iVT cabinet, but that's it. The iVT is fully dependant on the availability of a central system. Without that connection, the iVT won't work. We also refer to this structure as true server-based gaming because all game functionality and control has been moved from the cabinet to the remote central server. Hence the reason why we have chose TruServ™ to be the name of our server-based gaming solution.

How about ways that gaming terminals, EGM's and VLT's, might be integrated with Internet gaming platforms, enabling players to access their favorite games and social gaming networks via both channels?

M. Koch: This is absolutely where we believe the industry is going. To invoke a phrase

that has been over-used, but the key driver is the player. We need to understand that our players grew up with all kinds of different video entertainment. These players are used to picking the time, place and form of entertainment. Once the notion of server-based gaming has fully permeated the player's behaviors and attitudes, the player will expect to be able to walk up to a gaming machine at any place and any time, put in their loyalty card and start playing their favorite games which do reside on the lottery's server of approved games. There is no reason whatsoever why concepts like iTunes, Amazon or Netflix which make great use of the 'long tail effect' cannot be introduced to VLT players. Players want to have the freedom to also choose on which device they experience their games, equal to enjoying your iTunes on your home PC, iphone, iPOD, iPad or iTV. The closest you can get to this kind of approach is with our TruServ™ system and Indago™ VLT that you can find in live operation in Norway. We are just a small step away from these kind of personalized gaming experiences. However, we will only be successful bringing these experiences to players if suppliers, organizations like WLA, and individual lotteries are willing to jointly advocate for new technology and innovation.

Your Norway implementation uses a Personal I.D. card system, doesn't it? Does it work as well as expected, any compromises in security or with prevention of underage players?

M. Koch: It met all expectations and then some. No compromises on security whatsoever are permissible or have happened. Norsk Tipping recently had its TruServ system undergo an external security audit by Ernst & Young. It passed with flying colors.

I would think that a Personal I.D. card system would yield huge benefits to the operator. Wouldn't that direct line of communication with the player enable the operator to market other products and services, perhaps even non-gaming products? One of the services would be responsible gaming communications and help resources, correct?

M. Koch: Absolutely to all the above. But once again, it is vital that the lottery operator have a very clear holistic approach carved out on how to use such an ID system, and to have it all in place before beginning the implementation. When it comes to personalized marketing activities, it becomes less clear what should or shouldn't be attempted. Each jurisdiction has different data protection and privacy laws.

And, apart from the laws, players expect the operator to respect their privacy and not market too aggressively to them.

I'm also thinking that the obsession with privacy is sort of a legacy attitude that us older folks have. Young people do not seem to be so concerned with the issue of privacy, do they? Look at Facebook and how everyone practically bares their souls to people they sometimes don't even know. It seems to me that the desire to broaden one's network of friends and acquaintances totally overwhelms any qualms about privacy. I would think that the

player may be more receptive to personal player i.d. cards than some people assume.

M. Koch: I couldn't have said it better. The current generation that gets into gaming grew up as video gamers with different expectations about how to learn, work and pursue careers. They are technologically literate, but that does not necessarily make them media literate. They are content creators and that shapes their notions about privacy and property. They are product and people rankers and that informs their notions of property. They are also multi-taskers,

often living in a state of "continuous partial attention", where the boundary between work and leisure is quite permeable. Once you consider that and accept that, you'd be able to adapt your organization as a supplier accordingly. We certainly have understood that and are in constant re-organization in order to meet these demands of not only today's but also tomorrow's players.

What other Big Themes am I missing?

M. Koch: I don't think anyone is stepping up with five-year predictions! ♦