



M. MATISONN STATEMENT

1 OCTOBER 2003



STATEMENT

MARK MATISONN

1. My academic qualifications are as follows: B Com (with honours) ("*cum laude*"), B Com (Honours) (with distinction) ("*cum laude*"), M Com including modules in financial reporting and corporate finance. In addition I am a CA (SA).
2. I have received numerous academic awards including awards for being the top student in Financial Accounting IV and Taxation IV.
3. I lectured Financial Accounting at the University of the Witwatersrand during my academic articles. I was requested to set a question for SAICA's final qualifying exam ("FQE"). This was included in Part One of the 1999 FQE.
4. I completed my articles at PricewaterhouseCoopers ("PwC"). During the course of my articles I was involved in the following divisions: Banking, Corporate Finance and Technical.
5. I co-founded, managed and subsequently disposed of a small company called VentureWeb involved in the multimedia and Internet industries.
6. I joined Corpcapital in January 2001.
7. I assisted Jade Hamburger in the preparation of the indicative valuation of Netainment/Cytech for the periods February 2001, August 2001 and February 2002. I also assisted Jade in the preparation of the draft indicative valuation for August 2002.
8. I received monthly management accounts for the business. Jade and I discussed the performance of the business and future strategies at monthly management meetings with operational management. In addition we had numerous informal discussions. Key issues and the performance of the business were discussed and formally reported to Corpcapital's investment banking exco. Most of Corpcapital's executive directors sat on the investment banking exco.
9. In collaboration with Jade I prepared the Cytech Valuation Report, Glossary and Cytech operational timeline of events which have previously been delivered to the inspectors. I confirm their contents and ask that these documents be read as if they are incorporated in my statement.



10. I have had numerous discussions and meetings with Sean Rose and Tal Harpaz relating to the business of Netainment. They are the beneficial owners of a combined 47.5% interest in Cytech.
11. None of the valuations have been inflated. They are a reliable estimate of fair value at the date of the reporting periods and our knowledge of the business and industry.
12. All valuations were prepared using input from a variety of sources and people. The valuations were prudent.
13. In an Appendix to my statement I have addressed certain comments and criticisms raised by Mr Abrahams and Mr Collett.
14. I have read Jade Hamburger's executive summary. I agree with its contents wherever it refers to me and to facts and circumstances where I was involved.

SIGNED at JOHANNESBURG on this the 1st day of OCTOBER 2003.

MARK MATISONN



APPENDIX

Mr Abrahams and Mr Collett have made various criticisms of the Corpcapital valuations of Cytech.

I would like to address certain of their criticisms and highlight key issues which they might not have been aware of. For ease of reference I have included their comments in bold italics.

THE ABRAHAMS REPORT

1 Mr Abrahams raises certain questions pertaining to adjustments which Corpcapital made to historical information which was the source data for the preparation of forecasts.

1.1 Sustainable profits (excluding non-recurring items) are the most appropriate benchmark to forecast future performance. The value of a company is the present value of expected cash flows discounted at an appropriate discount rate. Historic information is of relevance to forecast the future. All adjustments to Cytech's historical profits were non-recurring and made to determine a sustainable earnings basis from which to forecast future earnings. There were few adjustments and all were well understood by the auditors and Corpcapital management.

1.2 A summary of all adjustments has been included below:

Date	Amount (\$000s)	Nature of adjustment
February 2000	77	Non-recurring once off expenses including: bonus \$30k, royalty scheme fees \$27k and software expenses \$20k.
February 2001	600	CPA agreed to pay management a "bonus" due to the success of Netainment since inception. The payment was an extra-ordinary not



		to recur "bonus" in recognition of the exceptional achievements from the conception of Netainment. The "bonus" was over and above market related remuneration for their services.
February 2001	90	Legal fees for failed English Harbour merger.
May 2001	1,200	Dividend incorrectly classified in Cytech's management accounts as management fees. Paid to all shareholders in proportion to their equity holdings. Treated correctly in the audited Netainment financials as a dividend.
October 2001 – September 2002	600 (\$50k per month)	Cytech acquired Aqua's marketing team for \$600k payable in 12 equal monthly instalments from October 2001. The payments were excluded from sustainable earnings since the payments are non-recurring capital expenditure.

1.3 A conservative approach to adjustments was adopted. Numerous other non-recurring expenses were not adjusted. These include excessive promotional expenditure to migrate users onto a new software platform in October 2001 (approx. \$550k), additional overhead to support a multi-platform strategy, travel and legal expenses relating to software changeover, expenses relating to the failed acquisitions of Digiturf, Plus lotto and Geisha Casino.

2 ***Mr Abrahams says that in the 2000 year the old Corpcapital board (and in turn Corpgro) should not have considered it appropriate to use discounted cash flows for the purposes of the valuation at that stage because Cytech was an "early stage venture capital investment" and should have been valued at cost until it ceased to be early stage.***



- 2.1 Netainment was founded in May 1998. The casinos were operational in December 1998. At the end of August 1999 the business was over a year old. By August 2000 the business had been profitable for over a year, had generated substantial cash profits and was growing. The company was not regarded as an early stage venture capital investment. In Corpcapital's 2000 annual report Netainment was described as a "further development of successful early stage venture capital investment into a leading international online gaming and leisure group." It is clear that by August 2000 Corpcapital (CPA) considered the investment to have transformed from an early stage venture capital investment into a leading international online gaming group of substantial size. Its role as a leading online gaming group was justified by its profitability, client base and well-established brand (King Solomons).
- 2.2 The term early stage investment was extracted from the British Venture Capital Association ("BVCA") guidelines. There is no definition of early stage investments. BVCA guidelines are not GAAP. CPA did not use the BVCA guidelines although the principles were considered. BVCA guidelines 2.1. states that "The fundamental principle, which should underlie all valuations of venture capital investments, is to show a fair valuation of the investment to the investor."
- 2.3 Summary of the reasons why Netainment was not an early stage investment in August 2000:
 - 2.3.1 Founded over two years before.
 - 2.3.2 Over one year of positive cash generation every month.
 - 2.3.3 Highly profitable business (profits for the month of August 2000 and July 2000 were \$462k (R3,2 million) and \$204k (R1,4 million) respectively).
 - 2.3.4 Established infrastructure.
 - 2.3.5 Established and loyal client base. In the month of August 2000, 5 489 global customers deposited \$4 million (R28 million) into the casino.
 - 2.3.6 Well-recognised brands. In September 2000 King Solomons was voted the third (only behind state lottery and state sports betting) most recognised gaming brand in Israel by Ma'ariv (2nd largest Israeli newspaper).



2.3.7 Trading (excluding time spent on business plans, setting up and establishing infrastructure) for approximately 20 months.

2.3.8 In May 2000, Insinger Townsley (sponsoring broker) pitched to list Cytech on the AIM market in London. Insinger believed that they could raise between £3m – £5m new capital at a pre-new-money valuation of between £30m – £50m (\$50m - \$83m).

3 *Mr Abrahams says that Corpcapital described Cytech in its operational review in 2000 as a “successful early stage venture capital investment ...”. In other words Corpcapital itself described the investment as “early stage” and then proceeded to ignore this categorization for the purposes of valuation.*

3.1 Corpcapital did not describe Cytech as an early stage venture capital investment in its 2000 annual report. Page 12 of Corpcapital’s annual report for the year ended August 2000 stated, “Netainment – further development of successful early stage venture capital investment into a leading international online gaming and leisure group.” It is clear that by August 2000 CPA considered the investment to have transformed from an early stage venture capital investment into a leading international online gaming group.

4 *Mr Abrahams criticizes the forecasts since they included revenue streams that were based on management’s subjective views and global market research rather than on actual sales.*

4.1 It is not correct that projected revenue streams were based solely on management’s subjective views and global market research rather than on actual sales. The forecasts were always prepared using the historical trading up to the date of valuation as a base. In addition the forecasts took into account reasonable estimates using background industry data, operational issues, analyst reports, Corpcapital’s views and operational management input. Corpcapital’s independent auditors audited these assumptions and tested their reasonableness.

5 *Mr Abrahams says that the early stage rapid growth in the market was accompanied by the threat of significantly enhanced competition.*



- 5.1 Enhanced competition was taken into account in the forecasts. The forecasts included an increase in marketing expenditure to attract the same level of revenue i.e. decrease in marketing efficiency and profit margins. For example the August 2000 valuation forecasts for marketing are 31% of revenue in year one, 33% of revenue in year two and 37% of revenue year in year three. The increase was due to a forecast increase in competition and an increasing cost of acquiring players.
- 5.2 There was a strong argument in favour of profit margins increasing due to increasing player loyalty, increasing barriers to entry and the higher margin of non-US players but in the exercise of caution, this was not taken into account.
- 5.3 The following has been overlooked by Mr Abraham's:
- 5.3.1 In August 2000 the market was growing faster than the entry of competitors.
- 5.3.2 Established brands create barriers to entry. The barriers to entry increase over the life of an industry as early entrants have well established brands and a loyal customer base.

6 ***Mr Abrahams says that the August 2000 valuation has an EV/EBITDA valuation of 9.6 times, whereas Merrill Lynch in relation to their report on Ladbrokes in January 2001 indicate that they regard a 7.5 times EV/EBITDA as appropriate and he would accordingly have anticipated that a lower multiple would be appropriate for Cytech.***

- 6.1 Cytech had a 9.6 EV/EBITDA ratio based on the indicative valuation. This ratio was 8.4 on the fair value. Mr Abrahams reference to the Merrill Lynch report (page 125) is not in relation to their valuation of Ladbrokes' online casino, but their LBO's (high street betting business). This business had a significantly different growth profile. Merrill Lynch valued Ladbrokes' online gambling portal at £854 million despite profit not forecast for the next three years. Merrill Lynch's EV/EBITDA of the Ladbrokes business, which is comparable to Cytech, was infinite because it was loss making.

7 ***Mr Abrahams makes the observation that revenues fell consistently each month from June 2001 through to November 2001.***

- 7.1 As anticipated by management the revenue for the casino did fall from June 2001 to November 2001 due to intentional strategies adopted by management.



Actual revenue and marketing for the months May 2001 to November 2001 is included below:

\$000s	May-01	Jun-01	Jul-01	Aug-01	Sep-01	Oct-01	Nov-01
Revenue	2,691	2,803	2,701	2,039	1,885	1,750	1,442
Marketing	876	897	806	323	243	902	698

- 7.2 July 2001's turnover was 4% less than June 2001's turnover, but greater than May 2001's turnover. In June 2001 a portion of US banks started rejecting online gaming credit card purchases. This did not have a material effect on July's turnover.
- 7.3 In August and September 2001 Cytech intentionally reduced marketing expenditure in anticipation of the changeover onto new software in October. Management were reluctant to spend money leading up to the changeover to attract new players who may not migrate across. August and September revenues decreased as a result. The intentional decrease in marketing expenditure in August and September has been highlighted above with August's marketing being 60% lower than July's.
- 7.4 The July Netainment management pack (for the meeting held on 15 August 2001) states in 3.1. "Very little advertising is underway or planned for Aug/Sept and accordingly we expect turnover to be down 20% in August and further 20-25% in September." August 2001 was down 25% and September 2001 was down a further 8%, the two months cumulatively were actually ahead of expectations notwithstanding the level of marketing activity.
- 7.5 In October 2001 Cytech changed onto a new software platform. This required migrating users onto the new software. In making the decision to change software it was anticipated that revenue would decline in the short term (in respect of the historic player database who do not migrate across). We anticipated that margin enhancements from the renegotiated administration and software contracts would more than compensate. Netainment's revenue could drop by 36% and still make the same operating profit. To incentivise users to migrate to the new software large amounts of promotional money was given to Cytech's players (\$708k). November 2001 revenue was lower due to reduced promotional expenditure.



7.6 The August 2001 valuation forecast revenue for September 2001 and October 2001 of \$1,969k and \$1,710k respectively. The actual results were \$1,885k for September 2001 and \$1,750k for October 2001. Cumulatively actual revenue was 99% of forecast at the time of the publication of the 2001 results.

8 ***Mr Abrahams says that by July 2001 it should have been apparent to management that targeted growth in revenues for the year ending 31 November 2001 which had been assumed would not be achieved.***

8.1 Forecast (per February 2001 indicative valuation) and actual revenue to June 2001 was as follows:

	Feb-01	Mar-01	April-01	May-01	June-01
Forecast	2,936	3,072	3,207	3,342	3,486
Actual	2,527	2,685	2,796	2,691	2,803
% of forecast	86%	87%	87%	81%	80%

8.2 CPA only received monthly management accounts approximately two months after the period reviewed. By July 2001 CPA would have had April or May numbers. The forecasts to November 2001 included two months of actual results. The cumulative actual revenue to April or May was not significantly less than forecast.

8.3 The forecast contained in the August 2001 valuation forecast reduced revenue but the fair value of the business was not materially different to February 2001 due to the reduced variable costs for services (administration and software) significantly enhancing profitability.

8.3.1 The forecasts contained in the August 2001's valuation were significantly lower than those used in February 2001. This was due to industry changes and, more particularly, the change in software (not foreseeable in February 2001). [Forecast revenue for the twelve months ending November 2001 - \$41 million (first year of forecast per February 2001 indicative valuation). Forecast revenue for the twelve



months ending August 2002 - \$25 million (first year of forecast per August 2001 indicative valuation).]

- 8.3.2 Notwithstanding the large decline in forecast revenue (19% lower than the prior year) profits were forecast to increase from \$4,6m (actual 2001) to \$6,8m (forecast 2002) due to the reduction in variable costs. Corpcapital would never have approved the software change unless it believed, based on operational management's representations that this would enhance the business.

9 *Mr Abrahams says that the 2000 valuation was marked "draft".*

- 9.1 The 2000 indicative valuation was marked draft. There was a subsequent unqualified copy of the valuation which was the final valuation. The draft valuation was mistakenly given to Mr Frangos due to the limited time frame which we had to prepare the information for the Saxon meeting.

10 *Mr Abrahams says the 2001 valuations should have been lower than the valuation in 2000.*

- 10.1 Reasons for February 2001 fair value (\$27m/R222m) being greater than August 2000's fair value (\$21m/R149m):
- 10.1.1 Sustainable profit for six months preceding February 2001 valuation was \$2,972k (August 2000 – January 2001). January 2001 was the latest available financial information.
 - 10.1.2 Sustainable profit for six months preceding August 2000 valuation was \$1,029k (February 1999 – July 2000). July 2000 was the latest available financial information.
 - 10.1.3 Increase in profit over comparative six month period – 189%.
 - 10.1.4 Forecast profit for six months ended January 2001 - \$1,830 (per August 2000 valuation).
 - 10.1.5 Actual profit for the six month period ending January 2001 was 162% of forecasted profit.
 - 10.1.6 At August 2000 a DCF valuation was undertaken using a 24% discount rate. On the assumption that Cytech achieved its profit forecasts and future forecasts remained constant i.e. same as those



included in the August 2000 DCF, the value of Cytech would increase by the discount rate of 24%. Therefore one would have predicted the value of Cytech at February 2001 to be 12% (24% divided by two) higher than that calculated in August 2000. In addition the value of the business should increase by the cash generated for the period i.e. \$3m. The performance over the six months as illustrated above indicated a substantially more profitable business and justified the increase in fair value.

10.1.7 The profit growth and extended track record of cash generation by the casino resulted in a reasonable increase in fair value.

10.2 At August 2001 we re-performed the forecast for 2002 and beyond. While the small underperformance of 2001 relative to forecast made at August 2000 was noted, the circumstances at 2001 were materially different and therefore the prior year, second year forecast was not relevant.

10.3 Reasons for August 2001 (\$26m/R221m) fair value in dollars being only marginally lower than February 2001 (\$27m/R211m):

10.3.1 At August 2001 the casino's forecast revenues were estimated to be far less than that forecast in February 2001. Forecast revenue for the twelve months ending November 2001 - \$42 million (first year forecast per February 2001 indicative valuation). Forecast revenue for the twelve months ending August 2002 - \$25 million (first year forecast per August 2001 indicative valuation).

10.3.2 However the business was forecast to have a significantly higher operating margin.

10.3.2.1 Cytech was in the process of changing software providers at a significantly reduced royalty (effective fee of 23% of revenue reduced to 6.75%) from October 2001.

10.3.2.2 Cytech was finalizing a new contract with Aqua at a reduced admin fee of an effective 6.75% of revenue from 12.5% of revenue from October 2001.

10.3.2.3 Cumulatively these two contracts saved the casino costs equalling 22% of revenue. The services were not considered to be materially different in quality.



10.3.2.4 In the August 2001 valuation, the forecast revenue for the eleven month period (period of new software) (October 2001 – August 2002) was \$23m and the cost saving on this revenue from these two contracts would have been over \$5 million (\$23m x 22%). To put this in perspective the February 2001 indicative valuation forecast profits for the twelve months ending November 2001 (first year of the forecast period) of \$8.3m.

11 Mr Abrahams says the revenue forecasts in the February 2002 valuation were "optimistic".

11.1 Mr Abrahams has based his analysis of "optimistic" revenue figures on the incorrect figures. He extracted his revenue forecasts from the Indicative Valuation document for February 2002. This document has a typing error. Forecast purchases were incorrectly transcribed as revenue numbers in the summarised narrative.

11.2 Purchases are the amount of cash deposited into the casino and revenue is the amount won by the casino net of payouts. The forecast revenue for February 2003 included in the appended detailed workings (which was not included in the documents given to Mr Frangos in addressing his concerns) to the valuation. These show forecast revenue for the twelve months ending February 2003 of \$27.7 million (not \$50.6 million as included erroneously in the Indicative Valuation document) and forecast revenue for the twelve months ending February 2004 of \$36 million (not \$66 million as included erroneously in the Indicative Valuation document). Another document given to Mr Frangos by Jade Hamburger contained the correct figures. The discounted cash flow was based on the revenue numbers included in the appendix and not those included on the summarised income statement in the word document.

11.3 The revenue for the twelve months preceding the date of the February 2002 valuation was \$26.7m (February 2001 – January 2002). January 2002 was the latest financial information available at the date of preparing the valuation. The forecast revenue was 4% higher than the historic period. June 2001 revenue (prior to US rejection of credit card purchases and software changeover) was only forecast to be achieved in May 2003.



THE COLLETT REPORT

12 *Mr Collett says that the use of a discounted cash flow ("DCF") to value the casino was inappropriate. However he believes if the DCF was used it should have been compared to the net asset value of the business to determine if the DCF method is fair and reasonable.*

12.1 The Indicative Valuation was prepared using a DCF model and earnings multiple model. Both these methodologies are considered well accepted valuation techniques in AC 133. Merrill Lynch January 2001's (page 32) report states, "In our view, e-gambling companies have characteristics which lend themselves to a DCF valuation." In June 2000 PwC (London) were requested to perform a valuation of Netainment. They proposed a valuation based on a DCF analysis. Credit Suisse First Boston ("CSFB") valued Stanley Leisure (gaming group) using a DCF.

12.2 Net assets is not an appropriate valuation methodology for a cash generative business whose main assets are intellectual property and brand value, neither of which are recognised on the balance sheet.

12.3 PwC's 2002 valuation was not benchmarked against net assets.

12.4 Merrill Lynch's 2001 report (page 31) does not even consider net assets as a valuation technique. On page 32 they state, "In our view, e-gambling companies have characteristics which lend themselves to a DCF valuation:

12.4.1 E-Gambling companies which establish themselves in their markets will soon generate large and growing levels of free cash flow.

12.4.2 Gambling companies require little in the way of asset intensity.

12.4.3 Moreover, relatively low cash outflows are needed in order to sustain these assets."

13 *Mr Collett says the DCF valuation model could only have been valid on the assumption that Netainment was going to sell its total business to a third party and that the net proceeds were going to be distributed amongst the shareholders of Netainment or that the Corpcapital Group had total control over Netainment and its funds.*

13.1 A sale of the whole of Netainment's business and/or a merger and/or a listing was very much on the cards. There is evidence in the Cytech bundle that we



were looking to sell the whole business to a third party (e.g. Amalco deal, Gaming Internet, PwC mandate) or list the business and that the net proceeds were going to be distributed amongst the shareholders of Netainment. We were never in discussions to sell just our stake.

14 Mr Collett's says the value of Corpcapital's investment in Netainment was diminished due to the lack of any dividend policy.

14.1 Netainment did pay dividends. In May 2001 a dividend of \$1,2 million was paid. In November 2001 a dividend of \$1,4 million was paid. Numerous discussions were had between Corpcapital, Sean and Tal to agree on the dividends and dividend policy. A dividend policy was determined from time to time, according to the needs of the business.

15 Mr Collett says that the corporate structure of Mikado/Blue Eagle diminished the value of Corpcapital's investment. His rationale is that Mikado/Blue Eagle were not listed, did not have a dividend policy, did not produce audited financial statements and had no shareholder's agreement.

15.1 Blue Eagle is an investment company. It is 100% owned by Mikado which is 100% held by Corpcapital Investments. Due to them being 100% held subsidiaries of Corpcapital it was not necessary to have a dividend policy or shareholder's agreement. Both companies were SPV's formed solely for the purpose of holding its investment. The proceeds arising from a disposal of Netainment could be beneficially distributed to Corpcapital without any impairment in value. CPA never intended to sell Mikado or Blue Eagle. The intention was to sell or list the underlying business. Kevin Joselowitz's submission will deal with the structure in detail.

16 Mr Collett says that a minority discount should have been applied to the valuation of Cytech.

16.1 Corpcapital did not apply a minority discount nor did it apply a joint control/large block premium to its valuation. AC 428 Business combinations – "Date of exchange" in fair value of equity instruments para 10 states: "Equity instruments have only one fair value in a market...Therefore estimates of premiums for large, and discounts for small blocks of equity instruments issued



in comparison to that exchanged in observable transactions are not considered.”

- 16.2 However in calculating the DCF, the cost of equity was calculated with reference to market betas and a market risk premium. The use of market information where prices are based on minority interests necessarily implies that Cytech was valued as a minority shareholding. The same rationale would apply to the use of PEs of listed shares.
- 16.3 DCF and PE valuation methodologies are used extensively by analysts in valuing listed stocks on all major exchanges. These stocks are minority interests. Therefore a DCF or PE valuation is appropriate for a minority interest or larger stake. Mr Collett is seemingly unaware that Corpcapital had joint control of Cytech.
- 16.4 Corpcapital had joint control of Cytech with Sean Rose and Tal Harpaz. Any disposal of shares would have included the other party, contractually and commercially, there being a synergy of shareholder interests.

August 2000 valuation

- 17 ***Mr Collett says that to assume that the growth rate could continue for the next 36 months, increasing the August 2000 monthly turnover by approx. 225% was not prudent and reasonable in the circumstances.***
 - 17.1 Actual revenue growth from October 1999 to August 2000 (Annexure C1 of Mr Collett's report) shows a trend which supports the revenue forecasts.
 - 17.2 An increase of approximately 225% over 36 months implies a compound annual growth rate of 48%.
 - 17.3 Christiansen Capital Advisers were estimating Internet gambling expenditure to grow by 57% in 2001 and 32% in 2002. They were not anticipating the market to mature or growth to slow.
 - 17.4 As a comparable business English Harbour's results and forecasts validated our growth assumptions.
 - 17.5 Although not known at the time of the August 2000 valuation Merrill Lynch in their January 2001 report forecast a compound annual growth rate of 103% for the period 2000 to 2003.



17.6 At the time of the August 2000 valuation Cytech was growing faster than industry forecasts since it was coming off a relatively low base.

17.7 The three months revenue preceding the valuation were as follows:

	\$000s	Month-on-month growth	Annualised growth percentage
Historic revenue May 2000	1,476		
Historic revenue June 2000	1,616	9%	108%
Historic revenue July 2000	2,007	24%	288%

Cytech's revenue had grown from \$4.7m for the six months ending January 2000 to \$9m for the six months ending July 2000 (91% or in excess of 200% compound annual growth). Cytech had a large and loyal player base and was continuing to grow from this base.

18 Mr Collett also says that to assume that the monthly profit would grow from approximately \$400k to above \$1 million in 36 months was not prudent and reasonable in the specific circumstances.

18.1 Actual profits (Annexure C2 and C3 of Mr Collett's report) reflect a volatile pattern but indicate a general upward trend.

18.2 An increase from \$400k to \$1.1 million over 36 months implies a compound annual growth rate of 40%.

18.3 The reason for growth in profits was predominantly the revenue growth.

18.4 Mr Collett does state that "one should probably give some credit and/or recognition to the forecast on revenue and profits...the reason being that, despite our reservations, the actual trends do lend some support to an upward forecast."



February 2001 Valuation

19 *Mr Collett says that the actual revenue line indicates that historical growth might be flattening out.*

19.1 At the time of the February 2001 valuation information up to the end of January 2001 was available to Corpcapital. Mr Collett is incorrect in saying that the actual revenue line indicated that historical growth might be flattening. Up to and including December 2000 revenues had increased progressively on a monthly basis. January 2001 was slightly down on December 2000 (but not significantly) and was still higher than October and November 2000. December was understood to be a good month because of seasonal issues. It follows then that there was nothing to indicate that historical growth was flattening out.

19.2 All that was visible was January 2001 being down on December 2000. Revenue for the six months prior to January 2001 was \$14,7 million (August 2000 – January 2001). Revenue for the previous six months was \$9 million (February 2000 – July 2000). Revenue grew by approximately 63% for six months over the corresponding six month period.

19.3 We therefore disagree with Mr Collett's conclusion that historical trends of actual revenue did not sufficiently support the forecasts.

20 *Mr Collett says that the actual profit line indicates extreme volatility*

20.1 Monthly volatility in profits is expected and is in part due to the accounting treatment for marketing. Marketing expenditure is expensed when incurred. Marketing is the cost of acquiring customers from which a casino earns revenue over a number of months when players gamble (similar to an insurance company paying insurance brokers upfront on the sale of a life policy from which they derive economic benefit over the life of the policy). Variations in monthly marketing expenditure will affect monthly profit due to the significance of the expense. The benefit of increased revenue from an increase in marketing happens over several months, therefore it is more appropriate to analyse the trend over a period of time. That is what we did.



21 Mr Collett says the actual profit line indicates a possible downward trend.

21.1 The profits for the ten months preceding the date of valuation have been included below. Financial information was available up until January 2001 at the date of preparing the valuation.

	Apr-00	May-00	Jun-00	Jul-00	Aug-00	Sep-00	Oct-00	Nov-00	Dec-00	Jan-01
Profit (\$000s)	231	80	36	204	462	434	286	394	678	718
Month on month growth		(65%)	(55%)	464%	126%	(6%)	(34%)	38%	72%	6%

From the table above it is evident that the profits were showing an increasing trend.

August 2001 valuation

22 Mr Collett says that the actual revenue line indicates a downward trend.

22.1 It is correct that the actual revenue trend was downward. It was for this reason that forecast revenue (for the period ending August 2002) was approximately 19% less than the actual historical revenues for the twelve months ending August 2001 (\$31m versus \$25m). Forecast revenue of \$25m was considerably down on the February 2001 forecast revenue of \$41m.

23 Mr Collett says that the actual profit line indicates a strong downward trend but the profit forecast is aggressive and optimistic.

23.1 The profit forecasts for the twelve months ending August 2002 was \$6.7m. The actual profit for the twelve month period ending August 2001 was \$4.5m. It is not correct (as Mr Collett maintains) that the actual profit trend (by the time of the August 2001 valuation) was negative. In fact his own graph (Annexure C2 page 758) shows that profits for the month of June and July showed an improvement on prior months. The forecasts made in the August 2001 valuation contained the cost savings based on the forecast renegotiated contracts. These contracts were renegotiated as forecast.



- 23.1.1 In 2001 Netainment had a contract with Aqua to provide back office and administration services for 12.5% of revenue. This was reduced to 7.5% of revenue from October 2001 but revenue would exclude promotions and was therefore an effective 6.75% of revenue i.e. cost saving of 5.75% of revenue for the same services.
- 23.1.2 In 2001 Netainment had a contract with Microgaming for the use of software at an effective rate of approximately 23%. In October 2001 Cytech entered into an agreement with another software provider. The new software royalty rate was effectively 6.75%. At the time the new software was not considered to be of a substantially different quality. This resulted in a cost saving of approximately 16.25% of revenue.
- 23.2 Cumulatively these two contracts saved the casino 22% of revenue over the prior period. In the 2002 forecast period the forecast revenue for the eleven month period (October 2001 – August 2002) was \$23m and the cost saving resulting from these two contracts would have been over \$5 million (\$23m x 22%).
- 23.3 The profit forecast would have been significantly less than the prior year based on lower revenue and increased overhead if key margin sensitive contracts weren't renegotiated. They were not overly aggressive but reflected the forecast cost infrastructure at the date of the valuation. Both contracts were renegotiated as described above and effective from October 2001.

February 2002 valuation

24 Mr Collett says that the actual revenue line confirms a strong downward trend and the forecasted revenue is in total contradiction with the actual historical trends. He also says that the forecasted profit shows the same contradiction.

- 24.1 The February 2002 valuation is based on information available as at January 2002. For the twelve months ending January 2002 total revenue amounted to US\$26.6m. CPA forecast US\$27.6m for the twelve months ending February 2003.
- 24.2 Cytech's revenue was forecast to only increase marginally from historic revenue from the prior 12 month period (ie ending January 2002). The business was forecast to expand into new markets in Asia, South America and Central Europe. In April 2002 King Solomons was launched in Korea. However



Korea was not as successful as anticipated. In September 2002 King Solomons was launched in Turkey. Turkey has subsequently grown to be a material contributor to revenue in 2003.

24.3 The problem of US banks (experienced from June 2001) rejecting online gaming transactions was considered a temporary threat. The take up of alternative payment mechanisms (e.g a virtual wallet called Firepay) was showing encouraging results. In a Las Vegas Sun article (October 2001) Christiansen Capital Advisers estimated internet gambling expenditure would generate \$10.5 million in 2005. The year before (i.e. 2000), the worldwide industry generated \$2.2 billion.

24.4 In addition, Cytech changed software providers in October 2001 and it was anticipated that it would take time to migrate users onto the new platform. At February 2002 the feedback was that the new software had been well received by users. For these reasons Cytech was forecast to achieve the actual revenues of July 2001 again by March 2003. This was based on assurances from operational management and had been the rationale underlying the decision to change software.

24.5 Corpcapital forecast profits of \$6.7m for the twelve months ending February 2003. The actual profits for the twelve months ending January 2002 were \$2.9m.

24.5.1 The forecast increase in profit was due to a substantial operating margin improvement (new software supplier and Aqua contract at significantly reduced rates). The historic period includes trading results to September 2001 (8 months) incorporating terms of the old Aqua and software contracts. As discussed above the two contracts would save Cytech a cumulative 22% of revenue. The actual revenue for the eight months ended September 2001 was \$20.1 million. If the revised contracts were in place for the full historic period the 22% cost saving would have resulted in historic profits being \$4.4 million higher. ($\$4.4\text{m} + \$2.9\text{m} = \7.3m versus forecast of \$6.7m).

24.5.2 The new contracts were not considered to materially affect the quality of the business. The Aqua fee was reduced for the same service. The new software was considered to be of similar quality to the old software. The rationale for changing software providers was to increase the profitability of the business.