Racing Industry Transition Agency

New Zealand Racing Board Performance and Efficiency Report

September 2019

Murray Chandler
Partner
T +64 (0)4 474 8500
E murray.chandler@nz.gt.com

Russell Moore
Partner
T +64 (0)9 308 2570
E Russell.moore@nz.gt.com

Private and Confidential

Grant Thornton New Zealand Ltd
PO Box 1961
Auckland 1140
New Zealand

T +64 (0)9 300 5800
F +64 (0)9 300 5805
www.grantthornton.co.nz

The Board
Racing Industry Transition Agency
106-110 Jackson Street
Petone
Wellington

19 September 2019

Dear Board

Performance and Efficiency Audit of the Racing Industry Transition Agency (RITA)

We have pleasure in presenting our report for the recent Performance and Efficiency Audit, required under section 14 of the Racing Act 2003.

This review was conducted between June and July 2019 in accordance with the Terms of Reference approved by the Minister for Racing. We would like to take this opportunity to thank the staff of the Racing Industry Transition Agency for the cooperation and assistance provided. Please contact the undersigned if you have any queries in respect of this report.

Yours sincerely

Murray Chandler
Partner

Russell Moore
Partner

Grant Thornton New Zealand
Member firm within Grant Thornton International Ltd

Contents

Part A Section 1: Executive summary

Headlines

Background and recent historical context

- The New Zealand Racing Industry is estimated to be responsible for generating more than $1.6 billion in value added contribution to the New Zealand economy.
- Racing is a significant industry with approximately 14,400 full time employees. In total, 58,100 individuals participate in the New Zealand racing industry as employees, participants or volunteers. Many participants hold more than one role within the industry.
- Over the period domestic race numbers remained flat overall but this overall trend shields a decline in equine races and a growth in greyhound racing:

Domestic Race Numbers	2015	2019 Unaudited	# Change	% Change
Thoroughbred Races	2,790	2,582	-266	-9.3%
Harness Races	2,595	2,.469	-185	-7.0%
Greyhound Races	5,573	5,907	554	10.3%
Total Domestic Races	**10,958**	**10,958**	**103**	**0.9%**

- It is noted that less betting turnover per race is generated, on average, on a greyhound race than an equine race.
- The betting market continued to be challenging with on-going domestic and international competition for the gambling dollar and the growth in racing fixed odds betting has been offset by the decline of totalisator racing betting. In the period race betting turnover decreased by $17m to $1,651m, while racing betting margin increased 0.5% to 17.6%.
- Sports betting turnover increased by 56% to $634m, growing from 19.5% of total betting turnover to 27.7%. Sports betting margin decreased by 0.3% over the period to 9.3%.
- Overall betting turnover increased by 10.2% and overall betting net margin fell by 0.9% over the period to 12% due to the changes in product mix described above.
- Over the period NZRB's performance has become increasingly dependent upon sports and fixed odds betting, as well as gaming revenue.
- The racing industry was described by the Minister for Racing1 as being in "a state of serious decline". The racing industry review by John Messara, formation of the Ministerial Advisory Committee (MAC) and Racing Industry Transition Agency (RITA) were all designed to help ensure the long term viability of the NZ racing industry.

Strategy

- During the period the NZRB undertook significant investment in virtually all areas of its business to overcome years of under-investment in key systems and processes. In the review period the NZRB has invested over $90m in their key strategic initiatives including vision capture project, the new FOB platform, customer management and retail network refresh, effectively modernising every aspect of its interaction with its customers.
- The most significant project was the development and implementation of the Fixed Odds Betting (FOB) platform. Undertaken in conjunction with an international supplier the FOB platform went live in January 2019, 5 months later than planned, more expensive than planned ($1m or 2.6%) and largely to specification with some functionality still to be implemented. FOB was a complex project which is now operational, although it is yet to produce the full financial benefits anticipated (although FOB has only been live since January 2019).
- The Customer and Channels initiative focused on improving the customer experience (both virtual and physical) as well as attracting and retaining customers, with particular emphasis on the important elite customers. Over the period active customer numbers have increased by 49% to 230,000, with the majority of the new customers betting on sports.
- The Vision Capture project, which was the second largest strategic initiative capital investment is on track to be delivered on time and under budget.
- RITA's key role is in funding the racing industry through gambling and gaming. The strategy and resulting strategic initiatives were focused changes which were calculated to drive significant increases in revenue.
- While the key funding role has not changed it has become more explicit post the Messara Report as RITA is expected to transition the organisation to a purely commercial role.

1. *Ministerial Media Release, 17 April 2019*
2. *NZRB state that $10.8m of the costs relate to IBM licence costs which have a wider NZRB use*

Headlines (continued)

Financial Impact over period

- As can be seen in the following table, racing turnover remained flat while sports and gaming turnover have increased significantly. While racing turnover has decreased from 70% of total turnover to 59% of total turnover in the period, it remains the predominant contributor to RITA revenues.
- Between 2015 and 2019 totalisator race betting turnover fell by 25% ($298m), while fixed odds race betting increased by 61% ($281m) and fixed odds sports betting increased by 57% ($229m). The move away from totalisator betting to fixed odds betting is an international customer preference trend.
- Total betting turnover has increased by 10.2% with the growth in sports betting offsetting the decline in race betting, the change in betting mix has reduced margins by 0.9% to 12.0%.
- Turnover related expenses have increased by 0.1% over the period compared to an increase in total turnover of 17.1%. Operating expenses have fallen by 1.0% over the period pre-strategic initiative costs. Including strategic initiative costs, operating costs total $133.9 in 2019 (unaudited) an increase of 4.8% over the period.
- Operating profit (normalised) has increased by 3.8% over the period.
- Net profit (post strategic initiatives) fell 4.9% over the period.
- Distributions to the Codes have increased by 13% over the period. Without the decision to distribute the $12m additional funding and $2.6m TRLP funding, the distributions would have increased by 2.1% over the period.
- During the period NZRB have spent over $90m (opex and capex) on the strategic initiatives primarily the FOB platform, Vision Capture and Customer and Channels initiatives, all of which are consistent with the NZRB strategy, as well as AML which is a legislative obligation that came into effect 1 August 2019. NZRB also spent $10.7m on five year enterprise IT licensing in the period.
- The quantum of these investments and the decision to increase distributions has driven the decrease in NZRB equity and the increase in debt over the period with equity reducing from $71m to $23m.

Item	2015	2019 Unaudited	$ Change	% Change
Racing Turnover ($m)	1,668	1,651	-17	-1%
Sports Turnover ($m)	405	634	229	+56.5%
Betting Turnover ($m)	**2,073**	**2,285**	**212**	**+10.2%**
Gaming Turnover ($m)	317	513	196	+61.8%
Total Turnover ($m)	**2,390**	**2,798**	**408**	**+17.1%**
Net Betting Margin	12.9%	12.0%		-0.9%
Total revenue	**332**	**336**	**4.6**	**+1.4%**
Turnover Related Expenses	(64.6)	(65.3)	-0.7	+0.1%
Operating Expenses	(127.8)	(126.5)	1.2	-1.0%
Operating Profit (Normalised)	**139.1**	**144.4**	**5.3**	**+3.8**
Strategic Initiatives and other one-off items	5	(7.4)	-9.6	-195.5%
Net Profit	**144.0**	**137.0**	**-7.0**	**-4.9%**
Distribution to Codes ($m)	134.2	137.0	2.8	+2.1%
Additional Funding ($m)	-	12.0	12.0	
TRLP payments ($m)		2.6	2.6	
Total Distribution ($m)	**134.2**	**151.6**	**17.4**	**+13.0%**
Strategic Initiative Investment ($m)	-	45.8	45.8	
NZRB Bank Debt ($m)	-	35.0	35.0	
NZRB Equity ($m)	70.8	23.4	-47.4	-66.9%

Headlines (continued)

Operating cost management

- The NZRB has had a on-going focus on keeping costs down over the review period. This has been supported by cost transformation projects across most areas of spend and a number of business unit specific cost initiatives.
- Staff expenses (excluding strategic initiatives) have fallen by 9.5% or $6.0m over the period. Including strategic initiative costs staff expenses have fallen by $2.3m over the period.
- Operating expenses (excluding strategic initiatives costs) decreased at an annual compound growth rate of 0.24% between FY15 to FY19. Operating expenses (excluding strategic initiatives) for FY19 are marginally lower than the corresponding amount in FY15. After adjusting for inflationary effects in our review period for FY15 results, operating expenses have reduced by $8 million (excluding strategic initiatives) Including strategic initiative costs, operating expenses increased by $14m over the period (annual compound growth rate of 2.68%). After adjusting for inflationary effects, operating expenses have increased by $8m (including strategic initiative costs).
- Turnover related expenses increased over this period at an annual compound growth rate of 1.23% between FY15 to FY19 compared to annual compound growth of 4.02% for betting and gaming turnover.
- Communications and technology costs (excluding strategic initiatives) had the most significant annual compound growth between FY15 to FY18 due to the implementation of the IT managed service agreement with Spark under the Optimus programme (to upgrade and virtualise IT) which increased costs from $9.6 million in FY15 to $16.6 million in FY16 with some further increases between FY16 to FY18 although not at the same level. Communications and technology costs reduced from $19.1 million in FY18 to $18.7 million in FY19 (unaudited). Including strategic initiative costs, communications and technology costs have increased from $9.6m in FY15 to $26.1m in FY19 (unaudited).
- Strategic costs were separately presented in the annual report from FY17 onwards where a total of $17.9 million has been noted as spent between FY17 and FY18 with further spend of $16.9 million in FY19 (unaudited).

People capability

- Over the last 5 years NZRB has actively managed staff numbers, with FTE falling by 133 or 17% over the period from 2015. However, the reduction in staff numbers has not had any material impact on the overall capability required to carry out standard BAU operations and services and deliver the key strategic initiatives.
- Approximately 40% of staff are involved in customer facing functions, the majority of which relate to the retail network, 26% with broadcasting and 11% with betting operations and 12% with Technology.
- NZRB analysis, based on a commissioned job sizing benchmarking in 2019, indicates approximately 65% of NZRB personnel are paid below the midpoint of benchmark market bands (total fixed remuneration).
- The business is currently expanding the adoption of agile methodology. Implementation has focused on Technology, Product and Customer teams in addition to the strategic initiatives.

Governance framework and management mechanism

- The newly formed RITA Board are Ministerial appointments, the Board is diverse and represents members from various backgrounds. The new Board is supported by an established Chief Executive Officer (CEO) and leadership team.
- In the second half of FY19 the leadership team was reorganised into 6 domains of accountabilities in order to move to a new operating model based on the extensive use of agile teams. Adopting this model was a deliberate move by the NZRB to become more customer-led.
- The policy and procedures structure has matured over the last 4 years, however some policies require review and update. The ownership of policies has been defined and documented, however some polices are due for a refresh.

Statutory functions

- The statutory functions, as detailed in the Specific Statutory Functions section (below) are being complied with. The core functions of conducting race and sports betting and the resultant distributions to the codes have been the focus of the strategic initiatives. Many of the other industry functions of NZRB may be devolved to the Codes as envisaged by the Messara Report
- Key strategic initiatives have been consistent with NZRB statutory objectives and functions and are intended to address long term fundamental issues that have previously limited the NZRB's performance.
- We note the Racing Reform Bill No.1 (2019) has created additional objectives and functions for RITA to deliver on.

Headlines (continued)

2019 Financial Impact

- This year has seen slight turnover growth, but reducing margins and a significantly reduced profit when compared to budget. The (unaudited) profits of $137m is down $8.9m on the prior year and down $36.5m on the budget of $173.5m.
- The 2019 budget included significant benefits anticipated from the key strategic initiatives of $14.2 million. The delay in the launch of the Fixed Odds Betting platform and anticipated revenue from Betting Information Use Charge and Point of Consumption charge (offshore charges) legislation, combined with limited betting activity from high value elite customers in the first half of the year and significant margin compression experienced internationally in sport in the second half of the year, adversely impacted the NZRB profit result when compared to budget. We note, management are still confident FOB will deliver significant benefits over its 10 year life.
- Racing betting margin fell marginally and sport betting margin fell by 1.1% in 2019.
- Customer numbers continued to increase in 2019, with an increase in elite customers numbers in the second half of the year.
- Operating costs were reduced by $8m (6%) in 2019, primarily through reductions in staff costs ($1.6m), depreciation ($3.0m) and other costs ($2.2m) with the $1.2m reduction in consultants spend being the largest single contributor to the reduction in other costs.
- Operating profit (normalised) fell by $10.5m or 6.8% to $144.4m.
- Net profit (post strategic initiatives) fell $8.9m or 6.1%, producing a net profit of $137m for the year.
- On 3 April 2019 in its “Industry Update” the NZRB communicated with the Codes that it was not on track to meet the original budget of $173.5m but did “anticipate a net profit before distributions ahead of last year of around $155m”. In its June Industry update the NZRB confirmed the FY19 distribution amount and also communicated downside risks to the previously communicated forecast. Feedback we received from the Codes emphasised that some of the Codes “don’t trust the numbers” and that communication was not transparent.
- The draft budgeted net profit in FY20 of $165.8m depends on a number of key performance measures being met including (a) a significant improvement in revenue generated from the new Fixed Odds Betting (FOB) system, (b) continued development of new products and services, (c) a stable margin environment, (d) closely monitoring the impact of the anti money laundering legislation (AML), (e) delivering on-going cost savings and (f) the retention and growth in elite customer numbers.

Racing Reform Bill No.1 (2019)

- In December 2018, the Minister for Racing (the Minister) established the MAC to operationalise the Messara Report. When the Racing Reform Bill No.1 (2019) come into being in July 2019, the NZRB Board was disestablished and the RITA Board established. The RITA Board is made up of all the previous members of the MAC plus one other, and has been given a specific change mandate to improve the racing industry’s sustainability.
- The Minister for Racing has issued his Letter of Expectations to the RITA Board, this makes the Minister’s desire for change clear and has set RITA a series of challenging targets. This includes driving organisational change while maintaining business as usual operations. One of the challenges set in the Letter is the expectation that RITA will maintain the current level of overall funding to the codes while ensuring that there is no further deterioration in RITA’s balance sheet. This would be a reversal of recent trends as total distributions to the codes in FY19 were $151.6m while net profit was $137m and its equity position has reduced by $47.4m over the period. Accordingly, significant profit improvement is required to meet the Minister’s expectations.

Headlines (continued)

Conclusions

In 2015, the new management team of the NZRB inherited the impact of a number of long term trends including the growth of fixed odds and sports betting, the decline of totalisator betting, increasing international competition, reduced domestic race numbers and an aged technology infrastructure which was no longer fit for purpose.

While NZRB's strategies may have been sound, the full benefits in relation to the FOB platform are yet to be realised. FOB was delivered 5 months late, $1m (approx. 3%) over budget, and largely to specification with some further functionality yet to be delivered. The long term benefits from the strategic initiatives are hard to assess given the benefits are expected over the longer term (10 years).

In 2017, the NZRB Board made the decision to increase distributions to the Codes in response to feedback regarding industry confidence. This decision was made while NZRB was part way through investing over $90 million into its strategic initiatives. In FY18 and FY19 an additional $12m (per year) was distributed to the Codes underpinned by NZRB's expectation around the benefits that would flow from strategic initiatives and a legislation change (offshore charges). While the benefits from some strategic initiatives have been realised, the benefits from FOB are yet to be fully delivered and in addition the legislative change did not occur in the time period anticipated (as the proposed legislation was withdrawn). The NZRB's decision to advance $12m in the FY18 and FY19 racing seasons has significantly impacted its financial position due to the increase in debt and decrease in equity.

During the review period the NZRB has also had to develop and implement systems and processes to comply with three significant regulatory and compliance obligations in; (a) Health & Safety, (b) Payment Card Industry Data Security Standard (PCI-DSS) and (c) Anti-Money Laundering. The investment of close to $8 million was significant.

Throughout the period the NZRB has kept the NZ racing industry informed of their strategies, projects and performance through reporting in the NZRB Annual Reports and Statements of Intent (SOI), as well as regular industry briefings from the CEO. However, based on our industry interviews, it is apparent that at least some in the industry do not feel that communication has been adequate.

The NZ racing industry continues to face a wide range of challenges and issues, these have been well documented in the Messara Report on the state of the industry. The Department of Internal Affairs in its 2019 Regulatory Impact Assessment (RIA) stated "The racing industry is in a state of decline." The RIA goes on to state "The Department of Internal Affairs considers that the magnitude of the changes sought in the reforms exceeds the current mandate of the NZRB."

In July 2019 the RITA Board inherited similar macro trends but a new set of challenges around preventing further deterioration of the balance sheet, a commitment to maintaining the distribution payment to the codes at the same level as that paid in FY19, the delivery of benefits from the investment in strategic initiatives and operationalising the key recommendations of the Messara report, the success of which is considered critical to the revitalisation and long term health of the NZ racing industry.

Managing the business and achieving the required growth within these balance sheet constraints and revenue growth projections will present the RITA Board and Management with a significant challenge that will require cooperation of the whole racing industry.

The NZRB strategy was an ambitious response to a wide range of internal issues and rapidly changing market and customer expectations. The success of individual initiatives, and the overall strategy, will be determined by the revenue generated by RITA and ultimately by the level of distributions to the Racing Codes.

The core revenue generating strategic initiative, the FOB platform, has been operational for six months and while the 2019 profit performance has been significantly below budget, comparison to RITA's Australian competitors indicate the issues driving margin compression, and therefore financial performance, were shared.

We are aware that, across the spectrum of internal and external stakeholders, NZRB's operational and financial performance is viewed as alternatively proving the strategy to be well planned and executed or proving the strategy was high risk and poorly executed. While we acknowledge the legitimacy of elements of both perspectives, we believe six months results are insufficient to support either viewpoint.

Summary of recommendations

Recommendations

Statutory Objectives and Functions

- All business cases for strategic initiatives should contain a section on strategic alignment that clearly links the initiative to the statutory objectives and functions.
- Principal risks should be linked directly to the statutory objectives and functions.

Policy Framework

- We recommend the Policies which are overdue are reviewed and updated to reflect the current needs of RITA.

Cost Saving opportunities

- RITA should continue to pursue cost savings initiatives such as the Finance Function Transformation project, and RITA should consider utilising a similar approach to other core operational functions to improve efficiency, effectiveness and realise cost savings where possible. RITA should also complete Wave 2 of the Value Initiative and consider whether those suppliers excluded from Waves 1 and 2 could be included as Wave 3 of the Value Initiative.
- We note that RITA is currently in consultation with the Codes, to consider which racing functions should be devolved from RITA to the Codes and where opportunities exist for charging market rates for services and facilities provided. We note that while there is an estimated saving of approximately $900k to RITA, however, there is no sector benefit as the costs of these services would have to be met by the Codes.
- We note that RITA will continue to work with the DIA and the Minister on the Racing Reform Bill No.2 to broaden the range of betting products and bet types that RITA can offer to their customers so they are internationally competitive and to establish a level playing field around their class four gaming operation.

Outsourcing/JV opportunities

- We note that RITA will continue to investigate all options in regard to possible outsourcing and JV opportunities as noted in the Messara report.

Betting Information Use Charge

- We understand the revenue from the Betting Information Use Change will start to flow during the FY20 racing season and the distribution of this new revenue stream will be subject to a future decision of the RITA Board. Consideration should be given to RITA retaining this revenue to support their financial performance, and Code distributions, during RITA's transition period.

Part A Section 2: NZRB Strategy

Recent Historical Context

The perilous state of the NZ racing industry has been well canvased in statements by the Minister for Racing, the Messara Report and a wide range of industry commentators. While the reasons for the current state of the racing industry are beyond the scope of this report, we do note that the trends discussed below were evident in the prior review period and this situation is consistent with the challenges faced internationally by other gambling operators.

In the period 2015 to 2019 a number of the international trends, which had been previously identified, crystallised for the NZ racing industry. As can be seen from the following table total NZ racing was static with a slight increase of approximately 0.9%, with the 6.3% increase in Greyhound racing offsetting the 9.3% fall in Thoroughbred racing and the 7% fall in Harness racing.

Item	2015	2016	2017	2018	2019 Unaudited
Thoroughbred Races	2,848	2,790	2,564	2,568	2,582
Harness Races	2,654	2,595	2,492	2,483	2,469
Greyhound Races	5,553	5,573	5,624	5,903	5,907
Total Domestic Racing	10,855	10,958	10,680	10,954	10,958
Imported Racing	65,612	67,165	69,083	73,169	88,340
Exported Racing	10,133	10,612	10,300	10,515	10,582

As can also been seen, the amount of imported racing bet on in NZ increased by 34.6% while export racing grew by 4.4%. The growth in international races appears to be the primary driver in racing turnover growing by 13% in the period against a backdrop of flat to falling domestic racing. The growth in total turnover is primarily due to the growth in overseas racing, sports betting and gaming turnover (an increase of 61.8%).

Sports betting has increased significantly, with sport betting turnover increasing by $229m or 57% driven by customer engagement and acquisition campaigns. All sports betting is fixed odds betting, which has a lower margin than race betting. Sports betting margin are also volatile due to margin impact of on-field results.

Item	2015	2016	2017	2018	2019 Unaudited
Racing Turnover ($m)	1,668	1,715	1,665	1,654	1,651
Sports Turnover ($m)	405	555	579	609	634
Betting Turnover ($m)	**2,073**	**2,270**	**2,244**	**2,263**	**2,285**
Gaming Turnover ($m)	317	403	437	476	513
Total Turnover ($m)	**2,390**	**2,673**	**2,681**	**2,738**	**2,798**
Net Betting Margin	12.9%	12.4%	12.4%	12.7%	12.0%
Total revenue	**331.5**	**349.9**	**348.1**	**354.9**	**336.1**
Turnover Related Expenses	(64.6)	(66.4)	(66.4)	(65.5)	(65.3)
Operating Expenses	(127.8)	(138.8)	(133.7)	(134.5)	(126.5)
Operating Profit	**139.1**	**144.7**	**148.0**	**154.9**	**144.4**
Net strategic initiatives, one off items and other costs	4.9	2.0	(4.0)	(9.0)	(7.4)
Net Profit	**144.0**	**146.7**	**144.0**	**145.9**	**137.0**
Distribution to Codes ($m)	134.2	136.7	136.2	136.2	137.0
Additional Funding ($m)	-	-	-	12.0	12.0
TRPL payments ($m)	-	-	-	2.6	2.6
Total Distribution ($m)	**134.2**	**136.7**	**136.2**	**150.8**	**151.6**
Strategic Initiative Investment ($m)	-	2.3	8.2	45.4	45.9
NZRB Bank Debt ($m)	-	-	-	10.0	35.0
NZRB Equity ($m)	70.8	73.8	69.3	53.5	23.4

Turnover related expenses have increased by 5.0% over the period compared to an increase in total turnover of 17%. Operating expenses have fallen by 1% over period. Total operating expenses (including strategic initiatives) increased to $142.2m an increase of 11.3% over the period.

Operating profit (normalised) has increased by 3.8% over the period.

Net profit (post strategic initiatives) has fallen by 4.9% over the period.

Recent Historical Content (continued)

Total betting turnover has increased over the period by 10.2% with the growth in sports betting offsetting the decline in race betting, the change in betting mix has reduced margins by 0.9% to 12.0%.

Item	2015	2016	2017	2018	2019 Unaudited
Totalisator Betting %	58	48	45	42	40
Fixed Odds Betting %	42	52	55	58	60

The decrease in margin over the period can largely be explained by the change in product mix described above, being the growth in fixed odds betting and the decline of totalisator betting. As noted earlier in this report, this is consistent with international trends and changing customer preferences.

Distributions to the Codes have increased by 13% over the period. Without the decision to distribute the $12m additional funding and $2.6m TRLP funding, the distributions would have increased by 2.1% over the period.

During the period NZRB have spent over $90m (opex and capex) on the strategic initiatives primarily the FOB platform, Vision Capture and Customer and Channels initiatives, all of which are consistent with the NZRB strategy, as well as AML which is a legislative obligation that came into effect 1 August 2019. NZRB also spent $10.7m on five year enterprise IT licensing in the period.

The quantum of these investments and the decision to hold distributions has driven the decrease in NZRB equity and the increase in debt over the period with equity reducing from $71m to $23m.

Recent Historical Context (continued)

It is important to note that during this period the NZRB undertook significant investment in virtually all areas of its business to overcome years of under-investment in key systems and processes. In the review period the NZRB has invested over $90m in their vision capture project, the new FOB platform, customer management and retail network refresh, effectively modernising key aspects of their interaction with its customers. As importantly, RITA has implemented the systems and processes required to monitor and manage the business going forward, including continued improvements in the delivery of the core betting and gaming products to its customers alongside investment in new technologies and betting and gaming products to drive customer engagement and generate revenue growth for the racing industry and sporting organisations.

During the period the racing industry, and the NZRB have been impacted by the implementation of three significant compliance obligations, namely the Health & Safety Act 2015 (H&S), the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML) and the Payment Card Industry Data Security Standard (PCI-DSS). Each of these obligations have required significant investment by the NZRB to establish and maintain compliance.

Action	Requirements	Actual spend (to 31 July 2019)
H&S	To become compliant with H&S Act requirements a strategic plan was developed. The strategic plan adopted in 2016/17 was focussed on those areas where analysis of incidents, accidents, and external data identified that there was high personal safety and business impact risk and consequence. Two key areas that have improved performance significantly are working at heights related to on-course towers and driver behaviour including damage to third party property.	Capex $62k Opex $1.5m
PCI	To become compliant with the PCI requirements NZRB has had to invest in ensuring the security of the credit card details held within their systems.	Capex $201k Opex $1.6m
AML	To become compliant with the AML requirements significant change was required to systems, processes and staff training. The requirements are focused on knowing your customer, understanding their sources of financing and monitoring and reporting suspicious transactions. The programme was 95% complete at go live date on 1 August 2019. The 5% that was not complete was due to technology partner SGD being unable to deliver the 'New Join Journey' solution, we understand this has now been delivered. This delay required technical dependencies to be removed to enable other functionality to be deployed by 1 August 2019.	Capex $4.3 m Opex $2.1 m

All relevant RITA staff are provided internal training on H&S, AML and PCI-DSS to ensure they understand these regulations and assist RITA in meeting its compliance obligations.

Recent Historical Context (continued)

Investment in Capability

Over the period the NZRB has invested heavily in its key strategic initiatives, mainly in technology to lift its capability. In the process, the NZRB has delivered one of its biggest ever technological upgrades in the form of a new FOB platform. The FOB platform has increased the number of betting products available to punters, 2019 sports betting turnover increased by 16% since the FOB go-live in January 2019.

NZRB has also invested in the Customers and Channels Programme, which included a variety of initiatives to optimise the retail network, improve the customer experience within the network and improve the customer's digital experience through the website or app as well as managing the Elite customers.

The NZRB has also been investing in the Vision Capture Project, which changes how the footage from the race tracks is captured using high definition (HD) technology. This project is nearing completion. Greyhound racing has been moved to a centralised production model with a purpose-built fixed control room for greyhound racing.

The NZRB also has entered into a non-exclusive agreement with SKY TV (NZ) in 2018 which allows racing customers to be served by Trackside 1 and 2 and providing the NZRB and the Codes with greater control over the content and the ability to present racing to customers on new digital platforms.

Other than investments in the key strategic initiatives, the NZRB maintained a strict approach to cost management. Excluding strategic initiatives and turnover related expenses, operating expenses have reduced over the last 5 years from $127.8 million in FY15 to $126.5 million in FY19 (unaudited).

In the past year the organisation has embarked on a significant change to its operating model, shifting to an agile operating model, including training for all relevant staff.

The cost transformation programme including initiatives such as the Finance Function Transformation, is designed to allow the Finance Function to ready itself for the new agile operating model. This project has process improvement, reengineering and automation as explicit goals.

NZ Gambling Market

The NZ gambling market continued to grow over the period, but the changing mix of betting products reflects changing customer preferences.

Apart from a few exceptions such as high profile race days, long term trends show that betting on New Zealand racing has become less popular than in the past.

In contrast, sports is more popular. Over the last five years there has been a rapid rise in sports betting in the NZ gambling market driven by the growth in mobile and digital platforms.

There has also been substantial growth in all forms of on-line gambling which is resulting in significant revenue leakage to offshore gambling operators thereby directly impacting on the revenue available to the New Zealand racing industry and sporting organisations.

Recently enacted AML/CFT regulations required the industry to take stricter measures to detect, deter and report on any potential money laundering activity, which has the potential to impact on the legitimate customer betting experience.

Customers appear to prefer the certainty of fixed odds betting and there is a greater emphasis on overseas race meetings due to the volume of domestic racing being flat. The impact of this is that turnover on "imported" or offshore racing now exceeds turnover on New Zealand racing. Tote betting remains important but in decline within New Zealand, which is consistent with international trends

Despite the growth of sports betting, the broader New Zealand gambling market remains dominated by gaming machines (by revenue) followed by casinos and Lotto. The overall rate of gambling in New Zealand has been relatively static on a per capita spend basis, the overall gambling rate is low when compared internationally. RITA management consider the significant growth in offshore betting being indicative of strong latent demand.

NZRB Strategy

Strategic Context

From our research it is apparent the domestic and international racing industry is facing serious challenges. According to the MarketWatch 2015 Industry Forecast, North America has faced a 28 percent decline in gambling on horse racing over a 10 year period 2003-2013.

We have outlined in the following pages a number of the key challenges the international and domestic gambling markets have been experiencing, and NZRB's response to these challenges and the potential impact upon their business and the New Zealand racing industry. It is noted that the major trends we discuss are long term trends which have been impacting the New Zealand gambling market for some time.

In the DIA's 2014 Briefing to the Incoming Minister for Racing it was stated there had been a range of indicators that showed the racing industry had been in decline for some time.

In response to the significant challenges facing the industry in 2015, the new Chief Executive and leadership team developed a strategy to modernise the NZRB's technology, product offerings and customer service. A review of the strategy undertaken in 2016, identified that without a change in strategy, revenue was expected to decline by 1.5% CAGR and distributions to the Codes were expected to decline by 4.4% CAGR.

Driving much of NZRB's strategy is the belief that, "We have a responsibility to the racing industry to return it to a state of economic sustainability from which it can grow and prosper." [4]

Strategic Shift

In the 2015 Annual Report the NZRB asked the questions:

- What does a sustainable industry look like?
- What do we need to do to get there?

These are still the key questions facing both RITA and the racing industry, and while the strategy implemented over the review period has created many of the foundations NZRB believed necessary for a sustainable industry, the success or otherwise of these initiatives will determine whether this question has been answered.

The NZRB had previously determined that to achieve the growth in profitability required to sustain the industry, it must focus on substantially increasing the number of customers betting and improve the competitiveness of offerings through growth in products and improvements to customer experience given the shift in customer demographics. The main driver seems to have shifted over 5 years from increasing the spending from existing customers to increasing and broadening the customer base.[5]

To achieve the levels of increase in customer numbers NZRB has deliberately undertaken a strategic shift to become customer-led.[6]

The key strategies here are targeted customer acquisition and retention campaigns and online activities underpinned by a more agile and responsive operating model. This strategy is critically dependent on two key initiatives, the FOB platform and the Customer and Channels strategy.

The strategy included a legislative agenda to promote the introduction of legislation enabling offshore charges (betting information use charge and point of consumption charge) to reduce the impact of offshore competition on the domestic racing industry.

The success or otherwise of these strategies is also heavily dependent on what is happening in the market and how RITA identifies and responds to market changes.

3. Source – June 2019 – Industry Update from John Allen
4. Source – Annual Report 2016
5. Source – 2014 Performance and Efficiency Audit
6. Source – NZRB SOI 2019 - 2021

NZRB Strategy (continued)

Long Term Issues and Trends - Move to Digital and Online Gambling

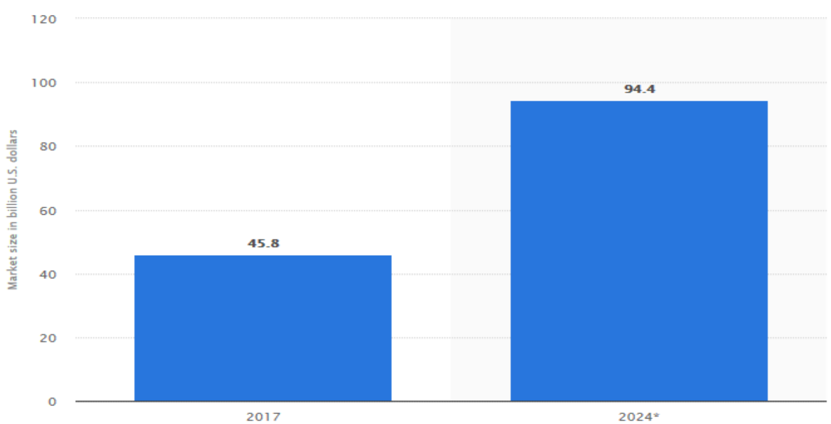
Analysis of international trends shows the growth in digital platforms including offshore betting and gambling. According to Global Online Gambling and Betting Market Report the online betting and gambling market will exhibit a compound annual growth rate (CAGR) of 11.4% over a forecasted period until 2024.

Online gambling is seeing a boom worldwide with the growth of online casinos, augmented reality and virtual reality, cryptocurrency, mobile friendly apps, and improved security. Some commentators have termed this as the “online gambling gold rush”.

This is backed up by studies that show that the global online gaming market topped 45 billion USD in 2017 and continues to grow at a rapid rate.

This market is predicted to grow significantly doubling in size over the next 7-8 years.

Size of online gambling market 2017 and 2024 (in USD Billions)



Source: Statista

How has the NZRB responded to digital platform and online gambling trends?

The disruptive influence of the internet has required the NZRB to change its business model to adapt to the opportunities and challenges it presents. However, this was not an overnight fix for the NZRB. As previously stated, they faced a legacy of long term fundamental issues which required significant investment.

Given the growth of digital gambling and the emergence of offshore operators actively seeking NZ customers, the NZRB concluded that doing nothing would result in an on-going decline in betting revenue and profits. The resulting strategy included the following major elements:

- Addressed the risk of a decade of underfunding its technology infrastructure by moving to more flexible, resilient and scalable technology platforms through the Optimus Strategic Initiative;
- Introduced a new fixed odds betting platform to provide higher quality and competitive betting products through the FOB Strategic Initiative;
- Introduced a modern website, redesigned TAB mobile app, and improved digital channels through the Customer and Channels Strategic Initiative;
- Legislative frameworks agenda (offshore charges) to address offshore betting competition; and
- Leveraging strategic partnerships and content distribution through the NZRB media strategy

NZRB Strategy (continued)

Digital Channel Percentage of Betting Turnover

Item	2015	2016	2017	2018	2019 Unaudited
Digital share of total betting turnover	43%	52%	55.9%	58%	60%

Source: NZRB Annual Reports

Added to the move to digital channels, the NZRB attempted to get the Betting Information User Charge and Point of Consumption (Offshore charges) legislation enacted. This was seen by many as a key driver to turning around the fortunes of the industry by recouping some of the revenue lost to offshore betting operators and protecting the domestic racing industry's intellectual property. In 2018 the draft legislation was withdrawn as the Minister believed, "The Bill wasn't fit for type."

It's successor, the Racing Reform Bill No.1 came into force on 1 July 2019. The Act included provisions for collecting revenue from offshore betting operators that provide betting services to persons residing in New Zealand and taking bets on New Zealand sports and racing events.

Long Term Issues and Trends - Change in Customer Demographics

Millennials and Gambling (those born between 1980 and late 1990s)

Research identifies that over 40% of those participating in online gambling are millennials between the ages of 21 and 34. It is this group that spends the most time of any generation online gambling (sources: Rymax and Gambling.net).

Traditionally, horse racing has attracted an older demographic. This is backed by various research that shows, for example, that only the PGA tour championship has a median age of television viewers older than those watching horse racing - both are in their sixties.

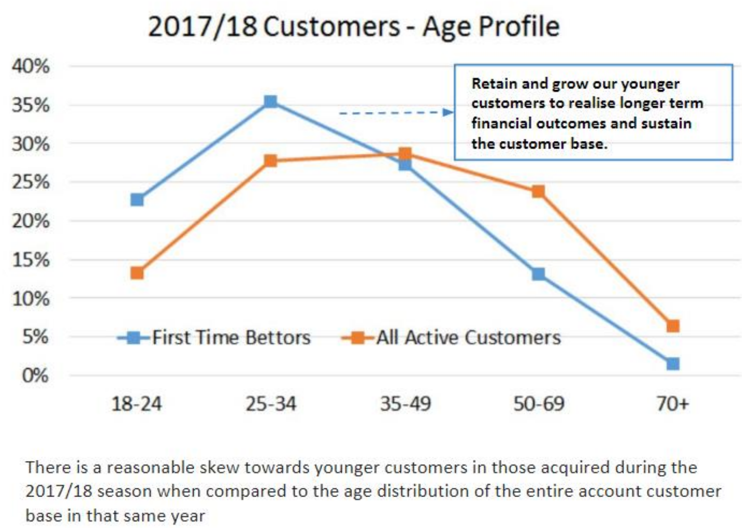
Since millennials represent the largest percentage of the population and if the TAB customer base is to be sustained then obtaining and growing the number of millennials is a major strategic opportunity for the TAB.

Note: Millennials (or Gen Y) are usually regarded as those born from early 1980s to 2000 or as someone who came of age in the new millennium.

NZRB Strategy (continued)

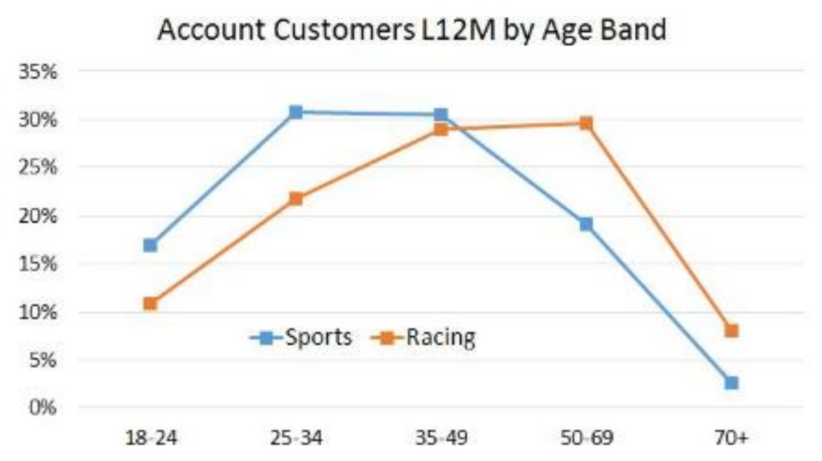
How has NZRB responded to customer growth to include millennials?

NZRB has done its own research on account customers by age and betting preferences.



Individuals aged 18-34 years in age account for 32% of New Zealand's adult population (source: NZ stats). 41% of TAB's current base is aged between 18-34 while first time bettors represent 58% of the customers acquired. It is noted the spend of younger bettors is not as high as older bettors.

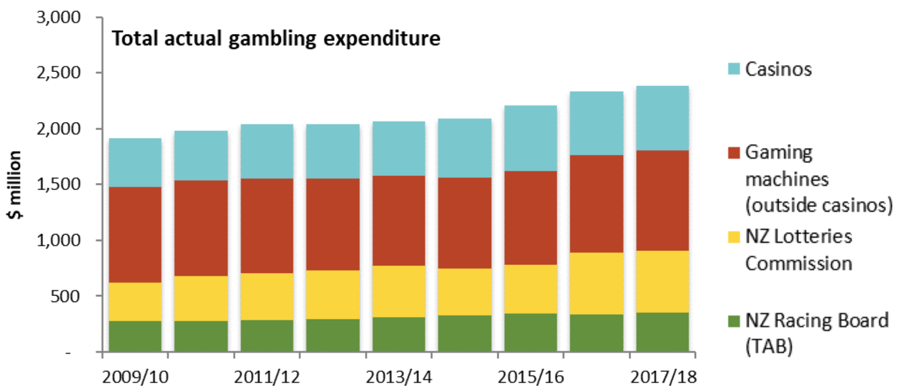
While millennials are adequately represented as part of the new customer base they are more focused on sports betting and when they do bet on racing the dollar amount is low. The NZRB has a number of relevant customer strategies in place aimed at acquiring new customers, retaining first time bettors and moving customers to more profitable gambling products. For example, the 2018 Lions Tour campaign resulted in approximately 17,000 first time bettors, of which 53% went on to place bets on racing by October 2018.



NZRB Strategy (continued)

Long Term Issues and Trends – Growth in Gambling

Trends since the 1990s show a gradual growth in gambling by New Zealanders of around 20%. As illustrated below, gambling has been steadily increasing since 2009.



Betting and Gambling statistics collated by DIA over the last 5 years support the view that while overall expenditure has been increasing, per capita expenditure has been fairly static and that the TAB continues to hold around 14% of the revenue (peaking at 16%) from total domestic Gambling.

Inflation adjusted Betting and Gambling Statistics

	2015	2016	2017	2018
TAB betting (millions)	$338	$353	$344	$350
TAB betting per capita	$97	$98	$94	$93
All Gambling per capita (*)	$622	$635	$648	$634

Source: DIA

(*) Excludes on-line overseas betting and gambling

How has NZRB responded to the growth in gambling?

NZRB's strategy has been to increase customer numbers as a key strategy through the Customer and Channels Strategic Initiative. This they have done successfully as active customer numbers have continued to grow year on year, the growth in customer numbers is an offset to the reduction in amount bet per customer. Discussions with management indicate they view the growth in offshore wagering as indicative of strong latent demand.

Actual Customer Growth

Item	2015	2016	2017	2018	2019 Unaudited
Active Customers Total	154,000	165,287	180,797	192,200	230,000

Source: NZRB Annual Reports

The dynamic facing RITA is that while customer numbers are growing, this growth is in fixed odds betting and primarily sports betting. So while active customer numbers are growing, margins are falling and bets are for a lower value.

Active customer numbers took a temporary dip when the FOB platform was introduced in January 2019. The CEO recently stated (August 2019) that active customer numbers are back where they were in December 2018 and that turnover on sport had grown considerably.

By the time this report was written, sports betting was up more than 30% on the number of sports bets being sold since the FOB platform went live.[7]

As stated above, RITA is actively marketing to retain existing and acquire new customers and to broaden the product range.

7. Source – June 2019 – Industry update from John Allen

NZRB Strategy (continued)

Source: NZRB

In contrast to customers numbers enjoying steady growth over the years, Elite customer numbers had been falling since April 2018. However, the recent establishment of a new role as Head of Elite Customer Growth and the introduction of the FOB platform seems to have arrested this trend.

Elite customers are identified as having a turnover of more than $100k per season and are very important to the TAB. These customers are managed by 8 Elite Customer Service Managers.

Elite customers make up around 1% of the total customer base but represent over 30% of turnover and 23% of revenue. Changes in behaviour of Elite customers can affect revenue by millions of dollars, the reduction in Elites was said to have a revenue impact of $4.1m in FY19 (unaudited).

Elite customers have an average age of 44. They are the smallest segment but also have the highest spend and frequency, betting 15 times a month on average, especially on sports betting. Around 95% of their betting is through digital channels.

The introduction of the FOB platform has seen turnover growth of 9% for the Elite cohort compared to a previous decline.

As part of their media strategy, the NZRB entered into a non-exclusive agreement with SKY TV (NZ) in 2018 which allows racing customers to be served by Trackside 1 and 2 and providing the NZRB and the Codes with greater control over the content and the ability to present racing to customers on new digital platforms.

Long Term Issues and Trends – Decline in Racing Tote Betting vs Sport Betting and FOB

Internationally, tote betting has been declining over the last 20 years. This trend has also been reflected in New Zealand. While betting on New Zealand racing has become less popular than in the past, betting on sports is more popular than ever. For example, sports betting had increased from 9.5 to 24.4 percent of total betting between 2001 and 2016.

The fall of racing tote as a percentage of TAB total turnover supports this trend within New Zealand.

Racing Tote Turnover

Item	2015	2016	2017	2018	2019 Unaudited
Racing tote as % of total turnover	65%	58%	48%	45%	42%

Source: NZRB Annual Reports – 2019 Unaudited

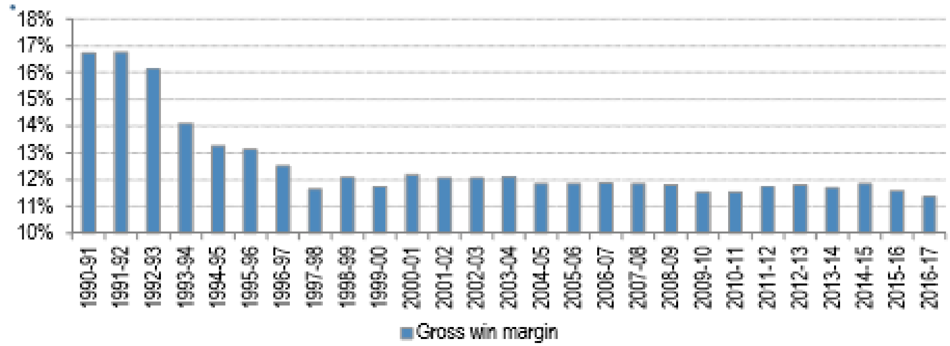
NZRB Strategy (continued)

How has NZRB responded to the decline in racing tote betting vs sports and fixed odds betting?

In response to the shifting needs and expectations of customers the NZRB has continued to focus on digital platforms, new sports products, fixed odds betting, and closer customer monitoring and management through 'generosity'. This response is consistent with the response from NZRB's offshore competitors.

As a result, sports activity continues to show significant growth especially since the introduction of the FOB platform which provided customers a greater number of options to bet on. Added to this, there were approximately 4 times the number of sporting events available to TAB customers this year. Features like in-play betting (betting takes places after the event has started) and cash-out (allows bettors to secure their profits or minimise their losses before the sports event has finished) have proved very popular.

Australian Gross Win Margin on Total Gambling Turnover



Long Term Issues and Trends – Reducing Margins

Volatility in margin is especially prevalent in sports betting. Globally, betting on sports has seen an array of competitive products introduced with better odds and added extras (such as free bets) to attract customers visitations and acquisition, all of which tend to compress margins.

Sports are also subject to specific event risks where the favourite loses. Examples from 2018/19 include the Ruiz fight, Tiger Woods winning the US Masters and the NBA finals. Such outcomes can result in low margins or a loss for the bookmaker.

The Australian betting operators have experienced a similar trend with margin compression over the years and 2018/19 in particular.

How has NZRB responded to the decline in margins?

Against the backdrop of customer numbers increasing year on year, TAB margins have fallen over the last 10 years due to shift in product mix.

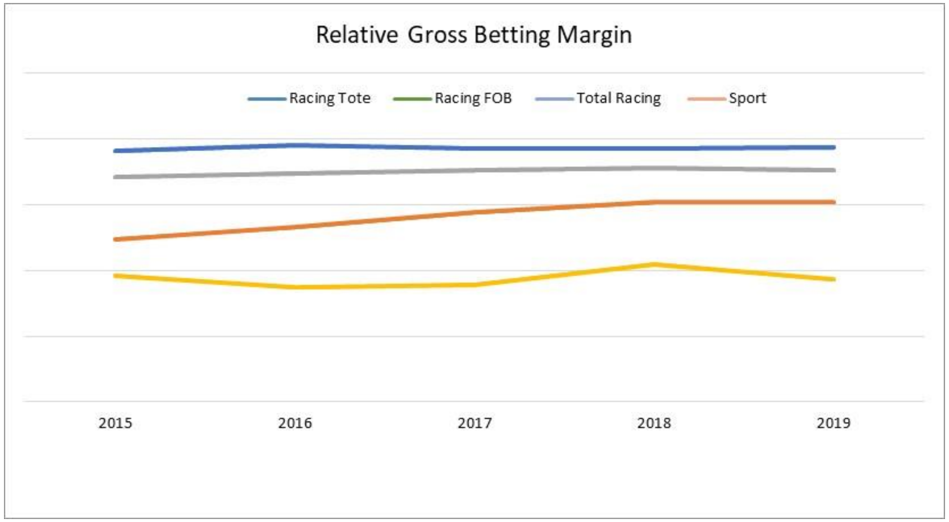
	2015	2016	2017	2018	2019 Unaudited
Net Betting Profit Margin	12.9%	12.4%	12.4%	12.7%	12.0%

Source: Annual Reports – 2019 Unaudited

Given the customers move away from the higher margin tote betting to the lower margin fixed odds betting, the NZRB strategy has been to grow overall customer numbers to grow total gambling turnover, and move customers to more profitable gambling products to protect the margin.

NZRB Strategy (continued)

As the following graph shows, racing totalisator margin has remained relatively constant over the period, while racing FOB margin has increased and sports FOB margin has been more volatile with a marked decrease from 2018 to 2019.



NZRB Strategy (continued)

NZRB's Strategic alignment with Statutory Objectives and Functions

The Statement of Intent (SOI) sets out the medium-term intentions and undertakings of the NZRB which include its strategic plans. We note the current draft SOI is for one year only, this is consistent with the RITA Board's term.

The NZRB Board approved the strategies and the Codes are consulted by virtue of their representation on the NZRB Board. We note the RITA Board composition has changed from the makeup of the previous NZRB Board and there is no longer explicit Code representation. Strategic matters were discussed as part of the CRIG (Combined Racing Industry Group) and CEO Forum process. NZRB also formed special working groups and facilitated workshops with the Codes when strategic matters needed to be discussed.

Post Board approval, the SOI is presented to the Minister for approval and subsequently to the House of Representatives.

We looked at how aligned the NZRB strategy and associated strategic initiatives were to its statutory objectives and functions. We also examined whether the NZRB was reviewing its performance against its statutory requirements.

From a governance perspective, the previous audit in 2014 commented that that there was no standing agenda mechanisms for the Board to review its statutory functions. On examination of the example Board agenda this situation seems to be unchanged.

The role of GM Strategy and Transformation was disestablished in 2015. Strategy is seen as a joint responsibility across the entire executive leadership team. Strategy as a function was structured under the Services Division supported by a Head of Strategy, a tier 3 role and was subsequently disestablished in 2018.

From an operations and programme perspective, we would expect to see the imperatives for each strategic initiative to be traceable to the statutory objectives and/or functions.

From a risk perspective, we found that a suitable framework existed and is being utilised, however, the principle risks are not explicitly linked to the statutory objectives and functions. By linking its principle risks to its statutory objectives and functions RITA may gain further insight into the priority of their risks and proposed risk treatments.

We recommend that consideration is given to explicitly linking the principle risks identified as part of the risk process to the statutory objectives and functions.

Furthermore, we recommend that consideration is also given to requiring all business cases for strategic initiatives contain a section on the alignment of the initiative to the statutory objectives and functions.

The Key Strategic Initiatives

There were 8 strategic initiatives over the past 5 years. These were:

1. Optimus;
2. Fixed Odds Betting (FOB) Platform;
3. Customer and Channels (C&C) Strategy;
4. Offshore Betting;
5. Future Venue Plan;
6. Vision Capture;
7. AML; and
8. Optimise the Calendar (OTC).

NZRB Strategy (continued)

Original cost and timeline per business case compared to actual

Total Costs of Strategic Initiatives until end of FY19 (unaudited)

	Opex	Capex	Total
FOB	$0m	$38.9m	**$38.9m**
C&C	$13.4m	$4.8m	**$18.2m**
AML	$2.1m	$4.3m	**$6.4m**
OTC	$1.5m	$0	**$1.7m**
Vision Capture	$1.0m	$15.9m	**$16.9m**
Total	**$25.6m**	**$62.7m**	**$88.5m**
IBM Licenses	**$10.7m**		$10.7m

Fixed Odds Betting

The Fixed Odds Betting Platform cost $1.1m more than in the original business case (3% overrun) and was delivered 5 months later than planned. The cost was reported as $40.8m by the CEO to the industry and to the NZRB Board (sources: RITA website “June 2019 - Industry Update” and 29 January 2019 FOB Board Update). The overall FOB project cost was $38.9m, with $7.0m of operating costs since implementation. We have been informed that $10.7m of the project costs attributed to FOB relate to IBM enterprise licence costs which have a wider NZRB use.

The project ran 5 months beyond the forecasted timeframe. According to the latest Interim Financial Statements the delay in launching the FOB platform was a contributing factor to the overall drop in net profits. FOB also impacted the profitability of other Strategic Initiatives. For example, it was estimated that the $3.6m reduction in net profit for the Customer and Channels programme was primarily due to the delay in delivering the FOB platform.

The launch of the FOB platform was not without it’s challenges being a significant and complex project as some of the racing customers struggled with the new layout or experienced technical issues. There were a significant number of issues reported which swamped the contact centre. The initial impact was lower active customer numbers and a reduction in elite customers betting, both of which have subsequently recovered. Feedback from the Codes noted there is an over emphasis on promoting sports betting with racing events attracting less of a profile on the app.

Fixed Odds Betting Costs and Timeline

	Business Case May 2017	Actual
Investment - Total	**37.8m**	**$38.9m**
Timeline	July 2018	7 January 2019
Opex increase (pa)	$17.3m	$7.0m (first 6 months)
Expected Incremental Net Betting Revenue over 10 years	$834m	$70m additional turnover in 6 months

NZRB Strategy (continued)

Customers and Channels

Although there had been a Channels Strategy in place for some time, the Customer and Channels programme was established in FY17. The main tranches are customer growth, channel experience and lowering costs. Business cases exist for FY18 and FY19. The programme capacity for this work has now stopped and remaining work has been transitioned to BAU activity.

This programme was highly dependent on other strategic projects such as FOB and AML. For example, the reduction of the FY19 forecasted net profit for the Customer and Channels programme was primarily driven by the knock on impact of the delayed go-live of FOB.

C&C Project Costs and Timeline

	Business Cases (FY18, FY19)	Actual
Investment - Total	**$19.2m**	**$18.2m**
Timeline	Not specified	BAU
Opex increase (pa)	Not specified	$3.3m
Expected net profit uplift over 3 years (by 2021)	$17m	$5.3m (2018 & 2019 unaudited)
Expected revenue growth FY19	$6.8m	$3.2m

Anti-Money Laundering (AML)

There was a statutory requirement to have the AML processes in place by 1 August 2019. The project was 95% completed by that date. The outstanding 5% was due to Scientific Games Digital being unable to deliver the 'New Customer Join Journey' solution on time.

NZRB has implemented interim measures in place to meet their obligations. DIA has been informed of the delay and have verbally agreed to the revised timeframe.

In the July 2019 update to the RITA Board the AML project was predicted to cost an additional $0.7m (including contingency) to cover the retention of key contractors and external parties and an additional Customer Remediation team member to mitigate the risk.

We understand the project is now complete.

We note the DIA has set the betting or prize limit at which AML has to be undertaken at $1k. In Australia this limit is set at A$10k.

Anti Money Laundering Project Costs and Timeline

	Business Case	Actual
Investment - Total	**$7.3m**	**$6.4m**
Timeline	End July 2019	End September 2019
Opex increase (pa)	$1.385m	$2.1m
Avoidance of criminal convictions and fines	$300k – individuals 2 yrs prison- individuals $5m – company	Not tested
Other risks of non-compliance	Risk to RITA's license to operate	Not tested

NZRB Strategy (continued)

Optimising the Calendar (OTC)

The first phase of the OTC project focussed on structural changes to the dates calendar. The project completed on time but did not fully deliver all its Business Case scope.

The scope included a future state view of racing venues and related transition / infrastructure investment plans. Although these were not delivered, additional funding of $566k was sought to develop a plan to address the industry's venue problems.

The first stage of future venue plan was partially developed but before it was completed the Messara review of the racing industry was published which contained recommendations on venues, approximately $155k was spent on the future venue plan. OTC is now treated as a BAU activity.

OTC Costs and Timeline

	Business Case	Actual
Investment - Total	**$0.9m**	**$1.5m**
Timeline	31 July 2018	31 July 2018
Opex increase (pa)	None	None
Expected benefits FY18	$3.m (economic benefits)	2018 $0.8m 2019 BAU

Vision Capture

There have been 3 phases to the Vision Capture project. Each phase had its own business case, cost and timelines. Overall, the project is running to time and under the original budget.

The Phase 3 Business Case re-forecasted the total cost to be $0.7m less than the originally estimated budget bringing the cost down to $18.6m at the conclusion of the project.

The initial roadmap had proposed that the third and fourth outside broadcast vehicles (OBVs) would be implemented in subsequent financial years. However, the final business case recommended this was brought forward to accelerate the benefits of complete risk reduction of equipment failure by completing the implementation sooner.

Vision Capture Phase 3 will finish when the fourth OBV is deployed in Dunedin in November 2019.

Vision Capture Costs and Timeline

	Business Cases (Phases 1-3)	Predicted
Investment - Total	**$19.3m**	**$18.6m**
Timeline	November 2019	November 2019
Opex increase (FY19)	$1.252m	Mainly depreciation for new assets
Expected benefits	No direct monetary benefits but underpins other revenue streams. All racing available in full HD by the end of 2019	All racing will have HD by end of 2019.

NZRB Strategy (continued)

Progress of strategic initiatives

Key initiative	Description	Cost	Progress so far
Optimus	Modernising NZRB core system and moving systems into the cloud. Upgrade and virtualise the IT infrastructure, allow scalability, introduce DR redundancy and avoid future capex investment.	Capex $1m Opex $10.2m	Completed May 2017.
Fixed Odds Betting (FOB) Platform	Development and implementation of new fixed odds betting platform to modernise NZRB operations and allow product parity with offshore competitors.	Capex $38.9m Opex $7.0m	Completed January 2019. After an initial loss of customers, numbers have recovered. Forecast benefits have not yet been delivered. Opex is for 6 months since go live. Excludes $10.7m of IBM Enterprise License costs.
Customer and Channels (C&C) Strategy	Variety of initiatives to optimise the retail network, improve the customer experience within the network and improve the customer's digital experience through the website or app as well as managing the Elite customers.	Capex $4.8m Opex $13.4m	On track to deliver by 2021 but already resulting in significant customer growth - up around 5.9% on last year (source: Interim Financial Statement to January 2019).
Offshore Betting (Offshore charges)	Work undertaken to promote into legislation a Betting Information User Charge and Point of Consumption Charge to be paid by offshore competitors taking bets on NZ racing or from NZ domiciled punters.	Estimated $0.5-1m	The Bill was halted following the Messara report. Now superseded by Racing Reform Bill No.1. Impact is estimated by NZRB at around $1m per month (source: Annual Report 2018).
Future Venue Plan	Capex $15.9m Opex $1.0m	Capex Opex $0.2m	Overtaken by the Messara Report - further consultation needed between the Codes and RITA.
Vision Capture	Implementing high definition racing broadcasting through acquisition of new equipment and constructing a fixed control room for Greyhound racing.	Capex $15.9m Opex $1.0m	Phase 1 completed November 2017.Phase 2 completed October 2018. Phase 3 scheduled to finish end of 2019.
AML	Developing the systems and process needed to become compliant with the Anti-Money Laundering and Financing of Terrorism Act.	Capex $4.3m Opex $2.1m	Legislative compliance to be met by 1 August 2019 including training of all staff. However, SGD was unable to deliver software changes on time resulting in a delay until 1 December 2019.
Optimise the Calendar (OTC)	Financial modelling and consultative process designed to maximise revenue from the racing calendar.	Capex $0 Opex $1.5m	Overtaken by the Messara Report - changes to 2018/2019 calendar delivering positive financial results (source: Interim Financial Statement to January 2019).

NZRB Strategy (continued)

OPEX costs associated with Strategic Initiatives

NZRB has budgeted $19.8m in 2019/2020 for costs associated with strategic initiatives. This is made up of operating costs relating to the FOB platform, ongoing investment in Customer initiatives arising from the Customer and Channels Strategy, AML and Future Venue Planning.

Ongoing investment and operating costs

Item	$m
Fixed Odds Betting Operating Costs	16.5
C&C Retail transformation	0.8
Other items (Regulatory AML)	1.9
Total strategic initiatives operating costs	**19.2**
Offshore Betting Income	(4.1)
Net strategic initiatives operating costs	15.1

Benefits associated with Strategic Initiatives

The Profit and Loss Forecasts for 2019-2020 (draft) put the total revenue growth in FY20 at 11.7% and profit contribution growth of 10.1%.

Distribution to the Codes for FY20 is forecast at $151.6m which is consistent with the Minister's expectation of Code distributions being held at the same level as 2019.

Future Product strategies

The key strategy that NZRB has adopted regarding fixed odds betting is achieving product parity with international competitors.

The FOB platform is centrally controlled by Scientific Games Digital (SGD) as the new owners of OpenBet. Every 12 weeks SGD releases new products (or functions) driven by a 2 month pipeline. NZRB gets to see the pipeline and has the option to take or leave new products as there are no direct costs.

However, the integration and testing costs fall to NZRB who must be able to respond to the 12 week cycles. This they are seeking to achieve through agile teams. Agile working is relatively new to NZRB.

NZRB has the opportunity to influence what is on the roadmap through monthly interactions with the SGD Development Team and annual face to face meetings with senior staff. NZRB also has the ability to develop their own products and features for the NZ market, utilising their agile development process.

In turn, NZRB stay in touch with customers requirements through the Elite Customer Managers and the Small Customer Insight Teams (who do monthly surveys of customers).

These 12 week releases of new FOB products will serve to keep the NZRB FOB market vibrant and current since the SGD roadmap is based on international customer requests and international betting trends.

NZRB Strategy (continued)

Achieving the strategic goals and sustainability

All of these strategic investments and associated new features were designed to ensure NZRB was meeting the demands of current customers, attracting new ones and ensuring that they can create a sustainable future for the racing industry.

The Messara Report used statistical trends to assess the health of the racing industry (especially thoroughbred horse racing) and came to conclusion that "on any test, the thoroughbred racing industry in New Zealand today is in a state of serious malaise." The author also argued that, "the NZRB is not delivering sufficient returns to the Racing Industry to ensure its ongoing viability."

One of the statutory objectives of RITA is to maximise its profits for the long term benefit of NZ racing. It is apparent from this statutory objective that RITA's primary role in ensuring industry sustainability is maximising its profits and therefore industry funding. To measure performance they utilise key metrics in their Annual Reports such as:

- Financial results;
- Customer numbers and growth;
- Distribution to Codes and sporting bodies; and
- Future investments.

The financial results for 2019 (unaudited) show profits have fallen to $137m, which is $8.9m below the prior year and $36.5m below the budgeted profit of $173.5m. Profit levels are similar to 2013 and 2014. Management have identified the delay in the FOB launch, the lack of offshore charges revenue and a reduction in Elite betting in the first half of the year combined with significant margin compression in the second half of the year, as the major drivers of the poor result.

Challenges to sustainability of RITA

Some significant challenges remain that threaten RITA's ability to fulfil its statutory purpose and to fund a sustainable future for the racing industry.

NZRB has real momentum in customer activation and retention coupled with turnover growth. But this must be balanced against the pressure coming from reducing margins and the need to continue to contain costs. Added to this:

- The FOB platform has yet to deliver the anticipated revenue benefits, given the importance of FOB revenue generation to RITA's future it is vital the platform delivers the benefits forecast.
- NZRB faces aggressive competition offshore as well as rapidly changing customer preferences. Offshore betting and gambling is threatening RITA's and the industry profits through the loss of customers and revenue, especially the Elite and VIP customer base who like others are seeking a wider range of products with better odds. This impact is expected to be lessened by the introduction of the Betting Information Use Charge and Point of Consumptions Charge. The GenY (millennials) generation are still not well represented in racing (by numbers and betting levels) which is both a concern and an opportunity for the long term sustainability of the racing industry. The continued emphasis on Elite and VIP customers is logical but also creates a concentration risk;
- Tote betting continues to decrease each year due to changes in customer preferences towards fixed odds betting and sports betting; and
- Relationships with key stakeholders and the Codes is complex. NZRB has a dual function as an administrator and funder of the Codes. Interests and goals are not always aligned with, or between, the Codes and conflicts do arise from time to time. This was addressed in the Messara Report which recommended that NZRB was reformed to have only a commercial focus and that racing responsibilities are devolved to the Codes.

NZRB Strategy (continued)

There are a number of risks to the RITA strategy and the budgeted performance of 2019/20, we have outlined below the key risks we have identified through our review:

Risk	Description	Progress so far
Customer acquisition and retention	Sports fixed odds betting produces a lower margin than racing fixed odds betting or racing tote betting, to grow profits RITA needs to grow customer numbers, retain existing customers, encourage larger bet sizes and move as many customers as possible into racing betting. RITA has a risk around the success of their customer acquisition and retention programmes and the availability of opex to fund these programmes.	RITA continues to implement their customer attraction and retention strategies including the use of "generosity" (incentives) and marketing campaigns to encourage the desired customer behaviours.
Continued margin compression	Margin compression, largely driven by sports results has compressed margin of gambling operators throughout Australia and New Zealand. RITA expects the FOB margin to "normalise" in 2020, and if this does there is an anticipated revenue improvement of approximately $10m. While intuitively logical it is noted the FOB margin is event driven and still subject to unexpected results impacted profits. We note that the increased dependence on sports betting increases the impact of major events being low or negative margin.	The nature of fixed odds betting and the ultimately unpredictable nature of sports events ensures this risk will always need to be monitored and managed by RITA.
Financial viability of racing industry	While significant efforts are being made to increase the revenue and profits generated by RITA to improve industry funding there is a risk that failure to increase industry funding in the short to medium term may result in some Codes not being able to make ongoing participation financially viable for owners and trainers leading to the effective demise of the Codes.	While the industry, Codes and Clubs are under significant financial pressure, this is a medium to long term issue. Growth of profits and distributions is the primary RITA response.
Gaming Machine Limitations	The current gaming regulations put a cap on the number of gaming machines RITA can operate, there are also limitations imposed at the local government level in terms of caps or sinking lid policies. Gaming machines are proven to improve the profitability of the TAB sites which house them, as well as generating profits (noting the limitation on distribution of gaming profits)	2020 budgets do not include any increase in gaming machine numbers with revenue growth equivalent to expected gaming market growth.
Offshore gambling companies moving to BIUC Regulations	Currently a number of offshore gambling organisations have entered voluntary arrangements to pay for the use of NZ racing/sports information/images. We understand these arrangements are equivalent in cost to the offshore operator as the BIUC/POC (Offshore charges) legislation. However, the voluntary arrangements fees are paid to RITA while the BIUC/POC will be paid directly to the codes. If offshore operators should move into the BIUC/PCO legislation there would be a direct financial impact to RITA, although no net change for the NZ Racing Industry.	RITA has budgeted $4.1m revenue from the voluntary offshore charges arrangements established with offshore gambling organisations and has not factored in any additional revenue from the passing of the offshore charges legislation, therefore this is considered a low risk to RITA's performance over the next 12 months.

NZRB Strategy (continued)

Risk	Description	Progress so far
International sports bodies charging product fee	Currently the ability to take bets on international sports events is paid for via payments to the domestic NSO for the relevant sport on a legislated formula. There is a risk that the major international sports organisations (such as the NBA) could charge a product fee for the domestic gambling rights. The risk is exacerbated by the growth in sports gambling. If the product fee was equivalent to the current formula in negotiation with Sports NZ and Domestic NSO (26% of GBR) this would equate to a payment of $20.9m for 2019	Considered unlikely for the 2020 year.
New NSO product fee agreement	We understand the product fee agreement with the domestic NSOs may be amended to move from the current formula (1% of sports betting turnover and 5% of sports GBR) to a new formula. On the assumption the new formula is more beneficial to sports there will be less sports revenue retained for distribution to the Codes.	The 2020 budget calculates NSO fees on the same basis as prior years (increased due to growth in sports betting turnover and GBR), with the implicit assumption any change is NSO product fees will not be in place until 2021.
Elite Retention	While Elite customers are closely monitored and managed they represent a very small percentage of the customer base (approx. 1%) but account for 30% of turnover and 23% of revenue. There is a risk to RITA in the concentration of these customers and the retention of the Elites is critical to the future profitability of RITA.	RITA has a Elite strategy as well as a team focused on managing the Elite customers.
Customer loss through AML requirements	Risk that the increased controls required by AML (particularly around customer identity) will cause a number of the cash bettors (approx. 43% of retail customers) to stop betting. AML processes become live from 1 August 2019 so it is too early to identify the customer impact.	We understand there are approximately 300 customers at risk, a communication and retention strategy has been implemented.
New digital products	RITAs ability to offer new digital products is limited by regulation, with the expectation these regulations will be eased as part of the Racing Reform Bill No.2 expected to be in law by April 2020. The new digital products range from adjacent products (such as in-race betting) through to completely new products such as virtual casinos. We understand products allowed by the Racing Reform Bill No.2 are part of the product development programme.	RITA are working with the Department of Internal Affairs to develop the Racing Reform Bill No.2 and implement the regulations enabled by the Racing Reform Bill No.1 (2019).
Increased international competition	The increased customer acceptance of digital gambling, lack of regulatory barriers to international digital gambling in NZ and the desire of international gambling operators to maximise the return on their investment in technology all point to increased international competition for the NZ punter. Failure to retain existing customers, prevent new customers from going to the international sites and ultimately enticing NZ based punters away from international competitors limits the already modest NZ market size available to RITA given statutory restrictions on competing offshore (Australia).	The FOB platform and the initiative of being a fast follower to gain product parity with competitors, together with on-going ‘generosity’ programmes are designed to retain customers and attract new customers.

NZRB Strategy (continued)

Risk	Description	Progress so far
Customer Demographics	RITA's race gambling customer base is skewed towards older age groups who have been punters for some time, which has the obvious risk of being a declining cohort and impacting on betting revenues, younger RITA customers are more likely to be sports punters than race punters. RITA's strategies to retain punters and move punters from sports to race betting are critical to their long term viability.	RITA a re developing, or have developed engagement strategies for all major customer groups including millennials and first time bettors.
Cost management	We understand RITA is seeking to further reduce opex and capex in the 2019/20 year by $10m and $6m respectively. There is the risk that the spending cuts will impact RITA's ability to realise the benefits from the investments in FOB and customers and channels, and may impact future profitability by creating a need for big catch up investments.	Based on our understanding of the proposed savings, the savings do not overly constrain RITA's profit generating ability and continue a level of investment in the key revenue drivers.
Balance Sheet Pressure	The RITA balance sheet has come under increasing pressure as capex and opex has been expended on the strategic investments and $24m of additional industry funding was paid out. Equity has fallen and debt has increased over the past two years, this has reduced RITA's ability to further invest in strategic initiatives and has also reduced RITA's ability to cope with any reduction in gambling profitability.	RITA has reduced the 2020 capex and opex budgets and retains headroom in their standby debt facility. Meeting the Minister's expectation of distributing the same amount to the Codes in FY20 as in FY19 puts further pressure on performance so that the balance sheet position does not deteriorate further.
Inability of Codes to undertake devolved functions	A number of industry functions are to be passed to the Codes/Racing NZ to allow RITA to transition to a pure gambling operation. There is a risk that some or all of the Codes will not be ready to pick up these functions, or of they do so the function will be perform less efficiently than when centralised within NZRB. There is also the risk of increased costs for the industry if each Code replicates the functions currently undertaken by RITA.	RITA has the option of providing for temporary management of the residual functions if the Codes/Racing NZ are not yet in a position to take on the responsibility.
Achieving the 2019/20 profit forecast	In the draft 2019/20 budget RITA has set a profit goal of $165.8m which is an increase on 2018/19 which is an increase of over 20%. This increase is driven off the back of a 22.6% increase in betting revenue and a 4.5% increase in gaming revenue. The increased profitability is required to fund the $151.6m Code distributions within the parameters established by the Minister's Letter of Expectations.	The profit increase is dependent upon FOB performance and cost management. We understand the revenue from the recently enacted offshore charges legislation is expected to be received in 2019/20, consideration should be given to RITA retaining this revenue to underpin their financial performance, and Code distributions, during RITA's transition period.

Alternative Models

Identification of potential alternative service models and/or improvements to NZRB's operating model.

RITA delivers all the core components needed for a modern gambling operation itself, from broadcasting to betting odds establishment to gambling system management and management of a retail network. This service model is partially a reflection of the history of NZRB and partially a reflection of the size of New Zealand. RITA has NZ's largest outside broadcasting operations, NZ's sole betting odds operation and one of NZ's largest retail networks.

Potential alternative service models include the full outsourcing of operations, partial outsourcing of some operations and full or partial privatisation. We understand most, or all, of these alternative models are being, or have been, explored by NZRB or RITA. We set out below our views on the main risks and potential benefits of each of these alternatives:

Full Outsource

A full outsource model is contracting a third party to deliver the RITA gambling business. The third party would be responsible for all related activities from Broadcasting to managing the retail network.

NZRB undertook an indicative review of the viability of outsourcing as part of its decision making process for the FOB platform development. This included obtaining preliminary advice on outsourcing options and benefits. The advisor considered Australian models and returns and preliminary concluded that significant benefits could be gained from outsourcing. This included giving the NZRB access to scale and technology. The advisor also highlighted NZRB's "escalating costs" and risks of future competition from international corporate bookmakers and identified that risks in regards to execution could be transferred to a third party Operator.

NZRB decided that it wouldn't fully outsource and instead invested in the FOB platform as an attempt to transform the business and meet changing customer demands.

We have heard differing views from the Codes as to the desirability of outsourcing with the primary trade-off being between the benefit of an upfront payment to the codes and lower risk earnings against the loss of control for the period of the outsource.

The challenge for the outsource provider is being able to realise the potential synergies of incorporating the RITA business into their existing business. The size of these synergies will dictate the size of any upfront payment and the product fee payable to the industry.

One of the key reasons NZRB considered outsourcing was that it did not have a world class betting platform. Now that the investment in the FOB platform has been made and the platform is operational, the case for full outsourcing has changed and is now more focused on risk reduction and the economics of outsourcing (access to immediate investment and savings that can be achieved via scale).

The view from some of the Codes is that full outsourcing is still a viable option and that the third party Operator will still pay a significant upfront payment to RITA. While RITA will consider this option given its mandate, the attractiveness of RITA to a third party Operator may have changed since the previous review given NZRB's recent financial performance and the future commitments entered into by NZRB as part of its FOB platform investment. In addition, a third party Operator is likely to want some form of guarantee from the New Zealand Government that protects RITA's monopoly position.

Potential Benefits	Risks
• Potential upfront payment to the racing industry • Creates the scale required to compete in an international gambling marketplace • Better quality/lower risk earnings	• Loss of industry influence/control of gambling operator • Loss of voice - Relative importance of NZ industry to operator compared to RITA

Alternative Models (continued)

Partial Outsource / Joint Venture

A partial outsource would entail partnering with a third party to operate one element of the RITA gambling business, broadcasting, core gambling or the retail network. We note a significant proportion of the retail network is currently outsourced to agents or pubs and clubs. The benefit from a partial outsource stems from the partnering with an organisation with greater expertise and/or scale which allows higher quality or lower cost for the same quality.

Potential Benefits	Risks
• Gives access to the expertise required to compete in an international gambling marketplace • Better quality/more efficient service • Reduced on-going investment need	• On-going investment and operating costs would be priced into transaction by provider • Certain obligations (legislative) such as AML and problem gambling are still likely to sit with RITA.

Privatisation

Under a privatisation model the RITA business would be sold to investors and would be operated as a stand alone business. The privatisation model does not address any of the scale challenges currently faced by RITA but would provide a capital injection into RITA and/or the racing industry. The trade-off would be the new share holders would require a return on their capital which would impact on future returns to the industry.

Potential Benefits	Risks
• Upfront capital injection which could be utilised for investment or distributed to the industry • Better quality/more efficient service • Reduced on-going investment need	• Industry distributions diluted by required return on capital of investors • Does not address scale challenges • Does not bring in industry expertise •

We note some Codes see the loss of control and share of voice being the major issues preventing outsourcing being an acceptable option, while other Codes are sceptical of the degree of control they currently possess and see the immediate injection of funds being critical to the survival and prosperity of the industry. The potential benefits to the racing industry of full or partial outsourcing is dependent upon the deal which is able to be struck and the synergies between RITAs operations and the outsource provider.

Devolution of Functions to the Industry

The Messara Report, and subsequently the MAC recommended the NZRB become TAB NZ and focus on commercial activities with racing responsibilities devolved to the Codes. This devolution has subsequently been included in the Minister's Letter of Expectations, with the important proviso that RITA should provide for temporary management of these functions if required. The functions being considered for devolution include:

- Racing Dates Calendar
- Industry Training & Development
- Racing Integrity Bodies
- Animal Welfare
- Equine Health Association & Equine Research Foundation
- Tri-code management of Industry & PR issues

The Messara Report envisaged the establishment of Racing NZ as the vehicle for joint industry management of the devolved functions. The MAC established the Industry Governance Project Group to investigate the options for devolving functions to the Codes. Key to the decision is the Ministers requirement that the transfer of functions to the Codes does not result in an overall increase in costs to the industry.

In our discussions with the Codes there was broad support for devolution of industry functions, with concerns additional resources would be required and the proviso that funding needs to follow the additional responsibilities.

Part A Section 3: Financial Analysis

Financial overview

Financial summary ($millions)

	FY15	FY16	FY17	FY18	FY19 (unaudited)
Gross betting revenue	325.1	342.3	337.7	349.9	331.8
Net betting revenue	267.1	281.0	277.5	284.0	264.4
Net gaming revenue	18.4	23.2	24.8	27.0	29.0
Other revenue	45.9	45.7	45.8	44.0	42.7
Total revenue	331.5	349.9	348.1	354.9	336.1
Turnover related expenses	(64.6)	(66.4)	(66.4)	(65.5)	(65.3)
Total operating expenses	(127.8)	(138.8)	(133.7)	(134.5)	(126.5)
Operating net profit	**139.1**	**144.7**	**148.0**	**154.9**	**144.4**
SI and other one-off items	4.9	2.0	(4.0)	(9.0)	(7.4)
Reported net profit	**144.0**	**146.7**	**144.0**	**145.9**	**137.0**
Assets	131.9	139.9	136.7	130.1	134.7
Liabilities	(61.1)	(66.1)	(67.4)	(76.6)	(111.3)
Equity	**70.8**	**73.8**	**69.3**	**53.5**	**23.4**

Key Commentary

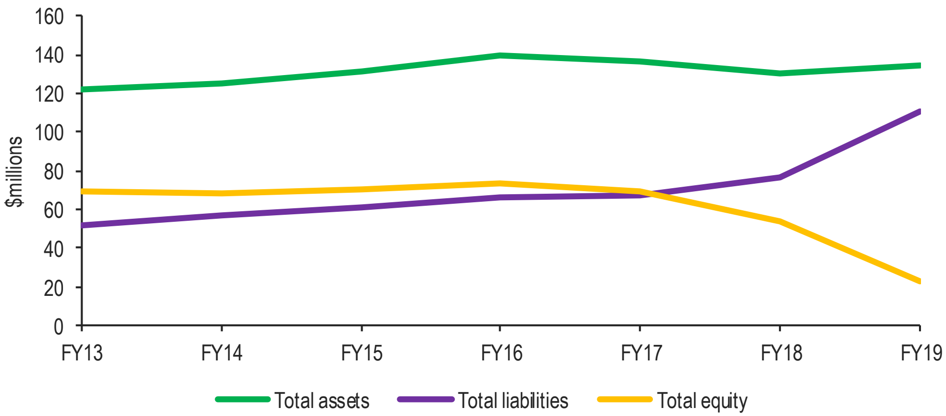
- Overall, reported profits (including one-off items and strategic initiatives) remained steady over the period from FY15 to FY18 but decreased in FY19. The profitability level achieved in FY19 (unaudited) is below that achieved in FY15.
- Operating profit (normalised) has increased by 3.8% over the period.
- Net profit (post strategic initiatives) has fallen by 4.9% over the period.
- Distributions have increased over the period to the Codes. However, in FY18 and FY19 (unaudited), total distributions have exceeded profits (FY18: distributions of $150.8 million against profits of $145.9 million, and in FY19: distributions of $151.6 million against profits of $137.0 million)
- Combined with capex spend, which was deemed necessary due to previous under investment, this has meant the NZRB had to borrow to fund cash outflows (distributions and capex) which reduced the equity position from $70.8 million in FY15 to $23.4 million in FY19 (unaudited).
- External debt now totals $35 million.
- The FY20 distributions have been set at $151.6 million which is set at the FY19 level but will require an increase in profits to fund.

FY18 vs FY19

- FY19 (unaudited) net profit of $137m was $36.5m below budget (approximately $173.5 million) and was $8.9 million down from the prior year.
- Overall, betting turnover has increased marginally from $2.26 billion in FY18 to $2.29 billion in FY19 (unaudited).
- Betting turnover for the first half of the year (H1) was lower than the corresponding period in FY18 although turnover recovered in the second half of the year (H2). Management stated that this was partly attributable to a lower spend by elite gamblers in H1 which then recovered in H2.
- Management also advised that margin compression in FY19 was significant which impacted on overall profitability with Gross Betting Revenue reducing by $18 million from FY18 to $332 million in FY19 (unaudited). We note FY18 net betting revenue margins were at 12.7% compared to 12.0% in FY19 (unaudited). In particular, Sports margins fell from 8.2% to 7.1% based on NZRB's internal reporting. From our benchmarking exercise, we note Tabcorp is also experiencing margins compression with their fixed odds yield reducing by 0.8%. In addition, we note revenues, EBITDA and EBIT margins have reduced for Tabcorp in FY19 for the wagering and media segment which is consistent with NZRB (based on normalised FY18 results as if the Tatts combination had been in place for the full year). We note Flutter Entertainment also note a reduction in net revenue margin for Sports and also an underlying reduction in EBITDA margin in FY18 (December year end)

Equity position

Assets, liabilities and equity



Key commentary

- We present opposite a summary of NZRB's assets, liabilities and equity at each financial year end.
- The equity position was relatively stable up until FY17 as NZRB looked to increase equity to fund the strategic initiatives, before declining significantly in FY18 and FY19 (unaudited). The deterioration in the equity position since FY17 is a result of the NZRB borrowing and utilising cash reserves to fund investment in the strategic initiatives-and the increase in code distributions. In FY18 there was $10 million of additional borrowings, this was further increased to $35 million by July 2019 (unaudited) which resulted in the large reduction in the equity position.
- The increase in liabilities is predominately due to the investments in the FOB platform (some costs were expensed rather than capitalised) and the increase in debt. Effectively, NZRB's current equity position is the result of advancing additional funds to the industry when it also required significant funding to implement strategic goals necessary for the long-term sustainability of the racing industry.
- We understand that the additional $12 million of advances were made by the NZRB after considering the future benefits arising from its strategic initiatives and a change in legislation (offshore charges), underpinned by a commercial agreement between NZRB and the Codes. As such benefits were not realised in either FY18 or FY19, the NZRB had to accordingly fund the additional advances from other sources (existing cash flow and debt).

Comparison of normalised CPI adjusted FY15 performance to normalised FY19 (unaudited)

Comparison of normalised CPI adjusted FY15 performance to normalised FY19 (unaudited) ($millions)

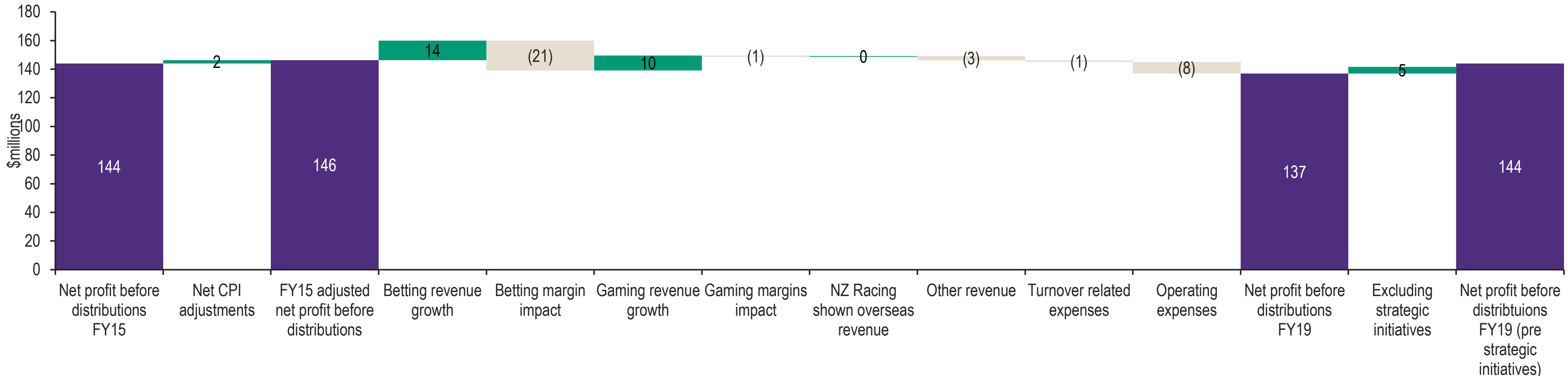
	FY15	FY15 CPI and one off items adjusted	FY19 (unaudited)	FY19 (excl new initiatives)	Variance	Variance %
Betting						
Betting turnover	2,073	2,178	2,285			
Less: dividends payable	(1,748)	(1,837)	(1,953)			
Gross betting revenue	325	342	332			
Betting duty	(13)	(13)	(13)			
GST	(43)	(46)	(44)			
Problem gambling levy	(2)	(2)	(2)			
Net betting revenue	**267**	**281**	**274**	**264**	**(16)**	**(5.8)%**
Net betting revenue margin %	***12.9%***	***12.9%***	***12.0%***			
Gaming						
Gaming turnover	317	333	513			
Less: dividends paid	(289)	(304)	(469)			
Gross gaming revenue	28	30	44			
Gaming machine duty	(6)	(6)	(9)			
GST	(4)	(4)	(6)			
Problem Gambling Levy	(0)	(0)	(1)			
Net Gaming revenue	**18**	**19**	**29**	**29**	**10**	**49.8%**
Net Gaming revenue margin %	***5.8%***	***5.8%***	***5.7%***			
NZ Racing shown overseas rever	20	21	22	19	(3)	(11.9)%
Other revenue	30	27	24	24	(3)	(11.1)%
Total revenue	**336**	**348**	**348**	**336**	**(12)**	**(3.5)%**
Turnover related expenses	(65)	(68)	(69)	(65)	3	(3.8)%
Operating expenses	(128)	(134)	(142)	(127)	8	(5.8)%
Cost to turnover %	***8.0%***	***8.0%***	***7.6%***			
Net profit before distributions	**144**	**146**	**137**	**144**	**(2)**	**(1.3)%**

Key commentary

- In the table opposite, we present a comparison of normalised CPI adjusted FY15 performance to normalised FY19 (unaudited) results.
- Our FY15 CPI and one-off items adjusted column represents FY15 results adjusted for:
  - Excluding the one off gain on sale of the Petone building of $4.9 million; and
  - Adjusted FY15 actual performance with the net movement in the RBNZ published CPI Index between 1 July 2015 to 30 June 2019 (the CPI index is updated quarterly) to determine whether NZRB's financial performance has improved over the review period.
- In addition, we also show normalised FY19 (unaudited) results that excludes the impact of new initiatives undertaken over this period which have impacted on the comparability of NZRB's underlying performance over this period (column 'FY19 (excl new initiatives)'.
- These initiatives include:
  a) The development of the fixed odds betting platform;
  b) Offshore Charges;
  c) The Customers and Channels Programme;
  d) Optimise the Calendar initiate; and
  e) The AML/CFT project to comply with legislation.
- Overall, Betting turnover increased by $107 million (or 4.9%) above the adjusted result in FY15 while the Gaming turnover improvement was $180 million (or 54.0%).
- This had the impact of improving net gaming revenue in FY19 by 49.8% while net betting revenue reduced by 5.8% (given margin declines).
- NZ Racing shown overseas revenue, excluding new initiatives, reduced by $3 million (or 11.9%) compared to its normalised CPI adjusted level in FY15. Similarly, other revenue also reduced by $3 million (excluding new initiatives) compared to its normalised CPI adjusted level in FY15.
- Overall, unaudited results for FY19 of $144 million (i.e. excluding the impact of new initiatives) indicates a profitability level lower than its comparative normalised CPI adjusted position in FY15 of $146 million.
- If we factor in total net profit before distribution (inclusive of all new initiatives costs for FY19), then the overall reduction is $9 million (or 6.3%).
- Actual, unadjusted reported net profit reduced from $144m in FY15 to $137m in FY19.

Summary bridge between normalised CPI adjusted FY15 and normalised FY19 (unaudited)

Net profit before distribution bridge between normalised CPI adjusted FY15 and normalised FY19 (unaudited)



Key commentary

- The increase in betting turnover between normalised CPI adjusted FY15 and normalised FY19 (unaudited) of $107 million resulted in additional betting margin generated of $13.7 million. This is offset by a reduction in margin on betting products resulting in a net reduction from betting of $7.1 million.
- The increase in gaming turnover resulted in an overall increase in margin contribution of $10.5 million (post CPI adjustment). This is slightly offset by a small reduction of margins resulting in an overall impact of $9.6 million.
- The improvements from higher total betting and gaming revenue turnover is slightly offset by the reduction in other revenue (post normalisation and CPI adjustment) of $3 million.
- This is further reduced by an increase in operating expenses of $8.0 million.
- Expenses have increased as a result of strategic initiates that were undertaken in FY18 and FY19 around AML, the FOB platform and the Customer and Channels programme.
- Turnover related expenses have increased marginally from FY15 to FY19 (unaudited).
- Operating expenses as a percentage of revenue have increased from 38.0% in FY15 to 40.8% in FY19 (unaudited). However, we note that operating expenses before strategic initiatives are lower at 37.7%.

Strategic initiatives

Strategic Initiatives ($000)

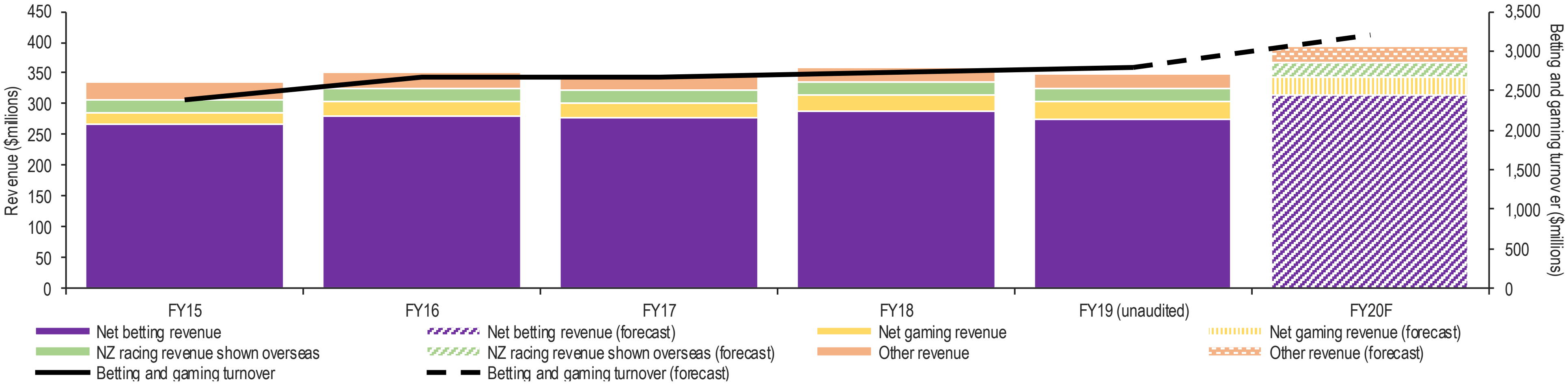
	FY16	FY17	FY18	FY19 (unaudited)
Strategic benefits (net of TRE except Advertising and promotions included in strategic spends below)				
Offshore Charges	-	-	362	2,997
Fixed odds betting platform (FOB)	-	-	-	3,854
Customer and channels programme	-	-	2,625	2,708
Optimise the calendar (OTC)	-	-	785	-
Total strategic benefits	**-**	**-**	**3,772**	**9,558**
Strategic costs (operating expenses and advertising and promotion costs)				
Fixed odds betting platform (FOB)	-	-	-	7,001
Enterprise licenses (IBM) and Iaas costs	-	1,400	5,320	4,013
Customer and channels programme	1,174	2,861	6,042	3,381
Anti-money Laundering (AML) compliance programme	-	79	697	1,873
Optimise the calendar (OTC)	599	220	714	-
Future Venue Plan (FVP)	-	-	-	155
Labour recoveries/allocations, interests and other	-	-	-	502
Strategic spends not separately recognised in the Annual Report				
PCI	-	406	1,146	9
Vision capture	83	335	330	278
Capitalised strategic costs				
Fixed odds betting platform (FOB)	-	573	21,827	16,483
Customer and channels programme	-	618	2,265	1,871
Anti-money Laundering (AML) compliance programme	-	-	-	3,102
Optimise the calendar (OTC)	-	-	-	-
PCI	-	-	150	51
Vision capture	-	1,679	7,117	7,082
Total strategic spends	**1,856**	**8,170**	**45,610**	**45,802**
Net strategic costs	**(1,856)**	**(8,170)**	**(41,838)**	**(36,243)**

Key Commentary

- Over the review period, NZRB has undertaken several initiatives to minimise costs, improve revenue and future proof the business.
- The total opposite presents the net cost of the strategic initiatives between FY16 to FY19 (unaudited). We understand the Strategic Initiatives commenced in FY16.
- We understand that the strategic benefits as shown in the opposite table are estimated based on a series of assumptions applied, rather than being directly traceable (with the exception for offshore charges). The strategic benefits shown opposite are net of associated turnover related expenses such as NSO levies, overseas racing rights costs and other turnover related expenses. We have combined advertising and promotion costs as part of the strategic costs.
- The table opposite includes the total costs of the strategic initiatives inclusive of any costs that have been capitalised.
- We note over the review period, the largest spend was in relation to the FOB Platform totalling $42.0 million (net of strategic benefits). Ongoing additional annualised costs associated with the FOB platform are expected to be approximately $17.3 million with around $4.7 million being depreciation.
- The AML project is ongoing and annualised operating costs associated with the AML programme are expected at $1.6 million with approximately $763k in depreciation.
- Some of the other initiatives in the review period includes:
  a) Strategic retail growth relating to the increase of gaming sites and review of its retail network;
  b) Launch of the TAB Mobile app and watch and bet racing;
  c) Split content broadcasting;
  d) The implementation of the Optimus programme;
  e) Staff cost management;
  f) Review of its property portfolio; and
  g) Improvement of its merchant fee recovery.

Revenue trends

Historical revenue trends

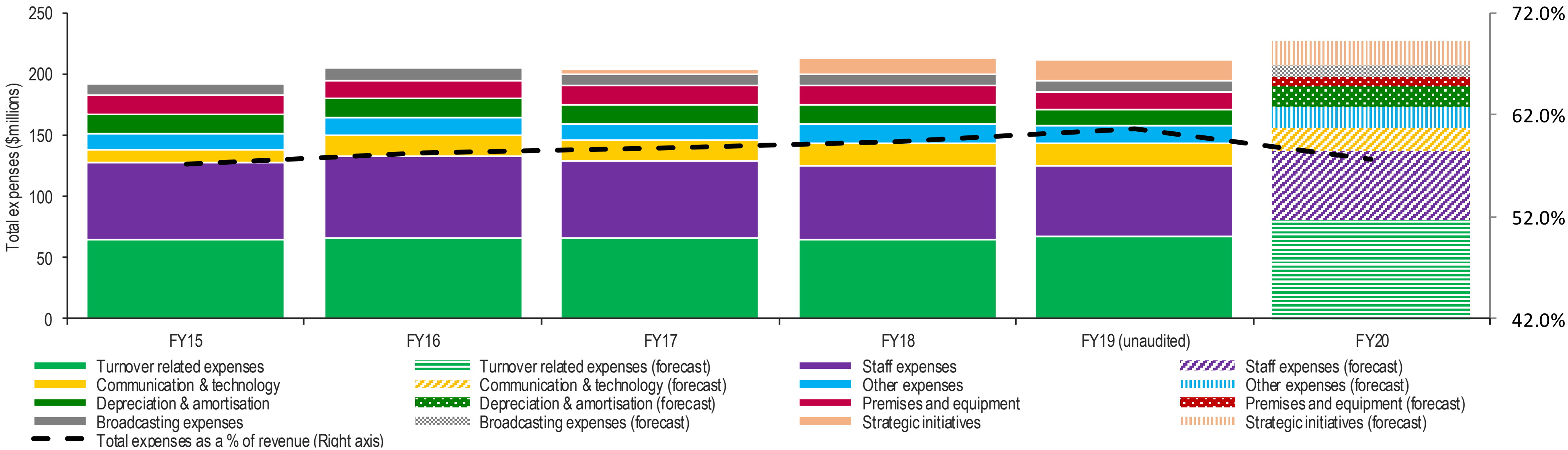


Key commentary

- We present total revenue inclusive of the benefits from strategic initiatives and one-off items in the graph above.
  - In FY15, there was a one off gain on sale on the Petone building of $4.9 million.
  - In FY16, the Christchurch building was sold resulting in a gain on sale of $2 million.
  - In FY17, there was a gain on sale of buildings of $611k.
  - Total revenue from strategic initiatives for FY18 and FY19 were $4.3 million and $12.2 million respectively.
- Total revenue for the FY16 to FY19 (unaudited) period is broadly static but is forecast to increase in FY20. The forecast change is significant given the historical trend. Accordingly, RITA is heavily reliant on the FOB platform delivering on expected benefits to deliver forecast revenue growth.
- Betting and gaming turnover in the historical period (between FY15 to FY19 - unaudited) increased at an annual compound growth rate of 2.47% and 12.78% respectively. The annual compound growth rate of net betting revenue was 0.60% and 12.01% for net gaming revenue;
- A key initiative undertaken in the review period is the Customer and Channels programme which is aimed at increasing customer numbers and the customer experience. We note that active customer numbers increased from 154k in FY15 to 230k in FY19 (unaudited).
- The FOB platform was launched in FY19 recognising the trend away from Tote products towards FOB and also to maintain competitiveness of its FOB offering compared to overseas operators.
- The benefits of the FOB platform and the ongoing Customer and Channels programme are expected to further improve revenue in the forecast period although we note the benefits realised from the implementation of the FOB platform have not flowed through in FY19 as originally anticipated by the NZRB.
- In anticipation of the passing of the offshore charges legislation, NZRB has been able to agree voluntary commercial arrangements with some overseas operators which resulted in additional revenue streams for FY18 and FY19.
- Management advised that no revenue from legislative changes are included in the forecast.

Expenses trends

Historical total expenses ($millions)

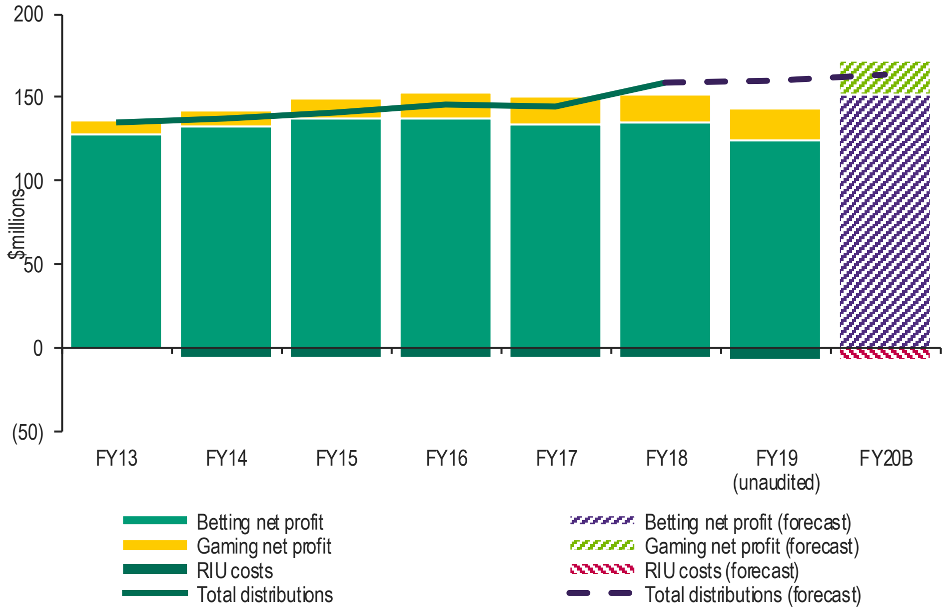


Key commentary

- We present total expenses of NZRB in the chart above. Total expenses include turnover related expenses (that are related to revenue generated) and operating expenses (that are the underlying operating costs of the NZRB). We further separated out expenses relating to strategic initiatives in each year presented.
- In FY16, NZRB changed its classification of expenses in its annual report resulting in additional expense categories presented post FY15 (which have been restated to be consistent with FY16's presentation). We understand the amendment resulted in some advertising and promotion expense and race from publications expense being recognised as turnover related expenses rather than operating expenses.
- In FY16, communications and technology expense increased by $7 million with the new IT managed service agreement with Spark under the Optimus programme.
- Excluding strategic initiatives, total operating expenses reduced from $138.8 million at its peak in FY16 to $126.5 million in FY19 (unaudited). Total operating costs (excluding strategic initiatives) in FY19 is lower than the corresponding amount in FY15.
- Staff expenses increased between FY15 to FY16 but reduced in FY17, FY18 and FY19 (unaudited). Staff expenses for FY19 (unaudited), excluding those relating to strategic initiatives are lower than the corresponding staff costs in FY15.
- Total expenses and expenses as a percentage of revenue have increased over the period under review. The trend in expenses as a percentage of revenue is forecast to reverse in FY20 but this is reliant on RITA achieving its forecast revenue growth.
- Strategic costs associated with the new initiates (such as FOB platform, the AML implementation etc) have been separated into one category.
- The FY20 forecasts incorporates the impact of NZRB's adoption of NZ International Financial Reporting Standard (IFRS) 16. The expected net impact of the adoption is a net increase in operating expenses of $0.2 million Rent expense (classified under Premises and equipment) is expected to reduce but is offset by an increase in depreciation and interest expense.

Net profit and distribution trends

Historical net profit vs distributions ($ millions)



Key commentary

- We present reported net profit and total distributions in the graph above. This incorporates the impact of one off items and strategic initiatives. For net operating profit excluding one off items and strategic initiates, please refer to the table at the start of this section.
- Profitability has improved over FY15 and FY16 as a result of changes that have been implemented previously. Profits dropped in FY17 with a slight improvement in FY18 before falling in FY19 (unaudited). Profits in FY19 (unaudited) is lower compared to those achieved in FY15. However, if the net costs associated with the strategic initiatives are excluded, profit is slightly higher than that achieved in FY15.

- Betting revenue as a percentage of total revenue has reduced slightly over the review period from 79.4% in FY15 to 78% in FY19 (unaudited). Gaming revenue has improved from 5.5% in FY15 to 8.3% in FY19 (unaudited).
- The gains in gaming revenue as a percentage of total revenue are offset by the reduction in New Zealand racing shown overseas revenue.
- While revenue has increased, margins on net betting revenue have reduced. Net betting margins (being Net betting revenue over betting turnover) have reduced from 12.9% in FY15 to 12.0% in FY19 (unaudited).
- In FY17, a new initiative was implemented in relation to Merchant fee recovery which charged a fixed transaction fee of $2.15 per transaction (with some exceptions) to cover the costs incurred by NZRB. Since its implementation, recovery in FY17, FY18 and FY19 (unaudited) of merchant fees is 94.6%, 99.7% and 92.4% respectively compared with 71.1% in FY16.
- Offshore charges income was initially expected to be earned in FY18 as a result of a change in legislation. This funding together with the strategic initiatives implemented, were the basis of the additional industry funding distribution of $12 million in each of the FY18 and FY19 financial years. However, the expected enabling legislation change was scrapped. The NZRB has been able to secure some voluntary arrangements, it has been insufficient to cover the extra $12 million of additional distribution provided to the Codes.
- We understand the current voluntary arrangements are consistent with the current proposed draft legislation for the Betting Information Usage Charge except for the inclusion of broadcast distribution of NZ Racing into Australia which is not covered in the legislation. In addition, as they are voluntary, there are also different agreement terms with different operators.
- Distributions for FY18 are significantly over total net profit achieved for the period. This is due to the additional $12 million of industry funding provided to the Codes as mentioned above. The shortfall between total distributions and net profit is even more profound in FY19 (unaudited) as a result of the decline in profitability which is consistent with the deterioration of RITA's equity position.
- Forecast profit for FY20 is expected at $165.8 million with total distributions expected at $164.1 million resulting in a surplus of $1.7 million (of which $1.7 million relates to provision for undistributed gaming surplus). Total distributions to the Codes is consistent with the level in FY19 of $151.6 million (unaudited).

Benchmarking

Benchmarking to Australia operators

	RITA (FY19 (unaudited))		**RWWA** (FY18)		**Tatts** (FY18)		**Tabcorp** (FY19)	
	NZ$m	%	AU$m	%	AU$m	%	AU$m	%
Gross revenue	348		346		2,874		5,500	
Turnover related expenses	(69)	(20)%	(153)	(44)%	(2,043)	(71)%	(3,671)	(67)%
Profit contribution	279	80%	193	56%	830	29%	1,829	33%
Staff costs	(62)	(18)%	(41)	(12)%	(169)	(6)%	(421)	(8)%
Communication & technology	(26)	(7)%	(6)	(2)%	(43)	(2)%	(126)	(2)%
Premises and equipment	(14)	(4)%		0%	(48)	(2)%	(70)	(1)%
Operating expenses	(24)	(7)%	(52)	(15)%	(323)	(11)%	(187)	(3)%
Operating profit before depreciation & amortisation	154	44%	94	27%	247	9%	1,026	19%
Depreciation and amortisation	(17)	(5)%	(13)	(4)%	(85)	(3)%	(301)	(5)%
Operating profit	137	**39%**	81	**24%**	162	**6%**	724	**13%**

Key commentary

Benchmarking the financial performance of RITA is difficult given a number of differences between RITA and other operators including:

- RITA's monopoly position in New Zealand versus the relatively competitive state of Australian racing. For example this results in the need for significant advertising and marketing spend by Australian operators;
- Government involvement/funding in the industry. For example Racefields legislation (even between states) operates in Australia;
- There has been some historical consolidation amongst Australian operators (for example Tabcorp Holdings Limited (Tabcorp) has acquired Tatts Group Limited (Tatts);
- RITA's structure versus Australian operators;
  - RITA is comparatively small to other operators aside from Racing and gambling WA (RWWA). Accordingly, scale is a significant factor to take into account when assessing RITA's performance relative to some other operators such as Tabcorp and Tatts;
  - RITA owns and operates a broadcaster with broadcasting via two Sky TV channels. RWWA for example outsources its broadcasting to Tabcorp;
  - RITA owns and operates a FOB platform while RWWA outsources its gambling platform;
  - RITA operates a gambling business, RWWA doesn't;
  - Tabcorp and Tatts operate lottery businesses;
  - RITA has a different financial year end to the some of the Australian operators making comparison between periods more difficult.

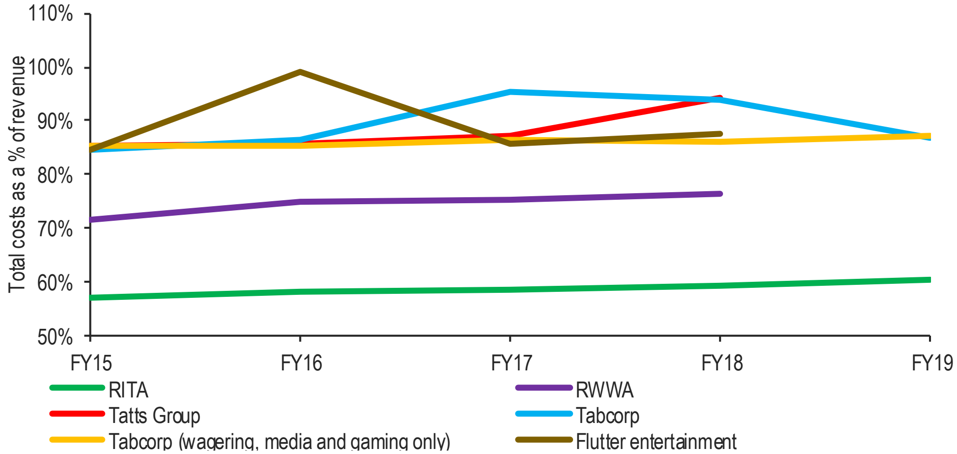
Accordingly there are large differences between the operators when we attempt to analyse relative performance at the profit contribution and operating expense level. For example RWWA's turnover related expenses include the cost of its gambling platform while the cost of operating RITA's FOB (salaries and technology spend) are included in its operating costs.

Given the issues with comparability it is difficult to assert with any certainty that RITA is more or less efficient than the Australian operators shown in the table above.

Benchmarking

Comparing total costs movement trends (each in local currency in millions)

Cost as a percentage of revenue (%)

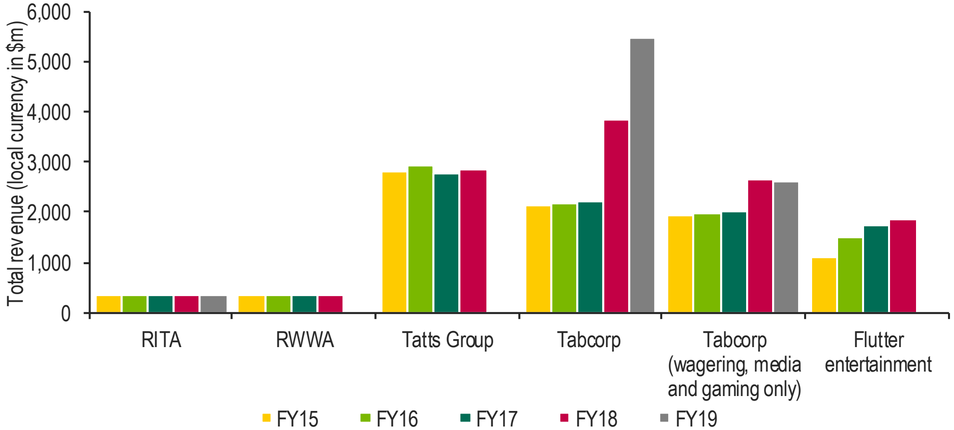


Key commentary

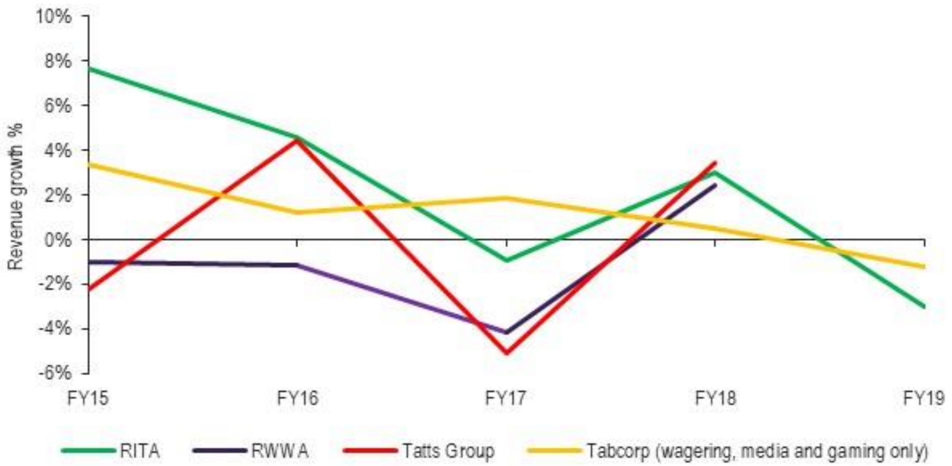
- We present a comparison of RITA's total cost (inclusive of turnover related expenses and operating expense) and total cost to revenue percentage to other identified comparable companies. We use total costs to eliminate any differences that might arise from classification differences between different entities' financial statements.
- In addition to the Australian operators noted in the previous slide, we have also added the gambling, media and gaming operations of Tabcorp and Flutter Entertainment Group (previously Paddy Power Betfair Plc) (Flutter).
- The information presented opposite is presented in local currency (in millions). We have not translated these into NZD to remove the impact of movements in exchange rates. Accordingly, the total costs graph is presented to show the year on year trends rather than an absolute comparator in expense levels.
- We note in the period presented, Tatts was acquired by Tabcorp in December 2018 resulting in the significant growth in total costs for Tabcorp but also note the reduction in Tabcorp costs as a percentage of revenue in FY19 which could indicate a level of synergy arising from the transaction.
- For Tabcorp (wagering, media and gaming) FY18 results, we have used the investors presentation issued by Tabcorp which shows a normalised FY18 position and presents FY18 as if Tatts Group was consolidated in Tabcorp for a full year (rather than a portion of the year). Accordingly, there is a significant increase in cost in FY18, but shows costs are relatively static between FY18 and FY19 as a percentage of revenue.
- We note RITA shows an increasing trend in total costs as a percentage of revenue. (from 57.1% to 60.6%).

Benchmarking

Comparing total revenue movement trends (each in local currency in millions)



Comparing revenue growth (%)



Key commentary

- We present a comparison of RITA's total revenue trends and revenue growth trends between FY15 to FY19 (unaudited).
- Due to the acquisition of Tatts Group by Tabcorp, revenue for Tabcorp in FY18 and FY19 increased significantly. Tatts Group was purchased in December 2017, accordingly, the FY18 results reflects half a year of Tatts Group results and FY19 reflects a full year of revenue impact on the Tatts Group acquisition. It is therefore difficult to determine the actual revenue trend from Tabcorp and Tatt's Group core business. However, prior to the acquisition, we see some revenue growth for Tabcorp and Flutter between FY15 to FY17 which is consistent with the trend for RITA although there was a marginal dip for RITA in FY17 which rebounded in FY18.
- For Tabcorp (wagering, media and gaming) results shown in the graph opposite, we have used the FY19 investors presented as discussed in the previous slide which include adjustments to the FY18 results as if the Tatts combination had been in place for a full year. On this basis, revenue, EBIT and EBITDA for the wagering and media business declined.

Cost Savings

As part of the review we have been asked to consider whether the TAB could save costs and/or enhance revenue. We have set out below potential cost saving opportunities together with the work the TAB is currently undertaking relevant to the identified opportunity.

1. Outsource the retail network

Outsourcing the retail network to rely solely on Agency or Hosted (pubs and clubs) venues was considered, with potential savings through a reduction of FTEs involved in the retail network. However, we note the TAB supplies all the retail equipment, provides training for all retail personnel (customer service, use of equipment, AML and problem gambling training) and the Agency payment formula shares the value of high turnover with the Agent.

The TAB has put significant effort into understanding the value received from every retail site (cost to serve, profitability to the TAB, turnover, volumes, NBR and GBR and CGAR) as well as softer factors such as geographic coverage and brand representation. Since the beginning of 2017 the TAB has closed 9% of retail venues (19% of TAB venues and 7% of hosted venues) after analysing the value of the venue and the ability to migrate customers to an adjacent venue. We note the TAB venues closed are generally those without gaming, which has increased the proportion of TAB venues also hosting gaming which has a positive correlation to profitability. The ability of the TAB to consolidate is limited to some degree by the duration of leases of some venues and the business needs to give agents a variety of venues to operate.

We are satisfied the consolidation stream of the TAB network optimisation project is appropriate and adding value to the TAB.

2. Digitise the Retail Network

Reducing personnel costs through increasing the prominence of digital gambling was also considered as a way to reduce FTE costs. A key component of this option requires the movement of punters from cash to electronic payment forms (through their account) which has cost and safety advantages through reduced cash handling as well as AML compliance advantages as the customer is known (for AML purposes) through the account sign-on process.

While the proportion of cash has been steadily falling it is still significant at approximately 47% of bets taken through the retail network. Significant work has been done to understand customer preferences and to build these into the technology of the self-service terminals. The TAB has adopted an agile product development approach to enhance their speed to the market. We note the current self-service terminals are getting to the end of their useful lives and further investment will be required to maximise the benefit of improved technology.

We are satisfied the digital stream of the TAB network optimisation project is appropriate and adding value to the TAB.

3. Increased gaming

The analysis shared with the review team shows a positive correlation between profitability and the presence of gaming machines in the gambling venues. As stated above, the TAB has increased the proportion of TAB venues offering both gaming and gambling. However, the TAB is limited by both legislation (Gambling Regulations 2004) and local council by-laws in its ability to increase gaming machine numbers, with many councils adopting a cap or sinking lid policy on gaming machine numbers.

We understand efforts are underway to change the legislative restrictions.

Cost Savings (continued)

4. Operating cost reduction

In 2017 the TAB initiated a project to improve its procurement processes and capability and to review its operating costs. The TAB identified approx. $135m of external spend, which excluding $13m of government costs (taxes etc) and a number of complex international contracts, totalled $80m, this was broken into a series of reviews as follows:

Wave	Description	Approx. Value ($m)	Projected Savings ($m)	Realised Savings ($m)
1	ICT, Business services	35		1.7
2	Business services, media, tail	30 - 40	1.2 – 1.7	

We note that Wave 2 is still in progress. From our discussions with management we are aware the spend categories which have not been included in the initiative to date are subject to external dependencies which make their inclusion in this programme problematic. We are satisfied the operating cost reduction process is effective and appropriate.

5. Process re-engineering / automation

TAB management is aware of a general low level of process maturity, process automation and continuous improvement within the organisation. While there is not a central continuous improvement or business excellence programme, there is a general acceptance of gains to be had. Our estimate of the gains to be had in process improvement and re-engineering are in the range of $3-3.5m.

While we are not aware of a general organization wide effort on process improvement, there are at least two significant moves to capture this value. At time of writing the organization has embarked on a significant change to its operating model, shifting to agile. Secondly the Finance Function has commenced a programme of work called Finance Function Transformation to ready itself for the new agile OM. This project has process improvement, reengineering and automation as explicit goals.

It is recommended the TAB continues the cost savings initiatives, such as the Finance Function project and extends this more broadly to all major business processes to realise the potential gains identified.

Cost Savings (continued)

6. Outsource broadcasting

Broadcasting is a significant expense for the TAB, The TAB broadcasts all NZ domestic racing (approx. 11,000 races pa) making TAB the largest outside broadcaster in NZ. The TAB has spent approximately $19m on its vision capture project which has included implemented a fixed control room for Greyhound racing, purchasing 4 high definition broadcasting trucks and supporting technology and equipment.

In 2016 TAB undertook a major review of its broadcasting operation to determine the most effective and efficient future state. This review included an analysis of outsourcing broadcasting to one of the two other outside broadcasters operating in NZ at the time. One of the broadcasters withdrew from the process citing an inability to be competitive with TAB current costs, the other broadcaster's pricing would have increased opex by approximately $9m pa. We note TAB has spent a significant amount on upgrading equipment and technology since this analysis was undertaken and a new international operator now has a presence in NZ.

While the outsourcing equation has changed with TAB's investment in equipment and technology, it is unlikely to be overly impactful as the outsourcer would be factoring in paying for existing equipment rather than factoring in the purchase of new equipment. We are aware TAB management continues to explore opportunities to outsource or joint venture with other parties.

7. Digital Revenue Opportunity

We are aware that the TAB's international competitors are able to offer a wide range of additional digital gambling and gaming opportunities such as virtual racing, on-line casinos, in-race betting, etc. The TAB is currently limited in its product offering by legislation, although we understand there is the potential for some of these legislative restrictions to be amended in the second round of racing reforms expected in June 2020.

We note the decision to go with the current provider and configuration of the FOB platform was specifically to allow the rapid introduction of new products and the opportunity to access internationally developed new products. We are aware the TAB has undertaken considerable work in identifying and understanding the future opportunities for enhancing digital revenues.

8. Product Fees

Product fees are a mechanism to incentivise the Codes to produce a uniformly high quality product which maximises the gambling potential of domestic racing. The current distribution model makes the introduction of product fees problematic as at least two of the three Racing Codes would need to agree to the change. We are aware the current distribution model is being reviewed and it is expected product fees will be part of this conversation.

9. Devolved Functions

NZRB has historically provided a number of services, access to premises and functions to both the racing industry and the Codes themselves. We have outlined the various functions which could be devolved from RITA to the industry in the Using resources to benefit the racing section above. NZRB has made an initial estimation that the devolution of these activities would reduce costs by approximately $900k made up through a combination of charging market rates for activities/rentals and ceasing to perform certain functions which would become industry responsibilities. Further work on the actual cost reduction from devolved activities is continuing. We note devolution of these activities would not create cost savings for the industry.

Recommendations

- RITA should continue to pursue cost savings initiatives such as the Finance Function Transformation project, and RITA should consider utilising a similar approach to other core operational functions to improve efficiency, effectiveness and realise cost savings where possible. RITA should also complete Wave 2 of the Value Initiative and consider whether those suppliers excluded from Waves 1 and 2 could be included as Wave 3 of the Value Initiative.
- RITA should, in consultation with the Codes, consider which functions could be devolved to the Codes and where opportunities exist for charging market rates for services and facilities provided. We note that while there is an estimated saving of approximately $900k to RITA there is no sector benefit as the costs would have to be met by the Codes.
- RITA should continue to work with the DIA and the Minister on the Racing Reform Bill No.2 with emphasis on reducing restrictions on digital gambling and gaming products able to be offered.

Part B Section 1: Background to the Review

Part B covers the majority of the requirements established in Schedule 2 of the Racing Act 2003.

Approach and Focus

The Racing Act 2003 requires the NZRB to arrange for an audit to be conducted in relation to how effectively and efficiently it is performing its statutory functions at least once every 5 years.

Grant Thornton performed this audit in accordance with Terms of Reference dated May 2019 and approved by the Minister for Racing, Rt. Hon. Winston Peters, and are taken from Schedule 2 of the Act. Grant Thornton was engaged to carry out this audit and provide an independent view as agreed in the Terms of Reference. Our approach for conducting this audit included:

- Reviewing relevant NZRB policies and procedures;
- Meeting with the Chief Executive Officer including the General Managers of the Racing Board Leadership Team (RBLT);
- Meeting with members of the RITA Board and representatives of the Racing Codes;
- Reviewing relevant public and internal artefacts and Board papers; and
- Considering a number of concerns or comments raised during our meetings.

Under the 2003 Act all decisions related to day to day business affairs must be made in accordance with the most recent Statement of Intent (SOI). The last formally approved NZRB SOI was for the period 2019/2021. The RITA SOI which is in draft and covers the financial year 2019/20, is expected to focus on the Ministers expectations of operationalising the Messara Report.

The Minister's Letter of Expectations establishes the following expectations for RITA for 2019/20:

- Change Leadership
- Service Delivery
- Stewardship
- Culture
- Advice on how to operationalise the Messara Report to deliver better governance and economic outcomes
- Repositioning the racing industry
- Ensure as much money as possible goes to additional prize money – not racing industry overheads
- While meaningfully addressing community concerns that could impact on the racing industry's social license to operate
- So that unnecessary government involvement in the industry can eb avoided

The Letter of Expectations also sets out the following general expectations under the themes of:

- Diversity;
- Engagement;
- Reporting;
- Core Accountability documents;
- Conflicts of interest; and
- Effective working relationships

Approach and Focus (continued)

Our review approach included the following steps:

- NZRB current operating model and business plan/strategic initiatives;
- Detailed review of NZ Market environment and NZRB organisational structure, service delivery model and operating costs over past 4 years (2016 - 2019) including the current financial year (2019), covering:
  a) Market environment - changes in Technology, Regulatory environment, Customer preferences, offshore competition;
  b) Organisational and Internal Management structures including purpose, functions and roles, service delivery model (i.e. Distribution channels) and Industry stakeholder management;
  c) Workforce Dimensions - functional capabilities, headcount by Dept; Employment Type (permanent, fixed term contract, temporary, casual) and Remuneration bands/levels;
  d) Staff Remuneration including Pay / Remuneration bands benchmarked against comparable NZ Industry pay scales;
  e) Key Drivers of Operating Expenses by Division/Dept and Category;
  f) Facilities, Equipment and Technology (Property, Equipment, IT Infrastructure & Operating Systems) deployed to meet the requirements of customers;
  g) Fixed (committed) versus Variable cost structure including long term contractual commitments (i.e. NZ Live, Spark, etc); and
  h) Progress of Cost Transformation Initiatives.
- Review and benchmark NZRB cost efficiency/effectiveness against comparable racing industry peer groups (including International benchmarks);
- Assess the efficiency (inputs/outputs) of existing services delivered to Customers (Betting & Gaming incl. Problem Gambling) and Industry participants (Racing Calendar, Racing Integrity functions, Vision Capture, On Course, etc);
- Assess whether the current operating model and services delivered to Customers including Betting/gambling, Gaming, Broadcasting, Industry, etc is appropriately structured and cost effective in achieving NZRB's objectives;
- Review projected operating costs (per SOI / Business Plan), including revenue and ongoing costs following the implementation of NZRB's key strategic initiatives; and
- Identification of (1) strengths, good practices, positive outcomes and productive improvements in performance in recent years and (2) potential alternative service delivery models and/or improvements to either NZRB's operating model or broader NZ Racing Industry model, including the Racing Codes.

Naming Conventions used in this Report

As noted on the following page the NZRB has been reconstituted as the Racing Industry Transition Agency (RITA). For the purposes of this report we will use NZRB to describe the organisation up to 30 June 2019, and RITA for periods beyond that date.

We have also used the TAB to define the commercial operations of NZRB/RITA covering both the review period and future periods.

Reliance on Information Provided

Throughout this report we have relied upon the information provided to us by RITA personnel, as well as the information published by RITA in Annual Accounts and Statements of Intent (SOI). We have used the unaudited financial results for FY19.

We have also used the draft 2019/20 SOI to understand future projections and intentions, we understand this SOI has yet to be approved by the RITA Board.

Messara Report

In April 2018 the Minister appointed senior Australian racing expert John Messara to review the New Zealand racing industry's governance structures and provide recommendations on the future direction for the industry. John Messara's report *Review of the New Zealand Racing Industry* (the Messara Report) was presented to the Minister in August 2018 and Cabinet has subsequently agreed to its overall intent.

In December 2018 the Minister for Racing announced a five-member Ministerial Advisory Committee (MAC) to operationalise the Messara Report. The MAC described the Messara Report as "The far-reaching report touches on many aspects of the industry. Its 17 recommendations, and associated sub-recommendations, deliver a comprehensive plan to reinvigorate and reform the racing industry". The MAC grouped the 17 key recommendations into 4 categories, and we have set out how each recommendation has impacted the scope of our review, as follows:

Action	Requirements	Spend ($)
The governance and structure of racing		
1	Change the governance structure, so the NZRB becomes Wagering NZ with racing responsibilities devolving to the individual Codes.	Addressed in the Racing Reform Bill No.1 with NZRB becoming the Racing Industry Transition Agency for 1 July 2019. Change is outside of our scope period.
2	Establish Racing NZ as a consultative forum for the three Codes to agree on sector-wide issues.	As at 30 June 2019 Racing NZ has yet to be established. No impact on our report beyond the activities potentially to be devolved to the Codes and/or Racing NZ.
3	Change the composition and qualifications for directors of regulatory bodies.	Not applicable to this report.
6	Initiate a special review of the structure and efficacy of the Racing Integrity Unit (RIU) and allied integrity bodies, to be conducted by an independent qualified person.	Not applicable to our report, but we note RITA has retained a function under section 9 of the Racing Act to administer the racing judicial system, the execution of this function is covered in our report.
16	Introduce robust processes to establish traceability from birth and the re-homing of the entire thoroughbred herd, as the foundation stone of the industry's ongoing animal welfare program.	Not applicable to this report.
Finance and distributions to the Codes		
5	Amend the Section 16 distribution formula of the Racing Act 2003 to a more equitable basis for fixed 10-year term.	Not applicable to this report.
10	Introduce Betting Information Use Charge and Point of Consumption tax legislation.	Not applicable to our report, we note these changes are enacted through the Racing Reform Bill No.1.
11	Repeal the existing betting levy of approximately $13 million per annum paid by the NZRB and redistribute to Codes	Not applicable to our report, we note this change is enacted through the Racing Reform Bill No.1 over a three year period.
17	Increase thoroughbred prizemoney to over $100 million per annum through a simplified payment model.	Not applicable to this report.

Messara Report (continued)

Action	Requirements	Spend ($)
Betting and the TAB		
4	Request that a Performance and Efficiency Audit of the NZRB be initiated under Section 14 of the Racing Act 2003, with particular emphasis on the operating costs of the NZRB.	Subject of this report.
7	Begin negotiations for the outsourcing of the TAB's commercial activities to an international gambling operator, to gain the significant advantages of scale.	Discussed in the NZRB Strategy – Alternative Models section of this report.
8	Seek approval for a suite of new gambling products to increase funding for the industry.	We note the Racing Reform Bill No.1 allows betting on sports not currently represented by a qualifying domestic national sporting organisation and the proposed Racing Reform Bill No.2 is expected to address other gambling products.
9	Confirm the assignment of intellectual property by the clubs to the Codes.	Not applicable to this report.
Consolidating venues and clubs		
12	Clarify legislation to vest race club property and assets to the code regulatory bodies for the benefit of the industry as a whole.	Not applicable to this report.
13	Reduce the number of thoroughbred race tracks from 48 to 28 under a scheduled program.	Not applicable to this report.
14	Upgrade the facilities and tracks of the remaining racecourses with funds generated from the sale of surplus property resulting from track closures to provide a streamlined, modern, and competitive thoroughbred racing sector capable of marketing itself globally.	Not applicable to this report.
15	Construct three synthetic all weather tracks at Cambridge, Awapuni and Riccarton with assistance from the New Zealand Government's Provincial Growth Fund. Support the development of Waikato Greenfields Project.	Not applicable to this report.

Messara Report (continued)

A number of the Messara Report recommendations have been enacted through legislation, in the Racing Reform Bill No.1. We are aware that further legislative changes are proposed in the Racing Reform Bill No.2, expected to be passed into legislation by April 2020. The Racing Reform Bill No.1 came into force on 1 July 2019. The Racing Reform Bill No.1 included the following changes of direct relevance to the NZRB:

Section	Section provision
4	New Zealand Racing Board (NZRB) renamed Racing Industry Transition Agency (RITA).
8	Objectives amended to include - to reform New Zealand racing in a manner that supports effective governance and improves industry sustainability.
9	Functions amended to include - to lead and manage the reform of the New Zealand racing industry during the transition period, including (without limitation) by: a) Implementing a fit for purpose organisational structure for the governance of the racing industry; b) Preparing for the transfer of the Agency's functions to the racing codes and its successor organisation; c) Supporting sustainability of the racing industry by undertaking initiatives to ensure efficiency and drive revenue growth; and d) Carrying out any other things necessary or desirable to promote the objective of reforming New Zealand racing.
11	Membership of Governing body amended to consist of up to 7 members appointed by the Minister, and the Minister will appoint the Chairperson.
55A (2)	The Agency may conduct sports betting on any event where there is not a qualifying domestic national sports organisation where they have entered an agreement with Sport NZ.
Part 6AA	Offshore Betting Charges a) Establishes a scheme for betting information use charges for using NZ racing or sporting information for taking bets; and b) Establishes a scheme for consumption charges for offshore betting operators to pay charges in respect of bets they take on racing or sports from persons located in NZ Department of Internal Affairs (DIA) is the designated authority for both changes (collection, enforcement & distribution) – DIA can delegate this authority to another entity. Does not impact agreements in place before legislation passed.
Part 2	Taxation (totalisator duty) repeal Betting Levy drops from 4% to 2.67% to 1.33% to 0% over 3 years.

As a key participant in the racing industry, NZRB is obviously impacted by a large number of the Messara Report recommendations and the amendments to the Racing Act, although we note the passing of the Racing Reform Bill No.1 at the end of our review period. Where we have identified an actual or potential impact on TAB operations we have identified that in the body of the report.

Objectives and Functions of NZRB

The objectives and functions of the NZRB were established in the Racing Act 2003 (the Act) are as follows:

The objectives of the NZRB under the Act (section 8) are to:

a) Promote the racing industry;

b) Facilitate and promote racing betting and sports betting; and

c) Maximise its profits for the long term benefit of New Zealand Racing.

The functions of the NZRB under the Act (section 9) are to:

a) Develop policies that are conductive to the overall economic development of the racing industry, and the economic well-being of people who, and organisations which, derive their livelihoods from racing;

b) Determine the racing calendar each year, and issue betting licenses;

c) Conduct racing betting and sports betting, make rules relating to betting;

d) Distribute funds obtained from betting to the Racing Codes;

e) Administer the racing judicial system;

f) Develop or implement programmes (or arrange for such) for the purposes of reducing problem gambling and minimising the effects of that gambling;

g) Undertake (or arrange for) research, development, and education for the benefit of New Zealand racing;

h) Use its resources for purposes that will directly or indirectly benefit New Zealand racing;

i) Keep under review all aspects of racing and to advise the Minister for Racing of those aspects; and

j) Other functions given by or under any other Act.

In carrying out its functions, the NZRB must:

a) Comply with the principles of natural justice; and

b) Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates.

The Act requires the NZRB to arrange, at least once every 5 years, for an audit in relation to its performance and efficiency. Specific requirements for the audit are set out in Schedule 2 to the Act. The previous such audit was carried out in 2014.

The Racing Reform Bill No.1

The Racing Reform Bill No.1 came into force on 1 July 2019 and amended the objectives and functions of RITA as follows:

- Adds a new objective under section 9:
  - a) to reform New Zealand racing in a manner that supports effective governance and improves industry sustainability.
- Adds a new function under section 8:
  - a) to lead and manage the reform of New Zealand racing during the transition period, including (without limitation) by –
    - i. Implementing a fit for purpose organisational structure for the governance of the racing industry;
    - ii. Preparing for the transfer of the Agency's functions to the Racing Codes and its successor organisation;
    - iii. Supporting sustainability of the racing industry by undertaking initiatives to ensure efficiency and drive revenue growth; and
    - iv. Carrying out any other things necessary or desirable to promote the objective of reforming New Zealand racing.

Part B Section 2: Governance and Management Mechanisms

Governance and Management Mechanisms

Following on from the earlier section which dealt with the strategy, the section below captures boarder governance and management frameworks of the RITA.

Balanced Independent Board : An independent review of the NZRB Board in November 2017 by Kerry McDonald noted “The NZRB Board is a good Board – amongst the better Boards in New Zealand”.

The new RITA Board appointed by the Minister from July 1, 2019 consists of Board members from a mix of backgrounds. The Board includes members with background in business, racing, law and sports. The Minister can appoint up to 7 members and the Board currently has 6 members. The current Board bring a wealth of knowledge which will be helpful for RITA as it progresses forward with its planned strategies. The RITA Board is supported by an experienced 6 member RITA management team.

The recently passed Racing Reform Bill No.1 serves as the Board's charter and the Board should structure the meetings around the act and strategy.

Management Structure: The management structure has been fairly stable with the appointment of the new CEO in 2015. The CEO of RITA is supported by 3 General Managers (Media and International, Betting and Product and Customer) and a Chief Financial Officer (CFO). The leadership team brings a range of skills including policy, finance, commercial, racing and gambling, product, foreign affairs, retail and customer.

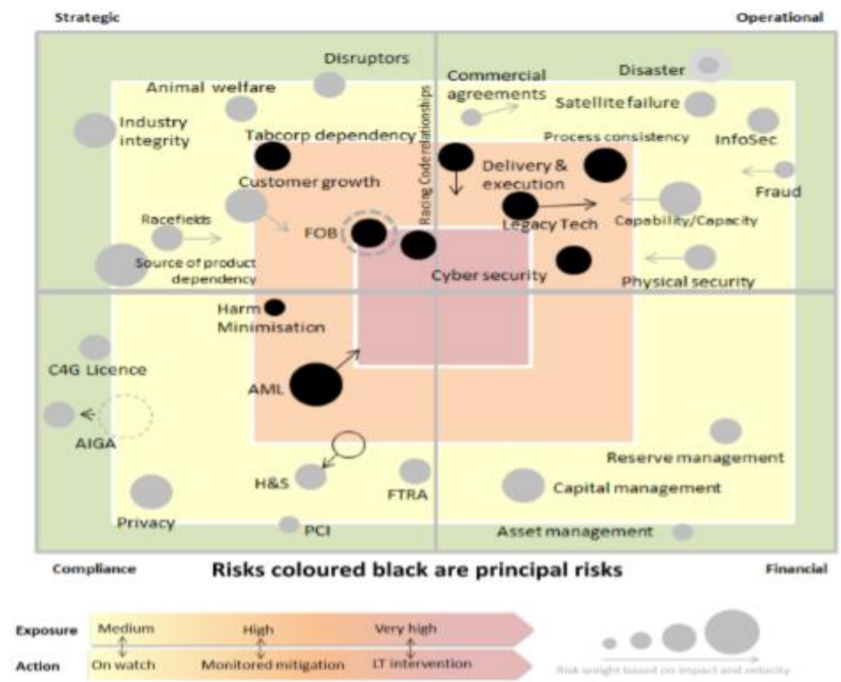
Engagement with Codes: As in the past, RITA plans to continue engagement with the Codes in an on-going basis. The formal processes of Combined Racing Industry Group (CRIG) and CEO's forum were established as a mechanism to engage with the Codes.

Delegations to CEO: The financial delegation of the Chief Executive Officer has stayed the same ($1m) over the review period.

Assignment of responsibility: We found that the responsibility for each function has been clearly defined and understood within the organisation. Roles and responsibilities have also been captured through job descriptions.

Enterprise risk framework: The enterprise risk framework has been developed and implemented. Enterprise-wide risk and assurance function has been established. During the period under review, principle risks have been monitored and discussed quarterly by the RBLT. Full reports were also provided to the Audit and Risk Committee twice a year. Changes from 2018 highlight that identified risks are under control. The biggest risks are being addressed as priority.

The risk landscape



Governance and Management Mechanisms (continued)

Policy framework

Since the last review, management has established the risk framework and implemented the policy framework. A number of key policies have also been updated since the last review in 2014 and are available to staff for reference through the RITA internet portal. Although, significant work has been completed to refresh the policies, there are still some key policies which require attention as follows:

Privacy Policy	Procurement policy
Recruitment & Selection Policy	Relocation assistance guidelines
Remuneration reward policy	Protected disclosure policy
Long service recognition policy	Leave policy
Flexible working policy	Education support policy
Harm prevention and minimisation policy	Information security policy
Bullying harassment prevention policy	Acceptable use of IT policy
Anti-money Laundering AML CFT policy	Asset management policy
Drug and alcohol policy	Disciplinary policy
Departures and exist policy	Contracts policy

Recommendation

The policies listed above should be reviewed and updated as required and presented to the RITA Board for their review and approval.

New Operating Model

Over the last three years, the NZRB has addressed a number of key issues such as ageing vision capture infrastructure, poor customer acquisition, aged technology and lack of clear understanding of the revenue drivers of the racing calendar which hampered growth of the business.

With the delivery of the FOB platform, the NZRB established a new operating model to drive growth and optimise the FOB platform, invest in product development and customer insight, maximise operational, productivity and cost efficiencies and provide opportunities to explore new gambling markets including transitioning to TAB New Zealand.

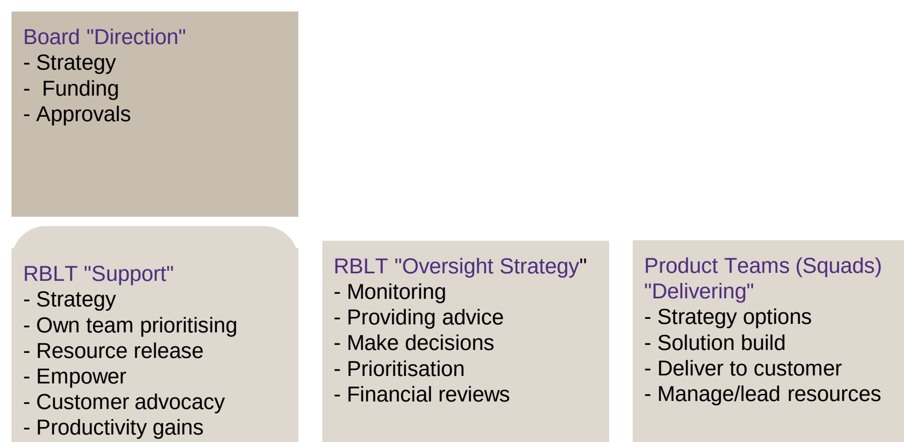
The new operating model focused on promoting a high performing team culture, establishing accountability, streamlining the business, investing in products and removing bureaucracy. The new operating model was intended to allow NZRB to become better focused on the customer and to enable the development and implementation of new products quickly and efficiently.

NZRB utilised a customised agile approach, which they had trialled and proven the approach to be effective within their organisation. We note agile is only being used where it will add value and there is a speed imperative, so many areas of the business will supply personnel and expertise to agile development teams but will not adopt an agile approach to business as usual activities.

The new operating model also streamlines the GM roles within RITA and focuses on:

- Building agile capability; and
- Interaction of Domain Steerco's, Product teams, RITA Leadership team and Board.

The relationship between the Board, RITA Leadership team, Domains and product teams are illustrated below:



People Capability

RITA employs a wide range of personnel covering specialist broadcasting, gambling, data analysis, financial and technology skills as well as a range of permanent, part time and casual retail personnel. The current head count also includes a number of contractors focused on delivery of strategic projects and programmes. The range of activities undertaken by RITA makes benchmarking of personnel numbers difficult, as it requires comparison of external organisations against parts of the RITA operation.

NZRB undertook a pay band benchmarking exercise in 2018 and developed a range of short term and longer term initiatives to ensure NZRB had the right skills and expertise available and staff costs were consistent with organisational imperatives. The short term initiatives included ensuring personnel were realigned when strategic initiatives were completed or organisational structures were changed, this included considering the outsourcing of specific services where there was a viable and cost effective external option.

The longer term initiatives were focused on how the organisation should operate as an agile organisation, the impact of devolved functions as envisaged by the Messara Report and the opportunities presented by increased automation of core processes.

NZRB selected Ernst & Young (EY) to job size roles throughout the organisation using the EY banding methodology. There are 9 broad bands which have been created by EY based on the job sizing of all job groups within NZRB.

Within each band a salary range is developed between 80—120% either side of the midpoint which is set at 50% of the market data for TFR (total fixed remuneration). Even with 120 employees moving to 85-95% PIR from October 2018, approximately 80% of employees were within the lower quartile of the banding (under 95% of the midpoint); and only 20% around market or above in 2018. An updated benchmarking review by EY in 2019 indicates that 64% of NZRB personnel where paid beneath the band midpoint. Other than base pay and KiwiSaver, certain groups will also be offered UniMed (medical insurance), and others a work vehicle if required for work purposes.

Remuneration ranges have not been created for bands 8-10 due to the diverse nature and salary ranges of the roles. This has been reviewed each year by EY, and their position was that a range could not be created for band 8 or 9 with a fair midpoint. If a new Executive team member is hired, EY would be requested to provide recent market data points for the specific role.

Over the period, NZRB has continued to manage staff numbers, which has resulted in a net decline of FTE of 133 or 17% over the period. The majority of the reductions since the peak in 2016 have been across the largest divisions being Customers and Channels, Media and Content and Services.

	2015	2016	2017	2018	2019
Headcount	908	965	910	863	747
FTE	763	806	768	734	630

Whilst a new Learning & Development (L&D) strategy has not been developed, the organisation is starting to focus on driving culture and leadership moving forwards.

There are five new L&D initiatives currently being implemented (mainly through the internal HR Advisory team), which build leadership and management capability and will support the agile rollout included in the short-term people plan:

- TMP (Team Management Profiles);
- Conflict Resolution;
- Realign/Review Purpose session;
- Management 101 (for people leaders new to management or need refresher. Currently focussed on Retail Frontline leaders); and
- Agile.

The business is currently developing an agile methodology with an external provider to create an agile methodology tailored to NZRB. Implementation will focus firstly on Technology, Product and Customer teams.

There is also a limited amount of external study funded, and professional development and technical training undertaken which is managed and budgeted within each business unit.

Part B Section 3: Specific Statutory Functions

Specific Statutory Functions

Sub- Section Header	Statutory Function – Section 9 Racing Act 2003
Industry Development	a) Develop policies that are conductive to the overall economic development of the racing industry, and the economic well-being of people who, and organisations which, derive their livelihoods from racing.
Racing Calendar	b) Determine the racing calendar each year, and issue betting licenses.
Conduct sports and race betting	c) Conduct racing betting and sports betting, make rules relating to betting.
Distribute funds to the Codes	d) Distribute funds obtained from betting to the Codes.
Administer the racing judicial system	e) Administer the racing judicial system.
Problem gambling and harm minimisation	f) Develop or implement, or arrange for, programmes to reduce, and minimise the effects of, problem gambling
Research, development and education	g) Undertake (or arrange for) research, development, and education for the benefit of New Zealand racing.
Using resources to benefit racing	h) Use its resources for purposes that will directly or indirectly benefit New Zealand racing.
Advising the Minister/other functions	i) Keep under review all aspects of racing and to advise the Minister for Racing of those aspects. j) Other functions given by or under any other Act.
Social responsibility and natural justice	In carrying out its functions, the NZRB must: • Comply with the principles of natural justice; and • Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates

Industry development

Statutory function (a) "Develop policies that are conducive to the overall economic development of the racing industry, and the economic wellbeing of people who, and organisations which, derive their livelihoods from racing".

In the NZRB's 2015 Annual Report the Chief Executive stated "One of the clearest messages I took from my initial few months was that this is an industry under significant pressure; people are struggling and NZRB's performance both as a funder and as an advocate is pivotal to the industry's ongoing future."

NZRB has a dual role in the industry as both the primary funder through its gambling and gaming activities as well as a number of industry roles such as administrating the racing calendar process. NZRB has always been faced with a tension between the funding needs of the Codes and the capital needs of their business. During the period under review significant capital investment has been needed across core systems, vision capture and the retail network. The drivers for this investment were both historic under-investment by NZRB as well as unprecedented growth in the size and reach of international competitors and digital gambling.

While the level of investment allowed NZRB to implement their strategy to increase their competitiveness and drive revenue growth, funding for the Codes has been static through the period.

Item	2015	2016	2017	2018	2019 Unaudited
Distributions to the Codes ($m)	134.2	136.7	136.2	150.8	151.6
Less: additional funding to the Codes ($m)	-	-	-	14.6	14.6
Underlying Code distribution ($M)	134.2	136.7	136.2	136.2	137.0

The Department of Internal Affairs in their 2019 Regulatory Impact Assessment (RIA) stated "The racing industry is in a state of decline. In April 2018 the Minister for Racing advised Cabinet of his concerns regarding the racing industry. An industry expert, John Messara, was commissioned to assess the racing industry and his report discusses many of the reasons for its decline. Some of these are due to competitive inroads into the betting industry from offshore. Some are about the governance structure needing to change to better focus the industry on its commercial activities. Other are due to the large number of racing venues and the challenge of upgrading facilities."

The causes of the identified issues predate our review period. The issues are well known to industry participants and while there are differing views on both the causes and solutions to these issues, there is acknowledgement that they are industry issues requiring whole of industry solutions.

The RIA goes on to state "The Department of Internal Affairs considers that the magnitude of the changes sought in the reforms exceeds the current mandate of the NZRB."

In the MAC Interim Report, the MAC states "Collectively, the potential outcomes from each of the recommendations will deliver more revenue to increase prizemoney levels; better governance across all industry organisations; a renewed focus on integrity and animal welfare; a more efficient network of racing venues that cater for national, regional and community racing; and investment in our ageing infrastructure and investments in our thoroughbred tracks (both turf and synthetic), to provide top-class racing, training and trialling surfaces year round."

The Messara Report recommended the NZRB's commercial and racing regulatory functions be split allowing NZRB to sharpen its focus to gambling on racing and sports. The industry regulatory functions were to be devolved to the Codes through Racing NZ. The Racing Reform Bill No.2 is expected to provide for substantive changes to the structure of NZRB, to establish TAB NZ to focus on the commercial activities of NZRB and to devolve racing functions to the three Codes and Racing NZ.

Race Calendar

Statutory function (b): to determine the racing calendar each year, and issue betting licenses under Part 5.

The NZRB Dates Committee was established in accordance with Section 42 of the Act, which requires the committee to be established and maintained in order to determine, in consultation with the Codes:

- All the dates in the forthcoming racing year on which domestic betting races will occur;
- The allocation of those dates among the racing clubs; and
- Any conditions of allocation.

NZRB works with the Codes to develop the draft calendar and then test the proposal against Code feedback, broadcasting and on-course totalisator logistics needs. The Dates Committee aims to confirm the calendar by 30 April for the season beginning the following 1 August.

In 2017 the NZRB implemented a strategic initiative to Optimise the Calendar. The intention of this initiative was to maximise revenue, optimise the cost of its service delivery and improve the quality and competitiveness of racing, while not impacting the number of race meetings by Code. NZRB estimated that an additional $3m in economic value (changes to NZRB and club costs and revenues) could be realised through this initiative, compared to rolling over the standard calendar from the previous season.

Optimise the Calendar increased betting turnover by approx. $2.6m and added an additional $790k to profit contribution. There are no figures available for the impact on Club costs.

In 2019 betting was offered on approximately 99,000 races, an increase of approximately 19,000 on the previous year. Domestic racing accounted for approximately 11,000 races with additional Australian races and races from around the world thanks to new gambling agreements signed with countries such as America, Japan, South Africa, Europe and Korea. Racing from other countries allows NZRB to “fill the race clock” for domestic punters and maximise revenues.

Item	2015	2016	2017	2018	2019 Unaudited
Thoroughbred Races	2,848	2,790	2,564	2,568	2,582
Harness Races	2,654	2,595	2,492	2,483	2,469
Greyhound Races	5,553	5,573	5,624	5,903	5,907
Total Domestic Racing	10,855	10,958	10,680	10,954	10,958
Imported Racing	65,612	67,165	69,083	73,169	88,340
Exported Racing	10,133	10,612	10,300	10,515	10,582

From our interactions with the Codes it is apparent that, while all the Codes agree with the principle of maximising NZRB revenue for the good of the racing industry, they are all acutely aware of the potential impact on their Codes of what they view as higher value race dates/times.

In the Messara Report it was recommended that Racing NZ be established as a consultative forum for the Codes. One of the duties proposed for Racing NZ was development of the racing calendar in conjunction with TAB NZ. The MAC established the Industry Governance Project Group to consider industry governance including where responsibility for the racing calendar should sit.

Conduct sports and race betting

Statutory function (c): "to conduct racing betting and sports betting, and make rules relating to betting, under Part 6"

RITA has a statutory monopoly for conducting sports and race betting in New Zealand, although we note the ability of offshore competitors to take bets from New Zealand customers on their digital platforms. Product payments from gambling on sports events are paid to National Sports Organisations (NSOs) under a formula previously set in statute. The Racing Reform Bill No.1 (2019) extended RITA's ability to wager on sports events where there is not a domestic qualifying NSO, and we understand the payment formula for sports may be subject to change based on discussions between the NZRB and Sports NZ.

Once the product payment has been made to the relevant NSO, the remaining revenue forms part of the overall NZRB profit which is then distributed to the Racing Codes based on the prevailing distribution formula. Sports are an important contributor to NZRB profits and distributions to the Racing Codes:

($m)	2015	2016	2017	2018	2019 Unaudited
Total Sports gross betting revenue	$40.0m	$48.1m	$51.9m	$64.2m	$58.3m

As noted above, we understand a new product payment formula was discussed between the NZRB and Sports NZ, but has yet to be finalised.

RITA has three core products, totalisator race betting, fixed odds race betting and fixed odds sports betting. As discussed above, totalisator betting has the highest margin for the NZRB and is the traditional form of race betting in New Zealand but has been declining in popularity and turnover. In contrast, fixed odds betting is experiencing growth, particularly sports fixed odds betting. This is both a reflection of international trends and support for the investment in the FOB platform. However, we note that the nature of fixed odds betting means there is greater margin volatility and RITA could lose money on a particular sports event where unfavourable results occur.

The provision by the TAB of the three core products requires a considerable distribution and broadcasting infrastructure as set out in the following table.

Conduct sports and race betting (continued)

Distribution Infrastructure

Channel	Description
Branches	Premises leased or owned by NZRB. NZRB pays for the fit out and employs and pays staff. Contains staff- operated and/or self- service kiosks. RITA currently has 26 Branches, 18 of which have gaming.
Agencies	RITA may provide the venue but agents pay for items such as power, phone and staff. RITA also provides marketing and brand support. RITA currently has 37 Agency Venues, 25 of which have gaming.
Pubs and Clubs	RITA provides the TAB facilities for pubs and clubs. These may contain either staff operated or self-service kiosks.
Internet	Publishes odds and takes bets off website and interfaces real-time with FOB platform or Jetbet. Accessible through the TAB website and the mobile app.
Touchtone	Customers connect to Jetbet directly through their telephones.
Phone Betting	Betting through call centers in Petone and Christchurch, becoming less popular as digital platforms grow. Mobile app utilises the internet as described above.
On-course Betting	Self service terminals are utilised at the clubs. The terminals, support equipment and connectivity are provided by the TAB. Cost of servicing on-course gambling is recovered from the clubs by the TAB under the Venue Services Model. On-course staff are employed by the clubs.

Conduct sports and race betting (continued)

The launch of the FOB platform has allowed RITA to release a number of new products into the market. Sport activity has also increased significantly since the implementation of the FOB platform which provides customers a large number of options to wager on. The number of sports events on offer in this 2019/20 calendar year has also increased significantly compared to the last year.

Strategies and Plans

A number of programmes have been put in place over the past 3 year period to ensure these strategies would be delivered. These programmes of work have covered the market facing (the TAB) components of the business:

a) Customers - continuing to grow the business by increasing visibility in the New Zealand market, attracting new customers while retaining existing customers;

b) Products - ensuring the quality and availability of both racing and sports products offered to meet the needs of their customers; and

c) Technology platforms - fit-for-purpose systems and infrastructure that underpin the betting business.

The FOB platform was implemented to give RITA customers a world class betting experience. Along with the new betting platform a new website and mobile application have been delivered. This significantly increases the number of betting opportunities RITA can offer while leveraging the scale, capability and experience of their strategic partners, Open Bet and Paddy Power Betfair.

Retail Network Optimisation

The retail network remains an important betting channel for the TAB. The service they provide is a key point of difference to offshore competitors and according to Colmar Brunton builds trust with customers (source: Annual Report 2015). However, the TAB faces both shifting customer preferences to on-line and digital channels, as well as a solid core of customers who prefer gambling in the physical venues.

This has been partially addressed by the TAB through the introduction of the FOB platform, the mobile app, digital forms and self service terminals.

Alongside this the TAB has invested in modernising retail venues by refurbishing them with new design elements including an improved look and feel, dedicated betting zones, improved in-store viewing and new self-service zones. The top 100 venues have also been provided with high-grade, ultra-fast broadband and WiFi.

Even with these changes, the TAB continues to monitor and evaluate all venues as some of the TAB venues (branch, agency and pubs/clubs) still have low profitability.

The TAB has been actively optimising its retail network during the period under review. From FY17 to FY19 the total number of venues reduced from 643 to 577 with further consolidation planned.

There are many factors that influence the need to consolidate TAB venues other than just the level of profitability. These include, where applicable, the length of leases, space constraints, overhead costs, the costs to serve the different types of venues, people capability, growth opportunities, financial viability of agents, alternative TAB venues nearby, the potential impact on account activity in the catchment, and the need to maintain brand representation.

All venues are regularly assessed against a set of criteria that looks first at a pure cost efficiency perspective and then takes into consideration a number of operating factors to ensure a thorough assessment is made.

These assessments will overtime affect the balance between branch and agency venues in a drive to right size the retail network and to respond to changing customer needs.

Distribute funds to the Codes

Statutory function (d) to distribute funds obtained from betting to the Racing Codes in accordance with sections 16 and 17.

Section 16 requires the TAB to determine the amount to be made available for distribution, and to then distribute through either:

a) To the Racing Codes in accordance with the proportions that each of those Racing Codes has contributed to domestic turnover (the default distribution model); or

b) To the Racing Codes in accordance with an alternative distribution model, provided that the alternative distribution model is agreed in writing by the majority of Racing Codes (an alternative distribution model).

We note the default distribution model has never been utilised. Distribution over the period have been based on a distribution formula agreed by the majority of the Codes, as follows:

Agency	2015	2016	2017	2018	2019 Unaudited
Thoroughbred Racing NZ	54.0%	54.3%	54.3%	53.7%	53.7%
Harness Racing NZ	29.5%	29.5%	29.5%	29.6%	29.6%
Greyhound Racing NZ	16.5%	16.2%	16.2%	16.7%	16.7%
Total	**100%**	**100%**	**100%**	**100%**	100%
Thoroughbred Racing NZ	$73.1m	$73.9m	$74.0m	$79.6m	80.0
Harness Racing NZ	$39.9m	$40.3m	$40.3m	$43.8m	44.1
Greyhound Racing NZ	$21.2m	$22.5m	$22.0m	$24.8m	24.8
Total	**$134.2m**	**$136.7m**	**$136.2m**	**$148.2m**	**$148.9m**

The 2018 and unaudited 2019 distributions include additional funding of $12m pa, this funding was initially extended in anticipation of legislation enacting Betting Information User Charges being passed into law, therefore creating an additional revenue stream for the industry. The anticipated additional revenue from the legislative change gave the TAB the confidence to distribute beyond forecast profits. As noted above, the anticipated revenue did not eventuate in either 2018 or 2019 and the relevant legislation (see below for details) was passed into legislation in the Racing Reform Bill No.1 as at 1 July 2019.

The funding beyond profits earned, together with the significant investments, have placed the RITA balance sheet under significant pressure with increased debt and decreased equity. The Minister of Racing has specifically tasked the RITA Board with avoiding any further deterioration of the RITA balance sheet.

As noted above, in April 2018 the Minister for Racing commissioned the Australian Racing expert John Messara to review the NZ racing industry, an element of this review looked at how NZRB distributes funds to the three Codes. The Messara Report proposed the following changes to the funding distribution model:

- Amend Section 16 of Act to provide that NZRB (gambling NZ) profits are distributed to Codes on the following basis:
  - a) Provided the NZRB (Wagering NZ) surplus is sufficient, each Code to receive the same amount in any year that it received in the previous year (where the surplus is less than the previous year, the Codes will receive a proportionate amount based on their previous year's receipts); and
  - b) Additional amounts are to be calculated as follows:
    - 25% on Gross Betting Revenue on Code domestic racing
    - 25% on Gross Betting Revenue on Code overseas racing
    - 50% on each Code's contribution to NZ economy.
- Provide for the new scheme to be fixed for a period of 10 years unless changes are agreed unanimously between the Codes and approved by the Minister.

The Ministerial Advisory Committee, and the RITA Board, have commissioned an independent review of the distribution model.

Distribute funds to the Codes (continued)

The Racing Reform Bill No.1 (2019) enacted three new revenue streams for the NZ racing industry: the Betting Information User Charge (a charge on offshore betting operators taking bets on NZ sports and racing), the Point of Consumption charge (a charge on offshore betting operators taking bets from NZ domiciled punters) and the repeal of the Betting Levy (a 4% levy on all bets made in NZ) over a 3 year period. How these additional revenue streams are to be collected and distributed is still to be determined.

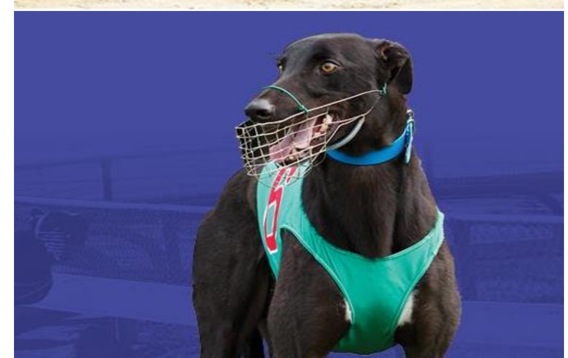
While the Codes agree the need to maximise the TAB betting profits and acknowledge their interdependence in maximising profitability, there is less agreement on how the funds should be distributed. This is driven, in part, from the very different operating models utilised by the equine and canine Codes, historic compromises around race dates and times and the relative growth or decline in popularity domestically and internationally of the different Codes.

It should be noted that all of the Codes are dependent upon the TAB funding as their primary source of funding, which magnifies the impact of any change to the current funding model.

During the period under review, NZRB enacted a Capital Management Strategy which is intended to allow the NZRB to retain sufficient profit to enable the capital investments needed to achieve their strategy. Management are acutely aware of the necessary trade off between long term investments and funding the Codes.

NZRB also distributes gaming profits to the racing industry and sporting organisations as part of the authorised purpose established with their Class 4 Gaming License.

	2015	2016	2017	2018	2019 Unaudited
Distribution to racing authorised purposes	10.6m	11.7m	12.3m	12.8m	5.0m
Distribution to sports authorised purposes	2.8m	3.1m	3.2m	3.4m	4.1m
# of grants made to community sporting groups	253	365	434	543	560



Administer the racing judicial system

Statutory function (e): to administer the racing judicial system in accordance with sections 36 to 41.

There are three components to the racing judicial system:

- Judicial Control Authority (established under the Racing Act 1971) – the JCA is an independent statutory authority that provides one and two-person committees (from a panel for each Code) at every race meeting to decide on complaints under the respective Rules of Racing as well as a non-race day decisions process and an appeals tribunal.
- Racing Integrity Unit – The RIU commenced operations on 1 February 2011 bringing together the Stipendiary Steward and Racecourse Investigator functions for each NZ Racing Code and is responsible for investigating and prosecuting breaches of the Rules of Racing. The RIU carries out race day monitoring and investigations and collects samples for independent laboratory testing for banned substances. The Stipendiary Steward, at each race meeting, observes race day activities to identify and investigate potential breaches of the respective Code's Rules of Racing. The RIU also takes a leading role in animal welfare initiatives and in sexual harassment and bullying initiatives. The RIU also undertakes analysis of betting data that may highlight any unusual betting activity on particular events.
- Racing Laboratory Services - Racing Laboratory Services is a privately-owned company that has an agreement through the NZRB to provide drug testing services to the New Zealand Racing Industry. The contract with the NZRB makes up over 90% of the Racing Laboratory's income. The Racing Laboratory undertakes the testing of over 8,000 race day samples and over 1,200 out of competition samples. The Racing Laboratories have established the capability to undertake the testing of equine and canine hair samples for anabolic steroids.

NZRB fund the racing judicial system through gaming revenue, as an authorised purpose of NZRB's Class 4 Gaming Licence. NZRB reviews and approves the budgets of the JCA and RIU, which is done in collaboration with the Codes.

Distributions from gaming revenue are approved by the NZRB's Net Proceeds Committee (comprised of Board members who are not Code representatives) under a policy that ensures that the grants are consistent with the purpose specified in NZRB's Class 4 Gaming licence.

The funding provided by NZRB is as follows:

Agency	2015	2016	2017	2018	2019 Unaudited
JCA ($m)	1.2	1.3	1.3	1.4	1.4
RIU ($m)	5.8	5.6	6.0	6.3	6.7
Laboratory ($M)	1.5	1.8	1.8	1.9	1.9

We note administering the racing judicial system is one of the non-gambling functions carried out by NZRB which the Messara Report recommended be devolved to the Codes.

Problem gambling and harm minimisation

Statutory function (f): "to develop or implement, or arrange for the development or implementation of, programmes for the purposes of reducing problem gambling and minimising the effects of that gambling."

As required under the Gambling (Problem Gambling Levy) Regulations 2019, NZRB funds the Problem Gambling Levy, which is NZRB's contribution to the Ministry of Health's programme aimed at minimising the harm from problem gambling that does occur. For the period 1 July 2019 through 30 June 2022, a levy of 0.52% is charged on racing and sports betting.

NZRB offers self-exclusion and betting limit programmes to support customers who may wish to restrict their betting activity and provide information online and in-store for customers on where they can seek problem gambling help.

NZRB has a dedicated Responsible Gambling Team of three staff, who oversee its Harm Prevention and Minimisation processes.

NZRB invests each year in the provision of training in harm minimisation and prevention procedures for staff in customer-contact roles within NZRB and the wider racing industry to ensure leadership continues to be taken in this area. NZRB goes beyond the requirements of the Act by requiring all staff (i.e. not just supervisors of gaming and gambling per the Act) who oversee TAB gambling or Class 4 gaming directly to undertake training in harm minimisation. This applies to 2,700 staff who oversee gambling conducted on behalf of NZRB via two online training modules (one developed by the NZRB and specific to the TAB, and one for Class 4 gaming developed in conjunction with the Health Promotion Agency and the Department of Internal Affairs).

NZRB uses software to proactively monitor accounts, looking for transactions that indicate unusual betting behaviour. Where such monitoring identifies customers as potentially experiencing issues with their gambling, the account can be then be actively monitored or the Responsible Gambling Team alerted for immediate intervention.

The NZRB also provides tools to customers to minimise harm such as Account Exclusion (self exclusion or blocking) and Set Your Limits Programme.

Type	2015	2016	2017	2018	2019 Unaudited
Problem Gambling Levy	$2.3m	$2.5m	$2.2m	$2.3m	$2.7m
Provision of training in harm minimisation	118,500	118,500	118,500	118,500	29,000
Account Exclusion notices issued	441	474	534	636	545
On-account customers placed on Set Your Limits	37	30	27	31	-

The provision for training in harm minimisation has fallen as the training has moved from an external provider to the use of an online training module.

The On-account customers placed on Set Your Limits" – for the 2015, 2016, 2017 and 2018 years reflect customers that were placed on NZRB's 'Set Your Limits Programme'. This now superseded system required customers to complete some forms, provide information about limits they want in place, and was administered manually by the Responsible Gambling Coordinator.

When the FOB platform was launched - customers gained the ability to set their own limits via the account dashboard (i.e. it became no longer necessary for a person to process setting a limit through our Responsible Gambling Coordinator). These customer set limits are different in nature to the historic set your limits programme, as customers can increase/remove their own limits (subject to a stand down period that is automatically triggered).

Research, development and education

Statutory function (g): “arrange for the undertaking of, research, development and education for the benefit of New Zealand racing”.

In January 2017, NZRB introduced the $4.77 million Industry Enhancement Funds towards supporting stakes, infrastructure and youth development. Utilising gaming proceeds for racing authorised purposes, this funding, available from the second half of 2016/17 through to 2018/19, directly addresses three key areas of concern within the industry:

- Stakes enhancement fund - tactically boosting stakes to attract higher quality racing, improving the overall race experience for industry people and punters alike;
- Infrastructure enhancement fund - investing in the key infrastructure we need to advance our industry; and
- Youth enhancement fund - helping build the next generation of racing by encouraging and incentivising the development of career paths into and through the industry.

The investment has been described as providing critical benefit to grassroots racing throughout New Zealand, to clubs and participants of all three Racing Codes.

NZRB also provides an annual contribution to the Equine Health Association, and is represented on the boards of both Equine Health Association and the Equine Research Foundation Board.

Using resources to benefit racing

Statutory function (h): “to use its resources, including financial, technical, physical, and human resources, for purposes that, in the opinion of the Board, will directly or indirectly benefit New Zealand racing”.

RITA primarily uses it resources to manage and grow betting profits which allows them to fund the industry. We have outlined previously many of the initiatives undertaken by NZRB during the period to modernise their operations and improve profitability. The table below outlines the functions and services currently provided by RITA to the industry, some or all of which could be devolved to the industry in line with the Messara Report recommendation:

Type	2015
Code management of Industry and PR issues	Currently management provided through NZRB Public Affairs team. Codes/Racing NZ to be responsible for PR on animal welfare, race and race participant promotion, venue incidents, compliance and licence holder issues and communication of industry initiatives.
Equine Health Association & Equine Research Foundation	NZRB currently contributes $50k in funding to Equine Health Association, but nothing to Equine Research Foundation. NZRB is represented on the Boards of Equine Health Association and Equine Research Foundation.
Industry Training and Development	Under a Memorandum of Understanding NZRB has agreed to fund $180k to the three codes for industry training and development. Primary ITO cash contribution for all 3 Codes. Funding for development of industry careers pathways (contestable fund). GRNZ education programme funding.
Club Finances – Accounting support, reporting and managing distributions to clubs	**Operational accounting services -** Daily race settlements reporting & analysis, management of Code funding distributions (to clubs) and reporting. **Advisory services -** Technical review and reporting financial statements, technical accounting advice, tax advice, audit advice. **Racing Integrity Unit Accounting Support -** End to end financial & accounting support to RIU, use of TechOne financial system by RIU.
Administration Functions/Support	**IT Support** - IT support for internet, IT security and IT support services to GRNZ, HRNZ and RIU. **Payroll Support -** Payroll support to GRNZ and RIU. Payroll and HR support to TRLP.
Property Rental & related services	**NZTR -** Sublease of office space in NZRB Petone Building & 7 car parks **GRNZ - S**ublease of office space in NZRB Petone Building & 3 car parks **RIU -** Office accommodation in Christchurch, storage & fridge space in Hamilton **The Races -** Lease of warehouse in Lower Hutt, office space in NZRB Petone Building
Racing Calendar	Managing the development of the annual Racing Calendar in conjunction with the Codes
Animal Welfare	Supporting animal welfare through the Animal Welfare Fund by NZRB Public Affairs team, $50k contestable fund
Racing Club Class 4 Audit	Reviewing the Clubs Class 4 Gaming grants funding from other gaming societies. Independent review of C4 gaming reports NZRB review of C4 gaming reports
Property Related shared Services	Reception, visitor management, courier and post management and building faults management

Using resources to benefit racing (continued)

NZRB has also invested in a number of initiatives to improve and develop the racing industry:

- Optimise the Calendar - worked with the wider industry to introduce a new set of principles and guidelines for the allocation of dates in the 2017/18 season, which resulted in setting a race schedule and calendar that maximises both customer engagement and opportunities to lift revenue. This approach has resulted in no material change to the number of meetings or races by Code, however NZRB estimates $3 million in economic value will be added to the industry;
- Stakes enhancement fund as part of the Industry Enhancement Fund - tactically boosting stakes to attract higher quality racing, improving the overall race experience for industry people and punters. The Industry Enhancement Fund also includes infrastructure improvements and youth development; and
- Future Venue Plan - looking at the optimum number of venues required to conduct race meetings in the medium/long term.

Advising the Minister / other functions

Statutory function (i): “to keep under review all aspects of racing and to advise the Minister of those aspects, either on its own initiative or at the request of the Minister.”

NZRB has transitioned to working with the new Minister (post-2017) including providing input to the Minister regarding the revised Racing Act; the revised Act is now law.

NZRB is has worked with Government to address the impact of offshore bookmakers on the New Zealand racing industry and enable NZRB to be more competitive.

From 1 July 2019 NZRB was reconstituted as the Racing Industry Transition Agency, as the Racing Reform Bill No.1 (2019) comes into force. This is a precursor to a second Bill to be introduced in 2019 by the Minister, resulting from the Messara report. NZRB has provided submissions to the Act, and to the upcoming Bill.

Statutory function (j): “Any other functions that it is given by or under this Act or any other Act.”

NZRB is required to be compliant with the Anti Money Laundering/Counter-Financing of Terrorism Act from 1 August 2019. A project team was established in September 2017, which is undertaking a programme of work to ensure NZRB is able to meet the statutory deadline. This includes working with the Department of Internal Affairs as the AML/CFT regulator for NZRB.

Social responsibility and natural justice

The Act states that in carrying out its functions, the NZRB must also:

- Comply with the principles of natural justice; and
- Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates.

Nothing has come to our attention during this review to indicate NZRB is not meeting these obligations.

Natural justice

According to the State Services Commission, the principles of Natural Justice are:

- Freedom from bias on the part of the person making a decision/judgment; and
- Transparency and fairness of procedure.

NZRB demonstrates compliance with this principle by:

- Separating the investigation and decision-making functions of its integrity and judicial system;
- The Board and CEO have open relationships with The Codes, and significant matters are discussed/consulted with Codes and industry as required;
- As defined in the Act, the distribution of surpluses requires agreement from at least two Codes; and
- NZRB funding and providing support to the industry integrity units (RIU, JCA and Laboratories).

Social Responsibility

Diversity

In June 2018 the CRIG identified the need and opportunity of having increased focus on diversity and inclusion matters and committed to developing effective guidelines, programmes and initiatives to encourage responsible behaviour and appropriate conduct across the industry, while also encouraging a clear process for managing allegations of inappropriate behaviour, including activity on social media.

In June 2018 NZRB issued their diversity and inclusion statement, which was subsequently published in the NZRB 2019-2021 SOI:

NZRB is committed to becoming a more diverse and inclusive organisation. We welcome diversity in all forms, and want all of our people to know they are respected and valued, whatever their background, identifiers, beliefs or affiliations. People are at the heart of our success. By embracing and incorporating the vast ranges of experience and perspectives our people bring to NZRB, we are able to broaden our understanding, make better decisions, and deliver an improved experience for our customers. Not only is it great for the hearts and minds of our people, it's great for our customers.

We know that diversity and inclusion doesn't just happen, which is why we have embedded these principles in our organisational values which underpin the way we work and how we treat each other. We are building our strategy and our first focuses are on resolving gender-based pay inequalities, and improving representation of women and ethnicities in leadership. We may be at the beginning our diversity and inclusion journey, but we are excited to see where it can take us.

Social responsibility and natural justice (continued)

NZRB support their social responsibility approach with a robust set of policies:

- Bullying Harassment Prevention Policy;
- Code of Conduct;
- Disciplinary Policy;
- Flexible Working Policy;
- Harm Prevention and Minimisation Policy; and
- Protected Disclosures Policy.

NZRB continues to invest in industry initiatives such as Youth Recruitment and Retention, which is an Authorised Purpose of its Class 4 Gaming License.

NZRB has developed and delivers staff training on harm minimisation for staff at all sites. NZRB has also developed Retail Exclusion Programmes, Transaction Monitoring and a range of customer accessible Harm Minimisation Tools. The harm minimisation tools have been developed for the recently launch FOB platform.

NZRB has an established suite of procedures in place to help identify harmful gambling and work with its customers to minimise the harm of problem gambling.

NZRB currently supports animal welfare initiatives through an Animal welfare Fund administered through the Public Affairs team. $50,000 of contestable funding per year is available to the Codes. The objective of the fund is to improve the quality of animal welfare programmes within the racing industry.

NZRB returns funds to the community through two funding streams, one to racing authorised purposes and one to sports authorised purposes (across multiple grants to community sporting groups).

Part B Section 4: Terms of Reference

Terms of Reference

NEW ZEALAND RACING BOARD

Terms of Reference for the S.14 Performance and Efficiency Audit

Background

The Ministerial Advisory Committee (MAC) has been appointed by the Minister for Racing to set a sense of direction for the intended racing reforms, with particular focus on prioritising those recommendations that have been identified as the main drivers required for successful industry reform.

The Committee is also charged with scoping up the operational decision points (whether technical, legal, financial or process orientated) for racing reform, engaging with industry throughout and offer analysis to the Minister for Racing on opportunities (i.e., the industry's untapped potential) as well as roadblocks to returning the industry to a well-managed and sustainable growth path.

Purpose

The NZRB is to undertake a Performance and Efficiency Audit consistent with its statutory obligations per Section 14 of the Racing Act 2003. This information is to be provided to the MAC in relation to:

Executive Summary - from the Messara Report

Recommendation 4

Request that a Performance and Efficiency Audit of the NZRB be initiated under section 14 of the Racing Act 2003, with particular emphasis on the operating costs of the NZRB.

Objectives

The Performance and Efficiency Audit must meet the NZRB's statutory obligation to conduct an audit of the operations of the NZRB and more specifically evaluate the efficiency and effectiveness of the current operating model and cost structure in delivering on its key statutory objectives which are to:

a) Promote the racing industry; and
b) Facilitate and promote racing betting and sports betting; and
c) Maximise its profits for the long-term benefit of New Zealand racing.

In accordance with section 14 of the Racing Act 2003, the Board must arrange at least once every 5 years for an audit to be conducted in relation to how effectively and efficiently the Board is performing its statutory functions. Specific requirements for the audit are set out in Schedule 2 of the Racing Act 2003 (refer Appendix A).

A specific focus of this Performance and Efficiency Audit will be on the cost structure of the NZRB to ensure it is efficient and effective in today's competitive environment. It is anticipated that strategic and tactical opportunities to reduce NZRB's operating costs are identified while maintaining the organisation's competitiveness. The Ministerial Advisory Committee, appointed by the Racing Minister, the Rt Honourable Winston Peters, has asked for this review to be undertaken consistent with recommendation 4 of the Messara Report.

Performance and Efficiency Audit 2019

The report of the previous performance and efficiency audit report in 2014 identified 11 formal recommendations for which comment on satisfactory implementation is required as part of the Audit process.

Scope

In addition to a review of the NZRB in meeting its statutory obligations as defined in the Section 14 of the Racing Act 2003, an assessment of NZRB's current operating model and associated cost structure will be undertaken in the context of the current industry model, including the identification of potential improvements and alternative operating models. This will cover the role of each function in managing the efficiency and effectiveness of business operations while delivering the strategic initiatives that underpins NZRB's transformation agenda.

It will also take into consideration the significant regulatory and compliance obligations that NZRB needs to proactively manage and resource in line with new legislation such as Occupational Health & Safety (OH&S), Credit Card fraud/compliance (PCI) and Anti-Money Laundering (AML).

During this review, the Working Group will conduct (on a quantitative and qualitative basis) a:

- Review of NZRB's current operating model and business plan/strategic initiatives;
- Detailed review of NZ Market environment and NZRB organisational structure, service delivery model and operating costs over the past 4 years (2016 - 2019) including the current financial year (2019), covering:
  - Market environment - changes in Technology, Regulatory environment, Customer preferences, offshore Competition;
  - Organisational and Internal Management structures including purpose, functions and roles, service delivery model (i.e. Distribution channels) and Industry stakeholder management;
  - Workforce Dimensions - functional capabilities, headcount by Dept; Employment Type (permanent, fixed term contract, temporary, casual) and Remuneration bands/levels;
  - Staff Remuneration including Pay / Remuneration bands benchmarked against comparable NZ Industry pay scales;
  - Key Drivers of Operating Expenses by Division/Dept and Category;
  - Facilities, Equipment and Technology (Property, Equipment, IT Infrastructure & Operating Systems) deployed to meet the requirements of customers;
  - Fixed (committed) versus Variable cost structure including long term contractual commitments (i.e. NZ Live, Spark, etc);
  - Progress of Cost Transformation Initiatives.
- Review and benchmark NZRB cost efficiency/effectiveness against comparable racing industry peer groups (including International benchmarks);
- Assess the efficiency (inputs/outputs) of existing services delivered to Customers (Betting & Gaming incl. Problem Gambling) and Industry participants (Racing Calendar, Racing Integrity functions, Vision Capture, On Course, etc);
- Assess whether the current operating model and services delivered to Customers including Betting/Wagering, Gaming, Broadcasting, Industry, etc is appropriately structured and cost effective in achieving NZRB's objectives;

- Review projected operating costs (per SOI / Business Plan), including revenue and ongoing costs following the implementation of NZRB's key strategic initiatives;
- Identification of (1) strengths, good practices, positive outcomes and productive improvements in performance in recent years and (2) potential alternative service delivery models and/or improvements to NZRB's operating model.

The review will assess the core drivers of each area (inputs/outputs), expenditure levels and associated outcomes/benefits that will cover all of NZRB's operating functions including:

- Betting and Product (GM: Glen Saville)
- Customer (GM: Gary Woodham)
- Media & Content (GM: Andy Kydd)
- Technology (GM: Dianna Taylor)
- Services (GM: Stephen Henry)
- Finance incl. Property & Procurement (GM: Shaun Brooks)
- People (GM: Janine Belcher)

In determining the Board's performance and efficiency, the person appointed to conduct the audit must take into account:

- the extent to which the Board has established objectives for the performance of its functions;
- the nature of those objectives;
- the progress the Board is making towards the achievement of those objectives;
- the extent to which the Board has put in place policies and strategies to use its resources effectively and efficiently for the purpose of achieving those objectives;
- the nature of those policies and strategies, and the manner in which they were put in place; and
- any other matters determined by the Board.

While the Act states that the audit must relate to the Board's performance on the particular day on which the audit is conducted, and its prospective future performance, the person conducting the audit may also have regard to the Board's performance during the five years before that day.

The audit will examine, verify, and if appropriate, validate the steps the Board has taken to date and recommend any further steps the Board should take to ensure that it is well positioned and capable of discharging its functions.

The scope of the review will exclude the following:

- Racing Codes, Clubs and Recognised Industry bodies

Appointment of auditor

To conduct the audit the Board is required to appoint a suitably qualified and experienced person who may not be a member, former member, or employee of the Board. The Board envisages that such a person would have relevant experience in the corporate governance of statutory and similar entities and, in particular, in the evaluation of the performance of governing boards.

Resources and Budget

The NZRB will pay the reasonable costs of the audit, to the person who conducts it in terms of fees and the reimbursement of expenses. The NZRB in close consultation with the MAC, will ensure that the person appointed will be supported in the conduct of the audit by way of access to information and personnel and the provision of administrative support when requested.

Key Outcomes

The key outcomes of the audit will provide the MAC and NZRB with a clear understanding of:

- the efficiency and effectiveness of NZRB in performing its statutory functions per Section 14 of the Racing Act 2003;
- the NZRB's operating cost structure and efficiency & effectiveness against comparable industry peer groups including racing (covering International benchmarks);
- the financial position of the current commercial activities of the NZRB (Wagering NZ/TAB NZ), and those roles, functions and responsibilities identified as devolving from the NZRB to the three racing codes and/or Racing NZ (if it is established).

Reporting

The firm who conducts the audit must, after conducting it:

- prepare a written report covering all aspects of the audit scope and key outcomes, with key findings and recommendations being presented in the first instance to the RITA Executive Team and Board;
- provide a copy of the full report and key findings and recommendations to the Minister, RITA, and key industry organisations.

The report will be delivered to the Minister by the end of July 2019

The key findings and recommendations of the audit report will be utilised by various MAC initiated working groups.

Auditor

Grant Thornton will be appointed to conduct the Performance and Efficiency Audit. Information to support the work of auditor will be provided by two internal groups at NZRB.

Performance and Efficiency Audit Working Group (Engagement Team)

The *internal NZRB Working Group* will comprise:

• Shaun Brooks (engagement lead) / Stephen Henry	NZRB Executive (RBLT)
• Ian Long / Bill De La Mare	NZRB (Public Affairs)
• Adrian Ogier / Josie Farrell	NZRB (Finance)

- Lou McCrorie / Jo Nelson NZRB (People Team)

Key Industry Stakeholders

The key Industry Stakeholders to be engaged as part of this review will comprise:

- Ministerial Advisory Committee (MAC)
- Chair and CEO of Code bodies (NZTR, HRNZ and GRNZ)

Appendix A - Schedule 2 of the Racing Act

Functions of the NZRB

The statutory functions of the NZRB are defined as follows:

a) To develop policies that are conducive to the overall economic development of the racing industry, and the economic well-being of people who, and organisations which, derive their livelihoods from racing.
b) To determine the racing calendar each year, and issue betting licenses, under Part 5.
c) To conduct racing betting and sports betting, and make rules relating to betting, under Part 6.
d) To distribute funds obtained from betting to the racing codes in accordance with sections 16 and 17.
e) To administer the racing judicial system in accordance with sections 36 to 41 and Schedule 3.
f) To develop or implement, or arrange for the development or implementation of, programmes for the purposes of reducing problem gambling and minimising the effects of that gambling.
g) To undertake, or arrange for the undertaking of, research, development, and education for the benefit of New Zealand racing.
h) To use its resources, including financial, technical, physical, and human resources, for purposes that, in the opinion of the Board, will directly or indirectly benefit New Zealand racing.
i) To keep under review all aspects of racing and to advise the Minister of those aspects, either on its own initiative or at the request of the Minister.
j) Any other functions that it is given by or under this Act or any other Act.

In carrying out these functions, the Board must also:

- Comply with the principles of natural justice.
- Exhibit a sense of social responsibility by having regard to the interests of the community in which it operates.

Conduct of audit

Scope

In determining the Board's performance and efficiency, the person appointed to conduct the audit must take into account:

- the extent to which the Board has established objectives for the performance of its functions;
- the nature of those objectives;
- the progress the Board is making towards the achievement of those objectives;
- the extent to which the Board has put in place policies and strategies to use its resources effectively and efficiently for the purpose of achieving those objectives;
- the nature of those policies and strategies, and the manner in which they were put in place; and
- any other matters determined by the Board.

While the Act states that the audit must relate to the Board's performance on the particular day on which the audit is conducted, and its prospective future performance, the person conducting the audit may also have regard to the Board's performance during the five years before that day.

The audit will examine, verify, and if appropriate, validate the steps the Board has taken to date and recommend any further steps the Board should take to ensure that it is well positioned and capable of discharging its functions.

Reporting

The person who conducts the audit must, after conducting it:

- prepare a written report on the conclusions reached as a result of the audit; and
- provide copies of the report to the Minister, the Board, and the recognised industry organisations.

Part B Section 5: 2014 Findings Follow Up

2014 Findings Follow Up

Recommendations from 2014 Performance and Efficiency Audit	Management Update
1. That NZRB formally assesses, over the next two to three years, the return attributable to its investment in increased capability.	Investment in building organisational capability and leadership is a crucial element in improving the future performance of any organisation, and the New Zealand Racing Board is no different. The investment in people capability has historically centred on 4 key areas to (refer 5yr Staff Expense Analysis): 1. Drive Revenue growth - investment in Betting, Customer & Broadcasting has resulted in a corresponding lift in Betting Turnover / Revenue; 2. Manage the significant transformation programme relating to the Top 5 strategic initiatives leading to greater transparency, accountability & execution going forward; 3. Enable Technology platforms and corporate services to support the growth initiatives and lift engagement with key stakeholders including the Govt, Codes & Sporting bodies; and 4. Manage the introduction of significant Regulatory and Compliance legislative requirements / risks (H&S, PCI, AML). The investment in capability (people and technology) remains a key strategic focus area for NZRB. Notwithstanding this, it is always critical to ensure that staff costs are delivering appropriate return and cost saving initiatives have been implemented to mitigate some of these cost increases (refer Cost Transformation Programme), including structural changes where the NZRB's operating model has evolved and this investment in people capability is no longer required.
2 That management continue to update the Board periodically on progress towards identifying and quantifying specific actions that will deliver the strategic goals under the future strategic initiatives. This information could also be shared with the codes. There is already good dashboard reporting on the current priority initiatives. 3 That management consider the timeframe for introducing a longer-term element to the performance incentive framework.	A new CEO and Leadership Team were appointed by the Board in FY15/16. This resulted in a new strategic framework for the Board that aligns the strategic focus areas with five key initiatives, centred on the customer (refer Strategy documents). Driving Revenue growth, transforming our cost base, continuing to invest in capability and building a sustainable Industry model lie at the heart of these key strategic focus areas. Performance incentive schemes have been progressively removed by the Board given the focus on operating costs.

Recommendations from 2014 Performance and Efficiency Audit	Management Update
4. That a review of the performance of the NZRB's statutory functions be included as part of the compliance function's programme and reported on in management's Continuous Disclosure Confirmation paper for the Board. 5. That management develop and maintain a comprehensive organisation chart, which is an important part of any organisation's control framework. It would also improve the NZRB's ability to develop internal and external benchmarking. 6. That management reassess the timeframe for re-establishing its internal audit function, with a medium-term emphasis on independent assurance over change and investment processes, and gaps in control that can arise during periods of change. 7. That management set a definite timeframe for establishing its organisational policy framework.	Given the three lines of defence model employed for risk management, current NZRB Management has not elected to establish a standalone compliance team. Rather, the compliance functions sit across multiple teams and disciplines, including across the Technology and Risk and Regulatory Affairs Team (and are reported up to Board accordingly). The NZRB's statutory functions are regularly assessed by the Board as part of the other standing agenda items, both at Board level and across the various Board sub Committees. Organisation chart software is used and maintained by NZRB. This is widely accessible across the business and contents is updated daily from the payroll system. The payroll system is also a source of all current employee positions, titles and reporting lines and reports are able to be extracted at anytime to provide this information. A top down risk management approach was approved by the Board in 2017 and principal risks are officially reviewed every six months by the Board and by the RBLT. Assurance has been in place, albeit focussed on material risks combined with other internal controls (eg. flush tests). Critical processes are being mapped by our Assurance function, and readjusted after the implementation of FOB. When the AML/CFT legislation comes to force for the NZRB, operating model will reflect a more formal audit programme, requiring internal/external resources. A Governance Documentation Policy was approved by the Board in 2017 in order to organise, tier and provide guidance to policy documentation. Risk and Regulatory function is a gatekeeper in this process providing process and templates. A new phase to simplify & reformat policies for better reach across the business is underway, with a set of new policies in the People area being approved. The Audit and Risk Committee will be requested to endorse this new approach. All policies are centralised in the NZRB's intranet.
8. That the Board initiate, with the codes, a review of the governance structures of the racing industry with a view to supporting the long-term interests of each racing code and the industry as a whole, including industry efficiency.	CRIG forums we're formally put in place and two (2) key Industry related issues we're agreed to focus on between NZRB and the Codes, being (1) Annual Racing Calendar and (2) Future Venue Plan. Racing Calendar : Following the introduction of a new set of principles and guidelines for the allocation of dates in the 2017/18 season, the New Zealand racing calendar was redesigned to maximise revenue, optimise the cost of its delivery and improve the quality and competitiveness of racing. While the approach resulted in no material change to the number of meetings or races by code, it provided $3 million in economic value to the industry (made up of changes to NZRB and club costs and revenues), compared to rolling over the standard calendar from the previous season. Future Venue Plan: the development of a National Venue Plan was implemented to ensure we had the appropriate track and training infrastructure in the future that delivers the best possible environment to train and race horses and greyhounds, that also meet the expectations of owners and punters, both domestically and internationally, to invest and wager on New Zealand racing. Engagement with the wider racing industry also took place to seek feedback and input into this plan, however it is now on hold following the release of the Messara Review.

B. Follow Up of 2014 Findings

Recommendations from 2014 Performance and Efficiency Audit	Management Update
9. That the NZRB identifies and quantifies the impact of different forms of leakage to overseas gambling providers and, if appropriate once the results of this work are known, use this to support a case for legislative remedies with the Government.	In 2015, a Government Working Group was appointed by the Racing Minister to assess the level of offshore revenue leakage. In October 2015, this working group concluded the following estimates of the amount of offshore gambling, and total expected revenue if a charge of 2% of turnover was introduced for each fee:

Activity	Offshore fee type	Estimated turnover	Proposed fee	Estimated maximum revenue
Bets placed on NZ Raving events with offshore bookmakers	Product fee	$300 million pa.	2% of turnover	$6million pa.
Bets placed by New Zealanders on racing with sport with offshore bookmakers	Point of consumption fee	$518 million pa.	2% of turnover	$10.4 million pa.
Total				$16.4millon pa.
Note: product fees on sport are not included in this table. These were accessed $60million pa turnover, and $1.2million pa revenue by Working Group.				

New analysis based on voluntary offshore charges arrangements with Australian bookmakers and anonymised credit card data largely substantiates this 2014 analysis, but also emphasises the growth of offshore betting in the past five years since this report.

A legislative remedy for leakage was progressed with the Racing Amendment Bill 2017. This Bill was subsequently withdrawn due to a change in government, however, leakage will be now be addressed through the recently introduced Racing Reform Bill No.1.

B. Follow Up of 2014 Findings

Recommendations	Management Update
10 That the NZRB initiate a discussion, with codes, about racing club incentives contained in the code distribution models to help ensure full industry alignment. Incentives should enable optimum profitability for the industry as a whole, as well as lowest cost betting channels.	The opportunity to review the distribution model was explored with the Codes in 2016, including the introduction of Product Fees to drive improved returns, however litigation initiated by GRNZ subsequently determined by the Courts that Code funding was a matter for the codes' to determine and not the NZRB. Additionally, the 2018 Review of Racing by Mr John Messara resulted in a subsequent deferral of any further changes in the code distribution model that is now being reviewed independently, governed by the Ministerial Advisory Committee.
11. That management establish internal and external efficiency metrics, and begin tracking trends and setting targets. This will be an important part of the framework for managing towards the strategic goal of a cost to income ratio below 30%.	The original strategic goal of a cost to income ratio below 30% set by previous management did not appear to have any comprehensive plans behind it. Management has reset these measures to align with the published SOI & Annual Operating Budget. From an FP&A perspective, a formal Quarterly Forecast process has been implemented and the Monthly Board Ops Report has been redeveloped to report on a number of measures ie. Health & Safety, HR / People metrics, Industry engagement, Portfolio Governance, Key Performance Trends and Financial Performance & Compliance. A Cost Transformation Programme was also implemented that included some high level benchmark comparisons (eg. OPEX % of Revenue).