Appendix K PricewaterhouseCoopers Final Independent Expert Report – May 2016

Independent Expert Report

Greyhound Racing NSW

May 2016

pwc

Ms. Cheryl Drummy
Special Counsel
NSW Crown Solicitor's Office
Level 5, 60-70 Elizabeth Street,
Sydney NSW 2000

12 May 2016

Dear Cheryl,

PricewaterhouseCoopers ("PwC") has performed certain procedures to assist NSW Crown Solicitor's Office ("Client") in carrying out a review of the financial viability of Greyhound Racing NSW ("GRNSW"). Our services were performed in accordance with our engagement letter dated 13 January 2016 and are subject to the terms and conditions included therein.

This report includes our conclusions in relation to all the agreed scope of work set out in our engagement letter. You have also requested that PwC comment on GRNSW's updated forecast. We have reviewed and analysed the revised forecast prepared by GRNSW and therefore this report does include our conclusions on that particular item.

The procedures we performed did not constitute an examination or a review in accordance with generally accepted auditing standards or attestation standards. Accordingly, we provide no opinion, attestation or other form of assurance with respect to our work or the information upon which our work was based. We did not audit or otherwise verify the information supplied to us in connection with this engagement, from whatever source, except as may be specified in this Report.

Our work was limited to the specific procedures and analysis described herein and was based only on the information made available at 6 May 2016. Accordingly, changes in circumstances after this date could affect the findings outlined in this Report.

This report and all PwC deliverables are intended solely for the Client for their internal use and benefit and are not intended to nor may they be relied upon by any other party ("Third Party"). Neither this deliverable nor its contents may be distributed to, discussed with, or otherwise disclosed to any Third Party without the prior written consent of PwC. PwC accepts no liability or responsibility to any Third Party who gains access to this deliverable.

We appreciate the opportunity to assist you with this matter. If you would like to discuss any aspect of our report further, please contact me on 02 8266 3524.

Yours faithfully

[redacted]

Andrew Cloke
Partner

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1. Executive Summary

1.1. Introduction

PwC were engaged by the Client to undertake an independent review of the current and future financial viability of Greyhound Racing New South Wales (GRNSW) to assist the Special Commission of Inquiry into the Greyhound Racing Industry in NSW.

Our scope of work included:

a) Analyse and comment on Ferriers report in relation to profitability, solvency, liquidity and expenditure of GRNSW.

b) Review GRNSW's historical financial performance for the period between FY12 – FY15.

c) Comment on GRNSW's financial forecasts to 2020 together with the underlying assumptions used to develop these financial forecasts. Where appropriate, identify vulnerabilities and apply sensitivities to these assumptions.

d) Overlay the financial forecasts with the revenue impact of proposed legislation changes across future years.

e) Review GRNSW information detailing assumptions relating to expected increased expenditure on animal welfare in relation to structural changes in the greyhound racing industry and incorporate this additional expenditure in the financial forecasts.

f) Consider potential additional expense assumptions in relation to animal welfare expenditure, provided by the Commission.

Our conclusions are based on the review of the documents provided by the Client (Refer Appendix 2). We held meetings with GRNSW Management on 29 January 2016 and a separate meeting with Dr Rod Ferrier on 16 February 2016. A question and answer process with GRNSW management was coordinated by the Client. Otherwise, we did not have further access to GRNSW management or Ferriers.

1.2. Scope and process

We have not carried out anything in the nature of an audit nor, except where otherwise stated, have we subjected the financial or other information contained in this report to checking or verification procedures. Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of the information in this report, except where otherwise stated.

Any underlying Prospective Financial Information referred to in this report was not prepared or developed by us and we have not restated any PFI or made assumptions or projections relating to PFI. Management has full responsibility for the judgements involved in, and results of, its PFI preparation processes. While we have performed sensitivity analyses on the PFI and underlying assumptions, any tables aggregating our comments or observations on vulnerabilities and sensitivities do not represent restatement of or revisions to the PFI; they are only a summary of our analysis to assist you with your evaluation of the PFI. It is your responsibility to consider our analysis and make your own decisions. As events and circumstances frequently do not occur as expected, there may be material differences between PFI and actual results and cash flows. We take no responsibility for the achievement of predicted results.

We have not shown a draft of this report to management of GRNSW. As a result, we have no confirmation from them regarding the factual accuracy or completeness of this report.

1.3. Background

As a consequence of the 2015 “live baiting” scandal involving the Australian greyhound racing industry, the Special Commission of Inquiry into the Greyhound Racing Industry in New South Wales (“Commission”) was established. The Commissioner is required to examine, among other things, the financial standing and future viability of the greyhound industry, specifically:

1 Identify issues relating to the governance, integrity and animal welfare standards of the greyhound racing industry in NSW; and

2 Evaluate whether the issues identified in Term 1 are able to be appropriately addressed, to permit the continuation of a greyhound industry in NSW that is sustainable and provides an ongoing economic and social contribution to the state.

1.4. Key issues identified on the Ferriers report

1.4.1. General comments

- There is a lack of in-depth analysis undertaken in the Ferriers report with regards to the GRNSW historical financial information in order to understand trends and movements of revenue/expense categories. This is an important exercise in order to prepare and form a view on the forecast financial performance of GRNSW.

1.4.2. Consideration of 'Abnormal/Non-operating items'

- The Ferriers report considers certain adjustments and restates the financial statements of GRNSW based on these adjustments. In our view, the adjustments proposed by Ferriers are not exhaustive and our analysis identified a number of additional items which are presented in the table below :

Table 1: Reconciliation between EBIT per Ferriers report and PwC

$	FY12	FY13	FY14	FY15
EBIT per financial statements	4,504,703	(2,403,950)	3,597,684	1,888,653
Ferriers adjustments				
International GST Recovery	-	(652,610)	-	-
Deferred revenue realised	(6,913,157)	-	(2,846,211)	-
NCA loan forgiven (Gardens purchase)	2,100,000	-	-	-
Investigation Four Corners	-	-	-	1,373,924
Ferriers adjustments total	**(4,813,157)**	**(652,610)**	**(2,846,211)**	**1,373,924**
EBIT per Ferriers report	**(308,454)**	**(3,056,560)**	**751,473**	**3,262,577**
PwC adjustments				
1) Product fees - PGI Agreement	-	729,245	(729,245)	-
2) Deferred revenue	-	2,846,211	-	-
3) Revenue from Playhouse Pet Motel	-	-	-	(436,207)
4) Infrastructure and IT costs from acquisition of The Gardens Property	1,200,000	-	-	-
5) Deferred infrastructure costs	-	-	-	(500,000)
6) Deferred drug detection tests	-	-	-	(130,000)
7) [redacted]	-	-	-	[redacted]
PwC adjustments total	**1,200,000**	**3,575,456**	**(729,245)**	**(1,203,082)**
PwC normalised EBIT	**891,546**	**518,896**	**22,228**	**2,059,495**

<u>PwC adjustments</u>

1) Product fees from the Premier Gateway International ("PGI") agreement amounting to $729k were recognised in FY14 but were related to activity in FY13 and hence we have adjusted to reflect these in the correct period.

2) Deferred revenue relating to amounts in dispute with Tabcorp for the current year which is settled in the following year should be incorporated in the EBIT in the years they were earned. In the table above we reflect the $2.8m in FY13 as the $6.9m were earned in FY11, which is out of our scope.

3) Revenue from the Playhouse Pet Motel amounting to $436k is not expected to occur going forward and therefore should be deducted from normalised EBIT.

4) $1.2m one-off expenses related to Infrastructure and IT costs arising from the acquisition of The Gardens property in FY12 should be deducted from normalised EBIT.

5) Infrastructure and IT costs amounting to $500k deferred into FY16 should be recognised in the year that costs relate and have therefore been reflected in FY15 EBIT.

6) Drug detection costs amounting to $130k costs were conducted in FY16 and therefore, we consider this cost should be adjusted for in the calculation of the normalised EBIT of GRNSW in FY15.

7) In light of the 'live baiting' scandal, the services of the then CEO of GRNSW were terminated and salaries corresponding to the months of February – June FY15 were not paid. We consider this cost should be included in the calculation of the normalised EBIT of GRNSW in FY15.

1.4.3. Profitability considerations

- We have recalculated the profitability ratios used in the Ferriers report based on our view of GRNSW normalised EBIT, concluding that, after all the proposed adjustments, GRNSW was profitable between FY12 – FY15.

Table 2: Profitability indicators compared

Profitability indicators	FY12	FY13	FY14	FY15
EBIT/Operating revenue				
Per Ferriers Report	*-0.75%*	*-7.85%*	*1.66%*	*6.75%*
Per PwC	*2.17%*	*1.22%*	*0.05%*	*4.30%*
Operating expenses/operating revenue				
Per Ferriers Report	*100.75%*	*107.85%*	*98.34%*	*93.25%*
Per PwC	*97.83%*	*98.78%*	*99.95%*	*95.70%*
EBIT/Average Equity				
Per Ferriers Report	*-2.50%*	*-22.15%*	*5.13%*	*18.59%*
Per PwC	*11.94%*	*3.76%*	*0.15%*	*11.76%*
Surplus/Average Equity				
Per Ferriers Report	*41.07%*	*-15.29%*	*25.97%*	*11.45%*
Per PwC	*-24.80%*	*10.62%*	*1.56%*	*4.60%*

- Further, we have presented below the profitability arising from purely the racing activities of GRNSW.

Table 3: GRNSW Profitability

$	FY12	FY13	FY14	FY15
Revenue				
TAB Distributions	30,704,497	30,448,406	32,018,231	34,020,554
Race Field Information Use Fees	8,905,038	6,734,242	11,341,362	12,235,588
Race Form	455,105	479,309	322,382	258,105
Licensing & Registration Fees	415,187	594,133	732,415	739,120
Vet Servs, Blue Paws, GAP	317,777	409,044	486,308	496,609
Marketing & Digital	144,818	152,520	120,419	116,234
Fines & Penalties	27,078	38,748	56,591	31,955
Normalization adjustments:				
Deferred revenue	-	2,846,211	-	-
Product fees - PGI Agreement	-	729,245	(729,245)	-
Operating Revenue from racing activities	**40,969,500**	**42,431,858**	**44,348,463**	**47,898,165**
Expenditure				
Racing and club infrastructure	(3,172,681)	(1,465,417)	(2,012,517)	(980,366)
Depreciation, impairment, loss on sale	(392,426)	(318,011)	(298,716)	(370,693)
Prizemoney & Race Club Costs	(29,625,412)	(30,508,353)	(31,907,926)	(31,695,838)
Stewarding, integrity auditor	(2,267,421)	(2,446,418)	(2,387,785)	(2,416,282)
Drug Detection	(964,092)	(1,040,200)	(1,227,731)	(1,182,551)
Grading & Member Services	(539,345)	(827,316)	(1,079,775)	(1,462,049)
Vet Servs, animal welfare, Blue Paws, GAP	(925,827)	(1,140,966)	(1,309,908)	(1,954,733)
Normalisation adjustments:				
Infrastructure & IT cost	1,200,000	-	-	-
Deferred infrastructure costs	-	-	-	(500,000)
Deferred drug detection costs	-	-	-	(130,000)
Operating Expenditure from racing activiti	**(36,687,204)**	**(37,746,681)**	**(40,224,358)**	**(40,692,512)**
Operating Profit from Racing Activities	**4,282,296**	**4,685,177**	**4,124,105**	**7,205,653**
Other income	71,474	102,280	68,945	25,032
Overheads and other indirect costs	(3,462,224)	(4,268,561)	(4,170,822)	(5,171,190)
EBIT	**891,546**	**518,896**	**22,228**	**2,059,495**
Operating Profit (%)	***10.45%***	***11.04%***	***9.30%***	***15.04%***

- The results from the analysis presented above indicate that the racing activities of GRNSW were profitable between FY12 – FY15.

- We note that overheads and indirect costs of GRNSW have been increasing from FY12 – FY15.

1.4.4. Solvency considerations

- The Ferriers report uses the current and quick ratio to assess solvency and liquidity of GRNSW. In our view these ratios are applicable to assess the liquidity of an entity but are less appropriate for solvency purposes.
- We have used the debt to equity ratio and total debt to total assets ratio to assess the solvency position of GRNSW. The calculation of these ratios indicates that the solvency position of GRNSW has deteriorated in FY14 and marginally improved in FY15.

Table 4: GRNSW Solvency

$	FY12	FY13	FY14	FY15
Current Liabilities	8,267,443	13,946,596	5,843,565	7,193,986
Non-current liabilities	-	-	81,200	81,432
Total Liabilities	**8,267,443**	**13,946,596**	**5,924,765**	**7,275,418**
Equity	14,853,606	12,743,708	16,547,884	18,463,541
Total assets	23,121,049	26,690,304	22,472,649	25,738,959
Total Debt to Equity ratio	0.56	1.09	0.36	0.39
Total Debt to Total Assets ratio	0.36	0.52	0.26	0.28

1.4.5. Liquidity considerations

- The ratios indicate that the liquidity of GRNSW is robust based on the current and quick ratio. However, in our view Ferriers has used incorrect inputs to calculate these ratios. The net working capital, and the derived quick and current ratios calculated by Ferriers, include receivables balances due from Wentworth Park Trust amounting to $6.5m which is unlikely to be fully collected in the short term. In addition, provision balances included in current liabilities have not been considered in the calculation of quick ratio.
- We have recalculated the ratios excluding the receivable due from Wentworth Park Trust and have considered the provision balances in the computation of quick ratio. The recalculated current and quick ratios indicate strong current and quick ratios of 208% and 200% at 30 June 2015 (compared to 307% and 330%, respectively, stated in the Ferriers report).
- The Ferriers report does not consider the liquidity constraints highlighted by management in the FY15 Annual Report, especially in the lead up to Christmas and end of financial year period due to income streams received from Tabcorp on a bi annual basis.
- The Ferriers report does not consider the cash ratio which further refines the current and quick ratio by assessing the ability of GRNSW to pay current liabilities with only cash and cash equivalents. In our opinion, the cash ratio is a more appropriate measure to assess the liquidity of GRNSW liquidity considering the timing difficulties to convert revenue into cash due to the long collection terms with Tabcorp.

Table 5: GRNSW Liquidity ratio

$	FY12	FY13	FY14	FY15
Current Assets				
Cash and cash equivalents	4,400,966	8,463,821	897,286	2,082,467
Receivables	10,114,166	9,721,758	10,801,394	12,330,336
Financial assets	-	-	-	275,000
Other current assets	4,175	675	110,136	263,491
Total Current Assets	**14,519,307**	**18,186,254**	**11,808,816**	**14,951,294**
Current Liabilities				
Deferred revenue	-	7,648,112	-	-
Payables	6,787,571	5,186,645	4,781,298	6,671,463
Provisions	1,479,872	1,111,839	1,062,267	522,523
Total Current Liabilities	**8,267,443**	**13,946,596**	**5,843,565**	**7,193,986**
Current ratio	1.76	1.30	2.02	2.08
Quick ratio	1.76	1.30	2.00	2.00
Cash ratio	0.53	0.61	0.15	0.29

- By utilising the cash ratio to assess liquidity, the calculations above highlight that GRNSW's liquidity position has decreased in FY14 and FY15 from a high point in FY13.
- In our view, GRNSW may have liquidity constraints if the level of cash buffer keeps decreasing and management maintains the current long collection terms with Tabcorp.
- We note that the FY15 Annual Report acknowledges the inherent liquidity constraints within GRNSW as income streams from Tabcorp are received on a bi annual basis.

1.4.6. Ferriers forecast

Ferriers have considered the following methodology to forecast revenues and expenses, except for RFIU fees:

1 The annual percentage change in the amount of each revenue category;

2 The average annual change in the amount of each revenue category over the four year period 2012 – 2015;

3 The amount of revenue forecast to occur in the 2016 year adopting the excel "FORECAST" function. This function calculates, or predicts, a future value by using past values and applying linear regression. Essentially, it determines a line of best fit based on past information in relation to a variable and uses that line to predict the amount of that variable for the next period.

4 The expected average annual inflation rate implied by the difference between 10-year nominal bond yield and 10-year inflation indexed bond yield, as published by the Reserve Bank of Australia, which was 2.33% as at June 2015.

- We have identified the following issues in relation to the forecast included in the Ferriers Report:
  - ***Basis for development of forecast assumptions***: We note that the actual assumptions utilised for forecasting revenues do not consider the historical results and the excel 'forecast' function and are according to Dr. Ferrier developed based on a 'best guess' basis. The lack of a sound basis for development of assumptions through either discussions with GRNSW management or more comprehensive analysis of the historical performance results in an inaccurate representation of GRNSW's future performance.
  - [redacted]
  - ***'Blue Paws' expenses:*** We note that the Ferriers report considers the expenses of Blue Paws during the forecast period, increasing at CPI. However, the corresponding revenues are not considered during the forecast period due to the discontinuance of the Blue Paws programme in FY15. The impact of this results in an overstatement of expenses during the forecast period and the understatement of forecasted profits.
  - ***Special Commission expenses:*** We note that the Ferriers report considers the Special Commission expenses to grow during the forecasted period, increasing by CPI. We note that expenses related to Special Commission should be classified as one –off in nature and not expected to be incurred beyond FY16. The impact of this is the overstatement of expenses during the forecast period and the understatement of forecasted profits.
  - ***Computation of interest income and expense:*** We note that interest income and the overdraft rate have been assumed to be 8.07%. While current interest rates for deposits range between 2.35% - 4%, the bank overdraft rates currently stand at c.9.5%. According to GRNSW management, interest rates applicable for GRNSW on their deposits range between 0.1%-2.75%. Consequently interest income is significantly overstated in the forecast period.
  - ***Revised FY16 Budget:*** We note that a revised revenue and expenses budget for FY16 has been prepared by GRNSW which differs significantly to that originally provided to Ferriers. Therefore, the current forecast is not reflective of the updated views of GRNSW.
  - ***Capex requirements****:* We note that the actual forecast does not consider any capital expenditure. Based on our review of the annual reports during the period FY12-FY15, we note that GRNSW, as part of its function to develop the greyhound racing industry, undertakes capital expenditure on an annual basis. While we note that the Ferriers report highlights that no capital investment budget was provided by GRNSW, the exclusion of capital expenditure does not present a true financial position of GRNSW.
  - [redacted]
- In our opinion the forecast prepared in the Ferriers report contains a number of inappropriate assumptions and is based on inaccurate data. Consequently, it does not reflect a true and accurate view of GRNSW's future financial performance and therefore, cannot be used to assess GRNSW's sustainability.

1.5. GRNSW forecast analysis

1.5.1. Forecasting considerations of GRNSW management

- Revised forecasts for FY16-FY20 prepared by GRNSW differ significantly to those prepared by Ferriers. The revised forecasts include a number of amendments in relation to the organisational structure of GRNSW in response to the issues identified as part of the reform process currently being undertaken including the modification of the RFIU fees scheme.

1.5.2. Key assumptions utilised in development of forecasts

In our opinion, GRNSW have prepared the forecasts on a conservative basis. Key assumptions are highlighted below:

- **TAB Distributions:** Historically, TAB distributions, on a CAGR basis have grown by 3.48% between FY12–FY15. GRNSW management have projected [redacted]

- **RFIU fees:** Between FY12-FY15, RFIU fee income, on a CAGR basis, grew by 11.17% reflecting the move by punters from pari-mutuel betting to fixed odds. According to the revised Racing Administration Regulation, GRNSW is entailed to charge up to 4% of a wagering operator's turnover in respect of wagering turnover derived from wagers laid by the wagering operator at totalizator derived odds; and up to 2.5% of the wagering operator's wagering turnover in respect to wagering turnover derived from wagers laid by the wagering operator at odds other than totalizator derived odds. GRNSW have considered the revised Racing Administration Regulation and consequently, [redacted]

- **Animal welfare income**: Animal welfare related income, on a CAGR basis, increased by 16% between FY12 – FY15, primarily due to the increased focus of GRNSW in animal welfare programmes such as GAP, Blue Paws and veterinary services. With the discontinuation of the Blue Paws programme in FY15, animal welfare related income shall comprise of income obtained from Veterinary services and GAP. GRNSW management forecasts c.35.8% increase in FY16 compared to FY15 largely due to the projected $235k revenue from the Playhouse Pet Motel. Commercial operations at this facility are expected to cease at 30 June 2016 and subsequent revenue has not been included in the forecast from FY17 onwards. Income obtained from Veterinary services and the Greyhound as Pets programme has been projected to decline by 11.6% in FY16 mainly driven by cessation of the Blue Paws programme in June 2015. Subsequent to FY16, the animal welfare related income is expected to increase until FY20 reflecting the increased level of animal welfare measures adopted by GRNSW.

- **Administration and other overheads:** Finance and Corporate Overheads are expected to grow by 42% ($1.16m) in FY16 due to increased headcount across finance, people and culture, and legal and policy. IT costs are expected to increase by 132% ($463k) in FY16, primarily due to the one-off upgrade to the existing OzChase system. The IT costs are expected to decline by c.20% in FY17, as the one off costs in FY16 are not expected to reoccur in FY17. Special Commission costs which are one off expenses incurred in FY16 and are not expected to be incurred from FY17 onwards

- **Stewards and integrity costs:** Stewarding costs are expected to increase in FY16 by 19% ($463k) reflecting additional head count costs incurred within compliance, intelligence and investigative teams to enhance animal welfare mechanisms. Subsequent to FY16, stewarding and integrity costs are expected to increase until FY20 reflecting the continued focus of GRNSW in improving animal welfare mechanisms. Drug detection costs are expected to increase by c.10% annually from FY17 onwards reflecting the increased emphasis on drug detection measures adopted by GRNSW.

1.5.3. Sensitivity analysis

- Sensitivity analysis has been undertaken to understand the impact of the decline in TAB Distribution income and RFIU fee income on EBIT. Further details are shown in Section 4.2.1.3.

[redacted]

1.5.4. Conclusion on GRNSW financial forecasts

- In our opinion, the basis on which the forecasts prepared by GRNSW management are sound with a bottom-up approach incorporating individual assumptions to each account of the income statement and considering the number of races to be held during each season.

[redacted]

- We note that while revenue and expenses have been estimated conservatively, EBIT is expected to be negative in FY16 reflecting 'one off' expenses related to the implementation of the OzChase system and costs arising from the 'live baiting' scandal. As operations normalise, both EBIT and operating margin is projected to improve in FY17 and to remain profitable thereafter.

1.6. Legislative changes

- GRNSW's revenue is derived from two main sources: TAB distributions and RFIU fees. The NSW Government has announced changes to both of these funding streams resulting in higher funds money being provided to the three racing codes in NSW including GRNSW.

- In order to estimate the potential updated monetary benefit obtained by the greyhound industry and GRNSW in FY18 and FY19 as a result of the Betting Tax Legislation Amendment Act 2015, the methodology detailed in Section 5.2 was developed by PwC and adopted after obtaining approval from the Client. While the methodology adopted provides an estimate of the potential benefits available to the greyhound industry and to GRNSW from the application of revised tax rates, no assurance on the accuracy of the actual benefits to the greyhound industry and to GRNSW resulting from the revised tax rates can be provided

- Based on the above methodology, the following tax harmonisation benefits could be expected by the greyhound industry and that by GRNSW:

Table 8: Tax harmonization benefits to the greyhound industry and GRNSW

Announced totalisator tax rate	Enacted totalisator tax rate	Announced fixed odds tax rate	Enacted fixed odds tax rate	Announced start of reduction	Enacted start of reduction	Announced money back to industry ($m)	Updated money back to industry ($m)	Amount to GRNSW p.a. ($m)
19.1%		10.9%						
17.7%	16.2%	10.1%	9.2%	Jan-16	Jul-15	10	25	3
14.6%	13.5%	8.3%	7.4%	Jan-17	Jul-16	25	45	5
12.0%	12.2%	6.9%	6.6%	Jan-18	Jul-17	45	52	5
9.3%	10.7%	5.3%	5.8%	Jan-19	Jul-18	70	67	7
7.6%	7.6%	4.4%	4.4%	Jan-20	Jul-19	85	90	9

- The impact on the EBIT of GRNSW as a result of tax harmonisation benefit is as follows:

Table 9: Tax harmonization impact on GRNSW

$	FY16	FY17	FY18	FY19	FY20
Operating revenue	53,156,732	53,517,158	54,140,092	54,794,777	55,489,011
Tax harmonisation benefit	2,500,000	4,500,000	5,200,000	6,700,000	9,000,000
Adjusted operational revenue	**55,656,732**	**58,017,158**	**59,340,092**	**61,494,777**	**64,489,011**
Operational expense	(53,523,671)	(50,380,380)	(51,345,062)	(52,439,173)	(53,364,573)
EBIT	**2,133,061**	**7,636,778**	**7,995,030**	**9,055,604**	**11,124,439**
Operating profit margin	***4%***	***13%***	***13%***	***15%***	***17%***

- We note that the revised forecasts provided by GRNSW consider the maximum cap on RFIU fees levied on the participants per the revised Racing Administration Regulation. The financial impact of the benefits obtained from the tax harmonisation is provided in Appendix 5.

1.6.1. Conclusion on impact of legislative changes

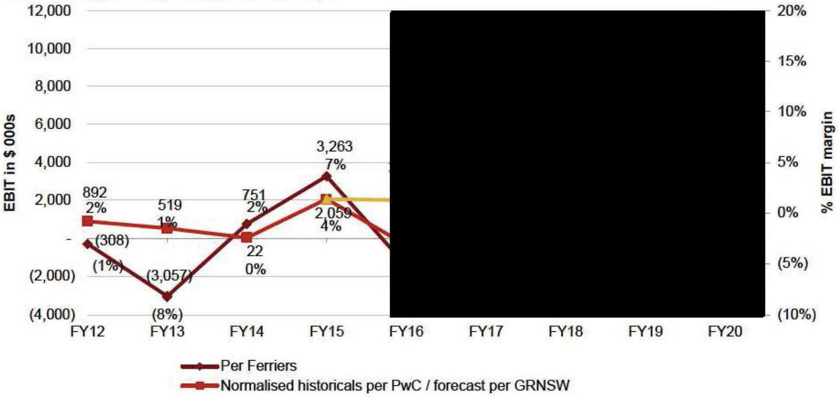
- It is evident from the results shown in Table 9 that the legislative changes have a positive impact on GRNSW with EBIT levels and the operating profit margins improving significantly.

[redacted]

1.7. Conclusion on GRNSW profitability

- The following chart highlights GRNSW's historical and projected EBIT and operating margins under the following scenarios:
    - Per the Ferriers report;
    - Per historical data adjusted for normalisations by PwC and forecasts provided by GRNSW;
    - Per forecasts provided by GRNSW adjusted for the impact of legislative changes.

EBIT and operating margin comparison



- FY16 losses in both GRNSW and Ferriers forecasts are mainly driven by one off Special Commission expenses as a result of the 'live baiting' scandal.

- Profitability levels indicated by Ferriers are significantly lower, primarily due to inadequacy of historical analysis and forecast data which did not consider the impact of the increase in the RFIU fee cap.

- The forecasts considered by PwC to compute profitability levels were provided by GRNSW management and are outlined in Section 4 of this report. As highlighted, forecast EBIT and operating margin from FY17-FY20 reflects a declining trend primarily due to a higher increase in growth of operating expenses as compared to that of operating revenue. This is primarily due to relative decline in growth of TAB distribution income and increased animal welfare expenditure.

- The impact of legislative changes on profitability levels are based on data reflected in Section 5 of this report. Legislative changes arising as a result of tax harmonisation and RFIU fee cap change have a significantly positive impact on the profitability of GRNSW.

1.7.1. Impact of additional expenses

- We have been instructed to overlay the financial forecasts with the inclusion of new assumptions in relation to additional animal welfare expenditure and the rationalisation of the number of clubs from 34 to between 8 and 14. The additional expenses are mainly comprised of the following:
    - Additional infrastructure costs to convert the clubs into Centres of Excellence. GRNSW estimates that the cost to convert a track will be $8.5m and $10.5m for a 'one turn track' and for 'two turn track' respectively in the next 20 years.
    - Additional one off costs in relation to the expansion of the Greyhounds As Pets rehoming facility, infrastructure improvements, the closure of Breeding Incentive Scheme, the launch of the Online Services Portal and the digitalisation of Kennel Inspections.
- As the definitive number of clubs is yet to be agreed, we have been instructed to evaluate 8 potential scenarios in the event the number of clubs is reduced to 8, 10, 12 or 14 and these clubs are converted into Centres of Excellence of one track or two tracks.
- The impact of the additional expenses has been prepared considering that GRNSW shall be eligible for the benefits accruing from tax harmonisation and the RFIU fees will be calculated in accordance with the revised Racing Administration Regulation.

[redacted]

- The graph above shows that the profitability of GRNSW is significantly affected for the scenario where 14 clubs are improved, even after considering the benefits of tax harmonization.
- From a profitability perspective, GRNSW is still forecast to be profitable if track improvements for a maximum of 12 clubs are undertaken.
- Illustrative sensitivities have been calculated to understand impact on EBIT if the track turn is undertaken over 3, 5 and 10 year period (refer Section 6.3)

2. Review of Ferriers report

On 20 August 2015, Ferriers Practice Pty Ltd prepared a report at the request of the solicitors acting for GRNSW to address the following questions relevant to the financial position and financial sustainability of GRNSW:

Question 1 - What is the profitability, solvency and liquidity of GRNSW, based on the financial statements of GRNSW for each of the four years ended 30 June 2015?

Question 2 – What is the profitability, solvency and liquidity of GRNSW when compared with the profitability, solvency and liquidity of Greyhound Racing Victoria ("GRV"), based on the financial statements of both organisations for each of the three years ended 30 June 2014?

Question 3 - Will GRNSW be able to meet its budgeted expenditures for the five years ended 30 June 2020 if:

(i) it does not implement new welfare and integrity initiatives which, if implemented, would result in additional costs as set out in document 5 in Annexure C to the Ferriers report ("additional planned expenditures")? or;

(ii) it does incur the additional planned expenditures?

Question 4.1 - Will GRNSW be able to meet its budgeted expenditures for the five years ended 30 June 2020 if it receives additional funds from the State Government as set out in paragraph 14 of my letter of instruction, such that "tax parity" with Victoria is reached and if:

(i) it does not incur the additional planned expenditures? or;

(ii) it does incur the additional planned expenditures?

Question 4.2 – Under the two scenarios identified in Question 4.1, what will be the financial position of GRNSW for each of the five years ended 30 June 2020?

Question 5.1 – How much will GRNSW receive in Race Fields Information Use ("RFIU") Fees for each of the five years ended 30 June 2020, assuming that the basis of calculating RFIU fees changes such that:

(i) in the year ended 30 June 2016 the RFIU fee is the greater of 1.5% of turnover and 15% of gross margin; and

(ii) in each of the four years ended 30 June 2020 the RFIU fee is the greater of 2% of turnover and 15% of gross margin.

Question 5.2 – Assuming that tax parity is introduced and that the basis for calculating RFIU fees is changed, will GRNSW be able to meet its budgeted expenditures for each of the five years ended 30 June 2020 if:

(i) it does not incur the additional planned expenditures? or;

(ii) it does incur the additional planned expenditures?

Question 5.3 – Under the two scenarios identified in Question 5.2, what will be the financial position of GRNSW for each of the five years ended 30 June 2020?

Question 6.1 – Is GRNSW financially sustainable, assuming that tax parity is not implemented and there is no change to the basis of RFIU fees, if GRNSW:

(i) does not incur the additional planned expenditures? or;

(ii) does incur the additional planned expenditures?

Question 6.2 – Is GRNSW financially sustainable, assuming that tax parity is implemented and the basis of RFIU fees is changed, if GRNSW:

(i) does not incur the additional planned expenditures? or;

(ii) does incur the additional planned expenditures?

We have set out below further details regarding our key findings/commentary based on our review of the Ferriers report:

2.1. Consideration of 'Abnormal/Non-operating items'

- The Ferriers report considers certain adjustments and restates the financial statements of GRNSW based on these adjustments, we consider the list to be not exhaustive and additional items should be considered:

Table 10: Abnormal/non-operating items considered by Ferriers report

$	FY12	FY13	FY14	FY15
EBIT per financial statements	4,504,703	(2,403,950)	3,597,684	1,888,653
Ferriers adjustments				
International GST Recovery	-	(652,610)	-	-
Deferred revenue realised	(6,913,157)	-	(2,846,211)	-
NCA loan forgiven (Gardens purchase)	2,100,000	-	-	-
Investigation Four Corners	-	-	-	1,373,924
Ferriers adjustments total	**(4,813,157)**	**(652,610)**	**(2,846,211)**	**1,373,924**
EBIT per Ferriers report	**(308,454)**	**(3,056,560)**	**751,473**	**3,262,577**
PwC adjustments				
1) Product fees - PGI Agreement	-	729,245	(729,245)	-
2) Deferred revenue	-	2,846,211	-	-
3) Revenue from Playhouse Pet Motel	-	-	-	(436,207)
4) Infrastructure and IT costs from acquisition of The Gardens Property	1,200,000	-	-	-
5) Deferred infrastructure costs	-	-	-	(500,000)
6) Deferred drug detection tests	-	-	-	(130,000)
7) CEO's Salary (Feb-June)	-	-	-	(136,875)
PwC adjustments total	**1,200,000**	**3,575,456**	**(729,245)**	**(1,203,082)**
PwC normalised EBIT	**891,546**	**518,896**	**22,228**	**2,059,495**

2.1.1. Deferred revenue

- According to the FY12 and FY14 annual reports, the deferred revenue represents amounts in dispute with Tabcorp for the current year which was settled in the following year.
- We note this revenue was earned by GRNSW during the normal course of its business. However, the revenue was recognized in FY12 and FY14 when the disputes were settled whereas revenue was earned and therefore related to FY11 and FY13 respectively.
- The Ferriers report has not considered the appropriate period that the revenue related in the computation of EBIT.
- While we agree with the Ferriers Report in adding back the deferred revenues identified from the FY12 and FY14 EBIT (when they were recognised), we consider that on a normalised basis, this revenue should have been captured in FY11 and FY13 respectively and therefore should be incorporated in the calculation of EBIT in those years.
- Based on our discussions with GRNSW management, we note that a new system is in place with Tabcorp to avoid disputes of revenue recognition in the future.

2.1.2. Acquisition of The Gardens property

- We note that the FY13 Annual Report states:

"On the surface Industry Infrastructure & IT Costs are significantly lower than the 2011/12 level. However this is due to last year's figure including a $1.2 million cost involved in the acquisition of 70% of The Gardens property. With that figure removed, the year-on-year difference is $51,101."

- We note that the above mentioned cost of $1.2 million represents a non-recurring expense and in our opinion, should not be considered in the computation of a normalised level of EBIT for GRNSW.

2.1.3. Revenue from Playhouse Pet Motel

- FY15 was the first year of operations of the Playhouse Pet Motel from which GRNSW recognised $436k of revenue. We understand GRNSW is phasing down the boarding operations to focus purely on the Greyhounds as Pets (GAP) program and therefore this revenue will cease to be earned by GRNSW from 1 July 2016.

- We, therefore, consider this revenue should be adjusted for in the calculation of the normalised EBIT of GRNSW.

2.1.4. Product fees - PGI Agreement

- We note that the FY14 Annual Report states:

"Further, a new product fee agreement was reached during the year with TAB Limited with respect to its Isle of Man joint venture, Premier Gateway International (PGI). The PGI Agreement resulted in GRNSW receiving $729,245 in product fees that related to 2013 racing activity in 2014"

- Product fees from the PGI agreement amounted to $729k in FY14 but were related to activity in FY13 and hence should be reflected in the correct period.

2.1.5. Deferred Infrastructure and IT costs

We note that the FY15 Annual Report states: *"There was less expenditure in the area of Racing & Club Infrastructure due to the work on a number of infrastructure projects extending into the 2015/16 financial year and as a result of associated expenditure not being realised in the same period for these projects"*

- According to GRNSW Management, deferred expenses on infrastructure and IT projects from FY15 amounted to c.$500k which were not accrued for in FY15 and therefore have been adjusted for.

2.1.6. Deferred drug detection costs

- According to GRNSW Management, drug detection costs amounting to $130k were deferred to FY16 due to the temporary cessation of operations due to the 'live baiting' scandal. These drug detection costs should have been conducted in FY16 on a normalised basis and therefore, we consider this cost should be adjusted for in the calculation of the normalised EBIT of GRNSW in FY15.

2.1.7. CEO's salary consideration

- According to GRNSW management, in light of the 'live baiting' scandal, the services of the then CEO of GRNSW were terminated and salaries corresponding to the months of February – June FY15 were not paid. We consider this cost should be included in the calculation of the normalised EBIT of GRNSW in FY15.

2.2. 'Profitability' considerations

2.2.1. Profitability ratios in the Ferriers report

- Ferriers has used the following ratios in relation to the profitability of GRNSW:

a) *EBIT / Operating Revenue. This ratio indicates the relationship between earnings and revenue. A higher ratio indicates a more profitable entity. A negative ratio indicates that the entity is not profitable;*

b) *Operating expenses / Operating Revenue. This ratio indicates the extent to which expenses are able to be met from revenues. A ratio of more than 100% indicates that expenses exceed revenues and that the entity is not profitable;*

c) *EBIT / Average Equity. This ratio indicates the ability of the entity to use its net assets (average equity) to generate operating profits before interest. A negative ratio indicates that the entity is not making operating profits;*

d) *Net surplus / Average equity. This ratio indicates the ability of the entity to use its net assets (average equity) to generate profits after interest and abnormal / non-recurring items. A negative ratio indicates that the entity is not making a surplus."*

- We have recalculated the above ratios based on our conclusion on the normalised EBIT as follows:

Table 11: Profitability indicators compared

Profitability indicators	FY12	FY13	FY14	FY15
EBIT/Operating revenue				
Per Ferriers Report	*-0.75%*	*-7.85%*	*1.66%*	*6.75%*
Per PwC	*2.17%*	*1.22%*	*0.05%*	*4.30%*
Operating expenses/operating revenue				
Per Ferriers Report	*100.75%*	*107.85%*	*98.34%*	*93.25%*
Per PwC	*-97.83%*	*-98.78%*	*-99.95%*	*-95.70%*
EBIT/Average Equity				
Per Ferriers Report	*-2.50%*	*-22.15%*	*5.13%*	*18.59%*
Per PwC	*11.94%*	*3.76%*	*0.15%*	*11.76%*
Surplus/Average Equity				
Per Ferriers Report	*41.07%*	*-15.29%*	*25.97%*	*11.45%*
Per PwC	*-24.80%*	*10.62%*	*1.56%*	*4.60%*

- The Ferriers report concludes *"On an operating basis, GRNSW was not profitable in the 2012 and 2013 years, but returned to profitability in the 2014 and 2015 years"*

- However, we conclude that, after all the proposed adjustments, GRNSW was profitable between FY12 – FY15.

2.2.2. Additional profitability analysis

- We note that the Ferriers report only performs profitability analysis on an EBIT and Net surplus basis, however, no analysis was performed in order to understand the underlying earnings derived from GRNSW racing activity.

- Per Greyhounds Racing Act 2009:

"The functions of GRNSW are as follows:

a) To control, supervise and regulate greyhound racing in the state

b) To register greyhound racing clubs, greyhound trial tracks, greyhounds, owners and trainers of greyhounds, bookmakers for greyhound racing and other persons associated with greyhound racing

c) To initiate, develop and implement policies considered conducive to the promotion, strategic development and welfare of the greyhound racing industry in the state

d) To distribute money received as a result of commercial arrangements required by the Totalisator Act 1997 and

e) To allocate to greyhound racing clubs the dates on which they may conduct greyhound racing meetings."

- We have considered the revenues and expenses corresponding to the above functions of GRNSW and reflect the profitability from GRNSW's racing activities as follows:

Table 12: Revised profitability ratio

$	FY12	FY13	FY14	FY15
Revenue				
TAB Distributions	30,704,497	30,448,406	32,018,231	34,020,554
Race Field Information Use Fees	8,905,038	6,734,242	11,341,362	12,235,588
Race Form	455,105	479,309	322,382	258,105
Licensing & Registration Fees	415,187	594,133	732,415	739,120
Vet Servs, Blue Paws, GAP	317,777	409,044	486,308	496,609
Marketing & Digital	144,818	152,520	120,419	116,234
Fines & Penalties	27,078	38,748	56,591	31,955
Normalization adjustments:				
Deferred revenue	-	2,846,211	-	-
Product fees - PGI Agreement	-	729,245	(729,245)	-
Operating Revenue from racing activities	**40,969,500**	**42,431,858**	**44,348,463**	**47,898,165**
Expenditure				
Racing and club infrastructure	(3,172,681)	(1,465,417)	(2,012,517)	(980,366)
Depreciation, impairment, loss on sale	(392,426)	(318,011)	(298,716)	(370,693)
Prizemoney & Race Club Costs	(29,625,412)	(30,508,353)	(31,907,926)	(31,695,838)
Stewarding, integrity auditor	(2,267,421)	(2,446,418)	(2,387,785)	(2,416,282)
Drug Detection	(964,092)	(1,040,200)	(1,227,731)	(1,182,551)
Grading & Member Services	(539,345)	(827,316)	(1,079,775)	(1,462,049)
Vet Servs, animal welfare, Blue Paws, GAP	(925,827)	(1,140,966)	(1,309,908)	(1,954,733)
Normalisation adjustments:				
Infrastructure & IT cost	1,200,000	-	-	-
Deferred infrastructure costs	-	-	-	(500,000)
Deferred drug detection costs	-	-	-	(130,000)
Operating Expenditure from racing activiti	**(36,687,204)**	**(37,746,681)**	**(40,224,358)**	**(40,692,512)**
Operating Profit from Racing Activities	**4,282,296**	**4,685,177**	**4,124,105**	**7,205,653**
Other income	71,474	102,280	68,945	25,032
Overheads and other indirect costs	(3,462,224)	(4,268,561)	(4,170,822)	(5,171,190)
EBIT	**891,546**	**518,896**	**22,228**	**2,059,495**
Operating Profit (%)	***10.45%***	***11.04%***	***9.30%***	***15.04%***

- The results from the analysis presented above indicate that the racing activities of GRNSW were profitable between FY12 – FY15.
- We note that overheads and indirect costs of GRNSW have been increasing from FY12 – FY15. In FY14, the overheads/indirect costs exceeded operating profits from racing activities, resulting in an overall loss to GRNSW.

2.3. 'Solvency' considerations

- The Ferriers report analyses the liquidity and solvency of GRNSW. The solvency of an entity is defined as the ability to meet its long-term financial obligations whereas the liquidity is defined as the ability to meet its short term obligations. We note the ratios used by Ferriers (current ratio and quick ratio) are suitable to assess liquidity but not solvency.
- We have computed two solvency ratios namely Total Debt to Equity Ratio and Total Debt to Total Assets Ratio which are a better measure of solvency. The computations are shown below:

Table 13: Additional solvency ratios

$	FY12	FY13	FY14	FY15
Current Liabilities	8,267,443	13,946,596	5,843,565	7,193,986
Non-current liabilities	-	-	81,200	81,432
Total Liabilities	**8,267,443**	**13,946,596**	**5,924,765**	**7,275,418**
Equity	14,853,606	12,743,708	16,547,884	18,463,541
Total assets	23,121,049	26,690,304	22,472,649	25,738,959
Total Debt to Equity ratio	0.56	1.09	0.36	0.39
Total Debt to Total Assets ratio	0.36	0.52	0.26	0.28

- Based on the above table, we note that the solvency position of GRNSW deteriorated in FY14 and has marginally improved in FY15.
- We note that GRNSW has minimal long term liabilities (i.e. employee provisions) and has no external bank financing.

2.4. 'Liquidity' considerations

2.4.1. Ferriers' ratios

- The Ferriers report has computed the working capital, the current ratio and the quick ratio based on GRNSW reported financial results derived from the Annual Reports and has concluded that the liquidity position of GRNSW is sound.
- The Ferriers report does not consider the entire amount of current liabilities in the calculation of the quick ratio as the provisions are excluded. In our opinion there is no rationale to exclude the provisions in the calculation of the quick ratio as it is likely that these balances will be settled within one year. We have therefore recalculated the ratio including the provisions.
- We note that the net working capital of GRNSW in 2015 and the derived quick and current ratios calculated by Ferriers includes a receivable balance due from Wentworth Park Trust amounting to $6.497m. The FY15 Annual Report of GRNSW states the following:

"As disclosed within Note 1m, Greyhound Racing New South Wales has a receivable due from Wentworth Park Trust which is carried in the statement of financial position at $6,497,681. We were unable to obtain sufficient appropriate audit evidence about the recoverability of this receivable as at 30 June 2015 due to uncertainty about the ability of Wentworth Park Trust to repay the full amount due. Consequently, we were unable to determine whether any adjustments to this amount were necessary."

- In our opinion, since the recoverability of this balance is uncertain, the net working capital should exclude this receivable balance which would result in a reduction to $8.159m at 30 June 2015. The impact on the quick and current ratios is reflected as follows:

Table 14: Revised Current and Quick Ratio

$	FY12	FY13	FY14	FY15
Current Assets	14,519,307	18,186,254	11,808,816	14,951,294
Current Liabilities	8,267,443	13,946,596	5,843,565	7,193,986
Non-current liabilities	-	-	81,200	81,432
Total Liabilities	**8,267,443**	**13,946,596**	**5,924,765**	**7,275,418**
Equity	14,853,606	12,743,708	16,547,884	18,463,541
Total assets	23,121,049	26,690,304	22,472,649	25,738,959
Total Debt to Equity ratio	0.56	1.09	0.36	0.39
Total Debt to Total Assets ratio	0.36	0.52	0.26	0.28
Current ratio	1.76	1.30	2.02	2.08
Quick ratio	1.76	1.30	2.00	2.00
Per Ferriers Report				
Current ratio	1.76	1.30	2.02	3.07
Quick ratio	2.14	1.42	2.45	3.30

2.4.2. Additional ratios

- The Ferriers report concludes that:

"At 30 June 2015 there was no indication that GRNSW was in immediate danger of becoming insolvent or unable to pay its debt as the fall due"

- We note the following excerpt obtained from the Annual Report FY15:

"The 2014/15 financial year delivered a positive result of $1,915,657 off the back of strong wagering performance in all sectors. However, GRNSW faced a number of financial challenges across the last reporting period, particularly in the area of cash flow management.

The timing of income streams from Tabcorp continues to present a large challenge for GRNSW. As major payments are received on a bi-annual basis, GRNSW faces a cash shortfall in the lead up to the Christmas and end of financial year periods."

- The above statement obtained from the FY15 Annual Report highlights management's acknowledgement of cash flow/liquidity issues within GRNSW, especially in the lead up to Christmas and end of financial year.
- Further detailed analysis on the cash flow position of GRNSW has not been performed as monthly management reports were not provided to us for our review.

- The Ferriers report does not consider the cash ratio which measures the ability to pay off current liabilities with only cash and cash equivalents compared to the current and quick ratio which includes other assets (receivables). A higher cash coverage ratio implies that the entity is more liquid and has more resources to fund its debt obligations. In our opinion the cash ratio is a more appropriate measure to assess liquidity considering the difficulties to convert revenue into cash due to the long collection terms with Tabcorp.

Table 15: Computation of cash ratio

$	FY12	FY13	FY14	FY15
Cash and cash equivalents	4,400,966	8,463,821	897,286	2,082,467
Current Liabilities	8,267,443	13,946,596	5,843,565	7,193,986
Cash ratio	0.53	0.61	0.15	0.29

Source: GRNSW historical financial information obtained from Ferriers report

- The cash ratio identified above indicates that GRNSW's liquidity position has decreased in FY14 and FY15 from a high point in FY13.

- GRNSW may encounter liquidity constraints in the future if the cash buffer continues to decrease and the long collection terms with Tabcorp are maintained.