

Bill Thorburn

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Every other year, the World Lottery association (WLA) holds its international conference and trade show. This is the Big Kahuna of lottery industry conventions, the singular event at which industry leaders from all across the globe convene to address the most provocative issues of the day. An extra special bonus this year is that participation requires us to go to Brisbane, Australia, at the end of October, the best time of year to visit Australia. Bill Thorburn and the Golden Casket Lottery Team are excited about hosting the conference and promise a most remarkable experience for everyone. Visit www.wla2010.com for complete info and to register! Golden Casket Lottery is now part of the Tatts Lotteries division of Tatts Group Limited, which purchased (in the form of a 65-year operating licence) the lottery from the government of Queensland for AU \$542 million back in 2007. In April of this year, Tatts Group closed

on the purchase of another Australian lottery, the New South Wales Lottery (which includes Sydney and is the largest of the Australian markets with annual sales of \$1.25 billion).

Public Gaming: *The theme for the WLA 2010 is A Bright Future. My question, only half-jokingly, is...what's so bright about having products, strategies, and distribution channels all disrupted and possibly rendered obsolete by new technologies, new forms of competition, and changes in player styles and preferences? And how can lotteries get on the leading edge and not be overtaken by others who are attempting to get there faster?*

Bill Thorburn: It's true that the industry is clearly facing a number of new challenges. Changes in technology, the competition that ensues from the deregulation of markets, governments re-assessing the pros and cons of different operating models...these can all be disruptive to our ways of doing business. Equally, you could say that Lotteries have been evolving for some time as they faced fresh challenges from new competition such as slot machines and casinos. I would also point out that the lottery industry is not unique - highly disruptive change is happening across all businesses and industries, so we're all in the same boat. Change and progress is disruptive, but it's what modern business is all about and it challenges us to embrace the opportunity to evolve with confidence and enthusiasm. That's why our WLA2010 focus is on the "Bright Future" that we as an industry are facing. The future will be as bright as we choose to make it!

The beauty of this biannual WLA conference is that industry leaders from all across the globe can share experiences that many of their colleagues are in the midst of experiencing or

are yet to face. Our focus is on turning those disruptive challenges into opportunity. My view is that lotteries are truly in a very bright position and have a unique and powerful platform from which to meet these challenges. If you compare our strengths and market position with those of businesses competing in the gaming and gambling industry Lotteries have by far the highest participation rate, with a majority of the population supporting us and our products. And we also have the strongest community and public support because of the tremendous funds we contribute to the various good causes and beneficiaries. Being a distributed business also means that we can more easily respond to demographic and population changes within jurisdictions. This allows us to go to the people, unlike say Casino's where the people have to come to them.

Lotteries may be well positioned but that does not make us immune from the types of market shifts buffeting other gambling industry participants. Like everyone else, Lottery operators need to be innovative. Being willing to "innovate" is just a start. We need to take ambitious steps to consolidate our position as the leaders in the broader context of the gaming and gambling industry. So, when I say we have a "Bright Future," that doesn't mean it will be easy or that leadership in this industry is for the faint of heart.

Lottery leaders all around the globe are taking bold steps to respond to changing market dynamics and growing competition. Both jointly, as evidenced by the jackpot games cross selling initiative in the U.S., or individually such as

responding to market openings in Europe, lottery industry leaders are being called upon to revisit business paradigms and forge new operating structures and strategies.

That is why the WLA biannual conference is so important and lottery industry leaders consider it vital to tap into the experiences and thoughts of others. There is no other event that brings unparalleled experience and insight together like this. Additionally the trade show is by far the biggest in our industry. Nothing else like it. Our commercial partners are all here and putting on the very best show that our industry has to offer. No doubt those partners will be drawing from their development and innovation pipeline to present the latest and greatest on offer in Brisbane.

Golden Casket was purchased in the form of a long-term operating license by Tatts back in 2007. Could you tell us about how that has worked out for your different stakeholders? From everything we read, it appears to have been a win-win-win for Tatts shareholders, for the government, for the players, for the general public. Any bumps in the road or things you would have done differently?

B. Thorburn: I don't know that every single aspect has been perfect, but I think that's a reasonably accurate description of the outcome from the Golden Casket acquisition. And we're all aiming for the same outcome now with the acquisition of New South Wales Lotteries of

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course. There is a lot of effort that goes into these transactions to ensure that the key stakeholders (Community, Government, Retailers) respond positively and are pleased with the results. In the model adopted state government retained the right to tax the lottery sales revenues going forward, at around 30% in Queensland, so they enjoy an ongoing income stream from the business while we figure out how to increase that revenue. They therefore remain a key stakeholder as well as the regulator. What was "sold" to Tatts Group were the rights to operate the Golden Casket Lottery for a 65-year period. The length of the license gives Tatts the security that enables us to invest in the long-term health and prosperity of the business. The sales growth rate since 2007 has exceeded projections, above the historical average, so there's been no loss of momentum in the business during the transition from government operations to private operation. As part of the deal, we also agreed to do some very specific community contributions. There's been \$10 million donated to specific charities over the first three years. And the shareholders of Tatts are very happy since the contribution from the Tatts Lotteries division to the overall Tatts Group business has grown three-fold in that three year period. These benefits have been delivered through the efficiencies of the combining two lottery businesses together and removing duplication of systems and processes as well as enhancing revenue growth.

Outwardly we aimed for a seamless transition. As the players and the retail agent network are major stakeholders we aimed for there to be limited change in the service delivery model and operation of the games. The players and agents really just enjoy the same service and products that they experienced before. As we have taken over the existing long running brands and products the branding and products have not really shifted in any significant way. I think overall it is a situation where all stakeholders have come out with a very positive result.

We will be applying our experience and learnings from the Golden Casket acquisition to the New South Wales Lotteries' integration. Our experience will enable us to move ahead reasonably quickly in New South Wales. During the Casket integration we established combined operating model that we can now apply to New South Wales Lotteries. This model allows us to also pick up the best of their operations as well. It is not a cookie cutter approach because we recognize unique jurisdictional factors during our operational assessments. We expect this operating model to translate very well to the New South Wales Lottery and serve the government

and people of NSW and all our stakeholders just as well as it did in Queensland.

It seems no small feat to create alignment among all those different constituencies.

B. Thorburn: Exactly. I think the alignment comes from the recognition of unique interactivity of each of the stakeholders and the clear purpose of the operator. The length of the licenses also helps because you are not only building off a business today, but you are developing a longer term business into the future. Contrast this model with some of the earlier models that were promoted for the U.S. market. They were attempting to monetize the lottery including the future duties streams, to turn an ongoing duty stream into cash in the form of a large upfront payment. We think there are definitely problems with that approach. It is vital that all of our interests stay aligned so that the regulatory process continues to evolve and not fall out of step with community values. Whilst all operators want operational and regulatory clarity and stability, the certainty required to fund the future tax stream is so large that requirements to impinge future politicians make such privatization models difficult to gain bipartisan support.

The governments have turned over operational responsibilities and the associated risks to Tatts but they still hold the key responsibility for regulating, taxing, and setting the social policy agenda. The government establishes regulatory parameters that protect the players and create alignment with all other public policy concerns. Of course, the government is also interested in our success because we're the ones charged with driving the taxable revenues. It is in essence a symbiotic relationship. It definitely works best in longer term licenses (Queensland is 65 years and NSW is 40 years versus Victoria 10 years) because you can build long term momentum and evolve the business through technology cycles, but also be able to deal with unexpected shocks. It also allows the operator to work effectively with Governments on fundamental regulatory reforms as they arise

Tatts Group CEO Dick McIlwain said, "The consolidation of state-owned and Tatts lottery operations will drive significant operating efficiencies and offers considerable benefits from moving to a single operating system." Tatts chief financial officer Ray Gunston added, "the purchase of New South Wales gives us the scale to enable us to achieve the sort of things that we want to achieve not just in NSW but across all our jurisdictions." What kinds of economies of scale or benefits accrue from adding NSW to your businesses?

B. Thorburn: There's two parts to that. One is the efficiencies that can be gained by operating an integrated approach to the business across the various jurisdictions. Tatts has spent the last few years integrating Golden Casket into its operations and building a lottery operating model that allows us to support a far bigger and more complex business that stretches across multiple jurisdictions. For instance, marketing campaigns can be integrated across all of our jurisdictions. Differences between jurisdictions do exist. Regulatory requirements may be different, local branding requirements certainly differ; cultural preferences may dictate different approaches in some ways. We also acknowledge and want to preserve the local brand values and player attachment to those brands. However we can also leverage the network to develop new brands and products that previously may not have been available. We can leverage successful campaigns across jurisdictions; and sitting behind all that is an integrated approach to all of the back office operating infrastructure and corporate services. Lotteries operate very similarly around the world and there are obvious commonalities and overlaps which can generate efficiencies without interrupting the service delivery. The key is identifying those overlaps and how to manage them. On the revenue side, larger market populations give us more flexibility to offer prize structures and pools that are attractive to players. We continue to benefit from the scale that's created by the Bloc here in Australia for a number of Bloc games; and the additional scale that we can bring across jurisdictions will benefit some of the local state based games as well. These games can retain their local focus but can be extended across a wider player base enabling new game features and more attractive prize offers to players.

So even though products and strategies aren't necessarily replicated in each jurisdiction, the success that you have in one jurisdiction can inform the product development and marketing strategies in other jurisdictions. So there would be efficiencies and savings by being able to leverage product development, R&D and the production of advertising, etc to support a much larger revenue stream.

B. Thorburn: Not just cost savings but, just as importantly, it will result in enhanced products and service that will benefit the players and increase revenues in all of the jurisdictions we service. We have a wider pool of experiences with product development and also can learn from what others have tried and failed or succeeded with in the past. We also appreciate that not all games translate to different markets.

You've been the CEO of Golden Casket for many years before it was purchased by Tatts. How have operations changed? What things can you do organizationally, operationally, and strategically now, working under Tatts, that were perhaps more difficult to do when you were a government-owned operation?

B. Thorburn: There's no doubt that we certainly have achieved a higher level of operational flexibility under the private model. So we still adhere to appropriate levels of regulatory compliance and responsible play, but I think strategically we can now operate with a higher risk appetite. I think it's fair to say that a government as owner of an operating business will never have quite the same tolerance for risk as a private operator. Risk management is a highly developed competency of all private operators in any competitive market. That enables us to invest in new ideas and test strategies and product concepts and basically manage the business for optimal long-term profitability.

In many ways, though, the fundamentals of the business have not changed. Our focus has changed because we now are able to run the business across multiple jurisdictions. We've been able to build a highly efficient integrated operating model which we can adapt into new jurisdictions. But those are primarily back-office operational functions. The basic business of producing a great product, promoting and marketing and distributing it have not changed significantly under private management.

Do you anticipate the possibility of trying to carry this business model to jurisdictions outside of Australia?

B. Thorburn: The business model that we've created contains all the essential elements required to operate a lottery efficiently and effectively and we think it is transferable to other markets. It has at its core the mechanisms and business processes that integrate the resources of a centralized system with a lottery operation that remains fundamentally local. In the absence of clarity on the models being adopted elsewhere and our attraction to them, we haven't got any specific plans to go after contracts outside of Australia at this stage. The successful integration of NSW Lotteries is our primary goal in the short term. Applying our capabilities and business model to jurisdictions outside of Australia is something for consideration a little further down the track.

Are there any particularly interesting differences between the New South Wales transaction versus the Golden Casket transaction?

B. Thorburn: They're actually quite similar. Both are based on single long-term operating licenses. The longevity of the lease term provides the foundation to support thoughtful, forward-looking investment decisions. A number of the other elements of the models are also similar. The New South Wales government is currently establishing a formal regulatory structure independent of NSW Lotteries to oversee the business similar to the model previously established in Queensland. Overall social policy and responsible gaming standards are set by the government. The lottery staff and agents in both cases were offered some job security and retail network protections as key stakeholders and as part of the transition of the business to ensure it proceeded smoothly. One difference with the New South Wales transaction of course was that it was put out to competitive sales process, which elicited multiple bidders.

Would it be fair to say that the similarities are not really accidental? Did the political powers in New South Wales observe how it worked in Queensland and set out to replicate some of the positive results that were achieved in Queensland?

B. Thorburn: I'm not sure how the New South Wales government determined their final structure, but clearly they would have been aware of the key elements in the structure that was adopted in Queensland. I think they also would have been aware that it achieved many positive results. Before the tender and bidding process commenced the NSW government put out a regulatory discussion paper for general consultation. They set out the general framework of what they intended to put in place from a licensing and regulatory framework point of view and then invited comments and feedback from interested parties. I think this was a smart thing to do, enlisting all the best thinking to contribute to the process of establishing the legislation for the transaction in advance of the bid process. That input would likely have been partly based on the strengths and weaknesses observed in models operating elsewhere in Australia.

Could you comment on the trade-off between managing the long-tail revenue of maturing products and whether or when to be shifting resources over to the development of new and untested products?

B. Thorburn: In the end the players decide what the longevity of the game is. So we will continue to provide support to games that the player base finds attractive. We might enhance and update the games from time-to-time, but in the end it's the players who decide. We always

try and maintain a portfolio balance, providing ongoing support for the established and successful games that resonate with our players. We certainly want to balance that support with the development of new games that might attract new players, or even appeal to existing players.

We always carefully consider how new product opportunities will impact the existing portfolio. Our object is to achieve growth in the overall portfolio of our products. You have to avoid the temptation of throwing a whole lot of new games at a market place – new games do not always mean incremental sales and can result in overall player confusion and detachment if they get too bombarded with product. As I said before games that work in some jurisdictions just do not translate into others. But we're not about just allowing mature products to drift slowly away and end up with a benign growth portfolio. Growing the overall market requires us to maintain a portfolio balance between the loyal players who are attached to the existing games and those players that are looking for something new and different.

It seems you're saying the conservative bias of the lottery business is based on economic drivers. The revenue stream is so large for the traditional products that have the loyalty of the core player that you would never, ever allow the need to innovate to cut short the life cycle of a product that still might have some legs on it?

B. Thorburn: Yes. I think that has merit. I think a big driver though is the intangible nature of lottery products. Our customers have established rituals such as playing their lucky numbers and become emotionally connected to the game and its heritage. So they do become very attached to the brand and loyal to games. Our experience has been that players in general don't like change. Even when we undertake game enhancements we're very careful in the way we do that to ensure that it doesn't change that game too significantly for the players. There have been one or two cases where we have made changes that we expected to be easily assimilated and accepted by the core players but have had to restore the game to its original form. For example, if people are used to and happen to love the product, you don't want to force them to move on, but you would like them to buy another product as well. You've simply got to find different ways to attract new players, and maintain the participation of existing players. And in doing that, you really need to be cautious not to throw too many new products into the market and cause player confusion and dislocation.

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ing every week and there's no doubt that the addition of Mega Millions will be a very positive and impactful addition to our product mix.

How about the other lotto games? Hot Lotto and Super Kansas Cash?

E. Van Petten: Hot Lotto is up slightly and our in-state lotto game, Super Kansas Cash, is staying steady. And we feel really good about that. We are very pleased to have integrated Mega Millions into the mix without negatively impacting our other lotto games. So Mega Millions is incremental and now we can focus on growing all of the different games. However, we are showing some

decrease on our keno game, and our monitor poker game. Our instant games are steady but actually off a half of a percent. Overall we are showing a gain of about 2% right now. Of course, we'd like more and expect to finish the year at a higher growth point than that. But 2% year-to-date is still a net gain, and that's not bad in this economy.

What do you think is causing the softness in the keno and scratch-offs?

E. Van Petten: I think people aren't patronizing social environments quite as much. And that's where people play those games. And the smoking bans have somewhat hurt

bars and other social environments. Attendance at these venues has gone down. Retailers do tell us they do not have the patronage they used to have. But I'm just speculating and can't say for sure what exactly causes the softness in those product categories.

You're saying that the down economy would especially impact products sold in social venues because there it's not just about the few bucks for a lottery ticket, it's also about the money it takes to buy drinks and other consumables?

E. Van Petten: Absolutely. Both are factors. Smoking ban and less discretionary funds to spend. ♦

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innovation, better products and business processes, improving our capabilities for the benefit of our lottery customers.

That actually works in reverse too. Our core competencies in B2G have served us well in the B2B markets. B2G requires a higher degree of regulatory compliance, higher standards in most aspects of security, reporting, and other regula-

tory issues. The capabilities that we are required to have for the B2G space make us better suppliers in the B2B space. Consumer-facing operators in the B2B space like working with us because they know we are most able to support their ability to meet the highest regulatory and licensing standards. Governments that are beginning to license non-government operators will require

those operators to comply with standards equal to those of the government operators. This especially applies to internet gaming which is being brought under more regulatory control and why our Scisplay joint venture is so synergistic. Scientific Games' abilities, acquired from decades in the B2G markets, enables Scisplay to meet the most exacting regulatory standards. ♦

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So we can talk all we want about the need to innovate, but the overriding priority is to not mess up the giant revenue stream provided by the traditional products and core player.

B. Thorburn: I think that oversimplifies it. We are not about withering the vine here – we have a dynamic market place and we must actively manage it. We just have to be aware of players' attachments to our existing products. There have been a lot of years of investment in those products and that has generated tremendous value for the lottery. This is not to say that they don't need to be enhanced from time-to-time. Our biggest success as an Australian Bloc in the last few years has been a re-launch of the Oz Lotto game, which was originally launched in 1994, and was significantly restructured about three years ago that culminated in last year's record Australian jackpot of just over A\$100 million. So there is actually room to maneuver and innovate while preserving the original character of the game that appeals to the core player.

So you'll do something different once every 13 years whether you need to or not?

B. Thorburn: Since you put it that way we actually constantly review our games and test

things all the time. We actively manage our portfolio of games – but in a balanced way. We only do something when we think it is right for the lottery and players, always ensuring that players perceive that they have received a benefit from the change. Within the portfolio we look at things like product positioning, price, prize structures and retailer commissions to ensure we maintain player engagement and support. New products are treated the same way.

The Australian Productivity Commission issued a report on Australia's gambling industries some 10 years ago and is preparing an update now that is supposed to be released in the next few months. You contributed to the draft that was released last year. Can you tell us some highlights?

B. Thorburn: The landmark study conducted in 1999 led to quite a big industry shift, particularly in relation to how problem gambling was dealt with, and particularly in the area of poker machines or VLTs. The Federal Government has asked the Productivity Commission to come back a decade later and do a second review to see what's changed and also to identify what are the current issues for the gambling industry. One very interesting aspect to the report is that it will have little or no impact on the traditional lotter-

ies directly. The Commission gave every other form of gambling a chapter or chapters but lotteries barely rated a mention in the draft report. I think that's because the assessment confirmed findings in the 1999 report that there was a net community benefit attaching to lotteries and that problem gaming is not the issue with traditional lotteries as it is with some other forms of gaming. The final recommendations are likely to focus on further limits to VLT play or poker machine play and the potential introduction of card based pre-commitment systems. And they're making recommendations on the national market for wagering and sports betting, the deregulation of that market and how to handle that from a regulatory and taxation point of view. And they've also called for a possible relaxation of the federal internet gambling laws which currently prevent Australian operators from providing interactive gambling services with a few exceptions, including lotteries and wagering. The report is not binding on the government, but the recommendations will likely be very influential to our industry.

Excellent. Susan and I can't wait to see you in November. I know everyone is looking forward to visiting Australia and being a part of WLA Brisbane. ♦