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A Report by UNITE HERE

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The Myth of the Las Vegas Locals Market Recovery, Part II

In this report, we examine key gaming metrics in the Las Vegas locals market in order to gauge the company's potential to grow back up to the peak levels of 2007.

As the Las Vegas locals segment accounts for most of the company's business (92% of net revenues and 87% of adjusted EBITDA in 2016), Red Rock Resorts is heavily dependent on the health of the Las Vegas locals gaming market. In [part I of this series](#), we presented data that indicate Las Vegas will not see significant population growth moving forward compared to what the city experienced in the early to mid-2000s. We also showed that the most recent statistics describe a noticeable decline in how much locals are gambling.

In this follow-up report, we examine key gaming metrics in the Las Vegas locals market – going beyond simple measures of gaming revenue – in order to gauge the company's potential to grow back up to the peak levels of 2007. **We challenge the myth that growth in the Las Vegas locals market will lead to recovery of the 2007 heights anytime soon.** As we focus on slot handle and slot payout trends, we find there is little increase in slot handle while higher gaming revenue has come from tighter slots. Investors should ask management when Red Rock will be able to grow to pre-recession levels of business in this stagnant and saturated Las Vegas locals market.

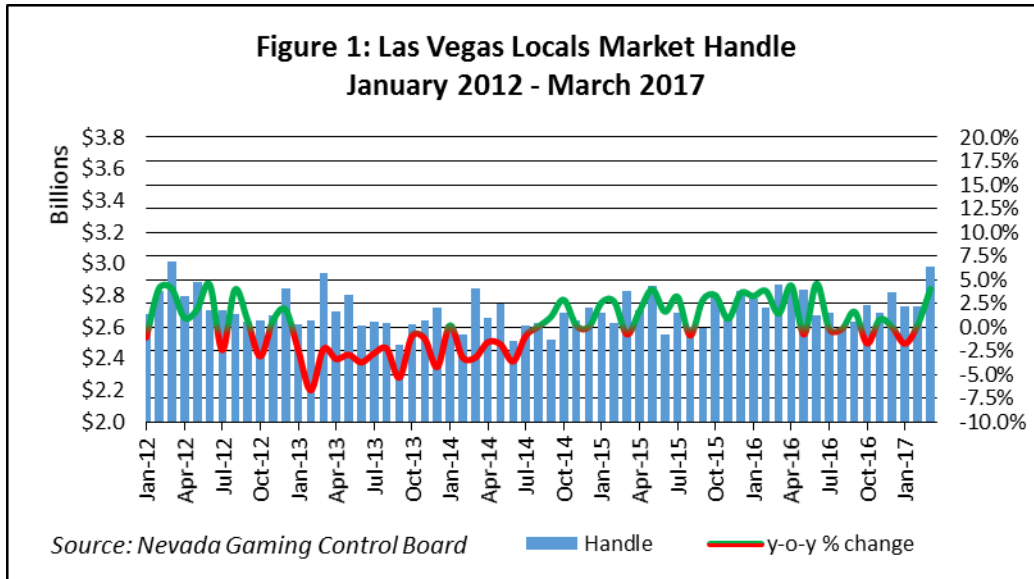
Flat slot handle trend

An analysis of the Las Vegas locals market that looks beyond gaming revenue numbers indicates that there has not been a significant uptick in how much customers are putting in slot machines. While there has been some growth in slot handle over the past several years, it has not been anything like the growth the market saw a decade ago in the early- to mid-2000s.

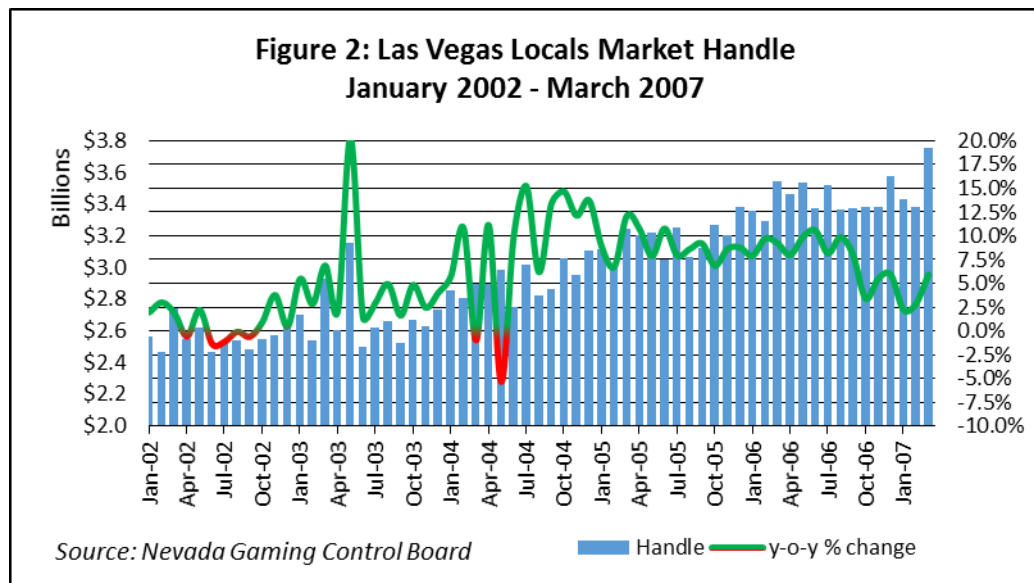
Many analysts look to “gaming revenue” or “gross gaming revenue” to measure the market's performance. We believe a better indicator of performance in the Las Vegas locals market is the amount wagered by players, namely, the “handle” for slot machines and the “drop” for table games. This is especially important for slot machines since the operators get to set the payout percentages (subject to certain state regulations) or the “house edge”, unlike with table games. The casino industry is unique in this regard because gaming revenue does not in and of itself track consumer spending and, therefore, does not serve as an accurate measure of market performance.

Looking at the Las Vegas locals market, we focus on the “handle” because slot play comprises approximately 85% of gaming revenue in the market.¹ “Handle” can be calculated from the monthly gaming revenue reports issued by Nevada's Gaming Control Board (GCB), which provide the amount of gaming win (“win amount”) and win percentage for Las Vegas submarkets.² “Win amount” divided by “win percent” equals the “handle” or total amount wagered.³ (Following industry practice, the data for the “Las Vegas locals market” are calculated by combining the data

for the North Las Vegas, Boulder Strip, and Balance of Clark County submarkets as reported by the GCB.)



What we see is that the slot handle has been increasing at a slow pace in the Las Vegas locals market. **From January 2012 to January 2017, slot handle in the locals market increased by only 1.88% with a CAGR of 0.37%** (Figure 1).⁴ These monthly handle numbers show a relatively stagnant market with little growth.



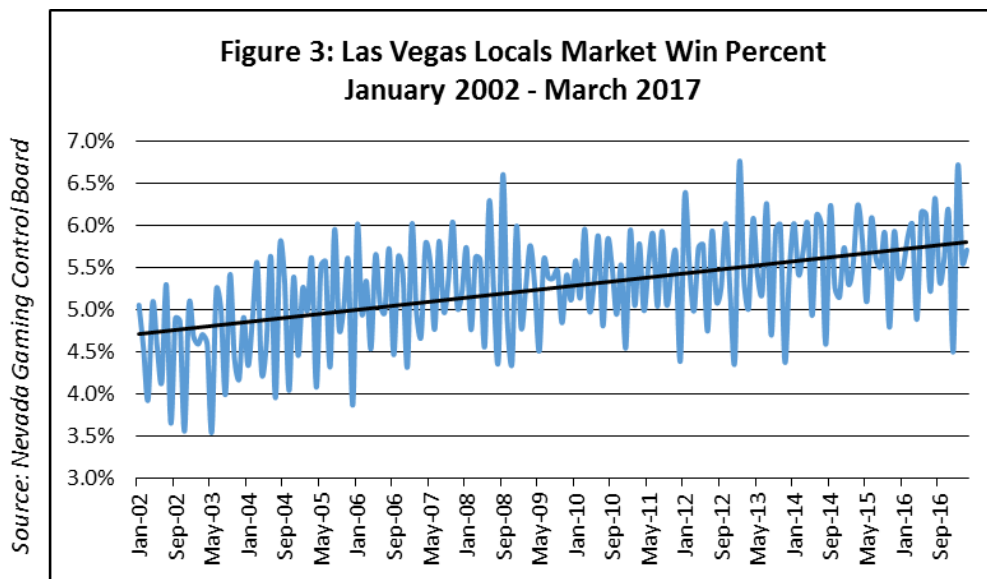
In contrast, the monthly handle numbers leading up to the Las Vegas locals market's historic peak in 2007 (Figure 2) paint a very different picture. **From January 2002 to January 2007, monthly handle increased by 33.8% with a CAGR of 5.99%**.⁵ As of March 2017, total slot handle in the Las Vegas locals market was down 20.6% from its historic peak in March 2007.⁶

Las Vegas Locals Market	Handle Increase	CAGR
Run up to peak (Jan 2002 - Jan 2007)	33.8%	5.99%
Current (Jan 2012 - Jan 2017)	1.88%	0.37%

From January 2002 to March 2007, y-o-y monthly handle growth averaged 6.18% and peaked as high as 20.3% in March 2003. In contrast, from January 2012 to March 2017, y-o-y monthly handle growth averaged only 0.21%. Although y-o-y monthly handle growth recently peaked at 4.63% in June 2016, we saw a similar peak of 4.55% in June 2012. A comparison of these two periods casts doubt on analysts claiming that the Las Vegas locals gaming market is currently experiencing an impressive expansion.

Progressively tighter slots

Nevertheless, Red Rock’s management and sell-side analysts have presented a mountain of data and all sorts of metrics trying to convince investors that macro conditions in the Las Vegas locals market are behind recent and continuing gaming revenue growth in the Las Vegas locals market. But, if – like we have demonstrated – slot handle has been flat in the market and Las Vegas locals are spending less on gaming, then what accounts for this growth in gaming revenue? We believe one answer lies in the progressive tightening of slot machines in the locals market over the past 15 years.



It is clear from the data that the win percent of slot machines in the Las Vegas locals market has risen steadily over the past decade and a half (Figure 3). What this means is that slots have gotten tighter, from the player’s perspective. The win percent for the Las Vegas locals market in 2002 was 4.55% while in 2016 the win percent was 5.64%. The 109 basis-point increase makes for a significant difference in the amount of player spending kept by the casinos. **If casino operators in the Las Vegas locals market had won only 4.55% in 2016 instead of 5.64%, slot gaming revenue for the year would have been reduced by \$358 million or 19.3%.**

Our analysis of historical slot handle and win percent numbers for the Las Vegas locals market shows that one reason for the increases in gaming revenue in the Las Vegas locals market (and the myth about the locals market recovery), is tighter slot machines. According to the monthly handle numbers, growth in the Las Vegas locals market looks relatively flat when compared to the market's most recent boom period from 2002-2007. In our view, increasingly tightening slots is an unsustainable business plan.

As Las Vegas locals, long-term, we believe the market will most likely return to the peaks levels of 2007, but the question is how long will it take. Investors looking for a quick rebound may find themselves disappointed.

Flat handle, coupled with [low growth population forecasts and reductions in how much locals are gaming](#), signal a much slower climb to 2007 peak levels in the Las Vegas locals market. Given these facts, we question whether investors should put much stock – and their own or their clients' money – in Red Rock Resorts and its management's myth about the Las Vegas locals market recovery.

Notes

¹ Deutsche Bank Securities, Inc. Deutsche Bank Markets Research: Red Rock Resorts. May 22, 2016, p. 25.

² The historical data are available directly from the Nevada Gaming Control Board.

³ We were provided with updated, historical gaming revenue data from the Gaming Control Board (GCB) on June 6, 2016.

⁴ The calculated handle for the Las Vegas locals market in January 2017 was \$2,729,252,024 and for January 2012 it was \$2,678,913,654.

⁵ The calculated handle for the Las Vegas locals market in January 2007 was \$3,430,229,648 and for January 2002 it was \$2,564,220,074.

Nevada Gaming Control Board. Gaming Revenue Information. <http://gaming.nv.gov/index.aspx?page=149>

⁶ The calculated handle for the Las Vegas locals market in March 2017 was \$2,981,567,506 and for March 2007 it was \$3,755,957,440.

Nevada Gaming Control Board. Gaming Revenue Information. <http://gaming.nv.gov/index.aspx?page=149>