

The state of the casino industries

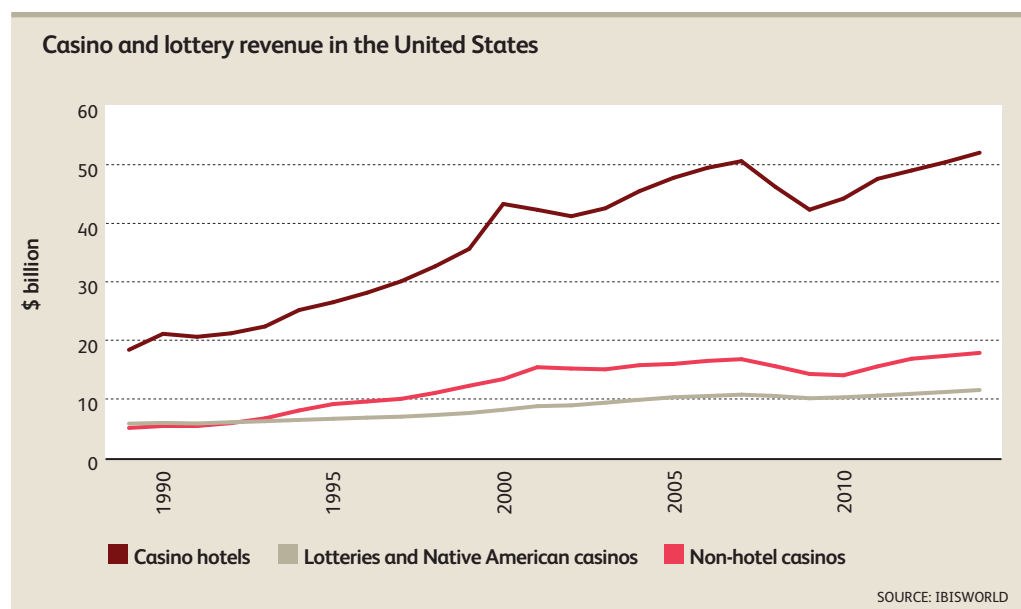
The U.S. casino industries today

The economic crisis that has gripped the globe has had a profound impact on the casino industries in the United States. In fact, combined revenue for the three core gambling-related industries (Casino Hotels, Non-Hotel Casinos, and Lotteries and Native American Casinos) throughout 2009 will slump to levels last seen in mid-2003. At year-end, revenue for the industries will have decreased about 14.6% from 2007 (when the combined revenue peaked at \$78.18 billion) to \$66.76 billion.

The greatest falls have occurred within the Casino Hotels industry (down by

16.4% since 2007) and the Non-Hotel Casinos industry (down 15%). The economic crisis has affected many of the key sensitivities and demand drivers for these industries, and subsequently this has influenced gambling activity and overall revenue generation.

First and foremost is the economy's impact upon tourism. Casinos are highly sensitive to changes in domestic and international travel. Domestic demand in the U.S. Tourism industry is down about 6.6% since 2007, and this has resulted in less being spent at casinos. Lower demand for hotel rooms, gambling, food and beverage and other forms of entertainment have all occurred over



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the past two years. Less travel is being observed both domestically and internationally, and fewer high rollers are spending their hard-earned money within the U.S. market.

As noted, it's not only lower levels of gambling activities that have been affected by the decline in tourism – there are various other revenue streams that have been influenced. Gaming tables and slot machines make up about 66.4% of all revenue for a hotel casino, which means there is still a substantial one-third of revenue to be had from other activities. Accommodation (which generates 13.1% of industry revenue), food and non-alcoholic beverages (10.7%), alcoholic beverages (3.1%), entertainment, meeting facilities, convention centers and merchandise sales have all observed lower levels of sales due to the decline in tourism. The casino sector is highly competitive, and thus all possible revenue streams must be explored in order to maintain profitability and attract a solid customer base. Consequently, a casino must provide entertainment experiences that go beyond the core product of gaming to minimize overall losses and maximize competitiveness.

Second to tourism has been the national level of unemployment. Unemployment has reached 10%, and it's likely to remain near this level for the better part of 2010. This will continue to suppress overall household disposable income, which will reduce consumers' ability to travel to casino destinations, partake in gambling, book hotel rooms and wine and dine, thereby constraining growth for the industries.

U.S. casinos have also begun to observe greater competition from around the world. In 2007, Las Vegas was replaced by Macau as the global center of casinos and gambling. This has negatively affected revenue for U.S. casino operators, as they compete to be the number one gambling destination

for high rollers. Recently, however, the Chinese Government has implemented restrictions on access to Macau by Chinese nationals, which has negatively affected demand, thus slightly assisting international visitor numbers to the United States. Overall, however, the increased international competition has resulted in fewer big gamblers entering the United States to spend on the entertainment aspects associated with the casino industries.

Growing competition and market saturation leads to sector expansion

As a result of growing competition within the overall casino market both domestically and internationally, operators have had to look at new revenue-raising avenues for maintaining competitiveness and building business performance. The casino industries are within the mature phase of their life cycle and will remain there for some time. Consequently, the market is experiencing saturation.

Operators will continue to face increasing competition from other forms of wagering and gaming industries while there is the ongoing threat of global competition. Some major operators have had to expand into horse and greyhound racetracks in an attempt to offer other forms of gaming and wagering to improve revenue growth and profit. Others have considered expanding internationally. Global casinos and gambling are growing at a rapid pace, and therefore businesses have increasingly looked offshore to build. As noted, Macau has been a hot destination, but in fact all of Asia remains a strong expansion opportunity for U.S. casino operators. Of particular note, Taiwan, Hong Kong, Korea, Singapore and, of course, Macau remain solid expansion prospects. These possibilities have been

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limited in recent years, because the global recession has restricted credit and viability.

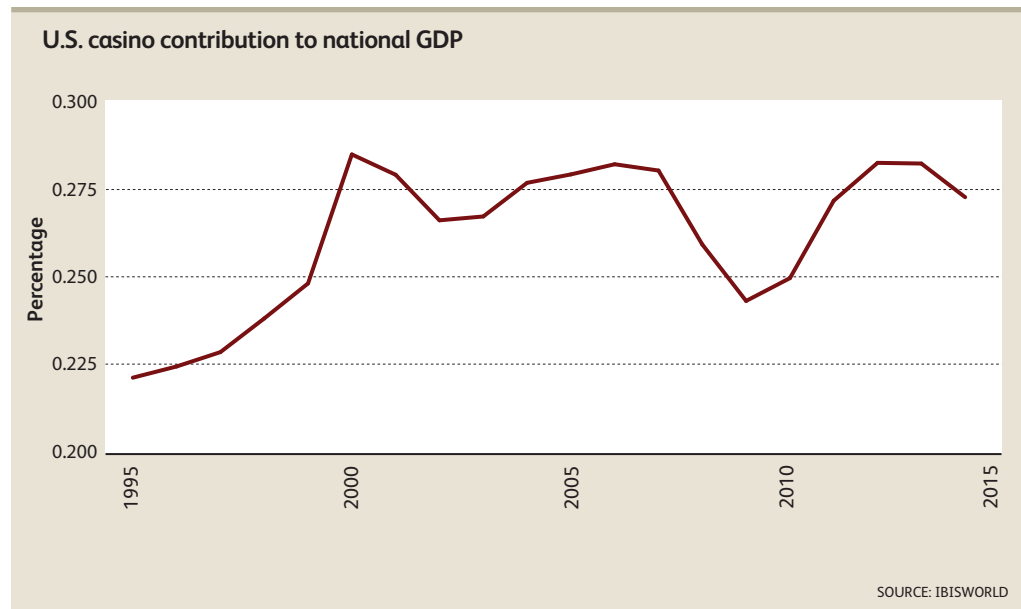
In addition to these developments, there has been an increasing move to transform Las Vegas into an even greater entertainment venue. Today, Las Vegas is not just a casino hub; it's becoming an increasingly varied entertainment world, offering a huge selection of non-gaming services and activities to attract a bigger crowd. Las Vegas has increased its publicity about this, advertising Broadway-like shows, golf courses, spas, fine dining, shopping and varied accommodation. All of this has helped maintain exposure domestically and to grow it internationally. The importance of Las Vegas to the U.S. casino sector cannot be underestimated: Roughly 46.3% of all hotel casinos and 19.1% of all non-hotel casinos are in Nevada alone. It therefore generates billions in revenue for the sector, but also hauls many more billions into the country for other tourism-related industries and casinos across the nation.

What does the future hold?

The U.S. casino industries have seen a very sharp fall over the past two years. This, however, has not crippled the sector. In fact, revenue is expected to rebound over the next five years, expanding at an average annualized rate of 4.1%. This growth will be largely due to the more robust economic growth from 2011 onward.

For 2010, forecasts of only marginal domestic economic growth together with remaining levels of high unemployment are expected to result in sluggish growth in household disposable income. This will result in modest growth in consumer spending on all forms of gaming. For most of the sector, the improving economic environment will lead to some recovery in real revenue growth. Combined, the three casino industries are expected to grow by 2.8% over 2010, reaching \$68.59 billion.

From 2011 onward, growth will be far stronger, as U.S. and global economies begin to pick up steam and return to more normal operating conditions. This will



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help spur tourism and travel for both business and casual ventures, which will also support demand for casinos. The rebound is not only going to result in revenue growth: The sector's contribution to U.S. GDP will also improve in the next five years, with profit and wages expected to increase.

Despite the forecasts of the return of relatively more robust economic conditions through 2014, the industries will continue to face much of the same challenges as previously indicated. Companies will consolidate and expand internationally, particularly into new growth areas, such as Asia, while market saturation will force more operators to look for additional revenue-raising strategies to maintain margins, grow customer traffic and build overall exposure.

The industries will continue to face a highly competitive domestic environment, and this will require ongoing and increasing level of professional management at all levels of operation in all casinos to ensure that individual operators will remain viable.

The competition for domestic and international premium gamblers will intensify. Some casinos may actually withdraw from chasing this market in

the short term, because costs to attract them may increase significantly. These financial and operating risks associated with chasing high-stakes players will continue over the next five years.

Furthermore, slot machines will remain an important revenue driver for the sector, as many casinos will continue to experience slow or declining growth on table gambling. This will be offset by much better growth with slot machines (especially with low-coin-value slots). Increasing slot machine revenue does not necessarily translate into increasing food and beverage revenue, however, so overall operator revenue may still decline. Slot machines have become an important customer driver for the casino market, and it is key to provide low denomination machines and to replace machines and games more quickly – every two to three years. Cashless machines (ticket-in, ticket out) have been rapidly introduced in states where legislation allows, which has offered lower operating costs and will enhance profitability in the near future.

In essence, casino operators must prepare for a difficult 2010, stay attuned to the changing market over the coming five years, look internationally to build business, and capitalize on the strong growth expected in 2011.

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