

US Internet Poker Market

Assessment of Internet Poker in California

January 2010

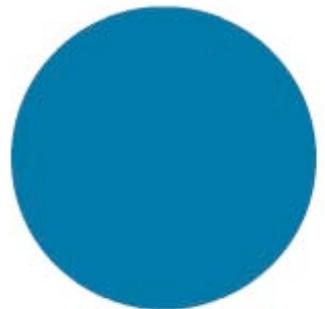
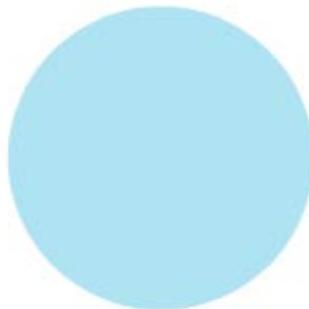
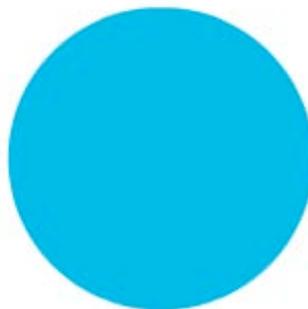


Table of Contents

Executive Summary.....	3
About Global Betting and Gaming Consultants (GBGC)	4
GBGC Project Case Studies.....	5
GBGC Engagement.....	6
A History of Online Poker.....	7
Timeline of Early Years of the Online Poker Sector	7
1998 – 2001	8
2002 – 2004	8
2005 – Present	9
The Online Poker Business Model	10
Rake and Tournament Fees	10
The Importance of Liquidity.....	11
Innovations and Drivers of Poker Liquidity.....	12
Liquidity Share	14
Poker Networks and Liquidity Threshold.....	15
US Internet Poker Market	17
California’s Share of the US Internet Poker Market	18
Case Study of Controlled Opening of a Market – Italy.....	20
A Regulated California Internet Poker Market	22
Market Size and Tax Revenues	23
A Monopoly Operator	23
Competitive Market.....	24
Regulated Poker Market Forecasts.....	25
Appendices.....	27
Forecasts for GGY (\$m), Active Accounts (000s) and Tax Revenues (\$m) in a Regulated California Market.....	27
GBGC Methodology and Data Sources	28
Assumptions for California.....	28
Sources.....	30

Executive Summary

- GBGC calculates that the current Internet poker market in California is worth **\$450 million** in revenues¹ (GGY) under existing market conditions.
- In a competitive, low-tax environment a regulated intra-state Californian poker market could generate **\$1.2 billion in poker revenues in its first year**.
- With a 5% tax rate, a regulated intra-state Californian poker market could generate **accumulated tax revenues of \$650 million over the first five years**.
- The online poker business model is designed to encourage regular play and operates on low margins. The model is only possible in a low-tax environment.
- For every percentage point increase in gaming tax, the offshore market becomes more attractive to both operators and customers. As the gaming tax rate increases, therefore, the cumulative GGY and number of active accounts in the regulated market decreases.
- The sustainability of a higher gaming tax rate (>10%) is not assured over the longer term because poker revenues are increasingly being lost to the attractive offshore market. Over longer time frames a lower tax rate provides consistent returns.
- Liquidity (number of players) is crucial to a successful poker website. As a minimum, a website should have **2,750 – 3,330 players** seated at its cash tables at peak times.
- A competitive market stimulates creativity and innovation – this is good for both players and operators. It also helps reduce the illegal market to insignificant levels.

¹ Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

About Global Betting and Gaming Consultants (GBGC)

Global Betting and Gaming Consultants (GBGC)² was established by its Chief Executive Warwick Bartlett in 1998. Bartlett has an extensive track record in the gambling industry spanning some 40 years.

GBGC has established itself as the largest and most credible specialist international gambling consultancy in the world. The company has worked with or supplied information to over 400 clients the majority of whom are “blue chip.”

Projects have included:

- market research,
- business and facility planning,
- product evaluations,
- operational reviews,
- the development of corporate strategies,
- license applications,
- regulatory development for and on behalf of governments,
- IPOs, M&A, and due diligence.

Typically clients include: operators, state monopolies, lotteries, suppliers, investment banks, the major consultancies, and governments.

In addition to its consultancy GBGC has produced four reviews of the global gambling market that have been widely acknowledged to be the best available both in terms of their detail and accuracy. The latest review was published in October 2008 and extends to over 1,000 pages.

The statistics and forecasts that are contained within the Global Gambling Report have become recognised, within the industry, the financial community, and the Media as the industry standard for sizing both the online and offline gambling markets. GBGC is widely quoted as a source of industry data in share prospectuses and analysts' notes as well as in publications such as the Financial Times, Forbes, Time Magazine, BBC Radio 4, BBC Breakfast, ITN news, the Economist and Fortune magazine.

² <http://www.gbgc.com/>

GBGC's personnel spend all of their time looking at the gambling market. As a result, they have an in-depth understanding of the key issues and the direction of that market.

GBGC's operational and financial experience, combined with our gambling industry focus, our extensive network of contacts, and our reputation as an independent commentator on the industry means we can scratch the surface and get to the bottom of issues which can sometimes be clouded by data alone.

With an international focus, GBGC is able to offer clients an additional perspective gained from researching markets, working on projects, and attending/speaking at conferences around the world.

GBGC Project Case Studies

1. Sector: Malaysia sports betting

GBGC recently completed a study for a conglomerate company in Malaysia on the prospects for gambling in that country that included: sizing the market, returns on CAPEX, software advice, and law. This was a 14-day project completed to the complete satisfaction of the client.

2. Sector: China's mobile lottery market

GBGC was engaged by a Hong Kong-based, listed company to provide a marketing report on access to the Chinese lottery market through mobile telephone services. A 10-day project involving visits to Shanghai, Shenzhen and Hong Kong completed to the complete satisfaction of the client.

3. Sector: Eastern European sports betting

GBGC was appointed by two Eastern European entrepreneurs because sports betting had been legalized in their country. They wanted to enter into a joint venture with a UK-based bookmaker who could bring to the partnership knowledge of risk management, odds compilation, customised software and western European accounting practices. The European partners were able to bring to the venture local knowledge, land-based sites, and contacts with government. GBGC's task was to find a company that met the business criteria of the European entrepreneurs along with a working social chemistry between the respective business people. GBGC introduced Stanley Leisure plc and now the business is successfully operating 145 betting shops.

4. Government Relations

Bartlett was advisor to the Government of Malta for two years and GBGC's advice helped Malta establish itself as the leading offshore gambling jurisdiction. GBGC is currently advising the Isle of Man government on future strategy for e-gaming.

GBGC also advised the Government of Botswana on the implementation of its new Gambling Act.

GBGC Engagement

GBGC has been engaged by Betfair US, the US operating division of UK-based betting firm Betfair, to provide a report on the US poker market with specific focus on California.

Betfair is the world's largest legal online wagering company for Horse Racing, Poker, Sports, and Casino depending on local regulatory rules. Betfair currently offers licensed gaming products and services in the U.K., Australia, Italy, Malta, Germany, and Austria.

Unlike other offshore operators, Betfair had never accepted bets from US residents until 2009 when Betfair purchased TVG, a state licensed and regulated advance deposit wagering provider for horseracing. TVG accepts pari-mutuel wagers from residents of 17 states.

Betfair is ranked the 11th highest revenue generating website in the world with over \$550 million in annual revenues. TVG is the largest legal online wagering operator for horse racing in the United States with over \$500 million in annual gross wagering.

The report will include a brief history of online poker and GBGC's calculations for the size of the US and California online poker markets.

A History of Online Poker

Timeline of Early Years of the Online Poker Sector

YEAR	EVENT
1998	Planet Poker is the first “real-money” online poker room.
1999	New poker websites like Paradise Poker and PokerRoom provide competition for Planet Poker . The TV series <i>Late Night Poker</i> is broadcast on Channel 4 in the UK. Credited with raising the profile and popularity of the game in the UK.
2000	Ladbrokes hosts the first Poker Million event in the Isle of Man.
2001	PartyPoker website launches.
2002	PartyPoker Million event held on cruise ship in Mexican Riviera. Helps boost PartyPoker’s profile. PokerStars opens its online poker room.
2003	Chris Moneymaker wins the World Series of Poker (WSOP) main event. He won his WSOP seat through an online qualifying tournament on PokerStars .
2005	PartyGaming lists on the London Stock Exchange (FTSE 100) with a value of GB£4.5bn.
2006	The passing of the Unlawful Internet Gambling Enforcement Act (UIGEA) causes the majority of poker sites to close to US customers.

Source: GBGC Analysis

1998 – 2001

Planet Poker claims the title of being the first internet poker room to offer poker games for real money in 1998.

This website was closely followed by competitor websites such as Paradise Poker and PokerRoom.

The television series *Late Night Poker* aired its first series in the UK in 1999 and is credited with raising the profile, popularity and image of the Texas Hold'em poker game.

The use of under the table cameras – now standard in poker broadcasts – made watching a game of poker on television more interesting because viewers could see each player's cards and assess the state of the game.

The show also helped improve the image of poker, making it a more "acceptable" game in mainstream entertainment.

2002 – 2004

The period between 2002 and 2004 was when online poker really exploded and established itself as a major Internet activity.

There were several reasons for this boom in online poker. First, Internet technology was improving. The increasing penetration of broadband Internet and better poker software made playing the game online easier and more attractive to players.

New operators were entering the market, each spending money on marketing their own Internet poker room but with the general effect of increasing the awareness of online poker in itself.

The importance of Chris Moneymaker winning the main event at the 2003 World Series of Poker (WSOP) in promoting Internet poker cannot be overestimated.

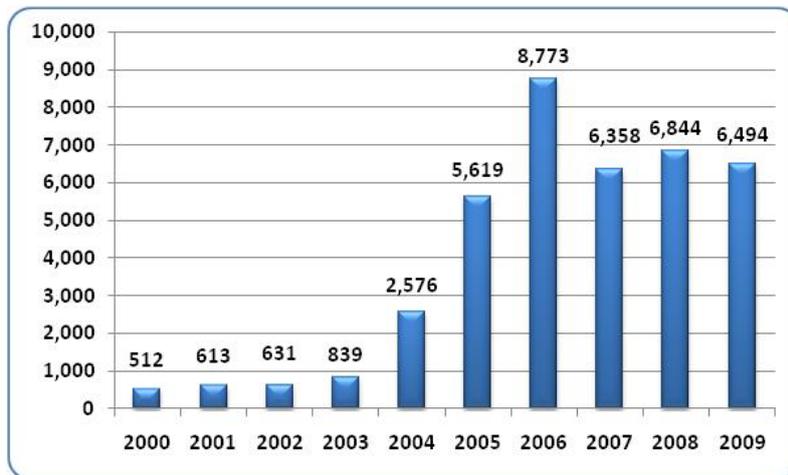
As a story, it was a perfect marketing aid to the online poker industry. Moneymaker – even his surname is ideal – qualified for the World Series of Poker by winning an online satellite tournament hosted on the PokerStars website.

He paid just US\$39 to play in this online tournament and turned it into \$2.5 million by going on to win the main event at WSOP. It gave hope to the "ordinary player" that they too might turn a small tournament fee into a life-changing prize.

In 2004 Greg Raymer also won the WSOP by qualifying for a place on the PokerStars website. These two winners helped boost PokerStars' popularity and it was becoming increasingly common for poker websites to offer seats at major land-based poker tournaments as prizes in their online games.

In the same year 50% of players at the Ladbrokes Poker Million qualified for their place through the Ladbrokes.com poker room.

WSOP Entrants 2000 - 2009



The graph above shows the number of entrants to the WSOP. In 2004, the year following Chris Moneymaker's win, the number of entrants increased by over 200% and more than doubled again in 2005.

2005 – Present

PartyGaming listed on the London Stock Exchange in June 2005, valued at GB£4.5bn (US\$8.7bn). It seemed to mark the arrival of Internet poker both in the corporate and public arena. At the time PartyPoker was the largest poker website in the world with a market share of around 48%.

But a little over 12 months later, the Internet poker landscape was completely changed. The passing of the Unlawful Internet Gambling Enforcement Act (UIGEA) in the US in October 2006 forced many poker websites to stop accepting customers from the US.

The move had a devastating effect on many websites because 85% - 90% of their revenues had been generated by US players.

The balance of power now shifted to private operators who continued to take business from the US, something that the publicly listed companies could not countenance.

Those companies that continue to take revenues from the US are also gaining an advantage in Europe too. This is because they can use their revenues from the US to spend on marketing and business development in Europe's emerging markets.

The Online Poker Business Model

Rake and Tournament Fees

Online poker rooms generate revenues from their customers in two main ways:

- **Rake:** the poker room charges a percentage fee ('rake') on each pot played in cash games. The amount of rake is determined by the size of the pot and the number of players. The rake tends to decrease as the limit on the table increases. It ranges from 1% to 5% of the pot.
- **Tournament Fees:** to play in a poker tournament the operator will charge each player a "buy in" which is used to create a prize pool for the tournament winners and a tournament fee, which is the operator's revenue. The tournament fee ranges from 0% to 25% of the buy in amount.

Example of Rake Structure for Cash Games

Table Limit (US\$)	Number of Players	Rake per Pot Size (US\$)	Maximum Rake (US\$)
\$0.10/\$0.20	2-10	\$0.01 per \$0.20	\$0.50
\$1/\$2	2-10	\$0.05 per \$1.00	\$1.00
\$10/\$20	2-3	\$0.50 per \$10.00	\$1.00
	4-5	\$0.50 per \$10.00	\$2.00
	6-10	\$0.50 per \$10.00	\$3.00
\$250/\$500	2-3	\$1.00 per \$100	\$2.00
	4-10	\$1.00 per \$100	\$5.00

Source: PartyPoker.com

As the table above shows, the rake percentage for the lower limit tables (\$0.10/\$0.20) is 5% of the pot (\$0.01 per \$0.20), while for the higher limit tables it falls to 1% (\$1 per \$100).

The Importance of Liquidity

Both methods of generating revenues from online poker place a great deal of importance on liquidity – the number of players using a poker room at a given time.

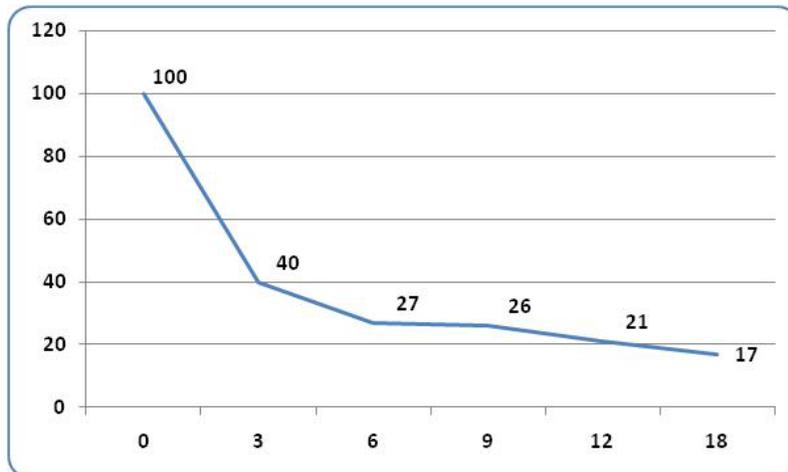
The more people that an Internet poker room can attract to its website the more games will be played and the more entrants it will get for its tournaments – both of which will generate revenues for the operators.

Liquidity is crucial for the success of an Internet poker room. When a player logs in to the website they want to be able to find a poker game both of the type they want and at the limit level they wish to play at.

If they cannot find a game quickly and easily, they will simply click to a competing website. Losing liquidity becomes a downward spiral for a poker room. As players drift away to competitors, the situation just becomes worse for the operator because it is hosting fewer tables because fewer players are able to find the kind of game they want.

Retaining players and attracting new ones is a key part of running a successful poker website. The lifespan of an average player is very short – often less than three months – so operators must try and either extend that lifespan or constantly recruit a stream of new players.

Percentage of Players Still Active after X months from sign-up



Source: GBGC Analysis

The graph above shows how many players are still active after a certain number of months after signing up. In the first three months 60% of players have become inactive. After one year just 21 players in every 100 signed-up are still active on the poker site.

Innovations and Drivers of Poker Liquidity

Poker websites will invest up to 30% of their revenues in marketing and promoting their website to attract and retain customers.

Given that the game of poker is generally the same between operators, they have to be creative and innovative to ensure that players choose their site to play poker.

Selection of Methods and Innovations to Create a ‘Liquid’ Poker Site

Feature	Description
Create a website with a design and layout that is easy to use	If you want players to spend time playing on your site (and generating rake) then it must be easy to navigate and well-designed.
Poker Tutorials and free-play sites	The lifespan of a new poker player can be extended by helping them to improve their poker game without it costing them money. Investment in tutorials and practice sites can achieve this.
Sign-up Bonus and Rakeback	<p>Websites will often match a new customer’s initial deposit to the value of 100%.</p> <p>Some sites offer a “reload bonus” if a customer adds new funds to their account at a specific time.</p> <p>Rakeback is a refund that a website gives to a player. It is a percentage of the rake that a particular player has generated. It is designed to get players playing more hands.</p>
Variety of games	While Texas Hold’em is the most popular variation in most markets, offering other games like Omaha, 5 Card Draw, etc. caters to all tastes.
Tournaments with Guaranteed Prize Pools	Operators host tournaments with a guaranteed prize pool, regardless of the number of buy-ins, e.g. PokerStars Sunday Million is a weekly tournament with a guaranteed pool of \$1.5m.

Feature	Description
<p>Television coverage of poker tournaments</p>	<p>Many poker websites run land-based tournaments and create television shows based around them.</p> <p>The shows are broadcast on television and the operator’s website. It acts as a promotional tool for the poker room.</p> <p>Sky Poker³ goes further and broadcasts the games that are played on its website. It gives the chance for ordinary players to see their games on TV. The draw of the “fame” of being on TV could encourage consumers to play with Sky Poker rather than elsewhere.</p>
<p>Win Seats for large land-based tournaments</p>	<p>This gives players the chance to win entry into the big tournaments (like WSOP) that they would not otherwise be able to afford. The prize often includes travel and accommodation for the tournament too.</p>
<p>Celebrity and Sponsorship</p>	<p>Sites will sponsor well-known poker players and will run tournaments with celebrities (sports stars, actors, etc.) taking part.</p> <p>It gives players the chance to play against the celebrities and win prizes for knocking them out.</p>
<p>3D Poker</p>	<p>PKR.com⁴ has pioneered 3D poker to appeal to the younger player that has grown up with computer games. The software allows the player to create their own avatar.</p> <p>It is a feature that aims to enhance the online poker playing experience.</p>

³ http://www.skypoker.com/poker/sky_lobby

⁴ <http://www.pkr.com/en/>

Liquidity Share

The situation regarding poker liquidity has changed dramatically since the passing of UIGEA in October 2006 in the US.

Once the largest Internet poker room, PartyPoker now has an average liquidity share of between 8% and 9%, following the closure of its US-facing operations.

The two operators that dominate the online poker liquidity share are PokerStars and FullTilt. Combined, they account for more than 50% of the market. Both continue to accept US players.

The top five networks account for around 75% of poker liquidity.

Average Share of Poker Liquidity by Network (%)



Source: GBGC Analysis

Poker Operator/Network	Liquidity Share (%)
PokerStars	33.9
FullTilt	18.8
Ipoker Network	9.6
PartyPoker	8.1
Ogame	4.6

Poker Networks and Liquidity Threshold

It should be noted that most poker websites do not run their own Internet poker room, but instead join a poker network.

The operator uses a network's poker software and has a poker website branded in its corporate colors. The operator is also responsible for the players it attracts to its poker website.

Key Poker Networks and Licenses

Poker Network	Key Licensees
iPoker Network (run by Playtech)	<ul style="list-style-type: none">• Blue Square Poker• Bet365 Poker• Expekt Poker• PaddyPower Poker• Victor Chandler Poker• William Hill Poker
OnGame Network	<ul style="list-style-type: none">• Bwin Poker• Betsson• Coral Eurobet• Eurosport Bet• PAF
IPN Poker (run by Boss Media)	<ul style="list-style-type: none">• BetClick• Poker Heaven• InterPoker• Virgin Poker
Microgaming	<ul style="list-style-type: none">• Mansion• Digibet• 32Red• StanJames Poker• Ladbrokes Poker• Unibet Poker

The big advantages for an operator being part of a wider network are: the operator does not have to develop its own poker software (which can be costly), and the players it attracts benefit from being part of a wider pool of players across the entire network. All individual operators on the network

benefit from the greater liquidity by pooling their players – a case of the whole being greater than the sum of its parts.

PokerStars and Fulltilt operate their own poker rooms and are not part of a network. PartyPoker had historically operated their own poker rooms, however recently they have ventured into the network model.

Liquidity Threshold

A poker website site that is not part of a wider network would need a **minimum of 2,750 – 3,300 seated players** at its cash tables at peak times to offer sufficient, competitive liquidity.

If a website were part of a wider, pooled network, it could manage with a lower threshold at its own tables because it could benefit from the liquidity of other sites in the network.

The table below shows different assumptions regarding the percentage of the implied total active player base represented by 2,750 - 3,300 cash players at peak times.

	Assumed Percentage (%) of Total Active Player Base	Implied Total Active Player Base
2,750 – 3,300 players seated at cash tables at peak time	2%	c. 165,000
	4%	c. 82,500
	8%	c. 41,250
	15%	c. 22,000
	20%	c. 16,500
	50%	c. 6,600

Source: GBGC Analysis

US Internet Poker Market

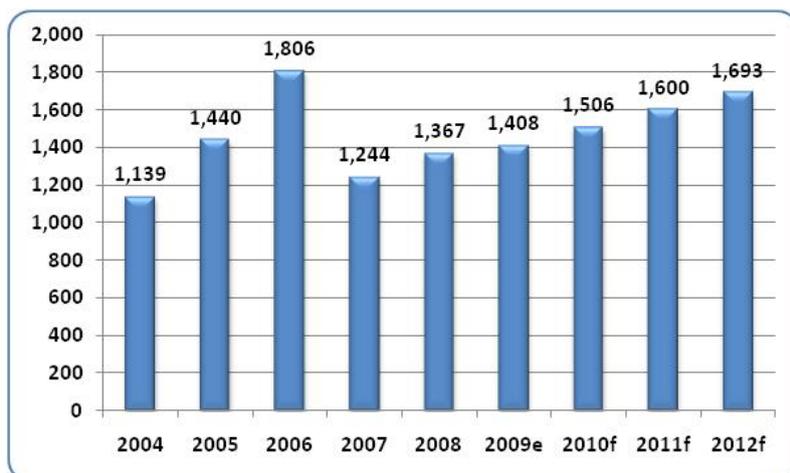
GBGC calculates that the US Internet poker market amounted to \$1,367 million in 2008, as measured by Gross Gambling Yield (GGY)⁵ – the amount collected by operators in rake and tournament fees.

In 2009 GBGC believes this figure will have risen to \$1,408 million, an increase of around 3%. Growth slowed in 2009 because of:

- the wider economic recession,
- rising unemployment and credit card defaults in the US,
- lower spending by high-rolling players,
- payment issues with US-facing poker operators.

These revenues relate to those generated by players using Internet websites licensed outside the US. The forecasts here assume **no change to the existing regulatory situation** (January 2010) either at a federal level or in any individual state.

US Internet Poker Gross Gambling Yield (US\$m) 2004 – 2012f



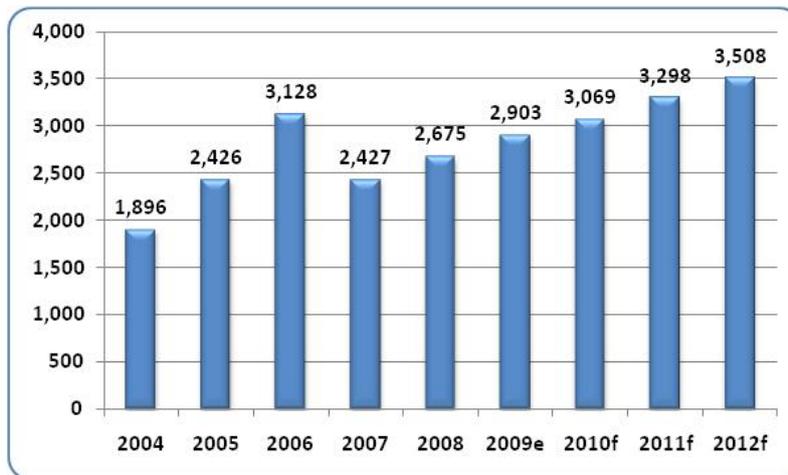
Source: GBGC Analysis

GBGC calculates that there are 2.9 million active poker accounts in the US. An active account is one that contributes to revenues.

Both Internet poker revenues and active accounts suffered sizeable falls in 2007 as the poker industry was re-shaped by UIGEA in October 2006.

⁵ Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

US Internet Poker Active Accounts (000s) 2004 – 2012f

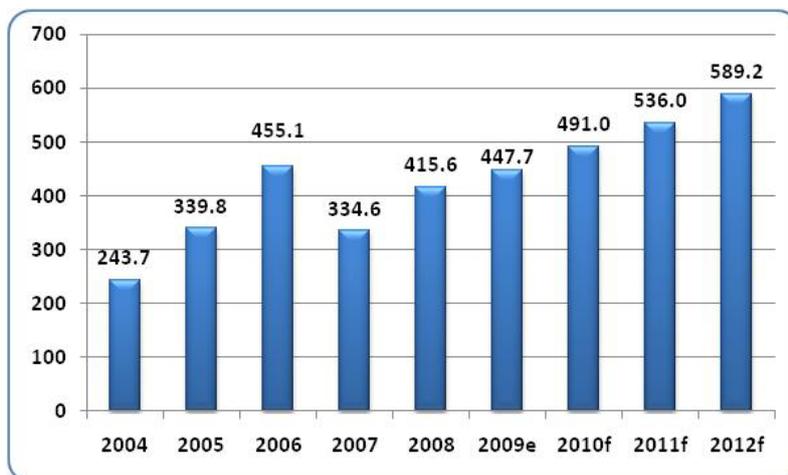


Source: GBGC Analysis

California's Share of the US Internet Poker Market

California's share of the US Internet poker market was calculated to be \$448 million in 2009, with some 778,000 active accounts.

California Internet Poker Gross Gambling Yield⁶ (\$m) 2004 – 2012f

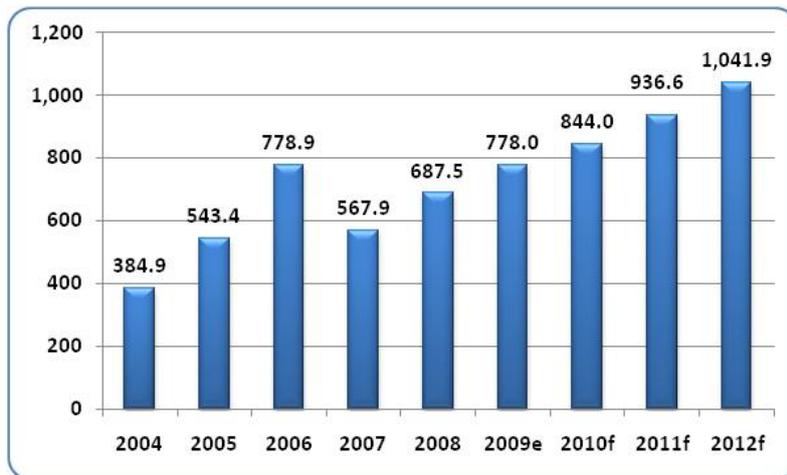


Source: GBGC Analysis

If the status quo were maintained until 2012, GBGC believes the Californian Internet poker market would reach \$589 million.

⁶ Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

California Internet Poker Active Accounts (000s) 2004 – 2012f



Source: GBGC Analysis

The number of active poker accounts in California could surpass one million by 2012 under current market and regulatory conditions.

Case Study of Controlled Opening of a Market – Italy

Italy has shown what can be achieved with a controlled opening of the Internet gambling market. Prior to 2006 there was no domestic regulation in place to permit Internet gambling in Italy. Numerous offshore operators, however, still targeted the market from other jurisdictions.

Partly as a desire to generate tax revenues and partly because of pressure from the European Union regarding its restrictive gambling legislation, Italy began creating Internet gambling regulation in mid-2006.

Italian-regulated Internet poker started in September 2008 and has been very successful. AAMS (the Italian regulator) has opened the market in a very controlled way, with various licensing stipulations:

- All operators must be licensed with AAMS, a license costs €300K (US\$ 424 thousands)
- To apply for a licence an operator must already be licensed to run gambling in a European Economic Area (EEA) state,
- Total turnover must be €1.5m (US\$2.1m) in the previous two financial years (alternatively a bank guarantee of the same amount can be provided),
- Customers must be registered with AAMS and enter into a gambling account agreement with the operator,
- Operators must notify AAMS of every bet, winnings, and payment made by its customers.

Italy's poker market is a closed network. This means that a poker operator must keep its Italian poker players separate from other players from other countries that play on its network.

In practice, this means that Internet poker operators have to have a separate .IT website, distinct from their .COM site. For example:

<http://www.partypoker.it/>

<http://www.pokerstars.it/>

Operators have complied with AAMS' requests and taken Italian licences because the Italian market is a good one for poker:

- A sizeable population,
- Good Internet and broadband access,
- High propensity to gamble,
- Poker is an established game,
- A low tax rate – AAMS set the tax rate for Internet poker at 3%.

The low tax rate of 3% has helped Internet poker boom in Italy since it was regulated. In 2009 the market was worth approximately **€350 million (US\$500m)** by revenues⁷. At present, the Italian market only allows tournament games and not cash games. This means that the operators have a

⁷ This revenue figure refers to the amount operator keeps after it has paid out in tournament prizes to winners.

higher margin than for cash games. Cash games will be introduced in Italy in 2010, which is likely to lower the margin. The market has grown by around **150% in 2009 versus 2008**.

Top 5 Italian Poker Operators by Market Share (%) 2009

Poker Operator	Market Share (%)
MicroGame	27.0%
Gioco Digitale	23.0%
Lottomatica	14.1%
PokerStars	11.8%
Snai	6.8%

Source: AAMS

Summary of First Year of Italian Internet Poker Market (2009)

- Tax rate of 3% of Tournament fees
- Total Tournament fees of €2.34 billion (US\$ 3.35 billion)
- Total revenues⁸ of €350 million (US\$ 500 million), assuming an average industry margin of 15% of tournament fees (maximum legal margin is 20%)
- Total Tax revenues for the Italian Government of €70 million (US\$ 100 million)
- Market growth of almost 150%

⁸ This revenue figure refers to the amount operator keeps after it has paid out in tournament prizes to winners.

A Regulated California Internet Poker Market

GBGC believes that a regulated intra-state Internet poker market in California has great potential, given the population size, relative economic wealth, and propensity to gamble in the state.

GBGC has made the following assumptions in assessing the market’s potential:

- A regulated market with licences issued by the Bureau of Gambling Control,
- Intra-state Internet poker market,
- Both tournaments and cash games will be permitted,
- Multiple license holders, including state lottery and private companies,
- A reasonable tax rate,
- The ability for operators to advertise their Internet poker services.

A regulated market provides several boosts to the sector’s revenues:

Feature	Benefit
Operators can gain a recognized state–issued Internet gaming license	<ul style="list-style-type: none"> • Operators are trusted by players • Confidence that winnings will be paid and recourse to regulator in a dispute • Operators lose the “offshore” stigma
Ability to advertise services across all media	<ul style="list-style-type: none"> • Mainstream advertising helps promote Internet poker to the mass market
Mainstream payment methods	<ul style="list-style-type: none"> • The ability to transfer funds is central to the Internet poker industry • A regulated market that permits credit card and regular e-wallet payments helps boost revenues through their ease and convenience • No fear of funds being seized
Competitive market	<ul style="list-style-type: none"> • Value for the customer • Customers open several accounts with different operators
Cross-selling with land-based facilities	<ul style="list-style-type: none"> • Cardrooms can promote their online service to their customers

Market Size and Tax Revenues

One of the determining factors in the success of a regulated Californian Internet poker market will be the tax rate set for poker operators.

Internet gambling is a low margin business, which means it can offer better value for money and payouts to the customer than the land-based sector can.

Offshore gambling jurisdictions have facilitated the Internet gambling sector by charging low gaming taxes on the activity.

For example, PokerStars' basic tax liability is as follows for its Isle of Man operations:

- **Corporate Tax: 0%**
- **Value Added Tax (VAT): 17.5%** - an indirect tax on services acquired by the business, including: legal services, accountancy, marketing, telecommunications
- **Gaming Duty: between 0.1% and 0.5%** of gross gaming yield (revenues)⁹

The UK provides a good example of what happens when the tax rate is set too high. The UK rate of tax on Internet gambling is 15% of gambling revenues. The UK has failed to attract any of the major Internet gambling companies from their current jurisdictions since the new Gambling Act of 2007.

The tax rate is simply too high and in 2009 two long-established UK companies – William Hill and Ladbrokes – moved the last parts of their Internet businesses offshore to compete with their rivals.

A Monopoly Operator

On first assessment, the idea of a monopoly operator to control intra-state poker seems appealing. A monopoly can control the product being offered and can ensure tax revenues are collected. This theory, however, does not always work out in practice.

In a monopoly situation it is often the case that the tax rate and rake percentage is set too high as the monopoly tries to maximize tax revenues. While this might seem good for the state's coffers, it does not offer the value for money for the customer.

This perpetuates the existing situation, whereby Californian players will continue to seek the better offer provided by the offshore operators who have low corporate and gaming tax liabilities (often less than 1% of revenues).

It could be the case that a monopoly operator with a high rate of tax and rake would provide diminishing returns over a period of time:

⁹ Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

- The higher rake percentage means players using the monopoly website play less because they are winning less. They spend their allocated gambling spend more quickly and they also have fewer winnings to recycle in further play.
- The lure of the better value, financially and technologically, offered by offshore operators still exists. The state loses tax revenues to money being spent outside the state.

Competitive Market

A competitive Internet poker market – which can include a state operator as well as private companies – is the most efficient means of generating tax revenues.

Competition means that operators have to be efficient and innovative to attract and retain customers. They know in a competitive market that the customer has choice and a rival more innovative site is only a click away.

A low tax rate in a competitive market helps to stimulate revenues. A low tax rate means operators can keep the rake percentage lower (if tax is high, rake percentages creep up to cover the increased cost).

A lower rake percentage:

- encourages more poker play,
- encourages multi-table play,
- gives customers more winnings to recycle in further play,
- increases liquidity.

A lower tax rate also helps to reduce illegal gambling to insignificant levels because the licensed market is attractive to both players and operators. The prevention of illegal gambling is important because it also reduces the social problems and crimes that are linked with an illegal gambling market.

Licensed operators can also be held to account for their social responsibility practices that can be stipulated in the requirements of obtaining a license.

In a licensed market the regulator is able to revoke the license of an operator that fails to take responsibility for pathological/problem gamblers. Operators should prevent them from accessing the website and provide advice as to where they can obtain help.

Social responsibility schemes adhered to by licensed companies can prevent pathological gamblers from becoming a burden on the state and tax payers.

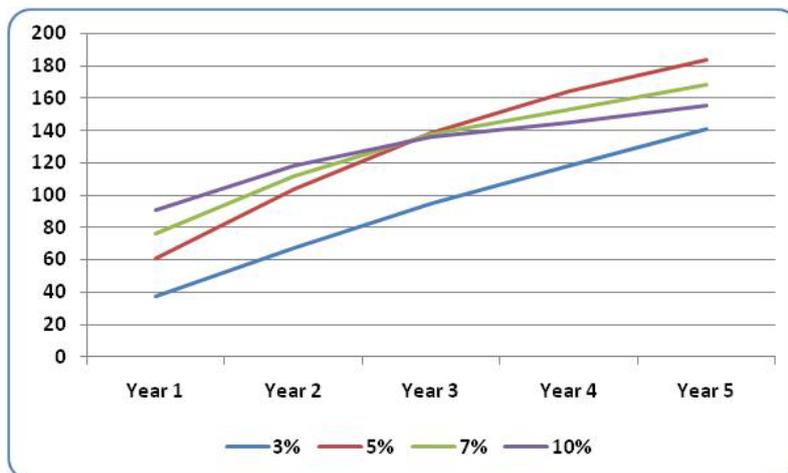
Regulated Poker Market Forecasts

Over a five-year period of a newly regulated market California could generate \$13 billion in poker gross gambling yield (GGY), assuming a tax rate of 5% of GGY¹⁰.

As the theoretical tax rate increases, the cumulative GGY and number of active accounts in the regulated market decreases. For every percentage point increase in tax, the offshore market becomes more attractive to both operators and customers.

According to GBGC calculations, a tax rate of 5% on revenues generates \$651 million in gaming tax from regulated online poker in California over the first five years. Over the same time span a 10% tax rate generates US\$ 645 million.

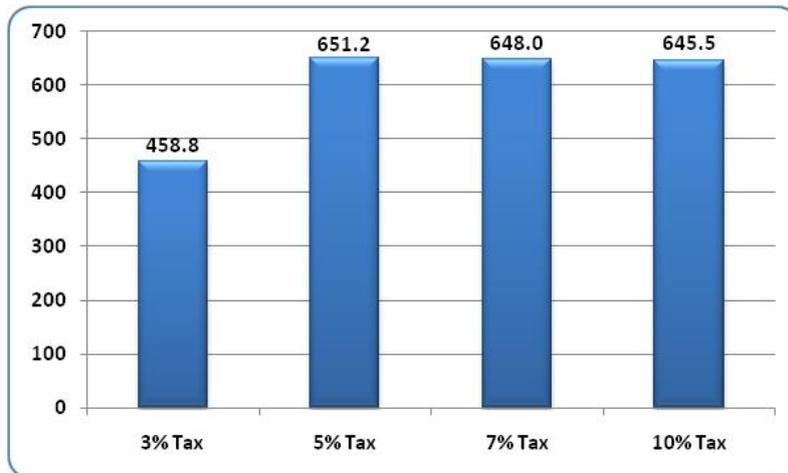
Annual Tax Revenues over Five Year Period (\$m)



Over the longer term, the sustainability of a higher tax rate (10% +) is not assured. This is because poker revenues are increasingly being lost to the attractive offshore market. Over longer time frames a lower tax rate provides consistent returns.

¹⁰ Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

Cumulative Five Year Internet Poker Tax Revenues (\$m)

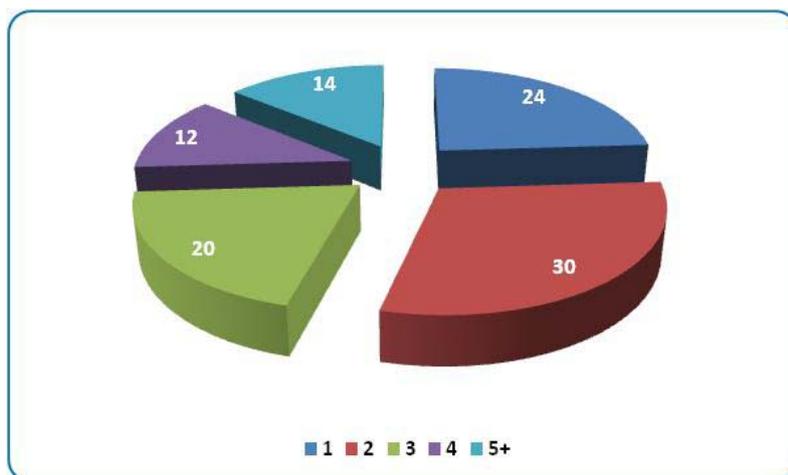


In a low-tax, competitive market the number of active accounts is also substantially higher than in a high-tax environment.

With a number of operators in the market all competing for players, it means that each player increases the number of websites they play on. Surveys of poker players have revealed that 25% - 30% of players use four or more different poker websites.

In this way, a low-tax, competitive market helps stimulate play, and thereby rake, tournament fees and tax revenues.

Number of Poker Sites Used By Poker Players (%)



Appendices

Forecasts for GGY¹¹ (\$m), Active Accounts (000s) and Tax Revenues (\$m) in a Regulated California Market

Tax Rate (% of revenues)		Year 1	Year 2	Year 3	Year 4	Year 5	Total
3%	GGY (\$m)	1,258.0	2,251.8	3,152.5	3,940.6	4,689.3	15,292.2
	Accounts (000)	2,017.2	3,146.8	4,091.3	4,991.4	5,740.1	
	Tax (\$m)	37.7	67.6	94.6	118.2	140.7	458.8
5%	GGY (\$m)	1,222.6	2,078.4	2,764.3	3,289.5	3,668.6	13,023.4
	Accounts (000)	1,941.2	2,931.2	3,546.8	4,185.2	4,642.4	
	Tax (\$m)	61.1	103.9	138.2	164.5	183.4	651.2
7%	GGY (\$m)	1,090.0	1,602.3	1,970.9	2,187.7	2,406.4	9,257.3
	Accounts (000)	1,831.5	2,619.0	3,195.2	3,610.6	3,971.6	
	Tax (\$m)	76.3	112.2	138.0	153.1	168.4	648.0
10%	GGY (\$m)	908.4	1,180.9	1,358.0	1,453.0	1,554.8	6,455.0
	Accounts (000)	1,772.4	2,321.8	2,716.6	3,015.4	3,286.8	
	Tax (\$m)	90.8	118.1	135.8	145.3	155.5	645.5

Source: GBGC Analysis

¹¹ Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

GBGC Methodology and Data Sources

The nature of the Internet gambling market makes it complicated to measure its size and extent. The industry is both cross-border in its nature and many of the key companies are not publicly listed and are not required to release financial data.

In calculating data for the Internet gambling market GBGC uses the following sources of data:

- Data published by regulators,
- Publicly available information on active customers, yields, and win margins in company reports,
- Data obtained through consultancy work with clients,
- Activity tracking services and website usage.

This is combined with economic and cultural information that GBGC has determined is related to the Internet gambling sector:

- GDP,
- Gambling tax rates,
- Cultural propensity to gamble,
- Internet and Broadband usage and growth,
- Regulation and the ability for operators to advertise freely in a market,
- Number of operators/websites targeting a specific market.

In assessing the data for California, GBGC considered:

- the state's adult population,
- household broadband percentage,
- land-based gaming facilities – casinos and card-rooms,
- contribution to total US GDP,
- Individual income.

Assumptions for California

GBGC has made the following assumptions in assessing the market's potential:

- A regulated market with licenses issued by the Bureau of Gambling Control,
- Intra-state Internet poker market,
- Both tournaments and cash games will be permitted,
- Multiple license holders, including state lottery and private companies,
- A reasonable tax rate,
- The ability for operators to advertise their Internet poker services.

GBGC made the assumption that California accounts for a greater percentage of the current US Internet poker market than is suggested by its share of US population and broadband usage.

California accounts for around 12.5% of the adult population in the US and around 15% of households with broadband access.

The state of California currently accounts for 25% - 30% of all licensed, regulated land-based poker tables in the US and has a comparatively wealthy population.

In making the forecasts for a regulated Californian Internet poker market GBGC has assumed that as the tax rate increases above 5% the amount of revenues lost to offshore websites increases.

As the tax rate increases above 5% the value that Californian-licensed websites can offer customers is lessened by comparison to those operators located offshore with low or no gaming tax to pay.

Double-digit tax rates limit the amount that operators can give to players in bonuses and rakeback. Offshore operators will be able to entice players with a more compelling sign-up offer, with more marketing funds at their disposal.

A high tax rate within California might also dissuade some operators from applying for a license, opting instead to remain offshore. This factor also increases the revenues being lost offshore.

It tends to be the case that the high-rolling players – the 20% that contribute the bulk of rake because they play at higher limit tables – will be the most value conscious because an extra 0.5% on rake taken will be significant to their winnings over time.

Under a higher tax regime, therefore, it is these players that are likely to seek the value offered by offshore websites rather than the state licensed ones.

GBGC estimates the following average revenues per active account for Californian Internet poker:

Tax Rate (% of GGY/Revenues)¹²	Revenues per Active Account (\$) Range
3%	\$620-\$820
5%	\$630-\$790
7%	\$595-\$610
10%	\$470-\$510

¹² Gross Gambling Yield (GGY) – for online poker this refers to the amount collected in rake and tournament fees by the online poker room operator, also described as “revenues”.

Sources

GBGC *Interactive Gambling Report 2009*

GBGC Poker tracking data

The Business of Gambling – The Poker Phenomenon (March 2005) Dresdner Kleinwort Wasserstein Research in conjunction with GBGC

Global Gaming Almanac (2008) Casino City Press

Broadband in America (2007) National Telecommunications and Information Administration (NTIA)

Official gambling data from AAMS (Italian regulator) <http://www.aams.gov.it/site.php?page=home>

Organisation for Economic Co-operation and Development (OECD) <http://www.oecd.org/>

PartyPoker website <http://www.partypoker.com/>

Point Topic World Broadband Forecasts <http://point-topic.com/index.php>

The World Bank <http://www.worldbank.org/>

US Census Bureau <http://www.census.gov/>

Company Reports:

- PartyGaming
- 888 Holdings
- Sportingbet Plc
- Bwin
- Ladbrokes Plc
- William Hill Plc

Please Note:

While great care has been taken in the preparation of this publication Global Betting and Gaming Consultants (GBGC) take no responsibility whatsoever for the accuracy or completeness of the data and information provided within this report. Although we have sought to ensure that all of the data and information contained herein has been obtained where available from reliable sources its accuracy cannot be guaranteed and no warranty is given as to the correctness of the information in this document.

This document also contains forward-looking statements and opinions that involve uncertainties and assumptions. All estimates, opinions and forward-looking statements contained within this report merely constitute a judgment as at the date of the document. As such, should any of these uncertainties materialize or any of these assumptions prove incorrect, the forecasts could differ materially from GBGC's expectations outlined within this document. In such an event GBGC accept no liability whatsoever for the accuracy of these and does not intend to update these forward-looking statements.

-[Ends]-