

1 CHAIRMAN JAMES: Mr. Ader?

2 MR. ADER: Okay. Good morning. Thank you for the
3 opportunity to address the Commission today. The topic area I
4 plan to discuss is Wall Street's perspective on the gaming
5 industry and I'd like to focus on a few key areas, including the
6 following: one, the role of investment banks and equity analysts
7 in the gaming industry; two, the investment community's
8 historical and current views on the industry; and three, how we,
9 as research analysts, look at gaming markets in addressing these
10 issues.

11 I'll also make relevant references to developments
12 here on the Gulf Coast, which I believe is really one of the
13 bright spots in the gaming industry.

14 I'd like to begin by discussing the role of an
15 investment bank, both in general and in serving gaming industry.
16 Investment banks provide a wide variety of services in the
17 capital markets.

18 These include advising companies and making strategic
19 financing decisions, providing capital, managing equity and debt
20 offerings, providing investment research and opinions, and
21 securities, brokerage and trading, just to name a few.

22 Investment banks have historically served the gaming
23 industry in each of these areas. My firm, Bear, Stearns, is an
24 international investment banking firm with a dedicated banking
25 and research division serving the gaming industry.

26 We've played a key role in over 60 gaming deals,
27 advising and managing offerings for some of the most important
28 transactions in this active sector.

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1 As an equity analyst, my personal role is to research
2 the gaming markets to provide investment opinions and valuation
3 analyses of gaming companies. It's important to note that
4 research analysts have complete autonomy to maintain research
5 integrity for our brokerage clients.

6 I'd now like to discuss how Wall Street sees the
7 gaming industry and touch on the concepts of investor confidence
8 and value creation. Wall Street's attraction to the gaming
9 industry has traditionally been related to high levels of cash
10 flow generated by gaming operations and high returns on
11 investment.

12 However, there has been a dramatic change in these
13 characteristics in most gaming markets as competition and market
14 saturation have ensued over the last several years. As a result,
15 gaming valuations have declined, capital has become more scarce,
16 and investor confidence in the gaming sector has diminished to
17 some extent.

18 Confidence in value creation are cyclical by nature.
19 Confidence in a market is garnered when returns on investment
20 consistently and predictably exceed the cost of capital. Wall
21 Street will provide financing for growth if it is confident that
22 the capital will generate high returns relative to the cost of
23 capital.

24 When an industry is in favor, Wall Street gives its
25 stamp of approval, freeing up resources for other enhancements
26 and improvements. These are improvements such as restaurants,
27 retail centers and entertainment venues, further develop
28 properties, making them more competitive.

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1 If companies are profitable and earnings are growing
2 from capital expenditures, stock prices will appreciate and value
3 creation for shareholders will be achieved.

4 In fact, between 1988 and 1998, the total market
5 value of public gaming companies grew from under \$4 billion to
6 over 20 billion. This represents a compounded annual growth rate
7 of over 20 percent. And over the same 10-year period, leading
8 companies in the gaming industry have shown stellar growth.

9 For example, Mirage Resort's market value is ten-and-
10 a-half times higher today than it was ten years ago, growing from
11 \$256 million in value back in 1988 to \$2.7 billion today.

12 However, high returns on investment will only attract
13 capital until the economic laws of supply and demand diminish
14 returns due to excess liquidity. Once capital yields returns
15 that fall below the weighted average cost of capital, valuations
16 will decline and capital availability becomes constrained.

17 Financing was readily available for casino
18 development throughout the early part of the 1990s with strong
19 initial performance by casinos in new jurisdictions. In some
20 cases the cash on cash returns was as high as 100 percent within
21 one year of opening.

22 However, with capital readily available into the mid-
23 '90s, too many projects have been developed in some markets and
24 competition has caused returns on investment to decline.

25 Taking the Las Vegas Strip as an example, a 20
26 percent return on investment was a benchmark for a successful Las
27 Vegas casino, and as new developments came on line between 1989
28 and 1997. This compares to an average return on investment of
29 between 12 and 16 percent for the average hotel property.

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1 However, with substantial competition and over 21,000
2 hotel rooms currently under construction in Las Vegas, supply
3 appears to be outpacing demand and it's unlikely that most of the
4 new projects planned for Las Vegas will be capable of achieving a
5 20 percent or higher return on investment.

6 The perceived risk of lower returns -- lower expected
7 returns has had negative implications on gaming stock prices, and
8 only evidence of successful development can remove the negative
9 sentiment currently surrounding gaming stocks and return investor
10 confidence.

11 And I'd point out that there are still markets and
12 projects within -- with the potential for high returns on
13 investment. On the Gulf Coast, for example, increasingly seen as
14 an emerging resort destination, we expect leading properties such
15 as Beau Rivage and The Grand to continue to achieve high returns
16 on investment.

17 I'd now like to turn to a brief discussion of the
18 gaming markets and how, as analysts, we measure market potential.
19 In discussing gaming markets, it's important to distinguish among
20 the local, destination and hybrid markets. Each market type has
21 unique characteristics and is influenced by specific factors.

22 The local gaming market typically includes a group of
23 casinos with close proximity to a major population base.
24 Although hotel rooms are frequently available for tourists, the
25 vast majority of play is from local players.

26 The competitive emphasis in local casinos is on
27 customer service rather than must-see attractions. We estimate
28 the size of local market by forecasting the percentage of the
29 population that will gamble and the average revenue per patron.

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1 This form of analysis is very similar to how retailers like Wal-
2 Mart and Home Depot determine their locations.

3 Based on our research, locals visit a casino
4 approximately eight to ten times a year and players at local
5 casinos typically spend approximately \$45-55 per casino visit.
6 Notable gaming markets include the Chicago and northern Indiana
7 market, the Las Vegas local casino market, St. Louis and Kansas
8 City.

9 Destination gaming markets typically include one
10 mega-casino gaming resort or multiple casino resorts clustered
11 together. Patrons arrive either by air or from outside of the
12 region by auto and they usually stay overnight.

13 Thus, lodging and transportation infrastructure are
14 important for a successful destination market. Destination

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1 area, the surrounding region and beyond. Such markets are
2 typically located in small cities or within a day's drive from
3 one or more major urban areas where gaming is not legal.

4 Many hybrid markets are in transition, starting as
5 local markets but becoming destination markets as transportation
6 and local infrastructure are introduced. Notable hybrid markets
7 and markets in transition include Atlantic City, which is a \$3.9
8 billion market; the Gulf Coast, which is an \$805 million market;
9 and Tunica, which is a \$915 million revenue market.

10 Finally, I'd like to address the major variables
11 affecting gaming markets. Gaming markets are affected by a
12 variety of market regulatory and economic factors.

13 First, gaming markets are extremely vulnerable to
14 increased competition. One new competitor in a market can
15 severely impact margins for other operators in that market.
16 Transportation infrastructure is also very important to casino
17 operations as individuals typically favor those casinos that are
18 most accessible, all else being equal.

19 Thus, changes in the transportation infrastructure
20 and poor weather conditions can impact operating performance.

21 The regulatory environment also affects gambling
22 operations. For example, the new tax -- the new increased tax
23 structure in Illinois has limited earnings for most of the
24 state's casinos. This has obviously been viewed negatively on
25 Wall Street and hurt the ability to raise capital for use in the
26 market.

27 Finally, the local, national and global economies all
28 influence gaming markets. Gaming markets depend on discretionary

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1 income which is most available to patrons when the economy is
2 stable.

3 In addition, the health of international economies is
4 important as it impacts the high-end gaming business, mostly in
5 Las Vegas. The current economic turmoil in Asia, for example,
6 has had a measurable impact on baccarat play over the last year.

7 Before closing, I would like to briefly explore what
8 Wall Street's view of the industry means for the Gulf Coast of
9 Mississippi. The Gulf Coast is viewed by Wall Street as one of
10 the most promising areas for growth. We followed the
11 transformation of this market into a true destination very
12 closely.

13 We estimate that market revenues, currently at about
14 \$805 million annually, could grow by more than 50 percent with
15 the addition of development and enhancements currently underway.

16 The performance of Mirage Resorts, Beau Rivage, and
17 its impact on other facilities will be key in shaping Wall
18 Street's perspective on future investment in the region. If
19 successful, Wall Street will likely embrace and provide further
20 capital for infrastructure development in the region.

21 Finally, in closing, I would like to thank the
22 Commission for the opportunity to make this address today, and if
23 I can be of any help in the future, please feel free to contact
24 me at any time. Thank you.

25 CHAIRMAN JAMES: Thank you.

26 COMMISSIONERS LEONE: Can I make a --

27 CHAIRMAN JAMES: Yes.

28 COMMISSIONERS LEONE: I want to make a point out
29 about the -- that I hope subsequent panelists will take

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1 seriously, and perhaps the initial panelists, if we have give and
2 take, will attempt to touch on.

3 We have a cluttered schedule with a lot of different
4 topics we're covering. The topic we want to cover this morning
5 to start is the national economic impact of the increase in
6 legalized gambling in the United States.

7 I understand, probably more than most, how difficult
8 and challenging a question that is. It would be a challenging
9 and difficult question about almost any category of economic
10 activity. We discussed it. It has some peculiar characteristics
11 in this area.

12 But that means issues like overall economic growth,
13 savings, behavior, investment, GDP displacement impacts. We know
14 from other visits and from this visit that when a particular
15 place develops legalized gambling there's new economic activity
16 in that place.

17 We also know that even in that place some of the
18 externalities like crime, social costs, are hard to measure.

19 We wonder -- we just want you to help us think
20 about -- because we know that there's no definitive, widely-
21 agreed upon set of conclusions about the impact of this dramatic
22 growth in gambling in the United States -- what the economic
23 impact might be, how we might think about that, how we might
24 address it.

25 We know it's built out of a lot of these components
26 which we appreciate hearing about but I'd just like to say that
27 because I think, without being unfair to you, we've heard a lot
28 about regional impact or a particular outcome of some new

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1 legalization in a particular place, how much lottery money a
2 state now gets.

3 We haven't really heard much about whether they cut
4 other taxes or didn't raise other taxes so that the net revenues
5 may be the same but I really hope we can focus on the national
6 impact. This is kind of our only chance and we're looking to you
7 to help us.

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