



Nomisma

THE ITALIAN MARKET
OF BETTING ON LINE

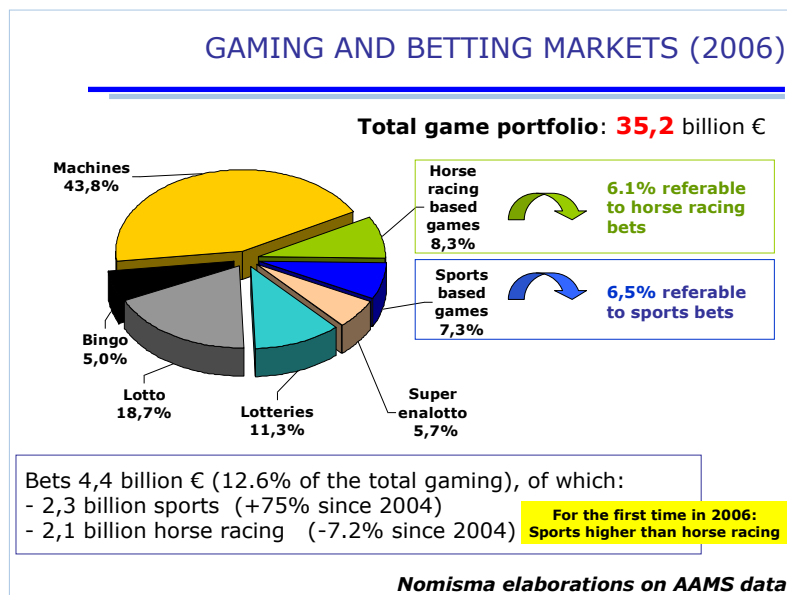
Executive Summary

June, 2007

1. The Italian gaming market

Over the past years, the Italian gaming sector has been subject to extensive legal and economic changes; the volume of business of the various gaming methods allowed increases constantly and significantly from one year to another showing a trend which seems destined to last at least in the medium term.

In 2006, the entire game portfolio managed by the Independent Authority for the Administration of State monopolies (AAMS) is around 35.2 billion Euro with a significant growth compare to 2004 (+42%). This result is closely correlated to the fermentation of the sector, as shown by the continuous introduction of new methods and the ease with which the weight of each segment varies in time.



Currently (2006), the major contribution to the market comes from slot machines (15.4 billion Euro), which – thanks to a growth of 245% - over the past years have assumed a key role in the entire AAMS portfolio (44% of the total stakes). The reasons at the basis of such an expansion can be looked for above all in the recent regulation of this type of game which has allowed the emergence of a process which was already previously widespread.

Lotteries and betting are currently growing, horse racing bets are stable, whilst the lotto, superenalotto and football pools (totocalcio, totogol, etc) are decreasing.

In this context, sports based and horse racing based games represent nearly 16% of the gaming market, of which the majority is attributable to betting.

2. Betting and the development of the on line method

Two fundamental types of bets can be distinguished:

1. totalizer bets for which the overall amount, less the fiscal burden, is shared between all the winning betters, according to specific modalities;
2. fixed stake bets for which the sum to be collected collect, in the case of a win, is previously agreed between the better and the bet manager.

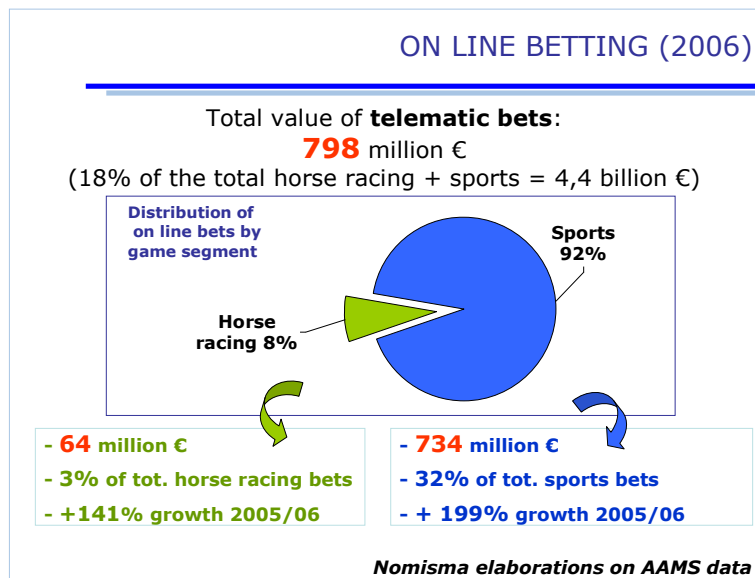
These regard both sports and horse racing bets.

In 2006 the overall stakes from bets was 4.4 billion Euro (12.6% of the total bets) distributed equally between sports (2.3 billion Euro) and horse racing (2.1 billion Euro).

The dynamics of the two segments are very different as, in the 2004-2006 period, an increase of 75% of the sports betting stakes corresponds to a 7% decrease of horse racing betting. It is not by chance that, in fact, in 2006, for the first time, the value of sports bets overtook the value of horse racing bets.

The significant growth in sports bets can be connected to the always more frequent use of on line methods (fixed stake bet made with "at a distance" methods, that is be telephone, fixed or mobile, internet or interactive TV).

The incidence of telematic bets on the total of sports bets has, in fact, gone from 17% in 2005 to 32% in 2006 with stake value of 734 million Euro and a growth of 199%.



However, it is the fixed stake sports segment which absorbs the majority of the telematic betting market; of the total of 798 million Euro, 92% refers to this type of bet, whilst horse racing bets represent 8% of the volume.

The development of the on line method is also evident in the horse racing betting segment, where between 2005 and 2006 an increase in the bets made on internet of 141% was

registered; in spite of this, the value (64 million Euro) and the weight (3%) of the betting method remain limited within this specific segment.

The preference for the on line method of those who bet on sports events is due to a number of factors; amongst these, the fact that it is a newly formed market closely connected to highly visible sports events, such as football. This favours the entry of new betters, often more inclined to using the web and electronic payment methods.

3. The on line betters' profile

A direct survey on a representative sample of on line betters on dot IT sites showed the main characteristics of the users in terms of behaviour, trends and expectations.

As well as a very low access to this method by women (2%), it emerges that betters who use the on line method to make bets are often younger than 40 and educated. This characterisation of the on line better can be connected to the strong link that exists between these classes of the population and the use of internet.

The development and growth of the weight of the on line method compared to the total of all bets seems to be due above all to the ease of use the web guarantees to the user; the ease of use is, in fact, considered the main advantage of this method.

The most frequent reason at the basis of a bet is connected to the possibility to follow a sports event and the passion for a determined sport; this is consistent with the net prevalence of football amongst the events bet on (98%) and the fact that bets are generally made on national events (80%).

THE ON LINE BETTERS' PROFILE

Main identification characteristics

Male (98%) **Young** (79% less than 41) **Education** (24% University degree)

Behaviour

- Exclusively (62%) or mainly (85%) use web for on line bets
- Close connection between bet, sports passion and possibility to follow the event bet on (98% mainly football; 80% Italian events)
- Loyal betters (54% use only one web site)
- Choice of web for easiness to use (91%);
- Better who does not trust the use of credit cards on the internet (55%)
- Choice of the operator on the basis of the credibility of the Internet site (58%)
- Preference for foreign sites (attractiveness of the odds and size of the event programme)
- Bets at least once a week (63%); average bet not over 5 € (62%)

Gamblers and betters

Different behaviour between those who only bet on line ("players") and those who also bet in agencies/at the race course ("bettors"). For the latter higher betting frequency and average amount of the stake

Nomisma survey on on line betters

The web site on which to bet is chosen above all on the basis of the credibility of the operator (54%); the widespread lack of trust for the use of credit cards (55%) and the lack of direct contact with the operator grant, therefore, a lot of importance to the knowledge, reputation and notoriety of the bookmaker.

More than half the on line betters (54%) use only one internet site for their bets; this loyalty is consistent both with the role of the operator's reputation and with a usually moderate betting method.

The frequency and average stake indicate a generally balanced approach to betting; the majority of on line betters bet on average not more than once a week (63%) and not more than 5€ (62%). In this regard, it should be underlined how, in fact, the average value of an on line stake (12.8€) is significantly influenced by a small group of users (4.7%), who bet an average amount of 129€ for each stake. On the contrary, in little less than 62% of cases, the average bet is around 3.7€.

A higher betting frequency and a higher average stake can be found, on the other hand, amongst those who also bet at agencies or race courses.

THE AVERAGE STAKE VALUE

Average amount of on line bets

	Share % Bettors on total	Average stake value (€)
Up to 5 euro	61.9%	3.7
6-10 euro	20.0%	9.4
11-40 euro	9.6%	21.6
Over 40 euro	4.7%	128.9
Didn't know/Didn't answer	3.7%	/
Total	100.0%	12.8

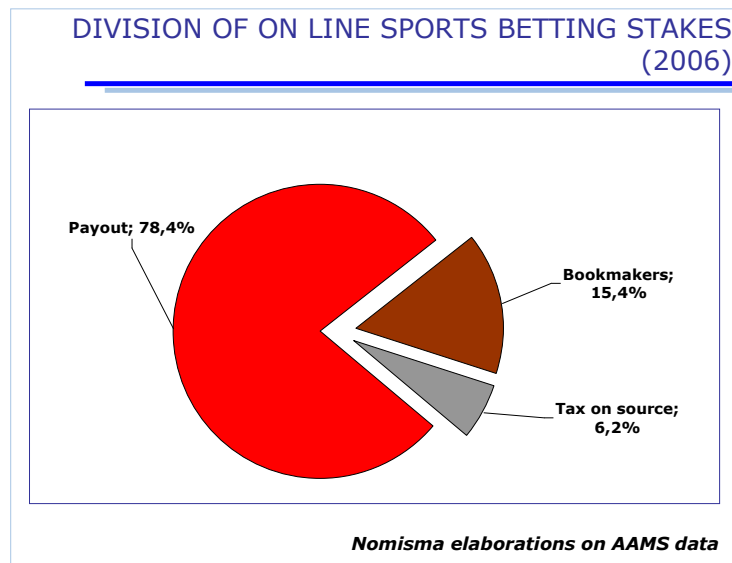
- The average value of an on line bet (**12.8 €**) is significantly influenced by a narrow group of users (4.7%), for which a value of 129 for each bet was found
- Little less than **62%** of on line betters has an average stake (3.7%) **which does not go over 5€**

Nomisma survey on on line betters

4. The Italian tax regime for on line betting and the case of the United Kingdom

The regulation of the on line betting sector in Italy currently foresees that the Inland Revenue withholds a share of the overall value of the bets made. The tax rate for fixed stake sports bets varies according to the value of the stakes of the previous 12 months and the number of events bet on. In 2006, the average tax rate for on line bets is around 6.2%.

The remaining part of the stakes is divided between the value of the payout (78.4%) and the bookmakers' profits (15.4%).



Besides the official channels, there exists a relevant parallel market of telematic betting. These are mainly foreign sites which are not licensed in Italy, but which are licensed in other countries (dot COM sites).

Even though the Italian authorities have prohibited their activity and have blocked their providers, this phenomenon is widespread. This is due to various reasons, amongst which the recent regulation of the sector subsequent to a first phase of activity during which Italian bettors used foreign sites; the lesser attractiveness of the odds offered by dot IT sites compared to those available on dot COM sites, due to a different fiscal regime; the smaller programme of events on which to bet on dot IT sites compared to dot COM sites, an objective difficulty to define instruments able to effectively block access to dot COM sites from Italy and a lack of perception of illegality regarding web operations.

This phenomenon is accompanied by the presence of on line betting sites without any type of license (in Italy and abroad), which operate out of any regulation system and therefore without any guarantee for bettors.

The estimated value for this parallel market is equal to about 6 billion Euro.

A similar situation was found in the UK, before the introduction of a different tax system for bets in October 2001, in which the tax of 6.75% on the entire value of the stakes was replaced by a fixed tax of 15% on the bookmakers' gross profits (equal to the total value of the stakes net of the payout).

The adoption of a new tax system guaranteed a significant boost to the on line betting market, thanks to the progressive transfer of resources to the bettors' payout, which stabilised at higher levels (near 90% of the overall stakes). The presence of more attractive odds for the bettors encouraged the growth of stakes and, above all, the return of a good part of the bets previously made on foreign sites. This is all translated into a positive impact, not only for the bookmakers but, in an indirect way, also on the other economic sectors (an English study

estimated a subsequent increase in the British GDP equal to 1.4 billion pounds for the period between 2001 and 2004, which can be associated to the employment of 19,000 people).

5. The consequences of a change in the Italian tax regime: the scenario analysis model

Consistently with the example of the UK, the study simulated the Italian on line betting market trend and the government income trend connected to it, assuming the transfer from a system of tax on the entire value of the stakes to a fixed tax of around 15%, on the bookmakers' gross profits.

Given the limited relevance of the on line horse racing betting segment on the total and the significant differences between the two segments in terms of market position and tax system, the simulation focused on on line sports betting.

In the hypothesis of a change in the tax system, the current Italian system would change and reach a new stable position. The evolution would involve a number of interdependent variables amongst which:

- a) The division of the stakes between payout and bookmakers' gross profits which would tend, as in the English case, to favour the attractiveness of the odds for the betters. Therefore, two scenarios are foreseen, one short-medium term (80% payout and 20% bookmakers' gross profits) and one long term (90% payout and 10% bookmakers' gross profits).
- b) The volume of the overall stakes of on line bets, which should undergo a progressive increase connected to an increase in the inclination to bet of betters who already use dot IT sites thanks to the presence of more attractive odds (estimates in the direct survey are between 6% and 10% of the 734 million Euro of current value of stakes) and to the recovery of bets currently made on sites which are not licensed in Italy, mainly dot COM sites (estimated value of around 6 billion Euro, hypothesising the emergence of 10% to 80%).
- c) The structure and size of the fiscal burden, due to the elimination of the tax on source, and the parallel increase in the tax revenue generated by the fixed tax of 15% on the bookmakers' gross profits, by an increase in IRES revenue charged to the bookmakers' calculated on the increase in profits, by an increase in VAT revenue and other indirect taxes generated by the transformation of the bigger payout in an increase of private consumption.

In the following figure, the hypotheses selected to define the different possible scenarios connected to the introduction of a tax system which foresees a fixed tax (15%) on the bookmakers' gross profits are illustrated.

THE SELECTED SCENARIOS

Scenario 1 – long term

(90% payout – 10% gross profits)

Scenario 1A) Very Prudential:

dot Com sites (10%, 600 mln €) - dot IT sites (6% of tot, 44 mln €)

Scenario 1B) Prudential:

dot Com sites (25%, 1,5 bln €) - dot IT sites (6%, 44 mln €);

Scenario 1C) Intermediate:

dot Com sites (50%, 3 bln €) - dot IT sites (8%, 58,7 mln €);

Scenario 1D) Optimal

dot Com sites (80%, 4,8 bln €) - dot IT sites (10%, 73,4 mln di €).

Scenario 2 – short-medium term

(90% payout – 10% gross profits)

Scenario 2B) Prudential:

dot Com sites (10%, 600 mln €) - dot IT sites (6% del tot, 44 mln €)

Scenario 2C) Intermediate:

dot Com sites (25%, 1,5 bln €) - dot IT sites (8%, 58,7 mln €);

Scenario 2D) Optimal

dot Com sites (40%, 2,4 bln €) - dot IT sites (10%, 73,4 mln di €).

Each hypothesis corresponds to a different impact on the overall telematic sports stakes, which in turn generates a different level of government income. The model allows the study to quantify the entries and to compare them with the tax on source which would be lost (45.7 million Euro). The net impact for the Inland Revenue connected to the introduction of a new tax system is then found.

6. The impact of a new tax regime on the on line betting market

The first group of hypotheses examined refers to Scenario 1, a long term situation, in which the betters' payout reaches 90% of the overall stakes and the remaining 10% constitute the bookmakers' gross profits.

In this case, the growth of stakes on dot IT sites and above all the recovery of bets on non licensed sites would increase the volume of the overall stakes in each of the hypotheses considered.

Only in Scenario 1 (Very Prudential, 10% of recovery from dot COM sites), the government income associated to the tax change would not manage to compensate for the elimination of the tax on source. In the other three scenarios selected, the net impact on the government income would become positive and progressively increase (+5 million Euro; +37 million Euro; +76 million Euro) as much as the new system is able to facilitate the return of sports bets currently made on dot COM sites (from Scenario 1A towards Scenario 1D).

The growth of the payout subsequent to the tax change would also favour the creation of new added value equal to 91 – 110 million Euro and new employment possibilities for 1,800-2,180 work units.

IMPACT SIMULATION OF SCENARIO 1
(90% payout – 10% gross profits)

<i>Mln €</i>	Stakes	Government income	Added value	Employees
Scenario 1 A Very Prudential	644,0	-13,2	90,7	1.796
Scenario 1 B Prudential	1.544,0	5,3	90,7	1.796
Scenario 1 C Intermediate	3.058,7	37,6	100,3	1.986
Scenario 1 D Optimal	4.873,4	76,3	109,9	2.177

Nomisma elaborations on various sources

Scenario 2 represents, on the other hand, a transitory short-medium term situation, in which the bookmakers' gross profits would reach 20% of the stakes and the betters' payout would be around 80%, slightly higher than the current 78.4%. The change in the tax system would, in this case, increase the volume of the overall stakes in each hypothesis considered: in the three scenarios selected, the net impact for government is always positive (respectively +8 million Euro, +46.7 million Euro, +85.5 million Euro).

IMPACT SIMULATION OF SCENARIO 2
(80% payout – 20% gross profits)

<i>Mln €</i>	Stakes	Government income	Added value	Employees
Scenario 2 B Prudential	644,0	8,0	34,1	675
Scenario 2 C Intermediate	1.558,7	46,7	42,6	843
Scenario 2 D Optimal	2.473,4	85,5	51,2	1.013

Nomisma elaborations on various sources

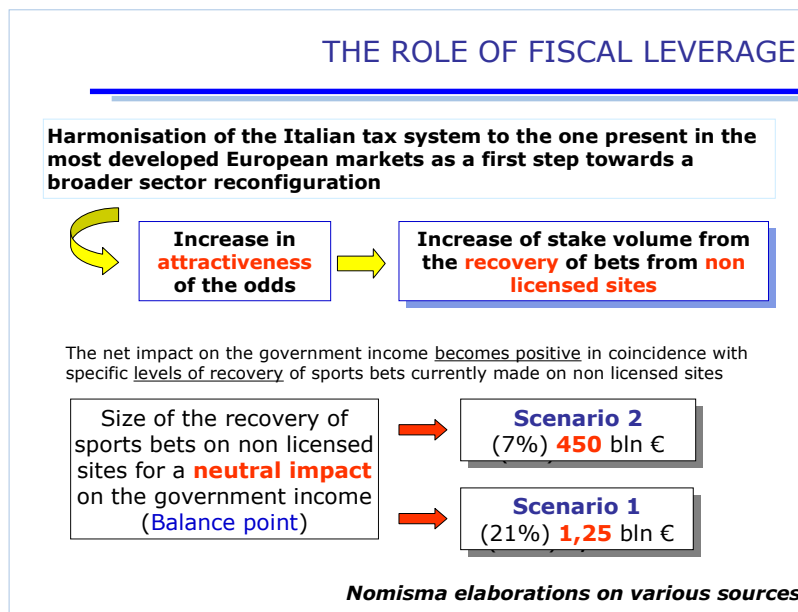
With the same hypotheses and conditions, the impact on government income would be better in Scenario 2 compared to the previous one, following the bookmakers' higher gross profits (20% vs 10%), on which the "newly" introduced (15%) tax would be applied. But similar

reasons make it less possible to verify a consistent recovery of bets made on non licensed sites, due to the lower payout. For this same reason, the increase in added value and in employment would be more limited (respectively between 34 and 51 million Euro of added value and 675-1.010 new employment positions).

For the two different scenarios, it is possible to define the size of the recovery from non licensed sites which would compensate for the elimination of tax on source and which would bring a stable situation to government income compared to the current situation:

- **About 1.25 billion Euro** for Scenario 1 – long term, equal to 21% of the estimated value;
- **About 450 million Euro** for Scenario 2 – short-medium term, equal to 7% of the estimated value.

These amounts are compatible with an evolution which initially sees the betting market open up due to the effect of the new tax regime and then consolidate thanks to the increase in the attractiveness of the odds for the betters in a system which progressively guarantees a higher payout.



In conclusion, the indications from the development of the analysis identify the change of the tax system as being the main lever on which to operate in order to favour the Italian on line betting market.

It is only by intervening on this that it is possible to initiate a modernisation of the sector which can bring the Italian market to operate in similar conditions to those in other European countries.

The structural change of the tax burden represents a necessary but not sufficient condition for this to happen. Its effects will be positive, above all, if such a change is part of a broader revision of the sector. The long term situation proposed in the simulation model (Scenario 1) is, in fact, totally verifiable only in the presence of an effective market liberalisation which includes a number of other factors amongst which: the entry of new operators into the Italian market, the simplification of the communication procedures and the validation between operators and control authorities and the expansion of the betting programme.

Such considerations are even more important in the market due to its global nature. In this case, in fact, it is difficult to regulate individual behaviour aimed at finding the most satisfaction from a service which uses the internet, an immaterial communication system which is currently not easily controllable by the public authorities.



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