

# IN THE AUSTRALIAN COMPETITION TRIBUNAL

ACT 1 of 2017

# Re: Proposed acquisition of Tatts Group Limited by Tabcorp Holdings Limited

Tabcorp Holdings Limited (Applicant)

Statement of:	Damien Johnston
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Occupation:	Chief Financial Officer, Tabcorp Holdings Limited
Date:	8 May 2017

This document contains confidential information which is indicated as follows:

[HIGHLY Confidential to Tabcorp] [.....] [Confidential to Tabcorp] [.....] [Confidential to Tatts] [.....] [Confidential to Tabcorp and Tatts] [.....]

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Α.	Introduc	tion	3
В.	Cost say	<i>v</i> ings	3
	B.1	Corporate cost savings	4
	B.2	Wagering cost savings	6
	B.3	Technology cost savings	10
	B.4	Property cost savings and field services cost savings	11
	B.5	Pass through of cost savings	12
	B.6	Claims that cost calculations do not align with revenue synergies	13
C.	Revenue	e increases	15
	C.1	Revenue increases – fixed odds performance	15
	C.2	Revenue increases – wagering business improvements	19
	C.3	Revenue increases - rebranding and improving the retail network	20
D.	Pass-th	ough of revenue synergies	20
E.	Merger	with TAB Limited	21

### A. Introduction

- 1 I am employed by Tabcorp Holdings Limited (Tabcorp) as Chief Financial Officer. I am authorised to make this statement on Tabcorp's behalf.
- I have previously filed a statement in these proceeding, dated 6 March 2017 (First Statement). This statement is supplementary to my First Statement.
- 3 Unless otherwise defined in this statement, terms used in this statement have the same meaning as defined in my First Statement.
- I have read the ACCC Report in this matter (ACCC Report), the Second Re-affirmed Affidavit of Giles Thompson dated 24 April 2017 (Second Thompson Statement), the Third Affidavit of Giles Thompson dated 13 April 2017 (Third Thompson Statement), the Statement of Robert Hines dated 25 April 2017 (Hines Statement), the Report of James Mellsop dated 27 April 2017 (Mellsop Report), the Statement of Nicholas Tyshing dated 13 April 2017 (Tyshing Statement), the Statement of Tom Hird dated 21 April 2017 (Hird Statement) , the Statement of Julian Christian dated 26 April 2016 (Christian Statement) and the Report of Greg Houston dated 21 April 2017 (Houston Report). My response to specific sections of these materials is set out below.
- 5 The matters set out in this statement are based on my knowledge of Tabcorp's operations, my review of Tabcorp's business records, my participation in the Senior Executive Leadership Team, my involvement with Tabcorp's business, my knowledge of Tatt's operations (which I previously set out in Part A.3 of my First Statement) and my experience in the gambling and wagering industries over 13 years (which I previously set out in Part A.1 of my First Statement).

### B. Cost savings

- I refer to paragraphs [5.9] [5.19] of the ACCC Report and [93] [95] of the Hines Statement, where the ACCC and Mr Hines question the accuracy of the expected cost savings detailed in my First Statement and Mr Hines asserts that there is insufficient information provided in my First Statement to enable him to comment on whether certain costs savings will eventuate as a result of the merger.
- I am confident that the proposed transaction will likely result in annual costs savings of at least approximately [Confidential to Tabcorp]
   I refer to paragraphs
   [22] [38] of my First Statement where I explain the basis of these expected costs savings.

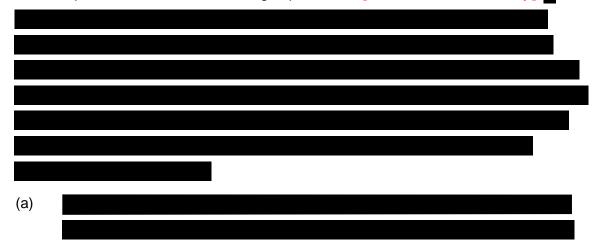
- 8 These cost savings were considered and agreed by me and by Tatts CFO, Neale O'Connell. I refer to paragraphs [16] – [21] of my First Statement, where I set out the process undertaken to quantify the cost savings, including several meetings I attended with Neale O'Connell where we discussed and agreed the cost synergies that were likely to result from the proposed transaction. We presented these to Tatts in September 2016. The expected cost synergies were also provided to the Board of Tabcorp as part of its consideration and approval of the proposed transaction.
- 9 These expected cost savings were adopted by Tabcorp in its ASX announcements concerning the proposed transaction. They were included in the at least \$130 million of EBITDA synergies and business improvements (net of benefits to the racing industry), which was publicly announced by Tabcorp on 19 October 2016.
- 10 In my view, the quantum of the expected costs savings detailed in my First Statement is a conservative number and the costs savings that ultimately occur as a result of the proposed transaction (assuming it goes ahead) could well substantially exceed this amount once a transition plan is developed and the two business are combined.

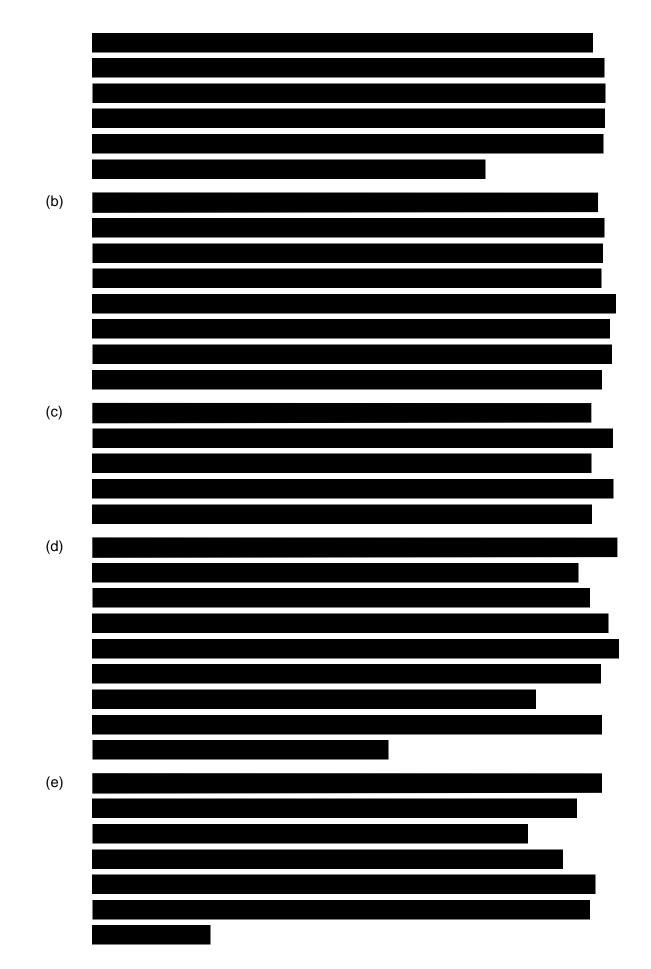
## B.1 Corporate cost savings

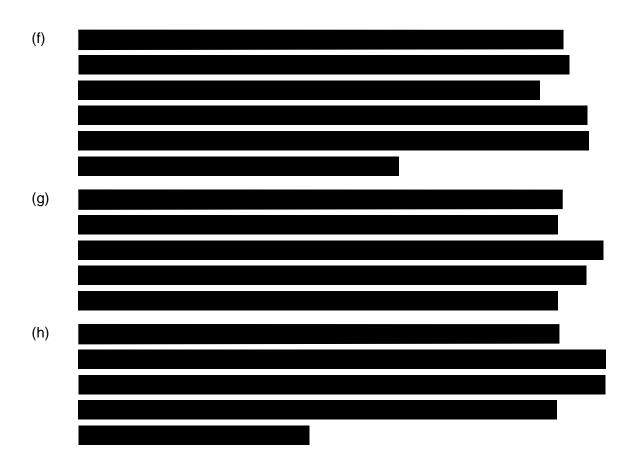
11 I refer to paragraph [5.13] of the ACCC Report, where the ACCC claims that the cost savings of [Confidential to Tabcorp]

are overstated, due to the fact that they allegedly represent 100 per cent of Tabcorp's cost base. The expected costs savings in these areas do not represent 100 per cent of Tabcorp's cost base. Further information on the calculation of these savings is provided in the following paragraphs.

In relation to external advisor fees, I refer to paragraph [34(d)(1)] of my First Statement, where I set out the cost saving of approximately [Confidential to Tabcorp]







13 In respect of the ASX listing costs savings, I refer to paragraph 34(b) of my First Statement where I explain the expected cost saving of approximately [Confidential to Tabcorp]
Tabcorp]
The ACCC asserts that these costs are reasonably expected to be higher for the larger and more complex merged entity. Based on my experience, I believe that some of Tabcorp's current costs will increase with the size of the entity, such as [Confidential to Tabcorp]

. I consider it reasonable

to assume that Tatts incurs similar costs which will be largely removed once the two ASX listings are consolidated.

## B.2 Wagering cost savings

#### Marketing

14 I refer to the Second Thompson Statement at paragraph [11] where he suggests that the expected reduction in marketing costs will reduce the level of marketing conducted by the Merged Entity. This is not the case. The marketing cost savings are not based on a reduction in advertising, promotional or other marketing offers, but rather [Confidential to Tabcorp]

This	s includes reduced [Confidential to Tabcorp]
Bookmaking	
I refer to paragraph [94(a)]	of the Hines Statement, in respect of the cost saving of
[Confidential to Tabcorp]	from savings in the costs of [Confidential to
Tabcorp]	, where Mr Hines requests further information as to

16 In response, I provide the following information requested by Mr Hines:

[Confidential to Tabcorp]

15

Table 1: Tabcorp's FY16 total costs of [Confidential to Tabcorp]

17 Table 1 shows that the current cost to Tabcorp of acquiring [Confidential to Tabcorp] is approximately [Confidential to Tabcorp] Accordingly, the expected cost savings of approximately [Confidential to Tabcorp] referred to in paragraph [29(b)(ii)] of my First Statement actually represents a conservative estimate of the savings for [Confidential to Tabcorp] that are likely to be achieved by the proposed transaction.

Call centre systems and software costs

20

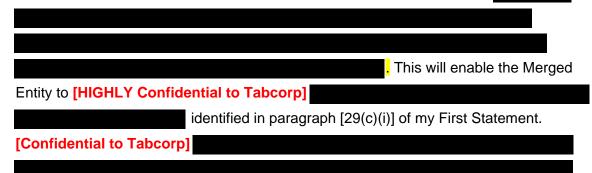
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18 I refer to paragraph [5.13] of the ACCC Report, where the ACCC asserts that the estimated cost savings of [Confidential to Tabcorp]

is based on eliminating 100 per cent of Tabcorp's costs base and may be overstated. I disagree.

19 I refer to paragraph [29(c)(ii)] of my First Statement were I explain the expected cost saving of approximately [Confidential to Tabcorp]

	. The costs of [Confidential to
Tabcorp]	
. т	he actual cost to Tabcorp of
[Confidential to Tabcorp]	per
annum. There is a small variable cost component	nt for [Confidential to Tabcorp]
However, I have accounted for the expected sm	all increase in variable costs by
discounting the saving by approximately [Config	dential to Tabcorp] , by
reference to Tabcorp's actual costs. Further, I ex	xpect that increase in variable costs will
be substantially reduced by [Confidential to Ta	bcorp]
, as referred to in parag	raph [29(c)(i)] of my First Statement,
which will in turn reduce [Confidential to Tabco	prp]
I also refer to paragraph [94(b)] of the Hines Sta	tement where Mr Hines states that he
could not assess the [Confidential to Tabcorp]	of savings for
[Confidential to Tabcorp]	without more information as to the
[Confidential to Tabcorp]	
	. This matter is also addressed in
paragraph [16] of Thompson's Third Statement.	
Tatts currently has three call centre operations,	while Tabcorp only has one. I consider
that the Merged Entity will be able to [HIGHLY (	Confidential to Tabcorp]



#### Radio operations

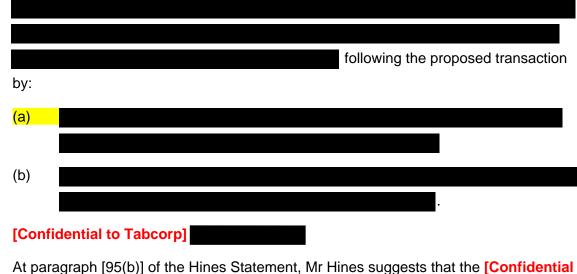
I refer to paragraph [19] of the Third Thompson Statement, where Mr Thompson asserts that the cost savings expected for the Merged Entity's radio operations will risk reduced revenue. I disagree. Mr Thompson makes this statement on the assumption that the two radio stations will be rationalised into a single station. [Confidential to Tabcorp]
I refer to paragraph [19] of my First Statement, where I explain that [Confidential to Tabcorp]

#### B.3 Technology cost savings

Race-day operations

23 At paragraph [95(a)] of the Hines Statement, Mr Hines acknowledges that he considers that [Confidential to Tabcorp]

24 This statement appears to be based on an assumption that the expected costs savings could only be achieved [Confidential to Tabcorp]



At paragraph [95(b)] of the Hines Statement, Mr Hines suggests that the [Confidential to Tabcorp]

26 This suggestion is incorrect. [Confidential to Tabcorp] Wagering system capex 27 I refer to paragraph [95(d)] of Hines' Statement, where Mr Hines acknowledges that the cost savings relating to wagering systems identified at paragraph [32(d)] of my First Statement in respect of [Confidential to Tabcorp] should be achievable. However, Mr Hines goes on to say that it is unlikely that these savings could be realised within three years because: (a) [Confidential to Tabcorp] (b) 28 Based on my discussions with Tabcorp's Chief Information Officer and Tabcorp's experience of integrating TAB Limited and ACTTAB, I am confident that [Confidential to Tabcorp] following the Proposed Transaction. The cost of the existing [Confidential to Tabcorp] referred to in paragraph [46(a)] of my First Statement. Property cost savings and field services cost savings **B.4** 29 I refer to paragraph [5.13] of the ACCC Report, where the ACCC states that the [Confidential to Tabcorp] have been claimed without providing any explanation as to how a significantly larger merged entity [Confidential to Tabcorp] . 1 also refer to paragraph [31] of the Third Thompson Statement, where Mr Thompson asserts that it would be difficult to extract any savings on field services as they are dependent on location and are resource intensive.

30 In response, I refer to paragraph [38(a)(i)] of my First Statement, where I note that the cost saving of approximately [Confidential to Tabcorp]



I again refer to paragraph [38(a)(i)] of my First Statement, where I explain a further
 property cost saving of approximately [Confidential to Tabcorp]
 from the Merged Entity [Confidential to Tabcorp]

[HIGHLY Confidential to Tabcorp]

### **B.5** Pass through of cost savings

32 I refer to paragraph [96] of the Hines Statement where he says that the pass through of the cost savings to the racing industry has been calculated without any regard to the



33 I refer to paragraph [97] of the Hines Statement, where Mr Hines asserts that the pass through of cost savings to the racing industry may not be achieved as he does not consider the cost allocation methodologies currently in place for profit sharing arrangements to be binding. I disagree.

I refer to Table 13 of my First Statement, which sets out the methodology for allocating the post-transaction cost base. This methodology is based on the [HIGHLY

Confidential to Tabcorp]

Tabcorp considers these rules and principles to be binding, and this methodology to continue following the merger.

# B.6 Claims that cost calculations do not align with revenue synergies

- 35 I refer to paragraphs [5.17], [5.27] and [5.30]-[5.32] of the ACCC Report, where the ACCC alleges that the revenue increases may be overstated, due to not aligning with Tabcorp's retail business improvements, and not accounting for the costs of the retail business improvements. This is incorrect. As I explain below, the business improvement initiatives have been built into the expected costs savings.
- 36 At paragraphs [5.31] and [5.32] of the ACCC Report, the ACCC refers to the cost involved with [Confidential to Tabcorp]

, and notes that these initiatives may also result in increased operating costs in relation to IT infrastructure and operations, which the ACCC asserts does not align with the estimated [Confidential to Tabcorp and Tatts]

I disagree and respond as

follows:

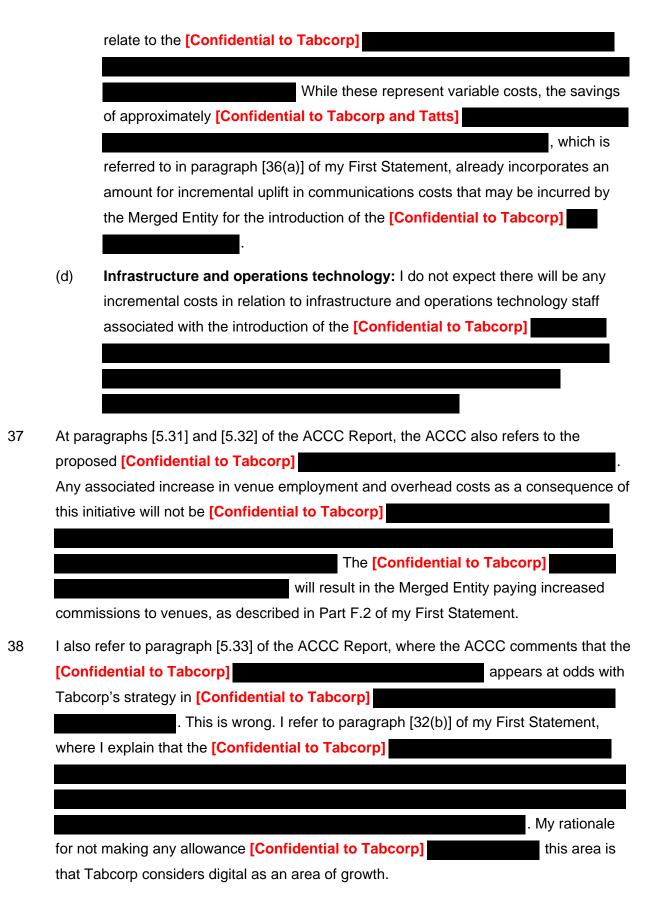
- (a) Capital costs: I refer to paragraph [90] of my First Statement, where I identify an investment of approximately [Confidential to Tabcorp] Confidential to achieve the wagering business improvements. This amount incorporates the capital costs associated with the planned introduction of the [Confidential to Tabcorp]
- (b) Maintenance costs: The [Confidential to Tabcorp]

will be maintained by the Merged Entity's integrated field services team. I note that in paragraph [38(b)] of my First Statement, I have made a conservative cost savings reduction of [Confidential to Tabcorp]

This amount

accommodates an incremental increase in maintenance costs associated with the [Confidential to Tabcorp] , which are expected to be minimal.

(c) **Communication costs:** The introduction of **[Confidential to Tabcorp]** may involve incremental communications costs which



# C. Revenue increases

# C.1 Revenue increases – fixed odds performance

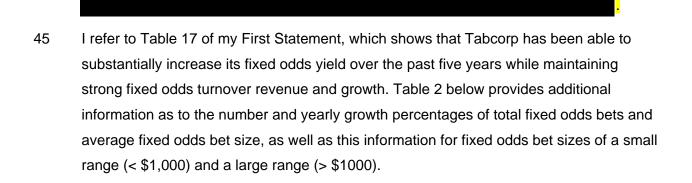
- 39 The ACCC Report at paragraph [5.25], the Third Thompson Statement at paragraph [36], the Mellsop Statement at paragraph [86(b)], the Tyshing Statement at paragraph [463] and Hines Statement at [102] assert that Tatts could make changes to its fixed odds risk management system either independently or by merging with any fixed odds wagering business, noting that [Confidential to Tatts]
- I do not agree. I refer to paragraphs [68] [72] of my First Statement, where I set out
   Tabcorp's significant investment and experience in improving its fixed odd performance,
   and paragraphs [73] [77], where I provide a comparative assessment of Tatts' fixed
   odds performance, including [Confidential to Tatts]
- 41 Tabcorp's investment in developing [Confidential to Tabcorp]

are unique to Tabcorp in that they allow Tabcorp to:

- (a) [Confidential to Tabcorp]
   (b)
- I note that more information about Tabcorp's fixed odds risk management systems and the investment that Tabcorp has made in these systems is contained in the statement filed by Douglas Freeman at paragraphs [327] to [335]. I also refer to Tables 17 and 18, and paragraph [76], of my First Statement where I explain that Tatts has not been able to manage risk in its retail channel in such a targeted manner.
- 43 Tabcorp has also demonstrated its ability to improve fixed odds performance through its acquisition of ACTTAB. I refer to paragraphs [82] to [84] of my First Statement, where I show that Tabcorp achieved substantial improvement in all three components of ACTTAB's fixed odds performance (turnover, yield and revenue) by the end of the first financial year (FY2016) after the acquisition. I do not believe that Tatts has the experience or systems in place to achieve the revenue increases in fixed odds results that I expect the merged firm will achieve using Tabcorp's experience and systems following the proposed transaction.

Fixed odds improvements resulting in a detriment in the form of fewer bets

I refer to paragraph [396] of the Houston Statement, where Mr Houston asserts that 50 per cent, or [Confidential to Tabcorp] , of the improvements represents a public detriment as a result of the Merged Entity no longer providing bets to customers on low yielding products. I disagree with this statement. I refer to paragraph [332] of the statement of Douglas Freeman, where Mr Freeman explains that the purpose of Tabcorp's fixed odds risk management system is to [Confidential to Tabcorp]



# [HIGHLY confidential to Tabcorp]

Table 2: Tabcorp's fixed odds performance FY11 – H1 FY17 based on number of bets

[HIGHLY Confidential to Tabcorp] investment in fixed odds systems]					$\rightarrow$	
Fixed odds performance indicator	FY11	FY12	FY13	FY14	FY15	FY16
Total bets						
Growth (%)						
Average bet size						
Growth (%)						
Total bets in <\$1k range						
Growth (%)						
Share of total bets (%)						
Total bets in >\$1k range						
Growth (%)						
Share of total bets (%)						

#### 46 Table 2 shows that:

- (a) while the growth rate of turnover on fixed odds bets slowed as a result of Tabcorp's fixed odds risk management system being deployed, the growth rate in the total number of bets has not been affected in the same way;
- (b) the majority of the bets affected by the risk management system have been in the [Confidential to Tabcorp]
   (confidential to Tabcorp]

(c) by contrast, Tabcorp has maintained [Confidential to Tabcorp]
 growth rates in the number of bets in the [Confidential to Tabcorp]
 over the same period. This shows that the risk management system has not substantially affected [Confidential to Tabcorp]

- (d) the vast majority (over 99%) of customers were unaffected by the introduction of Tabcorp's fixed odds risk management system.
- 47 I also refer to Table 19 of my First Statement, which illustrates Tabcorp's experience in improving fixed odds performance with ACTTAB. Table 3 below provides additional information as to the total number of fixed odds bets placed and yearly growth percentages.

### [Confidential to Tabcorp]

# Table 3: ACTTAB fixed odds performance based on number of bets

	Pre-Tabcorp acquisition	Post-Tabcorp acquisition (occurred FY15)		
Fixed odds performance indicator	FY14	FY15	FY16	FY17 half year*
Total bets				
Growth (%)				

\*Compared to FY16 half year results

Yield improvements involving price competition

- 48 Table 3 shows that the total number of fixed odds bets has grown significantly since the ACTTAB acquisition notwithstanding the introduction of Tabcorp's fixed odds risk management system and the corresponding improvement in ACTTAB's average fixed odds yield.
- 49 I refer to paragraph [104] of the Hines Statement, where Mr Hines asserts that the expected risk management improvement in Tatts' yield of 2.6 percentage points and corresponding increase in Tatts' fixed odds revenue of at least [Confidential to Tabcorp]
  Tabcorp]
  Total Confidentiation of the time of time of the time of the time of time of the time of time of the time of time of time of the time of time of time of time of the time of time
- 50 I disagree that the estimate is overly optimistic. Mr Hines has misunderstood the rationale for the revenue synergies. I refer to paragraph [78] of my First Statement where I explain that Tabcorp's strategy in improving fixed odds yield is not focussed on a change in pricing, but on improving risk management and intercepting and limiting certain high risk bets.
- 51 Similarly, I refer to paragraph [292] of the Hird Statement where he refers to paragraph [82(a)] of my First Statement concerning the fixed odds yield improvement in the ACT following Tabcorp's acquisition of the ACTTAB business. Dr Hird's statement that this

yield improvement represented a 50% increase in price is incorrect. This improvement in yield was achieved by implementing Tabcorp's fixed odds risk management system into the ACTTAB business which limits large, high risk bets by, for example, sophisticated punters. This did not involve any change in the way that the ACTTAB priced its fixed odds products, as the odds for those products were already being set by Tabcorp on behalf of ACTTAB for approximately 2 years prior to Tabcorp acquiring ACTTAB.

## C.2 Revenue increases – wagering business improvements

- 52 At paragraph [107] of the Hines Statement, Mr Hines states that the revenue increases from business improvements would be difficult to achieve in the face of increased competition from corporate bookmakers. I disagree with this statement for the reasons given in paragraphs [85] to [89] of my First Statement.
- 53 Mr Hines also asserts at paragraphs [108(a)] that the introduction of new products and broadening of coverage of other products would not necessarily grow the market due to punters switching bet types. I agree that some product substitution will occur as a result of the introduction of new products. The calculation of the expected revenue increases referred to in my First Statement incorporates a rate of [Confidential to Tabcorp] per cent for own-product substitution (cannibalisation).
- 54 Mr Hines next says at paragraph [108(b)] that the revenue increases from new products will involve significant costs of implementation on the Tatts systems and are unlikely to be available until at least year 3. I disagree. There will be no costs of implementing the products on the Tatts system because the products will be introduced on the Tabcorp platform. I anticipate it will take [Confidential to Tabcorp]

to complete the systems migration for retail venues, and that new products will be implemented progressively in those venues over this period. I expect that digital products will be implemented within a shorter timeframe. Accordingly, I stand by the phasing estimates in Table 24 of my First Statement.

55 At paragraph [108][c] of the Hines Statement, Mr Hines asserts there is a disconnect between the expected costs savings in relation to wagering systems capex referred to in paragraph [32(d)] of my First Statement, and the revenue increased derived for new products. This is incorrect. The cost of implementing the new products and broadening the scope of products in Tatts states has already been included in the [Confidential to

Tabcorp]

56 At paragraph [284(b)] of the Mellsop Report, Mr Mellsop states that it appears I have assumed an increase in Tatts' tote take out rates from FY16 to FY17 when modelling the expected revenue increases in both the counterfactual and factual. This is correct. It reflects the take out rate increases that were introduced by Tatts during this period which are unrelated to the proposed transaction.

### C.3 Revenue increases – rebranding and improving the retail network

- I refer to paragraph [108][d][ii] of the Hines Statement, where Mr Hines considers that there is not enough information to assess whether the [Confidential to Tabcorp]
  estimate at paragraph [90] of my First Statement is sufficient to cover the investment in Tatts' wagering retail network.
- 58 This is a conservative figure, taking into account the size of Tatts' network, which includes:



### D. Pass-through of revenue synergies

- 59 I refer to paragraph [109(c)] of the Hines statement where he suggests that Tabcorp has the incentive to direct new customers to register in the jurisdictions which generate the most revenue for Tabcorp, such as the ACT, which would impact on the estimated industry pass through amounts. Tabcorp does not take steps to influence its customers to register in the ACT. As can be seen from paragraph [330] of the Tyshing Statement, Tabcorp leaves it to the customer to choose where it will register its account. The proposed transaction will not change this.
- 60 As the following table shows, **[Confidential to Tabcorp]** approximately **approximately** of Tabcorp customers domiciled in Victoria and New South Wales hold a Tabcorp account registered in the ACT.

Table 4: NSW and VIC customers holding accounts registered in the ACT [Confidential to Tabcorp]

	ACT only account	ACT + NSW accounts	ACT + VIC accounts	Accounts in all 3 states
NSW domiciled Tabcorp account customers in total)				
VIC domiciled Tabcorp account customers in total)				

# E. Merger with TAB Limited

- 61 The ACCC Report at paragraph [5.29], Third Thompson Statement at paragraph [4] and Hines Statement at paragraphs [114]-[120] refer to the synergy calculations undertaken for Tabcorp's acquisition of TAB Limited in 2004 and the subsequent performance of the merger. Details of the synergies identified and provided to Racing Victoria Limited, VicRacing and the Victorian racing industry are contained in the Christian Statement at paragraphs [21] – [34].
- 62 The primary reason why the synergies in the TAB Limited merger did not eventuate was that there was a [Confidential to Tabcorp]

63 Since then, Tabcorp has completed the acquisition of ACTTAB. While the proposed transaction will involve the integration of a much larger entity than ACTTAB, I expect that the migration process for Tatts' wagering systems and customer data will be similar to what was required in the ACTTAB transaction, which was completed [Confidential to Tabcorp] My team and I have taken into account Tabcorp's experiences in the TAB Limited integration, the ACTTAB integration and the Intecq integration when estimating the likely cost savings, revenue increases and integration timelines for the proposed transaction.

Signature of witness

Name of witness Date of signature Damien Johnston 8 May 2017