

Submission of Comments on Gaming Saturation in Western PA

By Jeff Favre, VP/GM Presque Isle Downs

Thank you for the opportunity to speak before you today and to offer my perspective on the issue of gaming saturation in Western Pennsylvania and on the recent report released by the Legislative Budget and Finance Committee prepared by Econsult. We were obviously anxious to see the conclusions that would be made in this study as it related to the future of gaming in Pennsylvania and in particular those that related to Presque Isle Downs, our property in Erie.

Frankly, we were disappointed in the Econsult study on several grounds though the most significant are:

1. This was billed as a study of the future viability of gaming in Pennsylvania. In this regard, we found the study lacking in that more than half the document is devoted to past experiences and the economic impacts that casinos have brought to the Commonwealth. While this is useful information on the impact gaming has had, it does not further the discussion on the future viability of gaming in western Pennsylvania where existing properties are facing stiff and increasing out of state competition as well as the potential for an additional in state competitor in the form of the proposed Lawrence Downs racino.
2. The study lacked any specificity on the impact that would be felt by existing properties in western Pennsylvania. Instead the Econsult study made very broad sweeping generalizations without any analysis to support their conclusions.

I will take this opportunity to put the focus on the issue of market saturation in western Pennsylvania. To that point, there were several general statements in the Econsult study that ring true for the entire western region. Let me read a few comments directly from the study:

“The only casino in the Northwest, Presque Isle, has already been affected by the opening of Ohio casinos and faces increased competition from the 2014 opening of a casino in Youngstown, Ohio and from Lawrence Downs, should that casino be licensed. It also may be affected by a New York license. Thus, Presque Isle faces competition from three sides.”

“In general, new competition has the potential to impact some existing casinos **significantly**. For example, Sugarhouse and Presque Isle each have less than \$200 million in slots revenue currently and both will face new competition in the next several years from newly constructed casinos.”

“For the casinos that are likely to be significantly impacted, **it is impossible to predict whether the revenue decrease will be large enough to force capital restructuring or even bankruptcy.** Some casinos may need to be recapitalized at a new, and lower, basis.

Current ownership will try hard to avoid default on debt, and several owners have the resources to maintain control of casinos even if operating income shrinks to the point it cannot cover casino specific debt service."

This was a shocking conclusion. It implies that the Commonwealth should be willing to take such a risk. I can assure you that the ownership of PID will indeed do everything to avoid such a calamitous situation. However, I think it is cavalier to suggest that casino owners will step up to fund casino debt should revenues prove to be insufficient. There are few companies or individuals who will be willing to operate at a loss for any length of time. The closing of Harrah's Tunica yesterday should be an indication of how a company deals with negative earnings and saturation.

The Econsult report failed to study market saturation issues which can be addressed in a number of ways: 1) Looking at the number of persons per gaming position in a given market and comparing it with other markets, or 2) Looking at the win per capita in a specific market to establish whether or not this has reached its nadir and if the market can sustain another competitor. This was in fact done in the report commissioned in September 2011 by Treasurer Robert M. McCord which indicated that western Pennsylvania was at or near market saturation.

A more definitive approach is through the application of a calibrated gravity model. The method has the ability to forecast the revenues of a new operator and the impact on existing operators. Given the data request made by Econsult, we were under the impression that was being done. Yet the report only addresses the origins of revenue by state for various scenarios without providing the impacts on existing operators. Nor does it calculate the net benefit to the state from the advent of a new operator. State taxes are likely to not rise if western Pennsylvania casinos simply cannibalize each others' market share. The Econsult study did not analyze if alternative license locations would provide greater net revenues to the state. I would refer you again to the Treasurer McCord's report which did consider alternative locations.

Turning now specifically to Presque Isle Downs. Since its peak GGR in 2011 of \$188 million, PID has lost 23% of its revenues despite the addition of table games. In fact, table games (impacted largely by the opening of Horseshoe Cleveland) have declined since 2011 by 35.6%. Slots-only revenues peaked in 2010 and have since declined by 23.1%. This is the effect of competition that is open today. In 2015, Presque Isle Downs revenues will continue to be under pressure. There certainly will be an impact with increased competition from Austintown and possibly Lawrence Downs.

The opening of the Austintown racino will bring the total number of gaming facilities within fifty miles of Pennsylvania's western border to nine. (Horseshoe, ThistleDown, Hard Rock, Austintown, Wheeling Downs, Mountaineer, Rivers, The Meadows and Presque Isle). This substantially reduces Presque Isle's ability to capture revenues in the Youngstown market. Youngstown is a market to Rivers and The Meadows as well and all will suffer significant losses. The Austintown racino, which is currently in its final building stages, already has acknowledged the saturation issue by scaling its operation back to only 800 machines. The possibility of Lawrence Downs, the tenth gaming facility in western PA, will further substantially erodes Presque Isle's, Rivers' and The Meadows' penetration into the northeast OH and all western PA markets.

Along with this decline in revenues will also come a proportional increase in fixed expenses. In addition, increases in marketing, advertising and player promotions will be necessary to combat the increased competition in an already saturated market. This will result in lower capital reinvestment into the property along with fewer jobs and less tax revenue.

The viability of new entries into western Pennsylvania is already at question. The Lawrence County racino has publicly noted challenges being financed and its ability to compete against already established operators with proven databases in what will be a highly competitive market. This is especially true when considering that Lawrence Downs will most likely pay an effective tax well above 60%, given the revenue potential being limited in an already saturated market. This is compared to its immediate competitors in Ohio where the effective tax rate is approximately 43%. Indeed the lower effective tax rate is the only thing that will make these Ohio properties, such as Austintown with its limited operation, in northeastern Ohio sustainable. This viewpoint was also echoed in the Treasurer's report:

“The license fee and Pennsylvania’s effective gaming tax rate would challenge the feasibility of the locations falling into the Small category, including Altoona and Valley View (i.e. Lawrence Downs)”

The marginality of the operation at Lawrence Downs will severely impact its ability to attract customers from Ohio where comparable facilities will enjoy an effective tax rate differential of over 17%, allowing them to outdo any promotional or marketing efforts Lawrence County might employ.

The Lawrence County developers themselves have stated that the project will only be feasible if the county provides \$50 million through public bonds. This seems to go against the intent of the legislation in designating the \$50 million license fee, which was to ensure that only projects were placed in sustainable markets with companies having the necessary wherewithal to obtain a gaming license.

In conclusion, we do not believe this study has added to the discussion of market saturation in western Pennsylvania. We believe that Pennsylvania has proceeded with the development of the gaming industry in an exemplary manner and should look to the Treasurer's own study that suggests the most potential for revenue for the Commonwealth. We urge caution and suggest further analysis of future casino developments, and how they will impact the existing operators; operators who have taken the risk and developed properties that have brought so many benefits to the Commonwealth.

THANK YOU for your time and consideration.