



# Global Market Advisors

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## Research Brief: Understanding Casino Operations

April 2020

Given the uncertainties of coronavirus disease (“COVID-19”), investors are looking to understand the general operating parameters of a given casino operation and fixed versus variable expenses. This document provides detail on the intricacies of casino operations from a revenue and expense standpoint, including gaming revenues, operating expenses, and earnings before interest, taxes, depreciation, and amortization (“EBITDA”). The goal of this exercise is to provide an understanding of how these items may fluctuate between operators, as well as between jurisdictions. Additionally, this document will provide readers with an understanding of fixed versus variable expenses (for facilities that are open), allowing investors to more accurately project the performance of target properties under a variety of recovery scenarios.

The following discussion is based on Global Market Advisors’ (“GMA”) experience of reviewing hundreds of income statements from casino properties across the world. For the purposes of this analysis, GMA focused its evaluation on regional gaming operations in the United States, representing casino operations that have generated between \$50 and \$700 million in annual gaming revenue. Often, the only access that investors may have to operating income statements would be from those published from Nevada and New Jersey. As will be seen within this document, many departmental and overall margins vary greatly from casinos between these and other states. While many operations may have expenses that lie outside of the ranges presented in this report, the overwhelming majority of regional casinos across the United States likely fall within these ranges.

GMA is the leading international provider of consulting services to the gaming, entertainment, sports, and hospitality, industries. The company's market experience extends throughout all regions of the Americas, Europe, Australia, and Asia. The company provides clients with strategic planning, market feasibility studies, primary research, due diligence, general counsel, payroll control, operations analyses, government relations, crisis communications, responsible gaming initiatives, business and marketing plans, and reward program design.

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## GAMING REVENUE

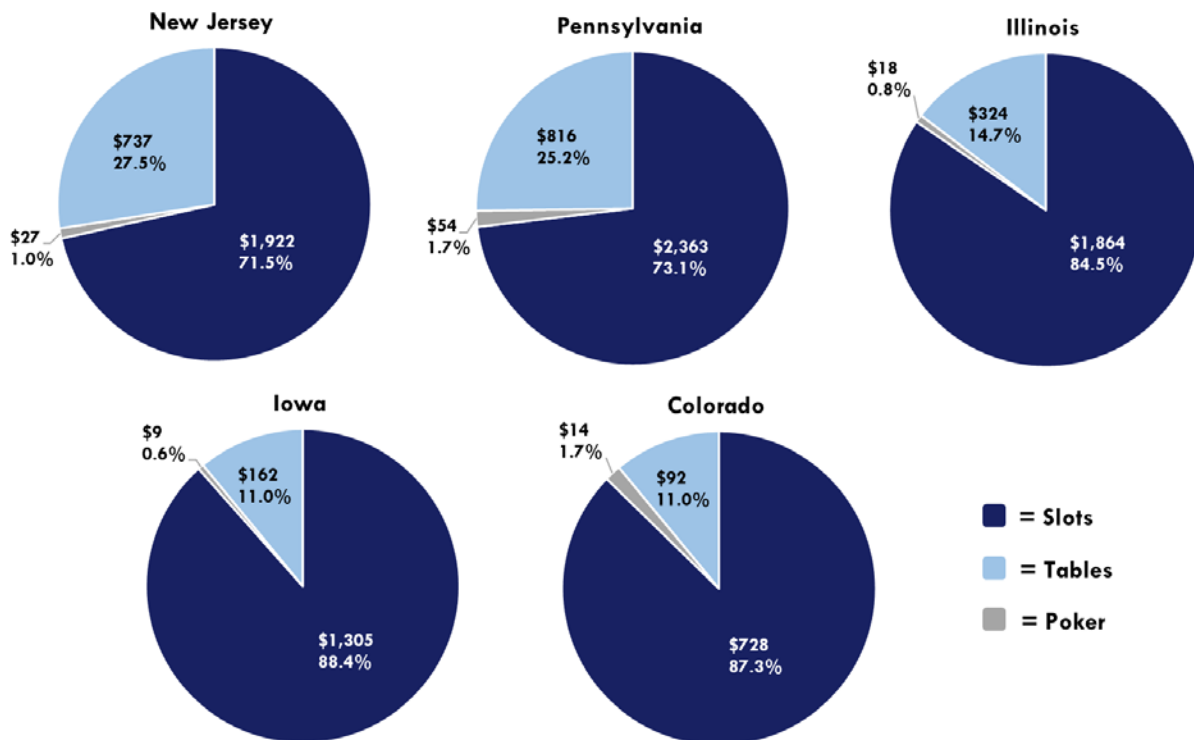
Gaming revenue, or win, refers to the total amount of money wagered at a casino, less payouts to players. In most jurisdictions, gaming revenue is a known number that must be reported on a monthly, sometimes weekly, basis. In Indian Country, however, the numbers are not often publicly available. Typically, in Indian Country, slot machines generate a higher percentage of total gaming revenue compared to table games. While this is often due to the restrictions placed on the types of table games and/or limits that a casino can offer, this can at times be attributed to the apprehension of tribal leadership to accept the risk of offering higher limits for table games.

Outside of Las Vegas, slot machines tend to comprise between 70% and 90% of gross gaming revenue (“GGR”). As this percentage can vary significantly, a good rule-of-thumb is to assume an 80/20 split of gaming revenue between slots and tables. In general, the more rural a location is, the higher the percentage for slot revenue is, as the consumer’s lifestyle seems more to fit that of a typical slot player. Poker revenue is highly dependent on the availability of poker options to a local population. While certain casinos can offer popular poker options, they rarely generate revenues as significant as slots or traditional tables, and their players can often expect to receive large amounts of incentives to play despite them making up only a small piece of the overall profit. Many operators use poker options as an amenity to attract a wider range of patrons to their properties. The following table illustrates the spread of slots, tables, and poker in select regional markets throughout the United States.



## 2019 Slot, Table, and Poker Revenue Comparison - Select Markets

Revenues in USD millions



Source: GMA, NJ Division of Gaming Enforcement, Pennsylvania Gaming Control Board, Illinois Gaming Board, Iowa Racing and Gaming Commission, Colorado Division of Gaming

### SLOTS

When evaluating slot revenue, it is crucial to look at net versus gross slot win. Whereas gross slot win is inclusive of freeplay, net slot win subtracts freeplay from gross slot win. As such, when comparing the performance of casinos from jurisdiction to jurisdiction, it is crucial to ensure an “apples-to-apples” comparison as some states report gross revenues and others report net revenue.

Freeplay is far from free and can often make up a casino’s greatest marketing expense, particularly in jurisdictions with a high tax rate, such as Pennsylvania. For example, in Pennsylvania, 20.6% of all gross revenue is freeplay, with some properties reporting over 30%. To further complicate the matter, some jurisdictions have created their own vernacular for each category. They may report a figure as “gross revenue” when it is actually net of freeplay. For example, in Pennsylvania, “gross terminal revenue” is gross slot revenue less freeplay. To this end, it is often necessary to evaluate whether freeplay is included instead of relying on the “gross/net” definition provided by the jurisdiction.



Slot machines, which tend to generate roughly 80% of any regional operation's revenues, are rather inexpensive to operate. After all, they really are nothing more than a computer with flashing lights plugged into a wall. However, it is crucial to identify appropriate games (referred to as titles or game mix in the casino industry) that appeal to customers. As such, slot manufacturers often do not immediately sell their latest and greatest devices. Rather, they provide the machines to operators for either a fee per day or on an 80/20 revenue sharing split, where the manufacturer receives 20% of the daily net slot revenue. These are known in the industry as fee-based games. Casinos are also often required to pay a minimum revenue share, such as \$70/day. For a more remote casino, that minimum can often make those machines unaffordable for the facility. Overall, between 5% and 8% of casino's slot machines should be the more popular revenue-share machines, although many operators have been going below that threshold in an effort to save operating expenses, which at times can be detrimental to revenue. As an expense, this will usually cost between 1.3% to 2.3% of slot revenue.

The other two primary expense categories for the slots department are payroll and slot parts. It is surprising how often the buttons on machines need to be replaced from players banging away on them all day long. Generally, the busier the casino, the higher the expense to fix the machines as they are being used more frequently. In any given year, a casino could expect to pay between \$500 to \$1,500 per machine to keep them running properly. Another major expense for casinos, which is generally shown below the EBITDA line on the income statement ("IS"), is the capital required to replace machines and titles. Generally, casinos look to replace between 10% to 20% of their titles on the floor each year, down from decades ago when casinos generally replaced 20% to 25% of their floor each year. This usually involves a mix of buying new machines, which can cost up to \$27,000 each, and conversion kits by purchasing a new title and decorative glass from the manufacturer, which ranges from \$2,500 to \$8,000 per device.

Payroll for slots is usually limited to slot maintenance and slot attendants to help customers with problems or provide hand-pays on jackpots over \$1,200. Slot payroll can generally range from 1.8% to 6.0% of gross slot revenue. It is important to use gross revenue rather than net, as gross revenue is more representative of how much play is going through the machines. From a fixed versus variable perspective, payroll can vary to a certain extent, but one must keep minimum staffing on the floor, even during slow times, to ensure proper levels of customer service. However, the maintenance cost is generally variable based on the amount of machine usage, and participation expenses are directly variable, unless there is a daily minimum that tends to be the dominant figure for determining the expense. Overall, approximately 60% of slot expenses are variable.



Casino Slot Expenses		
	Low	High
Slot Revenue as % of Total Gaming	70.0%	90.0%
Slot Expenses as % of Slot Revenue:		
Salaries and Wages	1.8%	6.0%
Participation Expenses	1.3%	2.3%
Parts and Other (Per Device)	\$500	\$1,500

Source: GMA

## TABLE GAMES

The single greatest expense in table games is payroll. A good table games director will understand how to staff tables appropriately to ensure the high limit tables are always available and that the low limit games are near capacity, while still allowing for some availability. Other than payroll, expenses are generally limited to the cost of dice, cards, replacing felts, and rental cost for the automatic shufflers. However, overall operating expenses can vary greatly depending on the demand of table players and the types of games offered at a casino.

An efficient table games department will operate with expenses as low as 30% of table revenue, and as high as 45% to 50%. Generally, table games operating expenses can be expected to range from 35% to 40% of table revenue. Except for the cost of renting shufflers, table games expenses are variable as one can reduce staffing at the tables when demand is low. However, in a situation where the volume of play is the same but the spend per customer is lower, the expenses remain the same as table payroll is based on the volume of players, not the volume of play. Similar to slots, nearly 70% of expenses will generally be variable based on volume of play.

## POKER

Although variable, it can generally be assumed that poker expenses will vary from 70% to 80% of poker revenue. This is a highly variable department, as most of the expenses are related to payroll and the level of play can be more predictable. Additionally, poker players are more predictable, in the sense that they will always go to the facility that has the best “game”, or their favorite game.

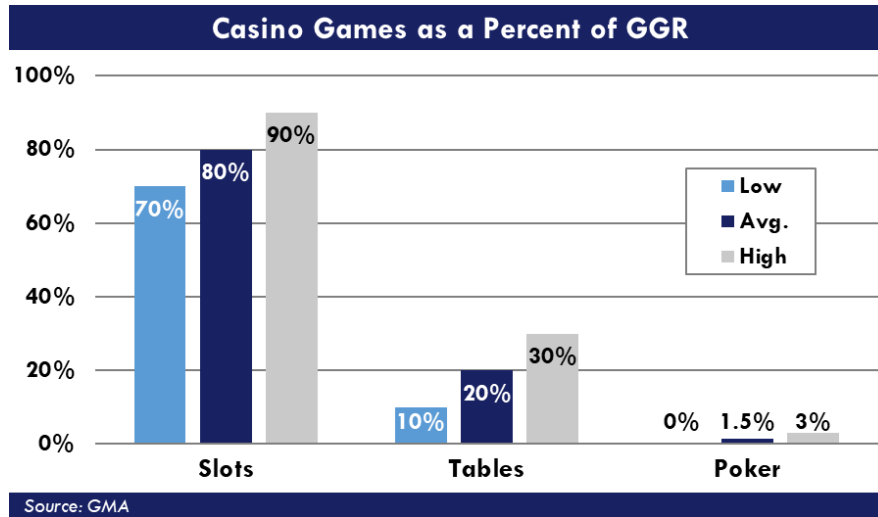
## CAGE AND COUNT

Not included in the areas above is the cost of the cashiers and drop team to count the money. With the advent of additional self-service kiosks, casinos have continued to realize savings in this department. However, while cashiers can be reduced as the business flow is down, most of this category’s expenses are primarily fixed. Generally, these expenses range from 1.3% to 1.8% of gross gaming revenue.



## GAMING REVENUE SUMMARY

The following table summarizes the expense margins of a casino operation by department. On average, casino expenses can be expected to range from 8.7% to 23.3% of GGR, depending on the size and scope of the casino. GMA notes that the table below does not include gaming taxes, which vary drastically throughout the United States and are often the highest expense to a casino operation. A further discussion of gaming taxes is provided later in this report.



<b>Gaming Expense Summary</b>			
	<b>Low</b>	<b>Average</b>	<b>High</b>
Slots (% of Slot Revenue)	3.8%	7.1%	10.4%
Tables (% of Table Revenue)	30.0%	40.0%	50.0%
Poker (% of Poker Revenue)	70.0%	75.0%	80.0%
Cage & Count (% of GGR)	1.3%	1.6%	1.8%
<b>Weighted Avg. Expenses (% of GGR)</b>	<b>8.7%</b>	<b>16.1%</b>	<b>23.3%</b>

Source: GMA



## OTHER REVENUE DEPARTMENTS

Historically, operators focused only on the casino department, and the other revenue departments were simply loss leaders. However, as Las Vegas has clearly demonstrated, non-gaming amenities can be profitable as well. As regional gaming has expanded across the United States, operators continue to recognize the need to further find available gross operating income from all operating departments. It is important to remember that any non-gaming amenity given to a customer on a complimentary basis would appear on the overall income statement as a “Promotional Allowance” and as revenue in the subject category’s IS. On the departmental IS, it is common for casino operators to show two sources of revenue: “cash” and “comp.”

### HOTEL

In casino hotels, occupancy levels are usually very high, with operators rarely seeing figures below 80%. Regional operators have incentives to fill their rooms, as it is likely that a healthy percentage of guests will also enjoy the casino during their visit. However, due to a large percentage of guests receiving discounted or complimentary hotel rooms from the casino, and the willingness of the casino to charge cheap rates for other available rooms, comparatively low average daily rates (“ADRs”) are experienced when taking into account the usual quality of the regional casino hotel. Overall, ADRs tend to range from \$100 to \$150 throughout these facilities.

In terms of operating expenses, it is best to look at the hotel in terms of the cost to “flip” (or turn over) a room. With a regional casino hotel, the other operating expenses (marketing, maintenance, etc.) are integrated throughout the rest of the resort’s operating income statement. In evaluating the cost per Room Night of Demand (“RND”), it should be evaluated whether the hotel’s ADR exceeds the cost to flip the room and to what degree. In doing so, it is important to note that a nicer hotel will logically have a higher cost associated with turning over a room than a lower quality hotel property. As an example, Wynn Las Vegas, compared to Circus Circus, needs to spend significantly more money when it cleans and turns over its rooms.

Overall, for a regional gaming resort, it generally costs between \$30 and \$60 to flip a room depending on the quality level of the hotel and other market dynamics. This number is mostly variable as the largest expenses, payroll, can be reduced if a property is experiencing large declines in occupancy. Additionally, as shampoos and other similar goods are only used when the room is used, the cost of these goods can also be reduced if occupancy declines. Overall, rooms expense generally comprise between 35% and 45% of rooms revenue. The following table illustrates the average cost to turn a hotel room. GMA notes that these expenses may increase over the near term based on current events and the uncertainty surrounding COVID-19.





Regional Hotel Operating Metrics			
	Low	Average	High
Occupancy	80%	89%	98%
ADR	\$100	\$125	\$150
Cost to Turn a Room	\$30	\$47	\$60
Expenses as % of Revenue	30%	38%	40%

Source: GMA

## FOOD & BEVERAGE

Food & beverage (“F&B”) has historically been one of the greatest challenges for gaming operators. Over the history of regional gaming, F&B has evolved from simple fuel for customers to an amenity to help drive more business and lengthen the stay of each guest.

Unfortunately, as it used to be acceptable for this department to lose money, many operators continue to believe that a good F&B operation cannot be profitable. This notion is wholly untrue, and F&B remains one of the greatest sources of potential upside for a gaming operation. A well-run F&B operation should provide a quality food product with good service, which will result in additional customers and a limited amount of profit. While the casino itself will always remain the key profit center, F&B can also assist with the bottom line. However, GMA has seen many operators turn to significant increases in prices as the solution to success, but this simply turns away gaming customers and hurts the operation in the long run.

A highly successful F&B department will generally run a 75% expense margin on F&B revenue, with the average margin achieved by proper operators generally reaching approximating 85% today. The two prime costs of F&B are the cost of goods sold (“COGS”) and Payroll. COGS will generally run from 35% to 45% of revenue and Payroll from 37% to 50% of revenue.

The quality of F&B operations also directly impacts the percentage that they contribute to overall revenue. As a percent of gaming revenue, F&B revenue for a local grind joint could be as low as 6% of gaming revenue, whereas F&B revenue for a robust regional casino could have F&B revenue as high as 17% of gaming revenue.



Food & Beverage Expense Margins		
	Low	High
As % of Gaming Revenue	6.0%	17.0%
Expenses:		
Salaries and Wages	37.0%	50.0%
COGS	35.0%	45.0%
<b>Total Expenses</b>	<b>72.0%</b>	<b>95.0%</b>

Source: GMA

## ENTERTAINMENT

Outside of Las Vegas, entertainment simply remains a loss leader on a stand-alone basis. Some of these losses can be covered by concessions and merchandise sales, but the greatest impact is felt on the gaming floor. However, this can be hard to demonstrate quantitatively as well. The goal of entertainment is to ensure that the acts are appropriate for the core gaming customer, and that the facility is the right size to ensure that not too much money is lost. Overall, the goal for most casinos is to break even on entertainment, while trying to keep operating expenses to no more than 110% of entertainment revenue. When this figure rises above 130%, there are likely savings to be had, which often can often be realized through reducing the talent level, moving to non-traditional entertainment, or better negotiations with the talent, which is where all the expenses are found.

## GAMING TAXES AND MARKETING

While they are counterintuitive, Gaming Taxes and Marketing are discussed in the same section as marketing expenses are highly dependent on the local gaming tax rate. A great example can be found in looking at the difference between Pennsylvania and New Jersey. In Pennsylvania, the tax rate on slot revenue is onerous at 54%, whereas table games are more reasonable at a 16% rate. In New Jersey (Atlantic City), the casino gaming tax rate is 8% (although the effective rate is slightly higher due to other fees casinos must pay). As Pennsylvania's slot tax rate is so high, casinos simply cannot afford to give away too many complimentary items or play incentives to their players and market their facilities appropriately in such a competitive environment.

Atlantic City (and New Jersey) should thank Pennsylvania for passing such a high gaming tax rate. If it had not done so, then Pennsylvania casinos would have had more revenue available to provide complimentary hotel rooms and dining to their players, thereby gaining a competitive advantage against Atlantic City and giving the nearby population further reason not to travel to Atlantic City to gamble. This is qualitatively illustrated by the following example: At a 30% reinvestment rate (exclusive of freeplay), Atlantic City operators would still be making roughly a 57% gross operating income margin on a given slot player. However, if the same 30%



reinvestment rate applied in Pennsylvania, the operator would realize a gross operating income margin of roughly 11%. While a 30% reinvestment rate may sound high when not including freeplay, many Atlantic City casinos would happily offer free room nights and dinner for two to a player from Pennsylvania to attract them down to the shore.

It is for this reason that we see such high levels of freeplay being offered in Pennsylvania casinos, as this is truly the only reinvestment that they can afford to give as it is not taxed.

Reinvestment for a \$500 Slot Player			
	PA	Atlantic City	
Average Win From a Premium Player	\$ 500	\$ 500	
Taxes to State	(270)	(40)	
Revenue After Tax	230	460	
30% Reinvestment Rate	(150)	(150)	
Operating Expenses	(25)	(25)	
<b>Gross Operating Income</b>	<b>\$ 55</b>	<b>\$ 285</b>	
GOI Margin	11.0%	57.0%	
Source: GMA			

## GAMING TAXES

Gaming taxes are one of the most variable expenses in the casino industry as they typically are tied to gaming revenue directly. Some states have implemented tiered tax rates, such as Indiana, where gaming revenues are taxed between 15% and 40%, and Illinois, where gaming revenues are taxed between 15% and 50%. Other states have instituted a rate that is a straight percentage of win. In some states, there are annual device fees, which are fixed based on the number of positions on the gaming floor. However, these fees are generally rarer and more minimal in comparison to a given state's tax rate. The rates charged range from a low of 6.75% in Nevada to over 50% in some states. In certain states where the lottery oversees casino gaming, such as in Maryland, Delaware, and Rhode Island, the state retains a sizable majority of revenues and pays the remainder to operators as a commission or management fee. However, when considering that the state also supplies the slot machines to its operators and pays to maintain them, the effective rate in in these states is lower than the published tax rate.

In an environment such as today, the advantage of a high tax rate is that it does allow for a casino to immediately cut back on one of its largest operating expenses. However, the much greater negative result of a large tax rate is that it prevents operators from having enough operating income to invest in non-gaming amenities, such as hotels, restaurants, and spas, which hinders an operator's ability to expand its market potential and continue to evolve with the overall market. There is a direct correlation between Nevada having both the lowest tax rate and the



largest integrated resort properties in the United States. The following table summarizes slot and table gaming tax rates for select markets within the U.S.

Current Gaming Tax Rates - Select Markets		
State	Slots	Tables
Nevada	6.75%	6.75%
New Jersey	8.0%	8.0%
Mississippi (1)	8.0%	8.0%
Arkansas (2)	13.0%	13.0%
Colorado (3)	20.0%	20.0%
Iowa (4)	22% - 24%	22% - 24%
New York	37% - 45%	10.0%
Maryland (4)	53.0%	20.0%
West Virginia	53.5%	35.0%
Pennsylvania (5)	54.0%	16.0%
Delaware	57% - 58%	20.0%
Rhode Island	71.5% - 74%	81% - 83%

Source: GMA  
Notes: (1) Additional 3.2% tax on slot & table revenues assessed by most, but not all, localities in Mississippi; effective rate is 11.2%. (2) 13% rate applies to the first \$150 million in gaming revenues. Additional revenues are taxed at 20%. (3) Tiered tax rate, with the 20% rate applying to revenues above \$13 million. (4) (3) Racinos pay 22% to 24% in gaming taxes. Casinos are taxed at a tiered rate, with 22% applying to revenues above \$3 million. (5) Slot taxes in Maryland range between 40% and 61% depending on the operator. As of Feb. 2020, the effective statewide rate for the fiscal year to date was 53%. (6) \$10 million local license renewal fee in addition to 54% tax rate. (7) The Rhode Island Lottery retains a vast majority of gaming revenues, with the remainder being in paid to operators as a commission or management fee.

## MARKETING AND PROMOTIONAL ALLOWANCES

Marketing is generally the largest variable operating expense of a casino resort. When casinos refer to marketing expense, it is usually inclusive of three primary categories: freeplay, promotional allowances, and marketing & advertising. Depending on the casino, these expenses can appear in a variety of areas on the income statement. In some casinos, freeplay is not even listed on the income statement as it is recorded as a contra revenue, as outlined in GAAP accounting. Promotional Allowances (comps, or the retail value of goods given to a player on a complimentary basis) may be presented as a line item between gross revenue and net revenue, or they may be found in the slots department and tables department based on who received the rewards. Although varying approaches may be taken to address these items, GMA prefers to call out freeplay and promotional allowances after gross revenue in order to arrive at a net revenue



figure, and then provide for a separate line for marketing under operating expenses. (It is important to note that financials utilizing GAAP accounting will not have promotional allowances listed.)

#### FREEPLAY

Freeplay is one of the numbers that varies the greatest from state to state. As previously discussed, states with higher tax rates often have some of the higher levels of freeplay being issued, providing that it is not taxed. However, some states will allow up to a predetermined percentage of slot revenue to be given to players before taxes, therefore dissuading operators from giving away too much freeplay. In New York State, for example, when an operator goes above the 10% threshold for freeplay, that operator owes the state about 40 cents (varies from racinos to resorts) in taxes on every dollar of freeplay that is redeemed, which makes freeplay far from free.

It is important to understand that when freeplay is not taxed, it artificially lowers the hold (or the percentage of coin-in that is retained by the casino) on slot machines. To counteract this, operators often increase the slot hold percentage programming to ensure that they can maximize the share of their player's wallet. The basic slot hold calculation is the amount wagered divided by the amount paid to the patron during one full cycle of the game. A basic slot game cycle is the total number of possible combinations that can be displayed to the patron. With an assumed 3 reels of symbols on a basic slot machine, the number of symbols on each reel (20) should be taken to the third power to determine the number of possible combinations ( $20^3 = 8,000$  possible combinations for a full cycle of the game).

The following section provides an example from Wind Creek Bethlehem in 2019. As can be seen, the casino held 9.9% on gross revenue and 6.2% on net revenue. This means that for every dollar wagered, 90.1 cents were given back to the player on a gross basis, and 93.8 cents given on a net basis. From a time perspective, this means that a dollar wagered by a player redeeming freeplay lasted about 55% longer than the one that didn't redeem freeplay. As such, this makes it harder to attract new players. When a player comes to the casino but hasn't earned freeplay yet, they quickly lose their money and many not have had the entertainment experience that they desired. It is then the goal of the casino to value their actual loss (versus theoretical) and send them an offer with freeplay to entice them to return (which is not often executed well at many casinos across the United States).



Wind Creek Bethlehem 2019	
Coin In (MM)	\$ 4,536
Gross Slot Revenue	\$ 447
Freeplay (MM)	\$ (162)
Net Slot Revenue	\$ 285
Slot Hold (Gross)	9.9%
Slot Hold (Net)	6.3%
Source: PA Gaming Control Board, GMA	

Overall, freeplay generally ranges from a low of 3.5% of slot revenue to as much as 15% of slot revenue or more. As illustrated above, there are outliers to this, such as Wind Creek Bethlehem at 34% and some Native American properties where the number may be as low as 1.5%, although both of these two examples are rare.

#### PROMOTIONAL ALLOWANCES

Promotional Allowances (promo allowances or comps) are the retail value of goods given to customers on a complimentary basis. Examples of these include free or discounted hotel rooms, food & beverage comps, spa treatments, concert tickets, etc. In addition, some casinos also consider freeplay and/or table match coupons as part of promotional allowances as well. As a percent of revenue, these generally range from a low of 3.5% of GGR to a high of 9.0% of GGR, when considering only non-gaming goods given away.

Generally, a casino with a larger number of amenities will have a higher percentage of promo allowances as they have more options to offer as comps to players. It is likely that the reason that the more robust resort was built and/or expanded was to allow the operator to attract a larger or more diverse group of customers. As a rule of thumb, a casino that has a higher level of comps is able to offer lower levels of freeplay. For casinos that are able to offer alcohol for free (certain jurisdictions prohibit casinos from giving away complimentary alcohol), this can often account for 1.0% to 2.5% of gaming revenue. Many argue whether it is beneficial to give away alcohol for free, as some operators see it as a blessing in disguise when they are prohibited from doing so. Provided that a casino charges relatively low prices for drinks and offers ample floor service to accommodate their customers, the disadvantages of having to charge for drinks can be mitigated and have the same effect on gross operating income while still giving customers what they want.

#### MARKETING & ADVERTISING

The primary buckets in this category include direct mail (cost to produce and redemption thereof), promotions, special events, bussing, advertising, and payroll. As with most businesses, this category typically approximates 5-6% of revenue, but can vary from as low as 3.5% to a high



of 8.5%. Logically, the more competitive the environment, the higher this number will be. In addition, this figure will tend to be higher for casinos who do not have as high-quality of a product and therefore need to “buy” more of their business. Advertising and direct mail each typically approximate 2.0% to 3.0% of revenue; promotions and special events will run between 0.50% to 1.75%; direct payroll will approximate 0.75% to 1.50% (much of which accounts for staffing of the rewards club); and the rest is distributed between the remaining categories.

The following table summarizes casino marketing expenses as a percentage of gross gaming revenue.

Casino Marketing Expense Margins		
	Low	High
Expense as % of GGR:		
<b>Freeplay</b>	<b>3.5%</b>	<b>20.0%</b>
<b>Promo Allowances</b>	<b>3.5%</b>	<b>9.0%</b>
Alcohol Comps	1.0%	2.5%
<b>Marketing &amp; Advertising</b>	<b>3.5%</b>	<b>8.5%</b>
Advertising	2.0%	3.0%
Promotions/Events	0.5%	1.75%
Direct Payroll	0.75%	1.5%
<b>Total Casino Marketing</b>	<b>10.5%</b>	<b>37.5%</b>
Source: GMA		

## PLAYER REINVESTMENT

Player reinvestment is the sum of casino marketing expenses that are spent directly on players to incentivize them to play. Player reinvestment should generally only be given to players that are part of the reward program and utilize their players club card during play. These costs include all comps redeemed by carded members (F&B, hotel, etc.), all points that are redeemed (not accrued), redeemed mail offers, all freeplay offers, the costs of promotions that are predicated on the use of a rewards card, and the costs of events for certain segments of the casino database. Advertising placement and production, marketing administration, direct mail printing, and postage are not forms of player reinvestment.

Discussion of Player Reinvestment is used in terms of relationship to carded slot play and rated table game play, which refer to the amount of play that is recorded through the use of the casino’s player tracking system. Player Reinvestment rates (player reinvestment divided by carded play) can vary but typically range from 20% to 30%. When a rate is greater than this, it is likely that the casino is overinvesting in many of its players. If the rate is below this level, either the casino operates in a more monopolistic environment where it does not have to invest too much, or it has a rewards program that players do not feel is competitive. Very often, a low



player reinvestment rate is found at a casino that has a low percentage of carded gaming revenue. Typically, a healthy percentage of carded gaming revenue ranges from 65% to 80%. Below that range, there are likely opportunities to expand market share, and above that range, casinos may be overinvesting in their players.

Player reinvestment does not show up directly on casino income statements. These are separate analyses completed by sophisticated marketing departments or by well-seasoned consulting firms, such as GMA.

## OTHER OPERATING EXPENSES

With the revenue departments discussed, the remainder of a casino's operating expenses are generally fixed. While fixed, it is important to note that as with most businesses, even fixed expenses began to get overinflated when the economy is strong. As such, there is generally always room for some areas of savings regarding fixed expenses. Within this section, GMA also discusses relevant absolute minimum expenses that should be upheld.

### GENERAL & ADMINISTRATIVE

Whether a casino generates \$100 million in revenue or \$500 million, the level of G&A expense should not change too drastically. As such, as a percentage of gross revenue, this line item can vary greatly. In a successful operation, this figure can be as low as 3% of revenue, increasing to as much as 6% for a smaller casino, or even as high as 12% for a small, single-owned operation. However, for those properties generally discussed in this report, a number above 6% would be of concern. Some of the larger items found within G&A include executive payroll, insurance, and real estate taxes.

### MAINTENANCE AND ENGINEERING

Maintenance and Engineering is largely a fixed cost and changes very little. Whether a casino is closed or running at full capacity, the machines are still plugged in and running. While a higher volume of customer would bring more wear and tear on a property, walls still need to be painted, and floors need to be cleaned. This is one of the more stable categories as a percent of gross revenue, varying from 3.1% to 3.7% of gross revenue. Approximately half of this expense is payroll, with utilities accounting for the largest percentage of non-payroll expenses.

### SECURITY AND SURVEILLANCE

Similar to Maintenance and Engineering, Security and Surveillance expenses are mostly fixed. Casinos have set plans for where guards need to be stationed and how many need to roam the property. These expenses do not vary much based on the number of customers. With





Surveillance, there are a certain amount of people in the surveillance room watching the cameras, with an extra person or two during peak periods. As a percent of gross revenue, this generally varies from 0.9% to 1.6%, with a majority of these expenses being in payroll.

## FIXED VS. VARIABLE

Overall, when taking into account all categories, roughly 21.4% (of gross facility revenue) of a regional casino’s operating expenses are fixed, while roughly 78.6% of operating expenses are variable. When looking at an overall corporation, the fixed versus variable ratio is closer to the 65% to 70% range due to corporate overhead. The largest and most variable expenses to a casino are usually its gaming tax rate, as well as freeplay and promotional allowances. While these expenses are variable, it is important to note that they are not directly variable (except gaming taxes) on a dollar to dollar basis. For example, if revenue is down 20% in the casino, promotional allowances will not go down a direct 20% as the casino will likely be employing a higher player reinvestment strategy to work on retaining customers. The following table further illustrates the variability of casino expenses.

% Fixed Costs vs. Variable Costs		
	Fixed	Variable
Slots	40%	60%
Tables	30%	70%
Poker	30%	70%
Cage & Count	90%	10%
Rooms	30%	70%
F&B	20%	80%
Entertainment	5%	95%
Gaming Tax	0%	100%
Freeplay	0%	100%
Promo Allowances	0%	100%
Marketing	50%	50%
G&A	90%	10%
Maint. & Eng.	90%	10%
Security	90%	10%
<b>Weighted Average on Gross Revenue</b>	<b>21.4%</b>	<b>78.6%</b>

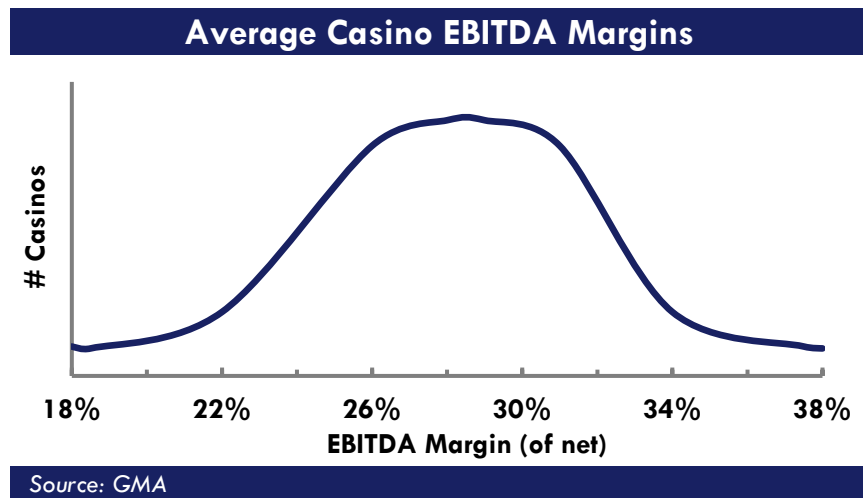
Source: GMA

The above chart is representative of an operation that is open and acts as a good guide to understand how to flex an income statement based on a reduction in revenue. In the current Covid-19 scenario, where casinos are forced to close their doors, a significant amount of the fixed costs become variable as well (utilities drop, fixed payroll may be significantly reduced, COGS are reduced to near zero as there is nothing to sell, etc.). For this, there is no rule of thumb and each casino and gaming company needs to be evaluated on a per facility basis.



## EBITDA

When taking into account all expenses, U.S. regional gaming properties generate EBITDA margins ranging from the high teens (often experienced in high tax-rate jurisdictions) to 38% for a successful casino resort. However, the majority of EBITDA margins usually approximate 27% to 31%. At times in Indian country, we have seen casinos reach margins in the 60<sup>th</sup> and 70<sup>th</sup> percentile, but these margins are usually anomalies as the facilities are operating with very low compact revenue sharing fees and enjoying a near monopolistic environment.



## ABOUT GLOBAL MARKET ADVISORS, LLC

GMA is the leading international provider of consulting services to the gaming, entertainment, sports, and hospitality, industries. The company provides clients with strategic planning, market feasibility studies, primary research, due diligence, general counsel, payroll control, operations analyses, government relations, crisis communications, responsible gaming initiatives, business and marketing plans, and reward program design. GMA also assists governments in developing public policy for integrated resorts, evaluating new markets and opportunities for public and private companies, and with due diligence for potential acquisitions. GMA's clients consist of the majority of public gaming companies, more than 75 Native American tribes, commercial and investment banks, and government agencies. The firm maintains active clients in Asia, the Americas, and Europe with offices located in Denver, CO; Las Vegas, NV; and Bangkok, Thailand. More information can be found by visiting [www.globalmarketadvisors.com](http://www.globalmarketadvisors.com).



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