

7 THE ATLANTIC CITY MARKET

7.1 Market Overview

In 2001, Atlantic City's casinos collectively avoided the first year-end revenue decline in their history when they reported an 18.2% gain in December 2001 gross gambling revenue compared to December 2000. The \$349.1 million made the total for 2001 \$4.3 billion, 0.09% more than 2000.

In 2001, Atlantic City surpassed the \$60 billion mark in total casino revenue for the first time since casino gambling began there in 1978.

A total of 33.2 million people visited Atlantic City in 2001, a 1.4% decrease, according to the South Jersey Transportation Authority. The agency said the decline was due to casinos' efforts to attract more overnight gamblers and reduce incentives to low-profit gamblers.

In 2001, Atlantic City casinos drew 9.1 million bus customers on 359,000 buses, or almost 1,000 a day, according to the South Jersey Transportation Authority.

Four of the country's ten biggest cash-producing casinos are in Atlantic City, according to Bear, Stearns & Co. Judged on 2000 EBITDA, Bally's ranked fourth in cash flow at \$177 million, Caesars seventh at \$159 million, Harrah's ninth at \$137.5 million, and Trump Taj Mahal tenth at \$137 million. Bear Stearns pointed out that Foxwoods, which does not disclose financial results, is probably the most profitable of all.

In 2001, gamblers dropped \$37.7 billion into Atlantic City slot machines, with casinos winning \$3.1 billion of that.

Although Atlantic City will have gone 13 years between new casinos when The Borgata opens in summer 2003, the Las Vegas Strip went 15 years between major casinos before The Mirage opened in 1989.

New Jersey has a self-exclusion law that lets gamblers ban themselves from Atlantic City casinos for a period of one or five years, or for a lifetime.

Atlantic City's dozen casino hotels have more than 33,000 parking spaces.

Park Place Entertainment, which owns Bally's, Caesars, Claridge and Hilton, controls nearly 40% of Atlantic City's gross operating profit.

Atlantic City casinos account for approximately 47,000 full-time, part-time and casual jobs. The workers earned \$1.1 billion in salary and wages in 2001.

Slot machines accounted for 71.8% of Atlantic City's casino revenue in 2001; in 1981, they accounted for 41.7%.

Atlantic City casinos have reported year-over-year declines in table-game revenue in six of the last 12 years. Slot-machine revenue has grown at least 2.1% every year.

Only 323,000 Atlantic City visitors last year arrived by air.

The inventory of hotel rooms in Atlantic City will increase about 50% from its current base of 11,356 rooms to nearly 17,000 over the next four to five years. Leading the room boom

will be the new Borgata, jointly owned by MGM and Boyd Gaming, with 2,010 rooms. Another MGM project was expected to add another 2,000 rooms, if the company continues with plans to construct. A proposed tax on comps in the state could halt plans.

In sheer dollar volume, Trump Taj Mahal had gross revenues of \$525 million, a 0.3% increase from 1998. The biggest gains in revenue were by number five Harrah's and number eight Hilton.

According to Greg Bousquette, U.S. Bancorp, the market is increasing just barely above the rate of inflation. While the market as a whole has changed little, some individual shares moved dramatically. It was mainly the strong getting stronger. Three of the top four gainers now belong to Park Place Entertainment (Atlantic City Hilton, up 13.7%); Caesars, up 8.6%; and Bally's, up 6.0%). The second biggest gainer belonged to the second-biggest company, Harrah's Entertainment (Harrah's Atlantic City, up 9.6%).

Two casinos reported revenue declines. Resorts dropped 5.7% due to construction disruption in the first half and a failure to benefit from its \$50 million renovation in the second half. Trump Plaza declined 5.5%, mainly due to the October 1999 closure of its World's Fair annex.

7.2 Market Assessment

Total number of casino hotel rooms in Atlantic City have been as follows:

1. 1998: 11,875
2. 1999: 11,356
3. 2000: 11,355

Cash comps as a percentage of gaming revenue have been as follows:

4. 1998: 12.25%
5. 1999: 12.54%
6. 2000: 12.45%

Total promotional allowances and expenses as a percentage of total revenues have been as follows:

7. 1998: 22.5%
8. 1999: 23.7%
9. 2000: 23.0%

Gross profit margin for all Atlantic City Casinos have been as follows:

10. 1998: 22.1%
11. 1999: 22.2%
12. 2000: 25.3%

A day-trip/locals market generates 75% or greater of its revenues from gaming, and typically generates total visitation well in excess of the total number of available hotel rooms in the market. Atlantic City generates approximately 81% of its total revenues from gaming, with a mere 6% of revenues coming from rooms and 2% coming from other (including entertainment). Meanwhile, food and beverage generates 10% of total revenues, further indicating the day-trip nature of market. Atlantic City currently has 0.26 hotel rooms per position, similar to the

Boulder Strip in Las Vegas, which has 0.3 hotel rooms per position. Another characteristic of a high-frequency day-trip market is the allocation of promotional allowances. Promotional allowances in Atlantic City are approximately 11.2% of total revenues, indicating a significant portion of room and food and beverage revenue is comped. On average, Atlantic City operators comp 65% of the city's total room revenue and 64% of its total food and beverage revenue.

An overview of the Atlantic City customer demonstrates just how diverse the market's customer base really is. Despite the city's reputation as a haven for retirees who casually stroll the Boardwalk, research indicates there are more people in the 18 to 34 demographic who have gambled in Atlantic City in the past 12 months than there are in the 55 and older demographic. Atlantic City's core customer comes from what could be termed baby boomers, as 38% of its customers are in the 35 to 54 year old demographic. For comparison, Las Vegas draws approximately 41.4% of its customers from the 35 to 54 year old demographic and 33.9% from the 18 to 34 year old market, indicating one of the differences between the two markets. Approximately 35% of Atlantic City's customers have household income exceeding \$75,000, compared to 21.8% for the general population. One other notable demographic is that Atlantic City draws 72.5% of its customers from the Mid-Atlantic region, but only 4.3% from New England. Connecticut casinos have partially truncated the marketing region by drawing New England patrons.

The bus patron makes up approximately 30% of total visitation to Atlantic City, while approximately 70% travel by automobile. Less than 1.0% of visitors arrive by air or rail.

Atlantic City also has rail and air service, but neither mode of transportation makes up a significant component of total visitation, as each comprises less than 0.5% of total visitation to Atlantic City. Atlantic City International Airport has struggled to bring in regional air service, and the majority of scheduled air service to the area does not bring in gamblers, but serves the local population. There were approximately 154,000 charter passengers in Atlantic City in 1999, and charters primarily service gamblers and casino executives. One regional carrier, Spirit Airlines, used to run direct flights from Atlantic City to Boston and Cleveland, but the airline pulled both flights because it was unable to make the routes profitable.

The airport underwent a \$17.7 million expansion in 1996, increasing capacity to 1.3 million passengers, but has not yet operated near its capacity. The Atlantic City rail, which runs from Philadelphia to Atlantic City, is primarily used by commuters to the city, and does not have a meaningful impact on gaming visits.

7.3 Recovering from September 11, 2001

The twelve Atlantic city casinos reported revenue of \$349 million for the month of December 2001, a gain of 18% over the previous December 2001. The December 2001 revenue brought the yearly numbers to about \$4 million higher than in 2000.

The *Atlantic City Press* reported the casino industry suffered just a 6.3% decline in gross gaming revenue in September 2001. The city's 12 casinos won \$354.2 million from gamblers in September 2001, a decline of \$23.7 million compared to 2000 record-setting September.

Many analysts and casino executives were predicting as much as 20% deficit due to travel and economic uncertainty caused by the September 11, 2001, terrorist attacks in New York City and Washington, D.C.

7.4 Proposed Tax on Atlantic City Comps

Gov. James McGreevey proposed new taxes for casinos in his state budget proposal in March 2002. As part of his budget proposal, McGreevey wanted to initiate a 6% tax on free promotions, comps casinos give to gamblers. Complimentaries are not taxed in any other state and include hotel rooms, meals, drinks and show tickets.

The Atlantic City gambling industry was preparing to fight the proposed state tax comps given free to gamblers as a marketing tool.

Atlantic City's 12 casinos gave away 1.9 million rooms, or 65.6% of their total, during the first nine months of 2001. The casinos valued those rooms at \$155.7 million. The casinos also gave away 13.7 million meals valued at \$171.5 million.

In 2000, Atlantic City's 12 casinos reported spending \$565 million in promotional allowances, including rooms and meals, according to the state Casino Control Commission.

The casinos pay 8% of their gross revenues to the state, with the money financing the state Casino Revenue Fund, which underwrites prescription drugs for seniors and other programs. According to casino officials, the proposed tax will cause a reduction in "comps" and a corresponding drop in casino revenue. According to McGreevey, his proposal would generate \$33 million for the state.

The future of a \$1.5 billion casino project by MGM Mirage in Atlantic City came into question after MGM Mirage halted planning on the casino temporarily, becoming the first company to acknowledge McGreevey's budget proposals had given it second thoughts about expanding in the state. The \$1.5 billion casino project is considered key to revitalizing Atlantic City and helping the state compete with its neighbors. Plans for another MGM casino in Atlantic City, the Borgata, were too far along to change.

7.5 Casino Operations in Atlantic City

In 2001, New Jersey lawmakers introduced a bill that would allow Atlantic City casinos to run online gambling operations. Because Internet gambling and virtual casinos are completely and totally unregulated, the New Jersey law was introduced to protect consumers. People who play in virtual casinos have no concept of whether such gaming operations are legitimate, safe and committed to paying out winnings. The bill only applies to licensed, land-based hotel casinos.

Joe Weinert, *The Press of Atlanta City (International Gaming & Wagering Business*, February 2001), provided the following overview of Atlantic City's 12 casinos and the 13th under construction:

13. Atlantic City Hilton: No longer the weak link in Park Place Entertainment's Atlantic City holdings, the Hilton has become the city's turn-around story. It far outpaced the city with a 12% increase in casino revenue (through 11 months) and a 55% increase in gross operating profit (through nine months). Park Place was considering a casino expansion and a permanent theater where its temporary theater now stands.
14. Tropicana: Aztar's flagship continues to refute the notion that an independent casino cannot be competitive in Atlantic City. Paul Rubeli understands the city better than any other corporate CEO and has put Tropicana on an enviable track record of success. This should be the year Aztar finally announces its long-discussed expansion project. It will probably have 4,000 to 5,000 rooms, making it bigger than the Borgata.
15. Trump Plaza: The glamour spot of Atlantic City in 1990 is now in shambles. Current Trump Hotels management says it inherited a casino with low employee morale and a marketing

program in disarray and whose scant reinvestment dollars had been spent unwisely. Closing the attached World's Fair problem was supposed to save money but ended up hurting profits. It is now generating less cash than Trump Marina. The Plaza could negatively affect the \$1.3 billion Trump Atlantic Bonds in 2001.

16. Caesars: Under Park Place's ownership, Caesars cut costs through synergies with the adjoining Bally's Park Place and enhanced revenue by capturing Bally's customers looking for their second-choice casino. Park Place planned to remodel the exteriors of the two older hotel towers and liven the Boardwalk facade. It was also discussing the best use of the adjacent pier, a project that if undertaken would open before the Borgata in 2003.
17. Bally's Park Place: The \$25 million Coyote Kate's expansion of the Wild Wild West annex was not a major project, but by physically tying Bally's with Caesars, it keeps center-Boardwalk customers in Park Place's dominion. With its master plan complete, any Bally's expansion would be in the form of a sister casino on the nearby old Traymore Hotel site. First, Park Place must see what happens with its Claridge bid.
18. Claridge: Before year end, most likely, the city's smallest casino will emerge from bankruptcy protection and wind up as either Park Place's fifth casino in the city or a part of the neighboring Sands. A contested bankruptcy trial looms, assuming Park Place received regulatory approval in January 2001 to increase its Atlantic City holdings. Its debt payments suspended since August 1999, Claridge has been posting decent operating results. Whoever takes over will be inheriting a solid operation in need of some serious cap-ex dollars.
19. Sands: Carl Icahn took over September 29, 2000, having defeated Park Place in a bankruptcy duel. He promptly began an expansion that will result in 282 more hotel rooms, an enlarged casino, a new Pacific Avenue lobby and other amenities. True to his promise, Icahn made Sands a real gambler's place, promoting "Binion-style" table action and the city's highest slot payouts. Should Park Place acquire Claridge and develop the Traymore site, Sands' future is cloudy.
20. Resorts: Sun International Hotels, never able to figure out what it wanted in Atlantic City, agreed to sell Resorts to privately held Colony Capital at about a 50% loss. Nick Ribis, former CEO of Trump Hotels, will have a 10% to 20% equity stake in Resorts and is CEO. Colony was expected to demolish the old North Tower, which has 160 substandard, motel-style rooms, and erect a larger tower that would put Resorts over the 1,000-room mark.
21. Trump Taj Mahal: Under new management for a year in early 2001, the Taj rebounded from its disastrous 1999. It continues to add nice touches here and there but does not have the capital for serious expansion. Though the Taj is performing well, it is inextricably tied to the Plaza as the other part of the Trump Atlantic City bonds.
22. Showboat: After 2.5 years of keeping Showboat as a separate division, Harrah's Entertainment finally "Harrahized" it in early 2001. Belatedly, it put Showboat into the Total Rewards program, then put Showboat under Tim Wilmott's Eastern Division and put a Harrah's veteran, Tom O'Donnell, in charge of operations. If it can work out some land issues, they could announce a sorely needed hotel addition in 2001.
23. Trump Marina: The Wild Side, rock and roll environment is working and cash flow is climbing. The challenge is to capitalize on coming major growth in the Marina District: The tunnel opened summer 2001 and the Borgata opens in 2003. Marina needs another hotel tower and some serious back-of-the-house upgrades, and it could really use the adjacent 14-acre parcel that MGM Mirage would like to sell. Trump has problems finding the money to

do any of this.

24. Harrah's: The city's most efficient operator continues to buck the market with its highly profitable base composed almost entirely of drive-in customers. It is now building a 448-room hotel tower to capitalize on the Marina District growth.
25. Borgata: The \$1 billion, 2,010-room joint venture between Boyd Gaming and MGM Mirage broke ground in September 2000. Winter was spent driving piles. Concrete for the hotel tower foundation was poured in March 2001, with steel for the low-rise going up in May 2001. CEO Bob Boughner predicted a summer 2003 opening.
26. MGM Mirage's proposed new mega-resort in Atlantic City's up-and-coming Marina District would cost between \$1 billion and \$1.5 billion, and will have a warm-weather theme. When first disclosed in 2000, MGM Mirage simply stated the resort would be on 50 acres of land next to the Borgata, its \$1 billion joint venture with Boyd Gaming Corporation, now under construction. The yet-to-be-named Atlantic City project on the New Jersey shore will create an environment that will be comfortable and compelling throughout the year. Renaissance Pointe is the new name for the land where the Borgata and MGM Mirage-owned casino will be located. Both resorts are in Atlantic City's emerging Marina District, which is away from most of the older and smaller casinos in the traditional Boardwalk area. The expected completion date is one to two years after the Borgata. The new resort will not necessarily be bigger than the Borgata, which, with more than 2,000 rooms, will become Atlantic City's largest casino when it opens in 2003. The two new casinos combined will significantly increase the number of hotel rooms in a city known for a shortage of rooms. Atlantic City, home to 12 casinos, now has about 12,000 rooms, compared to Las Vegas' 124,000 rooms. The second casino was in question because of the proposed tax on comps.

7.6 Atlantic City's Table Game Revenue

The three most popular table games in Atlantic City remain blackjack, craps and roulette, but for various reasons, visiting gamblers did not risk as much money at these tables in 2000, as compared to 1999. The Atlantic City casinos reported a combined decrease of \$87.1 million. This happened even though overall table revenue increased \$4.4 million (0.4%) to nearly \$1.213 billion.

The decline in "win" and "drop" for blackjack and craps (roulette was actually up slightly) can be attributed in part to the introduction of new table and slot games in 2000. Although down, the combined "win" total of \$797 million for these three games represented 65.7% of what the casinos won from all table games. Blackjack accounted for 36% (\$440.5 million); craps, 17.4% (\$210.5 million); and roulette; 12% (\$145.9 million). In 1999, the blackjack "win" rose \$12.6 million (2.9%), as compared to 1998, and the "drop" increased \$103.9 million (3.1%).

In blackjack, only four casinos produced higher "win" totals in 2000, as compared to 1999. Blackjack "win" in Atlantic City declined nearly \$11 million, or 2.4%, while the "drop" decreased by \$55.2 million, or 1.6%. Caesars (up 11.7%), Resorts (up 11.6%), Tropicana (up 8.3%) and Trump Marina (up 2.4%) were the four to buck the trend.

In craps, the "win" declined by \$17.3 million, or 7.6%, last year, and the "drop" decreased by \$66 million, or 4.2%. Four casinos bucked the downward trend. These included the Atlantic City Hilton (up 10.5%), Caesars (up 2.3%), the Sands (up 9.6%) and Tropicana (up 3.1%).

Roulette was the only game of the three to finish in 2000 with higher "win" and "drop" totals, as compared to the previous year. The combined roulette "win" was up \$1.15 million, or

0.8%, while the “drop” increased by \$34.1 million, or 5.4%. Five casinos did better in roulette in 2000 as compared to 1999. They were Bally’s Park Place (up 6.4%), Harrah’s (up 0.4%), Resorts (up 1.8%), Trump Plaza (up 4.0%) and Trump Taj Mahal (up 9.3%).

7.7 Expansion by Park Place Entertainment

While other casino companies have struggled with their decisions to enter the Atlantic City market, or outright withdrawn their plans, one company has steadfastly sought more and more of the market share. That company is Park Place Entertainment. The late Arthur Goldberg was a native of New Jersey. Park Place views Atlantic City as one of the five epicenters of gaming, with Las Vegas, Mississippi, Detroit and Chicago. According to Stuart Linde, Lehman Brothers, if it can acquire assets in Atlantic City at very attractive prices, and land is difficult to acquire there, they will take advantage of the opportunities.

Since 1996, six casino companies announced intentions to build a resort in Atlantic City. Park Place built the Wild Wild West casino at Bally's Park Place, added another hotel tower to the Atlantic City Hilton, constructed a transportation center at Bally's, and bought Caesars.

Park Place unsuccessfully battled Carl Icahn to win control of the Sands Hotel & Casino. PPE owns a prized Boardwalk development site. The 8.2 acre site of the old Traymore Hotel could be combined with the adjoining Sands to create Paris Atlantic City or some other must-see casino hotel.

Park Place owns the Shops on Ocean One mall opposite Caesars. The 900-foot-long structure, known as the Million Dollar Pier in the city's heyday, could be developed into a smaller version of the Forum Shops. In late 1997, the City Council gave casinos the right to put gaming on their piers, as long as they contained other attractions such as shopping, retail or entertainment.

Park Place gained valuable Boardwalk frontage with the Caesars purchase. Within one month of closing the deal, Bally's began a \$25 million project to expand the Wild Wild West and connect it to Caesars. Though a relatively modest project by current casino standards, Park Place officials conservatively project a \$10 million increase in cash flow from the 300-slot expansion, or a 40% minimum return.

Park Place owns various parcels of land around all of its Atlantic City casinos. Whether retained for defensive or offensive reasons, these parcels represent expansion opportunities. The best plots are at the Hilton, where what are not surface parking lots could become gaming, hotel and entertainment space.

7.8 Analysis of Revenues Per Active Player

According to Michael Pollock, editor and publisher of *Michael Pollock's Gaming Observer* (www.gamingobserver.com), the gaming industry's net revenues are approximately 0.34% of personal income. If Atlantic City were to match the national estimate in the Mid-Atlantic market, its top-line revenues would increase \$1.1 billion. The sum total of active players in databases throughout Atlantic City add up to fewer than eight million individual, or one out of every six adults in Atlantic City's primary geographic markets are regular visitors. One out of every six adults in the region accounts for more than \$4 billion in annual revenues.

This represents an annual loss of approximately \$500 per active player. A more reasonable estimate would be \$375 per active player, since approximately 25% of Atlantic City's gaming revenue is nonrated (i.e., it is from players not listed in any of the existing databases).

7.9 Atlantic City's History

Miss America, salt water taffy, a seaside boardwalk and a beach made Atlantic City one of America's top vacation spots long before gambling was introduced.

Originally named Absegami (Big Water) by the Lenni-Lenape Indians, the ten-mile long island, occupied by Atlantic City, Ventnor, Margate and Longport, was renamed Absecon Island by Englishman Thomas Budd in 1678.

Until the mid-19th century, only shanties dotted Absecon Island. In 1854, a doctor and a civil engineer teamed up to promote the island as a healthful seaside resort and Atlantic City was born.

Two railroads were built to service the seashore town and in 1870 the boardwalk was built to keep sand out of visitors' shoes and the lobbies of newly-constructed hotels. In 1921, the city hosted a beauty contest that evolved into the Miss America pageant by 1940.

Casino gambling was legalized in 1977. Baccarat is the most popular game in Atlantic City, with craps, big six and roulette following.