GAMING INDUSTRY FACES BLEAK SHORT-TERM OUTLOOK

(THOUGH ALL BETS REMAIN ON THE HOUSE)

By Sherri Snyder

From Small Town USA to highly industrialized China, there's hardly an establishment that hasn't been touched by the financial crisis. And the gaming industry and its suppliers are no exception. The biggest decrease in consumer spending since Sept. 11 is only one of the many factors woven together to create the current environment of the gaming industry.

Mix a worried consumer with natural disasters, high gas prices and the inability to borrow, and you've got a potent cocktail that reminds us the market is not a creature of uniform habit. "When you're looking at the gaming industry and trying to talk about the health of the gaming industry, remember it's not monolithic," stated Frank J. Fahrenkopf Jr., president and CEO of the American Gaming Association. "You've got to look at various parts of the country."

The first look is at the market itself. Big-name companies like MGM Mirage, Wynn, Las Vegas Sands and Boyd Gaming all sank close to their 52-week lows in the fourth quarter of 2008 as investors lost confidence in the overall market.

Although consumer spending plays a significant part in the economic challenges facing the gaming industry, the liquidity crisis trumps the decline of tourists and gamblers. The dismal state of our banking and lending system leaves blueprints for casino expansion, renovation projects and technology upgrades gathering dust.

In November, Pinnacle Entertainment announced it was halting the construction of a $2 billion mega-casino on the Atlantic City Boardwalk.

MGM Mirage put a hold on its $5 billion project in the Marina district near the Borgata Hotel Casino and Spa (which reported the layoffs of 400 workers, or 5 percent of its workforce on Nov. 6). The funds to complete projects are either hard to come by or best left in the bank.

"The lack of liquidity in the marketplace in the banking area hurts us because expansion and growth is really the hallmark of the casino and gaming industry," said Fahrenkopf. "The inability of bank lending leads to project cancellation."

Project cancelation translates into less expansion and casino floor room. But the woes of the gaming industry are deeper than the casino itself. The global gaming supplier segment generates $33.2 billion of economic output, nearly matching the $34.1 billion output of the commercial casino industry in the United States. An integral part of the gaming industry, these core suppliers, from a manufacturing aspect, are taking a hit as casino operators hold off or decrease the purchase and upgrade of technology, machine replacement, and other measures to save money.

The Association of Gaming Equipment Manufacturers (AGEM) Index represents 16 global gaming manufacturers of electronic gaming devices, systems and components in the gaming industry. As of October 2008, the AGEM index lost 20.54 points, to 71.57 from the close of 92.10 in September 2008, representing the largest one-month drop since the inception of the index in January 2005. Global gaming supplier International Game Technology (IGT) contributed the largest loss in the index. The company said the 4 percent fall in full-year earnings, to $2.6 billion, was because of a frugal customer base, the casino operators.

IGT previously developed server-based gaming technology, which came with a hefty price tag that many operators could not pay. To climb this hurdle, IGT is sharpening its focus on partial-floor solutions, and the company now finds itself in a more flexible position to generate revenue and maintain a customer base.

Another blow facing the gaming industry is cigarette bans on the casino floor. According to Fahrenkopf, no-smoking laws could create a 20 percent hit on a casino within the first year. When Illinois and Colorado banned puff and play, both suffered significant downturns as players left the table to head outside for a smoke.

Atlantic City recently lifted its smoking ban to cushion area casinos. For the first nine months of the year, Atlantic City casinos won $3.6 billion, down 6.3 percent from the same period in 2007. September saw the worst-ever monthly decline in revenues, down 15.1 percent. Though not all declines are attributed to the smoking ban, the longer each player is in his seat, the more money the casino makes.

And nothing will get a player out of his seat like a hurricane. Mother Nature occasionally wreaks her havoc on the Louisiana and Mississippi Gulf Coast, but this year's hurricane season didn't devastate the region like it did in 2005. The effects of Hurricane Katrina were crippling to coastal casinos, though the recovery efforts have proven successful, as Louisiana and Mississippi operations have regained their footing.

Thankfully, when Hurricane Gustav took shape and headed for the coast, only minor structural damages were reported, though precautionary evacuations, mandatory closures and storm surges left many casino seats empty, resulting in decreased revenues for some casinos in September.

While they do have to worry about storm surges and toppling winds, southern casinos aren't hindered by smoking bans or new competition. Still, the Gulf Coast region isn't beyond the reach of the credit crisis, which has halted the construction of several casino and condo projects in the area.

On the back end of hurricanes come torrential rains, and the Midwest suffered through near-record flooding in the spring thanks to Hurricane Ike. The swelling Mississippi River caused the floating President Casino in St. Louis to shut down several times this year because of high water.

the gaming industry has managed to side-step the cyclical nature of the market and keep its head above water. And although hard times are far from over, consumers are looking for a temporary way to forget their own problems. And with the return of the bull market comes the celebration of relief and perseverance.

"People want to go on trips, go to Vegas, gamble and have fun," said Michael A. Tew, principal at Sand Hill Research Partners. "Las Vegas is always one of the first places to recover when the economy begins to bounce back. The town is a celebratory town—that's the whole point of Las Vegas."

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So if it's not consumer spending, increased competition, the credit crisis, smoking bans or natural disasters, what else could go wrong? Prices at the pump affected the industry as well. And it wasn't just on the road; it was in the air. As major airlines jacked up flight prices, fly-in markets like Las Vegas were hit just as hard as the drive-in markets along the coast when gas hit $4 a gallon.

With the fall of the price of a barrel of oil, the drive-in markets are getting a bit of a break. But the Vegas market still feels the loss of the high-margin customer, and it is losing a significant amount of money as regular visitors cut back on spending and travel.

Airline prices are still relatively high, so for Vegas and Atlantic City, attracting those customers means slimming hotel prices while fattening bundled packages.

According to Professor David J. Paster from the University of Southern Mississippi's College of Business, the gaming industry has experienced a shift in the last 10 years. Although gaming activity has decreased in the past five to 10 years, auxiliary activity has grown. People are spending more time in the casino hotels but less money on the floor. Shows, clubs, fine dining, spas, golf and other leisure activities are benefiting; Vegas and Atlantic City are more than just slot machines and blackjack tables. Bundling these activities into a package for a discounted price lures customers looking for a temporary escape from their stresses and searching for a cheaper excuse to blow some of that cash tucked away under the mattress.

"One thing we've learned over the last 10 years is that the commercial casino industry is viewed as an entertainment alternative for discretionary spending, and that people will still go to destination resorts," Fahrenkopf said. Fahrenkopf relates the gaming industry to the entertainment industry in the Great Depression. "The golden years of the motion picture business was during the 1930s, during the Depression," he stated. "People saved all week, and then went to the movies on the weekend to get away from their problems. As we come out of this economic misery, I think the first thing people are going to do is return to the entertainment industry, the tourism industry; they're going to want to get away and enjoy themselves."

And not only will those with an eye for a new car or theatrical show return, but the gamblers will come back as well, enticed by the lights, the sounds, the people, the environment, the fun, the risk and the cash. That Great American Dream oftentimes lives within that slot machine or right behind the next blackjack hand.

It's the shared interest in gambling and auxiliary activities that will spur a recovery for the industry, just as it has in the past. Historically,

Casino operators hold a special regard for customers and their habits. The commercial casino industry is a living organism, constantly doing what it can to stay ahead of the game and build and keep customer loyalty and interest while ensuring smooth casino operations. Hotel/casino operators know what the customers want—and they know how to give it to them.

While the industry may be losing some of its marginal players, as soon as the scale tips toward a favorable market balance, people will be ready to spend some cash.

"One thing about the people in our business who operate these magnificent hotel/casinos is they understand their customers; they understand what the customer wants," Fahrenkopf said. "They're very responsive to what the consumer wants."

Although recovery is still a small dot on the horizon, the entertainment and gaming industry will be the first to come into focus.

"Las Vegas is a resilient market," said Tew. "However, we are looking at a very slow recovery, particularly given all of the new supply scheduled to come on line in the coming 12 to 18 months. Additionally, the market is devoid of capital—for businesses and consumers. Consumers are not spending money, and we do not know when that dynamic will recover."

According to Paster, part of the recovery is going to be the ability of hotels and casinos to gradually increase their prices without losing customers in the process. But if consumers are willing to play, they're usually willing to pay.

And as Fahrenkopf stated, the casinos know what the customers want, and they know just how far they'll go to win, save, spend and stretch that dollar.

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