

Anticipated acquisition by Astra Games Limited of certain gaming machine and related businesses from the Danoptra Group

ME/5413/12

The OFT's decision on reference under section 33(1) given on 3 July 2012. Full text of decision published 16 July 2012.

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**Please note that the square brackets indicate figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.**

## **PARTIES**

1. **Astra Games Limited (AGL)** is a wholly owned UK subsidiary of the Novomatic Group. AGL primarily designs, manufactures and supplies gaming machines and gaming software for use in the machines. AGL has two trading subsidiaries. The first, Greentube Internet Entertainment Services GmbH (**Greentube**), is an Austrian company specialising in internet gaming, providing casino, poker, bingo and skills games. The second, Empire Games Limited (**Empire**), is a UK based company in which AGL has a 70 per cent shareholding, which primarily manufactures and rebuilds gaming machines (mainly category D machines as well as some category B4 and C machines, see below).
2. **The Danoptra Group** is active in the UK and Europe in the design and manufacture of gaming machines, the supply of content and the supply of machines and associated products to a number of industries. Within the Danoptra Group, Bell Fruit Games Limited (**BFG**) is primarily involved in the manufacture of analogue gaming machines, Gamestec Leisure Limited (**Gamestec**) is an operator of gaming machines, RLMS Sales Limited (**RLMS**) is a distributor of gaming machines and Mazooma Interactive Games

Limited (**Mazooma**) develops gaming software.<sup>1</sup> All references to the Danoptra Group below are to these four entities unless stated otherwise. The amount of UK turnover attributed to the businesses to be acquired by AGL is [ ] (excluding intra-group turnover).<sup>2</sup>

## TRANSACTION

3. AGL, through its subsidiaries Astra Betting Limited and Astra Entertainment Limited, proposes to acquire the businesses (including business contracts, stock, goodwill, certain properties, IT systems, intellectual property, trade debtors, trade creditors and specified plant and equipment) of Gamestec, BFG, Mazooma and RLMS (the **Danoptra Group Assets**) for consideration of [ ] (the **Transaction**).
4. The merging parties signed two interlinked asset purchase agreements on 28 April 2012. The Transaction was notified to the OFT on 16 April 2012 and the administrative deadline is 3 July 2012.

## JURISDICTION

5. As a result of this Transaction, AGL and the Danoptra Group Assets will cease to be distinct. The OFT believes that the combination of assets acquired by AGL (paragraph 3) are sufficient to constitute an 'enterprise' for the purposes of section 23 of the Enterprise Act 2002 (the **Act**).
6. The merging parties submitted that the UK turnover attributable to the Danoptra Group Assets does not exceed £70 million. Therefore, the turnover test set out in section 23(1)(b) of the Act is not met.
7. However, the merging parties overlap in the manufacture and supply of gaming machines in the UK where the merging parties submitted that their combined share of supply by volume for 2011 is [30-40] per cent and therefore exceeds 25 per cent. As such, the share of supply test in section 23 of the Act is met.

<sup>1</sup> The Danoptra Group also has a significant presence in the leisure facilities segment providing services to local authorities, sporting bodies, hotels and charities. However, the businesses of the Danoptra Group which provide these services do not form part of the proposed transaction.

<sup>2</sup> Pursuant to paragraph 8 of the Schedule of the Enterprise Act 2002 (Merger Fees and Determination of Turnover) Order 2003 SI 2003/1370 as amended.

8. The OFT therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

## **COUNTERFACTUAL**

9. The OFT considers the effect of the merger compared with the most competitive counterfactual providing always that it considers that situation to be a realistic prospect. In practice, the OFT generally adopts the prevailing conditions of competition (or the pre-merger situation in the case of completed mergers) as the counterfactual against which to assess the impact of the merger.<sup>3</sup>
10. The merging parties submitted that BFG has not increased the price of its analogue machines since Barcrest's exit from the manufacture of analogue gaming machines because of the Transaction. However, BFG indicated that absent the Transaction it would [ ]. Thus, the OFT's counterfactual should take account of this and the Transaction should not be assessed against current pricing. Nevertheless, the merging parties have not submitted compelling evidence that a price increase of any given magnitude would have been implemented absent the Transaction.
11. The OFT has assessed the Transaction on the basis of the prevailing conditions of competition and prevailing pre-merger prices. The OFT has taken into account the exit of Barcrest from the manufacture and supply of analogue gaming machines where appropriate.

## **FRAME OF REFERENCE**

12. The OFT considers that market definition is a useful tool, but not an end in itself. Market definition provides a framework for assessing the competitive effects of the merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of a merger in a mechanistic way, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.<sup>4</sup>

<sup>3</sup> Merger Assessment Guidelines, A joint publication of the Competition Commission and the Office of Fair Trading, OFT1254, September 2010, paragraph 4.3.5.

<sup>4</sup> Merger Assessment Guidelines, paragraph 5.2.2.

13. The merging parties overlap in the manufacture and supply in the UK of gaming machines. The Gambling Commission's website states that gaming machines are 'a machine that is designed or adapted for use by individuals to gamble' and 'fall into categories depending on the maximum stake and prize available'.
14. The Gambling Act (2005) defines 12 different categories of gaming machines by maximum stake and maximum prize (see Annex 1) and determines how many of each category of machine may be situated in a particular type of business (see Annex 2). Of relevance to this case are gaming machines in categories B4, C and D. Specifically, the merging parties overlap in the manufacture and supply of category B4 (which have a £1 maximum stake and £250 maximum prize), C (£1 maximum stake and £70 maximum prize) and D (10 pence maximum stake and £5 maximum prize) gaming machines.
15. In terms of the route to market, large customers known as 'house accounts' can and do purchase directly from the manufacturer. In addition, distributors sit between the manufacturers and the customer. Distributors sell new, old and refurbished machines mainly to small customers but they also sell a small number of machines to operators. Additionally, distributors accept old machines in part exchange, which manufacturers do not.
16. Operators purchase machines which they then supply to retail venues by way of rental, income share agreement, or sometimes resale together with installation, maintenance and support. Third party comments from an operator and the majority of pub company customers received by the OFT suggest that in most, if not all, cases operators will have an ongoing maintenance responsibility for the machines that they provide. Third party responses to the OFT's enquiries also suggest that certain types of customers have a preferred distribution channel. For example, all pub chains who responded to the OFT's enquiries source gaming machines from operators.
17. The merging parties also overlap in the supply of gaming content. However, given AGL, BFG's and Mazooma's minimal presence in sales of standalone games content, the OFT does not consider this further below as

it is of the view that they would have a negligible impact, if any, on the competitive assessment.<sup>5</sup>

18. As noted above, Greentube is a specialist internet gaming operator, providing casino, poker, bingo and skills games. The overwhelming majority of third parties contacted by the OFT did not indicate that there were any alternatives that could fulfil the role of gaming machines. In the absence of direct evidence on consumer or customer reaction (such as a survey) to show that there is substitution between retail based and internet gaming, the OFT adopts a cautious approach and considers internet gaming to be part of a separate market. As such, given there is no horizontal overlap, internet gaming is not considered further below.

## **Product scope**

### **Manufacture and supply of gaming machines**

19. The merging parties submitted that the relevant product market is the manufacture and supply of gaming machines.
20. The OFT's approach to product market definition is generally to consider first if narrow candidate markets can be widened through substitution on the demand-side.<sup>6</sup> As noted above, the Gambling Act defines 12 categories of machines and the merging parties overlap in the manufacture and supply in the UK of category B4, C and D gaming machines. The OFT therefore considers below whether the evidence suggests that the manufacture and supply of each different category of machine can be widened by demand-side substitution.

### **Segmentation by category of gaming machine**

21. As noted above, the Gambling Act defines the category and number of machines, which may be situated in a particular type of business. Although the Gambling Act clearly offers some types of premises a wider choice of gaming machines than others, the categories of gaming machines available

<sup>5</sup> The merging parties submitted that AGL has a share of supply of [0-five] per cent and the OFT received evidence from the merging parties which suggests that the share of supply of each of BFG and Mazooma in the supply of standalone games content is also approximately [0-five per cent].

<sup>6</sup> See Merger Assessment Guidelines, paragraphs 5.2.6 to 5.2.19.

to any one type of premises is limited, which limits the scope for demand-side substitution between the different types of machines. For instance, the OFT was told by a bingo operator that a five per cent price change would not lead to a change in purchasing behaviour, as the only category of machine that they would be interested in switching to is a higher category, which is not permitted by the Gambling Act.

22. Third party customers indicated that the most important factor in deciding which category of machine to purchase is performance, measured by cash in box (that is machine turnover). The lack of demand-side substitutability in this respect is reflected in machine usage by respondents to the OFT's third party questions. In particular, despite having the choice between all categories (except A), 97 per cent of machines in casinos were category B1. Additionally, despite having the choice of category C and D gaming machines, 99 per cent of machines in pubs were category C. Consistent with this, customers did not indicate that changes in the cost of a category of gaming machine would influence their purchasing decision. This suggests that separate relevant markets exist for each category, or at least some categories, of gaming machine.
23. From a supply-side substitution point of view, based on the evidence received from third parties (and, in particular, a competitor), whilst the cabinet may be substitutable for most gaming machines, the OFT is of the view that new games may have to be developed for a new category of machine as different games are successful in different sectors. This is especially true with respect to category C machines sited in pubs, which limits the potential for supply-side substitution (see paragraph 34 below for further details). In addition, based on information provided by the merging parties not all suppliers are active across all categories of gaming machines.
24. In this case, it is not necessary for the OFT to come to a firm conclusion on the product market given that no competition concerns arise under any candidate frame of reference. Therefore, on a cautious basis and for the purposes of this assessment, the OFT considers the impact of the Transaction on the overall manufacture and supply of gaming machines, as well as each category of gaming machine where the merging parties overlap, namely categories B4, C and D.

## Segmentation by machine type (digital and analogue)

25. Within each category of gaming machine, the machine can be either analogue or digital. The OFT has also considered whether analogue and digital machines form part of the same market as customers in some cases have a preference for one or the other within each category of machine.
26. Analogue machines are reel based. The user interface is through a series of buttons, which give the player a choice of discrete actions, such as 'hold' or 'nudge'. The game will commonly occur on a lighted glass board, which sits above the reels. Thus, to introduce a new game, the glass, reels, and lighting would need to be replaced. Although these machines are referred to as analogue, they are controlled by a central processing unit.
27. Digital machines tend to utilise a touch screen interface, allowing for more options to be displayed and the set of controls to change as the game progresses. As there are no physical components to be altered when a new game is loaded on to the machine, the machines can carry more than one game, allowing the player to choose which game to play. The games loaded on the machine can easily be changed via connection to the internet.
28. From a demand-side point of view, the merging parties as well as the majority of third parties have indicated that category C analogue machines perform better than digital gaming machines in pubs. The OFT received testing data from both the merging parties and a third party operator which corroborated these statements.
29. The OFT understands that the popularity of analogue machines is due to a combination of technical (compensated games which provides greater certainty that the gaming machine will not pay out more than it takes) and user preference. Some third parties have indicated that increased player interaction could be one reason for the success of analogue machines as well as the fact that the user feels more in control. An internal BFG presentation from 2011 states that category C analogue machines are interactive and supports the fact that the player perceives he can influence the game outcome.<sup>7</sup>

<sup>7</sup> Presentation entitled 'GEB, 23.1.11 Agenda Item 'Market': Effect of Digital on Volume' by [ ].

30. Further, pub owners receive higher revenues in absolute terms from analogue machines as a result of the games' popularity, but also as the income on analogue machines is only shared with the operator, whereas the income from digital machines is also shared with the manufacturer who updates the games.
31. However, when asked whether they would switch from analogue to digital in response to a five per cent increase in the cost of siting a machine, the responses from pub owners were mixed. Although the number of third parties were split on whether they would switch from analogue to digital, the OFT notes that the pub chains (which represented a larger section of the gaming machine estate in pubs by volume) indicated they would switch. When deciding on the type of machine, the most important factor for pubs is the revenue which the machine generates for them. As such, whether or not pubs would switch in response to a five per cent price rise will largely be dictated by the revenues they receive from the gaming machine.
32. It is not necessary for the OFT to come to a firm conclusion given that no competition concerns arise under any possible segmentation. Therefore, for the purposes of this assessment, the OFT considers the impact of the Transaction on the wider category B4, C and D gaming machines looking at analogue and digital machines together.

#### Segmentation by customer type

33. The OFT further considers whether the frame of reference can be segmented by customer type. The categories of customers identified by the 2005 Gambling Act are casinos, betting premises, adult gaming centres (**AGC**), bingo halls, pubs and family entertainment centres (**FEC**).
34. With respect to category C machines, a third party indicated that there are differences between the type of games that perform well in pubs, AGCs and bingo halls. This is linked to the primary customer 'shopping' mission in pubs not being gambling, in contrast to AGCs and bingo halls, which means that machines in the pub environment are required to provide more entertainment. A third party has indicated that different expertise is required to develop the games for each of these customers.

35. For all other categories of machine, different customer types tend to have a preference as to which category of gaming machine they purchase or rent. These generally are linked to the highest category of machine (from A to D) that the premises are permitted. As such, the OFT is of the view that segmentation by category of machine adequately captures any distinction under customer segmentation for these other categories of gaming machines.
36. It is not necessary for the OFT to come to a firm conclusion given that no competition concerns arise under any possible category of gaming machines. However, on a cautious basis and for the purposes of this assessment, the OFT considers the impact of the Transaction on both category C machines for the pub sector as well as category C machines supplied to the non-pub sector.

### **Geographic scope**

#### **Manufacture and supply of gaming machines**

37. The merging parties submitted that the relevant geographic market is the UK in line with previous OFT decisions and given that the merging parties provide gaming machines to customers throughout the UK.<sup>8</sup>
38. The 2005 Gambling Act requires that manufacturers of gaming machines have an operating licence from the Gambling Commission. One third party customer indicated that the uniqueness of the UK legislation (in terms of stake, prize and technical elements) means that no non-UK company has been successful in producing machines to rival UK manufacturers.
39. In addition, whilst the manufacture of gaming machines may take place outside of the UK, some third parties have indicated that a UK presence is required. However, this may be only a sales office as many manufacturers are based outside the UK.

<sup>8</sup> Cases ME/5032/11 Anticipated acquisition by Scientific Games Corporation of Barcrest Group Limited and Cyberview Technology CZ s.r.o dated 27 July 2011 and ME/3766/08 Completed acquisition by Danoptra Limited of certain assets of Inspired Gaming Group plc dated 9 September 2008.

40. Therefore, out of caution and for the purposes of this assessment, the OFT has considered the Transaction on the narrowest plausible basis, which is UK-wide.

## **Conclusion**

41. The OFT has assessed the impact of the Transaction on the UK overall manufacture and supply of gaming machines as well as the narrower frame of reference, namely each of category B4, C and D gaming machines further segmenting category C gaming machines between those supplied to the pub sector on the one hand and the non-pub sector on the other hand.

## **HORIZONTAL ISSUES**

### **Shares of supply**

42. The merging parties submitted that they have a combined share of supply of [30-40] per cent by volume in 2011 in the overall supply of gaming machines with a [five-10] per cent increment.<sup>9</sup>
43. The merging parties identified a number of other competitors including Scientific Games, which owns Global Draw and Barcrest ([30-40] per cent share), Inspired ([10-20] per cent share) as well as a number of smaller players (Electrocoin, Blueprint and Projectcoin). The merged entity will therefore continue to face a number of competitors in the manufacture and supply of gaming machines and will be of a similar size to Scientific Games who will continue to provide a strong competitive constraint post-merger.
44. Given the competitive constraint the merged entity will face post-merger, the OFT is of the view that the Transaction does not give rise to a substantial lessening of competition (**SLC**) in the overall manufacture and supply of gaming machines in the UK. As noted above, the OFT has also assessed the Transaction on the basis of gaming machines in categories B4, C and D as set out below.

### **Category B4**

45. The merging parties submitted that they have a combined share of supply of [40-50] per cent with respect to the supply of category B4 machines

<sup>9</sup> Unless stated otherwise all shares of supply are by volume in 2011.

(both new and refurbished). However, the increment added by AGL is low, only [0-five] per cent given that AGL itself does not manufacture B4 gaming machines and its subsidiary Empire only sold [ ] such gaming machines in 2011.

46. The merging parties further submitted that there are five other manufacturers of category B4 gaming machines, namely JPM who have an [10-20] per cent share of supply, Reflex, Storm Games, Blueprint and The Ultimate Fan all of which could expand their capacity.
47. Category B4 gaming machines are primarily sited in clubs (registered members' clubs, predominantly working men's and social clubs, as well as commercial clubs) and miners' welfare institutes. However, such venues can also site B3A machines which have the same maximum stake of £1 but a £500 maximum prize instead of £250. In this respect, the OFT notes that it has received evidence that in a number of other venues the highest category of machine (from A to D) which is allowed is generally the most popular. This suggests that B3A machines also provide a competitive constraint on B4 machines at these sites.
48. The large majority of customers, competitors, distributors and operators did not express any specific concerns with respect to the effects of the Transaction on competition for category B4 gaming machines. Indeed, only one third party specified it has a concern with the Transaction related to category B4 gaming machines as well as category C.
49. On the basis of the available evidence, namely the low increment and the number of competitors who will continue to constrain the merging parties post-merger, the OFT considers that the Transaction does not give rise to a SLC in category B4 gaming machines in the UK.

## **Category C**

### **The non-pub sector**

50. The merging parties were unable to provide the OFT with shares of supply of category C gaming machines to the non-pub sector given a number of sales are made through operators and distributors such that the manufacturer is unaware of the end-customer. As such, the OFT has used

shares of supply in category C digital gaming machines as a proxy.<sup>10</sup> On this basis, the merging parties submitted a combined share of supply of [10-20] per cent with a low increment of [0-five] per cent.

51. The merging parties also indicated that Scientific Games has a [40-50] per cent share of supply; Projectcoin has a [10-20] per cent share and Blueprint a [0-10] per cent share of category C digital machines. The OFT is therefore of the view that Scientific Games (the market leader in digital category C gaming machines) will continue to provide a strong competitive constraint on the merging parties post-merger.
  
52. Where products are differentiated, for example by branding or quality, unilateral effects are more likely where the merger firms' products compete closely.<sup>11</sup> The merging parties are not close competitors as AGL's analogue machines target the arcade and bingo sector and BFG primarily focuses on the pub sector. In addition, AGL manufactures digital machines whereas BFG's digital offering is limited. The majority of responses to the OFT's third party enquiries supported this customer and type of machine split and the fact that the merging parties are not close competitors. Further, no merger concerns were raised by any non-pub customers who responded to the OFT's third party enquiries.
  
53. The OFT is of the view that the merging parties are not close competitors and there will be sufficient competition to constrain the merging parties post-merger. Therefore, taken together with the low increment and lack of third party concerns in this sector, the OFT considers that the Transaction does not give rise to a SLC in category C gaming machines to the non-pub sector in the UK.

### **The pub sector**

54. Scientific Games, a digital manufacturer, recently acquired Barcrest, a manufacturer of gaming machines including analogue machines.<sup>12</sup> Of

<sup>10</sup> The OFT considers this to be a reasonable proxy given that the merging parties and some third parties told the OFT that there are very few digital machines in the pub segment. In addition, analogue category C machines are mainly sited in pubs.

<sup>11</sup> Merger Assessment Guidelines, paragraph 5.4.6.

<sup>12</sup> Case ME/5032/11 Anticipated acquisition by Scientific Games Corporation of Barcrest Group Limited and Cyberview Technology CZ s.r.o dated 27 July 2011.

relevance to the industry, within six months of the acquisition, Scientific Games announced the closure of Barcrest's analogue business.

55. The merging parties submitted that BFG was expecting to capture [ ] per cent of Barcrest's sales in the first instance leaving it with a [70-80] per cent share of supply of category C gaming machines to the pub sector. By contrast the merging parties indicated that AGL is not active in the pub sector although it is trialling a new digital machine developed exclusively with Gamestec, the iPub.
56. [ ], the iPub has been on trial in pubs for [ ] and there are currently [ ] iPubs sited in pubs. Given the length of the trial, [ ], and that AGL is currently earning income from it, the OFT considers that there is an overlap between the merging parties in the supply of category C gaming machines to the pub sector. Based on the volume of machines purchased by large pub companies which site approximately 30 per cent of the total gaming machines in the pub sector, the OFT estimates that AGL has approximately a [25-35] per cent share of the supply of digital category C machines to the pub sector and a [0-five] per cent share of supply of all category C machines to the pub sector. Thus the increment from the Transaction is small.
57. The OFT was informed that Electrocoin, JPM and Reflex are also active in the pub sector supplying analogue machines. The OFT has used the shares of supply of analogue category C gaming machines provided by the merging parties (adjusted to take account of Barcrest's exit from the manufacture of analogue machines)<sup>13</sup> as proxy for the competitors' shares of supply in category C machines for the pub sector.<sup>14</sup> On this basis, Electrocoin has a [five-10] per cent share of supply and JPM a [0-five] per cent share.
58. Scientific Games and Keeday supply digital category C machines to the pub sector. As is discussed further below, Scientific Games' digital machines, with a share of supply of approximately [0-five] per cent, are more popular

<sup>13</sup> Barcrest's share of supply was split across manufacturers according to their shares of supply.

<sup>14</sup> The OFT considers this to be a reasonable proxy given that the merging parties and the majority of third party customers (which are pubs) told the OFT that the majority of machines supplied to the pub segment are category C analogue machines.

than the iPub. Combined with the low share of supply the digital category C gaming machines in pubs represent in total, the OFT considers that AGL is realistically unlikely to be more than the fourth largest player in category C machines supplied to the pub sector.

59. The merging parties are not close competitors. Indeed, BFG primarily manufactures analogue category C gaming machines whereas AGL only manufactures a digital category C gaming machine in the pub sector. The majority of third parties have indicated that digital category C gaming machines are currently a poor substitute and exercise a weak competitive constraint on analogue category C gaming machines in the pub sector.
60. Of the large pub companies who responded to the OFT's third party enquiries, half raised concerns that AGL will close BFG's manufacture of analogue machines post-merger. This concern was also echoed by operators. The OFT notes that a number of third parties who expressed this concern referred to Scientific Games' recent acquisition of Barcrest and its closure of Barcrest's analogue business.
61. The merging parties submitted margin calculations which showed that the absolute margin on the iPub is [ ] that of BFG's analogue machines. Thus, a [35-45] per cent diversion ratio from BFG's analogue machines to the merged entity's digital machines would be required for the closure of BFG's analogue business to be profitable.
62. The OFT received evidence that the iPub is [ ].
63. In addition, the OFT received responses from seven large pub companies, whose estates represent over 25 per cent of all gaming machines in pubs, as to who they would switch to in the event BFG shut down its analogue business. Three did not mention any diversion to the merged entity and two indicated they would not purchase more than 35 per cent from the merged entity. Pubs mentioned Electrocoin, Reflex and JPM as options for purchases of category C analogue machines and more pubs mentioned they would purchase from Scientific Games (or indicated they would do so in higher quantities) with respect to digital category C machines compared to AGL.
64. The evidence received by the OFT therefore suggests that diversion would be substantially less than 35 per cent and, thus, it would not be profitable

for the merged entity to close BFG's manufacture of analogue machines. Further, the merging parties provided evidence which suggests that they intend to continue BFG's manufacture of analogue category C gaming machines.

65. In this respect, the OFT notes a number of differences between Scientific Games/Barcrest and the current Transaction. In particular, as noted above in this case, the OFT has received evidence (in the form of [ ]) which suggests AGL intends to continue BFG's manufacture of analogue category C gaming machines. In addition, the competitive landscape differs in that BFG is now the only analogue producer of consequence and is successful in this segment (the merging parties submitted that this was not the case for Barcrest at the time it exited the manufacture of analogue machines), which enhances AGL's incentive to continue BFG's analogue business. By contrast, AGL's position in the supply of category C digital machines to the pub sector is weaker than Scientific Games'.
66. In addition, a minority of third parties expressed the concern that post-merger AGL would raise BFG's prices of analogue machines. In this respect, as noted above the merging parties are not close competitors. Further, the closeness of competition between analogue and digital products suggests that most BFG sales would be lost to analogue producers in the first instance (such as Electrocoin who have a [five-10] per cent share of supply as noted above at paragraph 57) and any loss to digital gaming machines is more likely to be recaptured by Scientific Games than AGL (see paragraph 63 above). As a result, the Transaction will result in little increased ability or incentive to increase prices of BFG's category C analogue machines post-merger. In addition, the OFT discusses below how any possible effects of the Transaction would be mitigated through barriers to entry and expansion as well as buyer power.

#### Barriers to entry and expansion

67. The merging parties submitted that entry into the overall gaming machine market would not require significant investment, with start up costs estimated at £500,000.<sup>15</sup> Additionally, they indicated that there is an established base of suppliers in the UK able to provide the components required to assemble complete machines. The merging parties further submitted that these barriers to entry are particularly low for analogue

<sup>15</sup> Comprised of basic plant and equipment, fixtures and fitting, and computer equipment.

machines; as server based machines require more investment in infrastructure.

68. This was corroborated to a certain extent by one competitor who indicated that it would be relatively easy for new suppliers to enter the gaming machine market, with the exception of the UK pub sector given the prevalence of the Deal or No Deal Games (**DOND**) which require a licence. However, whilst the licence is exclusively granted to BFG for the manufacture of analogue gaming content, it is non-exclusive for digital machines. Thus, other companies can obtain it.
69. With respect to analogue machines for the pub sector, the OFT notes that BFG manufactures machines for [ ] and [ ]. However, a few third parties have indicated to the OFT that [ ] is able to manufacture its own gaming machines as well as source them from other manufacturers.
70. With respect to digital machines for the pub sector, the OFT understands that there has been a lot of innovation and development of products in recent years, although their success has been limited.<sup>16</sup> In particular, the OFT received evidence that Sceptre Leisure and [another third party] are developing a digital gaming machine for the UK pub sector. The information received by the OFT suggests this entry is both likely and timely as trialling is due to take place in three months time.
71. The OFT is of the view that whilst barriers to entry in category C machines for the pub sector are not low, any new entrant (such as [ ]) would only need to gain a similar share to AGL, which is minimal, in order to mitigate any possible effects of the Transaction.

#### Buyer power

72. The merging parties submitted that the gaming market is characterised by countervailing buyer power and specifically that large customers, such as pub companies, have significant purchasing power. In particular, the merging parties very rarely are granted exclusive supply arrangements; customers are free to change suppliers and would do so in response to an increase in price to an uncompetitive level, or if the games produced were

<sup>16</sup> A BFG internal presentation (Presentation entitled 'GEB, 23.1.11 Agenda Item 'Market': Effect of Digital on Volume' by [ ]) referred to a 'Huge investment for less than 4% of market'.

no longer attractive. The merging parties indicated that they have lost custom to other suppliers due to price and there are numerous alternative suppliers.

73. Whilst the OFT has concluded in previous cases that there was a degree of buyer power in this market,<sup>17</sup> with respect to the pub industry, the gaming machines landscape has changed with the exit of Barcrest from the manufacture of analogue category C gaming machines. The OFT notes that BFG is now the main supplier by some distance of analogue category C machines. Further, the OFT received evidence which suggests the DOND analogue games are also the most popular games in pubs. In addition, one third party competitor indicated that, whilst many suppliers can provide a range of gaming machines and content, the UK pub market does not have buyer power.
74. That said, the OFT is of the view that there is likely to be some residual buyer power. In particular, the OFT received evidence which suggests that certain large pub companies would be prepared to look to manufacturers overseas as well as support smaller manufacturers of category C analogue machines (such as Reflex, Electrocoin and JPM). Therefore, the OFT considers that whilst the pub companies no longer have a large amount of buyer power, they would be in a position to sponsor a small scale entry and mitigate any increment AGL adds to the merging parties' share of supply in category C gaming machines to the pub sector.

## Conclusion

75. Given the above and, in particular, the low increment, the strong constraint Scientific Games exerts specifically on AGL with respect to digital category C machines as well as the presence of a number of analogue manufacturers, the fact that the merging parties are not close competitors and that any possible effects on competition would be sufficiently mitigated by entry (and expansion) and buyer power, the OFT considers that the Transaction does not give rise to a SLC in category C gaming machines supplied to the pub sector in the UK.

<sup>17</sup> Cases ME/5032/11 Anticipated acquisition by Scientific Games Corporation of Barcrest Group Limited and Cyberview Technology CZ s.r.o dated 27 July 2011 specifically with respect to pub companies and ME/1521/03 Anticipated acquisition by Gamestec Leisure Limited of Rank Leisure Machine Services Limited dated 5 January 2004.

## Category D

76. The merging parties submitted that they have a combined share of supply of [70-80] per cent with a [five-15] per cent increment (for both new build and refurbished category D machines) but that a number of other companies are active in the supply of category D fruit machines.<sup>18</sup> These are Reflex Games, Fair Games, Concept Games and Jabro Games. The OFT third party enquiries confirmed that three out of four of these companies were effective competitors in this segment. In addition, the volume of sales they provided suggests to the OFT that the merging parties' estimate of their combined share of supply was overly cautious and is closer to [25-35] per cent with a [0-five] per cent increment.
77. In addition, at least one distributor also refurbishes category C machines turning them into category D gaming machines by installing new software on the machine and buying new parts from the original manufacturer. This suggests that other players are also active in supplying category D gaming machines. Further, no operator or distributor expressed any concerns with respect to category D gaming machines and the customer who purchased the largest amount of category D products did not oppose the Transaction.
78. Each of the three competitors also indicated that they could expand their current production of category D gaming machines with one indicating they could expand by more than BFG produced in 2011. Therefore, given that the most supply is in the hands of competitors and the increment is very small, it is likely that expansion would be sufficient to mitigate any effects from the Transaction.

## Conclusion

79. On the basis of the evidence above, namely the most accurate shares of supply suggest a low increment, there are three other competitors in the industry who will continue to constrain the merged entity post-merger and could also expand production so as to mitigate any effect of the Transaction, the OFT considers that the Transaction does not give rise to a SLC in category D gaming machines in the UK.

<sup>18</sup> As opposed to penny pushers or crane grabs in which the merging parties are not active and which are therefore not included for the purposes of calculating the share of supply.

## **Barriers to entry**

80. As noted above at paragraph 67, the merging parties submitted that costs of entry into the manufacture and supply of gaming machines are not significant and barriers are particularly low with respect to the manufacture of analogue machines. This was corroborated by a third party competitor with respect to the overall gaming machine frame of reference.
81. Barriers to entry with respect to category C machines for the pub sector are discussed above where relevant. The OFT therefore considers barriers to entry with respect to category B4, C (for the non-pub sector) and D gaming machines below.

## **Category B4**

82. The majority of category B4 gaming machines are rebuilds of category B3 and C machines.<sup>19</sup> This suggests that barriers to entry into this category of gaming machine are lower given companies do not need to be manufacturers of new build machines to enter this frame of reference. In addition, a number of category C manufacturers who are not currently present in supplying B4 gaming machine could enter. These include Ace Coin, CMS Gaming, Concept gaming, Electrocoin, Genesis and Project Coin.
83. However, as the Transaction does not give rise to concerns over unilateral effects for category B4 gaming machines, there is no need for the OFT to reach a firm conclusion regarding barriers to entry and expansion.

## **Category C non-pub sector**

84. The general points mentioned above at paragraph 80 apply to category C gaming machines to the non-pub sector. However, as the Transaction does not give rise to concerns over unilateral effects for category C gaming machines to the non-pub sector, there is no need for the OFT to reach a firm conclusion regarding barriers to entry and expansion.

<sup>19</sup> Data from the British Amusement and Caterers Trades Association (**BACTA**), an industry body, suggests that 78 per cent of all category B4 machines are rebuilds.

## Category D

85. A large number of category D gaming machines are rebuilds of category C machines.<sup>20</sup> This suggests that barriers to entry into this category of gaming machine are lower given companies do not need to be manufacturers of new build machines to enter this market. A third party competitor indicated that new entrants generally tend to enter the category D market and then grow through the other categories. In addition, a number of category C manufacturers who are not currently present in supplying category D gaming machine could enter. These include Electrocoin and Projectcoin.
86. However, as the Transaction does not give rise to concerns over unilateral effects for category D gaming machines, there is no need for the OFT to reach a firm conclusion regarding barriers to entry.

## VERTICAL ISSUES

87. As noted above, AGL is acquiring an operator of gaming machines, namely Gamestec and a distributor of gaming machines, RLMS. As such, the Transaction creates two (new) vertical relationships each of which will be discussed in turn below.
88. The merging parties submitted that Gamestec's share of supply is [20-30] per cent of the overall operator gaming machines market and [20-30] per cent with respect to the pub sector. In both cases, the merging parties submitted that Sceptre Leisure and the Independent Operators Association (**IOA**) have similar shares. Third party information suggests these estimates are reasonable.
89. The OFT received no third party concerns relating to foreclosure of upstream manufacturers, which combined with the merged entity's position on the downstream market, means the OFT does not have any competition concerns with respect to this theory of harm.
90. However, the OFT did receive a number of concerns from a minority of third parties (including operators, a distributor, a purchaser of cabinets and a minority of pub customers) that the merged entity will foreclose rival operators by supplying gaming machines from the merged entity

<sup>20</sup> BACTA data suggests that 75 per cent of all category D machines are rebuilds.

exclusively through Gamestec, only making certain popular games available through Gamestec, delaying the supply of gaming machines to other operators or raising the price at which it sells gaming machines to Gamestec's competitors.

91. Whilst the iPub is being exclusively sold through Gamestec, the OFT received evidence that AGL is [ ]. In addition, the merging parties submitted that Gamestec rather than AGL requested the exclusive arrangement.
92. Further, the OFT is of the view that the Transaction does not increase the ability or incentive to engage in input foreclosure given that any such theory of harm relies on BFG's upstream market power, and as such, is not materially affected by the Transaction. As noted above, any increment AGL adds to the pub sector could be mitigated through entry, expansion and buyer power. Thus, any ability or incentive to foreclose must already exist, (although there is no evidence that BFG has sought to supply exclusively through Gamestec, which also suggests it may not be profitable to do so), and, as such, vertical concerns are not as a result of the Transaction. Additionally, when asked what they would do if BFG and AGL's machines were only available through Gamestec, responses to the OFT's third party enquiries indicate that a majority of pub customers would be willing to try to purchase from other UK or overseas manufacturers and a further two indicated that they would continue to review the arrangements with Gamestec, which suggests that such a foreclosure strategy would not be effective.
93. Separately to the above, a minority of third parties also expressed concerns that the merged entity will only make its gaming machines available through RLMS or at increased price to other distributors. However, the merging parties submitted that RLMS has a [10-20] per cent share of supply in the UK distribution of gaming machines. In addition, the OFT has received no evidence to suggest that RLMS has a strong position downstream. Further, where the merging parties overlap upstream, either the increment from AGL is low or the combined share of supply of the merging parties is not so high as to give the OFT prima facie competition concerns. As such, the OFT does not consider that the Transaction increases the merging parties ability or incentive to foreclose other distributors downstream such that it would be profitable to do so.

94. The OFT notes that AGL has a [40-50] per cent share of supply of category B1 machines. However, the OFT received two responses from casino operators who both purchase B1 machines and they both indicated that they generally purchase directly from the manufacturer. As such, the OFT is of the view that the Transaction does not vertically affect casino operators and category B1 machines.
95. With respect to category B3 machines where the merging parties submitted AGL has a [30-40] per cent share, the OFT did not receive any strong evidence as to how this category of machine is generally distributed. However, the merging parties submitted that Scientific Games has a [45-55] per cent share of supply of this category of gaming machine. This suggests that AGL would not have the incentive to foreclosure customers of its B3 machines by selling exclusively through Gamestec or RLMS given AGL most likely does not have sufficient market power upstream or the merged entity downstream to make this a profitable strategy.

### **THIRD PARTY VIEWS**

96. Most third party comments have been taken into consideration and discussed above where relevant. Other concerns raised by third parties about potentially anti-competitive practices are discussed below.
97. A couple of third parties raised concerns that upstream manufacturers may add software which prevents third parties from superimposing theirs on the machine when refurbishing cabinets or that digital machines can be designed so other parties' games cannot be added to them. However, the merging parties have indicated that the iPub is an open platform. In addition, the OFT is of the view that this is not a merger specific concern given that the Transaction does not enhance the merging parties' ability to do so.
98. A third party indicated that if the merged entity were able to leverage its position to obtain an exclusive DOND digital machine licence, then other competitors would struggle to compete in the pub market. However, the OFT has received no evidence to suggest that the merged entity would be in a position to do so.
99. In addition, the OFT received a number of positive third party views. In particular, some third parties considered that AGL's investment into the

Danoptra Group will lead to new technology as well as BFG and Gamestec improving their offering. Further, they indicated that the Transaction will strengthen the long term competitive landscape of the UK industry and competition with Barcrest.

## **ASSESSMENT**

100. The merging parties overlap, as far as is material for the competitive assessment, in the manufacture and supply of gaming machines and, in particular, category B4, C (both to the pub and non-pub sector) and D gaming machines.
101. With respect to the overall manufacture of gaming machines, the merging parties have a combined [30-40] per cent share of supply and will continue to face strong competition post-merger especially from Scientific Games.
102. With respect to category B4 gaming machines, whilst the combined share of supply is [40-50] per cent, the increment is low ([0-five] per cent) and a number of competitors will continue to constrain the merging parties post-merger.
103. When considering category C machines to the non-pub sector, the OFT found that the merging parties are not close competitors, the increment is low ([0-five] per cent) and there will be sufficient competition to constrain the merging parties post-merger. In addition, no merger concerns were raised by any non-pub customers.
104. With respect to category C gaming machines to the pub sector, the OFT assessed both whether there is a realistic prospect that the merged entity would withdraw from the manufacture of analogue machines or have an increased ability and incentive to increase the price of BFG's analogue machines. The OFT found it would not be profitable to close BFG's analogue business. In addition, the merging parties provided evidence suggesting they are intending to continue this business. With respect to any price rise, the OFT notes that the increment is low ([0-five] per cent), there are a number of analogue manufacturers in the market, Scientific Games exerts a strong constraint specifically on AGL with respect to digital category C machines, the merging parties are not close competitors and any possible effects on competition would be sufficiently mitigated by entry (and expansion) and buyer power.

105. The merging parties' presence in category D gaming machines is a combined share of supply of approximately [25-35] per cent with a low increment, based on third party evidence. In addition, there are a number of other competitors in the industry who will continue to constrain the merged entity post-merger and could also expand production so as to mitigate any effect of the Transaction. Further, third party operators and distributors did not express any concerns with respect to category D machines and the largest customer of category D machines who responded to the OFT's enquiries, did not oppose the Transaction.
106. Third parties expressed concerns with respect to vertical foreclosure of downstream operators and distributors. In both cases, the downstream Danoptra Group entities' share of supply is not high ([20-30] per cent for Gamestec and [10-20] per cent for RLMS) and either the increment upstream from AGL is low (in the manufacture and supply of all gaming machines, category B4 and C gaming machines to the pub sector) or the shares of supply are not such as to give the OFT prima facie competition concerns (category C machines to the non-pub sector and D). Thus, the Transaction is unlikely to have a significant impact on any ability BFG may have to foreclose the downstream market. In addition, the OFT did not have any vertical concerns with respect to the other categories of machine where only AGL is active. As such, the OFT is of the view that the Transaction does not enhance the ability or incentive of the merging parties to engage in such foreclosure and, any effect.
107. Consequently, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

## **DECISION**

108. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.

## Annex 1 – Categories of Machines

<b>Machine category</b>	<b>Maximum stake (from July 2011)</b>	<b>Maximum prize (from July 2011)</b>
<b>A</b>	Unlimited	Unlimited
<b>B1</b>	£2	£4,000
<b>B2</b>	£100 (in multiples of £10)	£500
<b>B3</b>	£2	£500
<b>B3A</b>	£1	£500
<b>B4</b>	£1	£250
<b>C</b>	£1	£70
<b>D non-money prize (other than crane grab machine)</b>	30p	£8
<b>D non-money prize (crane grab machine)</b>	£1	£50
<b>D money prize</b>	10p	£5
<b>D combined money and non-money prize (other than coin pusher or penny falls machines)</b>	10p	£8 (of which no more than £5 may be a money prize)
<b>D combined money and non-money prize (coin pusher or penny falls machine)</b>	10p	£15 (of which no more than £8 may be a money prize)

Source: Gambling Commission

**Annex 2 – Number of each category of machine that can be sited by venue**

Type of Venue	Machine Category						
	B1	B2	B3	B3A	B4	C	D
Large Casino (machine/table ratio of 5-1 up to maximum)	Maximum 150 machines. Any combination of machines in categories B to D (subject to machine/table ratio)						
Small Casino (machine/table ratio of 2-1 up to maximum)							
Casinos established under the Gambling Act 1968 (no machine/table ratio)							
Betting premises and tracks occupied by pool betting	Maximum of 4 machines in categories B2 to D						
Adult gaming centre (AGC)	Maximum of 20% of the total number of gaming machines which are available for use on the premises categories B3 or B4*			No limit on category C or D Machines			
Bingo premises				No limit on category C or D Machines			
Clubs or miners' welfare institute (with permits)	Maximum of 3 machines in categories B3A or B4 to D					1 or 2 machines of category C or D automatic upon notification	
Qualifying alcohol-licensed premises							
Qualifying alcohol-licensed premises (with gaming machine permit)						Number as specified on permit	
Family entertainment centre (FEC) (with premises licence)	Maximum of 3 machines in categories B3A or B4 to D					No limit on category C or D Machines	

Family entertainment centre (FEC) (with permit)	[REDACTED]	No limit on category D Machines
Travelling fair		No limit on category D machines

Source: Gambling Commission