



State of play

Mature products, flattening profits and increased competition from cyberspace have pushed the Atlantic Lottery Corporation to quietly seek out new opportunities – they just aren't very keen to discuss them

By Rob Antle

The Atlantic Lottery Corporation says its players have been “dreaming big” since 1976. That’s when ALC began offering lottery games on behalf of the governments of Nova Scotia, New Brunswick, Newfoundland and Labrador and Prince Edward Island.

Fast forward 35 years, and ALC seems to be dreaming big itself. The corporation is working to expand its suite of games both beyond the geographic confines of Atlantic Canada, and into the brave new world of cyberspace.

That quiet, behind-the-scenes search appears to be a major shift in philosophy for the corporation, which until now has been focused on offering gambling options to the two-plus million people living east of Edmundston and west of St. John’s.

The broader focus has led ALC to some surprising places.

Last year, the Illinois government announced plans to outsource the management of its state lottery. ALC met with officials there, but ultimately decided not to pursue that business opportunity.

And ALC is also eyeing the possibility of running the national lottery in the eastern European country of Albania. Albania, while now seeking EU membership, is among the poorest countries in Europe and has a checkered history that includes a near-civil war in 1997 dubbed the “Lottery Uprising.”

To date, the new focus on external opportunities has seen ALC ink one deal, with a U.K. company that offers a web-based lottery game.

The corporation has also spent millions on the pursuit of online casino gaming that its shareholders — the four Atlantic governments — have yet to sign onto.

The overall strategy is not something ALC officials are keen to discuss. The corporation redacted the locations of those foreign business opportunities from documents released under freedom-of-information laws, and turned down requests to reconsider the decision. Atlantic Business Magazine independently confirmed ALC’s dealings with Albania and Illinois. When confronted with that information, ALC defended the initiatives. The corporation declined interview requests, offering only written responses to questions.

The stakes are big. ALC is a \$1-billion-a-year business in Atlantic Canada. The corporation funnels all of its profits back to the four Atlantic governments, which can use them to do things like build hospitals, hire teachers and fix roads. But those profits have flattened in recent years, and operating expenses have skyrocketed.

There has been little to no public discussion about ALC casting a wandering eye to opportunities outside the region. And there has been similarly little disclosure of exactly what the strategy entails — what the rewards are, and what the risks and costs may be, as a company that oversees gambling makes its own roll of the dice.





So why? Why would ALC look beyond Atlantic Canada's borders?

The answer lies, in part, on the lottery corporation's balance sheet.

In recent years, ALC has funnelled between \$371 million and \$398 million in annual profits back to the four provincial governments. That's big cash.

But those earnings have been flat — in fact, annual profits were down 5.8 per cent in 2010-11 compared to 2005-06.

Meanwhile, ALC's operating expenses (before capital-related costs) are up sharply over the same time frame, jumping to \$125.1 million from \$78.3 million — an increase of 60 per cent. The corporation cites a number of factors for the jump, including costs associated with new lines of business, opening race track and casino operations in P.E.I., transition costs for outsourcing of IT services, increased pension costs due to market conditions, and increases in sponsorships and marketing.

In an interview last year, Newfoundland and Labrador Finance Minister Tom Marshall said ALC is projecting declining revenues from its current game offerings. That is not good news for governments whose thirst for revenues is never slaked.

Marshall said at the time that ALC is blaming a number of things for the drop. Those include a lack of growth in the size of the market; mature products; and decreasing profit margins caused by expenditures (such as replacing old machines) that don't drive revenues any higher.

If the status quo were to be maintained, Marshall said, Newfoundland and Labrador's revenues from ALC would decline by an estimated total of \$55 million over the next decade.

"ALC are obviously looking to grow, like any business would," Marshall said in 2010. "In addition to looking at getting into the online gambling business in Atlantic Canada, they also want to look at getting into the business elsewhere in the world as well. That would be the second phase.

"So they could go to some country or some state and say, 'Look, we've been doing this for 30 years. If you want to get into this, we can do it for you.' Or they could also provide consultation service to such states or countries."

At the time, Newfoundland and Labrador was still pondering whether to sign on to ALC's plan to launch online casino gambling. The province later said no. So did Nova Scotia and Prince Edward Island. Previously, all three had been cautiously supportive of the concept. Their ultimate rejections left only New Brunswick on the fence.

Despite the fact that no province signed on to the plan, ALC paid external suppliers in the range of \$3 million to \$4 million to develop online poker/casino gambling in 2009, 2010 and early 2011. That's according to invoices released to Atlantic Business under freedom-of-information legislation. It's not possible to determine an exact figure, because some of the invoices cover fees for projects "not

limited to iPoker/iCasino," ALC indicated.

The corporation is defending the big outlay of cash on an initiative that has yet to get approval. Nearly \$500,000 went to a local marketing and communications company. Other suppliers included a Swedish e-gaming software and systems developer, a Toronto law firm and a British software and service provider for the gaming industry.

"The expenditures for this project were in line with a project of this scope and magnitude we exercise in all our investments and projects," ALC director of stakeholder relations Paula Dyke said in a letter enclosed with the freedom-of-information response. "Additionally, much of this work is reusable and provides us with the ability to respond in an agile and expedient way to public policy changes."

ALC believes web and mobile gaming is vital to the future — both as a source of new revenues, and to protect the region's citizens from nefarious unregulated web-based gaming interests. The corporation cited the example of Full Tilt Poker, an online site which shut down this summer and has since been sued in civil court by the U.S. government. ALC estimates that more than \$74 million left Atlantic Canada last year, going instead to online gaming operators outside the region. One of the corporation's objectives is "to repatriate those funds and provide players the gaming experience they want in a safe environment," according to Mike Sandalis, senior manager of ALC's digital gaming group.

Sandalis noted in ALC's 2010-11 accountability report that there is an opportunity for the corporation to extend its online offerings "to a fully competitive suite of products." He said ALC will work with its shareholders — the four governments — "to determine exactly what the longer term view of the Atlantic Canadian gaming environment looks like."

In the same report, ALC board chair C. Sean O'Connor pressed a similar theme.

"Online and mobile gaming is the future of this industry," O'Connor noted. "Illegal and unregulated operators have shown this to be true. They are aggressively working to entice players



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**ALC board chair
C. Sean O'Connor**



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and encourage them to spend their entertainment dollars outside our region on sites of questionable standards. To remain relevant, we must respond.”

O’Connor cautioned that ALC could not be “hasty or careless” and must consider its shareholders — the four governments — and the citizens of Atlantic Canada. “The need to stay competitive must always be balanced with responsible, yet timely actions,” he said.

But when speaking to their peers, ALC officials have been more blunt about government reluctance to going digital.

In late March, just a week before her abrupt departure as CEO of ALC, Michelle Carinci addressed the Smart-Tech 2011 conference, an industry event held in New York City. Carinci stressed that players today have choices — unlike in the past, when there was no competition waiting in the wings. “I think that’s one of the single biggest differences today that our shareholders, our owners, have to realize is that they no longer control what their citizens can do from a gaming perspective,” Carinci said in a speech to the conference.

She lamented the erosion of ALC’s traditional market, noting that its core player base is dropping, and moving online.

“What’s changed, of course, is the world around us — both the state of play, and the players in our respective states. We’ve

spent the past 30-odd years operating in a highly controlled monopoly and we’ve thrived without competition. But without a wolf breathing down our necks, we haven’t really felt a need to step out of our comfort zones, or to push our legislators out of their comfort zone and challenge the status quo. We’ve made great profits in the absence of competition. So hardly a need to change, in that context, is there? Well, not so anymore.”

Carinci cited the example of Blockbuster, the movie rental chain that has collapsed into bankruptcy. “Ask their executive team,” she warned. The best time for Blockbuster to redesign their business model was years ago, Carinci noted, when the company still had a 90 per cent market share, and long before rivals like Netflix began “eating their lunch, breakfast and dinner.”

So what can be learned from the Blockbuster experience?

She stressed the importance of getting governments onside “to be able to play in this world and not be caretakers of a dying business.” And Carinci said she believes that approval is inevitable. “Ensure that you’re ready to move when the legislators and the regulators give you the green light, because they will. Because at one point they’re going to wake up and say, ‘This activity is not going away, and we want to be involved in it, and we want to regulate it, and we want to create that gaming

experience in a safe way for our citizens.”

Carinci quoted Gandhi in wrapping up her speech: “‘You must be the change you want to see in (the) world.’ And I know we can be.”

But an American gambling expert is cautioning that expectations should remain low for companies looking to get into the game online.

“Even where you have legal regulated internet, market penetration still tends to be pretty low, in the five to 10 per cent range of all gaming customers,” said William R. Eadington, director of the Institute for the Study of Gambling and Commercial Gaming at the University of Nevada, Reno. “And so far, the impacts have not been terribly dramatic on bricks and mortar, or, for that matter, other traditional forms of gambling. That said, there’s obviously a lot of potential, just because of the power of the internet.”

According to Eadington, the last big shift came with the introduction of video-lottery terminals, or VLTs, two decades ago.

“Will there be another breakthrough like that? Well, conceivably, if it’s going to happen, it would happen around either social mobility sites or smart phones or something like that. But there hasn’t been any substantial breakthrough that anybody has run across in other countries. So there’s no real evidence that you’re going to have a slam dunk where sales go up 30 or 40 per cent as a result of a new product. It’s a challenge.”

That’s online. But what about outside the country?

ALC has been active on that front as well. The corporation’s vice-president of strategy and governance, Patrick Daigle, flew to Chicago last year to meet with key officials involved with the proposal to outsource management of the Illinois state lottery.

“This is a very significant development in the lottery industry and the first such contract awarded in the U.S.A.,” ALC spokeswoman Paula Dyke said in an e-mailed statement. “As such it was a

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**William R. Eadington
of the University of Nevada, Reno**





good opportunity to learn from the experience of a lottery colleague about the process, as well as to look at the business opportunity for Atlantic Lottery. It was a great learning experience about the process, but not an opportunity that we pursued."

But that appears to conflict with ALC's rationale for initially refusing to disclose where Daigle travelled. Doing so, ALC stressed, would reveal competitive information in areas where possible business opportunities were still ongoing.

Ultimately, a private operator called Northstar Lottery Group won the Illinois contract. According to a 2010 Chicago Tribune story, Northstar pledged profits of \$4.8 billion over a five-year period. State officials said that figure was \$1.1 billion higher than what Illinois expected to make running the lottery on its own.

And then there is Albania.

In 2008, the Albanian government introduced legislation to reform its gambling laws. That included the possible establishment of a national lottery, with profits going to fund infrastructure projects. Albania was a communist country until the early 1990s, and has struggled at times in its transformation to capitalism.

In fact, in 1997, Albania plunged into anarchy, in what came to be known as the "Lottery Uprising." A series of government-endorsed pyramid schemes collapsed. The majority of Albanians were ensnared, with losses estimated at more than \$1 billion. As many as 2,000 died in the ensuing riots, which bordered on civil war.

Today, things have changed for the better. Albania is a member of NATO, and hopes to become part of the European Union. But it remains among the poorest countries in Europe, and is still not a model democracy. "The transition has proven challenging as successive governments have tried to deal with high unemployment, widespread corruption, a dilapidated physical infrastructure, powerful organized crime networks, and combative political opponents," the



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Central Intelligence Agency World Factbook notes.

But ALC is not expressing concern about the political situation in the country.

“Every opportunity that (ALC) considers pursuing is subject to a series of investment considerations and thresholds designed to manage residual risk to an acceptable level,” Dyke said in an e-mailed statement.

She added “it’s interesting to note that Export Development Canada reports that the Canada-Albania trade and investment relationship is established and stable and EDC’s position on the country is that it is ‘open for business on a case-by-case basis.’”

In May 2010, ALC vice-president Daigle went to Albania to “learn more about the opportunity” there. In response to a freedom-of-information request, ALC declined to identify the location of that business-prospecting trip, citing commercial confidentiality. The corporation only confirmed it when challenged about specific details by Atlantic Business.

To date, Dyke noted, the Albanian government has not issued a call for proposals for its national lottery.

One of the most notable things about ALC’s shift to look for new business is the vacuum of information surrounding the process.

“We continue to seek opportunities that will bring additional economic benefit to Atlantic Canada from areas outside our traditional lines of business,” Dyke said via e-mail. “Ensuring sustainable revenues to our owners is our mandate, and our strategy to do that includes both offering products to consumers within Atlantic Lottery, and participating in business ventures and investments inside and outside the region that bring benefit/revenue back to Atlantic Canada.”

When asked for a list of press releases, speeches or any other public mention of this shift in philosophy, Dyke referred to one line in ALC’s 2010-11 accountability report — a reference in the letter from the board chair to “... opportunities for growth and associated risks, as well as planning for what the future will bring ...”

Dyke added that “disclosing the details of that strategy is counterproductive to success.”

For ALC, discretion, it would seem, trumps disclosure.

“The reality of our industry is clear, in the absence of pursuing growth opportunities outside of its traditional lines of business,

(ALC) faces a significant decline in value as a result of a series of threats to its business,” Dyke noted by e-mail.

“These circumstances were presented to the (ALC) board and the shareholders who approved the growth strategy in order to protect and enhance the value of a Crown asset that for 35 years has returned 100 per cent of its profits for good causes in Atlantic Canada and is a significant economic contributor to the region.”

To date, the sole done deal straddles the overseas and online worlds.

It approached consummation on an unseasonably cold Moncton day this May. ALC officials gathered at a Keg restaurant with their counterparts from Roboreus, a United Kingdom internet lottery start-up. There was steak and salmon on the plates, cabernet sauvignon and single malt in the glasses, and talk of business in the air. The nighttime supper meeting — held a brisk eight-minute walk from ALC’s Main Street corporate headquarters — finished up just past 10 p.m.

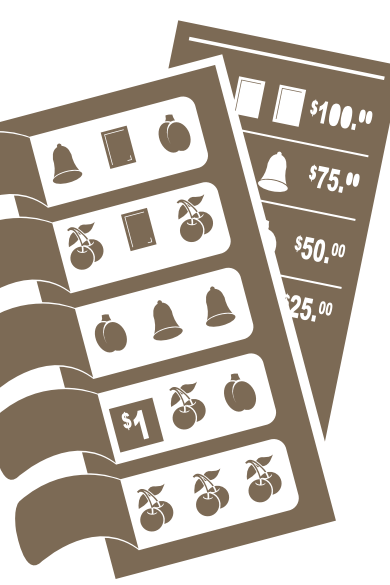
Within days, ALC incorporated a numbered company to handle its pending investment in Roboreus, which runs GeoSweep, a lottery that allows bettors to choose plots of land on Google Maps instead of numbers.

Daigle jetted off to London, where he was appointed a director of Roboreus. Roboreus registered a \$2-million debenture in the United Kingdom to 7865813 Canada Inc., ALC’s new numbered company.

ALC is releasing few details on its investment in Roboreus. Those scant nuggets of data were gleaned from freedom-of-information responses, public records searches in Canada and corporate registries in the U.K.

ALC denied access to a due diligence report it commissioned on Roboreus. Similarly, ALC won’t release the contract it signed with the U.K. company. ALC has never issued a press release about its investment in GeoSweep — or if there is one, it is not on the corporation’s website.

ALC’s total capital investment in GeoSweep/Roboreus was \$3.85 million as of June 30, according to information



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**Paula Dyke
ALC director of stakeholder relations**



released by the corporation under freedom-of-information laws. The lottery corporation spent another \$313,000 on business, legal and due diligence consulting related to the deal. ALC won't say who did that work.

Asked to explain the difference between the \$2-million debenture registered in the U.K. and the \$3.85-million capital investment outlined in ALC's freedom-of-information response, Dyke said: "The debenture was only part of the investment and was convertible into equity on certain triggering events which did occur. The remainder was a direct investment in equity. Further details of the transaction will not be disclosed to protect the commercial interests of our private sector partners."

ALC did grant an interview when initially asked about GeoSweep in June by Atlantic Business; within weeks, news of the investment broke after New Brunswick newspapers noticed it referenced in provincial government cabinet minutes.

In June, Daigle told Atlantic Business that ALC's investment in GeoSweep doesn't need government approval because it's "purely a lottery game" no different than the corporation's current online offerings. "What attracted us to this game was that it doesn't require any new regulations. This sits underneath all of the traditional lottery regulations that are in place."

Questioned about whether it is ALC's role to put public money into potentially-risky private business operations like GeoSweep, Daigle said: "This for us would have been just part of our capital budget, the same way that we would use other capital expenditures; it's part of our business plan and budget, approved by the board of directors. So we expect to generate a return on that money and obviously you put together a business case and try and run the business."

At the time, Daigle could not pinpoint exactly what return on investment the corporation hopes to reap from its Roboreus investment. "It's a good question. It's tough to really say."

ALC now says it expects to offer GeoSweep to customers in this region in 2012.

ALC has launched a website — askaway.ca — inviting residents to submit their questions about the corporation.

"We want people to know as much as possible about us and our business," Larry

Doherty, the vice-president of finance and risk management, notes in a message posted on the site.

That business may soon be changing, as ALC eyes expansion far beyond its traditional base, and traditional borders. | **ABM**

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