Research Brief: Japan's IR Opportunity

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Given these unprecedented and uncertain times, many questions continue to be raised as to how the process of integrated resorts in Japan may be affected by the ever-changing events surrounding the coronavirus (COVID-19) pandemic. As seen by government actions around the globe, this virus has not only affected Japan, but the rest of Asia, the United States, the Americas, and the world. China is experiencing a second wave of the virus not only in Wuhan, which just recently updated its case counts, but throughout the country. This has extended over the past few weeks to other jurisdictions such as Hong Kong, which just extended its lock down by 14 days, and other parts of Asia that were not initially hot spots but have extended as conditions have changed.

Japan's integrated resort selection process has come into the crosshairs between numerous issues including the virus, the now-2021 Olympics, the upcoming World Expo in 2025, and the microcosm of Japan's political process. While tourism has been halted across the globe, Japan will once again be on a path to achieve the tourism goals set by Prime Minister Abe; goals which are achievable with the introduction of integrated resorts once the pandemic subsides. The robust opportunity remains available for Japan to reach these goals and bring in tens of billions of dollars in investment between the three licenses, as well as job creation and other economic benefits that go along with them.

The tide continues to shift and challenge Japan's desire for integrated resorts, but it is a ship worth sailing as it rides out the choppy waters of current events. If the course is charted appropriately, the country can withstand the waves and push forward in due course with the creation of a strict regulatory structure that supports the ability to have the best operators invest in the next iteration of integrated resorts. However, if Japan does not take in to account some of the clear signs affecting the potential IR market, it may see its opportunity pass.

OLYMPIC-SIZED CHALLENGES

Since the initial report of COVID-19 late last year, the world continues to evolve as it responds to the outbreak and the circumstances surrounding the coronavirus. In the last two months, Japan has gone from dealing with a COVID-19 infected cruise ship, the Diamond Princess, docked in Yokohama to now handling the spread of the pathogen on its land. The response began with the initial closing of schools and has now evolved into prefectures implementing stay-at-home orders in an effort to contain, stop the spread, and mitigate any further loss of life.

Japan was supposed to be the focus of the world this summer as it hosted the 2020 Olympics, a crowning achievement for Prime Minister Shinzo Abe. However, this will have to wait a year as it will now become the 2021 Olympics, in what will likely become one of the best conducted Olympic games of the modern day as a result of Japan's determination, preparation, and desire to shine for the world. While sports will help to bring the world together when they resume play, the challenges leading up to the postponement of the Olympics bring into focus the challenges that major projects, including the development of integrated resorts, will face as the world seeks to return to its original timeline. Major conventions and events are still being postponed or canceled. Everyone's operations, whether at home or at a major corporation, continue to be impacted.

Each of the major integrated resort entities that are currently working to obtain a license in Japan is burning through cash daily as their existing operations remain closed. In some cases, these organizations have committed to paying their existing workforce during The Great Shutdown (Wynn Resorts and Las Vegas Sands Corp.). Operations in Macau have been treated differently, as the Macau regime has not allowed employees to be viewed as a variable expense. While some operators in jurisdictions outside of Macau have continue to voluntarily pay their employees, other operators have chosen to furlough their workers.

In a recent note by Gaming Analyst Barry Jonas at SunTrust Humphrey Robinson, it was estimated that the daily operating expense burn rate at current operation levels was $5.6 million for MGM, $6.0 million for Wynn, and $9.0 million for LVS. These numbers may be larger when considering cash rent payments, in the case of MGM, as well as other maintenance capex and cash interest. Melco Resorts on their earnings call in February 2020 reported that their daily burn rate in Macau was initially $3.0 million but had lowered to $2.5 million. While Macau is open today, it is far from a stabilized state as revenues are coming in at a trickle at best. This is due in part to the border restrictions between Macau and Guangdong Province in China. Other major markets like the United States and Singapore are at zero percent of stabilized operations with all casino operations shuttered.

These facts all bring into focus the Olympic-sized challenges that these operators face as they look to position themselves in an emerging market that some have been chasing for nearly two decades. As these companies continue to position themselves in the Japan market and RFP process, they will be asked about their ability to finance what will likely be among the most expensive IR projects in the world. This requires an evaluation of balance sheets that will show the challenges that were outlined above as operators focus on their operations in major jurisdictions including Las Vegas, Macau, and Singapore. While not an original part of any process, the stress test on balance sheets that has not occurred in previous RFI or RFC efforts will now likely be added.

PUTTING THE CART BEFORE THE HORSE

One of the biggest concerns from potential bidders and people that are actively following the process is the timeline. While there have been some adjustments to the process as prefectures engage in the RFP process, the central government timeline has not moved, even under the premise that the Olympics were moved.

As it stands currently, the central government will accept proposals from January 4 to July 30, 2021 and this timeframe will likely not move for a host of reasons. One of the main reasons for this is that the further this date gets pushed back, it is less likely that the integrated resort champion, Prime Minister Abe, will be spearheading the project. With public opinion still not in favor of IR implementation, as the public has not been appropriately educated on the subject through a targeted education campaign that highlights the IRs, there is still a bill in the Diet that would abolish the IR policy entirely. The current session, set to expire in June, would also have to take up the change in schedule should there be a desire to push back dates. Bringing up the timeline during this session could open up pandora's box on the entire IR debate.

For operators that will be putting forth a bid as part of an RFP process, one of the challenges that exists is the delay in the Fundamental Policy by the Ministry of Land, Infrastructure, Transport and Tourism. It was originally thought that this would be introduced earlier this year, but it was pushed back due to changes at the Casino Regulatory Commission and the delays caused by the 500.com scandal. Operators that are bidding in each of the prefectures are now being asked to provide commitments to the market when they still do not know the full rules that will be implemented and, therefore, cannot yet fully understand the market opportunity.

The Fundamental Policy is the final piece of the puzzle that Japan needs to complete in order to provide operators with a suitable environment. Some operators continue to look at Japan with great interest but want to know if it is a market in which they can ultimately succeed. Every operator that submits a business plan as part of an RFP process today technically should have a disclaimer to the effect of: "This submission is based on current conditions and may materially change based on the Fundamental Policy that is yet to be realized." Currently in Nagasaki and with the recent delay in Yokohama, potential bidders may get a fair advantage to determine their best business plan and RFP submission, as they would be due after the Fundamental Policy release, should it stay on schedule. Osaka and Wakayama have already launched their RFP processes. One would hope that operators would be given the chance to fully understand the Fundamental Policy prior to the full submission of their plans.

Prefectures are faced with their own set of challenges as they are being asked to keep to this schedule, with applications due to the Central Government in the next 15 months. They are also trying to navigate the waters in implementing their own local policy while trying to understand the Fundamental Policy's nationwide rules for engagement. Prefectures are running out of time to jumpstart the process as they need to meet the July 2021 deadline. Wakayama just recently laid out its timeline that began in late March, with the anticipated selection of an operator by November of this year. After this, they will begin to put together their submission to the Central Government, which will likely take another six months, in addition to pushing forward with any other local approvals so that projects can move forward once they are awarded one of the three licenses. This leaves little room for error, which is why operators are being asked to submit now in anticipation of meeting the deadline by July 2021.

However, as COVID-19 continues to impact the world on a daily basis, it could also delay the release of the Fundamental Policy as Central Government is redirected to more immediate needs as opposed to other long-term policy. With prefectures being forced to start their RFP process for the selection of an operator and investment consortium, it puts operators in the quandary of making commitments to the market that may not be possible because the economics of the project may not work due to the policy set forth by the federal government. The last thing that Japan likely desires in their journey is to have the market be untenable and cause quality operators to leave the opportunity.

Overall, GMA currently believes that any adjustment into the overall timeline will be minimal as the Central Government continues to push forward with its timeline of 2021 for the submission by prefectures. However, a delay in the Fundamental Policy beyond July 2020 could potentially cause an adjustment of three to six months in the timeline. For all intents and purposes, this would allow for a more transparent process that balances potential operators' desire to understand the full market opportunity and be able to put forward business plans that make sense for the market once the regulatory structure has been crafted. It also allows prefectures the ability to understand what commitments can and cannot be realized by these bidders, as operators will not enter into a market in which they cannot succeed.

Proposed Timeline for Integrated Resorts Development in Japan	
2019	
	Issuance of RFP - Osaka (December 20th)
2020	
Q1	Formation of Casino Regulatory Commission (State Independent Regulatory Author
	IR Zone Selection Committee created by MLIT Minister
	Issuance of Local Implementation Policy by Candidate Prefectures
	Issuance of RFP - Wakayama
Q2	Issuance of Local Implementation Policy by Candidate Prefectures
Q2 - Q3	Issuance of Core Decrees and Regulations
	Establishment of Fundamental Policy by Minister of MLIT
	Criteria for Selection Process of Zones
Q3	Issuance of Local Implementation Policy by Candidate Prefectures
	Issuance of RFP - Yokohama (August)
	Issuance of RFP - Nagasaki
Q4	Selection by Candidate Prefectures of Operator Group - Osaka
	Selection by Candidate Prefectures of Operator Group - Wakayama
	Selection by Candidate Prefectures of Operator Group - Nagasaki
	Selection by Candidate Prefectures of Operator Group - Yokohama
	Potential Selection by Other Candidate Prefectures of Operator Group
2021	
Q1 - Q3	Potential Selection by Other Candidate Prefectures of Operator Group
	Local Approval of Development Plan
	Preparation and Submission of Zone Implementation Plan
Q1 - Q3 (July)	Submission of IR District Development Plan for MLIT Approve from Local Prefecture
Q3 - Q4	Review and Presentation of IR Zone Implemention Plan to MLIT Minister
Q4	Minister selects up to three (3) Zone(s)
2022	
Q1	Minister approves Draft Contract between Prefecture/Operator Group
	Operator Group applies for Casino License
Q3 - Q1'2023	Financial Close and Construction Begins
2026	
Q1 - Q3	IRs Begin Operations

Source: Global Market Advisors
Based on current events as of 4/24/20

KILLING THE GOLDEN GOOSE

As outlined above, the Fundamental Policy will determine a majority of the opportunity that exists in Japan. This is in addition to the local policy that each prefecture establishes to govern the potential IR, assuming they are selected as one of the three potential locations. However, Japan needs to understand that policies have a push-and-pull effect, and legislators need to be careful not to kill the golden goose before it lays its eggs with the development of an integrated resort. This includes, but is not limited to, taxation, casino size and scope, infrastructure commitments, and other key aspects of the development. There are also issues at the local level, where local governments continue to modify the rules as they go, such as asking for additional commitments on infrastructure projects, adjusting rent in land leases, required partnership structures, and other issues that continue to push the development structure of these potential submissions.

One of the issues that arose at the end of last year was whether to tax foreigners on their gaming winnings before they exit the country. This would be opposite of the tax-free shopping that exists in Japan today. One can purchase an expensive pair of shoes or another good and take it back to their home country tax-free. Under this proposal, gaming winnings would be treated differently. If one of the main purposes is to drive tourism, this policy would be contrary to allowing gaming to be driven by tourists. This is already the case for the domestic market due to the tax that has already been implemented through the local casino levy of ¥6,000. If this additional policy were to be implemented, it would make it extremely difficult for operators that are tasked with driving international tourism and implementing a plan to utilize attraction enhancement facilities and tourism enhancement facilities in their integrated resort plan. Projections would mirror today's tourism traffic in a COVID-19 world, as very few tourists will come to a market to participate in gaming only to be taxed on their way out to the door. If this tax would be implemented, it would destroy the market opportunity on foreign gamblers.

The example above is one of the many items that still need to be decided as part of the Fundamental Policy. This includes the ability to finalize what additional taxes may apply to different aspects of the IR, the regulatory structure that will govern them, the counting of floor space for the gaming facility, and other non-gaming components in the overall structure. Using evidence-based information and best practices is the best course of action to craft a market that is as desirable and attractive as those in Nevada and Singapore, models of strict regulatory structures.

Japan cannot overlook the notion that a significant multi-billion-dollar investment is one that does not happen in every jurisdiction, let alone the opportunity to have up to three at the same time. The country must be careful not to seek a few more tax dollars at the cost of losing billions more in investment. Japan has the opportunity to build the next generation of IRs in a meaningful way and has spent the better part of the last 20 years waiting to get to this point. Overtaxing the industry or further inundating the process could turn away the most qualified operators. The gaming and non-gaming amenities of the IRs would generate billions of dollars in tax revenue. At this point in the process, one must realize the overall opportunity and not get overzealous in its attempt to produce a little more revenue.

THE $10 BILLION QUESTION

As the process unfolds, one of the key questions that will be answered is whether operators will maintain interest in new markets given how the current environment is impacting their overall liquidity and balance sheets as well as how that may impact each potential bidder's ability to commit to a project. Every prefecture that plans to submit to the Central Government will look into the financial suitability of these organizations as well as their long-term ability to finance a project that may in some cases reach $10 billion or more in investment.

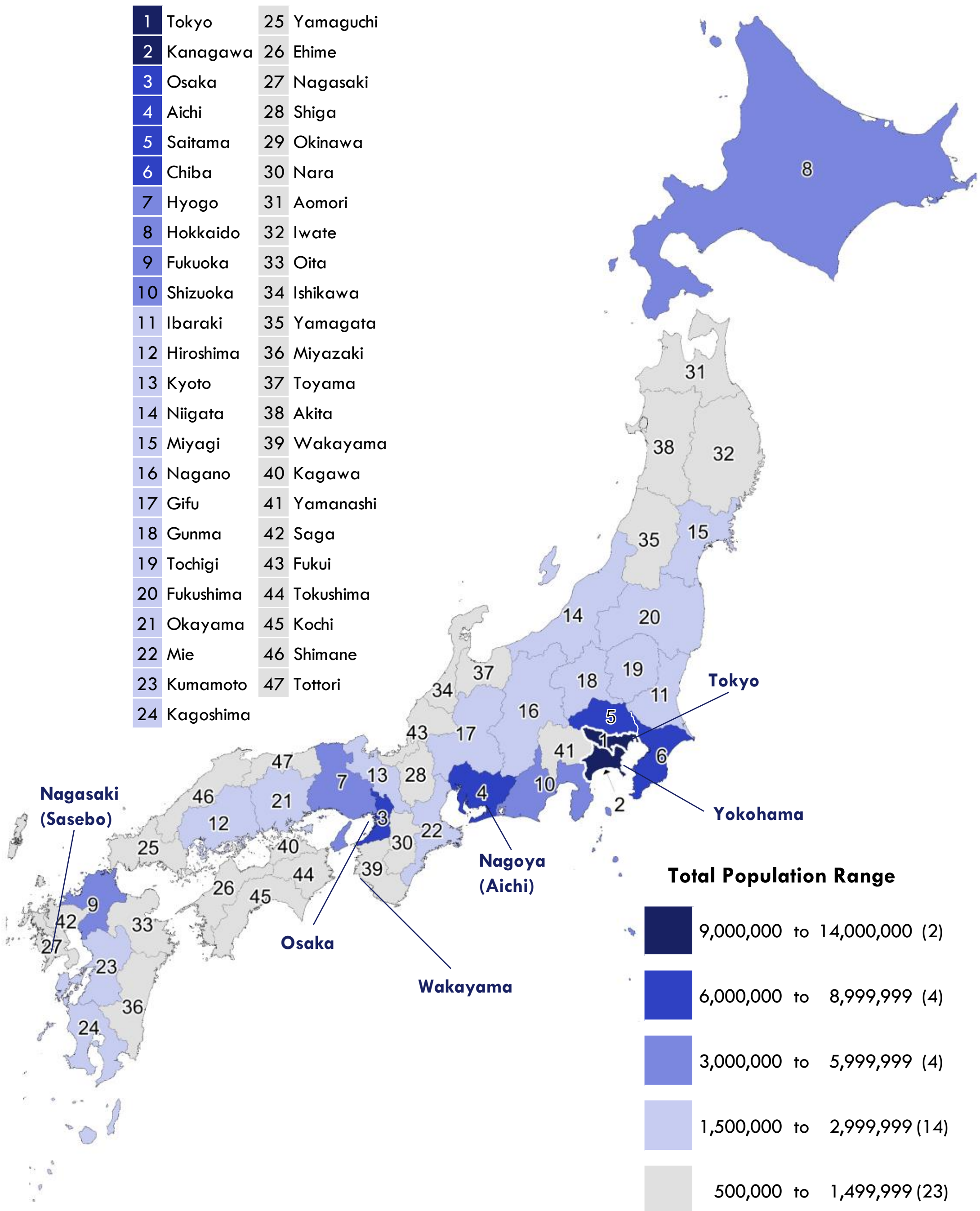
While it is more expensive to build an integrated resort in Japan, the $10 billion figure was already in question as operators and prefectures were trying to fully understand the opportunity from a financial perspective. Operators and their partners are trying to model the payback from these facilities considering the constraints that exist in the license term and the revenue limitations on the gaming floor. Additionally, prefectures have been focused on the proposed levels of investment as they continue to ask operators for further concessions in infrastructure and other community efforts that only increase the costs that will be undertaken with these facilities. There may eventually be a breaking point where either there is simply too much asked of the bidder or costs become too high to proceed.

THE SHRINKING LANDSCAPE

When GMA initially released its White Paper in 2017, the number of interested prefectures was significant. However, the number continues to dwindle as prefectures determine whether to pass and wait for the next round of licensing to occur seven years after the initial three are chosen.

Some of these prefectures that have taken a pass over the last few months include Hokkaido, which was looking to host an IR in Tomakomai, as well as Chiba in the Kanto region, and both Fukuoka and Kitakyushu which are stepping out as Sasebo in Nagasaki tries to position itself for a license. Currently, GMA believes that there are only six viable locations, with two of these – Nagoya and Tokyo – yet to formally raise their hands in the process. The other four prefectures that have active efforts are Nagasaki/Sasebo, Osaka, Wakayama, and Yokohama. All six of these prefectures are highlighted on the following map. Regarding the perceived crown prize of Tokyo, GMA has long stated that it is not a matter of *if* but *when* they will announce that they will participate in the process. Such an announcement could occur by the end of this summer following the Governor's reelection. The addition of Tokyo could cause several operators and prefectures to potentially rethink their strategy.

Potential Japan Integrated Resort (IRs) Locations



Source: Global Market Advisors, as of April 24, 2020

WEATHERING THE STORM

Japan continues to present the greatest opportunity across the globe for integrated resort development. However, Japan must realize that its place in the future of IR development must be balanced with the ever-changing world that exists; and this is true now more than ever, as the global community deals with the coronavirus. It must consider the impact on every casino and industry leader in the gaming world as it faces its greatest challenge across the globe. It also must give operators and prefectures the chance to put forth strong bids by knowing the full Fundamental Policy before they submit their initial RFP at the local government level.

Japan's opportunity is worth weathering the storm and potentially allowing some slight modifications in the timeline to, at a minimum, allow for the Fundamental Policy to be released, commented on, and finalized by operators to put forward their bids with all of the necessary information in hand. Every potential bidder in Japan, along with every prefecture at this point, has been impacted by COVID-19. It is imperative that this is considered as well as the stakeholders' response to the crisis as Japan adjusts in the future. The selection of the operators from this process will further help Japan pick the best partners as it looks to select up to three operators for their initial round of integrated resorts. It is about the journey and getting the process right in the development of a premiere gaming and tourism destination. It is about staying the course while adjusting appropriately to account for the uncharted waters that the industry is experiencing due to the current pandemic.

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