Manufacturers Consolidation: Effects on the Gaming Industry

By Lars Perry

After years of calls for consolidation of the gaming equipment manufacturers by the investment community, the dominos fell in rapid succession. In January 2013, Scientific Games announced plans to acquire WMS Industries, Inc., for $1.5 billion in an effort to create a combined supplier of lottery equipment and slot machines. In July 2013, Bally Technologies, a manufacturer of slot machines and casino systems, agreed to buy SHFL Entertainment for $1.3 billion to expand its operations into the table game market. Then, merger and acquisition activity really started heating up. On July 6, 2014, Australian-based Aristocrat Leisure, in an effort to expand its North American business, announced the purchase of Video Gaming Technologies, Inc., for $1.3 billion. Less than two weeks later, GTECH Holdings, the world's largest lottery company, rocked the gaming community by announcing it had entered into a merger agreement with the world's largest gaming equipment supplier, International Game Technology, for $6.4 billion. Not to be outdone, Scientific Games announced by the end of July it would be acquiring Bally Technologies for $5.1 billion. Only a month later, Global Cash Access, a provider of cash systems, announced its foray into the gaming machine market with its plans to acquire Multimedia Games ("MGAM") for $1.2 billion.

These moves were enthusiastically welcomed by investors as the acquired companies received a premium price for their shares. The purchase price of SHFL, at $23.25 a share, was 24 percent higher than SHFL's closing price at the time of announcement. The Scientific Games solicitation of $26 a share was 59 percent higher than WMS's share price the previous day. Global Cash paid a 31 percent premium for MGAM. While the shareholders of the selling companies received a tidy cash payout, the industry is waiting to see what the long-term impacts will be.

The case for acquisitions stem from the business theory that certain combinations of companies will have a net benefit when joined. Overall, the process is pretty consistent: the acquiring company integrates certain resources from the acquisition into its existing or expanding business model and may discard components which are either redundant or outside its model. Increased value is derived from using the acquired company's resources in such a way that the acquisition is accretive to the purchasing company's financials. However, acquisitions of this nature are not without risk. The Harvard Business Review places the failure rate of mergers and acquisitions meeting their objective to be in excess of 70 percent.[1]

With interest rates at their current lows, the financing of these acquisitions may have been the easy part. The real challenge begins with the actual integration of what may be vastly different cultures and organizations into one cohesively run company. Initially, the focus will be on "synergies," the term applied for overlapping costs in personnel, development, and other areas to streamline efficiencies. For gaming equipment manufacturers, this can be achieved through such examples as consolidation of regulatory functions and merging of common platforms. Many of the companies have already written off restructuring costs as part of this initial step.

The merger fever is occurring at a time when the casino industry is facing numerous challenges. Operators have been experiencing flat demand for traditional gaming products due to changing customer demographics. At the same time, competition for consumer dollars has increased from areas beyond traditional gambling, from product offerings such as social games, home video gaming, and fantasy sports that have all captured the attention of younger consumers. Industry pundits are now wondering how the consolidation will impact markets like Nevada as they strive to adapt to changing consumer demands.

From a regulatory perspective, all of the mergers have been approved by the jurisdictions in which the entities are licensed. As noted by Nevada Gaming Control Board Chairman A.G. Burnett, "One of our main concerns during industry consolidation is whether there are potential antitrust implications. During earlier casino operator consolidations, the potential impact to limit competition in a local market was clear. However, the equipment manufacturers are global businesses and antitrust is not as much of a concern." He adds, "Going forward, our interests are, what is the impact on Nevada, including its operators, employees and customers whom our industry serves? For example, how will the mergers lead to improved numbers for casinos?"

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Chairman Burnett explains, "From a compliance standpoint, while we will necessarily have fewer programs to monitor, the scope has increased in terms of how big the programs are and the amount of time staff will invest in routine audits of the compliance functions. Also, of course, the programs will necessitate much more work on the part of compliance teams within the companies."

Of particular interest to Chairman Burnett is the potential impact of the consolidations on Senate Bill 9. Chairman Burnett has been supportive of this measure in response to Nevada operator concerns regarding changing player demographics. This legislation authorizes the Nevada Gaming Commission to adopt regulations relating to the development of newer, more innovative technology in gaming, including gaming devices that incorporate an element of skill. "While there may be fewer manufacturer voices following the consolidation, it will hopefully allow for a more cohesive voice and healthier organizations which can provide a greater product focus to serve changing consumer preferences."

John McCafferty, Business Operations Officer for Umpqua Indian Development Corp., oversees casino operations at the Seven Feathers Casino Resort. He views consolidation of the equipment manufactures as a double-edged sword. "In the short term, operators may slow purchases from the companies involved in the mergers. We will want assurances that products are not going to be obsolete after the mergers are complete."

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Over the long term, McCafferty is optimistic the consolidation will be a benefit to operators. "We will get the best of the best as a result of consolidation. Economies of scale will create lower prices, one stop shop, and greater connectivity." However, he does have concerns. "Will the ability to get good pricing go away? Overall, when the dust settles, I believe that operators will end up with better products and enjoy a one stop, maybe two, experience that will offer the operator variety without having to deal with multiple vendors."

One possible side effect raised by McCafferty is that innovation may be less important to the larger manufactures. As a result, he sees opportunities for some of the smaller, emerging companies. "Smaller companies will have an opportunity to take advantage of the market during re-organization of the merging companies. The companies that are merging are large and re-organization will not be easy. At first, they may not be as quick to market with new product as they were prior to the merger. Smaller companies that have a good reputation with operators may be in a position to take advantage during a period of uncertainty following the first few months of the mergers."

Bob Luciano has experienced integrations first-hand, most notably as founder and CEO of Sierra Design Group, a gaming company acquired by Bally Technologies in 2004. He became CTO for Bally Technologies following the purchase and has directly participated in these types of acquisitions. "Initially, it can be a hard process. The acquirer has to integrate technologies, cultures, and personnel. Often the success can only be measured years later and depends extensively on the executive team's ability to be clear and concise internally in implementing the necessary organizational changes, and putting the right people in the right positions. It will be fun to watch which of the teams from the various companies are able to carry this out."

Luciano also sees industry opportunity in the consolidations. "Short term, there may very well be fewer products offered. Synergies are often promoted in these acquisitions, and the first steps are usually cost cutting measures which may involve the reshuffling of internal teams or development resources. While the larger companies are grinding through their reorganization, they need to focus on the larger, more established markets and products, which generate the most money. However, this also provides an opportunity for more nimble companies to exploit new and emerging opportunities and establish a market presence before the larger consolidated companies can react."

For the time being, it appears merger fever has cooled down while the new consolidated companies refocus their efforts from acquisition to integration. The success or failure of the companies now rests squarely on the executive teams and their ability to quickly and effectively revamp and retool their organizations. Ultimately, the winners and losers will only be known several years from now once the market weighs in on the products and services the consolidated manufacturers provide.

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1 Clayton M. Christensen, Richard Alton, Curtis Rising, & Andrew Waldeck, The Big Idea: The New M&A Playbook, HARV. BUS. REV. (Mar. 2011), available at https://hbr.org/2011/03/the-big-idea-the-new-ma-playbook