

Managing Margins in a Downturn



What the Recession Means to Charitable Gaming



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April 2009



Overview



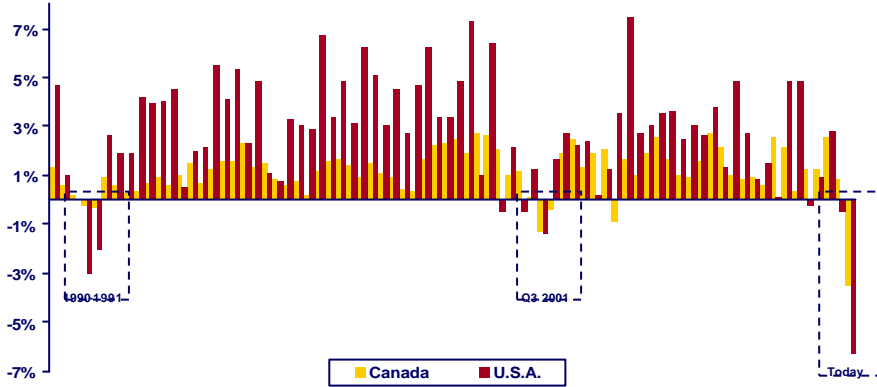
- ✦ **Current Economic Environment**
- ✦ **Economy and Gaming**
- ✦ **Succeeding in a Recession**
- ✦ **Managing Margins**
- ✦ **Summary**



What's going on in the economy?

The U.S. leads Canada into most recessions, including today's

GDP Growth in Canada and the U.S.A. from 1990 to 2008
(quarterly % change)



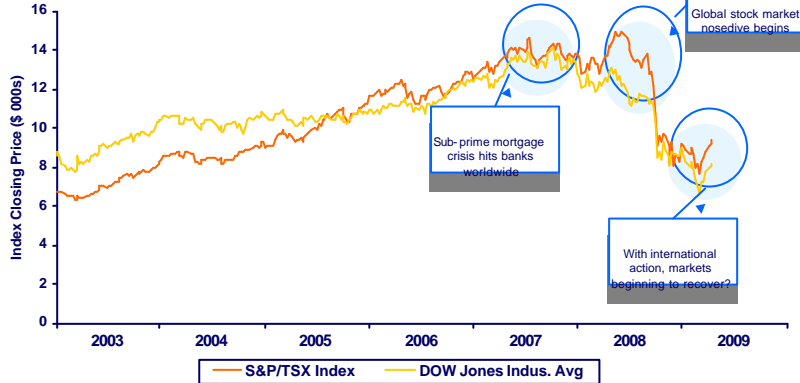
Source: Bloomberg, Statistics Canada, SECOR Analysis

The current recession is the deepest in recent decades

How did this recession start?

The sub-prime mortgage crisis shocked the credit markets in the summer of 2007, triggering a global recession in 2008

Stock Performance from 2003 to 2009

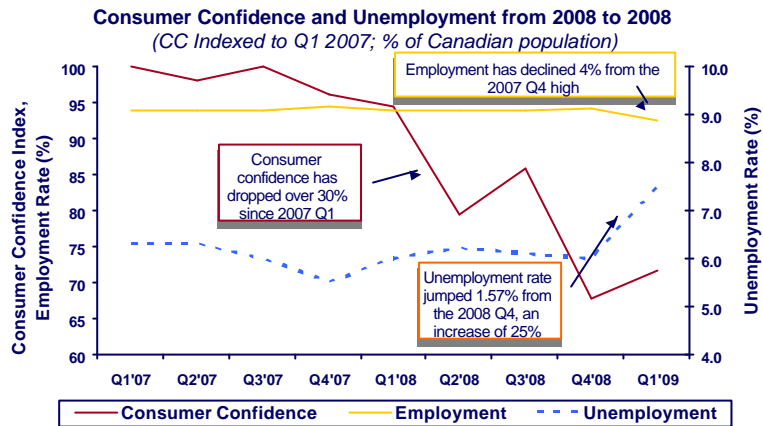


Source: Bloomberg, Statistics Canada, SECOR Analysis

With international government action, credit markets are beginning to ease

What does this mean for the people?

While unemployment has increased 25%, the recession has a greater impact on consumer confidence



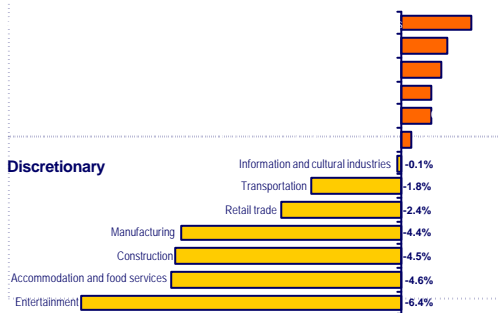
Source: Statistics Canada, SECOR Analysis

96% of Canadians are still employed, and enjoy lower taxes, gas prices, and interest rates

How can we expect people to respond?

During a recession consumers focus their spending more on staple goods than on discretionary goods

Average Growth in Canadian GDP During 1990 Recession by Industry



During a recession consumer spending is focused on staple products as discretionary products show negative growth

Degree of US Sector Declines in EBITDA During Recessions (Peak-to-trough change, %)

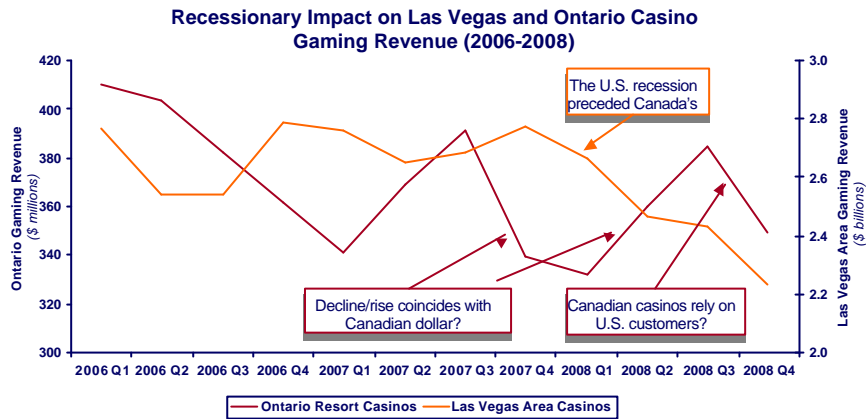
SECTOR	Consumer discretionary	Consumer staples
1980-82	-62%	-5%
1990	-47%	6%
2001	-36%	-5%

Consumer spending on staple products has minimal change during a recession

Source: Statistics Canada, McKinsey, SECOR Analysis

How has the recession affected gambling?

Although gambling is often considered recession-proof, Vegas casinos are struggling through the current downturn, Ontario impact not clear

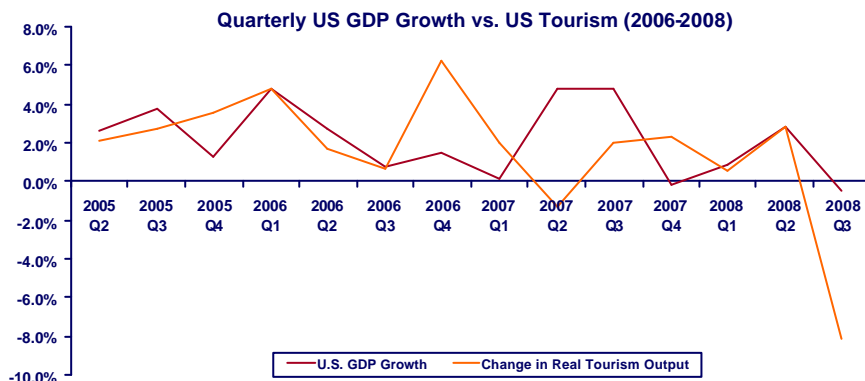


Source: The Times, Las Vegas Convention and Visitors Authority, IbisWorld Inc., OLG, Oanda, SECOR Analysis

Vegas Area revenue declines attributable to low passenger traffic

What has caused the decline in casinos?

Tourism, a significant contributor to casinos in Las Vegas, is closely tied to GDP and has reacted strongly to the recession

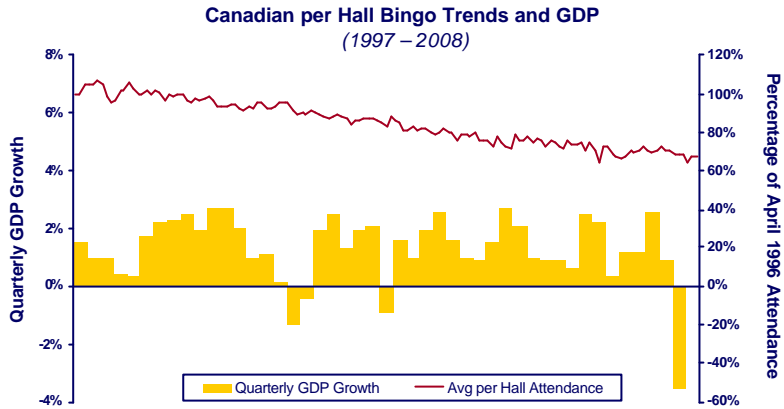


Source: The Times, Las Vegas Convention and Visitors Authority, IbisWorld Inc., OLG, SECOR Analysis

Low traffic in Vegas area is attributable to decline in tourism industry

How do recessions affect Bingo?

Bingo has weathered past recessions without significant change to attendance trends



Source: OLG, BCLC, Loto Québec, SECOR Analysis

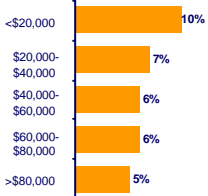
NB: Loto Québec data normalised to account for regulatory change

What's the demographic of Bingo customers?

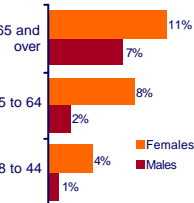
Bingo's customer demographic is focused on Baby Boomer women with household income less than \$40k

Boomer buying patterns are relevant to the success of the Bingo market

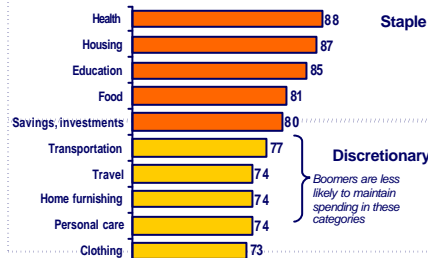
Average Household Participation by Income (Canadian \$; %)



Age and Gender Comparison



Boomers Spending Priorities in a Recession¹ (% who would not reduce spending)



Source: Responsible Gambling Council, McKinsey, SECOR Analysis

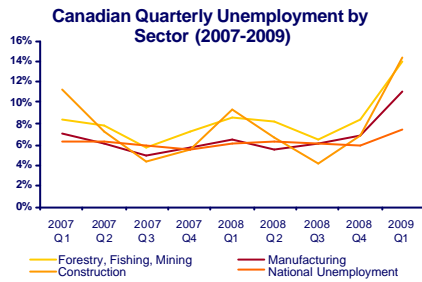
1. Categories boomers would cut when asked to reduce spending by 20%

Core players' household employment typically in labour-intensive industries such as manufacturing, auto, construction and forestry sectors

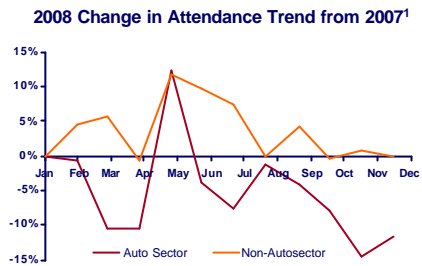
How is recession affecting Bingo markets?

Bingo trends largely unaffected except in communities with large unemployment such as Ontario's auto sector

Recession hits labour-intensive sectors hardest



Auto Sector layoffs have affected Bingo Attendance



Source: Statistics Canada; Globe and Mail; SECOR Analysis

1. Ontario/Quebec Bingo market

Systemic structural unemployment in some sectors may have long-term impact on Bingo

What products are resilient to the recession?

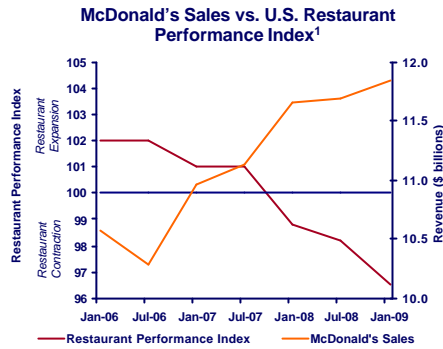
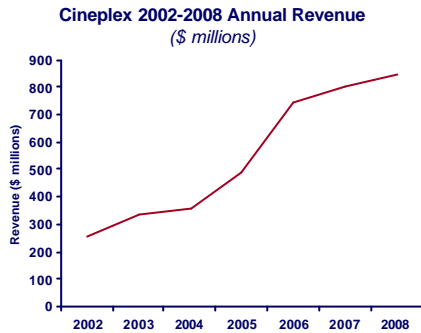
Products consumed out of habit and consistency, such as Tim Hortons and alcohol, succeed despite the economic recession



Source: Bloomberg; Statistics Canada; SECOR Analysis

What products succeed during the recession?

Products that offer an escape, such as the movie industry, or act as a lower price substitute, such as McDonalds, succeed during recessions

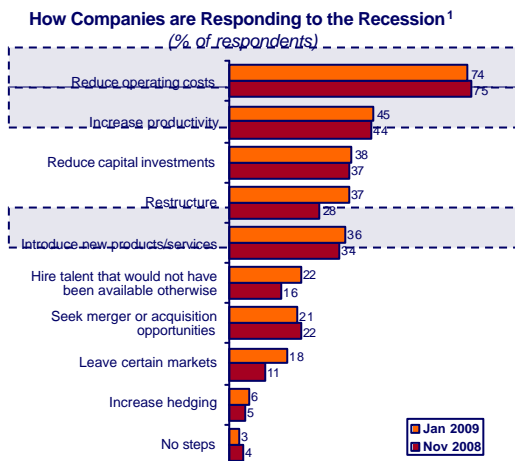


Source: Cineplex, National Restaurant Association, MSNBC, SECOR

¹ Restaurant Performance Index (RPI) is monthly index tracking health and outlook for US restaurant industry
² RPI measures restaurants based on financial indicators: sales, traffic, labour costs and capital expenditures

What approaches are companies deploying?

In a recession, companies focus on reducing operating costs and increasing productivity in order to manage margins



Focus on Customers

There are three customer segments:

1. Customers you have
2. Customer you don't have but can get. These are called *switchers* as they are neither loyal to you nor your competitors.
3. Customers you won't get because they are loyal to your competitors

During recession, focus on second customer group.

Cut the bad costs

- ☞ Good costs: Those essential to what your customers value and will pay for
 - ☞ Likely associated with a distinctive service or a better range of goods than your competitor
- ☞ Bad costs: Those that add little to what customers will pay for

To identify Good vs. Bad, focus on customer-benefit costing, not activity-based costing

Source: McKinsey Global Survey, SECOR Analysis

¹ Based on Survey question: What steps has your company taken or does your company plan to take as a result of the global economic turmoil?

Contributions to Charitable Gaming Centre Returns

Three areas offer opportunities for managing margins in Bingo

Revenue	
Gaming	85% - 95%
Bingo	80% - 95%
Link	0% - 5%
BOT	5% - 15%
Concessions	5% - 15%

1. Increasing Revenues

- Improve customer experience
 - Increase offering of services and concessions
- Introduce new products
 - Consider new low-cost gambling products
- Identify investment opportunities
 - Refresh and upgrade Bingo halls

Customer Attraction	
Prizes	70% - 85%
Net Win	15% - 30%
Marketing	1% - 3%
Net Contribution	14% - 27%

2. Improving Customer Attraction Performance

- Communicate value
 - Adjust pricing/promotions to increase customers' perception of value
- Drive traffic
 - Focus promotions on traffic generating vehicles

Expenses	
Charity Expenses	2%
Operator Expenses	10%
Net Proceeds	2% - 15%

3. Reducing Expenses

- Decrease unnecessary costs
 - Eliminate events with poor attendance
- Increase efficiency
 - Apply lean operation techniques to reduce waste

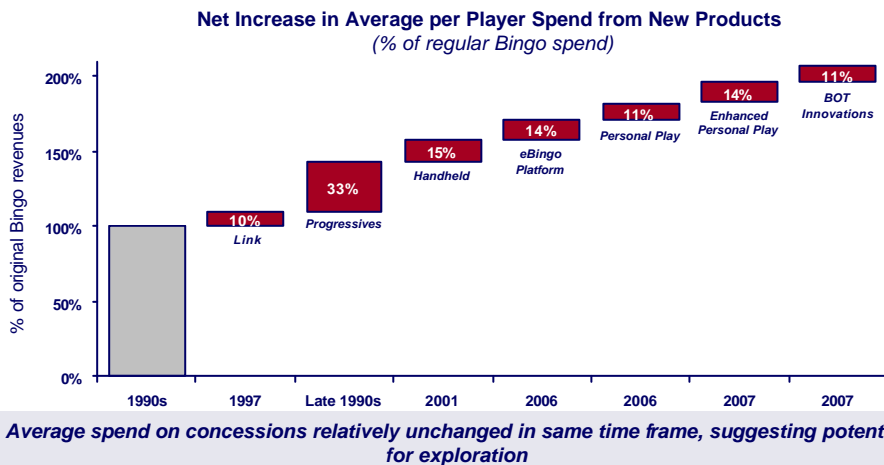
ILLUSTRATIVE

Source: SECOR Analysis

1. Increasing Revenues

Bingo player spend is restricted by the Bingo program

Over the past few decades, Bingo players have increased their average spend as new products have been introduced



Source: SECOR Analysis

2. Improving Customer Attraction Managing Prizing Strategies



The most significant component in customer attraction, prizing represents the single largest expense

Is prizing controllable?	<ul style="list-style-type: none"> ⌘ This challenge is not new ⌘ Advent of new revenue model in Ontario set prize reduction targets to achieve 70% ⌘ Industry has struggled with achieving this, <ul style="list-style-type: none"> ⌘ Overall the market has dropped from 80% to 77% ⌘ Average regional payouts still in the range of 72% to 80%
Fixed vs. Variable Payouts	<ul style="list-style-type: none"> ⌘ Of two forms of payout, the fixed portion is the more challenging ⌘ Fixed payout is the largest component of the Bingo game ⌘ Customers are very sensitive to changes in the advertized prize
Possible tools	<ul style="list-style-type: none"> ⌘ Retain some share of revenues while avoiding prize costs <ul style="list-style-type: none"> ⌘ Can poorly attended sessions be eliminated such that some players move to other sessions? ⌘ Can centres with multiple halls alternate closing of poorly attended sessions or days? ⌘ Add new products that reduce % payouts <ul style="list-style-type: none"> ⌘ We know new products will increase average spend

Source: AGCO; SECOR Analysis



- 16 -

2. Improving Customer Attraction Driving Traffic through Effective Marketing



Focused and targeted marketing tactics can effectively create new players

THE CHALLENGE	THE SOLUTION
<p>The Bingo industry has been and continues to be challenged by declining attendance</p> <ul style="list-style-type: none"> ⌘ Most bingo players are core or frequent players ⌘ Attracting new players continues to be elusive ⌘ Low consumer confidence during this period makes it even harder to attract new players 	<p>Steps to Effective Marketing and Promotions</p> <ol style="list-style-type: none"> 1. Know your target audience 2. Make sure the chosen media provides maximum exposure to that audience 3. Give the target audience a "reason to come" <ul style="list-style-type: none"> ⌘ Recent radio initiatives have introduced successful innovative events through radio partnerships ("Bring a buddy to Bingo Bonanza" and "Bingo Family Feud") <p>Critical Questions</p> <ul style="list-style-type: none"> ⌘ How can the core players be engaged and not alienated? <ul style="list-style-type: none"> ⌘ Can celebration of new players be leveraged by introducing new trial products? ⌘ Is there value in shared mass marketing during recessionary times? <p>Tools and Possibilities</p> <ul style="list-style-type: none"> ⌘ As advertizing industry is typically very hard hit by recessions, advertizing media is becoming less expensive ⌘ OCGA has produced a comprehensive list of tips and tricks that can complement effective marketing campaigns

Source: OCGA; Secor Analysis



- 17 -

3. Reducing Expenses Optimizing Costs

Bottom line performance drivers differ between charities and operators

Charities		Operators
<ul style="list-style-type: none"> ⌘ There is little flexibility on charity costs ⌘ Costs are primarily driven by licensing ⌘ Fortunately costs are small percentage of Charity net proceeds 	45%	55%
	Revenue (% of Bingo contribution)	
	5%	40%
	Costs (% of Bingo contribution)	
	40%	15%
	Net Proceeds	

ILLUSTRATIVE

Fixed costs:

1. Rent/Occupancy (10%) ⌘ *turn the lights off?*
2. Paper (5%) ⌘ *little flexibility*

Potential Variable Costs

3. Labour (12%)
 - ⌘ *Can part time staff be reduced to reflect attendance without impacting customer experience?*
 - ⌘ *Can sessions be eliminated to reduce total labour costs?*
 - ⌘ *Can greater use of volunteers be used to enhance the customers experience?*

Concessions (13%)

4. Can new higher margin products be introduced?
5. Can pressure be put on suppliers?

Source: SECOR Analysis

Conclusion

In times of recession, the Bingo business typically survives without significant impact

- ⌘ In current recession, Bingo markets in labour-intensive communities such as auto sector towns face the long-term threat of structural unemployment
 - ⌘ **Markets with accelerated attendance loss are very difficult to withstand**
- ⌘ For most other Bingo markets, creative and informed decision making may make it possible to retain and even attract new attendance

For these Bingo markets, opportunities to manage margins exist in:

- ⌘ New product development
- ⌘ Deployment of effective marketing and promotions
- ⌘ Optimization of session performance
- ⌘ Reduction of per session costs

There are many tools available to help Charitable Gaming during the downturn