William Hill PLC

Proposed acquisition by Ladbrokes plc (**LB**) of Gala Coral Group (**GCG**)

Addendum to submission of 24 February 2016

I. SUMMARY

1 This document:

(a) Updates WH's response to the CMA's SOI and LB's Initial Submission (the **February Submission**)[1], based on additional information that has been published since the February Submission; and

(b) Develops some of the points that the CMA has recently put to WH.

2 The February Submission provided detailed evidence of the following propositions:

(a) Retail and online are discrete markets;

(b) Significant parameters of competition between the Parties are determined nationally; and

(c) The Parties understate the impact of the proposed transaction on competition.

3 This document supplements the above with further evidence. In particular:

(a) Our response to the SOI demonstrated that the Parties' position on the decline of the retail sector is inconsistent with their own results. GCG's Q1 2016 results (as well as Paddy Power's FY2015 results) have since been published and confirm that, whilst susceptible to changes in regulation and taxation, the Parties' financial position is very different to the one LB describes in its Initial submission;

(b) A number of independent analyst presentations, which come to a similar conclusion;

(c) and

(d) A more detailed review of WH's recently prepared internal trading figures, which also demonstrate differences between retail and online.

II. THE LATEST RESULTS FROM GCG SUGGEST A HEALTHY RETAIL BUSINESS

4 In the February Submission, William Hill set out a number of excerpts from LB and GCG's own documents. Those excerpts clearly demonstrated that retail LBOs have remained resilient, even as online betting and gaming has grown in the UK (and despite the susceptibility of the industry as a whole to changes in regulation and taxation). The assumption which the Parties make in their Initial Submission, that online growth has been at the expense of retail, is not borne out by that evidence.

[1] It adopts the same definitions as the February Submission.

Gala Coral Group Limited

5 Since the February Submission, GCG's released its Q1 results on 3 March 2016. These note the following[2]:

(a) Coral Retail EBITDA of £40.7m was £0.2m ahead of last year and £9.6m or 31% ahead after adjusting for the impact of regulation;

(b) OTC stakes were £5.5m or 1% ahead with football stakes 10% ahead;

(c) OTC gross win margin of 18.2% was 1.5pp ahead, driven by horse racing margins 0.8pp ahead, and a recovery in football margins; and

(d) Machines net revenue was £4.1m or 4% ahead of last year with gross-win-per-machine-per-week increasing by 5% to £1,020 primarily due to increased B3 content.

6 It is also clear from the segmental information that the growth in GCG's Online division has not come at the expense of its Retail division. In particular, when comparing Q1 2015 with Q1 2016[3]:

(a) Although net revenue grew from £64.5m to £91.1m in Online, it also grew from £199.6m to £212.9m in Retail;

(b) Although gross profit grew from £45.6m to £60.4m in Online, it also grew from £151.2m to £155.6m in Retail;

(c) Although operating profit grew from £7.2m to £14.2m in Online, it also grew from £32.2m to £32.6m in Retail[4];

7 Finally, GCG's divisional KPIs (set out in Table 1, below) tell a very different story to that which the Parties tell in the Initial Submission[5].

Table 1: GCG's Retail KPIs for Q1 2016

CORAL RETAIL	QUARTER 1[2]		
	FY16	FY15	Var %
KPIs[3]			
OTC gross win margin (%)	18.2%	16.7%	1.5pp
Average number of LBOs	1,844	1,834	1%
Average number of Machines	7,358	7,317	1%
Gross win / machine / week (£)	1,020	975	5%

[2] http://www.galacoral.co.uk/~/media/Files/G/Gala-Coral/reports-and-presentations/quarterly-report/financial-results-q1-fy16-accounts.PDF, at page 1.

[3] http://www.galacoral.co.uk/~/media/Files/G/Gala-Coral/reports-and-presentations/quarterly-report/financial-results-q1-fy16.pdf at page 3, as above.

[4] This final figure represents 16 weeks to 17 January 2015 and 16 January 2016.

[5] As above, at page 7.

Paddy Power

8 In spite of changes in regulation and taxation, the Parties' figures are not the only ones showing a resilient retail estate.

9 The February Submission set out WH's own figures for comparison. Similarly, Paddy Power's Preliminary Results Statement for FY 2015 (only just released on 8 March 2016[6]), tell a similar story. In particular:

(a) Revenue up 24% to €1,094m, with double digit growth across all Online and Retail divisions;

(b) UK Retail revenue up 15% (up 6% like-for-like); and

(c) Operating profit of €23m up 12% before €5m of additional Machine Gaming Duty.

10 In describing the retail business, Paddy Power notes:

"*Our retail businesses in Ireland and the UK continue to grow strongly…. Operating profits grew by 18% on average over the three years to 2014 and grew by a further 11% in 2015 to €44m, despite increased taxes and regulation*."

11 Finally, the KPIs for the retail business (set out in Table 2 below), tell as similar positive story. Paddy Power has seen significant increases in all of its retail KPIs.

Table 2: Paddy Power's retail KPIs for FY2015

UK RETAIL

€m	2015	2014	% Change	% Change in CC
Sportsbook amounts staked	897	710	+26%	+14%
Sportsbook net revenue	100.9	80.5	+25%	+13%
Sportsbook net revenue %	*11.3%*	*11.4%*		
Machine gaming net revenue	121.1	93.5	+30%	+17%
Total net revenue	**222.0**	**173.9**	**+28%**	**+15%**
Gross profit	157.8	129.5	+22%	+10%
Operating costs	(134.4)	(108.3)	+24%	+14%
Operating profit	**23.4**	**21.2**	**+10%**	**(8%)**
Shops at year end	341	321	+6%	

III. INDEPENDENT ANALYSTS PRESENTATIONS CONCLUDE THAT RETAIL IS ROBUST

12 WH has also collated the views of a number of third party analysts over the past year, attached at Appendices 1-4. Some key excerpts are as follows:

(a) Davy, 10 August 2015 (Appendix 1):

(i) "*Retail performance continues to defy expectations*" (page 1); and

(ii) "*…underlying retail performance is actually proving to be more resilient than we expected. … Rumours of Retail's structural demise continue to be exaggerated*" (page 2);

(b) Exane, 21 September 2015 (Appendix 2):

[6] http://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/PPB/12727411.html

(i) "*UK retail – sustainable and cash generative*" (page 9); and

(ii) "*We believe the argument that high street retail is a dying business is overplayed*" (page 9).

(c) Numis, 18 January 2016 (Appendix 3):

(i) "*We believe the shops are ex-growth but stable. For some customers the shops provide a leisure activity which can't be replicated online. And those customers have contributed to gross win per shop being broadly unchanged since 2008*" (page 1);

(ii) "*Demand for shop-based betting and gaming has been resilient…*" (page 7); and

(iii) "*While the business is not immune to the challenges facing the rest of the high street we believe it will remain a valuable cash-cow at the heart of the group.*" (page 7)

(d) UBS, 7 August 2015 (Appendix 4):

(i) "*Divisional detail - Retail stronger than expected online weaker*"

IV. WH'S LATEST TRADING FIGURES ALSO DEMONSTRATE KEY DIFFERENCES BETWEEN RETAIL AND ONLINE

13 Since the February Submission, WH's has prepared its latest set of internal figures (set out at Appendix 5). It considers that a review of these figures could prove illuminating for the CMA, because they:

(a) Address a number of points which the CMA has previously put to WH; and

(b) Give rise to markedly different results than those which the Parties claim (as described above). In particular, the figures clearly demonstrate a number of key differences between the retail and online channels.

[✂]

14 The Parties initial submission notes that *"odds are set at the same level for the vast majority of events in horse racing, greyhound racing, other sports and for numbers products"*[7] and that *"in football, the odds are comparable on those selections in the higher leagues where the majority of staking takes place"*[8]. The Parties further note that *"bookmakers have limited ability to deviate from competitive odds in either segment or to set different odds across channels"*[9] and that *"were the Parties to offer poorer odds to retail customers compared to the odds offered to online customers, the migration to online would further accelerate and cannibalise their retail customer base"*[10].

15 In the Appendix to WH's Initial Submission (dated 13 January 2016), WH noted that the use of gross win is not necessarily representative of the overround (price) bettors receive[11]. This is due to the element of chance in gambling events, which can mean the gross win varies

[7] Paragraph 3.6 of the Parties' Initial Submission
[8] *Ibid*
[9] *Ibid*
[10] *Ibid*
[11] Paragraph 16 of the Appendix to WH's Initial Submission

compared to the overround on any given day, week, or even quarter[12]. However, when taken at over a longer period of time, e.g. over the course of a year, WH considers that persistent differences in gross win margin between retail and online channel indicate a difference in pricing and betting types between those channels. In this submission, WH considers what its data shows in light of this view.

Differences in gross win margin illustrate the underlying differences in prices and betting types between retail and online

16 The data provided in Appendix 5 compare the performance of WH's retail and online businesses, including data on turnover and gross win by sport, along with data on operating costs.

17 The data show that online sportsbook turnover[13] (£3.96bn) is significantly greater than retail over the counter ("OTC") sportsbook turnover (£2.42bn) [✂][14]. The "Margin %" figure presented in the data is "gross win margin". For example, for the retail sportsbook this is calculated by dividing retail sportsbook gross win by retail sportsbook turnover. It is the proportion of the total amount staked by customers which is not returned as winnings – i.e. revenue net of payouts. It is not margin in the traditional sense of a measure of profitability, and does not consider any costs to the business[15].

18 It is striking that there is a significant difference in gross win margin overall between WH's retail business (17.8%) compared to its online business (7.8%). [✂][16]. WH considers that this difference in gross win margin between retail and online markets is driven by two factors. First, from mix effects due to differences in the types of bets placed, and second, due to differences in overrounds. It discusses each of these factors in turn.

19 Part of the difference in gross win margin is attributable to the types of bet placed in the retail channel compared to online. WH provided detail on these differences in paragraph 31 of its initial submission dated 13 January 2016. In particular, LBO customers place a larger proportion of accumulator bets (i.e. betting on multiple outcomes occurring) than online customers. These products typically have a higher gross win margin[17].

20 However, WH does not consider differences in the types of bets alone to be the primary driver of gross win margin differences. As explained in WH's submission of February 24, there are clear differences in the pricing of sports bets between the online and retail channels.[18] For example, the significant differences in gross win margin for football betting are driven by the clear difference in prices between online and retail channels. This difference in pricing holds for the high profile football matches which the parties state odds are comparable[19,20].

[12] Paragraph 15 of the Appendix to WH's Initial Submission
[13] I.e. the total amount staked by customers
[14] [✂]
[15] For example, a betting company that takes £1,000 in stakes and pays out £900 in prizes would have a gross win margin of 10%. The gross win margin is calculated by taking the difference of stakes less prizes (£100) and dividing by total stakes (£1,000).
[16] [✂]
[17] Accumulator bets, where a customer places a bet on multiple outcomes to occur, typically have higher gross win margins than single bets, where a customer places a bet on just one outcome. For example, if all outcomes are priced to an overround of 1.10, the overround for a single bet is 1.10. However, a customer betting on two outcomes to occur (a "double") pays 1.10*1.10 on the bet, an equivalent overround of 1.21. All else equal, the payout will be lower, and therefore the gross win margin higher, for accumulator bets.
[18] Paragraphs 29 to 30 of the February 24 Submission
[19] Paragraph 3.6 of the Parties' Initial Submission
[20] WH considers that should the CMA conduct an analysis of the retail and online overrounds for football matches at the Parties, it would find that there is a consistent difference in these overrounds

Higher gross win margins are required in retail to cover costs

21 The financial data in Appendix 5 shows that retail has high cost operating costs [✂]. In total, operating costs as a proportion of total sportsbook stakes are 20.5% in retail compared to 7.5% online.[21]

22 It is therefore understandable that there are higher gross win margins, driven by higher prices (worse odds) and different betting types, in retail compared to online. These are required in order to cover the substantial operating costs incurred by the retail business, including retail costs that are driven by the need to compete on non-price factors (e.g. content, which is determined by WH at a national level).

23 The result of these cost differentials across channels is that operating profits as a percentage of sales between online and retail betting channels are more similar than the prices across those channels. WH's latest results indicate that its operating profits as a percentage of sales are 23% for online and 19.3% for retail.

The evidence is consistent with WH's view that online and retail are in separate markets

24 The fact that there are sustained differences in prices and gross win margins between the two channels that do not elicit a demand side response in the form of customer switching suggests that the two channels are in separate markets. If customers did switch between the two channels, and the retail market was forced to reduce prices to a point where it had a similar gross win margin to online, it would not be economically rational to run shops.

25 The WH financial data also indicate how retail and online use different competitive levers to attract and retain customers. The data show that WH invests free bets and bonuses to compete for online customers, but this is not a feature of retail competition. Retail customers, as explained in WH's earlier submissions, care more about shop location and quality of staff, and less about factors such as free bets and promotions. That customers of the two channels respond to significantly different competitive levers, together with the sustained price differentials across channels, suggests that they operate in two separate markets.

[21] Please note that due to data availability these figures are calculated on the basis of stakes for sportsbook bets only