



## Hold or Spin?

### *How Large are Hotels and Clubs in Victoria Really Rolling?*

- Comprehensive industry shake-up with Victorian Gaming Auction
- Hotels and Clubs to beware of significant risks
- Do new entrants understand player behaviour complexities

The Victorian State Government kicks off its shake-up of the pokie industry next Tuesday with the commencement of stage one of its online auction (Auction) for Electronic Gaming Machine (EGM) licences. The Auction is intended to provide an opportunity for clubs and hotels to gain a greater share of the lucrative Victorian gaming market, ending the duopoly of Tatts Group and TabCorp. While there are certainly benefits, Taylor Woodings warns hotel and club owners of the financial risks of gaming machines, concerned that the rush to cash-in may result in many covert costs and risks being overlooked.

It is not hard to see the benefits EGMs have brought their operators. Victoria's towns and suburbs are now dotted with clubs and hotels in impressive buildings, complete with modern attractive interiors made possible largely by gaming revenue. But the upcoming Auction presents a fundamental change in the game. Future decisions must take this into account and participants should not simply assume an easy windfall.

Below Taylor Woodings sets out the risks of the EGM auction, broadly categorised into four groups: Market, Financial, Regulatory and Compliance, and Management.

#### More information

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#### Market Risks

- Have hotels and clubs addressed in their business models the significant delay between capital outlays required for the Auction and the flow of revenue?
- There is no guarantee the Auction will deliver the expected results. Is the individual hotel or club flexible enough to meet unexpected circumstances? What contingencies do they have in place?
- The Auction may reveal additional market participants. Has the hotel or club relied too heavily on receiving its full allocation, underestimating market forces, geographic and individual venue limitations?



<b>Financial Risks</b>	<ul style="list-style-type: none"> <li>▪ Default bond (\$5,000 for clubs and \$10,000 for hotels) may be forfeited if obligations are not met.</li> <li>▪ Entitlement costs will be subject to market forces, potentially well above the forecast or budgeted amount, this could leave the hotel or club searching for significant extra funding. At what price does a licence become un-commercial?</li> <li>▪ The secondary market for entitlements has no instalment option available, leading to a heavy upfront cost.</li> <li>▪ Government required 87% return to players. For every \$100 inserted, only \$13 is returned to operators. This \$13 also attracts a tax liability</li> <li>▪ Rolling capital will be required to secure the EGMs through outright purchases or leasing arrangements.</li> <li>▪ Progressive tax rates will be applied to a venue's average monthly gaming revenue.</li> </ul>
<b>Regulatory and Compliance Risks</b>	<ul style="list-style-type: none"> <li>▪ Significant capital expenditure may be required to upgrade new or existing venues to accommodate gaming.</li> <li>▪ Venues may not receive development approval for upgrades from local councils. Any delay or rejection could see forfeiture of entitlement under the legislation's "Use it or Lose it" provision.</li> <li>▪ ATMs will be removed from gaming venues from 2012 impacting not only gaming, but also food and beverage revenue.</li> <li>▪ Pre-commitment mechanisms i.e. individual player smartcards. The effect on revenue in the short and long term is uncertain. One clear impact would be a reduction in the number of casual players.</li> </ul>
<b>Management Risk</b>	<ul style="list-style-type: none"> <li>▪ Previously, hotels and clubs did little more than host EGMs with strategic management of EGMS left to Tatts Group and TabCorp.</li> <li>▪ As operators, management oversight will need to extend to an understanding of the vagaries of player behaviour and psychology and the design and structure of the game room. This IP will not come with the new licence and may need to be sourced, at additional cost, from mature operators.</li> <li>▪ Management of ongoing reporting and compliance issues throughout the life of any EGMs will potentially require the employment of additional staff, and possibly higher fees paid to professional service providers such as accountants and legal advisors.</li> </ul>

The critical financial milestones of the change to the gaming legislation are as follows:



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**Conclusion**

Taylor Woodings has with worked with several financial institutions to perform due diligence, pre-lending and operational reviews on several hotels and clubs as detailed below. In doing so, we have provided information that allowed fully informed decisions to be made and potential problems avoided. We have also been appointed Receivers and Administrators of a number of hoteliers and clubs. As such, we see the next few months as critical for financiers to ensure that their customers are fully prepared to reap the genuine benefits on offer from the Auction and avoid some serious pitfalls.



Based on experience, Taylor Woodings strongly suggests that financiers seek independent third party assurance before bidding commences, to ensure that the customer has identified all possible hurdles and the security available against which to lend is adequate.

## Taylor Woodings' Experience

Some of Taylor Woodings' current and recent roles have included acting as:

- Voluntary Administrators of Cornerstone Hotels Pty Ltd, which operated a number of venues in Melbourne VIC. Working with the financiers and Receivers to restructure the business;
- Receivers and Managers of the Woolpak Hotel in Redfern NSW, which included the operation, marketing and sale of the business;
- Receivers and Managers of the Chook & the Ox Tavern at Tura Beach NSW, which included the sale of the premises;
- Advisers to financiers by undertaking detailed due diligence and pre lending reviews of operational hotels;
- Undertaking valuations of leasehold hotels for mortgage security purposes for financiers;
- Receivers and Managers of the Cauliflower Hotel at Waterloo;
- Receivers and Managers of the Skyways Restaurant located in Katoomba NSW, which included the operation, marketing and sale of the business;
- Voluntary Administrators of the Manly Fishing and Sporting Association Limited located in Manly NSW, which involved a restructure of the club under a Deed of Company Arrangement;
- Administrators of the Hunters Hill Club in Hunters Hill NSW, which involved a restructure of the club under a Deed of Company Arrangement.

Through these various assignments Taylor Woodings have developed a detailed understanding of the legislative and practical issues associated with formal insolvency appointments and commercial issues associated with the industry.

In addition, Taylor Woodings has an extensive network of contacts in the hospitality industry such as valuers, sales agents, business managers and suppliers who can work with us to ensure that due consideration is given to every aspect of the assignment.

Taylor Woodings has prepared a comprehensive report that examines all the issues we consider to be of most relevance to all parties contemplating direct or indirect involvement in the upcoming gaming Auction.

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#### Disclaimer:

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