

Performance Audit Report

Sale of the TAB

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Executive Summary

Executive Summary

On 21 April 1997, the Government agreed to proceed with preparations for the sale of the Totalizator Agency Board of NSW (the TAB) by public float. The sale was part of its wider reforms in the racing and gaming industries which included reform of Government financial assistance to the racing industry and reform of the taxation of wagering.

The reforms, and the sale process, entailed extensive and inter-related negotiations with the many parties involved. These made the process of floating the TAB more complex than many other Government sales.

In the Rules of Engagement to the major participants in February 1998, the Government's objectives were outlined by the TAB Task Force as follows:

- ⇒ *to build broad community and investor support for the sale*
- ⇒ *to ensure all potential investors are aware of and actively encouraged to participate in the sale*
- ⇒ *to conduct a sale process which is of the highest standards of probity and accountability*
- ⇒ *to achieve an optimum financial return from the sale of the NSW TAB for the NSW Government.*

Legislation

The sale legislation, the *Totalizator Agency Board Privatisation Act 1997*, included provisions for a review by the Auditor-General.

The Auditor General is to examine the sale of TAB Limited as he considers appropriate and is to report as soon as is practicable to both Houses of Parliament.

Audit Focus

The audit focussed on the extent to which the Government's objectives for the public float of the TAB, as outlined in the Rules of Engagement, were achieved with particular emphasis on the efficiency and effectiveness of the sale process and the extent that the share price set for the float represents value to the taxpayers of NSW.

The audit also comments briefly on the achievements of the Government's wider objectives in relation to the racing industry.

Audit Opinion

The Audit Office is of the opinion that:

- the sale was delivered with reasonable efficiency and effectiveness
- the sale yielded a satisfactory return to the NSW Government. The possibility for a higher return was limited to about 2% to 4% on gross proceeds of \$936m. It would have required setting a higher share price for all investors and adopting a more flexible approach to share allocation
- the Government's objective to promote community and investor support was achieved. The scale of the demand for script added to costs and was not fully translated into higher proceeds
- generally satisfactory accountability frameworks were put in place for the sale and no probity concerns were identified
- the frameworks to achieve the Government's wider reforms of the racing and wagering industries have substantially been implemented.

The Government's pre-condition that the sale price at least equal the value of the then current taxation arrangements (the arrangements by which the Treasury was paid a share of wagering) has been achieved under the assumptions used.

When the Government accepted that pre-condition, it did so without documented advice that the concept of maintaining value entails a reduction in revenue, offset by a reduction in ownership risk.

The Treasurer's second reading on the Totalizator Agency Board Privatisation Bill said the float would only proceed if the reserve price met or exceeded the value of the TAB's current taxation stream. The reserve price was comfortably exceeded, as was expected, but the reserve price did not meet that condition.

Audit Findings

These opinions are based on the following findings.

Management and Probity

To manage and implement the sale, the Government established the TAB Sales Taskforce and through it 10 working groups responsible for key components.

Use of Consultants

The sale process placed high reliance on consultants and contractors to implement the sale. The audit believes the reliance on consultants was justified because of the specialist knowledge required, especially in view of the short-term and time-critical nature of the work.

The clear responsibilities allocated in management structures, the presence of the probity auditor at key decision points and the dissemination of probity and accountability guidelines together provided an appropriate framework to deliver the Government's objective of high standards of probity and accountability.

The implementation of the sale process allowed these standards to be achieved in most places, although in some places, especially as the pressure of time increased towards the latter stages of the float, achievement of the standards could have been better. There was some lack of documentation to support decisions at key stages in the process; for example, in a review of maintaining value ("revenue neutrality") and assessing the quality of institutions bidding for shares.

There was also some blurring of accountability: the Government and the TAB each used the same financial adviser for the purchase of SKY and consultants' contracts were not always updated in a timely manner as new tasks emerged.

Value to the Taxpayer

Offer Pricing

The Audit Office considers that the sale price represents a reasonable return to the taxpayers and the Government, although the setting of the share price was somewhat conservative.

The indicative selling price range was set at \$1.80 - \$2.20, compared with a valuation of the TAB which equated to a share price between \$2.02 and \$2.41. The final institutional price was set at \$2.10.

The modest movement in the TAB Limited share price on the first day of trading indicates that the float achieved a better return to taxpayers than most floats by other governments in recent times. The significant rise in the share price over the first week, and the continuing good performance since against its closest comparator, TABCORP, tend to confirm that the market might have been able to accept a somewhat higher price for the float.

There was also a degree of inflexibility in retail pricing and share allocation. The strength of retail demand, evident during pre-registration, called into question the need for the retail incentives subsequently adopted. And the very strong retail demand that ensued was not translated into strong price tension in the institutional bidding process. Allowing a smaller differential between retail and institutional price caps may have generated greater price tension and marginally greater proceeds to Government.

Scale Back

The scale of the retail demand for shares required a significant scale back of indicative share allocations to individuals. This caused some frustration amongst retail investors and brokers, although the Government achieved its objective of widespread ownership of the TAB.

Float Costs

The direct costs of the float and industry reform were \$47m which represents 4.5% of the equity value of the sale. This percentage is higher than that in most comparable floats, although it includes some costs associated with industry reform. But the point is stronger if the cost to the Government in supporting the TAB's larger than anticipated share registry (estimated at \$10m) is included.

**“Revenue
Neutrality”**

The sale of shares generated gross proceeds of \$936m (net \$889m) to the Government. As mentioned earlier, the Government's precondition was that the value of these proceeds should have been at least equal to the value of the future taxation stream forgone.

On the data available, this has been achieved by using assumptions relating to the shedding of risks associated with future wagering tax flow and to the increased revenue from a more efficient private sector TAB.

The Audit Office strongly supports the NSW Government's use of "revenue/retention neutrality" targets, (including the recognition of risk factors associated with continued ownership). A more explicit and robust approach to assessing and reviewing such targets would assist in any future sales.

Pre-sale Review

Notwithstanding a specific requirement by Cabinet, there is no documentary evidence that Cabinet was advised in a timely manner of the reserve price for the sale of the TAB needed to achieve "revenue neutrality". The Audit Office considers that the Cabinet requirements should have been adhered to. The Government should have been advised of likely sale proceeds, compared to proceeds from retaining the asset, at an earlier stage in the process to allow the Government to abandon the sale, if that were considered appropriate.

Wider Reforms

The framework to meet the Government's wider objectives for the reform of the racing and wagering industries has substantially been implemented. A more commercial environment has been established for the racing industry. Restrictions on cross-ownership of wagering and gaming have been introduced in conjunction with maximum 5% shareholding limits in the TAB.

It is too early to draw conclusions on how successful the reforms will be in securing the long term future of the industries involved, but the initial signs are encouraging.

The framework has been developed at some cost to the Government, after intensive negotiations with the many stakeholders involved and some delay. In particular, the Government provided the racing industry with \$44m in one-off additional assistance in 1997 that had not been anticipated originally, when the sale was expected to be completed that year. There were also important concessions to the clubs, hotels and to the TAB itself.

The report makes a number of recommendations for the Government to consider in planning future sales.

Summary of Recommendations

The Audit Office recommends that, in future sales:

- **to strengthen the usefulness of “revenue or retention neutrality”, the condition be clearly identified and its achievement be measured with guidance on: how to assess net present values of cashflows pre and post sale; the discount rates to be used including those in respect of the treatment of private vs public sector risk.**
- **the Government should receive a stringent evaluation as to the merits of staging a float, rather than a single 100% float**
- **advisers should be required to prepare a general work plan at the beginning of the contract, followed by periodic progress reports and prior approval for any major variations to the plan**
- **more detailed consideration be given to setting selling commissions and fee levels**
- **flexible demand management and incentive measures should be considered in planning floats to respond to up-to-date information on demand from market research and pre-registration**
- **contingency plans be prepared for logistics arrangements taking into account available market research**
- **the Government should develop procedures to ensure that appropriate audit trails relating to accountability, including information up to the date of sale, are maintained**

Response to the Report from the Treasury

I hereby offer comments on the Performance Audit Report - Sale of TAB in accordance with Section 38c(3) of the Public Finance and Audit Act.

Broad agreement with Findings and Recommendations

The Treasury and Audit Office are in broad agreement on the main conclusions of the Performance Audit. These conclusions are that the sale of TAB was completed with reasonable standards of efficiency and effectiveness, achieving a satisfactory return, meeting generally satisfactory standards of accountability and raising no probity concerns. The audit notes that the foundation for the broader racing industry reforms have been put in place. The audit also notes that there was an appropriate framework to deliver the Government's objective of high standards of probity and accountability which were achieved at most stages.

The audit makes a number of specific criticisms and recommendations for future privatisations, the majority of which I agree with in full or with some qualification. Specifically, I acknowledge that there could have been more effective use of the available market research data in planning for the Share Information Centre. Further, I agree that on some specific points, the documentation and audit trail could have been clearer. However, in this regard, I am advised by participants in previous privatisations in NSW that the management of the process, the documentation and record keeping was a step forward from the GIO and State Bank privatisations. The TAB sale is a solid foundation for further improvement in any major reforms carried out in future.

Points of Clarification, Qualification and Emphasis

There are some findings and recommendations of the Performance Audit with which I would take issue. However, these matters relate to clarification, qualification and emphasis rather than major disagreements on fundamental points.

1. Return from the Sale

The Audit Office concludes that the sale yielded a satisfactory return but adds that the “possibility existed” for a slightly higher than the \$2.10 institutional price.

The Treasury notes that:

- the difference between Treasury and The Audit Office on this issue is small - both parties agree that pricing at \$2.10 yielded a satisfactory return with The Audit Office noting a “possibility” of a higher return limited to 5 cents or 10 cents.
- the case for any higher price is at best arguable rather than conclusive. The criteria used by The Audit Office give mixed answers - some criteria showing the issue was fully priced, other criteria showing a possibility of a slightly higher price. In our view, a number of the comments by The Audit Office about pricing are conjectural and speculative rather than conclusive in support of a view that the possibility existed for a somewhat higher price.
- the Government’s financial adviser and the Joint Lead Managers advised the Government that \$2.10 was the appropriate price. These advisers have reviewed the Report and confirm that they stand by this advice.
- many issues influence this recommendation, including the fact that only one of the six largest Australian institutional investors was prepared to take shares at \$2.20.
- the retail discount (or institutional premium) of 5 cents a share is, in the Government’s view, necessary to achieve equity between retail and institutional investors where retail investors pay in advance for shares applied for (as distinct from shares allocated).
- references by The Audit Office to the float of British Energy are interesting, but the application of that precedent to TAB is questionable (eg. in British Energy, institutional bidding was below the retail application price, not above it as was the case with TAB.)

2. Documentation for the Discussion on Final Pricing of Shares

The Audit Office comments that the basis for the final price of \$2.10 was unclear and that the factors considered in setting the final price “are not set out in writing”.

The Treasury notes that:

- most of the information relating to pricing on 19 June 1998 and quoted in The Audit Office Report is taken directly from documents used by the Government in the pricing decision.
- we take The Audit Office’s comments on this matter to be a proposal for clearer documentation - a suggestion that we acknowledge as constructive.

3. Pre-conditions for the Sale

The Audit Report notes that in the Second Reading Speech on the TAB Privatisation Bill (Legislative Council, 19 June 1997), the Treasurer said:

However, the float will only proceed if the Government is satisfied that a reserve price which fairly reflects the value of the current taxation stream which is foregone, can be met or exceeded.

The Report states that it would be proper for Parliament to be advised of the departures from the conditions which the Treasurer advised Parliament would apply to the float.

The Treasury notes:

- this issue was raised by both Treasury and Cabinet Office in preparing the Cabinet Minute dealing with the indicative pricing range for the float.
- the Treasury advised that gross proceeds (from the sale shares and licences) of \$1,023 million would meet the value test.
- the floor of the indicative price range for the sale (\$1.80) would have yielded \$910 million, ie, less than the \$1,020 million.

- Bankers Trust wrote to the Treasurer in the following terms:

“We believe it is reasonable for the Government to proceed on the expectation of gross proceeds to the Government of \$1,023 million or more, while acknowledging the possibility that the float may be subject to unexpected general specific adverse conditions.”

- Treasury and Cabinet Office advised that on the basis of Bankers Trust’s statement, the Government could be “satisfied that a reserve price ... can be met or exceeded”.
- Treasury and Cabinet Office advised that the words “satisfied that a reserve price ... can be met or exceeded” does not imply that the Government would proceed only if the reserve price could be guaranteed as certain without any risk whatsoever.
- We note that the actual gross proceeds were \$1,042 million, consistent with the undertaking to Parliament.

4. Valuations and Return to the Government

The Report contains numerous references to valuations and the returns to the Government from the privatisations. Care is required in making appropriate comparisons between valuations and results.

The Treasury notes the following points:

- the valuations attached to the Cabinet Minute of 21 April 1997 valued TAB in a float at between \$1.0 billion and \$1.15 billion.
- the Minute made reference to a “reserve price” of \$1.2 billion. In the context of the Minute it was clear that this was a very optimistic “reserve” and that it would be reviewed.
- the final, revised reserve was set at \$1,020 million.

- the results of the privatisation comparable with the above valuations, was \$1,042 million consisting of proceeds of the share sale of \$936 million and payment of \$100 million from TAB for licences to operate their wagering and gaming business. This also includes interest on application moneys.
- we note that the NSW Government in all of its major privatisations (GIO, State Bank and TAB) has addressed the value neutrality issue. To our knowledge, no other state or federal government gives this issue as much attention. This point is acknowledged in the audit report.

5. Other Matters

The Treasury acknowledges the constructive comments and recommendations of The Audit Office in relation to a range of issues, specifically:

- the need to develop further the concept of revenue or retention neutrality in privatisation.
- investigation of the merits of a staged sale (as in Telstra and Commonwealth Bank) in any future privatisations.
- the importance of contract administration.
- attention to selling fees.
- use of market research data in preparing for pre-registration.
- the importance of audit trails and documentation.

Treasury agrees with these recommendations with specific qualifications and reservations relating to clarity of The Audit Office comments and balance in assessing complex issues. Treasury believes that these matters have been dealt with fully in discussions with The Audit Office and that elaboration of these (very technical) issues is not required for inclusion in The Audit Office's Report to the NSW Parliament.

(signed)
G. Maltabarow
NSW Treasury

1 Introduction

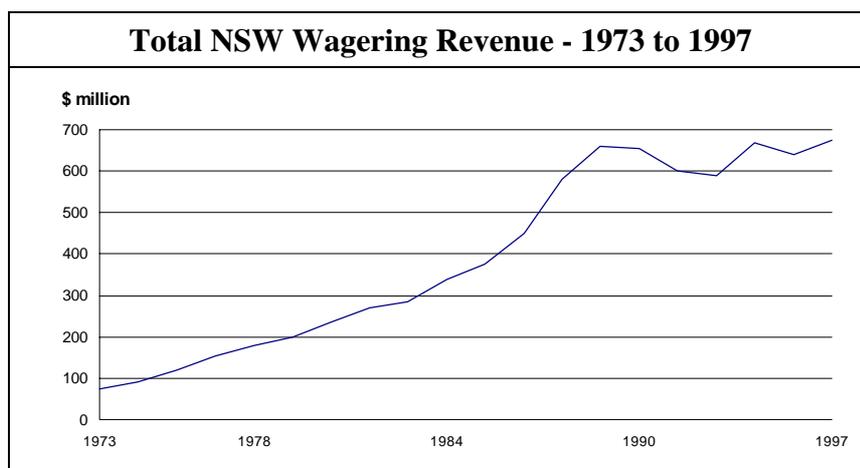
Background

In December 1964, the Totalizator Agency Board of NSW (TAB) was established by the NSW Government as a statutory authority to provide an off-course wagering service on thoroughbred, harness and greyhound racing.

History of Growth

By June 1997 the TAB had 549 branches and agencies, 540 PubTAB and 333 ClubTAB outlets throughout NSW. These annually generated over \$600m in gross revenue which was split between the TAB, the NSW Government and the racing clubs. In 1996/97 the Government received \$308m and the racing clubs \$124m. The rest covered the TAB costs.

Since the early 1990s, the growth in wagering revenue has slowed, as the graph below indicates. Since 1995/6, the TAB has had to pay funds (\$13m in 1996/97) out of its retained reserves to maintain payments to the racing clubs in the face of increasing competition from elsewhere, especially Victoria.

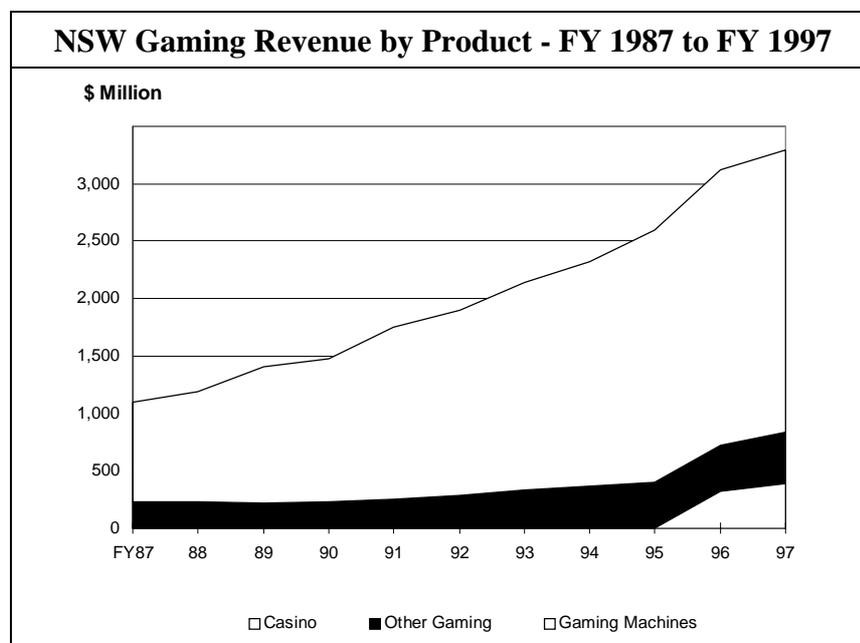


Source: TAB Share Offer Document, May 1998, p17.

Two of the reasons for the decline in growth are:

- increased competition from other forms of gambling, specifically gaming
- racing industry competition with Victoria.

The Gaming Sector The slowing of wagering growth in NSW has coincided with the increased growth in gaming, as the graph below indicates. The opening of the new Sydney casino (with its gaming tables) and the introduction of poker machines into hotels has increased competition for the gaming dollar.



Source: Appendices to the TAB Share Offer Document, May 1998, p8.

Victorian Racing and Gaming Industry

In contrast to NSW, the Victorian racing industry has been growing steadily since the sale of the Victorian TAB (now TABCORP) in 1994. The privatisation of the Victorian TAB provided a lower tax on wagering (reduced from 52% to 28.2%) which enabled greater distributions of funds to the industry. This resulted in significantly more prize money per race compared to NSW and attracted larger fields. As a consequence, the number of racing animals registered in NSW has fallen while it has increased in Victoria.

A large component of TABCORP'S growth has come from its gaming businesses. Now 80% of its revenue comes from this source, compared with 20% in the NSW TAB. TABCORP holds 50% of the poker machine licences in Victoria which is in that state a relatively new and expanding market.

The decline in growth in the wagering market and the increased competition from the gaming sector were factors taken into consideration by the NSW Government in its decision to privatise the NSW TAB. The NSW Government saw in the sale an opportunity to reinvigorate both the TAB and the racing industry at no cost to the State. It would also eliminate the

Government's conflicting role as both regulator, owner and beneficiary (through taxation revenue) of the wagering business in NSW.

Government's Decision to Sell the TAB

April 1997

On 21 April 1997 the Government approved in principle the sale of the TAB.

The Government agreed to:

- a sale of the TAB through a public float
- a new commercially focused Board
- the TAB being the sole NSW operator licensed to operate a State Wide Linked Jackpots System (SWLJS)
- the TAB providing a Centralised Monitoring System (CMS) for all gaming machines in all registered clubs and hotels
- cross ownership limitations being placed on other commercial gaming and/or wagering activities
- the negotiation of a Memorandum of Understanding (MOU), between the Government and racing industry which would outline the broad areas of agreement between the parties concerning a sustainable long term future for the NSW racing industry.

The Government's decision was made subject to the following conditions:

1. the sale price, inclusive of arrangements made with the racing industry plus new taxation arrangements, to be at least equivalent to the value of the current taxation arrangements
2. proceeds from the sale to be used primarily to retire debt
3. the current wagering taxation rate to be reduced to a level equivalent to that which applies in Victoria
4. any arrangement agreed with the industry to be sustainable in the long term and, in particular, not to provide for substantial increases in income without commensurate performance improvements.

The Government's Objectives

In the Rules of Engagement issued by the TAB Sale Task Force, the Government's objectives for the sale process itself were outlined to the major participants in February 1998 as follows:

- ⇒ *to build broad community and investor support for the sale*
- ⇒ *to ensure all potential investors are aware of and actively encouraged to participate in the sale*
- ⇒ *to conduct a sale process which is of the highest standards of probity and accountability*
- ⇒ *to achieve an optimum financial return from the sale of the NSW TAB for the NSW Government*

Source: Rules of Engagement for Sale of NSW TAB, Bankers Trust, Feb 1998, p1.

These were set in the context of the Government's objectives for the wider reforms of the racing industry and the TAB:

- to place the NSW Racing Industry on a financial basis that would give it a sustainable long term future
- to achieve this with the best available financial outcome for the NSW Government
- to achieve these two subject to meeting certain other Government objectives related especially to the administration of gaming and wagering.

Source: NSW Treasury.

Audit Requirement

The sale legislation, the *Totalizator Agency Board Privatisation Act 1997*, included reference to a review by the Auditor-General.

- *The Auditor General is to examine the sale of the TAB Limited as he considers appropriate and is to report as soon as is practicable to both Houses of Parliament*
- *The Minister is to ensure that the Auditor General is given access to such information and resources as may be necessary to enable the Auditor general to exercise the functions conferred by this section*

- *The Auditor general's examination under this section is to accommodate the timetable for the sale of the TAB Limited determined by the Minister.*

Source: Totalizator Agency Board Privatisation Act 1997 Section 32 (3-5).

Audit Criteria

The audit focussed on the extent to which the Government's objectives for the public float of the NSW TAB were achieved, with particular emphasis on the efficiency and effectiveness of the sale process and the extent that the share price set for the float represents value to the taxpayers of NSW.

The audit used the following criteria:

- decisions on restructuring and sale of the TAB conformed with Government objectives and conditions
- the objective of generating broad community and investor support was achieved
- the indicative price range set for the TAB matched an appropriate valuation of the company
- decisions on offer structure, allocations and discounts were based on best available information and taken at appropriate times
- the offer structure translated demand into price tension and thus maximised price
- the share price immediately after listing was close to the offer price (and on the positive side) and thereafter, all else equal, there was a stable aftermarket with the price trends of the TAB shares following the trends of shares in the comparable sector
- management arrangements for the sale were clearly defined and appropriate
- management arrangements operated effectively, with proper accountability and probity
- costs did not exceed those in comparable floats.

The audit also examined the reforms of the financial structure of the racing industry and the TAB, as they related to the Government's wider objectives.

Audit Cost

The total cost of the audit was \$396,000 comprising:

	\$
Direct salaries cost	152,000
Overhead charges	65,000
Value of unpaid staff time (at standard rates only)	30,000
Advisers	142,500
Printing (estimate)	6,000
Other costs	500
Total Cost	396,000

To help fund this audit, the Government agreed to provide up to \$250,000 to fund external costs incurred by The Audit Office in the conduct of the audit. The Audit Office contracted with Leadenhall Australia Limited for financial advice on the audit and with the Crown Solicitor's Office for legal advice. Their costs, totalling \$142,500, have been billed to the Government.

Acknowledgements

The Audit Office acknowledges the assistance provided in the conduct of the audit by NSW Treasury, its advisers on the sale, and by the Chairman and management of TAB.

2 The Value of the TAB

Introduction

In March 1997, prior to the decision to sell the TAB, the wagering business was valued at \$1100m. In April 1997, the Government approved the sale in principle with an indicative reserve price of \$1200m, subject to its further review once likely proceeds and reserve price had been more clearly established.

In May 1998, after the addition of SKY, and gaming developments (CMS and SWLJS), the TAB was valued at between \$1000m and \$1200m. (A summary of key events leading up the sale of the TAB is included in Appendix 1.)

The sale of the TAB generated gross proceeds of \$936 (net \$889m) to the NSW Government plus \$100m from the sale of licences to TAB. (A full breakdown of proceeds and costs is included in Appendix 2.)

The issues covered in this chapter are:

- how changes in the TAB and its environment impacted on its value between 1997 and 1998
- whether the valuation placed on the company at the time of sale was reasonable
- whether the indicative price range set for the share price was consistent with that valuation
- whether the sale of the company still met the pre-conditions on sale price and further review, set by the Government in April 1997
- the merits of staging the sale, versus a single 100% sale.

The Changes Impacting on the TAB Valuation

Three sets of factors had major impacts on the TAB's valuation between 1997 and 1998:

- ⇒ changes in operating conditions - affecting, in particular, estimates of the TAB real growth and earnings
- ⇒ changes in financial conditions - affecting interest rates, CPI and other financial assumptions
- ⇒ TAB purchases including SKY and CMS/SWLJS.

The audit has examined the valuations undertaken in 1998 and the changes since the scoping study valuation in 1997. The Audit Office has seen no evidence to suggest that the changes were not justified or that the revised valuation prior to sale in 1998 was not reasonable. (The changes in components of the valuation between 1997 and 1998 are itemised in Appendix 5.)

Changed Operating Conditions

The scoping study valuation in 1997 assumed that wagering turnover of the TAB would have a higher growth rate than the Bankers Trust (BT) valuation at the time of sale in 1998. The BT valuation also included higher advertising and promotion expenses and some small cost items (e.g. share registry costs) which were not factored into the original valuation. Together these reduced the valuation in 1998 by \$366m.

Changed Financial Conditions

This deterioration, however, seems to have been offset to a large extent by improvements in general market conditions during the period. The cost of equity dropped, so did the CPI. Together with other financial adjustments (e.g. mid-year adjustments) these had the effect of increasing the valuation between 1997 and 1998, by about \$267m.

The combined effect was a net reduction in the valuation of about \$100m to \$1002m, as the following chart illustrates.

Impact of changed Operational and Financial Conditions on the TAB Valuation	
1997 Valuation	1100m
Less net deterioration in Operating Conditions 1997-8	-\$366m
	\$735m
Plus net improvement in Financial Conditions 1997-8	\$267m
Revised Valuation	\$1002m

Source: See Appendix 5.

TAB Purchases

As part of the preparations for sale, the Government provided the TAB with licences to operate:

- off-course totalizator¹
- on-course totalizator²
- Statewide linked jackpot service (SWLJS)
- Poker machine central monitoring service (CMS).

The TAB also acquired SKY, the supplier of its racing picture.

Although it is not possible to identify precisely the impact each element had on the market price when the TAB was sold, the comments of brokers in research reports tend to support the view that the purchase of SKY was seen as a major attraction for investors, whilst the purchase of CMS/SWLJS licence was regarded as of limited significance, as the following example illustrates:

Our current valuation range is from \$2.52 for no benefit from pay TV and using the current undergeared capital structure, to \$3.08 when the full benefit of pay TV and an optimal capital structure are assumed. The vast majority of the valuation is generated by the wagering franchise while negligible value is attributed to the gaming licences.

Observation

The Audit Office is of the view that the changes in valuation between the original scoping study and the sale are substantially justifiable and that BT's valuation of the TAB at the time of sale was reasonable. Although the net change in the valuation between 1997 and 1998 was small, it seems to have been the product of some major offsetting variations in operating and financial conditions. These variations give some indication of the risks that a Government is associated with when involved in trading enterprises.

The Audit Office has some concern that BT was asked to act as adviser both to the NSW Government and to the TAB in undertaking the valuation of SKY. BT advised in relation to SKY valuations that it was the formal adviser to the TAB, whilst on other valuations it was the formal adviser to the Government. This may have been expedient, more so given the short deadlines for a decision about the purchase of SKY. The Audit

¹ licence granted for 99 years with the first 15 years as monopoly

² licence granted for 99 years

Office is of the view that such arrangements can blur accountability, especially if there were to be disputes between the two parties, each of which has separate responsibilities.

The audit sought information from the TAB Board to satisfy itself that there were no conflicts of interest in this case. Because of the commercial sensitivity of the information, the Board would only release this information if the Audit Office agreed to use it in ways the Board approved of, and only if the Audit Office indemnified the Board against any claims arising as a result (the TAB letter is at Appendix 6).

The Audit Office has not examined the information and therefore cannot reach a conclusion on accountability in this instance. It however considers that restrictions on access to information which relates to accountability is of concern. **The Audit Office recommends that, in future sale of assets, the Government should develop procedures that will ensure that appropriate audit trails relating to accountability, including information up to the date of sale, are maintained.**

Valuation and Price Range at Time of Sale

Price per Share

On 1 May 1998, BT wrote to the Treasurer recommending an indicative range for the share offer price and caps for the retail and broker firm price. The letter said:

The Joint Lead Managers and International Co-Lead Manager to the TAB Offer (“Brokers”) have proposed a Pricing Structure for the TAB Share Offer on the following basis.

	<i>Price per Share</i>
<i>Institutional Cap Price (indicative)</i>	\$2.20
<i>Broker Firm Application Price</i>	\$2.15
<i>Retail Application Price</i>	\$2.05
<i>Institutional Floor Price (indicative)</i>	\$1.80

The Brokers propose that the pricing structure set out above is, in their view, heavily weighted towards the high end of expected pricing and the institutional range of \$1.80 to \$2.20 is necessary to provide balance in the pricing process...

...Our view is that the pricing structure is reasonable having regard for current valuation parameters and demand. In our opinion, this indicated pricing structure maximises the opportunity for the Government to achieve a Final Price near the top of the indicative range.

Bankers Trust recommends that the Government approve the proposed pricing structure.

Source: BT Letter to Treasurer 1/5/98.

Value per share

In this advice, however, there is no reference to BT's 'component valuation', which, as the following extract outlines, suggested that the TAB's share value was in a higher range \$2.02-2.41.

TAB Valuation - May 1998	
<i>TAB Component</i>	<i>\$ million</i>
<i>Wagering Division</i>	<i>900-1,025</i>
<i>Sky Channel</i>	<i>200-260</i>
<i>Gaming Division</i>	<i>25-35</i>
<i>Enterprise Value</i>	<i>1,125-1,320</i>
<i>Less:</i>	
<i>Net debt (as per Offer Document)</i>	<i>113</i>
<i>Equity Value</i>	<i>1,012-1,207</i>
<i>Shares issued to vendors of Sky Channel</i>	<i>101.2-120.7</i>
<i>Proceeds from the TAB Share Offer</i>	<i>911-1,086</i>
<i>Value per share</i>	<i>\$2.02-\$2.41</i>

Based on the above analysis, we estimate the equity value of the TAB is between \$1,000-\$1,200 million. The valuation range has been reached after considering the cashflow generated by the three businesses together with the synergies between the operations, for example the impact a Sky Channel pay television service would have in generating additional turnover growth in the TAB wagering division.

Source: TAB Component Valuation, Executive Summary, BT, May 1998.

Nor was there a reference to this valuation range in BT's letter of May 4 to the Treasurer, the last formal advice before the indicative price range was set. In that letter a share price of \$2.05 was assessed as reasonable. It concluded:

Bankers Trust advises that in our assessment gross proceeds³ to the Government in the vicinity of \$1,023 million represent reasonable market value in relation to current valuation parameters and demand for the sale of the TAB under the terms and conditions normally applying to privatisations by IPO⁴.

A detailed analysis supporting this assessment is being supplied separately to the NSW Treasury.

Source: BT Letter to Treasurer 4/5/98.

This detailed assessment, which the audit understands was the component valuation referred to earlier, was not issued in final form until the middle of May. The advisers informed the audit that such information was provided earlier in oral briefings to the Treasurer supported by valuation papers, and the BT letters of 4 May were requested in summary form for the information of Cabinet.

The Audit Office recognises the substantial workload on all involved to meet the deadlines set for the float, especially with the late inclusion of SKY. However, the audit trail does not clearly demonstrate that the Treasurer was provided with full information on BT's assessment of value, when deciding on the indicative price range on 4 May. The Audit Office considers that this was important information that should have been part of the written advice that is filed to provide transparency and accountability of decision-making.

Difference between Valuation and Price The difference between the equity value for shares quoted in the component valuation and the indicative price range was justified by the Government's advisers thus:

The equity value determined above compares with the TAB share offer pricing which has an institutional offer price range of between \$1.80 and \$2.20 per share and a retail application price of \$2.05 per share. The equity value of TAB at these prices would be as follows:

³ The gross proceeds calculation of \$1023 consisted of 450m shares sold by the Government at \$2.05 (i.e. excluding 50m shares sold to the vendors of SKY); plus \$100m received by the Government from the sale of licences. This differs from the audit's definition of gross proceeds (see Appendix 2)

⁴ Initial Public Offering

<i>Application price</i>	<i>\$ million</i>
<i>Institutional cap price of \$2.20</i>	<i>1,100.0</i>
<i>Retail application price of \$2.05</i>	<i>1,025.0</i>
<i>Institutional floor price of \$1.80</i>	<i>900.0</i>

The valuations provided in Appendices 1-3 [of the component valuation] are one important indicator of value, however in an initial public offering there are other indicators of value including dividend yield and multiple based valuations (e.g. price earnings valuations).

In this context, the joint lead managers [JLMs] and international lead manager were each asked to provide a paper summarising their views as to the pricing of TAB. These papers are attached in Appendix 4 [of the component valuation]. A summary of their recommendations is provided in the table below.

<i>Broker</i>	<i>Institutional cap (\$ per share)</i>	<i>Retail price (\$ per share)</i>
<i>ABN Amro</i>	<i>\$2.05-\$2.15</i>	<i>\$1.95-\$2.05</i>
<i>Merrill Lynch</i>	<i>\$2.10</i>	<i>\$1.95-\$2.00</i>
<i>DMG</i>	<i>\$2.10</i>	<i>n/a</i>

Source: BT's TAB Component Valuation, Executive Summary, May 1998.

The audit recognises that a number of different indicators may be taken into account in setting an indicative price range. The Audit Office was also advised that JLMs will tend to promote a conservative price that ensures an offer is fully sold with a stable aftermarket. The ANAO also noted in its report on the recent Telstra float that:

....the Global Coordinators and Sale Business Adviser based their valuations on the expectation of a premium in the range of 5 per cent to 10 per cent.

Source: Sale of One Third of Telstra, ANAO, 1998, p101.

In the sale of the TAB, the \$2.20 institutional price cap chosen by the Government was 10c higher than that recommended by the JLMs, although still only at the mid-point of BT's valuation range.

The JLMs advice to their investor clients in May 1998 was:

<i>Broker</i>	<i>Value Range Advice to potential investors</i>
<i>ABN Amro</i>	<i>\$2.09 - \$2.30</i>
<i>Merrill Lynch</i>	<i>\$2.12 - \$2.23</i>
<i>DMG</i>	<i>\$2.18 - \$2.40</i>
<i>BT valuation</i>	<i>\$2.02 - \$2.41</i>

Source: TAB Component Valuations, BT, May 1998, Executive Summary and Broker Reports

Observation

The Audit Office considers that the indicative share price range for institutions was set somewhat conservatively, at the low end of the TAB's valuation range.

The Cabinet was advised on 4 May 1998, the day before the Share Offer Document was issued, that the \$1.80 was in effect the reserve price and that, in the unlikely event that that was the final price, the float would have to go on, even though it would not achieve the Government's financial objectives.

Did the Sale Satisfy the Government's Pre-conditions?

When the Government agreed in principle to the sale in April 1997, it set a number of pre-conditions including a "revenue/retention neutrality" pre-condition. This latter pre-condition required that the sale price of the TAB, inclusive of any arrangements made with the racing industry plus new taxation arrangements, must at least equal the value of the current taxation arrangements.

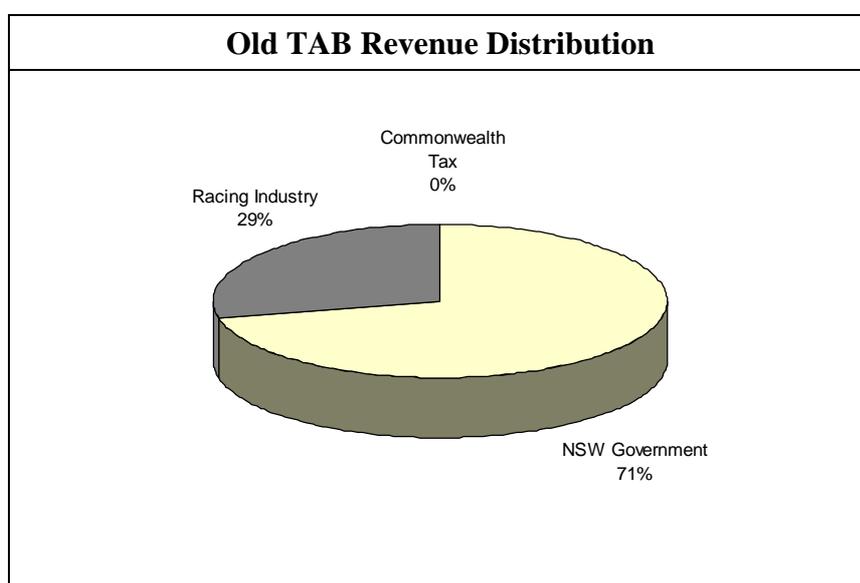
It also requested a further report on these issues "prior to the approval to proceed with the sale process".

It is somewhat unclear as to what is meant by ‘value of current taxation arrangements’, or how the future tax stream forgone is to be determined. The Audit Office has, however, accepted that, in view of the risk involved in future wagering tax flow to the Government, a risk factor is appropriate to be applied against current tax revenue in order to determine the value of the future tax flow.

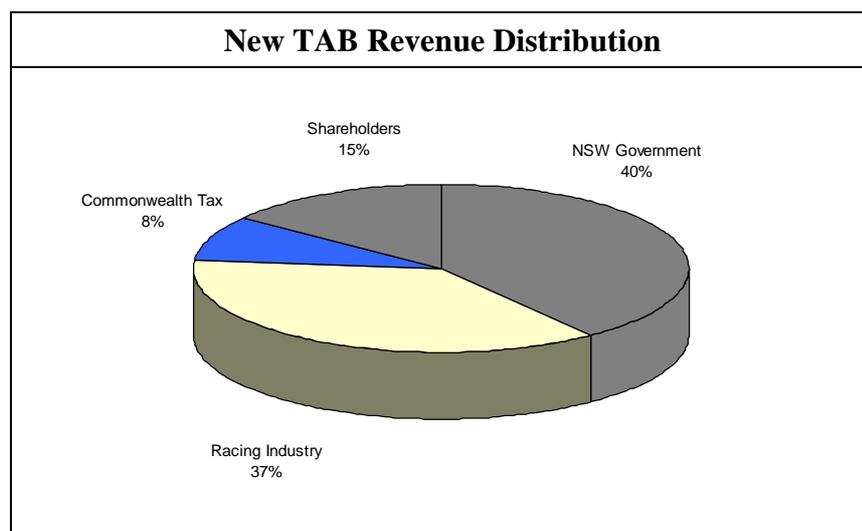
**Changing
Distribution of the
TAB revenue**

The reforms associated with the restructuring of the TAB changed significantly the distribution of funds from the TAB. Prima facie, the introduction of new recipients of the TAB revenue made the achievement of cash revenue neutrality more difficult.

Through the Racing Distribution Agreement, the NSW Government has reduced its share, to the benefit of the racing industry. Through privatisation, the Commonwealth Government and shareholders become beneficiaries too (the former from income tax, the latter from dividends) and the NSW Government benefits from the proceeds from the sale. The following charts show the extent of the changes.



Source: This has been prepared from the figures for the financial year ending 30 June 1997 as reported in the Annual Report of TAB Limited and the proforma basis shown in the 1998 Share Offer Document (p. 12).



Source: This has been prepared from the proforma basis shown in the 1998 Share Offer Document (Page 12).

Note: The Commonwealth tax cost is offset to some extent by consequent reductions in interest payments.

Assessing ‘revenue/retention neutrality’ in advance was complicated in this case by the uncertain impact of some of the changes. These impacts included:

- uncertain proceeds from the sale
- reduced risk for the Government of declines in returns from wagering (and gaming)
- some prospect of increased wagering revenue under private ownership (“rejuvenation”)
- reduced risk of the Government needing to subsidise the racing industry.

Given these uncertainties, and in the light of the lower valuation and indicative price range, the audit examined whether the pre-condition and the request for a further Government review were satisfied.

Revenue/ Retention Neutrality

A review for the NSW Treasury by Dr Barry Hughes in January 1998 indicated:

Although elements remain uncertain, it is reasonable to conclude that net proceeds from the TAB float in the vicinity of \$1.1billion will allow the new arrangements to pass the “value test” imposed by the Cabinet decision of April last. Indeed, it is likely that with some rejuvenating effect on TAB business from changed ownership, a surplus value will be returned for taxpayers. Clearly, the higher the net proceeds, the more substantial should be the achieved surplus.

There is no evidence that a detailed report was prepared for Cabinet at this time. The Government advisers say that the review paper prepared by Dr Barry Hughes in January 1998, was circulated to the Premier and relevant Cabinet Ministers, however, The Audit Office has not seen or been provided with any documentary evidence to confirm this. It was only on 4 May 1998, on the day before the TAB Share Offer Document was issued, that a submission was made to the Budget Committee of Cabinet on share pricing, which discussed and confirmed the conclusions reached earlier by Dr Hughes, but the paper also used and justified its conclusion with different estimates of proceeds. In this paper it was argued that net proceeds of sale of \$900m would now satisfy revenue neutrality.

These different conclusions are based partly on increased operating costs in the TAB and the lower estimates of revenue from wagering that have been discussed earlier, and which would have applied whether or not the TAB was privatised. However achieving “revenue neutrality” relied on assumptions about:

- the “rejuvenation” effects of privatisation
- the risk attached to future Government income streams
- the elimination of Government support to the racing industry.

These analyses are summarised in the following table.

Revenue and Expenditure changes to NSW Government arising from Racing Industry Reforms and the TAB Sale, and the Value of Risk Reduction		
	\$m	\$m
	Hughes Estimates Jan 1998 (on \$1.1b net proceeds)	Treasury Estimates May 1998 (on \$902m net proceeds)
Revenue forgone by NSW Government with reduction in wagering tax rate*	155	148.5
LESS		
• interest saved from retirement of state debt	71.5	54.2
• elimination of continuing payment from the TAB reserves to racing industry	10	10
• elimination of additional subsidy to racing industry to reach \$165m pa level agreed	35	35
• elimination of responsibility for paying increased the TAB costs and RDF contribution	n.a.	15
Sub-total	116.5	114.2
Net Cost to NSW budget	38.5	34.3
Valuation of risk reduction	38.5**	35.8**
Risk-adjusted cost (benefit) to NSW	0***	(1.5)***

Source: Treasury paper, 4 May 1998.

Note:

* Estimates based on prevailing conditions

** Value attached to risk reduction associated with future wagering tax revenue is 3.5% based on gross proceeds. This equates to a discount rate on the future tax stream of 9%-10%.

*** No allowance is made in these estimates for additional revenues associated with the TAB rejuvenation.

Valuing Future Risk

The Government saw particular risks in retaining the TAB in public hands, beyond the direct financial cost and benefits involved. Not only was it in the position of being owner, regulator and beneficiary, it also faced the risk of needing to increase support to the racing industry, if the TAB earnings growth continued to slow. At the same time its own revenue from the TAB would drop. In Government hands it was difficult to diversify these risks.

Putting a value on these risks is a complex issue and so is choosing an appropriate discount rate with which to assess the value of sale now versus future income for the Government. For ‘revenue neutrality’ to be achieved, under either the Hughes or the Treasury scenarios, the value of the Government’s future taxation revenue from the TAB needed to be discounted by 9%-10%. Given the nature of the risks involved this may have been appropriate but it was not justified in detail or in advance as part of an agreed framework for evaluating revenue neutrality.

Reviewing Pre-conditions and Targets

But more importantly, approval for the sale included that:

the float will only proceed if the Government is satisfied that a reserve price, which fairly reflects the value of the current taxation stream which is forgone, can be met or exceeded ...

Source: Totalizator Agency Board Privatisation Bill, Second Reading Speech by The Treasurer, Legislative Council 19/6/97 Hansard 10665.

Such targets may change in response to changing circumstances, but given their importance, changes should be supported by careful and complete analysis and be the subject of formal review before proceeding. The Government had requested such a review for its own purposes in April 1997. That review occurred only on the day before the Share Offer document was issued, in May 1998. There was no Parliamentary review of the change to the condition advised in the second reading speech mentioned above.

There should have been an earlier, formal review against targets and pre-conditions on the sale of the TAB, to fulfil properly the Government’s decision in 1997 for a review “prior to the approval to proceed with the sale process”.

It would also have been proper for the Parliament to be advised of the departures from the conditions which the Treasurer advised the Parliament would apply to the float. By the time the Government did review this and other conditions, in May 1998, the investment in the sale process was so well-advanced that stopping it without strong cause would have been wasteful, even if it were politically possible. A review by Government, say, in December, after the Racing Distribution Agreement was signed and before the sale process was fully developed, would have been more meaningful. It could then have compared the merits of full privatisation and stages in between, to confirm that a full sale was still the best way forward. That would also have allowed Parliament to be advised in the new year.

Rejuvenation Effects

Commenting on the requirements to achieve “revenue/ retention neutrality”, both Dr Hughes and BT referred to the likely favourable effect of a revitalised and privatised TAB Board. In May 1998, BT commented:

... In our view, the privatised TAB with its new Board, has over a period of years, the potential to generate turnovers substantially above those that could be generated by a Government-owned TAB in the significantly more competitive gaming and wagering market facing the TAB

Source: BT letter to Treasurer 4/5/98.

The Audit Office accepts that there is the potential for such “rejuvenation” effects from privatisation and that measuring them is difficult. It also recognises that a Government-owned TAB would not be in a position to take full advantage of growth opportunities outside NSW.

However, in view of the earlier comments of the Government’s advisers to the scoping study, that there was no hard evidence to support forecasts of wagering growth, The Audit Office would have wished to see some more sensitivity analysis of the potential, and the probability of this.

Conclusions

Revenue Neutrality The Audit Office, as does the Treasury analysis, concludes that the sale of the TAB would not achieve ‘cash revenue neutrality’. The achievement of risk-adjusted revenue neutrality depends on one’s views about risk and “rejuvenation” potential, once the Racing Distribution Agreement had been established. When Cabinet adopted the revenue neutrality precondition, it did so without documented advice that the concept of maintaining value entails a reduction in revenue offset by a reduction in ownership risk.

Revenue neutrality was achieved if the assumptions adopted by Government advisers are accepted. The Audit Office believes that these assumptions were not adequately justified, nor explained to Cabinet to make an informed decision on this issue, as it had requested in April 1997. Had Cabinet adopted a view of those risks which differed from advisers’ views, it could have come to another decision about whether revenue neutrality was achieved.

The Audit Office strongly supports the NSW Government’s use of “revenue neutrality” targets. It believes a more explicit and robust approach to assessing and reviewing such targets would be helpful for future sales proposals.

The Audit Office recommends, to strengthen the usefulness of “revenue or retention neutrality”, that the condition be clearly identified and its achievement measured, with guidance on: how to assess net present values of cash flows pre and post sale, the discount rates to be used including those in respect of the treatment of private vs public sector risk.

Staged Sale

The Audit Office also did not see any evaluation at that time of the use of a staged float to allow the Government to capture some of that benefit before it sold all of its stake in the company. The audit has found no formal consideration of staging beyond a brief discussion in July 1997. The Government's advisers informed the audit that such options were discussed but full privatisation was always preferred because of the "clean break" it provided the Government from its previous obligations to support the racing industry. The relatively small size of the float and the extra tax burden that would have been incurred anyway were also factors in the decision for a 100% sale.

A more formal evaluation would have usefully pointed to the sizeable changes affecting the TAB, and the additional risks and uncertainties of these recent changes on potential investors' perceptions of share price. The small value attached to the gaming part of the business, and the uncertainties brokers had about prospects here, meant that this element of the business was not a certain attraction for investors, as the following comments from brokers reports illustrate.

The provision of monitoring and linked jackpots provide blue sky for the group, however the time frame, post 2001 and the development risks suggest that this should be fully discounted in any short to medium term valuation. The systems are still to be developed, proven and commissioned

This is a low risk venture for TAB as every gaming machine owner will be mandated by law to be monitored by TAB. The revenue stream is estimated to be \$27m per year based on 90,000 machines by Jan 2000.

A second stage might have allowed the Government to realise a better return in the longer term, based on more certain prospects, even though there would be less proceeds to Government and no less tax on the TAB in the short-term. Moreover on the second stage of a float it is easier to set an optimum share price, based on that achieved by the first tranche of shares. For these reasons and based on their experience of UK privatisations, the National Audit Office there says:

We have long recommended that governments should start with a presumption that selling a company in stages, rather than all the shares in the initial public offering, will maximise proceeds. This is because market uncertainty about a previously unquoted company tends to depress the price institutions are willing to pay for the shares, and because, once in the private sector the floated company tends to improve its operating efficiency and its capital structure and hence its share price.

Source: Letter from NAO to NSWAO 29/7/98.

The Audit Office considers **that where an asset is sold through a public float, the Government should ensure that it receives a stringent evaluation as to the merits of staging a float, rather than a single 100% float.**

3 The Float

Outline of the Sale Process

Offer Structure

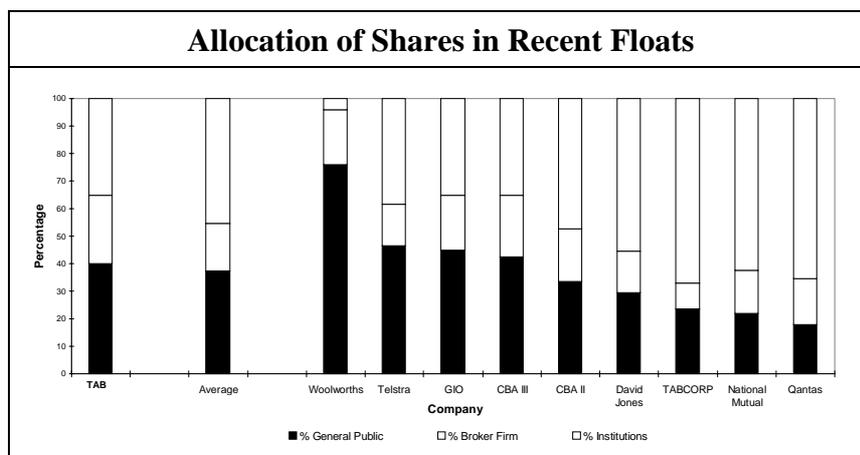
In 1997 the Sale Task Force agreed to an offer structure which it believed would best meet the Government's objectives for the sale. All the shares would be sold through a constrained open-priced tender, similar to that adopted in other major domestic share issues recently - e.g. Telstra, CBA II and III, GIO, TABCORP, National Mutual.

This offer structure would market the shares to the general public across Australia, including clients of brokers/financial planners (retail offer), as well as overseas and domestic institutions (institutional offer) in order to maximise demand. As the justification for this offer structure, the advisers suggested that:

Generating a strong demand from each of these sectors is fundamental for ensuring a successful issue. If the level of demand from each sector is high, competition for shares will help ensure that proceeds of the offer are maximised and that the share price will be actively supported following listing.

Source: NSW TAB Draft Offer Structure Discussion Paper, BT, October 1997, p5.

The proposed allocation of shares between these investor groups, with a higher proportion going to retail than in most other floats recently, reflected the Government's priorities for wide retail participation in the float. This is illustrated in the following graph.



Source: TAB Estimated Allocation of Shares, JLM's paper, 17/3/98, p16,22.

Institutions were allocated 35%, in proportion to their holdings in other floats and the minimum generally regarded as necessary to capture their interest in the float.

Retail Investors

The constrained open-price offer structure used different mechanisms to assess the demand and market the shares to the different investment groups. For potential retail investors, market research followed by a pre-registration process was used to elicit interest and to tailor both the advertising campaign and the details of the retail share offer to the response. Members of the public were encouraged to pre-register with the opportunity to apply for 25% more shares than those who applied later.

The NSW Government will soon launch a public share offer to sell its shares in TAB Ltd, one of the world's largest betting organisations....Reserve (a Share Offer Document) before May 1, 1998, and you'll be eligible to buy 25% more shares than the minimum public allocation.

Source: Newspaper advertisement for TAB Share Offer.

Brokers also participated in the pre-registration process on behalf of their private clients. Broker nominated clients were sent letters inviting them to participate in the pre-registration.

Pre-registration opened on 19 April 1998. There was substantial interest. By the end of the pre-registration period (which was extended from 2 to 3 weeks to enable the high level of retail interest to be dealt with) 1.3m potential investors had pre-registered. This compares with 2.6m Telstra pre-registrants for a float that was 12 times the size.

In response to the pre-registration interest, public advertising was scaled back to a minimum considered necessary to keep the public adequately informed. Some amendments were made to the Share Offer Document, before it was released on May 5. It contained the following commitments to potential retail investors:

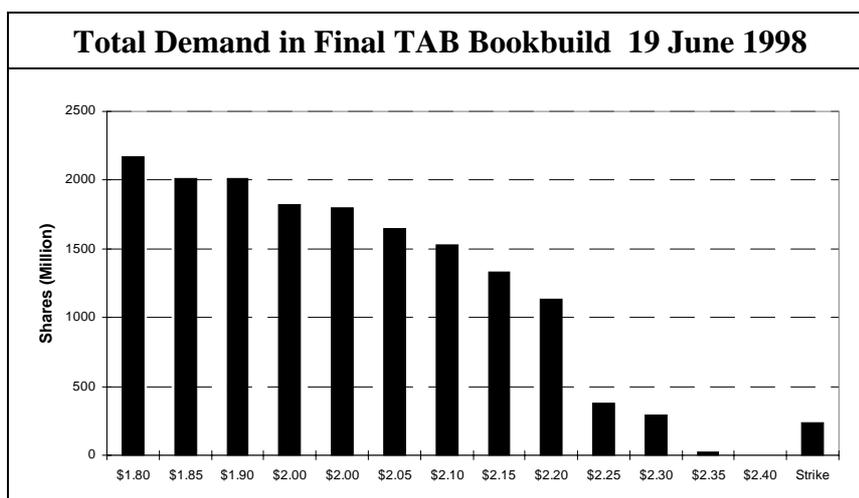
- pre-registrants who applied for shares were guaranteed 25 % above the minimum share allocation
- retail applicants would pay no more than \$2.05
- broker applicants no more than \$2.15
- no stamp duty or brokerage fees.

The Share Offer Document also made clear that the final retail price up to the retail price cap set at \$2.05 would be determined by the bidding response from the other major investor group - the institutions.

Institutional Investors

For institutional investors, a road show and institutional lunches were the main methods used to market the sale, along with the more informal stockbroker networks.

A “bookbuild” offer system was then used to receive bids for shares from institutions. Institutions were given an indicative price range of between \$1.80 and \$2.20 to inform their bids. The results of the bookbuild, showing the total bids for shares from institutions at different prices, is given below. The bids fall away sharply above the top of the indicative price range.



Source: TAB Final Pricing and Allocation, JLM’s paper 19/6/98.

The Government decided on a final offer price of \$2.10. The Sale Task Force had 157.5m shares earmarked for institutions. Total bids at this price exceeded that number by a factor of more than 8.

At the same time, pre-registrants and broker firms were applying for shares. The total applications from all three sources and the number of shares available for each, were as follows:

The TAB Shares Applications and Coverage			
Investor group	Shares applied for	Shares allocated	Coverage ratio
General Retail	980m	184.5m	5.3
Brokers	854 ⁵ m	108.0m	7.9
Institutions	1530 ⁶ m	157.5m	9.7
TOTAL	3364m	450m	7.5

Because of the demand, investors in all three groups received share allocations much smaller than their application, on average less than 20%.

Achievement of Broad Community and Retail Investor Support

In the Government's original decision, the only "outcome" objective related to *investor support and participation* was concerned with ensuring that no single shareholder held more than 5% of shares. A much more widespread shareholding was envisaged in the news release announcing the decision which included the following statement by the Treasurer:

We've chosen a float because it gives everyone in the community, with a little money to invest, the chance to buy shares.

Source: Premier's News Release on the TAB Package 22/4/97.

This was carried forward into the Share Offer Document issued in May 1998, which said:

The NSW Government will make TAB shares widely available to retail investors, with no shareholder being entitled to more than 5% of TAB shares.

Source: TAB Share Offer Document, 4 May 1998 p2.

Providing widespread access to the TAB public offer was thus an important consideration in planning the sale. However, achieving a widespread shareholding would involve costs which put it in conflict with the objective "to optimise the financial return to Government". The offer structure had to find a balance between the two.

⁵ Includes 43m shares allocated to DMG and ABN/ML (as they did not actually bid for shares) and 811m shares applied for by all other broker firms.

⁶ Bids received at \$2.10 19 June 1998.

**Balancing
Conflicting
Objectives**

The balance that was struck appears to have emphasised widespread share ownership over maximising proceeds to Government.

- the share allocation pool for institutions was set proportionally lower than in most recent floats. Limiting the institution allocation pool may create greater competition amongst institutions the smaller the pool is set, but there is also a greater risk of reduced institutional interest in bidding in the float
- a significantly lower price cap for retail investors than for brokers' clients or institutions. In the event this reduced flexibility in setting the final allocation mix between retail and institutions (important in generating price tension) and may have reduced proceeds as a result
- a guaranteed allocation to those who pre-registered. This resulted in small parcel allocations and additional share registry costs to be borne by Government.

**Response from
Investors**

The investor response to the TAB sale was positive. Applications exceeded shares available by a factor of 7.5, higher than on Telstra.

Coverage Ratios - TAB and Telstra compared		
Investor group	TAB	Telstra
General retail	5.3	1.2
Broker Firm	7.9	8.2
Institutions	9.7	6.2
Overall	7.5	4.3

Sources: TAB Task Force, TAB Final Pricing and Allocation, JLM's paper 19/6/98, Sale of one third of Telstra, ANAO 1998, p75.

Scale Back

As a result of the very high retail demand, retail applications had to be scaled back severely. The original planned minimum application size of 1000 was reduced to 700 in the Share Offer Document. How this 700 was arrived at is unclear. The Government advisers say that it was done so that the public would not be given false expectations of receiving a larger share allocation after the high pre-registration interest. But, in the event, the figure of 700 was almost three times the allocation finally offered.

While the reduction in the minimum application size could be seen as an equitable response to high pre-registration interest, reducing the minimum application size does nothing to curb demand: if anything it adds to demand because it lowers the minimum application costs, thus making the float more accessible to investors.

On the first day of the public offer, press comments by the Treasurer indicated that the minimum share application would be reduced from 700 to 400 because of concerns that strong demand would mean final allocations would be fewer than 700 shares.

The final parcel size offered was 257 shares.

This created dissatisfaction among small investors and the risk of instability in the aftermarket, as the selling syndicate noted on 14 May

Such small allocations are clearly uneconomic and problematic because:

- *parcel sizes are so small that many investors will consider they are not worthwhile holding, leading to increased selling in the after-market*
- *minimum brokerage costs (\$50-100) are disproportionately high on small parcels*

Source: Retail Demand Management, ABN AMRO, Merrill Lynch, 14 May 1998.

As expected in a float which is oversubscribed, interviews with brokers revealed a widespread dissatisfaction with the TAB float. Small broker firms claimed they were allocated little stock and the allocation system was lacking in transparency. Many said that it would not be worth supporting future Government floats if similar practices are adopted.

Conclusion

The audit concludes that the Government's objectives on community and investor support were achieved in the run-up to the sale.

However, the very success brought with it new challenges. Preparations for the sale of the TAB had focused on maximising demand and did not make enough provision for handling that demand in an efficient and effective way when it did materialise. How to manage demand, and investor expectations generally, needs greater attention in future floats if community and investor support for floats is to be maintained.

Decisions on Retail Incentives

The retail demand was influenced in part by incentives - by certain guarantees about allocations to pre-registrants and potential price discounts to retail applicants. Given the scale of the retail demand that eventuated and could not be met, the incentives may not have been necessary. The audit examined whether the decision-making which led to the use of those incentives was fully-informed.

The TAB Task Force agreed in February 1998 to the recommendations of the selling syndicate for retail incentives on the sale of the TAB. Retail incentives had a proven record of stimulating demand in earlier floats. They fitted with the Government's objectives to promote wide investor support for the sale. The main incentive agreed at that time was a retail price cap.

The issue of incentives was considered again later in February when the first results from the second phase market research on the TAB became available.

Market Research

Market research has shown that retail investors find discounts one of the most attractive features when deciding to invest in public share offers. This was confirmed in the recent Eureka Market Research where retail discounts were found to be the most favourable offer enhancements. It is interesting to note from the research that price caps were not as favoured. Notwithstanding these results the JLMS believe that the retail market will be more comfortable with a price cap, particularly given the more recent market precedents.

Source: Offer Structure Working Group Discussion Paper Retail Discount Analysis 23/2/98.

The Offer Structure Working Group at this stage left open the question of a retail discount (as well as a retail cap) noting:

a discount may be unnecessary given current research and the size of the offer. In any event, decision can be left to a later stage

Source: Offer Structure Working Group Minutes 26/2/98.

The market research had given some indication of the scale of the potential retail interest. On 20 February, Eureka had estimated the potential share demand at:

- 445000 people in NSW committing an average of \$5200 = \$2.3billion
- 575,000 people in rest of Australia committing an average of \$4200 = \$2.4billion.

These results are estimates and assume saturation marketing [and retail incentives].

Source: TAB Share Offer Summary Of Research Findings 20/2/98 Eureka Strategic Research.

Pre-Registration

However, as one of the participants later pointed out, the lessons from previous floats at TABCORP and QANTAS were that people did not always follow through on the intentions they expressed in market surveys. Hence the TAB's pre-registration process was regarded as a much more reliable gauge of the demand for shares and thus the basis for a final decision on retail incentives. And the public were given an incentive to pre-register by the offer of extra shares above the minimum allocation.

The response to pre-registration confirmed the earlier market research estimates. Over 1.3m people pre-registered either directly or through brokers.

Response to Pre-Registration

Within a week of pre-registration opening a number of changes had been made in response to the demand:

- extra resources were provided for the share information centre, share registry and printing
- planned advertising for the sale was suspended and then abandoned
- planned distribution of Share Offer Documents through the Commonwealth Bank was abandoned
- the TAB had requested, and the Treasurer approved, Government support for the costs of maintaining a larger than expected share registry
- the minimum share application was reduced in the Share Offer Document from a planned 1000, based on Telstra, to 700.

Moreover, when the price caps and indicative price ranges were announced in early May, the TAB Sale Task Force had sufficient confidence in the strength of broker demand to set the broker price cap at 10c higher than the cap for the rest of the retail offer. This generated an extra \$6m in proceeds in support of the Government's financial objectives.

The Government also had market research that indicated in the minds of the public:

...A price cap is desirable, rather than imperative and thus can be set at a high level.....

Source: TAB Share Offer Summary of Research Findings, 20/2/98, p4 Eureka Strategic Research.

**Equity
Considerations**

The Audit Office was informed by Government advisers that the Government went ahead with retail incentives, despite strong retail demand, for reasons of equity. The Government felt that, because the retail investors were asked to commit application monies earlier than other applicants, they should be compensated by being given a discount. This does not appear to have been documented in the sale process.

Observation

Given the size of the retail pre-registration, and the willingness to reduce incentives to brokers in response to indications of high demand there, the setting of a retail cap at \$2.05, some 15c below the top of the indicative institutional range, was a significant incentive.

It appears that neither the pre-registration nor the market research information were seen as sufficiently strong indicators to allow the Task Force the confidence to start curbing demand in the Share Offer Document, rather than promoting it. This caution is reflected in the justification for a 700 minimum share number offered to the press at the time:

We can't know what the level of demand is until that demand has materialised. The minimum public allocation will be determined by that level of demand and we won't know that until the offer closes in mid-June

Source: The Sun Herald, 10 May 98 : Comment attributed to Spokesman for Treasurer, answering questions on the realism of 700 as a minimum share allocation.

However, such caution calls into question the purpose and the value for money of the pre-registration process and of the market research in these circumstances.

Setting a retail cap at a discount of 10c to brokers and 15c to the maximum indicative price for institutions, also had the effect of reducing the selling syndicate's ability to create price tension between retail and institutions. If a retail price incentive is to be offered in future, a retail discount may be preferable to a retail price cap when retail demand is expected to be high. The additional administrative cost which may arise with a retail discount would need to be weighed against the benefits stemming from increased pricing flexibility.

Translating Demand Into Price Tension

Given the high demand for shares, the Audit Office found it surprising that a higher price was not achieved. At \$2.10 the final offer price of the TAB shares was set below the upper end of the indicative price range (\$2.20). This was despite the fact that bids for shares from institutions at \$2.20 exceeded shares available by a factor of 7. To understand why, the audit examined whether the offer structure created optimal price tension between retail and institutions. The audit also examined whether price tension was generated in the bookbuild.

Offer Structure

The offer structure adopted by the TAB restricted the Government's ability to translate demand into optimal sale proceeds.

By setting a retail price cap at a significant discount (15c) to the institutional cap, the NSW Government limited its flexibility to transfer share allocations between institutional and retail investors when, as in the TAB, retail demand was stronger than institutional. This in turn reduced the selling syndicate's ability to generate price tension in institutional bidding from the relatively strong retail demand.

By fixing the retail price cap (rather than setting the retail price at a discount to the final institutional price), the NSW Government risked forgoing proceeds if the final institutional price was significantly higher than the retail price cap.

Bookbuild

The institutional price setting process determines the final price for all three investor groups (subject to retail caps). The bookbuild is the main mechanism informing the institutional price setting process.

The JLMs recommended a bookbuild process to the Government as the best way of meeting its objectives to optimise its financial return from the sale.

The process encourages simultaneous competition for stock between the three key areas of demand - domestic institutions, foreign institutions and the retail sector (via placing pressure on the size of the final institutional allocation pool). The benefits of this process are that it:

- *encourages the price tension necessary to optimise the price;*
- *captures the benefits of the marketing program;*
- *can accommodate market movements during the offer period.*

Whilst an open priced tender may not provide the vendor with the same degree of certainty of proceeds as an underwritten offer, we note that none of the ten major IPO bookbuilds have failed in Australia, and only one has been priced at the floor price (Tabcorp after a concerted political campaign against the float by the Victorian opposition) versus seven where the institutional price has been set at or above the cap price.

Source: Offer Structure Working Group Discussion Paper: Pricing Structure 10/10/98.

In a bookbuild, institutions submit bids for shares at different prices over a two week period, guided by the indicative price range announced in the Share Offer Document. The selling syndicate seeks to promote bidding through a marketing campaign undertaken simultaneously and through additional messages to the market about the (high) level of bids coming in.

Stimulating Price Tension

In a bookbuild the vendor can stimulate demand by;

- giving feedback to bidders on strong demand
- moving the indicative price range higher in a strong market
- sending messages to institutional investors that more shares may be allocated to retail unless bidding is more aggressive (where offer structure flexibility and circumstances permit).

In the bookbuild for the TAB, messages were sent out about the strength of demand (including “after the first day of price bids, the book is strongly covered at the top of the indicative price range”). The Government was also invited to consider raising the indicative price range but, in the end, was recommended not to do so because it was felt that there was not very strong demand above the top of the indicative range.

There was no attempt to stimulate higher bids from institutions by (suggesting the possibility of) a reallocation of shares from institutional to retail, as the syndicate had advocated in their original advice to the Offer Structure Working Group, and which has been used in recent floats elsewhere. This reflects, perhaps, the large proportion of shares already allocated for the retail market.

In the sale of British Energy, for example, two days before the close of the bookbuild an announcement was made of a possible substantial transfer of share allocation to retail (from the large pool available to institutions) in an endeavour to stimulate demand.

Such an option was less attractive in the sale of TAB, because of inflexibilities in the offer structure. The indicative institutional allocation of 35% was already set at the minimum thought necessary to maintain investor interest. A greater allocation to retail would also have meant reduced sale proceeds if the institutional price was higher than the set retail price cap.

Observation

The sale's success in generating demand, particularly from the retail sector, was not translated into strong price tension in the institutional bidding process from which the final offer price was set. The full range of mechanisms to stimulate demand and encourage after market stability were either not deployed or not available.

The Audit Office recommends that more flexible demand management and incentive measures be considered in planning floats to respond to up-to-date information on demand from market research and pre-registration.

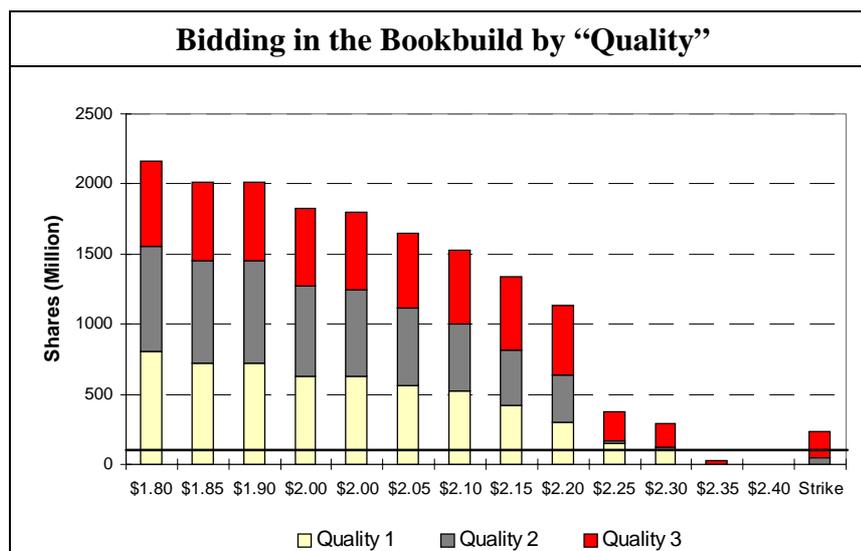
Pricing the Float

Bookbuild Bids as a Price Guide

The total bids in the bookbuild were not the final determinants of the institutional price. Although total bids exceeded shares available to institutions by a factor of 7 at \$2.20, the price chosen was 10c less than this.

Focus on “Quality” Bids.

In setting an offer price 10c below the indicative price cap, the Government’s advisers informed the audit that they focused on the bids from the “quality 1”⁷ institutions who were judged to be longer term shareholders and thus would contribute to an orderly aftermarket. On quality 1 institutions, the coverage ratio was 3 at \$2.10 and 1.5 at \$2.20⁸. The breakdown of bids by quality is illustrated below.



Source: TAB Final Pricing and Allocation, JLM’s paper, 19 June 1998.

Note: Horizontal line at 157m denotes number of shares allocated to institutions.

Amongst a wide range of factors it was the reduced coverage from quality institutions, particularly domestic institutions, and the risks this presented to a stable aftermarket, which persuaded the selling syndicate to advise the Government to adopt \$2.10 rather than a higher offer price.

In adopting a bookbuild the advisers had noted its limitations as a true price setting process because of strategic bidding. The JLMs indicated in float planning that once an indicative price range was set “conventional international practice” was to bid at the top of the range, or within it, not higher. This suggests that to some extent institutional bids may reflect the range set. A different range set for the TAB may have yielded different price volume bids resulting in a higher or lower final price.

⁷ Refers to investor quality rating assigned to institutions expected to be long term holders of TAB shares, so encouraging an orderly aftermarket. There is a further examination of this issue in Chapter 4.

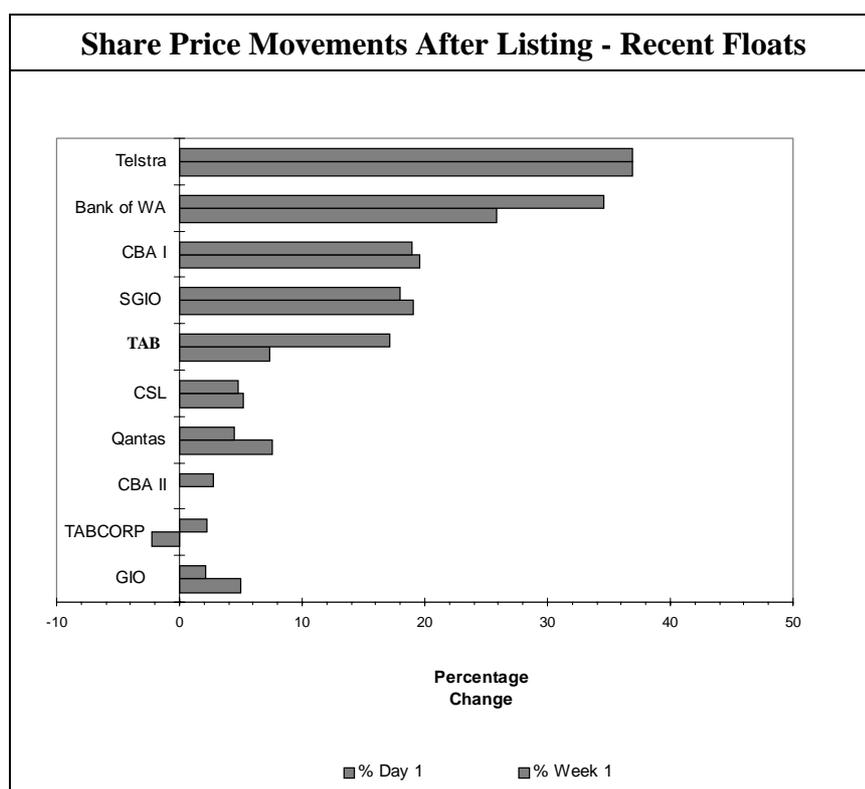
⁸ As per Bookbuild demand curve 19 June 1998.

Given strategic bidding in the bookbuild and therefore its limitations as a pricing mechanism, The Audit Office was unable to determine whether the TAB was fully priced on the basis of the bookbuild result alone. Post sale share price performance was used to provide assistance in forming a conclusion.

Post Sale Performance

On 23 June 1998, the TAB was listed on the stock exchange. The sale of shares generated gross proceeds to the NSW Government of \$936m.

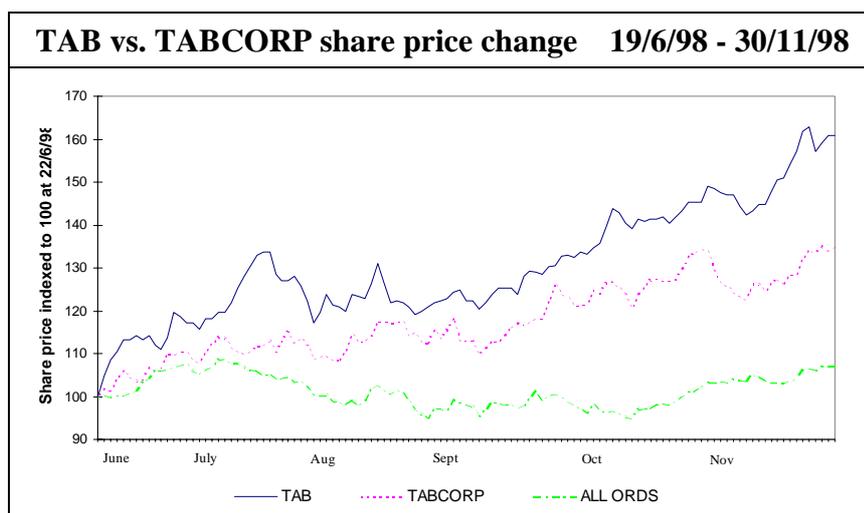
The share price increase in the first day of trading was modest relative to most recent Government floats. At the end of the first day of trading the share price stood at \$2.20, a gain of 7% on the retail price (4% on institutional). The gain continued so that, by the end of the first week, the share price had risen 17% from the original retail price.



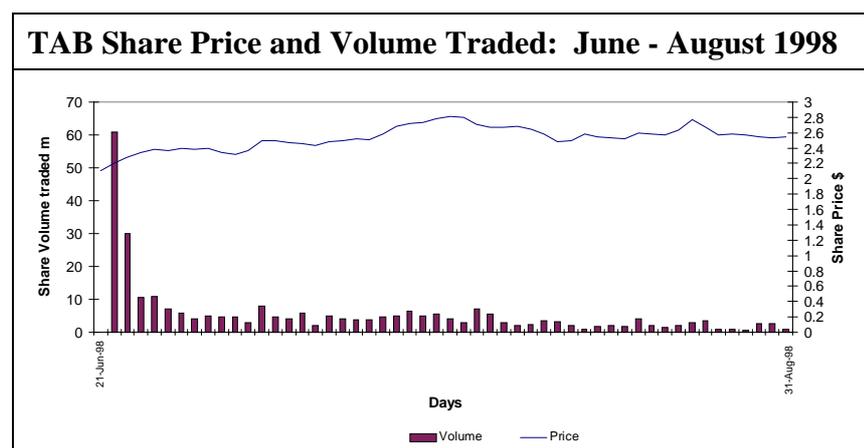
Source: Information supplied by BT, ANAO, Victorian Auditor General's Office.

Since then, the share price trend for the TAB has been similar, but slightly better, than the trend of its closest comparator, TABCORP in Victoria⁹. Both have done considerably better than the All Ordinaries index.

The graph below highlights the relative movements in the share price since listing in June.



Although there was substantial trading of shares in the first few days after listing, this was not exceptional and trading in the secondary market quickly stabilised and has been steady since, as the following graph indicates.



Source: NSW TAB Monthly Market Report (August 1998), ABN AMRO.

⁹ TABCORP is not a perfect comparator for TAB. It has a similar range of activities and exposure to international markets, but its proportion of gaming to wagering revenue is 80:20 whereas TAB's is 20:80. Nevertheless TABCORP was the comparator used by all the major brokers in coming to conclusions about the value and investment potential of TAB. It is used here as the best comparator available, and in the knowledge that the market uses the comparison itself.

Conclusion

The audit used three criteria to assess the pricing of the float:

- the share price immediately after listing should be close to the after price (and on the positive side), and
- there should be a stable after market, and
- other factors being equal, price trends of the TAB share should follow the trends of shares in the comparable sector.

The audit found that in respect to the immediate aftermarket, the rise of the TAB Limited share price on the first day of trading was relatively modest (7% above retail). Although, by the end of the first week, it has risen significantly to 17% above the original retail price.

In respect of the aftermarket stability, the volume of shares traded immediately post sale indicate an orderly aftermarket. In respect of comparative performance in the market, the share price trend has been similar to, but stronger than, the trend of its closest comparator, TABCORP.

This leads to the overall conclusion that the final offer price was satisfactory but may have been able to have been increased and the market would still have supported it.

An offer price of \$2.15 (2.5%) would have generated an additional \$13.5m proceeds under the current structure of retail and broker price caps.

An offer price of \$2.20 (5%) would have generated a further \$8m likewise.

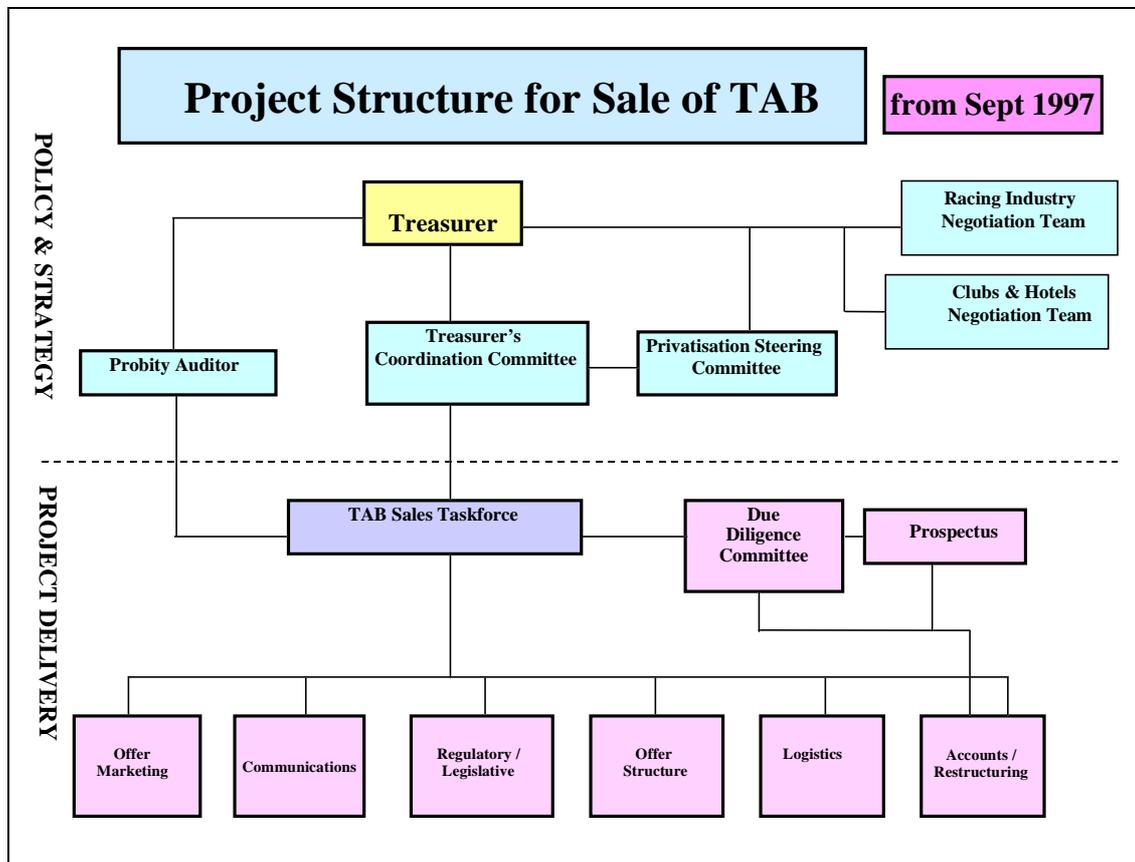
The inflexibilities in the offer structure may also have contributed to forgoing proceeds. A higher retail price cap might have helped to increase price tension and thus the final offer price.

Equating the price cap to that of the brokers would have generated a further \$9m at \$2.10, \$18m at \$2.15 and \$27m at \$2.20.

4 Management and Cost

Management Arrangements Defined

The initial examination of the sale of the TAB and wider racing industry reforms was undertaken by a Steering Committee established late in 1996, with representatives from all the Government departments involved, including the TAB. Once the decision to proceed with preparations for sale had been taken by Government, and a new TAB Board appointed, new structures were put in place to manage the various elements of work necessary to complete the sale and the wider reforms, as the following diagram illustrates:



Source: TAB Taskforce.

Note: The responsibilities of each group are outlined in Appendix 4.

Management Structures

At the highest level, a **TAB Coordination Committee** was established with responsibility for:

providing overall policy and strategy advice to the Treasurer and to communicate decisions on policy and strategy to the Sale Taskforce, TAB Board and senior management of TAB

Source: TAB Sales Project Group Structure 12/1/98 p6.

It met weekly and included the Treasurer and the Chairman of the TAB. It's role was to ensure effective coordination between the Government and the TAB Board. This was needed in the view of the Government's financial adviser because:

Under [the then] present arrangements, major differences between the Government and TAB Board are likely to surface late in the preparations - leaving little time for resolution or causing delay in the preparations.

Source: TAB Privatisation - Coordination of Government and TAB Preparations, paper from Banker's Trust 11/8/97.

The role of the new **Privatisation Steering Committee** was to:

be involved in key strategic issues and risk assessment involved in the sale process including the appointment of key advisors. This includes ensuring that recommendations which are endorsed by Cabinet are implemented in an appropriate manner.

Source: TAB Sales Project Group Structure 12/1/98 p6.

This was a narrower, advisory role than the previous steering committee played. Made up of the heads of Premiers, Treasury and Cabinet Office, it was briefed fortnightly by the Project Director of the TAB Sale Taskforce, and took action on any inter-departmental issues emerging. It was not directly involved in the management of the sale itself.

Responsibility for managing the implementation of the float lay with the **TAB Sales Taskforce** (TTF) and through it with 10 working groups responsible for key components.

The TTF role was pivotal. It was the key link between the policy/strategy level and sale delivery.

The Sales Taskforce has responsibility for managing the sale of the TAB.

In addition it has responsibility for managing the delivery and reporting of the Racing Industry's wagering and gaming reforms and restructuring of the TAB's balance sheet in readiness for the float.

In performing these roles the Taskforce will identify and allocate responsibilities for issues to be resolved by the Working Groups.

The Taskforce will monitor progress by Working groups in completing allocated tasks and receive recommendations from the Working Groups. Based on these recommendations, the Sales Taskforce will make decisions on issues which do not involve policy or strategic matters. On policy and strategic issues, it will make recommendations to the Treasurer's Co-ordination Committee or the TAB Steering Committee as appropriate.

Source: TAB Sale Project Group Structure 12/1/98 p6.

TTF membership was drawn from the chairs of each of the **Working Groups** who were responsible for most of the logistical decisions.

The powers of each working group are those necessary to carry out the work required consistent with objectives. Where a decision is required which has implications for other Groups, the issues would be canvassed by the Working group with a view to forming a recommendation which would then be put to the Sales Taskforce and then, if necessary, to the Treasurer's Co-ordination Committee for approval.

Source: TAB Sale Project Group Structure 12/1/98 p6.

This level of delegation is understandable given:

- the considerable cross-membership on working groups and in particular the representation of the project director and the financial adviser on every working group
- the short time frame for decision-making.

It placed on the Working Groups, as well as on the TTF, the responsibility for consistent recording of decisions for accountability purposes, and for setting and meeting deadlines within the overall project plan. The project director had issued guidelines to this end in July 1997 and again in January 1998.

Consultants and Contractors

The sale process placed high reliance on consultants and contractors to implement the sale. Two-thirds of the staff involved in the Working Groups came from external organisations. A similar emphasis is found in recent floats at the Commonwealth.

The consultants and contractors were all selected through a competitive process by appropriate staff and using appropriate criteria, overseen by the probity auditor in most cases. All had contracts.

To promote the high standards of probity expected for the sale, the probity auditor provided a probity policy to all participants and monitored key areas of risk, such as contract payments and bookbuild. To clarify accountabilities in the selling syndicate, the Task Force also issued “Rules of Engagement”.

Observations

The revised management structures and responsibilities for the sale were clearly defined, with appropriate emphasis on probity and accountability. The reliance on consultants was justified because of the specialist knowledge required.

Management Arrangements in Operation

The Government wished to complete the sale of the TAB before the end of FY 1997/98. This was achieved despite two major additions to the timetable:

- the extended negotiations on a more commercial Racing Distribution Agreement
- the TAB’s purchase of SKY

and many minor ones such as delays in reaching agreement on CMS/SWLJS, negotiations with clubs and hotels.

The TAB Sale Timetable				
	Original Schedule	Following Racing Industry Agreement	Following Purchase of SKY	
July 1997				
August				
September		Racing Distribution Negotiations		
October				
November				
December				
January 1998				
February				
March				
April				Acquisition of SKY
May				
June				
July				

Note: The TAB therefore took 11 months from appointment of advisors to listing date, including 3 months for RDA and 2 for SKY. This compares with the float of TABCORP which took 7 months and Qantas' 10 months.

Meeting the June deadline, despite the additional work, was a considerable achievement. It involved significant effort from the many participants and considerable management flexibility as new issues emerged. In particular, it placed additional responsibilities (for negotiations and crisis management) on a few individuals who also had key roles in managing the float, notably the Coordination Committee, project director and financial advisers. It also left little time during the latter stages of the sale process, to consider fully the emerging information on public demand and make adjustments to the retail offer structure and logistics. The audit has examined how the management arrangements handled these pressures.

Handling Additional Responsibilities

The effectiveness of the Coordination Committee can be judged by the successful negotiations on the Racing Distribution Agreement and on SKY, and by the absence of major public disagreements between the Government and the TAB Board, which the Coordination Committee was set up to avoid. Press comment was generally supportive.

The NSW TAB negotiations were tough, commercial deals forged with the NSW racing industry and the senior executives of Publishing and Broadcasting Ltd and New Ltd for the \$260m purchase of Sky Channel (in April).

Source: The Australian Financial Review, 20/7/98.

The Government's financial advisers were heavily involved in both negotiations, and on the sale generally. Their workload expanded accordingly.

Financial Advisers

The project brief in their original contract was written very broadly because it was difficult to predict at the start of preparations the scope and extent of the work involved, particularly on the wider reforms and restructuring which needed to be put in place before the sale could proceed. It said only:

Advise the TAB Steering Committee and Sales Taskforce on all financial matters including:

- *Valuation, costing, revenue sharing and other matters related to the State Wide Linked Jackpots System (SWLJS) and the Central Monitoring System (CMS).*
- *Commercial aspects of joint venture structure and agreements with the racing industry.*
- *Commercial aspects of TAB restructuring and business strategy.*
- *Development of strategy and initial planning for the sale/share issue.*

Source: NSW TAB Taskforce, *Financial Advisor Brief*, 20 May 1997.

The project brief remained very broad, but the Treasury sought to control the total cost through a capped fee. It later agreed to an additional payment because of the following work outside the original contract:

- *Negotiation of the RDA with the NSW Racing Industry;*
- *The completion of three licence valuations (Off-course and On-course wagering and CMS/LINKS);*

- *Negotiations with RCA and AHA in relation to gaming as well as analysis of the taxation structure in relation to gaming machines in NSW; and*
- *Assistance to TAB in relation to CMS and LINKS, including in submissions to IPART and financial analysis in relation to setting the CMS fee.*

Source: Bankers Trust, letter to NSW Treasury dated 10 August 1998.

All the work of the Government's financial adviser was overseen and approved by the project director. The appropriateness of the additional payment for unanticipated work was also confirmed by the probity auditor. Nevertheless, The Audit Office believes that a more specific brief, modified when major new tasks emerged, would have provided a more effective basis for contract management.

Accountants

The fee for the investigating accountants on the sale ended up being twice that estimated by the project director in October 1997. Substantial new work was required beyond that originally envisaged. This included work in relation to the Racing Distribution Agreement, the TAB's purchase of SKY and the consequent reworking of the financial forecasts in the Share Offer Document. Again, there was no revision of the project brief (there was no fee cap in this case) and no agreement on a work plan to indicate the likely costs involved in these tasks to form a basis for effective contract management.

Observations

There is a degree of unpredictability in the work involved in floats, especially in those like the TAB with substantial restructuring and negotiations prior to sale.

In these circumstances, the process for specifying advisers' work programs needs to balance the detail required to demonstrate accountability, with the generality needed to allow a flexible response within contracts and project briefs. In The Audit Office's view, more detail in the work plans for advisers on the TAB would have been possible and desirable to demonstrate the high standard of accountability sought for the sale. This might have been helped by greater resources for project management.

**Project
Management**

It was only in February 1998, that an additional manager was added to the Government's team to assist the Project Director with logistics (after the logistics contractors had been appointed). For more effective management and accountability, an earlier appointment would have been helpful.

The Audit Office recommends that float advisers should be required to prepare a general work plan at the beginning of the contract, followed by periodic progress reports and prior approval for any major variations to the plan.

Handling Unanticipated Demand

The volume of work involved in those parts of the float responding to retail demand are difficult to estimate in advance. In the TAB, this is well illustrated by the unanticipated load on the Share Information Centre when pre-registration began.¹⁰

¹⁰ The unanticipated retail demand also had a significant impact on other logistics - the Share Registry in particular. The Government is currently in a contract dispute with the supplier of Share Registry Services over matters to do with the sale. As a consequence, the audit has not examined management issues in the Share Registry.

Managing “Overwhelming” Demand at the Share Information Centre

On 19 April 1998 the Share Information Centre (SIC) opened to the public enabling potential investors in the NSW TAB to pre-register for a share offer document. The call centre had 90 staff answering telephone enquiries from 7am to 11pm, 7 days a week. Any overflow or out of hours calls were directed to an Interactive Voice Response (IVR) machine.

On opening day the SIC received nearly 250,000 calls. With the staffing levels it had, it was only able to answer 15,000 or 6%.

The following day over one million calls were received. Again the call centre was overwhelmed. Task Force management stepped in. Within 24 hours:

- operating hours were extended to 5am - 1am and staff numbers were doubled
- a week’s extension on the pre-registration deadline was announced to reduce the public “panic”
- The TAB float advertising campaign was suspended.

Over the next few days other demand management strategies were put in place:

- calls from States outside NSW were streamed to the IVR facility.
- 3 additional call-handling suppliers were sub-contracted to increase capacity.

At the end of the three week pre-registration period, the SIC had answered over half million calls.

From an examination of the actions taken between 19 and 25 April, the audit is satisfied that, once the scale of the demand was realised, management acted promptly and appropriately to increase supply and manage demand. However, the scale of the unmet initial demand raises the question of whether it could have been avoided or at least mitigated by better planning.

Unprecedented Demand

The audit was informed by those involved in logistics planning that the level of demand was unprecedented. Comparisons with the Telstra float, which was twelve times the size, appear to support this claim. Although it should be noted that Telstra had other means for the public to pre-register besides the phone: by mail and via the internet.

Share Information Centre Workload				
	Number of Calls Offered		Number of Calls Answered	
	Week 1	Week 2	Week 1	Week 2
TAB	5 807 920	696 945	130 869	210 874
Telstra	89 999	110 179	81 545	108 091

Source: SITEL and Rowland Company.

It may have been unprecedented, but could it have been predicted? Early market research for the sale of the TAB, conducted in August/September 1997 indicated limited public awareness and interest in the sale of the TAB. It prompted plans for a vigorous advertising campaign.

Market Research

In December 1997, the sale of Telstra by the Commonwealth Government, and the substantial share price increase that followed, appears to have produced a quantum shift in the public's perception of the merits of investing in Government privatisations. So, in February 1998, even though there had been limited advertising of the TAB, market research undertaken for the sale by Eureka Strategic Research estimated that demand for the share offer document could be 1.26m, given saturation marketing. This is very close to the 1.3m potential investors that actually pre-registered via the SIC or who were on brokers' lists.

However, the company contracted to provide the SIC was not given access to these demand estimates. They were distributed only to the Taskforce and Government advisors. The company was left to plan on previous experience, based largely on Telstra.

The Taskforce reacted cautiously to the estimates. The audit was informed that previous floats of TABCORP and QANTAS had also shown high initial interest but this had not translated into applications later. Pre-registration was felt to be a more certain indicator of the public's commitment to the purchase of shares. No major changes of plan were made as a result of the market research.

Observation

Given the lack of advance information on the volume of calls to the SIC, management action taken to deal with the demand was as prompt and efficient as it could be. It could not prevent substantial caller frustration and press comment at the time, as the following quotes illustrate, but it did allow people to pre-register by phone eventually; and it did allow the float to proceed on schedule:

...fewer than half the callers actually managed to register their interest, as the undermanned call centre was stretched to the limit. (The Daily Telegraph, 21.4.98)

The NSW Government has warned potential investors in the State TAB not to hit the "panic button" after demand for share pre-registration became overwhelming yesterday. (The Australian, 21.4.98)

However, the Audit Office also concludes that the scale of the problems experienced at the TAB SIC could have been mitigated if, in planning capacity for pre-registration, there had been a greater recognition of the range of possible public interest, informed by the market research results at hand. At the least, this would have allowed speedier activation of contingency plans. At the most, it would have provided alternative avenues for pre-registration besides a single real-time phone service.

The Audit Office recommends that for future floats, contingency plans be prepared for logistics arrangements taking into account available market research.

The costs of pre-registration are considerable. The TAB SIC alone cost the NSW Government over \$13m. For pre-registration specifically, The Audit Office believes that the NSW Government should consider other avenues besides or in addition to a telephone-based Share Information Centre.

Conclusions on Management, Accountability and Probity

The audit is generally satisfied with accountability frameworks for implementing the sale of the TAB and it saw no issues raising probity concerns. The clear responsibilities allocated in management structures, the presence of the probity auditor at key decision points, and the dissemination of probity and accountability guidelines - together provide an appropriate framework to deliver on the Government's objective of having the "highest standards of probity and accountability".

The implementation lived up to this standard in most places particularly, as in Due Diligence and other legal documents, where other pressures were operating. However, it was not universally achieved, especially as the pressure of time increased towards the latter stages of the float. There are limited records of some of the key decision-making points.

- Although minutes were kept of all Task Force and Working Groups, some of them lack clear details of decisions, thus reducing the transparency of decision-making. This is particularly so in the latter stages of the float. The audit sought to understand, for example, how pre-registration levels in late April were used to inform decisions on retail incentives and the scale back of retail allocations before the Share Offer Document was released in early May. It was unable to do so from the minutes of relevant Task Force and Working Group meetings.
- An accountability trail was easier to follow where decisions in Working Groups and advice to Government were in the form of separate papers or analyses. This is particularly the case for the key Offer Structure Working Group and for the detailed financial valuation modelling. However, most of these working papers were marked "draft" and some do not appear to have been finalised. Some of the modelling had limited written interpretation.

- The basis for the decision to set a final price of \$2.10 is also unclear. The Government advisers say that a wide range of factors were considered in setting the final price but these are not set out in writing to provide a clear audit trail of the information used in decision-making.
- There is also no record of how institutions were assessed against the key quality criterion in the bookbuild. Although a system of weights was published for this purpose, in practice a single factor - “expected long term holder of the TAB shares” dominated (75%). The assessment was made in informal meetings of the selling syndicate, financial adviser and the project director, where no minutes were taken.

The lack of sufficient “high quality” institutions in the bids was the major justification for the selling syndicate recommending the Government not accept a higher price than \$2.10. Because of the importance of “quality” in assessing bids, The Audit Office considers the basis for the assessment should have been better documented. The Audit Office would also like to see a post-sale review of the accuracy of these assessments, in terms of which institutions sold shares quickly. This would inform the Government and its advisors for future floats.

- Earlier chapters also commented on the same financial advisors being used by the TAB and the NSW Government in the purchase of SKY and the restrictions on access to the TAB information related to that decision. They also noted the lack of records to show that Cabinet was informed in January 1998 of Dr Hughes’ analysis of the value of the sale.

Costs

The cost to the Government of the TAB sale float itself was approximately \$47m. There are a number of additional costs associated with securing the agreement of the various stakeholders in the wider reforms. These are expected to make the final cost to the Government of the float and the wider reforms \$152.4m.

The TAB Float itself	\$47.0m
Support for the TAB share registry	\$10.5m
Early implementation of wagering tax reduction (1997)	\$19.4m
One-off support for racing industry	\$50.0m
One-off cost of racing industry negotiations	\$0.5m
One-off payment to the Racing Development Fund from float proceeds	\$25.0m
Support for racing industry Sub-total	\$94.9m
TOTAL	\$152.4m

Float Costs

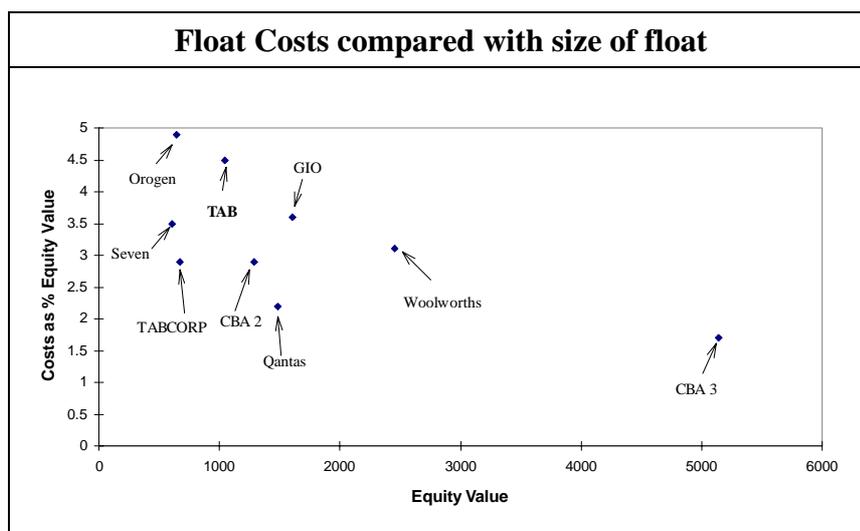
This section focuses on the float costs themselves and their management.

The \$47m cost of the float can be divided into four major components:

The TAB Float Costs	
Advisers	\$11.3m
Selling fees and costs	\$11.6m
Demand-related logistics	\$23.3m
Management costs	\$0.8m
Total	\$47.0m

Appendix 3 breaks these down into their major components.

These costs represent 4.5% of the equity value of the sale. This percentage is higher than that in most comparable floats.



Source: Audit analysis of information from BT dated 23 October 1997 p1-4; advice from NSW Treasury; NSW Auditor-General's Report to Parliament, v2, p141,145; ANAO Report on Sale of One-third of Telstra, ch5, Commonwealth Sale Proceeds; ANAO Report on Third Tranche Sale of Commonwealth Bank, part two, Sale Management; Victorian Auditor General, TAB Task Force reports p44-45.

The main component causing this is demand related costs. The costs of pre-sale restructuring, which are partly reflected in the fees to advisers, were also a factor, as described earlier. Some selling commissions also appear relatively high.

Demand-Related Costs

Demand-related costs of the float amounted to \$23m, nearly 50% of the total. By contrast, on the most recent, much larger, Telstra float it was 23% of total costs. On the sale of GIO in 1992/3, the last float by the NSW Government, it was 39%.

The high costs were mainly due to the extra resources needed to respond to unprecedented level of telephone calls by the public to the Share Information Centre. There were some off-setting savings. In particular, expenditure on retail advertising was reduced by 60% once the extent of retail interest became apparent. Nevertheless, these savings did not cover the extra costs incurred in the Share Information Centre and, to a much lesser extent in the Share Registry and in extra printing of the Share Offer Document.

Overall capacity in the Share information Centre was doubled in response to the demand. Its total cost ended up more than ten times the original budget estimated by the project director six months earlier, in October 1997. Whilst recognising that the

original budget may have not been very realistic, The Audit Office believes that costs and delays would have been reduced if the level of public interest could have been planned for. Alternative arrangements to handle the level of public interest (including the use of internet and postal mechanisms, as in the recent Telstra float) could also have been considered, at lower cost.

Brokers Fees

Brokers fees on the TAB were within the range found on other Government floats recently, except for the commissions on sales to international institutions, which were higher.

Selling Commissions and Fees						
Commissions and Fees	CBA 2 1993	TABCOR P 1994	CBA 3 1996	Qantas 1995	Telstra 1997	TAB 1998
Institution offer						
• domestic	0.4%	0.5%	0.5%	0.75%	0.8%	0.75%
• international	0.8%	1.5% - 3%	1.5%	1.5%	1.75%	2.25%
Public offer						
• broker stamped	0.75%	1.0%	1.0%	1.0%	1.10%	1.0%
• broker firm	1.05	1.5%	1.5%	1.25%	1.45%	1.5%

Note:

CBA (2&3), Qantas - Third Tranche Sale of CBA, ANAO 97/98

Telstra - Sale of One-third of Telstra, ANAO 98/99, p106

TABCORP - TABCORP Prospectus 1994, p119.

The audit recognises that a number of factors will affect the level of selling commission set, including the size of the float and the extent of the selling effort required in initial and secondary public offerings, so these comparisons can only be a guide. It also recognises that promoting international demand for shares helps to promote price tension domestically and so to maximise proceeds.

Nevertheless, the higher the differential between international and domestic selling fees, the greater the incentive for the selling syndicate to maximise international sales. The outcome on the sale of the TAB appears to support this. With a relatively high differential favouring international sales, a relatively high proportion (55%) of the institutional allocation went overseas. And other things being equal, the higher the international selling commissions, and the higher the allocation to international institutions, the lower the return to the NSW taxpayer.

The commissions were negotiated following selection of the selling syndicate. Fee levels were a very minor factor in the selection criteria (5%) and no guideline fees were provided by the TAB Task Force to those bidding for the work. The Audit Office believes this does not take full advantage of the Government's position of influence in the market place (based on its position of accountability to the public and on the prospect of repeat business) and does not offer a strong downward signal on fee levels.

The Audit Office recommends that in future floats, more detailed consideration be given to setting selling commissions and fee levels.

5. Government's Reform Objectives

Reform Objectives

The sale of the TAB was part of a larger reform of the Government's relationship with the racing, wagering and gaming industries in NSW. As the Treasurer outlined when the privatisation legislation was debated in June 1997, the Government's aims included:

...putting in place a genuinely reformed financial structure for the racing industry and the TAB. A reformed structure which, while guaranteeing the racing industry's future, also places it in a clear commercial context, with responsibility for improving its own performance....

and, for the TAB

the creation of a strong NSW-based wagering and gaming business, capable of dealing with the rigours of national and international competition.

Source: Totalizator Agency Board Privatisation Bill, Second reading speech, NSW Legislative Council 19 June 1997 (Hansard p10664).

At the outset of the audit, The Audit Office requested an official statement of the Government's objectives for the reforms, to provide an audit framework for measuring effectiveness. Treasury officers provided the Audit Office with the following objectives:

- to place the NSW Racing Industry on a financial basis that would give it a sustainable long-term future
- to achieve this with the best available financial outcome for the NSW Government
- to achieve these two, subject to meeting certain other Government objectives related especially to the administration of gaming and wagering.

From the documentation available, the audit has summarised the Government's targets under each of the reform priorities as follows:

A. to place the NSW Racing Industry on a financial basis that would give it a sustainable long-term future

- wagering taxation rate to be reduced to a level equivalent to that which applies in Victoria
- a financial arrangement between the TAB and the racing industry that links increases in income for the racing industry to improvements in its performance, measured in terms of increased the TAB income from wagering
- and specifically, the Memorandum of Understanding between the Government and the Racing Industry will include an agreement which sets the baseline for industry income at \$165m with any additional support above those levels determined by the condition of achieving a reserve price in the order of \$1200m (plus an amount, to be determined, representing the value of the SWLJS and CMS products), being met.

B. to achieve this with the best available financial outcome for the NSW Government

- proceeds of the sale of the TAB to be used primarily to retire debt
- the sale price, inclusive of arrangements made with the racing industry plus new taxation arrangements, must be at least equivalent to the value of the current taxation arrangements.

C. to achieve these two, subject to meeting certain other Government objectives related especially to the administration of gaming and wagering

- a sale by public float, limiting ownership by way of restrictions upon the maximum shareholding or interest in shares which can be acquired by any one person or institution.....
- limiting certain activities which can be undertaken by the privatised the TAB and the NSW racing industry, in their capacity as wagering licence holders
- a sale in 1997.

Progress on Reforms

Progress can be summarised as follows:

A. Racing Industry Targets

- The wagering tax rate in NSW was reduced from an effective 52% of the revenue available for distribution to an effective 28.2%, the same level as in Victoria, starting on 1 October 1997
- After extensive negotiations, a Racing Distribution Agreement was executed on 11 December 1997, between representatives of the Racing Industry, the TAB and the Government. Under this agreement, the racing industry receives:
 - ⇒ 21.64% of the TAB's net wagering revenue
 - ⇒ an incentive fee based on a 25% share of wagering earnings
 - ⇒ a contribution of 4.9% of turnover from the TAB's on-course totalizators to cover the costs incurred by racing clubs.

In total, this is expected to equate to an initial annual transfer from the TAB to the racing industry of approximately \$165m.

Through these mechanisms, racing industry income will only increase if there is growth in the TAB wagering revenue.¹¹

The Government, the TAB and the racing industry have begun a number of initiatives to foster such growth including:

- ⇒ the Government removing regulatory restrictions on Sunday racing and the maximum number of racedays per course, to increase the amount of racing at more popular times and venues
- ⇒ the TAB's introduction of a racing channel on domestic pay television from September 1998, coupled with its promotion of telephone betting, to increase the accessibility of wagering
- ⇒ the TAB and the Racing Industry's establishment of joint committees on Racing Product and Business Strategy.

¹¹ The racing industry also receives a similar incentive fee on a 25% share of TAB gaming earnings and has options to invest in 25% of any new TAB wagering or gaming enterprise.

B. Financial Targets

Some of the specific financial targets adopted by Government have been achieved:

- The target level of the TAB support to the racing industry has been achieved (\$165m pa) by the reforms described earlier
- The proceeds from the sale of the TAB (appear to) have been used to retire debt.

In June 1998, the Treasurer approved the retirement of Commonwealth Agreement Loans with a book value of \$1093m, using proceeds from the sale of the TAB. This would have needed all the gross proceeds from shares (\$936m), plus revenue from the sale of licences (\$100m), plus \$55m from other sources.

However, other financial targets have not clearly been met.

The Government's decision of April 1997 made additional support to the Racing Industry, above the annual \$165m, conditional on achieving a price of more than \$1200m for the sale of the TAB during 1997.

However, when the sale took place later than anticipated, in June 1998, the total gross proceeds amounted to \$1042, significantly less than the \$1200m threshold. Nevertheless, additional one-off payments of \$94.9m to the racing industry were made in 1997-98, comprising:

- \$50m for the Racecourse Development Fund
- \$19.4m from cuts in wagering tax brought forward to October 1997, eight months earlier than planned
- \$25m in additional benefits on completion of the float in June 1988
- \$0.5m to cover the expenses of the racing industry during the extended negotiations on the Racing Distribution Agreement.

Source: December 1997 Task Force Briefing Note to the Treasurer on TAB Privatisation and Hansard Legislative Council 3/12/1997.

The size of the additional payments gives some indication of the impact of the delay in the sale on the racing industry's financial position. It also reflects the difficult negotiations involved in securing the racing industry's agreement to the commercial framework sought by the TAB, instead of the joint venture between the TAB and the industry which had previously been planned.

The Government accepted advice that the extra costs involved in securing such an agreement would be repaid in a higher price for the TAB when it was floated than would be possible under the original joint venture proposal:

Under these arrangements there will be no joint venture between the racing industry and the TAB. The Government has received advice from the Chairman of TAB, Mr Gary Pemberton, and the Government's financial advisers, Bankers Trust, which in summary says, the [original joint venture] arrangements detailed above will not provide for a more commercial and effective base for the relationship between the TAB and the racing industry.

The additional \$56m¹² cost will - on the advice of the Government's financial advisers - increase the float value of the TAB by more than that amount. ...

Source: December 1997 Task Force Briefing Note to the Treasurer on TAB Privatisation.

¹² Note: The difference between the additional \$56m quoted here and the \$94.9m quoted above is a higher estimate of wagering tax foregone (a difference of \$11.1m), offset by a \$50m Government contribution to the Racecourse Development Fund which was touched in the following terms when it was announced (in April 1997) thus:

Around \$50m of racecourse development fund commitments will be paid out if the Government receives sufficient excess above the reserve sale price

Source: Premier's Press Release April 22 1997

C. Targets on Gaming and Wagering

- A sale by public float was achieved, but in June 1998. This was later than the original 1997 target. The delay was caused both by the lengthy negotiations to secure the Racing Distribution Agreement and by marketing considerations. The decision was taken in the interests of achieving the best available financial outcome for the NSW Government. The audit supports the view that an earlier sale without this agreement and without other TAB restructuring in place (the purchase of SKY, an agreement on CMS and SWLJS) arguably would have yielded a lower return in total.
- The enabling legislation placed restrictions on shareholding such that no individual or institution could hold more than 5% of the shares of the TAB. This was duly implemented in the float. Only two shareholders held 5% of shares (PBL and Radmar Ltd who received the shares as part payment for the TAB's purchase of SKY). There were more than 700,000 other shareholders in June and July 1998, the largest holding between 4% and 5% of shares.
- The enabling legislation prevents cross-ownership of gaming and wagering by the TAB or others. It provides that the holder of a licence to conduct totalizator wagering in NSW cannot also hold a casino licence under the Casino Control Act.
- The legislative framework for the gaming reforms has been established, but the implementation of SWLJS and CMS has been delayed. It will not be fully operational until 1999-2000. The registered clubs and hotel industries were also allowed (to buy) additional gaming machine licences and no increase in gaming machine tax in exchange for their support for the introduction of CMS and SWLJS.

Conclusion on Wider Reform Objectives

The audit concludes that the framework for the Government's wider objectives for the reform of the racing and wagering industries has substantially been achieved, with some uncertainty over specific financial targets.

A more commercial environment has been established for the racing industry and for the TAB:

- the taxation and regulatory framework is now consistent with that in Victoria
- funding for the racing industry is now dependent not on Government but on wagering revenue - the industry has been "incentivised"
- restrictions on cross-ownership of wagering and gaming have been introduced in conjunction with maximum 5% shareholding limits in the TAB.

It is too early to draw conclusions on how successful the reforms will be in securing the long term future of the industries involved, but the initial signs are encouraging.

The framework has been developed at some cost to the Government, after intensive negotiations with the many stakeholders involved. In particular, the Government in 1997 provided the racing industry with \$94m more in one-off assistance than had originally been anticipated. There were also important concessions to the clubs, hotels and to the TAB itself.

Appendices

Appendix 1: Summary of Key Events -Sale of the NSW TAB	
August 1995	The Micro Economic and Government Trading Enterprise Reform Committee (ME>RC) establish a Steering Committee to investigate the corporatisation of the NSW TAB. The Committee found that corporatisation per se would not provide the maximum benefits for the long-term growth of the NSW TAB nor the racing industry.
June 1996	The ME>RC requests the Steering Committee to explore the option of privatisation for the TAB and to undertake consultation with the racing industry.
March 1997	Scoping Study report prepared for the TAB Steering Committee. The report found that: <ul style="list-style-type: none"> • the privatisation of the TAB would be expected to be of net financial benefit to the NSW Government • that a trade sale by competitive tender would yield more proceeds than a public float.
April 1997	Cabinet approves the sale of the TAB by a public float process. An indicative reserve price of \$1200m was estimated, pending further analysis.
May 1997	TAB Sales Task Force established and key advisers to the sale appointed.
June 1997	Government appoints new TAB Board with Gary Pemberton as Chair. TAB Privatisation Act passed, includes provisions for the TAB's joint venture with the racing industry and for the TAB's development of gaming products (the linked jackpot system SWLJS and poker machine monitoring service CMS)
July 1997	TAB Board presents NSW Government with alternative commercial arrangement between the TAB and racing industry. Treasurer accepts and negotiations with racing industry begin again.
September 1997	Sale preparations put on hold until negotiations with racing industry complete
December 1997	Racing Distribution Agreement finally agreed with NSW racing industry. Under the Agreement, the TAB makes a range of payments to the racing industry in return for an agreed programme of thoroughbred, harness and greyhound racing meetings. Payments are tied to the TAB revenue and profit. NSW Government agrees to pay NSW racing industry an additional \$94.9m as a one-off payment to secure the agreement. Amendments to the TAB ACT to reflect the new arrangements, and other agreements including Auditor General's review of Sale.

Summary of Key Events <i>Cont.</i>	
February 98	Totalizator Agency Board of NSW corporatised to TAB Ltd. Selling Syndicate and logistics contractors for the TAB sale appointed NSW Government reaches agreement with Registered Clubs and hotel industry to secure support for the TAB's CMS and SWLJS. Includes lower tax on poker machines and increases in the number of machines allowed in clubs and hotels.
March 1998	TAB acquires 99 year licences for off-course and on-course wagering.
15 April 98	TAB purchases SKY Channel for \$260m in cash and shares.
19 April 98	<ul style="list-style-type: none"> • Share Information Centre opens. Potential investors who pre-register are guaranteed 25% more shares than the minimum allocation. • The Share Information Centre is overwhelmed with phone calls. The Centre operators extend the hours of operation and double the number of staff during peak times.
30 April 98	TAB Ltd acquires exclusive licences for SWLJS and CMS
4 May 98	Cabinet final approval for sale and share price range.
5 May 98	Launch of Share Offer Document. Price for retail investors capped at \$2.05 with a minimum application of 700 shares. Broker firm price capped at \$2.15; indicative price range for institutional bids between \$1.80 - \$2.20.
25 May 98	Public Offer opens.
21 June 98	Government announces final offer price at \$2.10. Thus, retail investors to pay \$2.05 per share, broker firm applicants and institutions to pay \$2.10 per share. Retail investors who pre-registered receive an allocation of 257 shares; non-pre-registrants receive nothing.
22 June 98	TAB Ltd floated on the Australian Stock Exchange. Gross proceeds from the sale of shares amount to \$936m and net proceeds, \$889m (see following page for full breakdown of proceeds and costs) TAB shares enter the market at \$2.16 and close at \$2.20.
September 1998	TAB launches SKY Racing, a home racing channel.
October 1998	TAB share price reaches \$3.00

Appendix 2: Sale of the TAB - Proceeds and Costs

<i>Share Proceeds</i>	No. Shares	Price	Value
		\$	\$
General Public	183 917 304	2.05	377 030 473
Buffer Stock	578 696	2.05	1 186 327
Broker Firm	108 000 000	2.10	226 800 000
Institutional - Domestic	69 738 000	2.10	146 449 800
International	<u>87 766 000</u>	2.10	184 308 600
	450 000 000		
Gross proceeds to Government from sale of shares			935 775 200
<i>Wagering and gaming licences</i> ¹³			100 000 000
<i>Interest</i>			5 772 000
Total gross proceeds to Government			1 041 547 200
<i>Less cost of float</i>			
Advisers			11 329 026
Selling fees and costs			11 607 618
Demand-related logistics			23 350 555
Management costs			757 536
Total			47 044 735
<i>Less Share Registry costs to be paid to TAB Ltd. (est.)</i> ¹⁴			10 500 000
Net Proceeds after sale costs			984 002 465
<i>Less Racing Industry costs</i>			
Racecourse Development Fund			50 000 000
Industry payment on completion of float			25 000 000
Early introduction of wagering tax cuts			19 400 000
Industry expenses due to extended negotiations			500 000
Total			94 900 000
Total Net Proceeds after reform costs			889 102 465

¹³ The purchase of wagering and gaming licences by TAB for a total of \$338m (\$308m for wagering licences and \$30m for gaming licences) was satisfied in part by Shares issued with a value of \$238m.

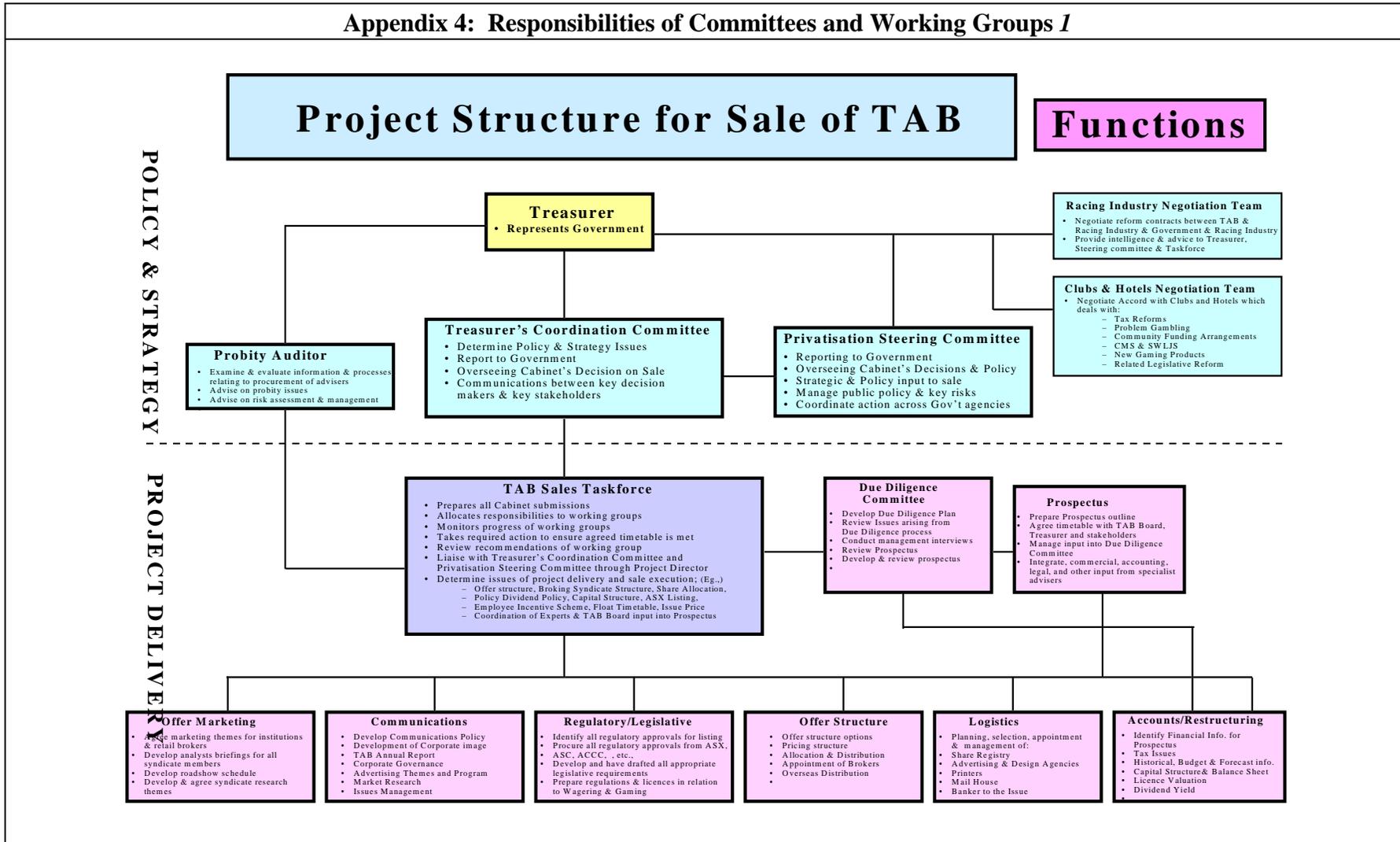
¹⁴ Based on 500 000 shareholders per year over the next three years.

Appendix 3: TAB Float Costs		
Item	Budget (Oct 1997)	Actual (1998)
Advisers		
Bankers Trust Corporate Finance	3 000 000	3 706 731
The Rowland Company	1 500 000	1 711 831
Freehills	2 500 000	1 656 810
Price Waterhouse	1 500 000	3 258 627
Deloitte	150 000	128 350
Sullivan and Cromwell	600 000	702 118
Jones Day Reavis and Pogue (legal) ²	-	(estimated) 83 333
Mallesons, Stephen Jacques (legal) ³	-	(estimated) 50 000
Other legal advice	-	31 226
Total	9 250 000	11 329 026
Management costs		
Project Management	280 000	150 000
Logistic consultant	-	120 902
Reimburse TAB Ltd for float expenses	-	486 634
Total	280 000	757 536
Demand-related logistics		
Advertising	8 000 000	1 299 730
Media ⁴	-	1 890 299
Share Information Centre	1 000 000	13 578 677
Share Registry (CRS) ⁵	500 000	420 000
Prospectus ⁶	3 700 000	5 449 940
CBA	-	711 909
Total	13 200 000	23 350 555
Selling fees and costs ⁷		
Float Syndicate	15 500 000	11 032 180
Roadshow costs	440 000	29 879
Bookbuild Data Room	-	80 259
Bookbuilding software/support	-	465 300
Total	15 940 000	11 607 618
Grand Total Float Costs	38 670 000	47 044 735

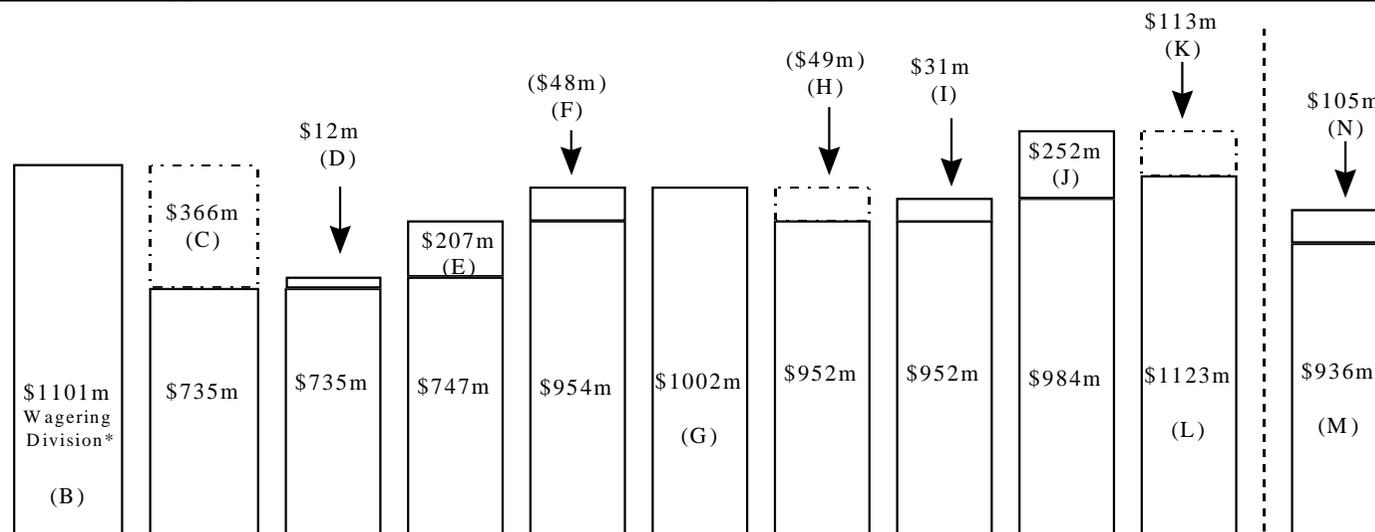
Note:

- 1 Excludes fees totalling \$300,000 paid to consultants employed by the TAB taskforce but in their opinion not on float specific tasks.
- 2 Upper limit of US\$50,000.
- 3 Upper limit of AUD\$50,000.
- 4 The \$1.8m paid to Zenith has not been fully used (due to cut in advertising), therefore is in credit - money in Treasury account until needed.
- 5 Cost claimed by CRS is \$2,639,881. Due to issues surrounding CRS performance, the Government has not accepted the cost claim. Instead, the Government has transferred funds to BT to buy shares to fulfil their commitment to shareholders who may have suffered due to problems with CRS. The Government is seeking to recover costs from the company.
- 6 Includes \$166 493 (est.) of prospectus costs yet to be paid.
- 7 Excludes listing fees estimated to be over \$300,000 which were paid by TAB Ltd.

Appendix 4: Responsibilities of Committees and Working Groups 1



Appendix 5 : Changes in TAB Valuation Components between 1997 and 1998 (A)

**Notes:**

(A) These valuations are for the components of TAB (wagering, SKY, CMS/SWLJS) not for the business as a whole. They thus exclude \$100m in cash not identified in the scoping study valuation in 1997, as a surplus asset and subsequently used by TAB as part payment for licences.

(B) Scoping Study Valuation of TAB Wagering 1997

Purchases

(H) Effect of SKY Deferred Consideration

(I) Effect of CMS and Links

(J) Effect of SKY

Operational Conditions

(C) Effect of Turnover/EBITDA decrease

Financial Conditions

(D) Effect of CAPEX

(E) Effect of Financial Assumptions

(F) Mid period adjustment to Scoping Study

(G) Revised valuation of TAB Wagering

(K) Effect of Debt

(L) Equity Value (Mid-point)

(M) Proceeds to Government in 1998, excluding \$100m from sale of licences and before costs

(N) Shares to vendor of Sky Channel

Sources:

- Scoping Study valuation of the TAB wagering by Hong Kong and Shanghai Bank.
- 1998 component valuation of the TAB by Bankers Trust
- Proceeds and costs of float from Appendix 3

Appendix 6: Access to TAB Information
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Letter from the TAB 2 December 1998

I refer to your letter dated 9 October 1998 addressed to my Managing Director, Mr Allen Windross, and our recent telephone conversation regarding the documentation you seek as part of the audit being conducted of the sale of TAB Limited.

Your request for access to extracts from TAB Limited board minutes for the period from December 1997 to April 1998 which relate to the Sky acquisition and also, details of the engagement of BT Corporate Finance Limited as adviser on the acquisition, including specification of the work required and work product, was considered by the TAB Board at its last meeting.

The Board resolved that the information sought by the Audit Office could be released subject to the following requirements:

- that in recognition of the commercial sensitivity of the information, the Audit Office enter into strict confidentiality obligations which prevent the use or disclosure of the information or its content without the express consent of TAB Limited; and*
- the Audit Office provide TAB Limited, Sky Channel Pty Ltd and the officers of those companies with indemnification in a form acceptable to TAB Limited, indemnifying those parties against any claims or actions arising as a result of or in connection with the release of the information to the Audit Office.*

Should you wish to discuss any aspects of the Board's decision or wish to proceed to make arrangements to access the documentation, please do not hesitate to contact me on 9218 1220.

Yours Sincerely

(signed)

Peter FRIEND

Company Secretary & General Counsel

Performance Audit Reports

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
Department of Housing	<i>Public Housing Construction: Selected Management Matters</i>	5 December 1991
Police Service, Department of Corrective Services, Ambulance Service, Fire Brigades and Others	<i>Training and Development for the State's Disciplined Services: Stream 1 - Training Facilities</i>	24 September 1992
Public Servant Housing	<i>Rental and Management Aspects of Public Servant Housing</i>	28 September 1992
Police Service	<i>Air Travel Arrangements</i>	8 December 1992
Fraud Control	<i>Fraud Control Strategies</i>	15 June 1993
HomeFund Program	<i>The Special Audit of the HomeFund Program</i>	17 September 1993
State Rail Authority	<i>Countrylink: A Review of Costs, Fare Levels, Concession Fares and CSO Arrangements</i>	10 December 1993
Ambulance Service, Fire Brigades	<i>Training and Development for the State's Disciplined Services: Stream 2 - Skills Maintenance Training</i>	13 December 1993
Fraud Control	<i>Fraud Control: Developing an Effective Strategy (Better Practice Guide jointly published with the Office of Public Management, Premier's Department)</i>	30 March 1994
Aboriginal Land Council	<i>Statutory Investments and Business Enterprises</i>	31 August 1994
Aboriginal Land Claims	<i>Aboriginal Land Claims</i>	31 August 1994
Children's Services	<i>Preschool and Long Day Care</i>	10 October 1994
Roads and Traffic Authority	<i>Private Participation in the Provision of Public Infrastructure (Accounting Treatments; Sydney Harbour Tunnel; M4 Tollway; M5 Tollway)</i>	17 October 1994
Sydney Olympics 2000	<i>Review of Estimates</i>	18 November 1994
State Bank	<i>Special Audit Report: Proposed Sale of the State Bank of New South Wales</i>	13 January 1995
Roads and Traffic Authority	<i>The M2 Motorway</i>	31 January 1995
Department of Courts	<i>Management of the Courts:</i>	5 April 1995

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
Administration	<i>A Preliminary Report</i>	
Joint Operations in the Education Sector	<i>A Review of Establishment, Management and Effectiveness Issues (including a Guide to Better Practice)</i>	13 September 1995
Department of School Education	<i>Effective Utilisation of School Facilities</i>	29 September 1995
Luna Park	<i>Luna Park</i>	12 October 1995
Government Advertising	<i>Government Advertising</i>	23 November 1995
Performance Auditing In NSW	<i>Implementation of Recommendations; and Improving Follow-Up Mechanisms</i>	6 December 1995
Ethnic Affairs Commission	<i>Administration of Grants (including a Guide To Better Practice)</i>	7 December 1995
Department of Health	<i>Same Day Admissions</i>	12 December 1995
Environment Protection Authority	<i>Management and Regulation of Contaminated Sites: A Preliminary Report</i>	18 December 1995
State Rail Authority of NSW	<i>Internal Control</i>	14 May 1996
Building Services Corporation	<i>Inquiry into Outstanding Grievances</i>	9 August 1996
Newcastle Port Corporation	<i>Protected Disclosure</i>	19 September 1996
Ambulance Service of New South Wales	<i>Charging and Revenue Collection (including a Guide to Better Practice in Debtors Administration)</i>	26 September 1996
Department of Public Works and Services	<i>Sale of the State Office Block</i>	17 October 1996
State Rail Authority	<i>Tangara Contract Finalisation</i>	19 November 1996
NSW Fire Brigades	<i>Fire Prevention</i>	5 December 1996
State Rail	<i>Accountability and Internal Review Arrangements at State Rail</i>	19 December 1996
Corporate Credit Cards	<i>The Corporate Credit Card (including Guidelines for the Internal Control of the Corporate Credit Card)</i>	23 January 1997
NSW Health Department	<i>Medical Specialists: Rights of Private Practice Arrangements</i>	12 March 1997
NSW Agriculture	<i>Review of NSW Agriculture</i>	27 March 1997

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
Redundancy Arrangements	<i>Redundancy Arrangements</i>	17 April 1997
NSW Health Department	<i>Immunisation in New South Wales</i>	12 June 1997
Corporate Governance	<i>Corporate Governance Volume 1 : In Principle Volume 2 : In Practice</i>	17 June 1997
Department of Community Services and Ageing and Disability Department	<i>Large Residential Centres for People with a Disability in New South Wales</i>	26 June 1997
The Law Society Council of NSW, the Bar Council, the Legal Services Commissioner	<i>A Review of Activities Funded by the Statutory Interest Account</i>	30 June 1997
Roads and Traffic Authority	<i>Review of Eastern Distributor</i>	31 July 1997
Department of Public Works and Services	<i>1999-2000 Millennium Date Rollover: Preparedness of the NSW Public Sector</i>	8 December 1997
Sydney Showground, Moore Park Trust	<i>Lease to Fox Studios Australia</i>	8 December 1997
Department of Public Works and Services	<i>Government Office Accommodation</i>	11 December 1997
Department of Housing	<i>Redevelopment Proposal for East Fairfield (Villawood) Estate</i>	29 January 1998
NSW Police Service	<i>Police Response to Calls for Assistance</i>	10 March 1998
Fraud Control	<i>Status Report on the Implementation of Fraud Control Strategies</i>	25 March 1998
Corporate Governance	<i>On Board: guide to better practice for public sector governing and advisory boards (jointly published with Premier's Department)</i>	7 April 1998
Casino Surveillance	<i>Casino Surveillance as undertaken by the Director of Casino Surveillance and the Casino Control Authority</i>	10 June 1998
Office of State Revenue	<i>The Levying and Collection of Land Tax</i>	5 August 1998
NSW Public Sector	<i>Management of Sickness Absence NSW Public Sector Volume 1: Executive Briefing Volume 2: The Survey - Detailed Findings</i>	27 August 1998
NSW Police Service	<i>Police Response to Fraud</i>	14 October 1998

Agency or Issue Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
Hospital Emergency Departments	<i>Planning Statewide Services</i>	21 October 1998
NSW Public Sector	<i>Follow-up of Performance Audits: 1995 - 1997</i>	17 November 1998
NSW Health	<i>Management of Research: Infrastructure Grants Program - A Case Study</i>	25 November 1998
Rural Fire Service	<i>The Coordination of Bushfire Fighting Activities</i>	2 December 1998
Walsh Bay	<i>Review of Walsh Bay</i>	17 December 1998
NSW Senior Executive Service	<i>Professionalism and Integrity</i> <i>Volume One: Summary and Research Report</i> <i>Volume Two: Literature Review and Survey Findings</i>	17 December 1998
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