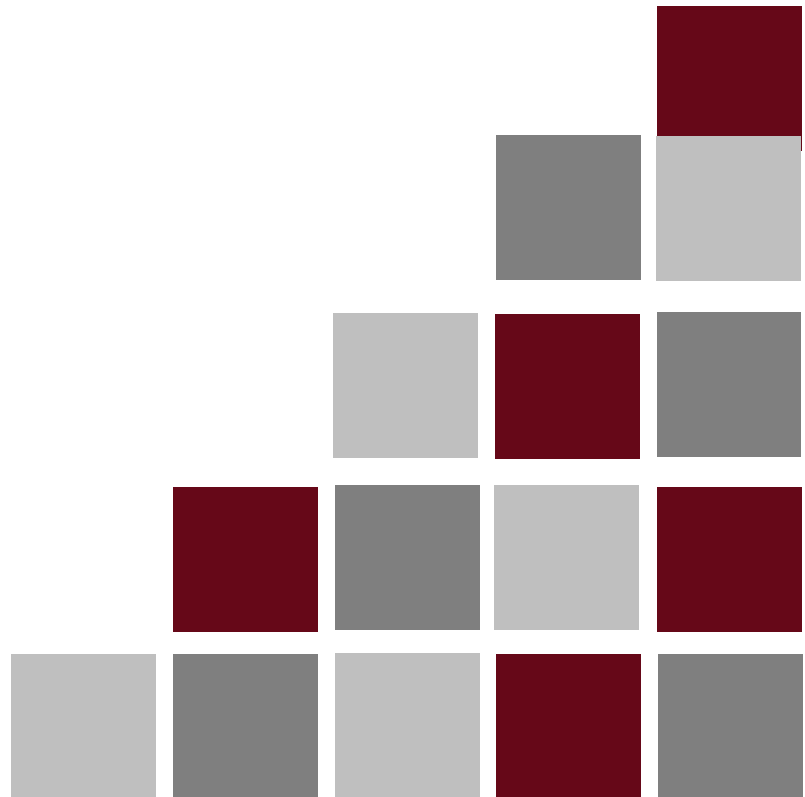


Principles by IUCG:

Emerging Trends in the US Casino Industry

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INDUSTRY OVERVIEW

Introduction

Gambling has long been a staple in American culture, serving as a valuable source of entertainment and a critical economic driver for the American people. Throughout history, the status of gambling in the United States has undergone countless regulatory changes.⁸ Following the Great Depression, the U.S. found itself in a deep economic crisis. In an attempt to respond to this crisis and provide financial relief to its residents, the state of Nevada passed Assembly Bill 98, effectively legalizing gambling in Nevada.¹ In the decades to come, casinos quickly sprouted up throughout the state, with direct connections to the mob. It wasn't until the 1960's that institutional investors, such as Howard Hughes, entered the industry and purchased many of the casinos in Las Vegas. This changed the public perception of gambling and created a legitimate, legal business around casinos. In 1977, New Jersey legalized gambling, paving the way for numerous other states to dive into the casino business in the decades to come. Today, we have 18 states with commercial casinos and 30 states with commercial and tribal casinos available to residents. U.S. casinos have become more prevalent and accessible than ever before.¹

PRODUCT AND SERVICE SEGMENTATION

Casinos in the United States rely on a few major sectors to generate revenue. Casinos offer an array of gambling opportunities to entice consumers. Electronic gaming devices (such as slot machines), table games (such as blackjack, baccarat, craps, roulette, and poker), and sports betting present lucrative opportunities for casinos to make money. Gambling activities account for just over half (53.6%) of a casino's total revenue.⁴

Slot Machines

Most commonly featured in the front of the casino, slot machines account for 69% of a casino's gaming revenue.⁵ Slot machines rely on bright lights, colorful animations, and loud noises to stimulate the user's brain and draw the individual towards the machine. While these machines have high initial costs, they have a long lifespan and virtually zero variable costs (with the exception of an occasional software update.)⁵

Table Games

Table games such as blackjack, baccarat, roulette, craps, and poker account for 28% of a casino’s gaming revenue.⁵ These games are routed in math and offer a statistical advantage for the casino (with the exception of poker, where players play against each other). In poker, the casino collects a percentage of every *pot*, also known as the money in the middle at the end of every hand. When playing a table game at a casino, physical pieces of plastic, referred to as chips, are used in place of traditional US currency. These chips are exchanged for real money prior to and after the start of play.⁹

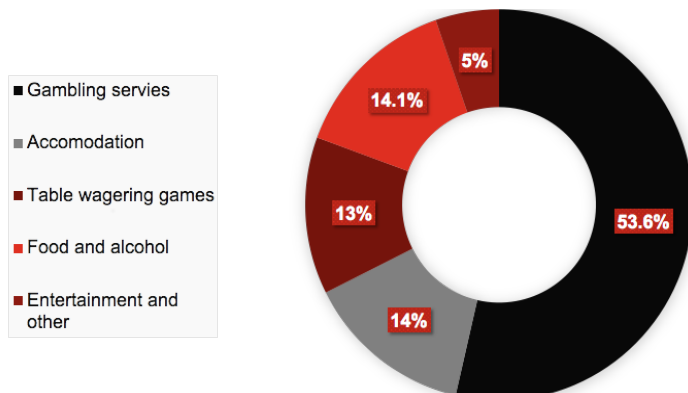
Sportsbooks

A sportsbook is a place where consumers go to place wagers on sporting events. The sportsbook assumes the job of determining odds, such as point spreads and money lines, on the outcomes of all major sporting events. These odds constantly change prior to the start of play, with the goal of encouraging an equal amount of money to be bet on each side of the outcome. The sportsbook generates revenue by collecting a percentage of every wager (*vig*). In addition to casino gambling opportunities, casinos offer hospitality and entertainment services to their players, which rounds out the casino experience and ultimately drives people back to the casino floor.⁷

Hospitality an Entertainment services

Hospitality and entertainment services account for the remaining ~47% of a casino’s revenue.⁴ From a business perspective, hotels have proven to be a lucrative opportunity for casinos to utilize. Overnight stays account for 28% of a casino’s hospitality and entertainment revenue, giving casino-goers the option to extend their stay for many days at a time.⁴ In an effort to constantly keep their patrons busy and satisfied, casinos offer an array of food and beverage choices to customers. The food and beverage sector make up 16% of the casino’s hospitality and entertainment services.⁶ Finally, entertainment events such as boxing matches and concerts account for 3% of this revenue segment.⁴

Product and Service Segmentation

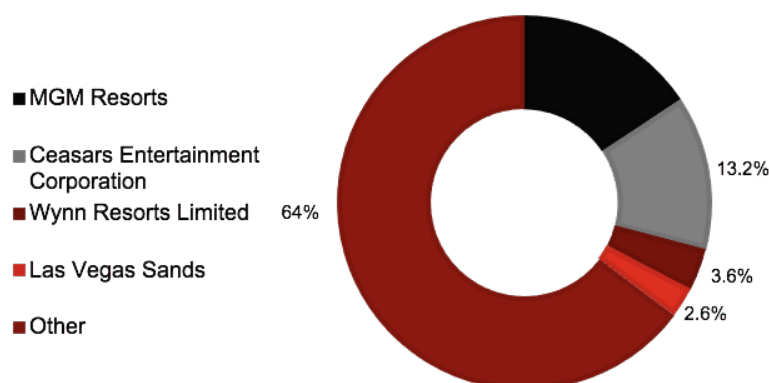


COMPETITIVE LANDSCAPE

The casino industry is dominated by a handful of major players. MGM Resorts has a 15.5% market share, followed by Caesar's Entertainment Corporation with a 13.2% share. These conglomerates own countless properties on the Las Vegas Strip, as well as hotels and resorts in other locations nationwide, such as Atlantic City. Wynn Resorts Limited, founded by American businessman Steve Wynn, controls 3.6% of the market. Wynn is known for his extravagant and over-the-top real estate projects. Finally, Las Vegas Sands maintains a 2.6% market share, which is slowly decreasing due to their increased global expansion.⁴ The barriers to entry in the casino industry are substantial. The average casino requires an initial investment ranging from \$550-600 million dollars just to develop the property. Real estate is scarce in Las Vegas and is largely owned by the major casino conglomerates (MGM, Caesar's, and Wynn.) This prevents new operators from entering the market.

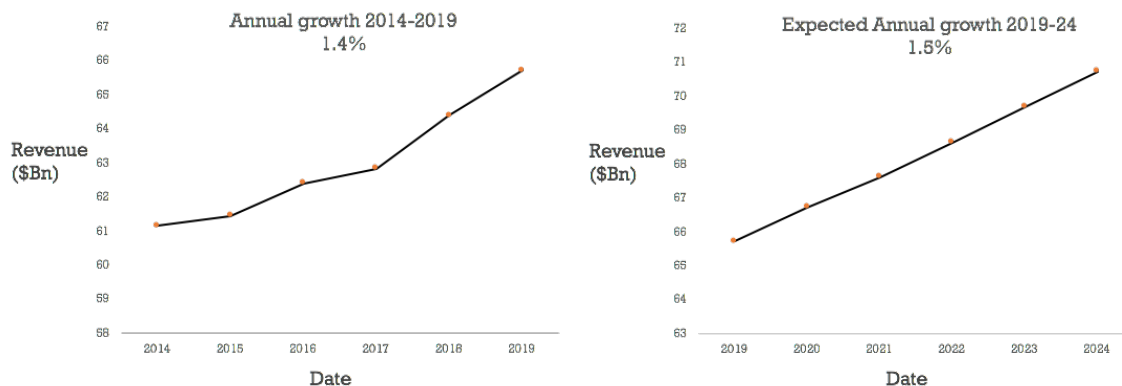
Las Vegas casino properties are subject to constant renovation and innovation in an attempt to compete with surrounding establishments on the Vegas Strip. Wynn Resorts, for example, has always prioritized amazing structural and developmental feats. The Mirage, a property owned by Wynn Resorts, features an elaborate artificial volcano that erupts every half hour. Other properties include expansive fountains that can be set off by the push of a button. The pure extravagance of Las Vegas resorts has served as a competitive edge for some companies, such as Wynn Resorts. Exclusive entertainment deals with groups such as Cirque Du Soleil and the UFC also allow casinos to differentiate themselves. If you want to enjoy a specific show or attend a specific concert, chances are good you'll need to travel to a specific property. Over time, the competitive landscape in Las Vegas has largely stayed the same due to the high barriers to entry. Most of the properties that dominated a couple decades ago are still prevalent today.

Market Share



INDUSTRY GROWTH

The casino industry has undergone modest annual growth over the last five years. Since 2014, the industry has grown by an average of 1.4% annually.⁴ This growth can be attributed to increased consumer spending as well as an influx of international travelers to US casino and resort destinations. Throughout the last several decades, Las Vegas has worked hard to establish itself as the premier casino gaming destination of the world. The over-the-top nature of Vegas, with its seemingly endless glitz and glam, has become a cultural icon of American excess. From an international perspective, Vegas has cemented itself as one of the top entertainment hubs in the United States and attracts large volumes of tourists. Additionally, as gambling and sports gambling have become more of a hot topic in the media as of late, the publicity around gambling has increased. This publicity has benefitted casinos, who have been incentivized to develop new casinos for gamblers to enjoy. For the next five years, between 2019-2024, the casino industry will grow at a projected rate of 1.5% annually. This growth is projected as a result of decreased government regulation, which will lower the barriers to entry.⁴ Additionally, the rise of digital casino gaming will play an important role in industry growth, as more casinos will offer online gambling options to their patrons.

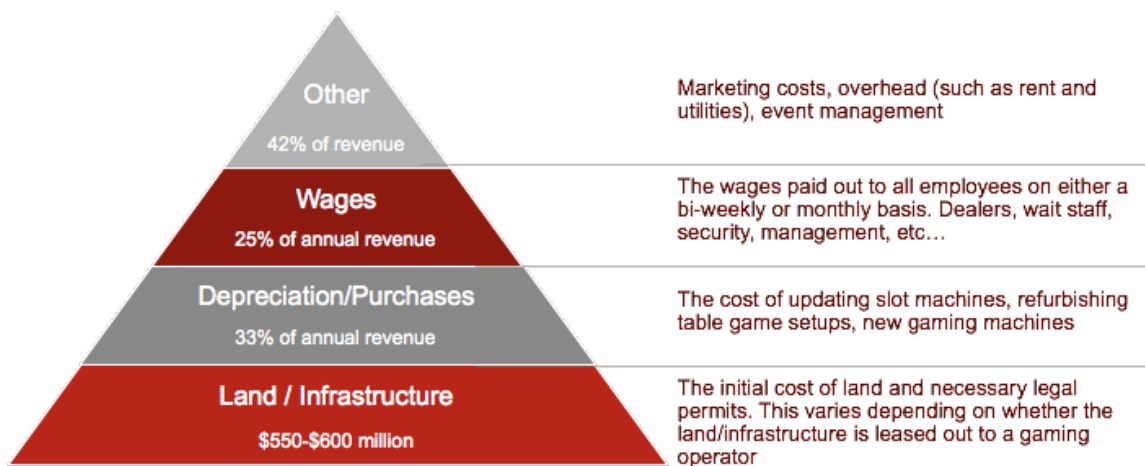


COST STRUCTURE

Developing and operating a casino is a very cost-intensive process. The initial process of buying land, building infrastructure, and obtaining the necessary gaming licenses typically costs anywhere from \$550-\$600 million dollars.⁴ Additionally, 33% of a casino's revenue goes towards the costs associated with purchasing and updating slot

machines and table games. These machines/tables endure a significant amount of wear and tear which requires them to be refurbished on a frequent basis.⁴

Wages represent one of the largest variable costs that casinos incur, with 25% of a casino's revenue being paid out to employees on either a bi-weekly or monthly basis. Many of these employees, such as dealers and wait staff, rely heavily on tips in addition to their base hourly pay. Upper level positions, such as security and management jobs, often warrant higher salaries with greater benefits. Finally, 42% of a casino's revenue is used to cover marketing expenses, overhead costs such as utility bills, and event management such as contracts with performers.⁴



REGULATION

Understanding the current regulatory status of gambling in the United States is imperative to understanding the casino industry as a whole. Currently, while gambling and sports betting are legal under US federal law, each individual state is left to make its own regulatory decisions. Following the federal legalization of sports betting in late 2018, more and more states are making plans to develop new casinos. With an influx of new casinos entering the US casino market, traditional gambling hotspots, such as Las Vegas and Atlantic City, may see a decrease in traffic in the coming years. As it stands now, 18 US states operate legal land-based or riverboat casinos, with an additional 6 states operating racetrack casinos (racinos). The future of casino regulation will continue to disrupt the casino industry as we know it.⁴ Given the enormous economic benefits that casinos can have for state governments, states will likely learn from Nevada and New Jersey and will promptly move to establish and regulate casinos within the next 10 years. The United States will likely create a more solidified bureau of government that will solely focus on casino regulatory policies in an attempt to expedite growth.

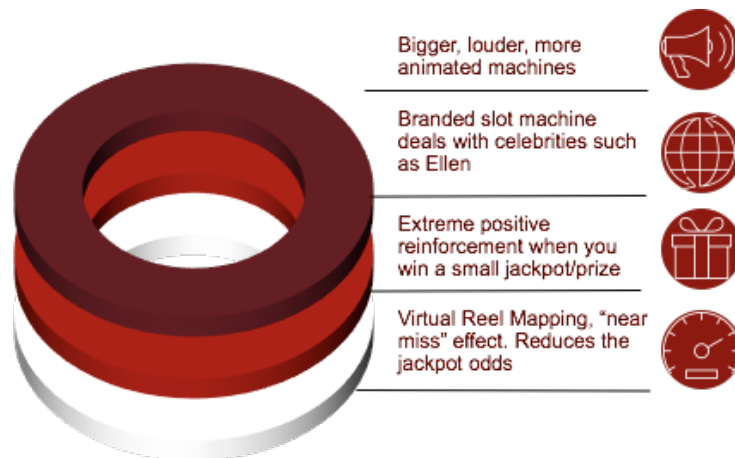
INDUSTRY DISRUPTORS

Electronic Gaming Machines

Technology has proved to be a key disruptor in the casino business. In the past, slot machines relied on physical levers to be pulled, activating several reels to spin and determining an outcome based on the formation of different icons. Now, as soon as the player presses the “spin” button, the slot machine has already determined whether or not you will win or lose based on predetermined odds. To further keep users glued to the screen, slot machines often manipulate the placement of icons to create the appearance that the user was close to winning before incurring the loss. This tactic is known as “Virtual Reel Mapping.”¹⁰

Today, slot machines feature louder noises, brighter lights, and more colorful animations than ever before. These features are meant to stimulate the senses and keep the player engaged for as long as possible. The use of extreme positive reinforcement is a powerful component of a casino’s business model. Whenever a player wins a small amount of money, the slot machines spews out loud noises and flashing lights. Often, a cocktail waitress will approach you and congratulate you with free drinks.³ The casino goes to great lengths to make customers feel like winners even when their relative wins are still less than their overall spend.²

Branded slot machines offer casinos the opportunity to sell ad placement on the exterior of electronic gaming machines. This has already been lucrative for some casinos, as celebrities such as Ellen have teamed up with casino companies to produce a specialized line of machines. The potential for advertising is limitless given the long amounts of time that the average player spends sitting and staring at their slot machine of choice.



Sports Gambling

With the federal legalization of sports gambling occurring late in 2018, casinos all around the United States are scrambling to roll out sportsbooks as soon as possible. Prior to 2018, only casinos located in Nevada were allowed to operate sportsbooks.¹¹ Additionally, while sports gambling was technically illegal, advocates for legalization argued that the vast majority of sports betting was simply occurring on the black market, funding overseas illegal gambling operations. Now, 8 US states have fully legalized sports gambling, while 2 states (New York and Arkansas) have legalization being rolled out in the coming year. Additionally, 29 states have introduced bills for sports gambling legalization. Many of these states are expected to permit sports gambling within the coming years.¹¹

As mentioned earlier in the industry report, the gambling segment of a casino's business accounts for about 53% of a casino's total revenue. Within that sector, sportsbooks play an important role in the casino's income. Sports betting allows casinos to appeal to a much wider range of people instead of just traditional casino-goers. Now, anybody who watches sports or identifies as a sports fan is incentivized to walk into a casino and place a bet. While inside, they'll get to enjoy a comfortable and expansive sportsbook with an abundance of leather couches, chairs, and huge TV screens. Casinos work hard to create an ideal experience for sports gamblers, even providing them with perks such as game-day meals and drinks. The federal legalization of sports betting has given casino companies the opportunity to expand their target audience and get more nontraditional gamblers walking through the doors.

OUTLOOK

In the future, casinos will likely shift more of their gambling business towards EGM's (electronic gaming machines). Given the low variable costs and high profit margin, these machines are cheaper for casinos to operate than table games. Technology will allow these machines to become even more interactive, with the development of VR opening up countless opportunities for expansion.

The continued collection and utilization of big data will be a defining factor in the future of the casino industry. Currently, casinos give players the option to create a player's card that rewards them with small bonuses and incentives based on how

much they play. In the future, we foresee that casinos will make players cards mandatory for everyone who wants to gamble. These cards will track people's tendencies, from which games they like to play, to how much money they typically spend, to what their favorite foods and drinks are. Casinos will be able to leverage software to sift through this data and categorize people based on their habits. Then, they'll look to retarget customers after they leave with lucrative and personalized

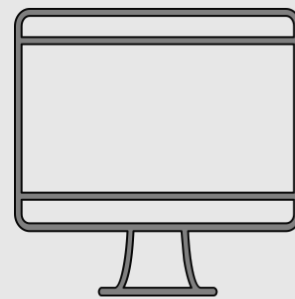
promotions sent via email and direct mail. Currently, casinos employ people who are tasked with personally dealing with high rollers and creating custom packages to draw them in. We envision that a similar process can be implemented in order to appeal to everyday gamblers. This process could be automated, allowing casinos to retarget people without wasting human capital.

We feel that casinos will take advantage of growing digital trends by creating branded online gambling sites. Currently, the leading online gaming sites are run by independent companies that do not operate physical casino locations. Given the decrease in regulation of online gambling, casinos will look to expand their presence and their brand into the online sector. Due to the extensive rewards programs that gaming companies offer, consumers are very loyal to specific casino companies. While some of these companies, such as MGM, currently offer online gambling platforms, many have yet to dive into the world of digital gaming. Casinos won't look to replace the iconic "Vegas experience" with online gambling. Instead, they'll use gambling websites to target their most consistent patrons who seek out their casino for the main purpose of gambling money.



Influx of Electronic gaming machines

- Better Margins
- Steady cash flow with minimal labor costs
- More profitable than table games



Branded Online Gaming Sites

- New source of revenue
- States loosen regulations

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