

CASINO

WHEEL OF FORTUNE? THE ODDS ARE FIRMLY IN YOUR FAVOUR WITH A PROPER ANALYSIS OF GAMING COMPANIES

By Alan Lok, CFA, Eunice Chu and Guruprasad Jambunathan

There is an old Chinese saying: "For every ten gamblers, nine will be losers." Typically, you might picture a down-at-luck gamer staring in shock at the card table. However, the casino itself may also not be on a winning streak.

Despite the deep-pile-carpet glamour and general hype about how profitable the casino business model potentially can be, gaming is actually a highly regulated and heavily taxed industry. After all, society expects to be compensated for absorbing the social costs that gambling engenders. As such, few public voices lobby against gaming levies.

Invariably, casinos and gaming facilities are accompanied by world-class accommodations and other high-end leisure amenities. This infrastructure is hugely capital intensive; it can take years of profitability before a facility can finally break even. On top of this, revenue cannibalisation from competitors operating in the same location is an ever-present risk, as is the threat of economic downturns. As you can see, running a casino has the potential to become a losing game.

Before you place your bets, look carefully at all the cards on the table. This framework is not a definitive guide to the sector, but is intended as a starting point that provide a systematic way of analysing a listed casino business model.

KNOW THE GAMING ENVIRONMENT

As with any sector review, assess all the relevant economic, geographic, and political factors.

- Look at where the company's properties are situated: Are they located in gaming hubs that offer choice and require little effort to reach, such as Macau, or are they one-off developments that gamers must be enticed to visit? Do they operate in politically stable regions?
- Examine tourism volumes, as these will tell you if a country or territory is falling in or out of favour. At the same time, compare visitor numbers alongside local patronage—are there enough home-grown gamers to sustain the company's operations?

- Turning to accommodation, does the company offer hotels at its facilities, and if so, can it meet current and future levels of demand? What is the quality of the hotel stock—are the rooms pristine and appealing or well-used and tired?
- Co-located tourist facilities and attractions are others factors worth exploring, especially for one-off developments. Other than the casino, what would persuade a gamer to visit the location? Does it have family-friendly attractions that will keep a spouse and children occupied?

Follow your initial review of the above factors with an analysis of the company's operational details relative to its competitors. From a purely economic perspective, consider the long-term factors that will drive growth and how the company expects those factors to evolve. How much does a gamer spend during each visit? Are there any factors that may restrict spending, such as the number of available tables for impatient gamblers? Is the general environment inviting and well ventilated, or does it permit smoking in public places? Crucially, survey the minimum and maximum bet limits on each game and find out if gamers have easy access to cash from onsite ATMs.

As an aside, check the opening times of the facility, as casinos are a favourite haunt for people who finish work in the early hours of the morning. Moreover, a surprising number of people frequent casinos not to gamble but to eat, so review the food and beverage options available to guests.

CHINESE CONSUMER AUDIENCE

In recent years, the rise of the Chinese consumer has had a significant influence on a wide range of industries, such as property, retail, and tourism, in addition to casinos. With this in mind, ascertain the amount of business derived from Chinese customers. Simultaneously, how does the per-capita spend by customers from China compare with that of customers from other countries? From a broader perspective, try to identify any factors that could affect Chinese customer volumes. Examples here could be both economic and geopolitical in nature.

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GAMBLING RULES

Governments love gambling revenues but are far more pious when it comes to the actual source of this cash. Consequently, any study of the industry must take into account the country's regulatory factors and how they might affect the business being analysed. Begin with the current license structure and what it means in terms of cost. Also, note that a relaxed license regime could result in greater competition in the firm's market. Find out if any regulations restrict customer entry to the gaming floor and whether governments place visa restrictions on their residents visiting countries where casino properties are located.

UNDERSTAND THE GAME

Earlier, we touched on competition in the company's market. It is worth delving deeper here to see how well a gaming business can manoeuvre in challenging operating waters. Key aspects you should note are the levels of competition concentration in any one market and whether the company is prepared to explore new territories where it can further develop its product. What factors facilitate or impede the entry of new players into this virgin territory? Moreover, how does the company expect its business model to evolve? Lastly, do not overlook the rise of online gaming—establish if the company has, or plans to develop, a digital presence.

GAMBLE RESPONSIBLY

Whether you work in finance or are an investor, awareness of environmental, social, and governance (ESG) issues has become a necessity in the investment world. For the gaming industry in particular, ESG factors connect closely with the human spirit. Gambling is enjoyed by millions. For some, it is often nothing more than one of life's many amusements, but for others, it can morph into something less frivolous. Bear in mind the measures a company takes to ensure responsible gaming. Simultaneously, look at the company's record on the prevention of corruption and money laundering. How does it treat its staff, many of whom are expected to work anti-social hours in a high-pressure environment?

A WINNING STREAK

Finally, study the numerical metrics of the company, as you can rely on these to establish a feel for how well a company is doing. Try to size up how the business has performed operationally and look at its metrics in relation to its competitors. These metrics should include, but not be limited to, profit margins, debt-to-equity ratio, and asset turnover ratio. Further down the line, how does the company expect industry trends to evolve? From a financial perspective, appraise the balance sheet and again look at those of the company's peers.

Do note that this article only provides a framework to help you analyse the casino business model, which, in actual operation, is usually bundled with the hospitality and business convention sectors. That said, good luck as you spin your wheel of research because, if you'll pardon a corny phrase, casino analysis is slots of fun!

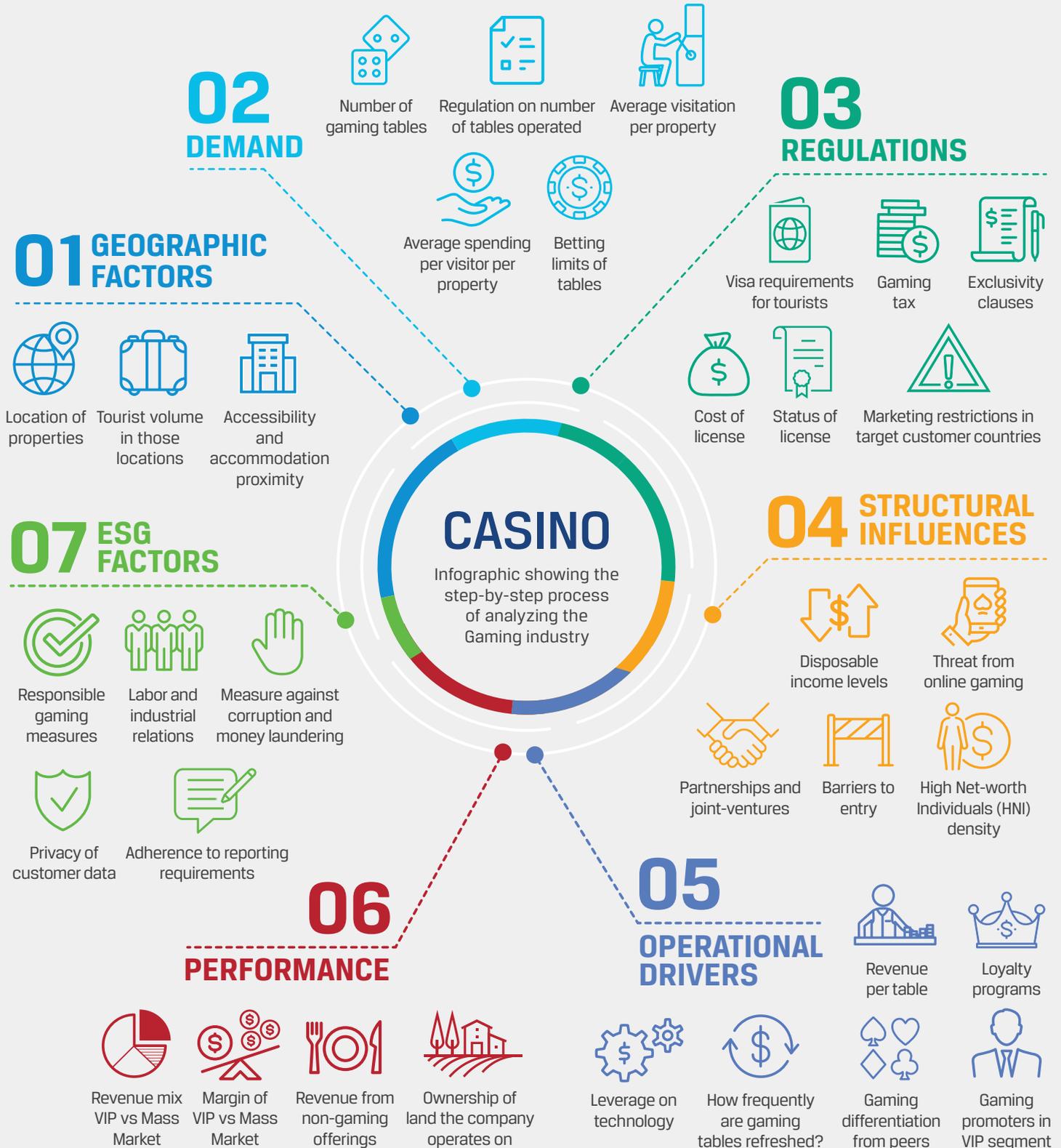
About the Authors

Alan Lok, CFA, is Director of Society Advocacy Engagement, Asia Pacific at CFA Institute. He researches and writes on investor protection issues and capital market structure and coauthored a CFA Institute position paper on capital market integrity, *"Portfolio Pumping in Singapore: Myth or Reality"*. Mr. Lok has more than 10 years of equity research experience, spanning various industries and sectors.

Eunice Chu is an ACCA-qualified finance professional. She was a regional finance director of a Fortune 500 multinational corporation and, at present, heads the policy function of ACCA Hong Kong.

Guruprasad Jambunathan, FRM, is a Director for Financial Research at CRISIL, a global research and analytics company. He has more than 12 years of experience in equity research and works closely with a broad clientele of buy-side and sell-side firms, as well as with academic think tanks across various continents.

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1. What is the geographic spread of the company's properties?

- In which countries and cities are properties currently located?
- How well-visited are these locations? How appealing and popular are these locations as tourist destinations?
- How well connected are these locations to key customer originating markets?

2. How large are tourist volumes in locations where company's properties are located?

- What is the level of inbound tourist traffic to locations where properties are located? How is this evolving?
- What is the breakup of tourist traffic between domestic and foreign visitors?
- What proportion of the company's customer base is estimated to be inbound tourist traffic versus the local population?
- How much hotel accommodation is available in locations where the company operates properties?
- What are the peak and average occupancy rates of hotels in those locations?
- Are any potential additional visitors lost during peak holiday seasons due to the unavailability of accommodation?

3. Key factors impacting demand.

- How many gaming terminals and tables does the company operate?
- What regulations govern the number of terminals and tables that can be operated?
- What are the annual visitation numbers and average spending per visitor in the each of properties operated?
- What factors affect time spent by visitors on the gaming floor?
- What are the minimum and maximum bet limits per game? Are there any regulations governing these limits?
- Is smoking banned on the gaming floor?
- Do regulations permit having ATMs on the gaming floor?

4. How much business is derived from Chinese customers?

- What proportion of the company's customers are from China? What percentage of revenue is derived from these customers?
- How does per-capita spend by customers from China compared with that of customers from other countries?
- Does the company foresee any factors that could affect the volume of Chinese customers visiting its properties?

5. What is the impact of regulation on the business?

- Do any regulations exist that restrict customer entry to the gaming floor?
- Are there restrictions on the amount of money that can be spent by gamers?
- Do governments in customer-originating markets place restrictions on marketing the company's properties and services?
- Do governments place any restrictions on foreign exchange that can be spent by their residents on gaming while visiting countries where the company operates properties?
- Do governments place visa restrictions on their residents visiting countries where properties are located?

6. What are the long-term factors that will drive future growth? How does the company expect these to evolve?

- What are the disposable income levels in key markets?
- How big is the population of high net-worth individuals (HNIs) in key markets?
- Which new markets are expected to drive business growth in the future?
- How much threat is anticipated from online gaming providers? What is the company's strategy to manage the impact from online gaming platforms?
- Might an integration of online and offline gaming be possible in the long term?

7. How does the company expect its business model to evolve?

- At what pace is the market expected to evolve from a pure casino model to an integrated resort model?
- What proportion of revenue does the company expect to derive from non-gaming offerings five years from now?
- What non-gaming offerings are expected to gain most traction and why?
- What is the company's strategy to leverage these opportunities?

8. What is the level of market concentration?

- How concentrated is the market? How much market share do the top-three and top-five players have in key markets?
- What is the mix of customers between VIP and mass market? How does this vary by customers' country of origin?
- What is the company's market share and standing in markets where it operates properties?
- How prevalent is the partnership and joint venture route in key markets, given the limited number of licenses?

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9. What factors facilitate or impede the entry of new players?

- What is the typical investment required to develop a property?
- How many licenses are granted by regulators in key markets?
- What is the typical duration of a license?
- How straightforward is the renewal process? What are the risks of a company being unable to renew its required licenses?

10. The current license structures.

- How many different countries or regions does the company operate in? How many properties are operated in each country or region?
- What is the gaming tax rate in the jurisdictions in which the company operates?
- How many licensees are in operation in each of the license areas where properties are operated?
- When are the company's current licenses due to expire? When do peers' licenses expire, if known?
- Do any current licenses have an exclusivity clause? If so, for how long are these valid?
- When is the next round of license issuance or renewal in the areas in which the company operates? How many licenses will be available for issue or renewal at that time?
- What was the cost of licenses when they were last obtained? How much are license costs expected to increase at the next renewal?

11. How has the company performed operationally? How do its key metrics compare with peers and how does the company expect trends to evolve?

- How much revenue per terminal/table is generated every day in each property? What are growth rates being observed? Has an increase in the number of terminals or units resulted in increased revenue and profitability?
- Does the company run loyalty programs? If so, what operating costs are incurred and how much incremental revenue do these programs bring?
- To what extent does the company utilize technology to drive business growth? Have all terminals been enabled for cashless gaming?

- What is the current mix of old and new terminals on the gaming floor? How frequently is the gaming mix refreshed?
- How are gaming offerings differentiated from peers?

12. How has the company performed from a financial perspective? How do its key metrics compare with peers and how does the company expect trends to evolve?

- What is the revenue mix between VIP and mass market? How do margins from these segments compare?
- What is the normalized win rate for VIP gaming in properties operated? How are these rates calculated?
- Does the company work with intermediaries such as gaming promoters in the VIP segment?
- What revenue growth, on a normalized basis, has the company achieved?
- What is the current normalized EBITDA margin?
- How much revenue is derived from non-gaming offerings? How do margins on these offerings compare to gaming margins?
- How much of the land on which the properties are situated does the company own?

13. ESG principles, practices and track record.

- What measures are taken to ensure customers practice responsible gaming?
- Does the company contribute to efforts to prevent, minimize and eradicate human trafficking?
- What is the company's track record concerning labor and industrial relations?
- What are the company's current obligations regarding prevention of corruption and money laundering? What steps are undertaken to enforce these requirements?
- How does the company ensure the privacy of its customers and the safety of customer data collected?
- How does the company ensure adherence to various reporting requirements? How many different jurisdictions and agencies is the company required to report to?