

Code Allocation Model Discussion paper #3



Feedback to date

Tasracing have received numerous responses from industry participants on the first two discussion papers. The following is a high level summary of the points raised.

For harness participants, the national trend on harness turnover in conjunction with restricted opportunities on Sky has led to a consistent call for CPI based increases. Most respondents noted that while the Harness code allocation has been increasing or stable, there has been a reduction in the share of the total code allocation to harness over the past three years. This has been due to the current allocation model and the relative commercial performance of the code.

Harness participants highlighted the gap between the economic activity created by the code and the current level of funding.

Greyhound participants have been focussed on the commercial returns of the code which has been particularly strong over the past few years. This has been despite a number of restrictions such as races per meeting limits and other product encroaching on their Sky positioning. The greyhound participants were concerned with the appropriateness of using code specific employment statistics derived from the IER study believing they did not properly represent part time and volunteer time and hence were not an appropriate basis for the allocation of funding.

Greyhound participants highlighted the gap between the turnover contribution created by the code and the current level of funding.

Both harness and greyhound participants were concerned with the level of promotion of the thoroughbred code and the impact that has on the comparative performance of each code and hence the code allocations under performance based models.

Similar to harness participants thoroughbred participants have highlighted the economic activity created by the code. The code's relatively strong economic activity position and good turnover performances means most models result in minimal changes. However thoroughbred participants noted the potential downside risk of lost meetings or other disrupting influences on any model where turnover was a major driver of code funding.

Both greyhound and thoroughbred participants suggested racefield fees earned on each code's product could make up part of the code funding.

Principles

The following principles have been used as the basis for considering the various options available for the allocation model.

Supporting Sustainability

For the Tasmanian racing industry the issue of sustainability remains of foremost concern. With current funding levels continuing to leave Tasracing with an operating deficit, growth in total code allocations is limited to CPI growth (in line with the funding deed). Tasracing

continues to pursue further funding, commercial revenue growth and efficiency reforms to provide a viable base for long term sustainability.

The pursuit of sustainability has a number of implications for code allocations beyond the historical increases. Firstly, not being sustainable prevents the options for the sharing of revenue growth from racefield fees (RFFs) with codes in the short to medium term. Providing the codes with incentives based on the growth of RFFs is an attractive option for the future but not currently possible in the existing financial situation. Tasracing is taking significant actions to improve RFF revenues through pricing and definitions. A sustainable business model should allow industry to share in commercial success and this remains a key ideal Tasracing is working towards.

Secondly, Tasracing may take action to improve RFF income which may influence code specific performance measures. These actions are undertaken to improve the long term viability of the industry as a whole, with code specific implications being a secondary consideration. Tasracing is developing a comprehensive marketing and business development plan which will focus more specifically on the growth of RFF income from all three codes. This is likely to result in an increase in promotional activity that is aligned with commercial growth strategies. Similar to RFFs above, including a measure of promotional spend within the code allocation methodology is attractive though not considered practical in the current situation.

Thirdly the CPI limit on growth of code allocations prevents any realignment of code allocations without impacting other codes. Any increase to a particular code outside of the CPI increase component would, by necessity, require reductions for one or both of the other codes.

Funding Stability

It is generally desired among participants that no code should have their funding decrease from one year to the next.

Code funding certainty and stability is considered important in that it provides confidence for participants and encourages longer term financial commitments in the areas of ownership, investment in training facilities, breeding stock and other items. A reduction in code funding (usually resulting in stakes reductions) or even the *potential* for reduced funding could detrimentally impact code confidence leading to declines in activity and investment within the code. An extension of this principle is that each code should see at least some increase on an annual basis.

Economic Impact

The Tasmanian racing industry receives approximately \$29M per annum from the State government. The government's return from this investment is the economic, employment and social activity the racing industry generates.

The recently completed Size and Scope Review of the Tasmanian Racing industry highlighted the economic value of racing to the Tasmanian economy of over \$103m per annum. 52% of this comes from Thoroughbred racing, 33% from Harness and 15% from Greyhounds.

Contributions to Revenue

Racefield fee revenue is now a critical component of the industry funding model representing approximately 17% of total Tasracing income. With Government funding fixed to CPI growth Racefield fee income remains the primary growth income stream capable of funding industry development. As an average, Tasracing currently receives approximately 1.6% of turnover generated on Tasmanian racing around Australia. Currently, thoroughbreds provide approximately 44% of all Tasmanian racing turnover, greyhounds 39% and harness 16%.

Performance Incentives

A performance based incentive component has been considered essential to encourage support for actions that improve revenue. Commercially based actions may from time to time disrupt industry traditions or be unpopular with participants. Having an incentive based component helps align participant returns with sensible commercial decisions that benefit the industry as a whole.

Due to potential choices that may need to be made, particularly around scheduling, it is considered important that international revenue be incorporated into any incentive based component. This ensures that where choices need to be made that are a net benefit to the industry but promote international revenue over domestic revenue, the specific code allocation does not “suffer” as a result, but rather can benefit from supporting sound commercial practice. Data received from Sky for the 2011-12 financial year showed that Tasmanian greyhound racing generated 36% of all international revenue by Tasmanian racing, harness 24% and thoroughbred 40%. The amount to be recognised for international revenue is expected to be less than 5% of total business.

Keeping It Simple

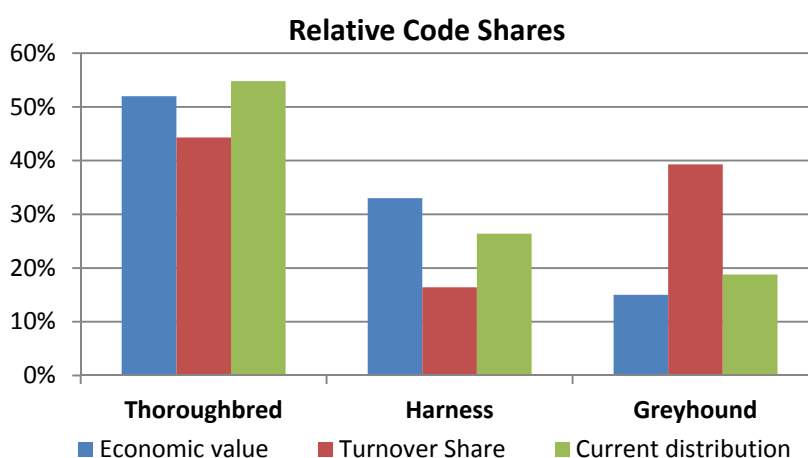
Consistent with Tasracing’s philosophy, transparency in any model for allocation is critical to ensure participants understand the concepts and the implications. It also helps allay any suspicions that the model is biased or misleading. The key to transparency is to ensure the model is as simple as possible and hence understandable by a wide target audience within the industry.

While this principle remains a focus, any code allocation model will, by necessity, be a combination of interacting mathematical formula. Appropriately reflecting the various principles into a model that is fair to all participants requires a degree of complexity. Tasracing aims to ensure that where this complexity exists, explanations are as clear as possible.

Comments

The major area of interest is the current allocation amounts and their link to either economic output or commercial performance. Harness participants highlight the differences between the amounts allocated to each code and their respective economic activity while greyhound participants have highlighted the difference between the commercial contribution of each code and their allocated share.

	Thoroughbred	Harness	Greyhound
Economic value	52%	33%	15%
Turnover Contribution	44%	16%	39%
Current distribution	54.8%	26.4%	18.8%



As noted in “Economic Impact” the government’s return for its \$29M annual investment is the economic, employment and social activity the racing industry generates. Alternatively, as noted in “Contributions to Revenue” Tasracing’s ability to fund the operations of the industry is dependent on the commercial returns generated by the turnover of the codes through national wagering operators. In the context of sustainability, commercial returns are clearly the primary focus at this point in time. Without further government assistance, growth in racefield fees is the sole opportunity to significantly reduce the funding gap and minimise the impact on industry funding. Tasracing has modelled the impact on the three codes were funding to be allocated according to economic value. For both the thoroughbred and greyhound codes it would result in decreased funding of \$600k and \$800k respectively with an increase for Harness of \$1.4M. It is estimated that the industry would lose between \$400k and \$700k per annum in racefield fees due to reduced racing in the thoroughbred and greyhound codes offset to some degree by an increase in racing in the harness code. Given the sustainability challenges this result would be to the detriment of all three codes.

The link between each code’s allocation and its economic impact is important but far from clear. There is no evidence at this time to suggest that changing a code’s allocation would result in a proportional change in their economic activity¹. Similarly it is unclear, given the limited opportunities for changing Sky coverage due to long term contracts and the

¹ See the report “Size and Scope of the Tasmanian racing Industry” (November 2013), page 10 for a representation of the investment and expenditure flow of the Tasmanian racing industry.

competitive nature of the broadcast landscape, if changing a code's allocation would result in a proportional change in their turnover share. While reduced races would certainly result in reduced turnover there appears limited opportunities to significantly increase the amount of racing from any of the three codes.

There is general (though in some cases, reluctant) acceptance that in order to provide stability and no negative impact on any one code, the current levels of funding to each code should be retained as a base. Most participants realise that the current distribution shares are the result of historical factors and performances. In the context of sustainability, any redistribution of the base level of funding to each code would result in a reduction in funding to one or more of the codes. In order to maintain stability and recognising that the current base distribution recognises the application of the performance-aligned model of the prior three years, it is proposed that the current base level distributions are maintained.

Proposed Model

Tasracing has taken into account all feedback to date and the above principles to derive the following allocation model. The primary objectives of the model are:

- To provide a level of funding stability.
- To include a performance based component where each code has a reasonable opportunity to achieve good outcomes.
- To include performance based incentives that are focussed on areas where the codes have some ability to influence.

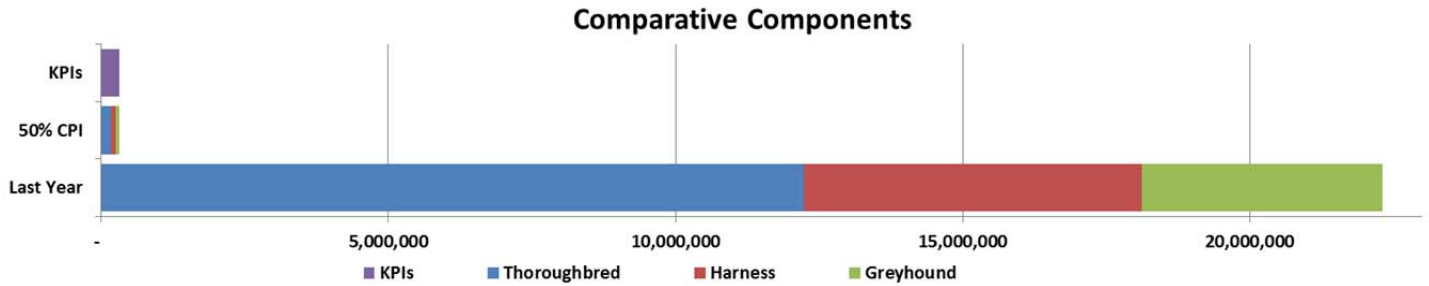
The model proposes three components.

The first component comprises the total funding received by each code the previous year. The retention of the previous year's funding as a base ensures no code will be faced with a funding reduction and is expected to provide confidence for industry participants.

The second component proposes an increase for each code based on 50% of the CPI increase in the same proportion as the base allocation. This ensures each code will get a funding increase each year. In combination with the first component these provide a high degree of surety to code participants.

The third component will be a performance based allocation of the final 50% of the CPI increase using KPIs developed on each codes historical performance trends applied to and adjusting the base allocation proportions of this funding component. This ensures participants are incentivised to support commercially sound decisions for the industry. Using each code's own historical trends as the basis for the KPIs means codes compete against their own historical performance and not against other codes.

While the second and third components are relatively small compared with each code's base level of funding, they each represent increases of around \$300k per annum in total across all three codes, as demonstrated in the graph below.



For the third component, four key performance indicators are proposed that will be based on each codes own historical performance. These include:

- Turnover growth
- Average Starters
- Average races per meeting
- Number of Races on Sky

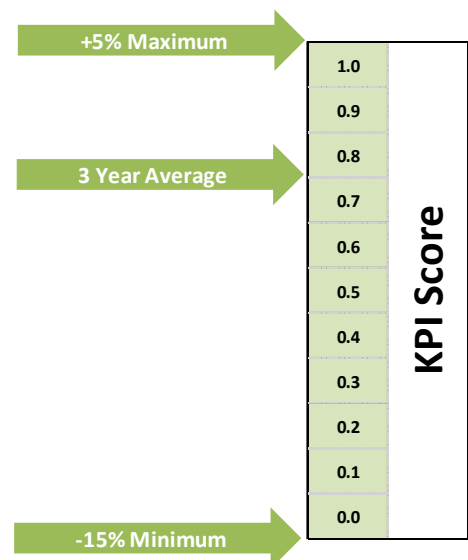
Four performance indicators have been chosen so as to limit the exposure of the code to potential problems in individual indicators while ensuring that positive results have a notable impact on the code score.

The four indicators have been chosen as they are relatively simple to understand, the data available to support each one is accurate and regularly monitored, they are aligned with the commercial drivers of the business and as a result they are aligned with the company's corporate plan. Tasracing envisages reporting regularly to the industry forums on their performance against these metrics. This will provide useful guidance and understanding of the impact on the next years funding.

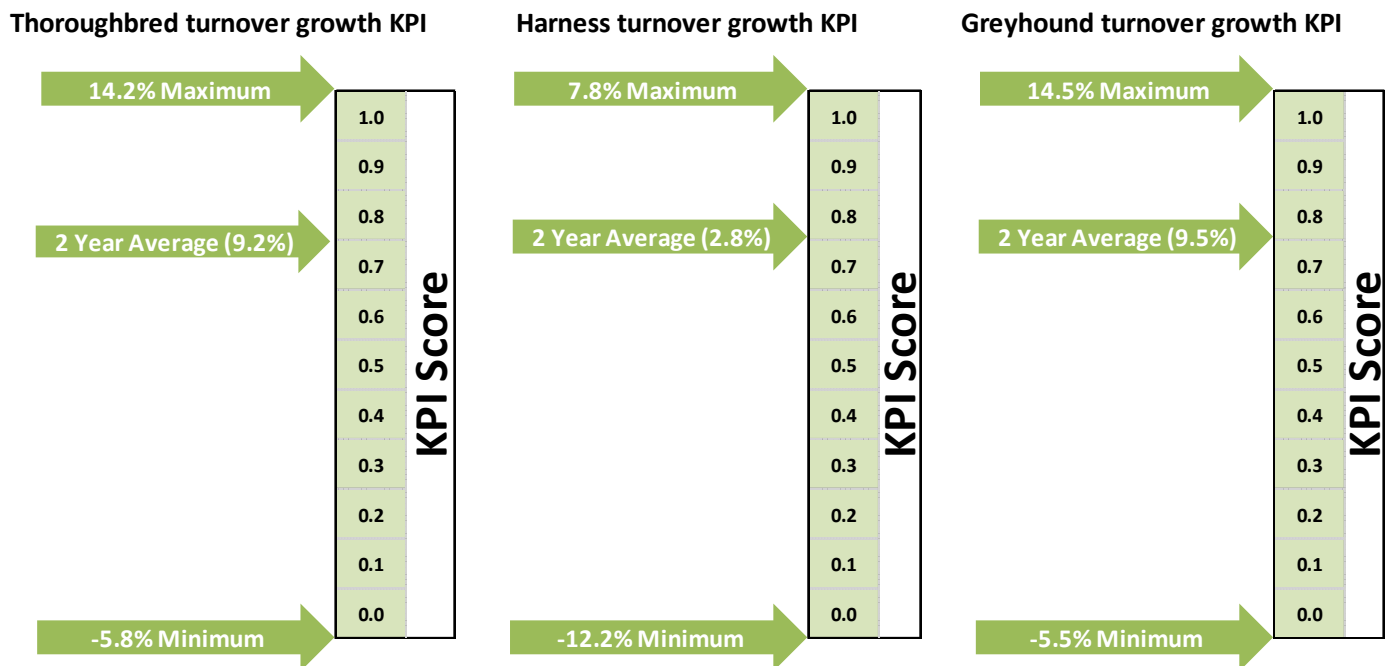
Average starters, average races per meeting and the number of races are KPIs that codes have at least some direct influence over. Race programming, scheduling, participation are all areas that can influence the outcome of these components. Turnover growth has a direct linkage to the financial performance of the industry as a whole and as such is a key area of interest though external factors are more likely to impact outcomes than for the other KPIs. Being one of four KPIs proposed, the impact of turnover growth will be 25% of the total code assessment.

Each code will have targets set for these KPIs based on their own performance over the past three years. The exception to this will be turnover growth due to incomplete data capture prior to the advent of racefield fee legislation in 2010-11. Turnover growth will use two year growth in the first year of operation and then three year growth for each subsequent year.

It is proposed that a target band be established for each code KPI that will range from +5% on their historical average to -15% with the maximum in the range worth 1.0 and the minimum 0.0.



Using the two year average turnover growth KPI as an example, the three codes have the following averages; thoroughbred +9.2%, Harness +2.8% and greyhound 9.5%. These create the following target bands for each code:



Taking thoroughbred as an example, their two year average is 9.2%. Their range is calculated as +5% = 14.2% growth and -15% = -5.8% contraction. This skewed scale protects codes in that it takes significant underperformance before funding is heavily impacted.

Applying the same methodology across all KPIs for each code derives the following target ranges:

Thoroughbred	Min	Max	Harness	Min	Max	Greyhound	Min	Max
Av Starters	8.4	10.3	Av Starters	8.0	9.9	Av Starters*	7.2	8.0
Av Races	7.0	8.6	Av Races	7.8	9.6	Av Races*	8.1	11.0
races	530.7	655.6	races	656.2	810.6	races	1369.1	1691.2
TO Growth	-5.8%	14.2%	TO Growth	-12.2%	7.8%	TO Growth	-5.5%	14.5%

* Greyhound average starters and races per meeting are limited to 8 and 11. The target ranges have been built around these limits and their historical averages.

Basing the target ranges around each code's individual averages ensure that many of the factors that are impacting code performance are taken into account. For example the impact of Sky positioning is taken into account when considering each code's turnover growth averages as is the historical promotional activity of Tasracing towards each code.

The positioning of the target range with the average at the 0.75 mark is designed to promote higher scores and reduce volatility in the allocations. Using each code's own historical values means each code has the opportunity to perform well against its own KPIs and diminishes the impact of intercode rivalry.

Using the April 2014 year to date figures for each code forecasts the following results for the above target ranges (note that these figures are likely to change for the full year):

Thoroughbred	FY14*	KPI Score	Harness	FY14*	KPI Score	Greyhound	FY14*	KPI Score
Av Starters	9.9	0.78	Av Starters	8.8	0.43	Av Starters	7.7	0.62
Av Races	8.5	0.97	Av Races	8.8	0.55	Av Races	10.2	0.72
aces	610.0	0.64	aces	734.4	0.51	aces	1,604.3	0.73
TO Growth	5.9%	0.59	TO Growth	7.2%	0.97	TO Growth	14.9%	1.00
Code Score		0.74	Code Score		0.61	Code Score		0.77

* Based on the April 2014 Year to date figures extrapolated for the full year.

The next step is to apply the scores to the funding allocation. This is applied by starting with the base allocation levels and then adjusting this up or down according to the codes average KPI score. This creates a weighted score from which the proportion can be calculated to produce a calculated share. The reason why the base allocation is used as the starting point is to reduce volatility of results and give each code the best opportunity to earn a 100% CPI increase.

The code score is the average of the individual KPI scores. Each codes score is then weighted by their previous years funding share to derive a comparable weighted score. The weighted score determines the proportion each code will receive of the performance based component.

	Code Score	Weight	Weighted Score	Calculated Share
Thoroughbred	0.74	54.1%	0.40	56.4%
Harness	0.61	27.1%	0.17	23.4%
Greyhound	0.77	18.8%	0.14	20.3%
		Total	0.71	100.0%

Where:

- Weighted score = Code Score x Weight, and
- Calculated share = Codes weighted score / Total Weighted Score as a percentage

The calculated share is each code's proportion of the performance component.

Again, using thoroughbred as an example, the code score (0.74) is multiplied by the weight (54.1% last year's allocation) to derive the weighted score of 0.40. The weighted score (0.40) is then divided by the total weighted scores (0.71) to determine the calculated share of the performance component that thoroughbred will receive (56.4%) i.e. $0.40 / 0.71 = 56.4\%$.

Assuming a 2.8% CPI increase for FY14 the above methodology would result in the following distributions for FY15:

	LY Funding	50% CPI	KPI Share	Total	% Increase
Thoroughbred	12,240,512	171,367	176,038	12,587,918	2.84%
Harness	5,879,708	82,316	73,074	6,035,098	2.64%
Greyhound	4,191,986	58,688	63,259	4,313,932	2.91%

Length of Operation

The previous model has been in operation for the full three year period as originally intended. Any new model introduced may be significantly impacted by changes in sustainability that may occur in the short to medium term regarding the Tasracing business model. A longer term view of allocations is considered a benefit to participants in relation to funding surety. It is intended that any new model will be in place for three years but Tasracing will reserve the right to review the model earlier if required.

The key driver for an earlier review will be any fundamental change in the Tasracing business model that changes the sustainability position.

The proposed model is a methodology that can be readily adapted to changes that may occur in the future. The percentages for each component can be adjusted as can the characteristics of target ranges or even the KPIs to be used. While the model as setup at the moment is focussed on funding stability it can be set more aggressively if future changes in sustainability reduces the CPI based restriction on funding growth.

FAQs

Why shouldn't allocations be based on economic value?

The economic value of the racing industry is an important component of the justification for the Government funding the industry receives each year. However at this point in time, sustainability remains the issue of highest concern for the Tasmanian racing industry. In this context, commercial performance is the more highly ranked driver of industry decision making, though these decisions are made while seeking to at least protect the existing economic activity the industry generates.

There is no clear evidence that changing a code's allocation will lead to significant changes in their economic activity. Page 10 of the report "Size and scope of the Tasmanian Racing Industry" shows a representation of the investment and expenditure flows of the Tasmanian racing industry. It demonstrates the complex interrelationships between a wide variety of inputs and the economic activity generated. Economic value is an output of the funding allocation and is not designed or appropriate to be used as an input to guide the funding allocation.

Does this model take into account Sky positioning?

The use of each individual code's historical performance to derive their KPI targets takes into account all the factors that those historical performances have been based on including the Sky positioning. As the codes KPI performance is against their historical performance, other codes Sky positioning is of lesser importance.

Does this model take into account marketing spend?

The use of each individual codes historical performance to derive their KPI targets takes into account all the factors that those historical performances have been based on including the marketing promotion each code has historically received. As the codes KPI performance is

against their historical performance, this accommodates the differing promotion levels between the codes.

Why not just increase each code by CPI?

Improving the commercialisation of the racing industry and aligning it with the contemporary operating landscape has been a fundamental tenant of the formation of Tasracing and the way it has approached its statutory responsibility as a state owned company.

Including a commercially based performance incentive component encourages participant support for sound commercial decisions that improve the sustainability of the industry as a whole. The model has been designed to ensure that all codes have a reasonable opportunity to receive a full CPI increase.

Why aren't the codes sharing in racefield fee income?

While Tasracing continues to face an operating deficit all possible sources of commercial revenue are being funnelled towards reducing the funding gap and limiting, as much as possible, the potential impacts on the racing operations and industry funding. A sustainable business model should allow industry to share in commercial success and this remains a key ideal Tasracing is working towards.

Will this model result in a stakes reduction?

No. This model protects funding levels for a code and guarantees a 50% increment of the CPI component and is aligned to give codes the best opportunity to achieve their performance KPIs for the remaining 50% of the CPI component.

Consultation Process

This paper is stage three of a three stage consultation process for the Code allocation model review.

Item	Date	Responses requested by	Status
Code Allocation Model Consultation Paper #1	Monday, 3 March 2014	Friday, 28 March 2014	Complete
Code Allocation Model Consultation Paper #2	Thursday, 15 May 2014	Friday, 30 May 2014	Ongoing
Code Allocation Model Draft Proposal	Friday, 6 June 2014	Monday, 30 June 2014	*
Tasracing Board to approve Final Code Allocation Model	Wednesday, 16 July 2014		*
New Code Allocation Model operational	Friday, 1 August 2014		

* To Be confirmed

Tasracing will be finalising the code allocation model with a final decision to be made at the July Tasracing Board meeting. The final model will be in operation from 1 August 2014.

Written comments on this paper are requested to Tasracing by 30 June 2014.

Chris Brookwell (CFO) and Daron Heald (Business Analyst) are available if required. Please contact Daron on 6212 9310 or d.heald@tasracing.com.au to discuss.