‘Vultures’ Eye Distressed US Casino Assets

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The US gaming sector could witness a significant transformation in its ownership structure as lenders foreclose on properties and investors still able to raise capital, including private equity firms, swoop to acquire casino assets from debt-ridden operators, experts agreed at last week’s Canadian Gaming Summit.

The ‘perfect storm’ of contracting revenues and highly-leveraged corporate balance sheets is likely to lead to significant restructuring of the US casino sector in the coming months and years but will not necessarily see a reduced supply in what remains a highly-profitable industry, Alex Calderone, a Michigan-based gaming insolvency expert with the firm CM&D Capital Advisors, told delegates at last week’s conference at the Caesars Windsor resort in Ontario.

“Casino enterprises are still profitable in themselves… but the companies are just so leveraged right now and capital is so expensive that they can’t service their debt,” Calderone explained.

Rather than mass temporary or permanent closures of US casino properties, Calderone said the industry would more likely witness ownership change hands either via asset sales – “a restructuring activity we will see a ton of” – or via lender foreclosure and operational takeover of highly-indebted casino venues.

Calderone also predicted further filings for Chapter 11 bankruptcy protection on the part of US casino operators, suggesting that as many as half of Atlantic City’s 11 casino properties could find themselves in bankruptcy proceedings by the end of the year.

CM&D was recently employed to oversee the emergence from bankruptcy of one of the most prominent US gaming interests to have already sought Chapter 11 protection: Detroit’s Greektown Casino-Hotel.

While the Motor City has found itself in the news recently primarily due to the parlous state of the US automobile industry, Detroit was also cited by Canadian Gaming Summit delegates as a prominent example of the troubles currently engulfing the US gaming sector. Two of the three Downtown Detroit casinos authorised in 1996 have effectively been put on the block by their financially-distressed owners in the past year, while the third required a $25m equity injection to avoid a showdown with its creditors.

“You only have to look across the river to see that the old adage that ‘build it and they will come’ is not always true,” said Kelly McDougald, chief executive of the Ontario Lottery and Gaming Corporation, the Crown-owned agency that controls the Caesars Windsor resort on the opposite bank of the Detroit River.

The MGM Grand Detroit was reportedly put up for sale by owners MGM Mirage in March. The property had a 43 percent share of the $1.4bn Detroit casino market last year, however, and is thus believed by analysts to be likely to attract the interest of buyers as its Nevada-based parent firm attempts to wade through its $13bn corporate debt load.

The Greektown casino was also put up for sale last year after its owners, the Ste. Marie Tribe of Chippewa Indians, filed for bankruptcy in March. Greektown lawyers are currently locked in proceedings before a bankruptcy court to secure a $17m tax break for the property due, they claim, following the completed construction of a permanent hotel facility in February, though the hotel-casino property has already attracted potential suitors, according to media reports.

But the high-profile bankruptcy filings and takeover talk actually create a misleading impression that the Detroit casinos themselves are losing money and that the market has already reached saturation, according to Calderone.

“A lot of people don’t realise that [a Chapter 11 filing] is a restructuring exercise and not a shutdown,” he told delegates. “People are under the impression that the Detroit market is so distressed and that one of these properties will close… but ten to 15 years from now I think there will still be four casinos in the Detroit/Windsor market, even if the owners and operators of the casinos will change.”

Cash-rich gambling operator Penn National Gaming - with $1bn-plus to spend as a result of terminated private equity takeover deal last year - has already expressed its interest in both for-sale Detroit properties, according to the Detroit Free Press.

Speaking at the Canadian Gaming Summit in Windsor, Penn National's chief operating officer Tim Wilmott described the company's $1.4bn compensation package as a "great growth opportunity for us to acquire some of the distressed [casino] assets out there".

"The sobering reality is that we are an industry in crisis, like many others," Wilmott added. "The gaming industry has to wake up to a new world order."

Penn National's billion-dollar cash pot places the firm in a unique position compared to rival gaming operators looking to reduce their debts rather than add to them, but the Pennsylvania-based company could face competition for distressed assets from other opportunistic investors, as well as from private equity.

"There will be a lot of people coming in for what they think are good deals on existing casinos," CM&D's Calderone told the Canadian Gaming Summit.

The Toronto-based private equity firm Clairvest is actively involved in talks over investing in companies with strongly-performing casino properties in the North American market, Clairvest's managing director Michael Wagman confirmed. "We would invest in local market casinos that rely on predictable traffic patterns," he said. "[But] those that are selling or looking for partners are going to have to accept different terms than they would have got 18 months ago."

"We think there's still substantial downside risk… but this type of environment also presents investment opportunities," agreed Gene Chayevsky, president and managing partner of the Finstar Financial Group. "Private equity is clearly going to take an interest."

However, securing the approval of gaming regulators for operational takeover of a facility remains a significant hurdle in any deal, especially so in the likely event of banking foreclosures on indebted casino properties, according to Calderone. The complexities of state gambling laws could therefore lead to significant opportunities emerging for specialist casino management companies being brought in to operate properties on behalf of lenders or outside investors, he suggested.

"Because of regulatory approval issues it is extremely hard for a bank to operate a casino," Calderone said. "Contracted casino managers will make a killing as lenders foreclose."

Alternatively, the regulatory matrix could lead to yet further acquisition opportunities among foreclosed casino assets, Wagman believes. "It will be interesting to see how the banks behave [in the event of foreclosure]; they never thought they would be the 'owners' of these properties and may not have the appetite to withstand the regulatory approval process… Would this lead to a fire sale?"

Clive Tilley, chief executive of casino operator Tilley Entertainment, suggested that current market conditions could mean acquisitions being pursued on a "vulture basis". "I look at the situation at the macro level of being one of crisis, but at the micro level one of opportunity... where there are clearly acquisition opportunities for underfinanced and underperforming businesses," he said.