German Market Update

Germany - past and present

The Germany gaming market continues to evolve with new operations and new machines changing the face of gaming

In this edition we take a look at how the casino slots and AWP's in Germany are regulated. The most highly populated country in the EU has over 220,000 AWPs in operation in almost 8,000 arcades. The 85 casinos operate around 8,000 slots.

Let's us begin with an anomaly by looking at the different levels of regulation between casino slots and AWPs (street machines). These two sections fall under different jurisdictions due to the fact that they both cater for different market-segments. The federal government is responsible for the street market, whereas the local states (there are 16 of them) govern the casinos.

AWPs are governed by the federal gaming law called the Spielverordnung. This gives explicit details of what can or cannot be done. Basically, these regulations ensure a legal, well-working market. There is no limit on the number of arcades allowed in Germany. The restrictions focus on how much can be won and lost per set definition and the locations in which the AWPs can be found.

Let's look into these restrictions. The Spielverordnung is split into 20 separate paragraphs with the most recent edition that became law on January 1, 2006, paving the way to a completely different type of market. There is no restriction on how an AWP has to look, which has resulted in the opening of the market to multi-games. The Spielverordnung relates to both AWPs and machines that pays out prizes. AWPs may only be sited in arcades, locations where food and drink are served and can be consumed and at bookmakers.

The number of AWPs is regulated – with a maximum of three for bars/food locations and bookmakers and 12 in arcades. The way the AWPs are placed in the arcades is regulated again. Each AWP requires 12sq.m. floor space – which leads to a minimum size of an arcade of 144sq.m. and only two AWPs may be placed side-by-side. There has to be a gap of at least one metre between the AWPs and a physical barrier that juts out 80cm. This has been done to hinder players playing on more two AWPs at any one time.

Each arcade has to have a 'concession,' in other words a licence to operate. It is possible to have multi-concessions, in other words several arcades linked together on the inside but looking like one big arcade on the outside. This has an anti-Tardis effect, going from the large to the small. The reason is simple. By law each concession/arcade has to have its own entrance and exit and it is not possible to enter through between the arcades. This sometimes gives the impression of being in a rabbit's warren, looking for a way to get from one hall to the next. Operators are showing interesting solutions around this. The most popular seems to be to place a walking zone in the middle to enter into several halls. It's like a star formation.

The entrance/exit to the arcade must be accessible from outside. Depending on your point of view, this is allowing the player greater choice or negating the reason-d'etre of the law – with the concern that large arcades closely resemble casinos with the increased potential of problem gaming.

The federal government focuses on preventing addiction and all AWPs have to be clearly marked as to how they operate and there's a number to call if any player feels they need specialist help. It's a fair comment that the German AWP industry works very hard to prevent gaming addiction. In casinos the new ruling of interlinked entry control is there to prevent banned players from one casino being able to play in another.

The emphasis is also very much on entertainment for AWPs. Alcohol is in a way seen as something that can impede this and reserved for gaming-only locations, thus allowed in casinos. If an arcade owner wishes to serve alcohol, then the number of AWPs allowed reduces to three per arcade. A trading licence is required to operate an arcade. Here it clearly states where an arcade may not be operated, for example, near schools. Furthermore, it clearly states that only bona-fide people may receive a trading licence, which may be withdrawn at any time should the licensee come into disrepute.

Only one testing body is allowed to license AWPs, namely the PTB in Berlin. Each AWP type requires a licence which costs up to EUR 4000, potentially up to double that in certain cases. An AWP manufacturer may only sell AWP's that have a licence. Each machine sold requires a licence form that clearly states several things – type of AWP, name and address of owner, explanation of the AWP, identification of the hardware and software and the length of time the AWP may be operated.

An AWP has to undergo a licence renewel every two years to allow its continued operation. Paragraph 13 clearly states the limits. The maximum stake is EUR 0.20 with a maximum win of EUR 2 for a five second game. If the length of the play increases, then the stakes may increase as well, by three cents per second for the stake and 30 cents per second for the win.

The maximum loss may not exceed EUR 80 per hour, with an averaged-out loss per hour of EUR 33 to be adhered to. The maximum win is EUR 500 per hour. The maximum credit allowed is EUR 25 – this is why the banknote readers in the Germany's AWP machines do not accept the EUR 50 note.

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Looking at the market size of AWPs, the coin-in was at EUR 6.8bn in 2006 with coin pay-out at EUR 4bn. The gross revenue was approx. EUR 750m or approx. EUR 3,400 per AWP. The gross revenue for casino slots was approx. EUR 2.3bn or approx. EUR 267,000 per slot per year.

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Ulrich Schönleiter works for the Federal Ministry for Economics and Technology and has much experience with the German gaming laws. He explains that the whole set of rules and regulations ensure legal operations in Germany. Secondly, as all manufacturers and operators must follow the same guidelines, this allows a level playing-field in the market. Free market aspirations are catered for in the way that the number of arcades allowed are not de jure limited. Mr. Schönleiter furthermore expressed that the federal government is aware of the dangers of over-regulating the AWP market. An over-regulated market may entice illegal operations, something that the federal government works very hard to ensure does not occur.

The states have a legal monopoly on casino gaming. The restrictions are in themselves limited. Players can win up to EUR 50,000 on one slot and up to EUR 500,000 via a jackpot. A player can lose up to EUR 50,000 in one hour and the average loss per hour is approx EUR 300 per slot. There are no restrictions on stakes nor wins. Thus, banknote readers commonly accept the EUR 50 note. Not only that, some casinos accept right up to the EUR 500 note.

The 8,000 slots generate approx. EUR 780 million in taxes p.a., thus at over EUR 90,000 per slot. The amount of tax reaped per AWP is much lower at about EUR 450 per AWP. With over 25 AWP's being operated per each casino slot, the total tax revenue from AWP's is above the EUR 1 billion mark.

Returning to the federal Spielverordnung, Mr. Schönleiter underlines the fact that regulations require flexibility. He gives an example of a recent change in the rulings. Via a point system some AWP manufacturers were allowing a pay-out win reaching EUR 7000 (paid out at rates of EUR 500 per hour). This goes against the intention of the law, as such high pay outs resemble casino slots and potentially increase player addiction. Therefore, all AWP's licenced by the PTB from July 1 onwards may only allow a maximum one-off win of EUR 1000.

The question remains what happens to the 150,000 AWPs that are in the market according to the Spielverordnung. These AWPs must be updated to resemble the new rulings and so receive a new licence. However, this change does not have to be completed overnight – manufacturers and operators have until 01.01.2011 to ensure that they acheive this.

The reason for the generous time scale is to avoid potential legal conflicts with operators and manufacturers, as the AWPs in operation today corresponded to the current AWP law. Mr. Schönleiter therefore advises that governments who are contemplating altering their AWP laws integrate a limited time span that a particular AWP may be operated. The affects of a gaming system are not fully clear until it is released in the market. Therefore, governments should allow themselves the right to be able to alter the laws when necessary.

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OPERATING AWPS IN GERMANY

In 2007, there were approx 220,000 AWPs in operation in Germany. The German law has set room for growth with a possibility of placing three instead of two AWPs in diners and 12 instead of 10 within the country's arcades.

Being a bureaucracy-friendly nation, one would expect detailed information on arcade owners, the number of arcades and the overview of who owns what. However, here the market bureaucracy lovers are stifled and statistic hunters challenged. Each German state has its own association/lobby as many laws are governed by the local states.

The national arcade owner association is know as the Bundesautomatenverband (BA) and can boast a membership rate of less than a third of the market. Approx. 2,500 arcade concessions are members of the BA out of a total of 8,000. But what does a concession mean? The arcade concession refers to one arcade hall (the better term is often room) where a maximum of 12 AWPs can be placed.

Returning to the structure of the market, there seems to be one side that is very public in its intentions and one side that wants to be left alone to get on with their business. In other words the large and small operators.

The major players can be linked into five chains – the Gauselmann Group, the Novomatic group, Löwen Play, the Ritzio group and the Schmidt Group.

The Gauselmann Group runs its arcade operations in Germany under the name of Merkur Spielothek. There are approx. 200 of these in Germany, mostly with multiple concessions per site.

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Another traditional arcade group is Löwen Play, which formerly belonged to NSM-Löwen, but was sold to ABN Amro and then in turn to a private investor. Despite the Löwen name, the arcades do not belong to Löwen/Novomatic. Figures from August 2006 showed the Group to own and operate 159 arcades, but this figure has risen and the company currently operates 200 arcades and is expanding this number further.

Ritzio, although relatively new to the German market, is making strong in-roads. Ritzio exhibited for the first time at this year's IMA and already has 70 arcades operating over 1,000 AWP's in Germany. The strong message is growth with a plan to increase its presence tenfold by the end of the year. The brand name of Ritzio's arcades is called Vulkan Stern.

Finally, the Schmidt Group is a large independent arcade chain owner. This company definitely has financial clout as during the IMA it was rumored that this company was planning to purchase Bally Wulff – a rumour that was killed immediately by the owner of the Schmidt group. The Schmidt Group runs over 160 arcades in Germany.

Thus, the larger groups dominate the market with an estimated 2,500 of the 8,000 arcade hall concessions. Another 5,500 are in smaller hands. The question is, for how long? Ritzio is not the only large operator looking for growth. Both Uwe Köppel and Christian Kägeler were independent operators until recently. Both sold their arcades to Ritzio and joined the company to help spearhead its growth. Merkur Spielothek had its own stand outright at this year's IMA.

Dieter Kuhlmann – Merkur Spielothek's Managing Director – explained of the company philosophy. The company is actively looking to expand its operations. Indeed, independents need not part with their arcade completely thanks to the 50-50 concept. Here an independent can team up with Merkur Spielothek, each investing 50 per cent into the joint venture. Merkur Spielothek manages the arcade/machines 100 per cent and from the remaining profit both sides receive 50 per cent.

This sounds enticing for those operators who want to pull away from the active management but want to keep a slice of the business. Naturally Merkur Spielothek want to grow their brand so this offer is made under the condition that the arcade is renamed Merkur Spielothek. This offer focuses on the possibility to link individual arcades into a larger multi-hall arcade.

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>> Indeed, all the major operators are offering to either buy independent arcades or form a joint venture. There are certain stipulations. For example the location. Locations in large towns and cities are preferred.

THE WIDER MARKET

All in all, 2007 was a good year for the coin-operated vending and amusement machine industry in Germany and the outlook for 2008 remains positive despite the troubles in financial markets. The new gaming regulations that entered into force on January 1, 2006 triggered a sea change in the offer of amusement machines with and without prize in arcades and pubs.

In the last year, operators continued to invest heavily in amusement machines with prizes that comply with the new gaming regulations. In total, more than 100,000 AWPs were sold, which corresponds to an increase of approximately 19 per cent.

The new gaming regulations gave our industry the possibility to make headway, although the Bundesrat in the last minute curtailed the original version of the gaming regulations as drawn up by the Federal Ministry of Economics. As chairman of the industry association and as an entrepreneur I have every reason to look confidently into the future.

The provisions of the new gaming regulations ensure the player protection that is politically desired by clearly limiting the stakes and wins on the one hand. On the other hand they offer game developers and manufacturers more freedom, i.e. allow them to finally offer interesting amusement games also in Germany – that are already common almost everywhere else in Europe. The increased entertainment character of commercial gaming with AWP machines is the decisive reason for the positive trend in recent months."

According to critics, however, the result is that when the old gaming regulations were still valid an average of 2.57 machines were played for 12 second games, which has fallen to today to a figure of only 1.38 machines. And this despite the fact that many last generation machines are still in the field. In other words, the barriers to prevent players playing several machines simultaneously appear to be working.

Furthermore, under the old gaming regulations the average hourly income per machine was EUR 20.00 to EUR 25.00. With the new machine generation it has dropped to EUR 15.00 to EUR 20.00. Meaning people play significantly

longer for considerably less money. This is an effect of the new gaming regulations that the legislator wanted to achieve and that was in the end also put into practice by the manufacturers.

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Video-based machines are offering 20 or even more games appealing to a wide audience. They also meet with tremendous interest, so that they have excellent capacity utilisation, especially in arcades. This makes arcades much more attractive and among others has the effect that what used to be a purely male domain in the past now also attracts a sizable number of women. On average they made up far more than 10 per cent of the patrons in arcades in 2007.

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The Physikalisch-Technische Bundesanstalt (PTB) announced 113,154 new approvals for the most important product group – amusement machines with prize in 2007. Since not all machines with approval actually >>

>> come into use, the market volume of the machines was somewhat lower, with more than 100,000 machines sold or leased, whereby the demand increased by approximately 19 per cent.

The investments resulted in an increase of amusement machines with prize installed in arcades to an average of 10.6 machines per arcade license. However, this number is still significantly lower than the maximum number of 12 machines admissible on a minimum surface of 144sq.m.

As of December 31, 2007, a total of approximately 360,000 amusement machines with and without prize, sports gaming machines, and the coin-operated internet terminals were installed in Germany. For many years the country had seen a dramatic drop in the numbers of amusement machines and sports gaming machines in the field which dramatically decreased after the ban on fun games came into force on January 1, 2006. At the end of 2005, more than 80,000 fun games had been installed in Germany.

The industry expects another slight growth of the number of machines installed for 2008, because almost all of the fun games have been dismantled and there is space available now to install the latest generation of AWPs that are well accepted by players. But a positive trend is also expected for the product groups of touchscreen machines, pinball machines, internet terminals, and sports gaming machines etc.

Last year, the new gaming regulations that improved the framework conditions showed a tangible benefit to Germany's operators, who saw their revenues rise by 8.1 per cent to EUR 3.3bn. In a nutshell, after negative developments in 2006 revenues have reached the 2004/2005 level again. Manufacturers generated revenues of EUR 420m and the wholesalers revenues of EUR 450m. Revenues totaled across all sectors of the industry amount to EUR 4.18bn, which corresponds to an increase of about nine per cent.

In recent years, commercial AWP gaming has continuously lost market share in the gaming and gambling markets. At the same time, state-owned casinos as well as lottery and pools have reached a market share of 75 per cent (in 1995 the market share was 70 per cent).

The conditions of the previous gaming regulations made it impossible for the very stringently regulated commercial

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Paul Gauselmann, Gauselmann Group.

gaming industry to follow the growth of state-run and state-licensed gambling with prize. At the same time, according to arcade operators, the lottery and casino market has infringed upon its core player market.

"Since the beginning of th 1980s, casinos with their gaming halls have been chasing customers in our market," states head of the Gauselmann Group, Paul Gauselmann. "With 10 cent machines without ceiling they entice part of our customers to their machines – without any regulatory framework. Neither stakes nor wins are limited. Machines do not have to be approved. In view of the possibility of large assets changing hands, player protection at these machines is a farce. Furthermore, you will find 100 machines on average in a gaming hall, in contrast to a maximum of 12 amusement machines with prize in commercial operations."

Mr. Gauselmann deplores the fact that some casinos and the Ministers of the Interior of the Länder use the excuse of player protection to hide what he sees as anti-competitive practices when complaints are made as to th similarity of AWP machines and casino slots. This was accompanied by the threat to use an initiative in Bundesrat to >>

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>> make the gaming regulations even more stringent. However, with the new approval rules that reduce the possible win scores but do not curtail the actual direction of the gaming regulations, the Federal Ministry for Economic Affairs contributes to making the discussion more objective.

"We are able to live with the new rules. We can also live with the restriction that wins in the form of points or special games must not exceed a potential cash value of EUR 1,000.00, because the players are usually rather more interested in the entertainment than in the actual wins. Only true gamblers will be disappointed," stated Mr. Gauselmann.

OPPORTUNITIES AND NEW ENTRANTS

Ritzio Entertainment Group took a stand at the IMA show in Germany at the start of the year to underline its commitment and stance on the domestic market. The company used the stand to inform the market as to the aims and ambitions of the Russian company in Germany's operations business, to develop contacts with local machine manufacturers and meet with domestic operators looking to merge their operations with those of the Ritzio Group.

Developing an enormous multi-national gaming operations business in such a short timeframe is a major undertaking that Ritzio has achieved without breaking its stride. Its projections for market growth in Spain, Italy and Germany are unprecedented in the European gaming market, as is the company's ability to micro-manage its operations within markets that now span: Romania, Ukraine, Russia, Germany, Italy, Belorussia, Bolivia, Mexico, Peru, Czech, Estonia, Serbia, Croatia, Latvia and Lithuania.

It's obvious that the group has spent a great deal of time, effort and resources in ensuring that its operations in every market in which it operates meet the standards and best-practice that has proved so successful to date.

To maintain its constant grip on an ever widening international operating base, Ritzio relies upon its analytics department, which is effectively an Intranet that the company utilises to share information between operators to increase profitability across the ever expanding group.

Ritzio analyse data from every location. Statistics such as: how many people visited a location per hour, the duration of their stay, the value of their play etc., are all logged into the database. Ritzio then used this information to support its

development programme as the company constantly evaluates every new and existing location, looking strategically at both companies, locations and new markets with a focus on continuous development.

Using these models, Ritzio has been able to evaluate different geographical markets, diversify in terms of products and legislation, and present models for growth based on empirical data from over 900 locations and 50,000 slot machines. "We have spent a great deal of time and resources evaluating the European gaming market," stated a Ritzio spokesperson. "It is important for us to present the right proposal for our investors, in that Ritzio is not just a Post-Soviet gaming operator, but a European and international group operating to worldwide financial standards."

Ritzio determined that the local market was not developing as quickly as it could and should. By establishing a company in Germany, Ritzio could quickly establish its business model in the marketplace.

The degree of market scrutiny undertaken by Ritzio is remarkable. Its management team is like a walking encyclopaedia of gaming legislation, facts, figures and regulatory information. This detailed knowledge of the European gaming market has led the company to new markets in 2007-08 in Italy and Germany. In 2007, law changes in both of these countries made it possible to establish the Ritzio gaming model in both Germany and Italy. Ritzio had previously examined these markets, but had determined that it was impossible, even through a policy of >>

>> widespread acquisitions, to develop the business in these markets. However, the liberalisation of the law created new opportunities.

Ritzio determined that the local market was not developing as quickly as it could and should. By establishing a company in Germany, Ritzio could quickly establish its business model in the marketplace. In the end, Ritzio in fact created three companies over a three-month time period with local groups supplying top tier management to run these new businesses.

Ritzio used its business model, infrastructure and sheer financial muscle to launch itself into the German market. Where possible, Ritzio uses local management, training and develops best-practices in this changing marketplace.

As the company continues to acquire small-scale operations at a rapid pace, several location managers have left the company, but many have also been revitalised by the processes and procedures put in place by Ritzio. While there have been many operators looking to retire from the business, there are also those looking for new opportunities presented by a major company that provides support and growth potential.

Every location Ritzio creates or acquires is unique. Unique in terms of the set of circumstances in which it operates, its

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staff, its legal requirements, players and environment. The company encountered a lot of businessmen that had created a family business, but whose sons and daughters had no interest in a career in gaming. There were also operators who would wanted to renovate their location, operate higher quality machines and deliver greater service-levels, and for whom a merger with Ritzio was a perfect solution. In order to process such a wide range of differing challenges, Ritzio created a management model that adapts to each location while at the same time delivering the right business model for its individual needs.

Management, operating and financing are standard procedures that Ritzio adopts throughout its international gaming estate. While there are certain requirements that the company absorbs into its basic model, such as the need for surveillance in Germany's gaming halls as opposed to security staff, which is the norm within its other sites, the methods and the means by which Ritzio implements them may differ, but its standards remain the same.

Ritzio describes the system as one of German management with Russian rules, with 99 per cent local managers in its locations with an aim to grow its marketshare to around 10-15 per cent this year. The Russian company believes this is an acceptable level, but underlines the point that it is not focused solely on marketshare. Profitability has to be the main driver as it's not logical to grow at the expense of profit.

Ritzio fundamentally believes that the AWP markets of Germany, Italy and Spain are the same as the casino slots business that it has established in its other markets. Taking a long-term investment view, Ritzio is seeking to grow its business over 5-10 years in stable gaming markets with stable laws, in which operators are made aware of the factors affecting future business.

Ritzio has first-hand experience of unstable markets and wants to ensure that it invests in gaming markets with long-term prospects. As such, in Germany, Ritzio is not just acquiring companies, it's also developing its own halls. The pace of development will not be as quick, but there are a large number of self-build projects in the pipeline.

The company has already determined a format for its gaming halls that Ritzio believes will be successful in the market. Ritzio is creating a range of large-scale halls and its currently working with three manufacturers in Germany to create machines for these locations.