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## **CEO AND CFO PRESENTATION TRANSCRIPTS FOR THE HALF YEAR ENDED 30 JUNE 2009**

Sydney, 25 August 2009

### **JAMIE ODELL**

Good morning everyone, welcome to Aristocrat's results presentation for the half year to 30 June 2009. My name is Jamie Odell, Chief Executive Officer and Managing Director, and I'm pleased to have here with me today the members of the executive leadership team of the business. Welcome everyone.

I'd like to provide a quick overview of today's briefing. After some introductory comments I will pass to Aristocrat's Chief Financial Officer, Toni Korsanos, to present the detail of our first half results, including a review of segment performance. I will then make some summary and outlook comments before taking you through the details of our turnaround strategy. Finally, I will open the floor to any questions and comments before we conclude proceedings.

At the AGM I said I would be focused on three things immediately:

- Firstly, ensuring we execute our 2009 plans effectively;
- Secondly, establishing an executive leadership team and other key leaders in the business with the necessary experience and skills for us to succeed; and
- Finally, completing a rigorous strategic review of the business to provide some clear choices and plans for improving our performance in line with our potential.

Today I will return to these themes, focusing in particular on our performance for the half, and the path ahead as we implement the outcomes of our strategic review. It's clear that we are not going to turnaround performance immediately. What I will be setting out today is a 3-5 year, commonsense plan, built on facts and big on basics: focusing on doing a number of things exceptionally well, clear deliverables, detailed and well resourced execution, and absolute accountability for outcomes.

Before setting out our plans in detail, I would like to provide an overview of our performance for the first half of this year to 30 June.

This was a very challenging half across all major markets, and our results, while in line with expectations, were poor. Weak trading conditions continued across all major markets. However, the key driver of revenue decline for the half was Japan, which Toni will shortly elaborate on.

Our revenue for the half was \$441.7 million, down 5.3% on prior period, and our operating profit after tax was \$44.2 million, which is at the upper end of our guidance of \$35.4 - \$45.4 million. This represents a 38.1% decline compared to the prior period.

Operating cash flow was up 15.8% to \$74.7 million, and closing net debt was reduced to \$111.5 million, an improvement of 58.6% over the prior period, largely as a result of our successful capital raising in April.

As foreshadowed earlier this month, we have reported a net loss post tax of \$33.1 million for the half. This is due to a non-cash writedown of \$79.9 million to our investment and associated inventories in the multi-terminal gaming businesses, PokerTek and Elektroncek.

I would now invite Chief Financial Officer, Toni Korsanos, to comment on the result in more detail. Toni...

## **TONI KORSANOS**

Thank you Jamie and good morning everyone. As Jamie said, this was a very challenging half across all major markets, and our results, while in line with expectations, were poor. There are, however, no surprises in today's result.

I propose to take you through our overall Group performance and then outline results by region.

Turning first to the summary profit & loss statement for the half. I have shown here reported results and those on a constant currency basis, had exchange rates remained at 2008 levels.

The decline in revenue was primarily driven by weak trading conditions across our key markets, most notably Japan. Overall market volumes continue to be negatively impacted by the challenging economic environment and the impact this has had on operator revenues and overall CAPEX spend.

The Australian dollar was weaker against the US dollar and Yen, depreciating 23.2% and 29.4% respectively, on a time weighted average basis, compared to the previous corresponding period. The weakening of the Australian dollar increased reported revenue and profit after tax by \$67.3 million and \$8.8 million respectively when compared to the prior corresponding period.

Gross margin declined slightly from 54.8% to 52.5%, reflecting the impact of lower gaming operations fee per day in North America, discounts on the *Indian Dreaming™* revocation games in Australia, adverse mix in the rest of the world and lower volumes in Japan.

We reduced SMG&A spend in the half by 7% on a constant currency basis, reflecting the impact of cost reduction measures.

Our investment in design and development spend totaled \$59.8 million increasing \$2.4 million in reported terms on the prior corresponding period. As a percentage of revenue, expenditure rose from 12.3% to 13.5%. On a constant currency basis expenditure declined \$5.0 million and represented 14.0% of revenue in the half. The reduction in spend was realised through a refocusing of design and development efforts and a reduction in cabinet engineering and design costs subsequent to the roll out of the *VIRIDIAN™* cabinet across major jurisdictions. Outsourcing of design and development effort to India is expected to deliver further efficiencies going forward.

Our effective tax rate on the normalized result fell to 25.8% from 27% at the 2008 full year. This was driven by a change in the earnings mix.

Fully diluted EPS for the half decreased to 9.1 cents (down 40.1%) from 15.2 cents in the prior corresponding period reflecting the poor result.

I will now take you through a brief comparison of our reported performance for the half versus the guidance we gave you in April.

Despite turbulent trading conditions, and the \$6 million negative impact of a strongly appreciating Australian dollar during the half, our operating result was at the top end of the guidance provided in April. The result was driven by better than expected performance in the rest of the world, particularly South America and New Zealand. This was partially offset by delays in commercializing *VIRIDIAN™GEN7™* in Queensland and continued challenges in Europe.

I don't propose to go through abnormals again in detail. As you know, these charges were disclosed to the market last month. Net abnormals for the period after tax were a loss of \$77.4 million, primarily non-cash impairments to our investments in Elektronček and PokerTek.

Before I go into more detail around segment performance, I will provide an overview of the key contributors to the normalised EBIT for the half, compared with the prior corresponding period.

I have isolated the impact of foreign exchange for the purpose of showing the underlying movements in revenue and cost elements.

The biggest impact on earnings was Japan, with units sold declining from 32,280 to 5,747 during the period. This was due to the absence of a major licensed game release in the half. ACE incurred additional business development costs, and Elektronček delivered a loss in the period.

Price/mix was also a negative factor on the half year result. Despite overall favourable average pricing being maintained across major regions over the prior corresponding period, the mix of games versus platform sales and their relative contribution to the overall result this period has had a negative impact.

Recurring revenue earnings were impacted by a slight decline in the average fee per day partially offset by an increase in the gaming operations installed base. I will discuss this further in a moment when I cover North America.

As I have already stated, across the Group, SMG&A decreased 7% on a constant currency basis. Excluding Japan and ACE, SMG&A was adversely impacted by increased legal spend associated with litigation, and costs associated with the move to the new head office in Sydney. This was offset by the previously noted savings in design & development.

Foreign exchange had a favourable impact on the EBIT number for the half versus the prior corresponding period as is visible on the chart.

Moving to cash flow.

Operating cash flow for the period increased to \$74.7 million. This represents 169.0% of profit after tax for the half and is above our 5 year average of 141.9%. This demonstrates our ongoing and aggressive focus on cash generation.

We continue to take a prudent approach to balance sheet management with conservative debt ratios and debt levels maintained, and well within those expected at the BBB- investment grade credit rating.

In April we successfully raised \$236.7 million. Our cash flow outlook remains positive, with the business requiring limited capital investment to grow organically, combined with a continued focus on cash flow management.

So overall, whilst our result for the half was poor we have maintained a sound balance sheet and strong cash flow delivery.

A fully franked dividend of 4.5 cents has been declared, representing a payout ratio of 54.3% of normalised earnings. This is within the Group's intended 50%-70% earnings payout ratio in line with guidance previously provided. The Dividend Reinvestment Plan will operate, at no discount, and participants will be issued shares.

I'd now like to provide more detail on segment performance.

On this chart I have shown segment revenue contribution by key region for the last four first half reporting periods. It demonstrates the resilience of earnings across our global portfolio, excluding Japan. Better managing volatility in Japan is a core objective of the Group's turnaround strategy as Jamie will outline shortly.

Conditions in the North American market, our largest, remained challenging, which was reflected in a 16.2% decline in profit for the half over the prior corresponding period. The decline in unit sales was matched by a lift in conversions, due to continued caution among operators with respect to capital expenditure. However, systems and services revenue increased, and the company's ship share of unit sales improved slightly compared to the prior year.

*VIRIDIAN™GEN7™* is gaining solid traction across many jurisdictions with over 10,000 units installed in North America to date. Confidence in the maths is strong and our focus is now on further refining features and continuing to expand the *GEN7™* games library.

Gaming operations.

Gaming operations represents a focus on the high yielding win per day recurring revenue products, both jackpot and non jackpot funded.

Our overall gaming operations installed base increased by over 500 units since the end of December 2008. The installed base average fee per day marginally declined from \$44 to \$43. We do, however, expect to benefit in the second half from both the increase in our participation gaming installed base and a higher fee per day as a result of the successful launch of *JAWS™*.

*JAWS™* is an exciting release. It was launched late in the first half and we currently have approximately 900 *JAWS™* units placed in North America, with signed contracts for over 200. The fee per day is also tracking in the \$60 per day range, well above our current average.

Overall, our performance in North America was varied, however, our ship share was slightly improved and we have driven an improvement in our gaming operations installed base.

Now turning to Australia.

In Australia, our revenue declined slightly compared with the prior corresponding period, and profit fell 11.1% to \$22.4 million. This result was driven by discounting associated with the mandatory *Indian Dreaming*<sup>™</sup> revocation. This was partially offset by improved *VIRIDIAN*<sup>™</sup> platform mix. The launch of *VIRIDIAN*<sup>™</sup>*GEN7*<sup>™</sup> in Queensland and penetration of licensing into both New South Wales and Queensland is reflected in the strong increase in hardware sales for the period: an increase of 30.4%. Installations of *VIRIDIAN*<sup>™</sup>*GEN7*<sup>™</sup> units in this market have increased to 4,000 units, up from 2,000 at the end of the 2008 financial year.

Moving to Japan.

Our Japan business reported a loss of ¥341.8 million or \$5.3 million for the half. Two games were released in the half, but the absence of a major licensed game release is evident in this result as I have already mentioned. Gross profit per unit was maintained but overall margins fell significantly due to lower sales volumes.

I will now finish with our fourth segment, rest of world.

Overall, results in other markets were down with the exception of New Zealand. Asia Pacific results were impacted by limited new venue openings and the unexpected closure of the Cambodian arcade / club market. Europe continued to be affected by negative economic conditions, while sales in South Africa and South America declined by 14.4% and 30.6% respectively over the prior corresponding period. The ACE business reported a \$3.2 million loss, largely due to business development costs as previously noted. Regulatory changes provided an opportunity for a significant lift in performance in New Zealand. Revenue and profit increased 113% and 209.5% respectively versus the prior corresponding period. We also successfully maintained or improved share across key markets in Europe as well as South Africa and Macau.

That provides an outline of Group and regional performance, and with that I would like to hand back to Jamie to summarise.

Jamie...

## **JAMIE ODELL**

Thank you Toni. I would now like to reflect briefly on the result and also say a few words about operating outlook for the second half.

Overall, there are a number of positives in our first half result, including strong cash flows and an improved balance sheet, but the reality is that this was a difficult and disappointing half. Today's result demonstrates the urgency of our challenge to fully implement our turnaround strategy and get this business growing again.

Looking ahead to the second half, we expect global market conditions to remain challenging. Operators continue to be cautious in terms of capital spend and new

venue openings have slowed markedly. However, we are maintaining pricing despite the difficult market conditions. We are controlling costs, maintaining strong cash flows and conservative debt coverage ratios, and our business fundamentals remain sound.

Our games pipeline is robust and we are confident in our ability to deliver high performing game content in all of our major markets, subject to regulatory approvals. In Australia, we will be releasing *JAWS™* and *Hit the Heights™*, with further penetration of *VIRIDIAN™ GEN7™* in New South Wales and Queensland. In North America we will continue the rollout of *JAWS™*, and release further participation games including *Foxworthy™*, *Hit the Heights™* and *Beat the Bandits™*. Japan will of course be key, and in that market we released *Zettai Shogeki™* in August, and plan to release the second series of a key licensed title which is currently in the approval process. In other markets, we will focus on the *VIRIDIAN™ GEN7™* rollout and further market-specific game content.

I will now move on to the strategy presentation.

I'd like to stress from the outset that we are not aiming for one-off savings or short-term results – but rather sustainable value growth. Consequently, you're not going to hear about quick or surprising fixes today.

This is a 3-5 year, phased strategy – nobody should underestimate the challenge – we certainly don't. It will take time to see improvements filter through to the bottom line, particularly in the present economic climate. We are working to deliver sustainable value growth, and there are no silver bullets.

What can be done quickly is being done quickly, for example the finalisation of our new executive leadership team structure and appointments, and the implementation of a disciplined and aligned, Group-wide KPI process. By the end of the year, we also expect to complete rightsizing of the business.

The reality is that we have to do many of the basic things more effectively: having clear goals, focusing on the big opportunities and disciplined execution through the line. Our strategy is about addressing the right issues, which will make a difference and drive performance, and I make no apologies for that.

As I said - we believe that what is required to deliver growth is a 3-5 year program of transformational change at Aristocrat.

Let me now take you through it.

We have taken a four-stage approach to developing our turnaround strategy that is thorough, rigorous and fact-based. We started with a clear view of where the business is and what we need to deliver, along with working hypotheses about our strategic options. We built a comprehensive fact base around industry profit opportunities, organizational capability issues and global best practice. Subsequent work focused on defining the strategy, developing our plans and getting ready to execute. I'd like to take you through these sequentially, and give you a few examples and insights into the process, beginning with stage 1: building the fact base.

A number of key facts and trends framed our thinking over the course of the review, some examples include the dominance of North America and Japan in the global gaming market, increasing diversity across markets, the critical role of technology in

adding value and driving replacement cycles, and finally the growing impact of regulation in shaping markets and market opportunities.

This slide demonstrates the importance of two markets – North America and Japan - to the global gaming industry. The Japanese market is predominantly pachinko, a specialized segment with high barriers to entry built on fundamentally different capabilities to the smaller pachislot market, in which Aristocrat competes. Whatever else we do, an increased focus on major markets, particularly the US, will be critical.

To drill down a little further on North America, the size of the opportunity in participation gaming is particularly apparent. To put it in context, the participation profit opportunity in North America is worth around \$2 billion per annum, or more than 7 times the value of the entire Australian market and nearly 3 times the value of the North American EGM outright sale market. This is something I will return to over the course of the presentation.

The overall number of gaming jurisdictions worldwide continues to grow, while the markets themselves are becoming more diverse with tailored strategies required to unlock value. Ultimately, this means that a generic export model along the lines Aristocrat has pursued in the past is not an option for the future.

It's also instructive to reflect on the impact of regulation in many markets, sometimes unexpected, sometimes negative and sometimes positive. One example is the impact in Japan of the mandated introduction of Regulation 5, which caused demand for new pachislot product to fall. Equally, however, regulatory changes in North America over the past few years have created real market opportunities. Our strategic challenge is to better manage the impact of regulation and position ourselves to capture opportunities more consistently.

These and other insights informed the next two stages of work, which first identified key themes and initiatives and secondly developed detailed, prioritized action plans which collectively form our turnaround strategy. I will now step you through these, turning first to how we defined our strategy.

We identified four compelling strategic themes which the strategy must address, that is: becoming truly player led and technology driven, ensuring we make the best games and systems, making sure we are focused on value-adding markets and segments and finally building a world class, enabling organisation. If we do these four things well, we will ultimately deliver sustainable shareholder value. I'll now provide more commentary on these four themes, along with some examples of the sort of initiatives we have identified and are pursuing under each heading.

I've said before that to be successful, player and customer needs must be at the centre of everything we do. Our games have to be better tailored to our key markets and make more use of technology to add value and excitement, and drive replacement cycles. That's why we are establishing a player, customer and competition insight function. That's also why we have appointed a US based, global Chief Technology Officer and are implementing a range of initiatives to put us ahead of the technology curve and get better at leveraging it. We also need to take a more strategic approach to managing our IP and the responsible gaming agenda.

A related theme is "best games and systems", and in our business, content is king. Our games must have the attributes that drive value, and on a market-by-market basis. To deliver this, we will get better at not only listening to customers, but also responding, with more locally focused game content. This is why we will be making

our product development process faster, more transparent, targeted and consistent. We will also measure our design & development ROI with clear metrics. We will use more innovative ways to develop content – for example, we will be launching our first games developed in collaboration with third parties at G2E this year, and there will be more to come.

We will continue to invest in our strongly performing US systems business, and prepare to take full advantage of the server based gaming environment as it emerges over time, driven by content.

Our ACE technology remains a key part of our future, in two distinct areas. In the video lottery market, we will continue to build on our successful Norsk Tipping installation in Norway. We will also utilize ACE technology in the Class III casino market to drive innovative new styles of game play and content.

We're also optimising our supply chain footprint and executing a comprehensive procurement strategy that will include outsourcing wherever effective. This will allow us to focus on core, value-adding competencies and give us additional operational strength and flexibility over the coming period.

In addition, we will be taking a more structured approach to decisions around the markets and segments in which we compete. We have clear aims and deliverables for each of our major markets in North America, Australia and Japan, which I will shortly explain in more detail. The message here is that one size no longer fits all.

Finally, the initiatives set out under “world class organisation” will build a lean and effective business, with the right behaviours and capabilities to ensure we are successful. The first priority here, which is well underway, is an aggressive overhead reduction program. This is about aligning our resources and processes with our strategy, and freeing up sufficient capacity to invest in the areas that will drive our turnaround. As Toni mentioned, we are controlling overheads across the business and have identified additional savings through outsourcing, rightsizing and the jurisdiction review that we will pursue over the coming period.

I would also highlight the establishment of a specialist Business Transformation Team reporting directly to me. We've invested in high calibre program management expertise and processes to ensure this strategy is executed fully and expeditiously.

Last month, I announced the appointment of a new executive leadership team and structure. The changes reflect many of the strategic themes I have set out today. More of the team will be based in North America, with Julius Patta, our Chief Technology Officer and Paul Kitchin, our Chief Marketing Officer both relocating to our Las Vegas office. We also boosted the team's capability in gaming technology, sales, strategy implementation and strategic people management. We have established focused management structures around our major markets while retaining substantial gaming industry experience.

I believe we're now extremely well positioned to build on our strengths while executing the sort of fundamental changes that are required to turnaround our performance.

I'd now like to provide more specifics around our objectives in our major markets, and how we plan to achieve them.

North America offers the most potential value for our business by a significant margin. Our number one strategic priority will be doubling our share of the North American participation gaming market over the next 5 years. The early success of JAWS in North America is encouraging. We're planning to double our share through greater investment in US specific game development and better use of leading edge technologies. Focus, planning and consistent execution will make us successful.

Focus is also being given to growing our US system footprint, and to further investment in our stepper product, *RFX™*. Now that *RFX™* has been launched, we will be accelerating development of compelling game content. This is going to be take time, however, as it's important to understand that we aren't just building games we are building a new stepper business.

As I've said consistently, we must become more genuinely embedded in the region as a local business delivering tailored solutions to North American customers, instead of continuing to act as an Australian exporter. This encapsulates our go-forward position in what is the world's largest video gaming market.

Our second key market is Australia, where we are committed for the long term. Our ship share has fallen below our installed base share in recent years, and we are determined to close the gap. To do this, our business model needs to change and we have to be more responsive to what players and customers tell us. In addition to our commitment to make games specifically for Australian customers, we are also introducing innovative licensing models and a more customer focused sales model.

Turning to Japan, we are sometimes asked whether we should remain in the market. We say yes. The Japanese market has high barriers to entry with proven profitability. What we must address, however, is the volatility of our earnings. Last year was successful for our Japanese business, due to the release of two strong licensed games. This is the sort of output we need to deliver consistently in the future, and that's why we are aiming to achieve over 50,000 unit sales per annum in the longer term.

We will implement strategies to optimise our game approval slots and make greater use of licensed characters, which have consistently stronger market appeal than characters developed in-house. We are building our pipeline of licensed characters. We are also increasing visibility over D&D in Japan by reviewing core processes and building management capability.

The other markets we currently service together comprise around 23% of our profitability. By the end of this calendar year we will have identified those that do not justify continued focus and will stop servicing these in a managed way. We expect to exit around 30 such jurisdictions in total, allowing us to invest more competitive energy and focus in those with real potential such as Macau, Spain, France and South Africa. We also see opportunities elsewhere in the Asia Pacific region, and some South American markets, for example, the potential of Class III games in Mexico. Tailored strategies with clear deliverables will guide us in those markets in which we decide to compete. We will not hesitate to get out of markets or segments that are unprofitable and distracting. Fewer, bigger, better is the guiding principle here.

Put simply, our future is not about being all things to all people in all markets. We must home in on the few game-changing opportunities that will make us successful. This means a resolute focus on our major markets of North America, Australia and Japan.

Doubling our share of the participation gaming market in North America over the next five years is our first priority. Lifting our game in Australia is also key. Better managing volatility in Japan is a third core objective. Also vital will be building a world-class product development capability, along with aggressively reducing cost and tightly aligning our resources with our strategy.

I'm confident that we've identified the issues that will make a real difference and drive sustainable improvement in our performance. As I said earlier, much of what we are preparing to do is not surprising. This is a commonsense strategy. It's about fixing business fundamentals with the aid of a clear plan with appropriate milestones, oversight and accountability.

What matters now is executing our plans and turning around performance, and we are already well into implementation of a number of our highest priority initiatives. Clear and aligned KPIs, together with hands on leadership from the executive team and leaders through the line, will make us successful. I'm determined to build our credibility through results, not words.

As I said a few minutes ago, this is a 3-5 year, phased strategy. Over the next 12 months we will exit low margin jurisdictions, optimize our Australian sales team structure and boost US game development resources. Our Indian Development Centre will also be fully operational within a year. Further ahead, we expect to see the benefits of our insights function coming on stream, in terms of more tailored game content and an improved systems offering.

While I can only reiterate the size of our challenge and the time it will take to see the full benefits, it's important not to lose sight of the bigger picture. This is an exciting industry, with high barriers to entry, solid margins, a relatively fragmented customer base and wide open potential to drive future growth.

I'm convinced that there is significant upside to be captured through successfully executing our plans. We are focused and determined, and ready to build on the positive momentum and progress already being made around our global business. Our people are energized and ready for change. We have a strategy, and it will be implemented. We are going to make the most of this unique opportunity to determine our future and I look forward to keeping you up to date on our progress in the years ahead.

And with that I would be pleased to invite any questions. Thank you.