

THE INTERNET: RACING'S BRIGHT FUTURE OR FEARSOME THREAT?

William Hornbuckle - President, MGM Mirage On-line

Mr. Hornbuckle: I'm going to go through some relevant facts about the industry, about the Internet and particularly about our efforts on-line which we started in earnest last August. Just prior to my doing this, I was president and chief operating officer of the MGM Hotel. From an Internet perspective this is relatively new space for all of us—for gaming at large on the Internet, but specifically for our company. We think it's something that holds great potential. I'm going to quickly go through overviews on the Internet to put things in perspective. Is it a threat or an opportunity? I will suggest at the end of this that it is both.

Currently the Internet connects to 159 countries. Traffic doubles every 100 days on the Internet. There are 17 new pages of content added every second. There are more than 450 million worldwide users. Now that number may be a tad exaggerated, but by any stretch it is a large amount of any customer base we might look at and particularly in a customer base that you might

look at. There are over 143 million Americans using the Internet. It had been growing at about 2 million users a month—America's saturation level has reached the point where we're slowing—but there is other growth around the world.

There are over 35 million sites that will be airborne in the year 2002. Just four years ago there were less than five million sites. It's safe to assume that the Internet and the Web, in terms of a communication tool and the adoption rate, is far faster than anything any of us have ever seen before. It took radio 38 years to reach 50 million homes. It took the Web five years to reach the same amount of homes. That number continues to decrease, particularly if you look at Europe, Asia and some of the other parts of the globe.

Currently there are between 14,000 and 15,000 gaming sites. The majority of them are unregulated jurisdictions but as the big players, the bricks and mortar enterprises like ourselves, start stepping into the space we have seen a couple things happen.

The industry is starting to consolidate. Of the 14,000 or 15,000 sites, there are only a few in fully regulated jurisdictions making money. There are a

couple of ways to get on the Internet today. You can do it at an enterprise level like we're doing, which takes approximately \$20 million to get up and operating by the time you do it in a fully regulated environment. Or you literally can go out to any one of these software shops and, for a handsome percentage, get on-line for a couple million dollars. It had been relatively easy to enter this business, at least prior to today, hence the number of companies and sites over-all.

What do we see the market as? The guys at Bear Stearns and others say that in 2003 the market will hit five billion. We think that number may be a bit exaggerated but we know, from the market share numbers we can get from the few publicly traded companies, that the Internet is from 1.5 billion to two billion today on a worldwide basis. It's pretty easy to reach a conclusion with that number. Today the U.S. dominates that market. It's share is falling but today everything on the Internet, in terms of gaming, emanates and starts with the U.S. We have 60 percent of the market share. Ernst and Young came out with a publication a couple of months ago that would suggest that the industry is making between \$100 to \$200 million. That's really isolated to a couple of key operators that are doing very well and the majority of the space, which is struggling.

A little more than five to six million customers in the U.S. are expected to use Internet gaming. Because technology is really starting to kick in, the growth is in Western Europe, the Isle of Man where we've chosen to get a license, and the U.K., which is trying to become the epicenter of e-commerce and has taken this space and the opportunity to really extend out. Japan, anything in the Asian countries, continues to grow. It's been phenomenal what's happened there in a very short period of time. The penetration of the Internet and computer is not yet in Latin America to the extent that we could get access to folks in their homes or workplace.

The market begins to shrink a little in the US in 2002, not in the terms of numbers of people who are gaming on-line but in terms of our market share. Because Western Europe and Asia are growing so rapidly, it's anticipated that we'll go from 60 down to 50 and ultimately settle around 40 percent of the total market to the extent that some pending legislation doesn't get put into play. Western Europe is up to 16 percent. It's culturally acceptable and common when walking around London to see a cab go by that advertises an Internet sports and race site. The whole presentation there is different and very well accepted.

By and large the activity on the Internet is sports and race driven—depending on the market, depending on the country. Obviously the Hong Kong Jockey Club, if you're in Hong Kong, has a great deal of horseracing activity. If you're in U.K. you'll see a great sports activity tied to the Premiere, which is their soccer league. Players are predominately male, although female is growing because of games of chance—the opportunities that we're going to put out there, the typical slot machines, black jack, etc—that are coming on-line. The female segment is growing but it's still around 15 percent.

Using U.K. as the market, because we've become very familiar there as that's our first target market, the ideal customer is a male between 26 and 40 years old; probably a big-city trader because he's tech savvy and had the opportunity to go on-line and is not afraid to do e-commerce activity. So we're dealing with a young crowd, a tech savvy crowd, and predominately male. And again, leveraged off of sports and not games yet.

If you were to go today to the Nevada State Gaming Authority, as we have, and say, “Look we want to get into this space. We've secured a license in a

place called the Isle of Man. What will your issues be?” First they would say to us, “We wish you wouldn’t do this.” They have suggested that to us and we said, “We appreciate that, but we’re a very large publicly traded company in gaming and this opportunity, when it reaches a couple billion dollars potentially, is too big for us to ignore and so we feel a necessity to enter into the space.” We are the first large publicly traded company, outside of a couple of companies in U.K.—Ladbroke of note—to get into this space. From a domestic perspective, we’re going first. What they have said to us, and what you begin to hear resonate through all of the jurisdictions where we have licensed, Mississippi, New Jersey and Michigan, are three issues. One is jurisdiction control. Under no circumstance can we take a U.S. bet. We can go find a database that has U.S. people in it and we’ll do a negative database and if anyone comes up we can’t use it. They’re looking for anything that’s reasonable but at a very high level. To them, jurisdiction control means if we’re not one in a 100,000 sure, meaning if only one person out of 100,000 gets in we potentially have a problem with them.

Our technology and our system for our technology has to be at a level that hasn’t been developed before. Our biggest challenge is putting a

combination of technologies together that restricts and controls from where people are gaming. Because we're not in a state-by-state issue, because it's country to country, it's a little easier for us to do. We've put together a series of technology solutions, about eight of them, into a combination that gives us a reasonable assurance that we've met that one in a 100,000 measure that they've put forward. There is no such thing as a perfect solution. It's software reliant but from our perspective it is the biggest challenge we've had to date and ultimately the biggest challenge any of you would face if you were to get into this. How do you know someone's gambling from California and only California and not Utah? There are no perfect solutions but we feel the technology is in place to protect us and obviously we have a lot at stake in doing this. This is an opportunity for us, one that we think will grow in the long term and one we are not willing to put at risk.

The next issue is age verification. Based on the demos I talked about earlier, 18 to 21 year olds are about 15 percent of the market all by itself. Outside of the U.S. the betting age, in all but three or four countries, starts at the age of 18. That opportunity exists in Europe and other places but getting your arms

around that presents, for us, a great deal of challenge and one that you ultimately would be faced with should you get into this space.

The last issue is responsible gaming. You saw the growth—50 million homes in five years—what do we do to be responsible? These hotels have been built around people coming and having an enjoyable entertainment experience and going home. As long as the games are straight. We've got the odds figured out we'll get more than our fair share, but the difference is you can go home when it's over. Therein lies the isolation of being out in the desert, it really isolates our industry. When you look at responsible gaming on a device that goes to people's homes, you can appreciate the red flags for their offices. It's particularly interesting in the U.K., the busiest time for gaming is Friday afternoon between three and five in the afternoon. So a bunch of guys are in their office banging away on the office computers trying to get their bets down before the weekend. It's a reality. It's pervasive everywhere.

The good news is the technology is there. Never has there been a medium that's more controllable. We are going to put into the system, and you'd be ultimately required if you get into the space to put into your system, control

mechanisms that help self-regulate the player. Meaning I could play \$500 a month and that's it. I could say how much per session I want, how many sessions, how long the session is. We have those controls as an operator and the customer will have those controls. That is a regulatory requirement in all of the legitimate jurisdictions. Yes it's pervasive, but never has there been a tool more prepared to handle gaming activities. Because ultimately this goes back to databases and ultimately become neuro-databases, meaning they become smart over time. It will detect patterns and if certain patterns come up like you've changed your betting pattern, little flashes will come out at the bottom—prompts for bettors anonymous, those kinds of things. It's required and it's something that they're going to make us do to get into this space. It's something we're prepared to do. The same thought that we put behind these places—come and enjoy yourself, have fun, make it entertaining, don't hurt yourself we'd like you to come back—will be the same thing we're trying to accomplish on-line.

There are a few bills floating around before us in terms of the states. One is the Goodlatte bill, another is the Kyl bill. Interestingly, the Goodlatte bill somewhat pits your core industry, horseracing in general, against ours. There are 14 or 15 states that allow Internet gaming for horseracing. What

the Goodlatte bill would profess to say is that “We will protect that and that’s ok for the horseracing industry but for the casino industry at large, the gambling industry, you can’t do that.” That’s an interesting dynamic that the Goodlatte bill presents to us here via the American Gaming Association.

The Kyl and part of the Goodlatte bill would restrict all credit card activity. In the U.S. about 80 percent of the funding of accounts is done on credit cards. In the U.K. about 80 percent of the activity is done on debit cards. The Kyl bill would seek to stop credit card use altogether.

There was an interesting piece of legislation that we got passed in Nevada last session, which really got us going in this space. Almost two years ago, we went before the legislature and said, “We’d like to get into this. We see this potentially passing our industry by. Nevada should have a presence.” We gave ourselves, and ultimately gave the Nevada Gaming Control Authority, enabling legislation to enact a bill that said we could do this. They are studying it.

There are a couple of key cases that are coming down. There’s one in District Five, the Federal Court out of Louisiana, which talks about the Wire

Act and will have a direct impact. They're also going to wait on the Goodlatte and Kyl bill to see how they go through session this spring. Ultimately Nevada has got the rule already passed by its legislature to say it's acceptable for Nevada gaming operators to do this activity. We don't think it will happen for a year or so. I think they're going to see again what happens to those bills and what happens to us in the U.K. Last week another license holder, Station Casinos, bought half of Sun On-Line Enterprise and will be partnered with Sun in the Isle of Man as a license holder.

A lot of our activity and a lot of the Internet gaming activity is based in the United Kingdom because they embrace the space more than anyone else, as well as gaming at large. Recently they put a commission together called the Budd Commission. Sir Allen Budd was asked by the government to look at gaming at large and see what he could do to open it up. The Budd report makes 180 recommendations to the government on how to open up gaming throughout the United Kingdom. Today you have to wait 24 hours to go into a casino and that type of activity. It would profess to make a majority of those restrictions go away and open it up. A large segment of the proposals deal with Internet gaming and it will open up the opportunity for full-fledged Internet gaming.

Today you can do sports and race, but you can't do games. Something of interest to this crowd, there's been a great deal of consternation and internal strife between the British Horseracing Board and the licensee holders, most of them on the Internet now. It's all about taxes; it's all about licensing fees for content and data. They recently changed the betting laws in England. They had a nine percent tax that went against the gambler. If you made a \$100 wager, a hundred pound wager, you had to pay 109 up front. They've changed that to a 15 percent net tax on winnings to the operator, which ultimately is better for the industry. Now the British Horseracing Board has stepped in and said, "We want another 1.5 percent to pay for our data-stream." There will be some resolution to that but right now it's a state of strife between the parties.

There are over 50 jurisdictions in the world that you can do Internet gaming from, as a natural operator. We've chosen the Isle of Man, which is a small island in the Irish Sea and an hour flight from Dublin or London, for a couple key reasons. For one, the tax rate is low, 2.5 percent of our gross gaming. They also have great technology inter-structure. The Isle of Man has been known as Europe's legitimate Cayman Islands. There has been a

great deal of offshore banking enterprises that have been established there for 20 or 30 years. With that came a great deal of technology. The main fiber optics that sits between Europe and North America goes right through the Isle of Man. They've got enough capacity to literally handle the world. They have 1,000 terabytes of capacity and they're using 12 of them. The technology is very present on the island. They have a great deal of reputational risk. The banking institution is prospering there and they don't want to lose that. What was key to us is that they wouldn't accept U.S. bets. They told their operators, of which we are one and all of their operators are brick and mortar operators meaning substantial operators, that they couldn't take a U.S. bet. For us to get our story told in the states and get through the various regulatory environments we need to get through that. It was critical to us.

What are we doing actually? We're going to have an on-line casino there. In terms of Internet, a casino simply means a gaming activity that includes slots and table games as you would know them in this casino here. We are going to subsequently launch, from U.K., race and sports. The United Kingdom does not have Internet gaming that is highly regulated, you go down and simply get a bookmakers license, which is easily available

through any of the townships. You can apply for one, get it and they'll let you take that bookmaker's license and go directly to the Internet with it. You don't need to go through a rigorous regulatory environment to get on-line. We will have servers located in the United Kingdom and the Isle of Man. A customer would go in through a common portal and, depending on what they wanted to do, click over to sports or race or games and there they would be put off into the Isle of Man or into the United Kingdom. We think it's a unique opportunity. We think it's a unique environment to do something from a foundation perspective to get this successfully launched into space. We'll have a play-for-free site. Much of the world really doesn't know how to play craps and it's incumbent upon us to provide education as it relates to games and how to make wagers.

Partnerships will be critical, how we integrate. There's a great deal of technology about to launch there, or has launched, about to take off with BSkyB Interactive TV and 3-G Technology for mobile phones. Remembering the guy who's making the bet at three in the afternoon could make it at five in the afternoon on his cell phone on the way home.

The biggest one and the one most important to us is code of conduct. Because this space has been around for four or five years, because it's been tainted for lack of a better word with some of the initial operators, it's of great concern to us that we act as an anchor tenant for the Isle of Man, summit the industry and try to reset the standard. So as the industry moves forward the standards are there and conduct is there that would represent and replicate in essence what we do here in Nevada in a building like the Mirage.

Why now, why us? We think brand credibility and recognition is critical in this space and therein lies our opportunity. I don't know if any of you have gone on-line and looked at some of these sites but some of them have no credibility and the thought that you would put your credit card up in "Joe's Casino"—and there is one called Joe's Casino— isn't very comforting. The fact that you might do that transaction with MGM Mirage—you understand who they are and where they are—and we think is a great advantage for us.

The ability to attract strong partners. Everything from Virgin to Bank of Scotland to BSky with potentially an interactive platform, has come to us and said, "Could you tell us about your activities, what you're doing. Would you like to partner in some shape or form?" Ultimately our ability, unlike

almost all other Internet providers, is to tie your on-line experience back here. If you go out into this casino today and start gambling and gamble enough, we'll reward you with free rooms and food. We'll take that same experience on the Internet and drop it back here at home. You can go out and gamble and we'll treat you on the Internet to the goodies that you'd normally get if you were in the casino here. We think that's an opportunity for us.

I did some quick research, gathering information from Bear Stearns and other publicly available information, to try to understand a little more about horseracing and your story. Live and on-track wagering has gone down substantially, but off-track and telephone continues to rise. This would suggest that a share of off-track handle booked in person opens further opportunity for account wagering, so this is saying that 67 percent of the folks are now doing off-track wagering in some form. Right now principally that is call accounting so the obvious opportunity exists. Where does the Internet play in that? How can we get to that marketplace and is our product relevant to that?

Something else we were tracking is the legality of U.S. account wagering, it's inception, what states—obviously most recently with California which now is beginning to set itself up as the most viable place and opportunity to begin to really introduce Internet gaming with your industry. In 1994, Nevada opened pari-mutuel wagering here. When I was running the MGM last year, 97 percent of all of our horse business was pari-mutuel. We don't know as much about it as you do and particularly we don't know as much about it as some of the folks who came in and bet with us. So we just as soon leave it up to all of you guys. It seemed to be very profitable for us, for yourselves and the customers like the product.

The suggestion is, particularly with the opportunity that California has presented itself, can you take that successfully onto the Internet? If you go out into the world, and even in the states, you will find a great deal of gray because the space is so new. We've gone to three attorneys in Italy and said, "Can we do this activity?" All three gave different opinions—yes, no, and maybe. We haven't figured that out but as it evolves it will become clearer. We're going to be conservative, we're not looking to find out that we say "yes" and ultimately they say "no". I like what I do for a living and I want to stay behind the other sides of the bar if you will.

Where's the opportunity? There's clearly new distribution forms. Currently in Britain five million people use BSkyB Interactive. It has a gaming portal tied to it. The technology is weak, but today you can go on-line and bet on live sports as it goes. You can bet that a guy's going to make a goal, click the button "yes" or "no" and bet two pounds on it. The technology is slow but ultimately where this entertainment business goes is interactive TV. Everyone has a TV, not everyone has a computer.

Because the Internet is all automated there is a huge customer relationship management opportunity to collect data from all your customers and then go back to them automated. It will tell you to tell them, "We haven't seen you in three or four weeks. How have you been? Here's an opportunity for you, here's an offer for you." We do some of that at The Mirage. It's a very large opportunity not only for our continued growth in our business but we think potentially your own.

Another interesting development in the U. K is exchange betting. If I don't like the market the books are making, I can go on a site, Betfair.com is a good example, and set odds. If I can find someone willing to take those

odds we have a transaction. It's like a poker game and the operator takes a piece of it. They're doing it principally in soccer right now but it has potential up to and including harness racing.

Closing with the question, "Is it threat or opportunity?" The threat's here, 400 million people have computers. Over five or six millions Americans are doing on-line gaming transactions today. Clearly you understand the state of your industry, where the betting activity is occurring. In our position, we didn't think we really had a choice whether we got into this or not. We did not want to see a several billion-dollar industry pass us by in what was our core competency, gaming. Yours, obviously, is the horseracing industry and gaming is a big component of that. Thank you.