



PRICING GAMING PROPERTIES IN TODAY'S MARKET

By John Knott

There are a variety of reasons why gaming property owners or lenders need to know the value of their properties at any given time. There could be a potential sale, financing, refinancing, or any number of balance sheet issues. Evaluating property taxes is another reason values might need to be estimated, and there could be other reasons unique to a particular owner.

Having been involved in numerous gaming property sales, property tax appeals, and development project advisory assignments, and having consulted on a number of occasions for CB Richard Ellis' Valuation & Advisory team, I have found that there are some unique issues involved with evaluating potential value/pricing.

EBITDA Multiples

If it is turning a profit, a property's value is generally tied to its income or EBITDA (earnings

before interest, taxes, depreciation and amortization) performance. EBITDA multiples are how the industry typically looks at operating gaming properties, but cap rates are often used in formal appraisals to conform with other types of real estate. The cap rate is merely the inverse of the EBITDA multiple. However, there are numerous factors that are used in establishing an appropriate EBITDA multiple for a gaming property. The following factors influence how a property is perceived based on its trailing EBITDA multiple basis:

- **Market Characteristics** EBITDA multiples tend to vary from market to market. Multiples in riverboat markets tend to differ from land based assets, for example, while markets with uncertain regulatory situations (e.g. tax rate changes, new licenses, smoking bans, etc.) can lead to depressed

EBITDA multiples.

- **Local Economy** Projected future economic conditions play a large part in determining multiples. EBITDA multiples will be higher in markets experiencing (or expecting to experience) economic growth than in markets that are experiencing slower or no growth. Las Vegas provides a particularly salient example of recessionary impacts and pressure on EBITDA and the potential upside for recovery. For those parties expecting an economic recovery in Las Vegas, they would likely be willing to pay a higher EBITDA multiple.
- **Location** All other things being equal, properties with the best locations will garner the highest EBITDA multiple in the market.
- **Anticipated Competition** EBITDA multiples are generally lower for markets that are either suffering from neighboring competition or where new competition is expected. Reno is a

relevant example of how a market can suffer from neighboring competition. California Indian gaming has eroded the Reno gaming market with Reno revenues down 36% since 2000.

- **Property Condition** EBITDA multiples will vary depending on property condition. Typically 3% to 5% of revenues are reserved annually for capital expenditures. When revenues decline, however, a higher percentage of its revenues are necessary to maintain a property. If an owner has not been maintaining the property appropriately, this could put



downward pressure on the EBITDA multiple as buyers will expect to spend significant amounts of money to bring the property up to standard.

- **Age** The age of the structure can also influence the EBITDA multiple. The useful life of gaming properties seems to be about 30 years (perhaps less in highly competitive markets or with riverboats). Major capital renovations and expansions can extend the life of a property but how properties are maintained and the amenities that are included changes over time. Older properties can become functionally obsolete. Las Vegas is, again, an excellent example of the importance of this consideration. Room square footage has grown considerably in the past decade, and older properties are inherently less competitive on that front.

- **Management** How a property performs in comparison to its competitive set is a major influencing factor in the achievable EBITDA multiple. If a property is viewed as underperforming, its potential buyers might pay a higher EBITDA multiple than when a property is viewed as fully performing or achieving more than 100% of its fair share. Property condition can be an influencing factor in this evaluation, but buyers view significant

difficulty in replicating the performance of great management or a strong customer distribution system. A property owned by a one-off operator will typically fetch a higher EBITDA multiple than one owned by a multi-property company. This multiple premium is due to the operating leverage that can be generated if the buyer operates multiple casinos, and brings those efficiencies to a less efficient property.

- **Equity Capital Markets** In the past, buyers were able to attract capital from a variety of private investors, private equity and hedge funds. These types of investors, as well as gaming companies, typically have identified minimum hurdle rates of return. The higher the hurdle rates, the lower the EBITDA multiple.

- **Debt Capital Markets** This has been perhaps the most important item to influence EBITDA multiples. Historically, buyers had been able to borrow three to four times EBITDA. The extraordinary run up in gaming property values during the boom years (early part of the millennium until July 2007) was tied to an unprecedented availability of low cost capital. Buyers were able to borrow as much as 10 times EBITDA as EBITDA was expected to grow and lenders were willing to fund on the growth projections. During the recession, borrowers were limited to once again borrowing about three or four times EBITDA for good properties in good markets. There has been a loosening of capital since the beginning of 2011, but the market is still substantially more conservative than the boom experience of a few years ago.

All these factors, as well as other issues that may influence a property's historical performance or its future outlook, need to be considered.

Other Approaches

The EBITDA multiple approach works well in many circumstances when estimating value, but there are times when other metrics may be better in

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imating the value of a gaming property. Similar to the EBITDA multiple approach is the Discounted Cash Flow (DCF) approach. The key difference

between the EBITDA multiple approach and the DCF approach is that the DCF approach discounts cash flows from future years (we recommend five years) to determine a present value whereas the EBITDA multiple approach only takes into account a single year's earnings. The DCF approach is typically best utilized when earnings will not stabilize until after the first year following a property changing hands. This could either be because the property is new, undergoing an expansion/renovation, facing a change in regulatory environment or expecting to have new competition in one of the out years.



Other pricing challenges arise when a property is generating little, no or negative earnings. What is the value when a property is generating \$5 million in EBITDA, but historically EBITDA has been more than \$25 million? What if the EBITDA is negative? Under these circumstances, which can be quite common today, the value can be estimated by using other approaches.

For one, we might refer to "bulk buy" value when properties are generating little to no EBITDA. Bulk buy is the value that someone will pay for the bricks, mortar, employees and other assets, even though the current operation does not provide a meaningful (or any) return on the price. These trades reflect the opportunity that people see with a property, not how the current owner has managed the performance. Recent trades in Atlantic City reflect the "bulk buy" asset values.

If a gaming property is not performing to its potential, it could be the result of poor management, a cash strapped owner that cannot invest in the property to keep it competitive, or the owner's perspective that the asset is non-core to a long-term strategy. Regardless of the circumstance, the value of these assets can vary substantially. New strategies for the property need to be considered. The casino's appropriate fair share, along with a capital budget that would enable the property to achieve that fair share, needs to be estimated. The property's value could then be estimated based on a multiple of projected income at the pre-determined fair share performance after deducting the necessary capital expenditures.

Alternate uses can also play a significant role in the evaluation of a property. It was not long ago in Las Vegas that the underlying land value was higher than the value of some operating casinos. Elad's \$1.2 billion purchase of the Frontier from Phil

Ruffin, announced in late 2008, is a prime example of this dynamic. Elad had a development vision for the land that far exceeded the value that could be extracted by operating the existing Frontier.

Prospective buyers are always looking at alternative real estate uses, such as converting hotel rooms to condos/hotel condominiums or adding retail space. The Grand Sierra in Reno is an example of a property that was acquired at least in part to convert its hotel rooms. Another example of enhancing the value of existing casinos is the Project Linq retail/entertainment project that Caesars Entertainment has embarked upon on the Strip adjacent to Imperial Palace and Flamingo. Although market conditions are always changing, real estate optimization opportunities will always



be explored by savvy investors. The key in understanding the property value is that it must be viewed from a variety of perspectives that consider the full range of opportunities for the asset.

John Knott is an Executive Vice President in the Global Gaming Group of CB Richard Ellis (CBRE) in Las Vegas. His Global Gaming Group has unique expertise that enables the Group to be able to advise its clients on the appropriate price to buy and sell gaming properties, while the CBRE Valuation & Advisory team has all the necessary tools and resources to provide the most accurate appraisals in the marketplace. Accordingly, the Group's ability to price a gaming property is second to none. CBRE is the only service provider that offers the combined expertise of appraisers, consultants and transaction specialists, which allows it to ascertain how much a property might be worth from a number of different perspectives. Mr. Knott can be reached at (702) 369-4860 or john.knott@cbre.com

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