

GLOBAL Gaming Business

In recent months, we've shifted our view from liking regional casino stocks the most to liking suppliers more.

So far, that shift has been borne out. Regionals have done well, tripling and quadrupling since their lows.

Now their stocks appear to be waiting for the economy to improve and their own revenue growth to resume.

Meanwhile, suppliers are running again.

The catalyst is the legalization of slots at Ohio racetracks and in liquor-licensed establishments in Illinois.

Together, the states might amount to more than 70,000 machines, a good number given that sales of replacements to update North America's 940,000 slots is only expected to be 25,000 to 50,000 over the next year.

The estimated effect on earnings is substantial. Todd Eilers of Roth Capital Partners, for example, thinks IGT earnings could grow 44 cents a share, and Bally and WMS a whopping 86 and 88 cents.

But reasons for optimism go beyond Illinois and Ohio, and even beyond other new jurisdictions like Kansas and Maryland.

There are other factors that should spell the end of the long supplier drought:

- Modernization and the replacement cycle. Historically, slot machines were thought to be on a five-year replacement cycle, or somewhat more. Today, replacements are being ordered at a rate that suggests more than 40 years to turn them over.

Obviously, machines don't last that long and casinos will have to start ordering slots again.

That process will be hastened by the dramatic improvements in slot technology. Whether it's IGT's multi-layer games, WMS' immersive technology, or the coming of 3D effects, new slot machines will be spiffy must-buys for casinos to grow revenue and to remain competitive.

- Domino effect. As more states legalize gaming, it strengthens the pressure on others to follow, or to expand what they have.

Ohio legalizing slots might be the straw that breaks the back of Kentucky opposition. Proliferation of slots in the northeast means that Massachusetts or New Hampshire will go next, and whichever is first, the other may well follow.

Likewise, Maryland legalizing slots has Delaware legalizing tables. Delaware legalizing tables has Pennsylvanians leaning further that way.

New York is legalizing e-tables. And on it goes.

- International growth. It isn't just Macau out there. It's Taiwan and the Philippines okaying mega resorts. Casinos are spreading through Latin America. It's Mexican electronic bingo, UK betting shops and pubs, and maybe in the not too distant future, Japan authorizing casinos.

- The coming Las Vegas building bust. The era of building multi-billion dollar meta resorts will end with whatever comes of the current projects – CityCenter, Fontainebleau, Cosmopolitan.

One reason is over capacity, but also too much debt and too little return on investment for such big risks.

In other words, operators will have to find less expensive ways to be competitive in an environment of recession and tight credit, regardless of capacity issues.

So far, the recession has hurt suppliers as casinos tighten their financial belts.

But soon, they'll search for ways to grow – or stay competitive – and it will be more feasible to update a casino floor than to build a \$3 billion or \$8 billion meta resort.

And when new games can be had on lease rather than capital outlay, that old nemesis the participation lease begins to look more like an old friend, at least until good times return.

Thus, we think the fundamentals are in place to lift supplier stocks like IGT, Bally, WMS, Aristocrat and Shuffle Master.

Several smaller companies are worth putting on the radar screen, too.

Among them, Multimedia Games is pushing hard to enter Class III gaming under new, big league management. And TransAct Technologies, which makes slot machine printers, will benefit from the growth of its customers. Eilers, for example, estimates that the Illinois-Ohio combination might add 25 cents a share to TACT earnings.

Source:

Frank Fantini, Editor & Publisher

Fantini's Gaming Report

July 2009 Issue of Fantini's Finance
