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ESG IS NOT ENOUGH: BETTER ALLOCATION AND LIQUIDITY, LOWER COST OF CAPITAL AND A RENEWED REPUTATION BECKONS IF THE GAMING AND LEISURE INDUSTRY EMBRACES A NEW COMPLIANCE APPROACH AND CUSTOMIZED TOOLSET

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ABSTRACT

Environmental, Social and Governance (ESG) mandates are affecting the gaming industry deeply, having the effect of adversely impacting both operating companies and investors and are slated to wield increasing influence both within and outside of the gaming and leisure sector for many years to come.

Environmental, social, and corporate governance (**ESG**), also known as **environmental, social, governance**,[1] is a business framework for considering environmental issues and social issues in the context of corporate governance. It is designed to be embedded into an organization's strategy that considers the needs and ways in which to generate value for all organizational stakeholders (such as employees, customers, suppliers, and financiers).[1]

ESG forms an approach to operating and investing that incorporates a given company's environmental, social and governance risks, but often lacks in performance and outlook data such as critical financial indicators. Alongside perceptions both qualified and unqualified around how ESG may mitigate against returns, this is one of the reasons ESG's value is challenged by many.

[1] Gelles, David (28 February 2023). "How Environmentally Conscious Investing Became a Target of Conservatives". The New York Times. ISSN 0362-4331. Retrieved 2 March 2023.

The size of the sector warrants increased ESG focus notwithstanding: for example, the US is expected for the first time to announce gaming revenues in excess of $100BN[2] for 2022 with Europe recording €108.5BN across land-based and online.

At the same time, some capital allocators have been reticent to enable capital flows into the gaming and leisure industries in the US, as well as in Europe where ESG's influence is more prominent, due to myriad ESG concerns and the inability of companies to satisfactorily represent ESG risk and compliance. The European Leveraged Finance Association states that *'Environmental, social and governance (ESG) factors have quickly grown to be a critical part of credit analysis in the European leveraged finance market. Despite the increasing focus on ESG, efforts have been fragmented as the market lacks consensus on the type of ESG disclosure that is necessary'.*[3]

Like it or not, no gaming and leisure sector company in North America or Europe will be able to avoid optimizing around ESG going forward.

Gaming-industry operating companies have had mixed results managing ESG individually and as an industry. The impact appears to have included lower valuations, higher volatility, adversely impacted access to capital and reputational and other issues with governments and regulators.

As a best practice, companies and investors need to utilize data and analysis via reporting processes and tools to interpret risk and performance relative to their peers and other indices. ESG is no different.

At best, the gaming and leisure industry presently uses a largely generalist approach to ESG reporting frameworks and tools. This is wholly inadequate for the gaming and leisure industry as these methodologies encompass none of the aspects particular to the sector and are absent the key financial indicators and analysis critical to investors.

Addressing these shortcomings carries significant upside potential for the gaming and leisure industry.

The purpose of this White Paper is to frame the status quo and validate the need for a superior approach, foster better industry understanding and dialogue around optimizing the industry's approach to ESG and the benefits of doing so, and to make specific recommendations and a plan of action for industry participants to reap the benefits of a more successful approach to ESG.

We call this new approach ESG Fintel.

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[2] Once the National Indian Gaming Commission reports. Commercial gaming revenues for 2022 were $60.42BN

[3] European Leveraged Finance Association- ESG Fact Sheet Gaming. file:///C:/Users/44791/Downloads/ESG-Fact-Sheet-Gaming-v2.pdf

EXECUTIVE SUMMARY

1. The gaming and leisure sector appears to trail other industries with respect to ESG generally and specifically with respect to financial indicators.
2. The industry has an inadequate reputation in terms of ESG compliance and compliance and performance while at the same time is held to a higher standard than many other industries.
3. The adverse impact of substandard ESG practices may be lower valuation, lower liquidity, higher volatility and higher cost of capital.
4. The cost to the sector of substandard compliance and performance could be significant and in the billions of dollars of value; the rewards for addressing ESG and reputational concerns are significant for companies and investors.
5. ESG reporting in and of itself is not enough to address the matter; detailed financially based data and analysis of compliance and relative performance customized to the gaming and leisure sector is needed by both companies and investors.
6. Better and more standardized industry-specific reporting tools are needed, or the industry risks remaining on the defensive side of the equation.
7. 'ESG Fintel' is proposed as a solution which aims to validate the matter in both qualitative and quantitative terms and thereafter address shortcomings through a data-driven technology platform, allowing a transparent view of gaming companies across a broad spectrum that is valuable to investors, operators and the wider gaming ecosystem
8. The most pressing indicators which appear to require augmented inputs as regards current ESG reporting for the gaming and leisure industry follow. ESG Fintel's proposed approach significantly addresses them. While the data emanating from these inputs are not always financial per se, the financial implications of performance are key criteria:

    a. Coherent Sustainable Development Goals

b. Financial performance and reporting
c. Market exposure
d. Responsible gambling
e. Board and Governance
f. Regulatory compliance performance
g. Operational performance and shareholder risk
h. Societal impact and reputational risk

9. The gaming and leisure industry clearly must do more or suffer the consequences. It is in dire need of an augmented data set which tracks inputs unique to the sector, and which can complement the standard ESG reporting milieu from existing generic suppliers.
10. While the respective European and North American history regarding ESG is divergent and outlooks vary, ESG is and will continue to be a growing force for the gaming and leisure industry.
11. In comparing gaming and leisure to other sectors, the alcohol industry has generally been more successful in optimizing outcomes within the ESG paradigm than gaming and leisure while at the same time alcohol arguably has a higher degree of adverse societal issues stemming from it.
12. ESG compliance and regulatory compliance go hand-in-hand. Large regulatory fines and the economic fallout resulting from them is both costly and avoidable for companies and investors and the negative fallout from these fines continue to compound. In contrast, the positive impact of best practices compliance is significant. Higher valuation, more straightforward access to capital at a lower cost, lower regulatory risk. On top of all this, a compliant business is a better run business which and of itself suggests higher returns for all stakeholders.
13. Questions remain: how significant is the problem for the industry in quantifiable terms? Is an approach such as what is proscribed herein - “weaponizing ESG” via the usage of superior financially based data reporting and analysis tools - destined to be effective? What changes would increase the chances of achieving the objective and is there the collective and individual will to ensure successful and widespread implementation? What are the negative factors associated with more diligent financial reporting within an overall ESG framework? Responses to these and other questions is sought.

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1. Framing the problem

a. Introduction

The regulated gaming industry and associated leisure sector has reached a metaphorical fork in the road. As operators and other providers decide upon a regulated or grey market route for their businesses, the industry is under pressure to find a satisfactory route to a sustainable future. ESG and its ramifications are at the heart of this debate, and despite the concept having significant opposition in some quarters, there is no doubt the principles are here to stay. The industry must either determine how to more successful manage within the ESG realm or resign itself to the consequences – feared or otherwise – of sub-par compliance.

ESG is seen variously as a checklist, a threat, or an encumbrance. The ESG movement is a reality that must be contended with. Via proper compliance, pro-activity, focus on relative performance, and communication, companies can optimize their ESG status to strong effect. Companies that are legitimately poorly rated as regards their ESG profile are paying the price for this, which will increasingly have a negative effect on both companies themselves as well as the whole gaming and leisure category. ESG should also be seen as an opportunity for those who accept the movement for what it is and are agile enough to take advantage of it.

ESG mandates are undoubtedly affecting the gaming industry deeply. Some capital allocators may have been reticent to enable capital flows into the gaming and leisure sector due to ESG concerns, particularly as regards the Social and Governance areas. This is felt more profoundly in Europe at present, and at first blush substandard ESG compliance and performance appears to have contributed in some fashion to lower valuations, higher volatility, adversely impacted access to capital, inability to put equity and debt capital to work for operators and investors alike, and reputational and other issues with governments and regulators to name a few.

Regulatory settlements and pending investigations created by a lack of governance or problem gambling safeguards are the primary reason for the reputational challenges, perception and credibility debate surrounding the industry. The UK has seen over £40m in fines to 3 leading operators in the last year alone. Kindred's £7.1m fine alone accounted for 5.6% of profit before tax in 2022[4]. As so called 'sin' stocks, gaming companies already have limited options for capital

[4] https://www.kindredgroup.com/media/press-releases/2023/kindred-group-plc--year-end-report-january--december-2022-unaudited/#:~:text=Podcasts-,Kindred%20Group%20plc%20%E2%80%93%20Year%2Dend%20report%3A,January%20%E2%80%93%20December%202022%20(unaudited)&text=Total%20revenue%2C%20from%20both%20B2B,increased%20by%201%20per%20cent.

raising and portfolio allocation. This trend is gaining momentum in North America and therefore the industry must be proactive and not reactive.

A recent report authored by Bain and the International Association of Credit Portfolio Managers summed up the present ESG situation:
'While institutions are making progress, they're hampered by a lack of consensus on frameworks and methodologies, as well as unclear decision rights and different regulatory priorities among the regions.'[5]

The entire gaming ecosystem therefore needs to work diligently to resolve these key barriers and improve its perception, realigning towards the more effective position of some of the key companies in the similarly challenged alcohol industry rather than be thrown into further reputational decline experienced by industries such as tobacco.

b. The rewards of addressing the issues.

The total market capitalization and enterprise value of the regulated gaming and leisure sector globally is difficult to measure. However, if we consider the combined market capitalization of the top 40 listed companies in the sector, we come up with an estimated value of $271.91BN[6]. Assuming that this entire cohort were able to improve their ESG standing marginally, and this resulted in a 2% improvement in valuation across the sector, the combined impact could equate to a $5.44BN increase.

Another lens for the potential impact of improved ESG compliance and performance is related to equity and debt financings, the satisfaction of investors' ESG requirements and its relationship to the cost of capital. If we isolate credit markets, listed sector companies in North America and Europe have tapped investors for a significant amount of debt. Should operating companies, by virtue of improved ESG compliance, be able to arrange for a lower cost of capital, such as even 5 BPS as a group, this would imply a considerable aggregate amount which would stay on the balance sheets of operating companies rather than be paid to lenders.

In parallel, there is also a cogent argument to be made to say that improved ESG compliance could have the effect of increasingly enabling additional capital allocators with the opportunity to invest in the gaming and leisure sector whereas they may have been previously absent, thus availing these investors of the benefits of exposure to sector risk and returns as well as providing an increased level of investment to sector growth to proceed at a faster pace. This could include some ESG or sustainability-led funds who are more identifiable and addressable via their self-identification. The 'European Leveraged Finance Association' has recognised this need and is already researching how to make this viable.[7]

[5] http://iacpm.org/wp-content/uploads/2023/05/bain_brief_how-financial-services-firms-wrestle-with-esg.pdf

[6] https://companiesmarketcap.com/gambling/largest-gambling-companies-by-market-cap/
[7] https://elfainvestors.com/publication/esg-workshop-briefing-paper-gaming-sector/

A specific concern that must be addressed in order to facilitate an optimized outcome for all concerned must be improved ESG reporting, tracking and methodologies – particularly with respect to financial indicators. The current approach that investors and operating companies alike have taken is too qualitatively and quantitatively simplistic and does not adequately enable a sufficient understanding of the sector and its unique and intricate factors. As such, evaluating how a given entity has fared versus a peer is almost impossible to establish. While this reality is generally true across the ESG landscape, the matter is particularly acute for the gaming and leisure sector and even more so as regards financial indicators. This White Paper seeks to frame cause and effect specifically related to financial measures which conventional ESG reporting, and methodologies are inadequate in addressing. The major ESG reporting providers include S & P, Fitch, Moody's and MSCI which account for over 80% of the market.

The environmental focus taken by most ESG endeavours does not give due concern and robust interrogation of either the social and governance aspects to which companies adhere. Some companies in the technology space of the gaming and leisure sector do not in any event have substantial environmental footprints to reduce or manage. By using financial and operational metrics as part of the information suite, a clearer picture can be gained in terms of the sustainable and responsible actions taken, or needing to be taken, by a given company. For example, as regards M&A, pre and post acquisition performance of assets, and the process of integration of that particular asset.

c. An Enhanced Solution

As such, via this White Paper we call for an enhanced approach to gauging and reporting ESG compliance and performance which focuses on criteria which are key to financially related outcomes and are industry specific. The current ESG formats will simply not enable the gaming and leisure industry to flourish and achieve its goals. Gaming is held to a much higher standard than most industries as a baseline, and the current simple ESG frameworks do not support such a standard. To gain traction in this regard requires a set of additional critical measures to highlight performance and to clarify intent through an evidenced based approach that is both qualitative and quantitative, well beyond the simple frameworks that currently exist.

The continual reputational damage experienced by the gaming industry requires a transparency around areas of continuing failure such as anti-money laundering, problem gambling and marketing transgressions. Additionally, integration of acquisitions and subsequent performance should also be recorded along with the accountability of Boards. These areas need to be added to the reporting suite to assess the true performance of a given company.

2.**Historical perspective**

a. The European experience

Europe has largely been responsible for the initial reputational damage to the regulated online gaming industry, and this is now spreading across the globe[8]. Wall-to-wall advertising, a disjointed response to problem gambling, and poor compliance to AML and KYC needs has undeniably contributed to the reputational issues of the iGaming model as we know it today. Over 20 years, the European industry grew from a very niche and financially modest proposition to the huge behemoth it is today responsible with revenues of around €38.2bn[9] in 2022. Inevitably, as the industry grew it attracted some less scrupulous operators focused primarily on grey and black markets, often bringing the standards of operation down and creating some of the reputational issues that exist today. The clamouring for growth in unregulated markets, and significant cross-border activities led to many issues such as enhanced regulatory and consumer scrutiny. It is fair to say that some of the more recognised operators have also contributed to this situation despite their relatively recent efforts to gentrify their respective offers. The United Kingdom, the world's single biggest regulated online gambling market at $12.5bn in 2022[10], has increasingly had its regulatory standards and processes reviewed in reaction to this, creating one of the most difficult markets in which to conform. For allocators, Sweden provided another object lesson when investors pivoted from gambling names over the past five years due to the industry's inability to successfully avoid a negative perception.

b. The prevailing attitude of the US and Canada

ESG compliance is a relatively newer phenomenon in North America than in Europe, although it has been an increasingly important movement for many years. ESG has had a more difficult time achieving traction on the western side of the Atlantic and its implementation and impact have met with mixed results. Despite this, ESG compliance is an increasingly important factor and inflows into ESG-compliant or sustainability led funds continue to grow[11].

The United States has emerged as a nation where the ESG agenda has become mired in political debate[12]. Whether real or imagined, implied lower returns as result of ESG compliant investing is being used by certain parties to fight the environmental compliance changes being pushed through by the Biden Administration and has resulted in confusion at best. The critical factor at issue is that ESG compliance remains important for the lion's share of the investment landscape and, despite the politicized assault at the fringes, the ESG movement is growing in importance.

The land-based casino industry in North America has long been subject to the impact of ESG requirements however the industry has arguably not taken ESG as seriously as other industry sectors. The industry continues to fight for smoking to be permitted in certain land-based

[8] https://www.nytimes.com/2022/11/20/business/sports-betting-investigation.html
[9] European Gaming and Betting Association: https://www.egba.eu/eu-market/
[10] H2 Gambling Capital
[11] https://www.morningstar.co.uk/uk/news/228186/10-reasons-why-esg-wont-be-stopped.aspx
[12] https://www.flgov.com/2023/02/13/governor-ron-desantis-announces-legislation-to-protect-floridians-from-the-woke-esg-financial-scam/

casinos, and the recent articles on regulated gaming published by the New York Times[13] have instigated a response characterized by an effort to shut down the issues raised rather than address the matters at hand[14].

The American Gaming Association has published guidelines which the industry has generally attempted to adhere to, and several companies have had the foresight to dig in to seek better outcomes.[15] The development of the online sports betting and limited iGaming markets in North America changes the market outlook to being more akin to the European market, requiring further scrutiny over compliance and optimization necessary. Given the influence of European operating companies in the North American iGaming sphere there is likely cause for streamlined compliance initiatives between Europe and North America despite the variance in underlying markets. European operators have had a head start and the focus is now on the North American market to determine the impact of the next phase of ESG and how it manifests itself.

c. Emerging Online Sports Betting (OSB) and iGaming

The repeal of PASPA allowing single game wagering to be offered in many US states and the liberalization of the industry in parts of Canada is relatively recent and the development of the associated market is nascent. As such, the ESG circumstances surrounding operating companies and investors is evolving. However, there are significant risks associated with an unsuccessful navigation of ESG compliance for all parties. For example, while digital products could arguably be said to be less relevant in the context of environmental concerns, the social and governance concerns – and in parallel financial factors – are considerable. Witness the relatively fresh management cadre now behind the explosion of operating companies, who themselves are marketing gambling products to consumers for the first time in many jurisdictions and contending with the labyrinth of regulatory regimes in North America. Online Sports Betting (OSB) is embraced as an extension of a product that is itself an extension of the sports themselves. iGaming has been less successful, and as such has led to the reluctance of states to legislate in favor of iGaming. To date, only six states allow operators to make iGaming available whereas around 34 are regulated for OSB. The intersection of these market developments and a growing ESG movement undoubtedly creates more attention around the need for focus and solutions which support the outcomes framed herein.

3. SWOT analysis – the industry and specific companies

a. Best practices

[13] https://www.nytimes.com/2022/11/20/business/sports-betting-investigation.html
[14] https://twitter.com/AmericanGaming/status/1594512195186229249
[15] https://www.americangaming.org/esg-landing/

Among several industries pushing to balance comprehensive ESG management with better outcomes, the alcohol industry is a key example for the regulated gaming and leisure sector to contrast itself with. If the industry can ape the concerted effort taken by the alcohol industry over the last 20 years, significant headway is possible with tangible financial benefits. At the time of pending regulatory reform, the alcohol industry united in creating change and established a move in both perception and reputation[16]. To date, the gaming industry has struggled to co-operate or share information to provide a persuasive narrative.

The alcohol industry worked tirelessly to change the narrative and enhance its reputation, campaigning to nullify the press coverage, setting up working parties and trade groups to conduct research and make recommendations. These efforts were ultimately successful, yet despite the perception, the United States has over 15m adults categorised as 'heavy' drinkers[17]. The United Kingdom has been assessed to have just below 700,000[18] problem gamblers of varying degrees, only 0.3% of those that gamble. The contrast with those drinking alcohol at 'increased or higher risk' is surprising given the rhetoric and narrative surrounding gaming, with over 8 million adults falling into this category[19]. Over eleven times higher.

The poster child of the movement has been Diageo following its rebranding from Guiness[20]. It has consistently delivered robust returns, a lack of volatility in share price and earnings, and is considered a mainstream stock by my investors, funders, banks and other capital allocators[21].

d. Stars and Dogs

It is difficult to point to categorical best practice or poor performance. The reality is that even the most advanced companies have mis-stepped as regards ESG. Perfection will likely continue to be elusive in this regard and thus companies and investors must pay continued attention to ensure optimization in ESG response.

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[16] https://www.jsad.com/doi/full/10.15288/jsad.2021.82.84

[17] https://www.cdc.gov/alcohol/data-stats.htm#:~:text=According%20to%20the%20Behavioral%20Risk,drink%20heavily%20also%20binge%20drink.

[18] United Kingdom Gambling Commission

[19] https://www.theguardian.com/society/2022/jan/17/millions-in-uk-drinking-harmful-levels-of-alcohol-at-home-experts-warn. https://yougov.co.uk/topics/society/articles-reports/2022/04/20/part-six-alcohol-consumption

[20] https://d1wqtxts1xzle7.cloudfront.net/11429569/MuzellecJSM08-libre.pdf?1390858808=&response-content-disposition=inline%3B+filename%3DCorporate_Rebranding_and_the_Implication.pdf&Expires=1683545095&Signature=Ae94hNQzUE5c6uEr8Q9w3XjJBgREjTDySx7zSr6bY4vwb5YSm~KvCEGGjMkZW39JSGrqDUzKw-Kz-tii0vHmWjP0Isl7rkyRYpjUjYQlIk14YnjAlsczubZYheyeKjnNh8~MmH0nTaTiDAFh9t3LaLaDHabTv-jwu8vdm12g3W9Q9Bb45GU7QoezZr5iRbQ1jq5LtOgvnzoCxqR6ZpYscUs4a1N3Kdvsox21ZESdD97haNvu9dSnfXE615FaVuWXnVssftils2GBR2FffsnSjNQ9VL5ARJEILZHNfzRIUIH0hMjuZ-Mq-ltNkosONsv3SlWfXZWwu18PzI~FlkctVQ__&Key-Pair-Id=APKAJLOHF5GGSLRBV4ZA

[21] https://sec.ure.diageo.com/media/gofp3ep0/diageo_esg_reporting-index_2022.pdf

When saying that ESG is not enough, the irony is that some of the leading gaming companies in this area such as Entain and Kindred are facing huge fines for AML/KYC breaches. Again, the 'S' and the 'G' comes to bite and adds to the already significant reputational damage being visited upon the sector notwithstanding efforts to date. Clearly, more focus is needed.
Entain has fulsomely embraced the ESG concept fully as of late and this can be seen across all its interactions as a business. But, it has been dogged with regulatory settlements, albeit dating back a considerable period. These transgressions appear to have been rectified, yet there is still much to be uncomfortable about for such a large player in the sector, with ongoing investigations continuing with no immediate end in sight. These matters, unless successfully handled, inevitably affect investor confidence.

At Kindred, the admirable 'Journey to Zero'[22] approach is a real game changer for the industry. Situated at the heart of ESG's gaming Achilles heel of problem gambling, it aims to reduce and ultimately prevent revenues from customers recognised to be at increased or high risk. This is to be applauded yet in contrast this very same company continued to be visibly active in the Netherlands grey market before being granted a licence under the new legislation which in the eyes of some serves as a contrast to Kindred's ESG efforts.

William Hill[23] has recently been fined a record sum by regulators for repeated contravention of the most basic of due diligence tasks. Its new owner, 888.com, now needs to address these legacy issues or face the wrath of the regulator once more.

The mismatch between regulators concerns and companies' responses appears most profound in the UK. Leading European gaming company 'Flutter' has recently announced its intention to seek a listing in the US. This is another blow to the UK gaming sector which is increasingly seen as not overly friendly in both valuation and future trading outlook terms for public companies. Valuation multiples in the UK have remained stagnant over recent years and analysts have suggested significant under-valuation at the peril of market capitalization and other financial indicators.

e. The impact of poor practices and performance

Gambling carries an increasingly damaging perception on the part of the investment community, banks, governments, regulators and consumers. It is unquestionable that some of this has been influenced by the poor practices and performance of certain players. Nonetheless, these actions have apparently infected the public perception of the sector which makes ESG and beyond compliance even more important, especially the financial indicators advocated for herein.

[22] https://www.kindredgroup.com/sustainability/our-journey-towards-zero/
[23] https://www.complianceweek.com/regulatory-enforcement/william-hill-fined-record-237m-for-social-responsibility-aml-failures/32893.article

Europe and the UK have seen numerous examples of reputational challenges in comparison to North America, so far at least. Problem Gambling continues to be the elephant in the room as far as regulated gaming is concerned, and there is a significant lack of trust in the industry and a continuation of negative headlines driving the perception narrative. With continuing regulatory settlements being enforced, share price and valuation pressures have created significant volatility in the global market as recently seen with the then record fine for Entain. The unresolved issues surrounding an ongoing investigation by UK tax authorities and legal action in Australia continues to depress the value of its stock. 888/William Hill recently received a record fine of £19.2m for a business it did not even own at the time of the breach. In fact, since its acquisition of William Hill in July 2022, the share price has declined by over 60%[24]. This equates to over £400m of shareholder value. Arguably, a better approach to ESG-related factors had the potential to mitigate some of this.

The UKGC continues to make examples of what it sees as contraventions of regulatory requirements and April 2023 has seen the release of the Government's White Paper on gambling which doubles down on the measures to protect customers[25]. What is more difficult to decipher is the lack of consistency of the breaches. The headlines always relate to the huge losses incurred over a short time period, but does the same happen with low level play? For example, industry pundits contemplate whether there is a glitch in the systems' algorithm or is this a pre-planned marketing tool associated with VIP level play?

Unfortunately, many of the issues that we see making headlines today are the result of legacies created by challenged acquisition integrations, less-than best practices and inadequate procedures which often presented themselves and were unaddressed for years beforehand, or due to ongoing strategic missteps. As the trend to consolidation continues, it is difficult to see the direction of this evolution diminishing anytime soon.

f. The impact of best practices.

In the developing ESG realm, it is surprising that there are not specific industry standards tailored to the gaming and leisure sector and that companies. Investors and intermediaries employ a raft of basic standards and checklists, mostly generalist. Our objective is the change this as regards the gaming and leisure sector. Think of it as "weaponizing ESG".

At present, best practices are patchy across the sector[26]. ESG reporting is inconsistent at best, and there is no single standard generally or within any specific industry with numerous reporting frameworks. Most of these are a combination of simple but arbitrary quantitative or qualitative checklists, and as regards the gaming and leisure sector none are sufficiently revelatory so as to fully support the objectives outlined herein.

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[24] https://www.google.com/finance/quote/888:LON?sa=X&ved=2ahUKEwi-_5bErob-AhWKFMAKHT1DAQkQ_AUoAXoECAEQAw&window=1Y

[25] https://www.gov.uk/government/publications/high-stakes-gambling-reform-for-the-digital-age/high-stakes-gambling-reform-for-the-digital-age

[26] https://quantive.com/resources/articles/esg-frameworks

Many ESG tools providers emanate from, and tend to focus upon, the more tangible Environmental pillar. This is no surprise as when Social and Governance aspects are considered, there is a more nuanced, soft skillset required. Furthermore, in the case of the gaming industry the approach of the incumbent ESG tools providers is certainly high level or “top of the waves” at best. The real S and G performance data and analysis is not unlocked for the benefit of any party, with a lack of interrogation of real performance in these areas. Concurrent with the industry’s struggles with problem gambling, no traction can be gained in ESG if the industry does not provide accurate and transparent data to support its performance. An improvement on the ESG data and analysis available needs to be a concerted and targeted effort by the entire industry encompassing companies and investors.

There is a large slate of ESG reporting tools which incorporate benchmarks and data from the checklists and apply them to a company or investors ERP or related platform for the ingestion and management of data and analysis. On the plus side, the fact that many enterprises and investors have such tools to manage data collection, reporting and communication leaves them prepared to improve their ability to benefit from stronger ESG compliance. However, given that these inputs are qualitatively lacking, the ability to engineer an improved impact from the financial objectives outlined in this White Paper are impaired. For example, Capterra compares 99 suppliers of generalist ESG reporting tools, which is likely just the tip of the iceberg, and zero providers of the kind of detailed analysis the Authors feel is necessary. [27]

In Europe, standards have evolved on the back of certain countries tightening requirements for initial player sign-up and throughout the customer journey. At entry level, these include customer identification, age limit confirmation, spend limit options and self-exclusion provisions, thus de-risking many of the factors for which regulatory settlements have been concluded.

Utilising existing data inputs alongside increased transparency and actual company data, a more sustainable approach that incorporates access to financial data and analysis is needed that is not typically available in the gaming and leisure sector.

In order to achieve a greater impact, the ESG approach of leading companies needs to extend to wider data collection and inputs engineered to reveal a more detailed analysis to really foster relevance. Despite the lingering effect of potential regulatory action impacting some leading companies, significant work carried out on problem gambling, in particular, has as yet not developed into any tangible recognition. Regulatory or taxation investigations inevitably take time, and this is not helpful when trying to distance a company from a past outcome.

We again refer to the alcohol industry which has shown that real progress can be made with both a concerted and combined effort with Diageo leading the way and ranking highly.[28].

[27] https://www.capterra.ca/directory/33377/esg/software
[28] https://www.sustainalytics.com/esg-rating/diageo-plc/1008254026

However, gambling and leisure sector companies are not remotely united, and do not approach either the problem or the opportunity as a collective. In addition, many companies are a significant distance from the basic requirements required to be on the path to sustainability. As cited, this lack of momentum and unification adversely impacts the whole sector. It has taken the alcohol industry close to 20 years to 'gentrify' its credentials in the form of the significant progress it has made[29]. The US is set to see CAGR of around 10% over the next 5 years in alcohol industry growth[30].

Yes, there will always be investors who will not touch the so called 'sin' companies, but alcohol's resolute and successful approach to ESG has offered a wider field of capital inflows and company valuation than would have been available previously[31]. Furthermore, the press and therefore public perception narrative has changed completely for the better[32].

4. Cause and Effect

a. Key indicators and what they portend.

The existing ESG frameworks and checklist approach may serve the purpose for some to "check the boxes", however as the responsible investing movement evolves a much more detailed approach to data and analysis is required. Although none of these providers even approach such levels of data and analysis, they are sufficiently embedded with companies and investors. It is necessary to propagate a view on the part of operators and investors alike that such expanded and focused inputs are necessary to improve the ability of all to determine accurate and relative performance.

b. What the industry needs

The authors are recommending a hybrid approach which takes full advantage of current practices and validated approaches and integrates critical indicators customized for the gaming and leisure sector which enables the collection, management and tracking of extra factors which support our thesis and its proscribed outcome. In due course it is envisaged that this approach can also be extended to other sectors. The headline elements include:

- Fit for purpose ESG requirements -building on current provider data

[29] https://www.google.com/finance/quote/DGE:LON?sa=X&ved=2ahUKEwihl_P2r4b-AhUyoFwKHbvEDWQQ_AUoAXoECAEQAw&window=MAX
[30] https://www.grandviewresearch.com/industry-analysis/alcoholic-drinks-market-report#
[31] https://www.macrotrends.net/stocks/charts/DEO/diageo/stock-price-history
[32] FTSE Women Leaders Review: Achieving Gender Balance (2023). https://media.diageo.com/diageo-corporate-media/media/ttuj0xel/2022-ftse-women-leaders-review-final-report.pdf

- Additional 'Operational' and 'Performance' data and analysis
- Built in applicable UN Sustainable Development Goals requirement
- Detailed inputs of ultimately an additional 100+ data points

By utilising a balanced approach to ESG principles along with operational and financial performance indicators above, a dashboard of the true performance of a company is created. With gaming companies benefitting most by exceeding the reporting standards of other sectors to demonstrate over-compliance, key elements can be addressed within these categories such as:

- Responsible gambling factors
    - Safer gambling measures
    - Customer screening
    - Protection of minors
    - Treatment support

- Compliance
    - KYC/AML
    - Identity verification
    - Personal data
    - Temporary accounts
    - Enforcement actions
    - Management Background and Ongoing Performance

- Marketing
    - Advertising
    - Bonus provision
    - Cost per acquisition
    - Social and media reputational profile

All of the above would have subset data inputs and be weighted in terms of priority where required.

c. "Watch out" factors as regards the dawn of an ESG Fintel Solution

Of course, the creation of a new solution which addresses the concerns focused upon herein is full of challenges and risks including:

- A current lack of cohesive and relevant data to quantify the problem
- Slow adoption by those who may benefit the most.
- Is the prize of more profound ESG reporting and compliance attractive enough?
- Will such a product really influence valuation and borrowing rates?

- Will it be too big of a burden for the companies to comply with? Put another way, how can the industry adopt an evolved approach that is able to be successfully implemented such that it has the desired effect?
- Will the investment industry buy-in to the proposition?
- Can an emergent, industry-specific approach truly become an industry standard in the face of other partially relevant products?

The authors do not want to oversell what benefits can be achieved through more rigorous attention to ESG in gaming but recognise that the industry needs to change in a meaningful way to put a stop to the decline in reputation and tackle tangibly improving the situation. Put another way, what is the downside to more diligent application of a custom approach with the objective of improving more granular ESG compliance leading to better visibility on equity value and credit? Furthermore this approach is also designed to dovetail seamlessly with current corporate or regulatory reporting requirements. The authors posit that the outcomes associated with such an approach would yield substantial upside for both operating companies and investors. Hence the approach of 'Weaponizing ESG".

<u>Best case and impact – industry and regions</u>

The ESG Fintel approach is focused on the US and European markets where the ESG movement is most advanced and the adoption of such a model as the 'standard' or 'go to' for the gaming industry is the ultimate goal. In addition, it is anticipated that showing evidence across a transparent dataset will increase the adoption for the wider ecosystem related to gaming such as banks, investors, insurance companies and large accounting firms. Recognition across the gaming ecosystem as a level of performance that reduces hurdles for operating companies currently in place would be a significant step forward. Accreditation or acceptance by institutions, funders and investors alike is the target, with ultimately other wider buy-in achieved. This approach could apply to regulators, insurers and others that are applicable to the gaming and leisure sector.

<u>Conditions needed for adoption.</u>

d. Worst case and impact – industry and regions

The gaming sector has to date accepted the status quo, unable or unwilling to unite around enhancing itself for the overall good of the industry due in part to lack of visionary leadership and organization. With the onset of further ESG requirements, complacency is no longer an option. Those that embrace and adopt to the new reality will survive and flourish. Those who do not may be forced to either move to grey or black-market activity or leave the sector altogether.

<u>5. Key success factors</u>

a. <u>ESG Fintel – Tangible benefits of enhanced ESG reporting</u>

Only when the relevant data is gathered will the quantum of the problem be validated and the solution fine-tuned.. Notwithstanding, a combination of factors built around reputational issues and ESG FINTEL will enhance companies ability to:

i. Achieve better liquidity and higher company valuations.
ii. Seek and borrow debt capital at a more competitive cost of capital.
iii. Address the strategic and inherent risk for investors in gaming companies.
iv. Provide for stability and the emergence of a consistently investible group of names.

By addressing the core principles around the value chain and providing a detailed and involved commentary on how a company performs through data, we believe the industry can improve how it is perceived and ultimately improve its reputation to many stakeholders or interested parties. The gaming industry is a complex sector due to a number of complex factors. Multiple jurisdictions, unique licensing systems by jurisdiction, regulatory intervention concerns and differing perceptions.

b. Critical criteria going forward – what has to happen?

The first job is to collect the inputs while at the same time confirm the industry's self-interest in doing so. As mentioned, the current models are restricted in their ability to look at gaming industry specific data with the knowledge required as they tend to be generalist and linked to, or concentrate on, a wide number of sectors. ESG Fintel is also intended to embrace other compliance heavy sectors where variants of the datasets can be substituted if required using the same intuitive AI/ML platform.

The gaming industry is significant in size and does require a more detailed approach in reality if it is to be judged to a similar level. For this to happen, the underlying data inputs need to build a wider understanding to a discerning and judgemental audience. Only then will the credibility of the industry have a true measure.

For the industry to be sustainable, it needs to supplement the current ESG methodology with both operational and financial objectives and inputs to recognise other risk items that are somewhat unique to the gaming industry and its understanding.

For example: how has a given company performed operationally? Is it exposed unduly to high risk or gray markets? What is the risk of ongoing or potential regulatory investigations? What progress has it made in its problem gambling approach? All of these areas give a clearer understanding of the strategic approach and consequential risks associated that at present are not included in the detail with any of the current frameworks available.

c. A methodology based on open-source company reporting.

The extension of the ESG methodology needs to be focused on a combination of primarily reported information. These sub-sets allow a more detailed and accurate picture to be built of the company. Additional inputs would be sector specific and weighted based on the methodology employed. A higher weighting would typically concern an elevated risk such as problem gambling or regulatory intervention.

6. Outline of new approach and objectives

a. How to get there?

This White Paper is intended to be the stimulus to utilise the experience and thought leadership across the gaming industry, capital allocators, investors and the wider gaming ecosystem. By aligning the requirements of both industry and financial institutions, it is hoped a pathway to easing some of the current requirements and dismantling some of the roadblocks that face the gaming sector.

b. Roadblocks and how to overcome them?

In financial terms, the real roadblocks to progress stem from allocators and financial intermediaries. Some investors have retreated from the sector largely due to AML and KYC concerns relative to their own onboarding processes. Institutional investors are often precluded from investing in gambling companies as many perceive it to be a 'sin' stock. Capital is still available in the market, particularly to the larger companies, but this comes at a price. Still, some very large institutions are active in the public and private markets; Blackstone, Apollo, and many others.

The threat of political intervention, particularly in the United States, has also polarised the ESG debate. Despite ESG requirements continuing at pace, business improvements linked to these initiatives are likely to face increased scrutiny. It is therefore essential that the messaging of any proposal is expertly crafted. Despite the politicization of ESG in parts of the United States, there is no evidence to suggest the movement is going to disappear. As such, the market needs to optimize around it as to not do so would be at mutual peril.

The recent claims of 'greenwashing'[33] have also not helped the ESG cause, but in terms of gambling, this is of little real relevance. The touchpoints around both social and Governance

[33] https://www.ft.com/content/780c931c-aa9f-4fb7-a229-426c14f61563

issues are the real deal. How the industry reacts and conforms to the wider framework, albeit under the umbrella of ESG, will determine whether it has a sustainable future[34].

The industry, whose focus is on regulated markets, needs to consolidate its position and show best practice through the use of robust and transparent data. This can be across the ESG suite along with gambling related specialisms including responsible gambling and regulatory factors, measuring success as well as areas for improvement.

c. Forecasting impact of an enhanced industry effort

By having a unified data set and utilising an approach such as that represented such by ESG Fintel could yield real benefits to the enlarged ESG reporting agenda. Transparency and clear use of data methodology can provide a much more rounded product that is easily analysed by stakeholders and with the ability to:

- Pre-empt investor queries and information requirements.
- Create meaningful comparison like for like data on sector competitors.
- Enable a wider group of capital allocators to the market.
- Prevent funds closing down options or introducing increased costs for gaming companies.
- Provide information for fair valuation of gaming companies.

d. Caution points

The gambling sector has to date consistently failed to move the dial as a group in areas such as responsible gambling, financial risk and banking provision. To do so in this instance will also be difficult. While data is available to make sense of entities within the regulated sector, to provide the momentum required for change, a more sophisticated and detailed approach will be required than currently exists or else the sector will continue to trail the market. While this is possible without co-operation from the industry, collaboration and disclosure has real and attractive merits for all parties. Greater transparency and industry input would greatly enhance any product and form the basis of real measurement of key data points.

7. Next Steps

In this White Paper, we have sought to set out the status quo for the gaming and leisure industry as regards ESG. In parallel we have attempted to posit a thesis around a profound pain point and also a solution that, if even modestly successful, could provide a real and quantifiable

[34] Myers, S.J., 'The Global ESG Conundrum' (2022). https://casinobeats.com/2022/08/16/myers-musings-the-global-esg-conundrum/

advantage to companies and investors. This solution, which we are calling ESG Fintel, is a proposed ESG and financial tool tailor-made to achieve the outcomes described herein.

For the gaming and leisure industry, ESG is clearly a matter where the level of concern varies greatly by company and by geography. It is understandable that a given party may not have a significant concern at present re ESG, particularly in North America. However, like it or not, ESG is a fast-moving freight train whose impact will increasingly be felt far and wide no matter the jurisdiction.

Across all industries, ESG is moving toward full organizational integration in terms of reporting in many organizations. Critically, reporting does not change performance, and this is where the industry needs to pay attention as there are growing benefits to demonstrating good performance and the specter for penalties looms for poor performers.

The reality is that the industry does not a have a technology product that can perform to the level as described in this paper. Much of the information exists, but it is fragmented and not available on one single, navigable and complementary place for companies and investors.

It seems logical that there is a gap in the market for a product that creates sustainable ESG goals through inputs that are investor friendly and understood by both analysts and capital allocators without creating further burdens on the gambling industry. A successful implementation of ESG Fintel could also have the attractive and game-changing by-product of having a platform recognised by investors, enabling access to more competitive cost of capital and by also opening doors to investment opportunities not currently available. As a consequence, the de-risking of the participating companies through enhanced understanding of financially based data and analysis as described herein could further help to reduce volatility in share price movement and impact valuation. As such, “weaponizing ESG”.

More research is being undertaken to develop the findings of this paper and evolve ESG Fintel in order to support the gambling and leisure ecosystem in its entirety, along with banks, insurance companies and investors alike.

The authors propose to proceed with such an initiative following feedback from this White Paper and further research.

As such, we welcome any and all qualified feedback and data in order to enable optimization of how the gaming and leisure industry successfully contends with the growing ESG movement and is able to manage it as an opportunity as opposed to a threat.

8. About the Authors

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Robert Montgomery is an investor and entrepreneur focused on the gaming, digital media, entertainment, business services, investment and technology industries. Robert is CEO of investment and advisory firm First Maximilian Associates / Axel Industries where his activities include an ESG product and advisory company, originating and leading buyout transactions, and investment and advisory for business services, marketing, gaming and digital media companies.

For many years Robert has been an executive, director or advisor for gaming and leisure, media, communications, marketing services and technology companies as well as the investment community, and is currently an active investor in emerging companies.

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Steve works in iGaming and land-based environments for both public and private sector clients. He has substantial experience in giving evidence to numerous Authorities, Governments, Civil Servants, and politicians. Increasingly, his focus is on ESG and reputation of the industry. He is a graduate of the UNR Executive Development Program where he also taught, and has a Masters in Major Programme Management from the University of Oxford along with a master's in law.

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