



Race Track Industry Program

TUESDAY, DECEMBER 6, 2005

WORDS OF THE ELDERS

Sponsors:

Breakfast: equineline.com

Panel Session: Scientific Games Racing

Speakers:

Karl Gagesch, Vice President, Development; Ontario Lottery and Gaming Commission

Walt Hawkins, Director - Business Development; IGT

Ronald Sultemeier, President; Delaware North Companies Gaming & Entertainment

MR. DOUG REED: Well, let's get things started. I'd like to introduce our moderator, Walt Hawkins, the director of business development for IGT, and a very appropriate moderator for this first panel.

Walt and IGT have been here for years, and [a] I appreciate it; and [b] I'd like to applaud him on his foresight for being at this conference many years ago, long before gaming and racing merger or before a lot of us were even thinking about this, Walt's been here.

So he's kind of a leader here and an appropriate person to start off the "Words of the Elders." I hope he doesn't get offended by that.

But please welcome Walt Hawkins.

(Applause)

MR. WALT HAWKINS: Having insight is being told where to go and when to be there. If that's the case, then I had terrific insight of being here back in '92.

We're going to take what we think is a very entertaining but somewhat historic view about where racing and gaming has been and why we're here today. I always would like to know who the people are going to be speaking and where we're going, so I

want to make sure that — we're one slide ahead, but I'm going to catch up to it very quickly.

The speakers that we're going to have today, just so you all know what to anticipate, are Karl Gagesch, a VP of financial planning and analysis for the OLGC, which is the Ontario Lottery and Gaming Commission. He's going to talk to us from what I'd call the public sector.

As you all know or should know, in Ontario the lottery actually for all intents and purposes operates and owns the equipment in the racing facilities that we're going to be talking about.

And of course as most of you know Ron Sulzemeier, who's the president of Delaware North Companies Gaming and Entertainment Division — it's a new title, Ron, I'm sorry I had to read that one — who has been here for more years than I have been, is going to talk to us from what I would call the private sector, and also is one of the companies that operates the most racing and gaming venues in the United States today.

I appreciate Doug's comment and qualification relative to the weather here in Tucson. But you have to remember while I come from Las Vegas, and proudly so, that my partners here come from Toronto and Buffalo. You can tell by the thickness of the jackets they're wearing, they're much thicker than mine. And we're just thrilled to have them both here because they came such a long distance.

I personally am going to lead off as moderator and presenter from a manufacturer's point of view. And I want to give a qualification because it's only fair. All of the slides you see will have our IGT bug on it. And again, I am equally as proud of that, but I want to represent that there are a great many other manufacturers that I'm proud to associate with that also are in this line of business.

I don't want to come up here and give you a sales speech because that will be the quickest way to clean the room out, besides a bad breakfast, which wasn't the case today. So I will give reference to a great many other manufacturers.

My apologies for the many times you're going to see the acronym IGT, but it is going to be there because the people that do my slides like to put those on there; including myself.

Anyway, I've had great pleasure, in some form or fashion, to be involved in racing and gaming from the very beginning. And we're going to kind of walk you through a little historical perspective. Now we can get to the slide.

The first slide that you see before you is going to give you an idea of where the 13 jurisdictions are in the United States. We're going to talk a little bit about all of North America including Canada in just a bit. But in the 13 United States, that are — of the 50 United States that are offering racing and gaming.

As you can see, we have a number of rather significant states in both Florida and Pennsylvania that are in a pending status. I'm sure during Q and A there might be a few questions; I'm not sure we have the answers.

In Pennsylvania we've learned to be very patient, in Florida we've learned the definition of politics once again. As you know, or as you may know, Florida went into special session yesterday to try to resolve the issues relative to Broward County.

We started with early experiments in West Virginia then went to Delaware, Rhode Island and essentially Iowa; those I've always termed as the four pioneers of racing and gaming. The important thing to note and that we should note is that in each one of these jurisdictions there's different types of operational plans and schemes in that the lotteries are sometimes regulator or you have a racing and gaming board that's a regulator, and in each case you have some kind of a different product, a product that is euphemistically called the VLT, sometimes called the slot machine and many times referred to as an electronic gaming device.

So while we have machines, electronic gaming devices at each one of these jurisdictions, it is not safe to assume that they are equal and across the board the same type of product.

Another thing obviously is the tax allocation. The number of racetracks in these 13 states that are operating racing and gaming now is currently at 30, and we expect it to rise to 46; and as I anticipated — my informative little block right in the middle is a bit of an eye chart, isn't it?

What we have up there, and I'll read it, and I hate to read slides but I will; we have Arkansas with two racetracks pending as you know with the latest local referendums. Florida there are four racetracks, they're going through special session, Louisiana has one more that's scheduled to come on line, New York has three more including Yonkers and Aqueduct, and then finally in Pennsylvania with the six tracks that have been earmarked, four that are currently operating and two to be assigned at some later date.

Now as importantly, how many machines exist there? And you're going to see a discrepancy between the number of machines we have on this slide and the number on the next slide; and the reason being that there's some timing difficulties when you present these.

But currently there's almost 40,000 games that are operating in these racing facilities across the United States. And again, it's important that I stress some are slots, full blown slots, some are VLTs, and some are just referred to as electronic gaming devices.

I will tell you that there's nary a difference between any one of the three definitions. Here's another slide that denotes how many machines are in each of states that we're talking about and how many tracks are operating there. I won't

spend a lot of time on this because this is historical perspective and you're all very familiar with it.

The important thing to note, I think, when it comes to racing and gaming is how well these games perform. In the State of Nevada on Las Vegas Boulevard the average win per unit is right around \$125. As you can see at these locations it's significantly better with the low being in New York with some of the initial start-up limitations we've experienced there, and obviously the high over in Rhode Island with \$320 win per unit per day.

That's not to say in all these other jurisdictions that we don't have machines that earn as well, and these are all manufacturers' machines across the board, but it's only to show that on the average that is what these games are doing. Pretty significant little number.

One of the things that we thought was important to express to everybody is this slide here. This is a deal. Bottom line is in the State of Nevada the state gaming revenue tax is less than seven percent. In Mississippi and Atlantic City, which are the other two largest gaming jurisdictions in the United States, they're less than 20 percent. As you can see, we don't have a racing and gaming venue in the United States that's less than 20 percent, and our good friends — and I'm sure Ron will be able to speak to it — in New York has established an all-time high, one of which he is dubious and not so terribly proud of, and certainly not the author of, I should remind you, but this is an important factor when we talk about racing and gaming because it is a very onerous tax.

Here's another slide that we threw up here to show you that there are other allocations that come out of the racetracks' revenue stream. It just isn't the tax structure, it's also purses; and again, I can see that that's not such a great read.

In some place like in the top, the vendors are paid out of a pool, so to speak, that the state actually pays but takes out of the tracks' share; and then we have the purse structure and other.

I've been one to note that any slide that you're trying to give some kind of representation of, if the picture or the table itself is smaller than the qualifications that are required, it's not a good slide.

But that's a case in point as it happens here with the allocations in these jurisdictions. And not to be outdone — and this is a slide that Karl loved, he said it looked like a grade school map — our friends up north in Canada, these dots are all of the gaming venues in the country of Canada, in all the provinces.

I think that you will see down in the south of Ontario's where the greatest accumulation, and that's I would like to say is the reason that Karl's here to speak to us today.

This slide shows that they too are continually growing in exclusively the racing and gaming segment. Currently I believe there's 25, I'm not entirely sure if the other two tracks came on; my apologies to the folks from Canada, but I believe that you are growing up to 27.

And I think it's interesting to note on this next slide that Ontario, again, with Karl's representation, is over 60 percent of all the racing and gaming venues in the country of Canada. So we're very fortunate to have Karl being able to speak to that today.

The last slide as it relates to Canada is to give you some indication of how successful they are. In Canadian dollars they are represented by \$3.05 billion of net income. That is a significant amount — or excuse me, net revenue. That's a significant amount of play at any level. So again, having Karl here will be very helpful to help us understand that.

Now we're going to get into a little, what we're really here to talk about today, and what we were asked to talk about is, how did they get there? It's 8:00 in the morning, all of us have been traveling a little bit so we're going to have some fun; little icons on there, that's the only way to do it.

The single most important issue on why any of us are where we're at today is the legislation factor. I've included a list of comments in here, all of which you can read, I don't need to probably tear them up too much.

But I think it's terribly important that without the legislative process we don't get off the dime. You don't get different takeout rates, you don't get different racing dates. The legislative process is terribly, terribly important.

I'm not here to represent or to have you hire every lobbyist in your state or any state that you're interested in, but I will tell you it's a different language they speak. I included the pristine little picture of one of our forefathers signing a bill. That's how I, as a kid, thought that legislation was done.

I've got news for you. I heard in grade school and I didn't understand it until the first time — I think I won't name the state out of respect — but the gentleman there told me that watching legislation being made is like watching sausage being made. The end result is pretty good but the process is really ugly.

And that's not to denigrate our legislative friends, they do a great job. But this is a tough, tough venue in which we operate. And I think — I tell you there's a couple of comments that are important in terms of the win-win philosophy, having reasonable expectations, particularly as it relates to tax structure. But the bottom comment there, patience, patience, patience is the most important.

A friend of mine, a couple buddies, particularly John Mooney — I'm not sure if he's here — reminded me that it was in 1988 that I first went into Delaware to talk to

him about racing and gaming. It was 1995 that Delaware Park, Harrington and Dover finally got to turn the switch to turn them on.

That is a definition of patience by anybody, and I see Barry Baldwin in the front row. I'm sure we're going to hear a little bit about the Arkansas process. With legislation or after the legislation, and again, we'll go through this real quickly because they're going to go into more details of their own, we talk about, after the fact, what to expect.

And this is something that I've had an opportunity, great opportunity many times to meet with many of you in your locations and talk about: Wow, we're here. Now what do we do?

Well, these are some of the things that we start talking about right away. The promulgation of rules and regulations. They're your operating structure, they're, after the legislation, the single most important issue, because you're going to live by those rules.

You're going to have to live by those rules for the rest of your collective professional careers at that location. It is exceedingly important that those rules and regulations are something that you can live with, something that the state feels comfortable, whether there's a central system or some kind of controlling factor, whether the lottery's involved. We can't stress enough that the rules and regulations are something you need to spend a considerable amount of time, energy and effort on.

The licensing is important, both corporations and individual personnel. We start talking about a time line, again the charge, per charge, whatever discipline you're from.

Facilities planning is probably the single most important item. We all think, great, we've got machines, let's roll them in on the linoleum floor and plug them in. And most of your floors, by the way, slant towards the apron of the track, not a really stable place to put machines on.

So we've always stressed that one of the things that happens is, get to know a very good architect, start looking at your design qualifications, and remember most importantly with facilities that typically, in fact almost always is the single most important item when it comes to being able to start up properly and timely.

The last thing I'll say about facilities, which is equally as important, is that we always look at other residual issues, other companies that have to be involved. You're going to have to run a lot more power to your facility; and again, going with the professional, your architect, your planning structure is very, very important.

In terms of capital needs, I think that's fairly obvious. And in operating plans, it's a little issue that we talk about a little bit that has always been an interesting thing to

note. I've always used the term of three specific operating plans, and this is very general, there's so many others that could be included.

But for the most part we have what we call the branding. Let's use our friends at Caesars. They come in, you create a relationship with them and you're instantly a Caesars facility of sorts. That makes an awful lot of sense for somebody who doesn't have the wherewithal to do it themselves.

The second line item that we typically look at is consultants or a management team. This is something that the native Americans have really perfected in that they bring people in for three to five years, they help set up, they help train, they establish a very professionally run organization, and they ride off into the sunset many times, or they continue their relationship with you depending on their success.

And thirdly is what I call the Bill Rickman approach, and that is roll up your sleeves, hire a key person, and go at it. And he has done that very successfully; and I have noted that a couple of other companies have done the same thing. It's a good approach; it's a risky approach, but with risk comes the best return.

And why you're all here today is education. You wouldn't sit through these panels if it weren't for education. We are big believers of getting pre-trained. It is something that you can do at minimal cost, it's something to be provided by a multitude of people, companies and individuals, the university systems.

I put my alma mater up here, the University of Nevada Reno has — which I know is represented here today — has a great program. And I know many of you have attended, I know some folks from Arkansas attended a couple of weeks ago as a matter of — or earlier in the summer.

There's operating companies; certainly as soon as you get legislation passed you're going to have some best friends; and there are very hard-working, successful companies called Harrah's and MGM and Boyd Gaming and Isle of Capri, and they are probably one of the best educators, particularly if you're going to be a partner of theirs.

Consultants; I look at people like the Innovation Group, I look at a great many other companies that have the ability to provide this.

And lastly, again my qualification, other manufacturers as well as us. We have Slot University, we like to think that we can train somebody from slot math all the way to operations, but it's not our forte. But we certainly can be part of the mix associated with that.

With that, I actually want to turn this over to Karl now. What I wanted to do is give you a 20,000-foot perspective of racing and gaming, the very quick 101 of the things that we think are important before you start the contemplation of opening the doors and letting customers in.

I'm very proud to be able to turn it over to Karl at this time and start talking about how Karl did it up north from a public perspective.

Karl?

(Applause)

MR. KARL GAGESCH: Good morning; and thank you, Walt. I'm from Ontario as you probably already know by now. And it really is nice to be here, inasmuch as this winter — this is really spring for us. So this kind of nice weather is a bit of a treat. This is my first time in Tucson and first time to this particular Symposium, so it's a great pleasure to be here.

I've put together a presentation for you this morning that I think is going to cover a lot of range and talk to you about the Ontario context and give you some information that you may not already know.

I'm going to talk to you about the Ontario gaming model and how we've used that particular gaming model, which is different than what you're going to find in many of the U.S. jurisdictions, to grow the racino side or the slots at the racetrack program in Ontario.

I'm also going to share with you some of the successes that we've had, because we think we've developed a very good program, but also talk about some of the challenges. We have some issues, and by talking through both the successes and challenges hopefully we'll leave you with some ideas that you can take back to your own organizations.

First of all I'll give you a bit of an introduction on the OLG or the Ontario Lottery and Gaming Corporation. We are what's called a Crown Corporation, and that's a term that you may not be familiar with in the U.S.

That means that we're a blend between a private sector organization and a public sector entity. On the private sector side we have a board of directors, we have a CEO, we have all the management structures that you typically find in any type of organization in the U.S., but we're also a blend of private-public sector, and that really comes into play in that the government owns 100 percent of our shares, so we're very in tune with what our shareholder want and we're also responsible for implementing gaming policy within the province.

The Ontario Lottery and Gaming Corporation has 26 gaming sites that we manage and we're also responsible for the sale of lottery products at over 10,500 retailers in Ontario. We provide gaming entertainment in a socially responsible way that maximizes the net economic benefit for the province.

That's a mouthful, and I'll kind of talk about that in a bit more detail. We view ourselves as being in the gaming entertainment business. We started out bringing

out a slots program and putting out commercial casinos and charity casinos, but more and more as the industry evolves the entertainment side of bringing broad-based amenities becomes an important element of providing the services that we think our customers need.

Social responsibility comes into play because again, as a quasi-governmental organization, we have to be very in tune with public sentiment and make sure that the politicians stay on side with us every step of the way.

And then we also have a concept of net economic benefit. We're a for-profit organization in that all of our profits go back to the provincial government, and it's a substantial reinvestment that we give them to the provincial economy. Our overall profitability on an annual basis is around \$2 billion, and as most provincial governments or most state legislatures that have gaming in their jurisdiction, they become very in tune with getting that type of revenue stream. So we're an important part of the provincial economy. And also in terms of job creation.

And what the government does with that revenue, and for all intents and purposes they reinvest that into health care, physical fitness, recreation and cultural activities. That's our mandate is to produce the money; their mandate is to fund it into those particular programs.

The OLGC has three major areas of business. Commercial casinos was the first area that we moved into back in the early '90s. We have four commercial casinos, they're run by third-party operators that work under license to OLGC.

Collectively with those four casinos we have 420 tables, over 11,000 slots, and each of these commercial casinos is a full-range traditional casino that has lots of slots, lot of amenities, hotel operations, and collectively we have almost 9,000 jobs dedicated in those four businesses.

We also have six charity casinos which are run directly by OLGC. Within those six we have 147 tables, around 2,700 slots. Each of those facilities is roughly the same size, between 450 and 500 slots, and we have over 2,000 jobs dedicated through those six communities.

And then we have the racino program, which I'm going to spend a little bit more time talking to you about today. We have 16 racinos, these are slots-only facilities, and they're run by the OLGC. We've got over 9,300 slots across these 16 sites and they range considerably in size. Some of them are as small as a hundred slots and our largest is up to 1,700 slots. And from an employment side there's roughly 4,500 people working in those facilities.

This is a map of Ontario, it's a little bit better than the one that Walt used. But basically here I'm just trying to give you a bit of a geography lesson. Ontario is a very large province but the majority of the population base is nestled in around the Great Lakes.

Our neighbor to the west is Michigan and to the east is New York State. These two bordering states are very important to us in that 25 percent of our gaming revenue comes from American visitation, so the American access to our facilities is very, very important to OLG.

Talk a little bit about the pari-mutuel side. Ontario has a total handle of around \$1.2 billion on the pari-mutuel side, this is in Canadian funds, but it's roughly of the same size as Illinois and Pennsylvania.

We have an adult population of around 9.3 million people, which is again roughly the same size as Illinois and Pennsylvania, and our spend per adult on the horse betting side is around \$127, so we're a very large racing jurisdiction and it puts us in about the third, fourth or fifth, depending on your measurements, in terms of the relative state comparators.

Racing in Ontario is run by the Ontario Racing Commission. They supervise more racetracks and more live race meets than any other jurisdiction in North America. There's 18 racetracks and over the last seven years the race dates have grown every year.

In 2005, this year we have over 1,700 race dates approved, and wagering from an Ontario context and sort of from a Canadian context, Ontario represents around 67 percent of the total wagering being done across the country.

On the racino side, we started a racetrack program in 1998, and in 1999 we opened our first facility. It grew very, very rapidly. We now have 16 sites; we have one under construction which is set to open in March of 2006 and one's in the active planning stage right now.

So we're going to finish off an 18-site program. We're at 16 right now but it's grown basically in five years. We have 9,300 slots, the revenue's around \$1.5 billion and we have roughly 17 million visits annually now through our 16 facilities.

In terms of the measurements of success, our revenue-sharing arrangements that we have we think are something that work very well for our model and work well in our industry in Ontario.

Ten percent of our revenue goes back to the racetrack owners and operators, and based on 2004's revenue that's \$154 million that went back into the track operations.

The horse people get 10 percent as well, and that's another \$154 million, and our host municipalities get five percent, roughly five percent, and that's \$55 million.

And since the inception of the racino program in 1998 we've given back \$1 billion that has been distributed through the track owners and the horse people. So it's a substantial amount of money that's been generated through this program.

From an employment perspective, direct employment, we have 4,200 jobs dedicated in this industry, a direct payroll of \$154 million and indirect employment of around 7,000 jobs that have been created in the agricultural sector.

From a racetrack side of things, between 1998 and 2003, Ontario racetracks had their purses grow by 142 percent from roughly \$104 million to \$306 million, handles increased 11 percent from \$1.1 billion to \$1.2 billion, and race dates have actually increased 17 percent from 1,614 to 1,742. So significant growth in the industry.

Quality of the product is another area that we're quite pleased with. As we moved in and set up our slots at racetrack facilities, every one of the facilities has been renovated to some degree, some more, some less. But money's gone back into grandstands, food and beverage operations and other related amenities.

And in certain cases, a few of our racetrack partners have actually built new facilities on new ground, so we have state-of-the-art brand-new facilities at two or three of our locations across Ontario.

Now, we have had some growing pains and there's been significant lessons learned; and part of that comes from implementing a program where 16 sites have been basically developed over a five-year period, which is very, very high growth and high stress.

The slots supply allocation is an area that we're constantly reviewing right now. Because of the way our program is seated inside of racetrack operations we went to where those racetracks were, and those racetracks are not necessarily in places where the demographics would indicate you'd want to put your facilities. But nevertheless it allowed us a very quick entry into the market.

But now we're looking at the logistics of where our operations are. Also, the program was predetermined to have 18 racetracks. Again, if you look at the population base in Ontario we're now looking at, is that too many sites? Is that not enough sites? And is it set up in the right, optimal way?

And the number of slots that we've allocated, and again, when the program was in its infancy or when we started it, we did a little bit of research obviously, we did the best we could in terms of sizing each of the facilities. But there wasn't a lot of data because the industry was brand new and the market was untapped.

So the set of allocations now that we have created a certain stakeholder expectations and a certain infrastructure, and we're in the process now where some of that needs to be optimized. And it's very difficult to make changes once you've implemented a facilities program.

That leads into demand. At some of our racetracks demand and slot supply are not in good balance, and this needs to be changed for the future.

The other issue that we've got in terms of how we've laid out the program is that we've put the racetrack program in place. We already had existing charity casinos and commercial casinos across the province. So we brought 16 sites on stream; there was a cannibalization effect and demand shifted around the province.

Again, with the number of stakeholders that we have and the importance of the job creation and infrastructure that we have in place, when demand shifts it creates winners and losers. And now we've had a situation where the market settled out, and we have to address that.

Last but not least on the demand side. The U.S. market has changed significantly, and I think I've mentioned, 25 percent of our visitation comes from American customers, and that's a very important customer base for us; we used to have a monopoly on the borders because we implemented our program first. The U.S., particularly in Michigan and New York, are now implementing their own racing programs and their own casino programs, and demand is re-shifting. And we're losing access of some of our markets.

On the operating side, food and beverage is an important ingredient to make for a successful operation. The OLG only operates two out of the 16 food and beverage operations within our sites. And our perspective on that is that, that's fine, but it creates a very different set of customer service expectations; and in a lot of cases our costs, our ability to produce the offerings to our customers varies by location. So without having direct control, we have we think a customer service challenge at certain areas.

On the marketing side, the racino experience, we've had an effective monopoly, but we're now in the position where we have to market our product. The market has matured, those folks that have come to our facilities have enjoyed the facilities, are there, but we still need to grow.

Now, in our situation we have a monopoly on the interior parts of the province, so there's a tendency to undermarket because we'll have to control margins. On the borders where we have significant competition we have to market more aggressively. But at the end of the day we have to have homogenous marketing plans that work across the entire province.

We also have to deal with the cannibalization impact in that we've got different scales of facilities between our big commercial casinos, our medium-size charity casinos, and we have racetrack operations which are both small, medium or large.

We're in the process now of trying to figure out how to differentiate and segment the market so the right customers get access to the right facilities, and the facilities are fitted out properly.

And we also have stakeholder considerations to worry about, in that we have a revenue-sharing program, and I've outlined that for you on a previous slide, and we're now questioning whether it's sustainable.

It's created a significant amount of redistribution into the horse racing industry, and we're very proud of that, and very pleased we've been able to do that.

But as we go forward and grow our business we have to readdress whether or not those arrangements are sustainable in the long run. And also we have to look at reinvestment of the facilities.

We have to put more money back into our facilities. We're at the point now where some of them are five years old and our racetrack partners have to look at the facilities in the same context.

So going forward, looking ahead there's three areas that we have a focus on. One is market reassessment, and here we're taking a very scientific approach or trying as best we can to make decisions based on facts and a good understanding of the marketplace. We're using consultants, we think prudently, to give us guidance and show us where the market trends are.

We're also looking very carefully at our competition, where the industry's going, what our competitors are doing, so we can position ourselves properly for growth. We're also focusing very heavily on supply-demand balancing.

We need to improve our margins. Again, one of our mandates is to produce profit for the province, but we also need to grow our revenue and we also need to make sure that we optimize the sites to the marketplaces that they work in.

And last but not least, the complementary side, on the amenities end, we view ourselves more and more as the industry matures as having to provide a broad base of amenities, whether it's food and beverage, entertainment or whatever it takes to keep our customer experiences going positive.

Those are three areas that we need to focus on and we have a lot of resources dedicated to.

So hopefully that gives you a bit of an update or a bit of an idea what's going on in Ontario.

And thank you very much.

(Applause)

MR. HAWKINS: Again, our theory was to give you a broad brush across all kinds of different disciplines on how racing/gaming has gotten to where it is today.

Touched on a little bit of manufacturer's side, the public sector side. Now Ron Sultemeier is going to talk about what he has done with his facilities in New York and in West Virginia, Wheeling, Iowa and soon in Arkansas. Ron?

MR. RONALD SULTEMEIER: Good morning. I've certainly taken a lot of flak over the last two weeks in the office about the title of this presentation. Certainly as you can see by the age of the two guys preceding me, age had nothing to do with this.

But some of the old guys that have been up here talking maybe have that "elder" title attached to them, but not me. Mine's only because I've been in the racino business since '94, racing since '72. So 30-some years there.

And we're involved in tracks in five states, and by next year we'll have alternative forms of gaming in four of those states. A small way in Florida with a card room operation there, but in a major way in West Virginia, in New York and, as Walt mentioned, coming soon in Arkansas.

We also do some racino consulting in Mexico, we've been helping a track there in Mexico City open up their racetrack to a racino gaming, which they opened a couple months ago, as well as some of their OTBs and bingos that they've been putting machines in there, and work in some of the U.K. on a casino operation.

Walt has talked a lot about the evolution, you've heard some of it, and one form of model in Ontario, so I won't dwell on the legislation side.

I'm also not going to dwell on the racing side, although I will have some comments at the end about that more to generate some questions that some of you may have on the impact on the racing product. But I'll stay mainly with gaming and talk about the addition of gaming to racetrack venues; not on the start-up form, as you'll hear in the next presentation, but more on the changes that take place over time at some of the operations.

Talking about some of the models that are out there, you heard about the Ontario model, which is strictly a government model. The racetrack is really the facility and a landlord where they conduct the gaming, and the OLG owns the machines, markets; all the employees for the gaming side are their employees and runs it that way.

There are two other models, one of which — and this is in my opinion or the way I group the various models that are out there — but one of them is the government/private enterprise model. New York would be an example of that, the government owns the — in this case leases the machines, the central system, they also put in the surveillance systems there. But everything else the track does. All the employees are ours, we do all the operations, we do all the marketing, so it's a partnership between the two. You need a lot of government approvals there. I'll talk a little bit about some of the start-up approvals, and it's difficult to change in some ways.

There can be very rapid changes on the games, but any other changes take quite a while to bring about under this model.

The private model, West Virginia would be a good example of that; there certainly are other states that operate this way also. But here we own the machines, at first we even provided the central systems to the state. They had control of it but we actually had to even provide the central systems at the various tracks.

And we started with the legislated amount of machines, but we very quickly could change the number of machines based on market conditions or our ability to expand. We presented a business case for that, and in all cases at all four of the tracks, the lottery commission has gone along with that.

It has to benefit the community, it has to benefit the track and it has to benefit the state; and we've certainly been able to show that that has been the case. So we've had a lot of flexibility.

And as I talk about our growth I'll also talk about the types of machines and availability to change there. The market conditions certainly have a lot to do with your change under a private model.

As you heard, in Ontario, there wasn't a lot of flexibility and hasn't been to match the number of machines with the demand. In West Virginia we've been able to do that. And that's been very beneficial to us.

We also are going to be able to react to changes in the competitive landscape, and we're going to have a negative change in that landscape; certainly Pennsylvania coming on board is going to be a lot of competition for several of the tracks there.

Also newly available and licensed gaming products. We've had a lot of changes there over the years, and we've been able to take advantage of changes in machines.

The taxation has certainly been touched on, as has been the marketing investment, but I'd like to tie it a little closer to what you really do at a facility. The higher taxation rates in either model are going to lead to lower investments. And you'll see a big change from what's been done in New York, for example, to what's been done in other states. You have narrower operating margins with that high taxation, you're going to have a lower return on investment if you overspend. You're also going to have to limit your marketing.

There's going to be lower margins there that you're dealing with. You have a partner taking a larger share of it. And the problems with those are that both that lower investment and the lower marketing are going to limit the gross gaming revenue that you're going to be able to achieve. That is important to the horsemen, it's important to the dogmen, it's important to the state, it's important to the operator. So it certainly can create some limitations.

Looking at some of the U.S. growth in three states, in Rhode Island with its two facilities and Delaware with its three facilities and in West Virginia with its four

facilities, it started up in '94 with three facilities and then Charles Town came on board, and came on board in a big way, in '97.

But you look back from '96 to '04, looking at the number of machines that were in those states and you see a lot of growth there, from 1,500 up to 6,700; but you look at the gross gaming revenues, under a hundred million in all three of those states back in '96, and you're looking at \$350 million, \$400 million, \$850 million and still growing, in the three states. So certainly a lot of growth. As you add machines, as you add amenities to the racetracks, a lot of potential.

Walt touched on the win per unit. And again, using just these three states, it is interesting to note though that New York was the lowest of the ones that he used, and we'll talk about that on investment in a minute.

But on these you're going to see that there was pretty steady growth in the early years on the win per unit, because we didn't have enough machines to meet the demand. Weren't even close. We opened with 400 machines in Wheeling, for example, and now have 4,262, so big differences there.

There's a blip in Delaware; the smoking ban caused a slowdown there, but you'll see that there was some slowing as you finally got to a number of machines that were starting to meet the demand in those areas.

Looking at the conversion from a racetrack to a racino, we've talked about, legislation certainly has a major impact, we've talked about some on the taxation levels. But there may also be restrictions on what you can do at your facility. In some cases it has to be within the physical racing plant, in others it has to be attached to but a part of the racing plant, in others you could put it elsewhere on the property. You could build hotels, you could do a lot of things, but you have to look at your legislation, what it allows.

You have to look at the types of machines allowed. When we opened in West Virginia we were only allowed video poker, blackjack and keno. Those were the only three games. The legislators did not want cherries and fruit and spinning reels and anything like that. So we were very limited in our product at the time.

And that had a lot to do with what we put in, in addition to the wording that said you can start with 400 and then make application to grow. Over the years we were able to add reel games and a video format at first, and then went to full slot machines, which is what we're allowed today.

We have both video and reel slots. The potential revenue and market size, of course, is huge in determining what you're doing. The physical structure of a track — and you're going to see some differences and some examples I'm going to give of what we were able to do at different facilities, within the existing facility.

The return on investment and the different models, a fixed number of machines versus ability to expand as market demands. So you'd have to look at, are we

really going to have a fixed number when we go in that's going to be the expectation from the state and they're going to be reluctant to change that, or is it going to be a, "Let's get started, let's show what we can do, and then grow?"

Case studies. I'll talk about West Virginia and New York on those very different operations. Wheeling Island, our largest, this is what it includes now, and it's a pretty full mix of racing and gaming operations there with a hotel, fine dining, casual dining, buffet, showroom, a major operation there.

Here's the time line of the way we've grown. And again, this had a lot to do with the types of machines that we were allowed to have and our willingness to invest in the facility. So you see in '94 we spent — that's not a misprint, that's \$1.25 million to get into business. We leased the machines, we took existing areas of the track, put some upstairs in the clubhouse area, some downstairs in what was our simulcast area, made a very small investment and got into business.

As we saw the potential we started growing rapidly, and there were times during this growth that we literally did have machines on tile floor. We just take out a mutuel line and put in machines; the demand was there and it was the fastest way to get into business, but not the best way.

And you'll see big differences if you look at Wheeling from what we were doing then to the oldest area now, to middle level of amenity and finish level, to our new area, and you'll see very different wins per unit in the areas of the track. The nicer you make it, the better people like it, and the more they're going to be playing.

The types of machines again is, we've gotten into full slots. It gave us opportunities to have a lot larger mix of machines, which the public reacted well to. Again, here's what we have today, and I won't go into that.

Show you some photos from what was an old tired racetrack to, this is now our front door at Wheeling Island coming into the gaming entry and to the hotel on the right-hand side.

Typical suite. There would be actually a typical room in the background with a suite attachment to it. Gaming area and our expansion area. Showroom, this is one I'm sure you'll hear some discussion on, the next one.

It's always a key item of, how do you size it? Do you have a bar with some stage area in it? Do you put in a showroom? Do you put in a large one, small one? Key issue, and it's always open for discussion, how much entertainment do you want to bring in. This one works well for small trade show-type events, for boxing, for bingo, for things like that.

It doesn't work well for name entertainment, it's just not large enough to pay someone \$40,000 and bring them in and be able to cover it, even from a gaming and a "seat charge" type basis, but it works out well for a wide variety of items.

In New York, very different situation there. There's now 5,000 VLTs in operation, but it's been a slow path getting there. Through three years of legislation from a, "We can't work on anything that low," to, "We can't still work on anything that low," to, "We'll give it a try but you're going to have to adjust it if it doesn't work," basis.

And luckily they have done some changing on that this year that has helped the operators and should pave the way. Yonkers is under construction as we speak, and will be getting open next year. NYRA is still working through some other issues but hopefully will move along.

We also had some court challenges. We went ahead in the face of those court challenges. They were resolved in our favor, but it certainly caused some angst for a number of people in the state.

Recent changes, and I'll show you on another slide how that's worked; but we're allowed a larger share of the gaming revenue — still very small — but 32 percent of the first \$50 million, 29 in the next hundred million and 26 above that. Along with some marketing funds.

Locations that are in operation at this time. So Saratoga, Finger Lakes and Fairgrounds that we either own or manage, Monticello and Batavia, Tioga Downs is under construction as we speak, and will get open next year. Vernon is trying to settle some ownership issues to get open, and you've heard discussion on Aqueduct and on Yonkers, went in with the state putting out some very specific project requirements in the case of New York, as to what they would provide, what the operators would have to provide, what we would have to submit in advance of opening in that state.

Here's what we were faced with when we opened last year. As far as our splits — and this is not something, if there's any legislators in the audience, that you want to take back and use as a model. It's been very onerous and you're going to see some very limited build-outs and some no-build-outs under this type of legislation.

It was a tough road but you see what the state took and the lottery and the purses, so the tracks were left with a very small share there to deal with and try to make a go, and it really didn't work. But it has been changed again to give a few more points to the facilities.

Looking at what we did do at the facilities, at Finger Lakes — and Finger Lakes is one of those examples where we had an area that we didn't even have any discussion on, we literally looked at the track and said, hey, we have a 30,000 square-foot area with high ceilings, very square area, not being utilized at the track. It was one of those no-brainers that you went into and said, "Okay, we'll figure out where we're going to put the offices in the back of the house and everything, but this is our gaming area."

So we were able to move ahead with that very quickly. Had a separate entrance, an old grandstand entrance that we still use and people can go upstairs to the

grandstand part of the track, but created some very close parking. It just worked ideally.

And we did put in 1,010 machines into that 30,000 square-foot area, along with a bar and some dining areas, and opened it very quickly. The floor plan here, we've actually made some changes to it to create a better flow through the facility; took out some of the carousels and created more straight lines to create a better path, and that's worked out well for us.

Opening showy day; this opened in February — sorry; Saratoga opened in January, Buffalo opened in March. We opened three facilities in two months and a week, and that was pretty a good challenge. But there were people at all the facilities even with that type of weather.

Again, a look at the gaming floor, a look at the lounge area, which that is overlooking the racetrack. It's on the lower level, but that's really the only area we have that you overlook the racetrack.

There's a lot of discussion about whether you ought to try to integrate with the racing facility, bring them more together overlooking the track. You have to be careful of that. They're different crowds to a great degree. Really helps racing but it's not the same crowd. So you do have to be careful of that.

Saratoga, a little different situation. Saratoga had a less competitive market, had Albany nearby looking at a larger number of machines, but it also had a smaller racetrack. So there probably about two-thirds of the machines went into a remodeled area of the grandstand and then part of it was a new build at that facility. So about 35,000 square-foot in the renovations and then new construction there to allow for the larger number of machines.

Finger Lakes, by the way, was about a \$10.5 million remodeling project. That doesn't include any machine costs or surveillance costs. Saratoga was about \$15 million.

Site plan I won't deal with. If anyone has questions about how you squeeze it in the gaming floor, a little higher level of finish look they wanted for more of the Old Saratoga-type look. At Finger Lakes we went wine country, dining area, food court, at the facility.

And then Fairgrounds — at Buffalo Raceway on the Erie County Fairgrounds in New York. This one was the most competitive market, it was the most challenge from the facility level, but we knew that it would do the least gross gaming revenue, and with that taxation there we knew we couldn't spend the money.

So you're seeing a \$7.8 million renovation project that's still about a thousand machines. Again, the state was providing them. We weren't sure just what the market would be, and went with that and 27,000 square feet. Opened that one mid-March of last year. Front entrance at the facility, layout here. You're going to

see a different layout than you saw at Finger Lakes where it was very square, laid out very nicely.

The facility here, the track had built in three stages over the years, was very linear. So this is a much more linear plan than we would have liked to have had; but again, with the limited dollars we had to do a remodeling, we looked at an addition attached to the track, we looked at a new build on the main street that runs past the track, they were just too large an investment for the tax structure. We'd be doing a higher level of gross gaming revenue, the horsemen would be happier, the state would be making more money, but again, the taxation limited what we could do.

So we built here within the existing confines of the track on this type of layout. Showing some of the look, we went with a fairgrounds look. There's some tile in the entry. But of course the rest is carpeted. But you'll see some carousel-type features through this facility.

Switching to impacts on racing. Again, that may lead to some questions. Certainly the positives; the most obvious, the increased purses, and you heard some figures from Ontario on that. To give you some examples, at Finger Lakes our purses were about \$10 million a year; first year of gaming, partial year we went to \$15 million.

At Wheeling, we generate, from racing, probably about \$2.5 million in purses; from gaming we generate almost \$20 million for purses. So night and day what can be done to purses.

The renovated facilities. You heard some comments from Karl about that. You've seen my focus be on the gaming, but we've also upgraded the racing facilities. And there's backside improvements at all the facilities. Sometimes it's legislated, sometimes it's agreements with the horsemen, but certainly backside improvements are made.

Increased starters per race. Finger Lakes went up 0.75 starters per race, which is very helpful, as you all know, for your betting public. It's a better product, leads to more Simulcasting opportunities when you do that. And the increased simulcasting will help your pool size at the facility.

On neutrals, there's been a little impact on track handle. And to the racing attendance, that's been disappointing to people.

Ontario's probably one of the best on that; they've gotten more people involved in racing, there's more cooperation between the horsemen and selling horses and getting those owners, new owners out to the track, so they've had some success with that.

I think I've seen Prairie Meadows is up one percent in handle, and some of the other cases though it's just slowed the decline that we were having before. But

again, I call that a neutral, not a negative. We were having great declines before and it certainly has slowed it, or in some cases helped to some degree.

Because of the fact that you haven't had a lot of on-track handle in most places, tax the simulcasting handle either not at all or at a much lower rate, there has been an increase in pari-mutuel taxes but there's been huge gaming taxes that have helped the state. So if there isn't a conflict between a lottery commission and a racing commission, the state certainly is getting a lot more money.

And you really can't drive your racing business from gaming promotions. If you hold a racing promotion, it will also help gaming; if you hold gaming promotion it really won't help racing, unfortunately. It will bring more people to the facility but they don't transfer over to the other part of the facility.

Looking at some examples of the impacts. Mountaineer Park, sometimes it drives me crazy when I go down to South America or go to Mexico or go to the U.K. and walk into a facility and see Mountaineer Park's signal up there. They've done a great job with getting their signal out. They've improved their product and gotten that signal out.

We're starting to do that with the greyhounds, for example, and getting it out. We have better product in the states where we have these increased purses and are able to put on better quality products, getting that word out and doing that.

But some of the horse tracks have been the best examples of that. The Wheeling kennel compound. We had a kennel compound at the track that was very old, in the flood plain. We spent over \$5 million to move that out and build a state-of-the-art kennel compound. You couldn't do that without gaming dollars.

Backside commitments. I mentioned at other tracks you certainly are making improvements on those.

Stall applications. Some of the racing secretaries may say it's a mixed blessing because it gets into a political nightmare of, "How do we take care of the old people that were with us for years, the new ones coming in to upgrade the product?" But certainly you have more people interested in racing at the gaming facilities with the higher purses.

Performances. It's been a worry in the industry that, well, what happens if people just go to gaming and forget about racing? It hasn't happened. You hear some talk about people cutting performances from 80 to 70 or something that makes sense, whether it's weather or availability of horses or something else, there may be some small part of that. But all in all, other than one jai alai situation, the racing and gaming have worked well.

We consider it an important part of our floor show, whether it's horse racing or greyhound racing, and haven't cut performances anywhere; in fact, we've increased them at Wheeling and extended the performances. And if you take our weekdays, a

weekday with racing is a better day for gaming than a day without racing. So we're proud of that.

And certainly joint marketing efforts that can help the racing just by the dollars that are spent, even though I say you can't bump the attendance a lot you can put some dollars to racing that you couldn't before to help sustain that product.

In summary, horse of a different color here.

(Chuckles)

Models are very different. The three models that we've touched on today, you're certainly going to have to balance that: Tax rate, the market, the competition, available space in your facility, what type of amenities you need to put in to attract the people.

You're going to have impacts on racing that are positive, that are direct and indirect, but that are certainly positive. There are no — you saw my slide wasn't a positive, neutral, negative. There are no negatives in any of the racino states for the racing operations. It's been a very positive experience for racing as well as helped all of the facilities and all of the states financially.

Thank you.

(Applause)

MR. HAWKINS: That was a great summary by both of our speakers. We have time for questions and answers, if you have any to pose. If you don't, I have a couple of softballs I'm going to offer up. Do we have any questions anybody wants to offer real quickly? None? Please.

A VOICE: (A question was asked by an attendee.)

MR. GAGESCH: The question had to do with the stakeholder payments that we're making, and are they sustainable and what will the future look like? And if that's the essence of your question, it's a very good question. And I think the way our deals with the individual racetrack operators are structured is that we contract, and those contracts are in some cases due to expire in the next three to four to five years. So this is a time when the program is at that sort of midstage where it's launched, the program is successful, there's lots of money being created for all the different parties.

But we're also at a stage where we need to reinvest in the product, reinvest in the facilities, and it's going to come down, going forward, to who's going to make those investments. If the government or the OLG is going to be making significant investments in facilities, putting in more marketing programs to create more economic mass and wealth, make the businesses move to the next level, then in some cases the deals are going to have to change.

If on the other hand the track owners are going to be putting money into facilities and broadening the base and increasing the amenity component, then the existing deals are probably sustainable. So we're at that flux point right now where things need to be reevaluated, the economics are good.

In Ontario I don't think anybody could really say that there's a problem with the health of the industry, it's a question of where it evolves to going forward.

So we're taking it very seriously. We're not making any statements to say that we're going to be cutting back as we renew. We're also looking at it from the health of the business and the health of all of our different stakeholders and looking after our customers in the best way that we can with our partners.

MR. HAWKINS: Any other questions? Sir?

A VOICE: (A question was asked by an attendee.)

(Chuckles)

MR. HAWKINS: Well, being the gentleman I am I'm going to defer that to Ron for a minute. But the question was, is there an ideal tax rate in the U.S.? And because I particularly referenced that racing and gaming has been impacted by what I would refer to as onerous tax rates, is there an ideal tax rate?

I have an opinion, Ron, but I'd love to hear yours.

MR. SULTEMEIER: Well, I know in Florida they're pushing for a 30 percent, they're saying we could still afford to build out nice facilities in a somewhat competitive market down there at a 30 percent tax rate.

It, of course, is also impacted by whether the state is going to own the central system, the machines, all of those things will go into it. But certainly if you get higher than that, say 40 percent level, it starts getting very difficult.

The thing that West Virginia did, for example, is they started at one rate and then adjusted that after a number of years and took some away from the tracks and some away from the horsemen and dogmen, but they did it on over this space year level, which still impacted our level of investment.

In fact, we shrunk the Wheeling expansion because we were debating that right at the time that they did do that. But it still allowed us to continue operating at a very high level and it made large investments from that state as opposed to what you saw in New York, which was very limited build-outs.

MR. HAWKINS: Ron's really put it all together perfectly. I will tell you, because I'm involved in a great many states, that I'm suggesting that people should get

very used to the 30 or 35 percent tax rate as a start. And be prepared to hear it go to 40 or 45.

There was some discussions yesterday in Florida that the base rate would be 35 percent and it could ramp up to 55 percent on over \$50 million of income. I don't believe it should be on the high end because you'll see the impact that it's caused out of New York, for example.

But I do think that we in this industry have to remember that we're not making the \$2.7 billion investments on million-dollar-acre land that they are in the Las Vegas market. Vegas is a — Nevada is totally different market. It has encouraged growth with the low tax rate and it has dealt on a massive amount of volume. And the state balances it very well.

In the newer jurisdictions there's still a concern, and they want to make sure they get as much as they can up front.

Very quickly, touching on what I believe is the most important issue that I want to leave you with, the legislative point of view is: If we don't get an agreement on a tax rate and we sit here and we regretfully do what, say Pennsylvania has done with some of the other issues that is resolved around getting them up and running you will have a legislator, a senator, a house representative who voted on this issue and is willing to take the heat because the benefit of the tax revenues coming in is going to be his salvation. Have to seek reelection without any of those tax revenues running in, because we are still two, three, four years out before the program actually starts.

So the more we get resolved up front on the legislative matter, the tax being the most significant, the better it will be for everybody in the long run. Sorry for the diatribe.

Any other questions? Yes; up front, sir?

A VOICE: (A question was asked by an attendee.)

MR. SULTEMEIER: I'll give you an example at Finger Lakes, for example, where we did a lot of blending. Our marketing director became the marketing director for both sides, food and beverages coordinated between the two. Certainly racing is not a stand-alone as a pari-mutuel operation, the racing office operation. No similarities there.

Security is done in different ways at various tracks, I think you'll hear some discussion on that Thursday. At Finger Lakes we actually have it separated. At Wheeling we have it combined, it's one security department for both the racing and gaming. So as much as possible we try to blend the two.

We think it's better for marketing, it's certainly more efficient for the track and keeping the payroll down. And you can blend the two in a lot of areas. You can we

also use some track people also work on the gaming side, that works out well and gives them some expansion in their positions. So a lot of the racing people like being involved in the gaming.

MR. HAWKINS: Are there any other questions? We're coming a little short on time and I know we've been here a long time, 90 minutes. I think it's one of the longest sessions I've seen or heard.

If there are no further questions I really want to thank Karl and Ron, I think their insight and their current operations is tremendous, I thank you.

(Applause)

I think it's good for all of us to note that they run over a third of all the racing and gaming venues in the North American marketplace. Thank you all for coming; enjoy the rest of the Symposium, appreciate it.

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