



The Future of Gaming in Atlantic City and the U.S.

By Robert Heller

The futurist, James Burke said: “To predict the future we must look to the past, because... there is nowhere else to look!”

Looking back to 1931 when gaming was legalized in NV and tracking gaming until today, we can see four themes:

- I. The industry has been tamed, moving from the “wilds” of the desert to our cities and into our homes.
- II. Gaming has matured and stabilized, moving from a few states to many, from the hands of entrepreneurs to those of institutions, and from a destination experience to one of convenience.
- III. It is a large global business.
- IV. Two unique gambling based entertainment cities thrive, Las Vegas and Macau; and Atlantic City still has a chance to become a third.

I. Domestication

Gaming began in a frontier town where gamblers and prostitutes practiced their professions legally. Forty years later, a sanitized version moved to Atlantic City, a fading resort town.

Twenty years later it came to the rivers in America’s Heartland, floating on boats down the Mississippi River in Iowa, Indiana and Mississippi, but still in no one’s backyard. Then it came inland to other towns down their luck and away from population, such as Tunica, MS, and Black Hawk, CO.

But the draw of tax revenues and

developers’ aspirations brought gaming closer to population centers, like downtown New Orleans and Detroit. It proliferated in the suburbs around places like St. Louis and Kansas City.

Ultimately, it came to large cities like Philadelphia and New York. Now, Wynn Resorts is developing a \$2B project six miles from Boston, and Paul Fireman proposed a \$4B project in Jersey City on the banks of the Hudson River, just three miles from Wall Street.

Casinos are now everywhere. So what is the future?

It is coming right into our homes. If you live in New Jersey and Delaware, it’s already there, and in Nevada, online poker is available. High stakes poker will come with interstate compacting. Daily Fantasy Sports games are available online in most

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U.S. states. Social casinos are a simulated experience but have grown substantially. In 2014, Caesars generated about \$180M from its Caesars Interactive subsidiary, as much as from all three of Caesars' AC properties combined.

II. Maturation, expansion, consolidation

The gaming business went from being a semi-criminal enterprise, to the place where pension funds invest for a safe yield. The 1988 passage of the Indian Gaming Regulatory Act legalized tribal casinos. By 2013, tribal gaming accounted for 42% of the total industry. The massive expansion of commercial gaming from 1995 to 2007 represented a 12-year compound growth rate of 8%, rising from \$16B in 1995 to almost \$40B in 2007. The industry declined, along with similar entertainment businesses, in the Great Recession, falling 9% by 2008. The less than 1% growth rate since then reflects a mature industry.

This growth required a lot of capital. By the late 1960's, the plans for casinos in Las Vegas outgrew the mafia lenders. Nevada changed the gaming laws to allow public company ownership. Since then, gaming has been dominated by public companies accessing Wall Street capital to build ever-larger projects.

Like most expanding businesses, gaming enterprises began to consolidate to gain operational and financial efficiency. In 1995, Gaming was a \$16B industry with at least thirty U.S. public gaming companies. Now the industry is 2.5 times larger, yet there are fewer than twenty public companies. Today, MGM and Caesars alone own over 80% of the 85,000 rooms on the Las Vegas Strip.

I predict that within five years only two-thirds of today's U.S. public gaming companies will remain.

Consolidation in gaming has led to institutional ownership. Pension funds, mutual funds, and hedge funds own most of the stock in public gaming companies and several operators are out-right controlled by licensed private equity and hedge funds.

As the business moves from the entrepreneurs to institutional investors, the funding approach is changing. Investors view gaming as a real estate based entertainment business, like hotels, ski resorts and theme parks. Part of the business success comes from its real estate elements – building and location – separate from the quality of the operation.

Enter the Real Estate Investment Trust, aka a “REIT”, which is viewed as less risky by investors. In 2013, Peter Carlino, one of the great visionaries of the regional casino business, split off from Penn National Gaming, a REIT called Gaming & Leisure Properties, leaving PENN as the operating company. Because of the difference in valuation metrics of real estate and gaming, PENN stockholders generated about 30% profit post-split.

My outlook for the future: In five years, we will have at least three gaming REIT's, one possibly spun out of MGM or BYD, and GLPI will double in size. Caesars, which is going through a restructuring, may spin off a REIT; that REIT could become a big force in the business.

III. Globalization

There is only so much gaming to exploit in the U.S., so the larger companies looked abroad for new growth opportunities. In 2001, Las Vegas Sands made a deal to build a casino in Macau and got a coveted license that made Sheldon Adelson one of the richest men in the world. Wynn and MGM followed suit. By the time Caesars tried to enter the market, it was too late.

In China gambling is more socially acceptable, with a population three times the size of the U.S. and an economy growing at three times the rate of the U.S. The GGR results were extraordinary – \$3B in gaming revenue in 2002 to \$44B in 2014, a 12-year CAGR of 32%. One city generated 68% as much GGR as all of the U.S.

With that success gaming spread to neighboring countries like Singapore and Philippines, Korea, Cambodia and Vietnam. These have

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offered good and not-so-good opportunities, but the next big prize is Japan, where two casinos could cost up to \$10B each to build.

Dependence on a control-economy such as China is risky. As the Chinese Government cracks down on corruption, we are seeing 40% year-over-year declines in Macau gaming revenue. At the same time, the economy slowed and credit markets tightened. This is happening just as six new multi-billion dollar properties are set to open over the next three years. This is the reason WYNN stock price is down over 50% over the last twelve months and LVS and MGM are down a third.

Global expansion will continue to be an important part of gaming. Some Asian gaming companies are now here in

the U.S. Asian gaming giant Genting owns the #1 grossing casino in America – Resorts World at Aqueduct Racetrack in NYC and is now building a \$4B Asian themed casino that will include a replica of the Great Wall of China, pandas, and a water park.

LVS spent three years working on a \$40B development in Madrid, which did not obtain enough support from the EU to make it feasible. However, Europe may now be ready for a transformation. The government of Cyprus is trying to attract an integrated resort by offering one gaming license with 15-year exclusivity.

So what is the future of gaming globalization? More U.S. companies will seek growth overseas, more foreign companies will come here. We may see a foreign com-

pany buy a U.S. operator. More foreign jurisdictions will legalize gaming around the world and the early participants will reap the rewards. Eventually, a U.S. company will step foot into a big project in Latin America.

IV. The Gaming Cities

Concluding with the final theme - if everything is so big, bland and corporate, where is the opportunity for differentiation?

Las Vegas has already shown how to be different, how to reinvent itself via consolidation of gaming, lodging and leisure into multi-faceted entertainment “department stores.” GGR grew by almost 5x from 1984 to 2014, while gaming revenue shrank from two-thirds to only one-third of total revenue.

The Las Vegas transformation over the last 25 years happened while gaming was spreading across the country. Las Vegas was inventive and resilient. In the early 1990’s, MGM built a theme park and Wynn built Treasure Island, family-friendly entertainment. That trend failed to develop and was replaced with celebrity chefs, Cirque du Soleil shows, ubiquitous adult entertainment, and an adult theme - “What happens in Vegas, Stays in Vegas.”

Comparable to Las Vegas, Macau will remain a unique gaming and entertainment hub. There are six new properties under construction, adding 50% to the Macau room supply by 2017. Accompanying this expansion are some great non-gaming attractions including a movie studio, themed hotels, and LV-like shows and architecture.

Like LV and Macau, Atlantic City too can offer something special and needs to develop its non-gaming appeal. It has close proximity to massive population, a large, mostly unused airport, a world-class beach, and a fascinating history. What American hasn’t played Monopoly?

Atlantic City has underutilized infrastructure - over 20,000 rooms; 1.3M SF of convention space; the longest boardwalk in the U.S. at 4 miles; 700-slip marina; 19 golf courses within 1-hours’ drive; and great shopping including the Quarter, The Walk, The Pier Shops and Bass Pro Shop.



We are seeing the beginnings of a renaissance:

- Tilman Fertitta spent \$150M transforming Trump Marina into the Golden Nugget.
- Carl Icahn renovated the Tropicana with restaurants on the Boardwalk and a sound and light show.
- Morris Bailey and Mohegan Sun introduced Margaritaville at Resorts with a beach bar and restaurant. “Resorts” is also bridging land based and internet gaming with the first Internet gambling lounge adjacent to the casino floor.
- Harrah’s introduced a dome-covered pool/club experience to create a summer atmosphere year-round and is now building a new convention center.

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- Revel could still be a catalyst for AC if a big vision is executed like combining with Showboat and building a water park between the two projects.

The city has the right mayor now – Don Guardian – a booster and facilitator of

change and improvement, but Atlantic City needs a faster expansion into non-gaming.

Surprisingly, funding could come from Northern NJ. Casinos in Northern NJ will hurt the gaming business in AC only a little as Northern NJ customers already visit convenience gaming locations in New York and Pennsylvania. NNJ gaming tax revenue could send a billion dollars to AC over ten years and AC could lever that into \$5B – \$10B in development – big numbers that could bring a “sea change” for AC’s future.

AC should seize this opportunity quickly as its monopoly on gaming in the Northeast is long gone, and the state needs the tax revenues. AC needs a new game, and it’s not called “Monopoly”. With money from Northern NJ, AC could join Las Vegas and Macau as one of three unique gaming and entertainment hubs in the world. ♣

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