

Building a Better Gaming Machine Program



Sales at Black Gold Casino have exceeded projections by approximately 15% since the November 15, the first day of operation of AEGIS-Video™.

It is well established that gaming machines are a cash cow for any government that has managed to pass legislation to implement them. In Delaware, Rhode Island and West Virginia machines dominate the revenue figures of Lottery agencies that are among the top revenue producers for their respective state governments.

It is also becoming clearer that the arguments in state governments about whether expanded gaming is a socially responsible way to generate revenue are slowly giving way to the reality that expanded gaming is here. Most Americans are within, at most, a few hours drive of a commercial, public or tribal casino. If citizens don't have a casino in-state, there is likely one just across the border.

As a result, several states are working on, or have already passed, legislation that would allow slots or VLTs to operate in various venues in order to raise revenue for their own jurisdictions.

While these states will likely have to operate machines for several years before they begin to catch up to the revenue figures already tallied by jurisdictions that have been offering the machines for years, they do have one advantage. They have the opportunity to study what has worked, and what has worked really well (let's face it, from a pure revenue standpoint, everything implemented has worked with gaming machines), and fashion their programs in such a way as to maximize revenue potential.

Revenue potential is affected not only by the number of machines allowed in a jurisdiction, but also by the average daily net win per machine. Many factors influence net win on a machine. The most obvious are the types of machines the facilities are allowed to operate (Class III, Class II, etc.) and the types of games allowed on the machine. These are very important factors to consider for any government body that is setting regulations for any state-sponsored gaming machine program.

What are slightly less obvious are the other factors that come into play. What commission rate do the operators receive? What types of venues will operate machines? Where are these venues located? How much competition will these facilities face? And, how many content providers are represented on the gaming floor?

Commission Rates

"One of the things that needs to be carefully looked at is, are you going to

enable the facilities you are trying to set up in your jurisdiction to be able to compete," said Robin Drummond, Senior Director Government Sponsored Gaming GTECH. *"What is the competitive landscape of your particular state or jurisdiction? Do you have gaming on your borders? Do you have Indian gaming in your borders? Do you already have existing casinos? Who are your venues going to need to compete with? That needs to be very closely considered when you're setting up the commission rate.*

"Like we've seen in West Virginia and in Delaware, you want to enable those facilities to be able to offer their players entertainment and other amenities associated with the program similar to what one would see in other jurisdictions. The return to the state does not necessarily drop if the tax rate is dropped."

When setting commission rates, state lawmakers have to walk a very thin line. If they set their commission rates too high they run the risk of seeming like they're only looking after the interest of the operators. If they set commissions too low the operators who are interested in trying to maintain a program won't be unable to reinvest profits in such a way that would build the customer base.

One recent example of this occurred in New York, where upon implementation of the program, only 29 percent of the net win was given back to operators in commission. While the machines have been successful at generating income, the program's growth has been slowed by the reluctance of some venues to launch their video gaming entertainment facilities.

"New York is losing hundreds of millions of dollars in revenues that could be going into education because VLTs are not up and running at the two biggest race tracks in the state," New York Senate Majority Leader Joseph L. Bruno said. *"We've been talking about this problem for almost two years since the Courts ruled the previous distribution system was unconstitutional."*

The good news for New York tracks is that Governor Pataki recently signed legislation that increases the track's share of the take. Tracks will now receive 32 percent of the first \$50 million in VLT revenue, 29 percent on the next \$100 million, and 26 percent on all subsequent revenue. Under the bill, tracks would also receive a marketing allowance of 8 percent on the first \$100 million and 5 percent on all revenues over \$100 million.

"New Yorkers go elsewhere for recreational gaming, horse betting, and entertainment," said New York Senator William Larkin. *"The gambling dollars people are already spending in neighboring states could be benefiting New York. VLT's could generate hundreds of millions of dollars for New York State education programs, which was the original intent of the program. The legislation we passed creates a workable reimbursement fee for the vendors who will be running the VLT's while providing a mechanism to successfully garner additional funding for the state. In addition, changing this formula will enable our race tracks to upgrade their facilities, and offer a variety of cultural and recreational forms of entertainment so that they can become true tourist destinations. Ultimately, this strategy will help keep lost revenue here in New York."*

Illinois is another state dealing with issues concerning operator commission. In 2003, legislators dropped operators' commissions from a rate of 50 percent to 30 percent. As a result, the casinos have decreased marketing, cut more than 3,000 jobs, and decreased operating hours. Admissions dropped by 18 percent. While the state's take did increase by roughly 26 percent, it was significantly lower than the near 50 percent gain that was expected.

Whether Illinois lawmakers did the right thing in decreasing commissions is a matter for debate. After all, the state did implement casinos in order to generate revenue, and decreasing the commission rate did increase revenue. But what about generating commerce? What about the income tax

revenue that was lost when 3,000 jobs were cut? There are no easy answers in an issue such as this.

The Oregon Lottery is currently winding up a struggle with this issue. When legislation passed allowing the Lottery to expand from offering only video poker on its gaming machines to allowing “slot-styled” line games, the state government requested that the venue owners commission, at the time an average of 28.8 percent, be lowered. The reasoning behind this was that the state didn’t mean for the advent of line games to be a financial boon to venue owners.

This is a fair point to ponder when one considers that many states chose to put machines in race tracks in order to give a much needed revenue boost to their dying racing industries. Oregon VLTs aren’t in race tracks, and they weren’t implemented to save the bar and tavern industry – they were implemented solely to generate revenue for the state.

Still, Oregon’s bars and taverns are businesses, and while the average venue, with 5.125 machines, wouldn’t gain enough VLT revenue to reinvest in something as grand as a hotel, they still look at their machines as an investment that they can build around.

When the operator commission for line games was initially suggested to come in at 15 percent (the video poker commission is 29 percent), many venue owners threw up their hands and said they wouldn’t add the line games. Through much negotiation, the commission rate has been reset at 24.8 percent for both line games and video poker.

Location, location, location

There are several different types of venues in the U.S. that serve as gaming machine outlets. There’s racinos (horse and dog tracks, Jai-Alai frontons), casinos, riverboats and bars and taverns. Many states operate machines at more than one of these types of venues.

So which of these venues makes the most sense for gaming machine implementation? Of course there is no definite answer to this question. From a pure distribution standpoint it would seem that several thousand bars and taverns, spread throughout a jurisdiction, would be the best option. In states historically linked to riverboats cruises, riverboat casinos seem to naturally fit in with the tourism thrust.

Still, there’s a reason why so much of today’s gaming legislation is tied to racetracks. It’s just a logical fit. With tracks, you already have a branded gambling facility with plenty of parking.

“If you look at what’s happened in Pennsylvania and Maryland, really the model that has been successful has been to keep it at the racetracks,” said Ted Arneault, Chairman and CEO of MTR Gaming. “There’s a good reason why. Most of the states have tracks with a long history that have had wagering or gaming since day one. Mountaineer Racetrack itself is over fifty years old. We’ve had gaming at Mountaineer a long time. It’s accepted, we have a base of employees, we have a base of horsemen that reaches out to the agrarian economy plus the regular tourism economy of the state...If you look at the models that have been successful, that have been out to market quickly, they’ve really centered around the racetracks for the good reason that they are historic for the states, they have provided jobs for a long time, and they’ve been in the gaming business for, usually, a very long time. The segue is not that severe.”

Brennan Lawrence, VP & General Manager of Scientific Games Video Gaming Systems, added “Certainly one of the things regulators have looked at is that in a racetrack you already have an age controlled environment. At a racetrack you’ve already shown the ability to monitor underage gaming and put some controls in place.”

Not only are tracks recognized gaming destinations with, in most cases, a long history of dealing with all types of issues associated with gambling, but the facility is already there.

“Choosing the existing venues can significantly speed up the time to market,” said Drummond. “You already have the venue in the community, all the zoning issues have been established, all your parking issues, all your traffic flow issues to the facility already exist and the ability to start a program out of an existing racetrack is significantly faster than if you’re going to try and do a green field site somewhere both



Ted Arneault, Chairman and CEO of MTR Gaming



Brennan Lawrence, VP & General Manager of Scientific Games Video Gaming Systems

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When Dotted I's and Crossing T's, Don't Overlook the Most Important T

Let's assume you've dotted all I's and crossed all T's. You've...

- selected the types of machines and types of games your venues will be allowed to operate
- chosen the types of venues and locations that will comprise your video lottery network
- established a maximum number of machines per location
- analyzed and understand the competition your facilities will face; and
- set your operators' commission rate.

There's one more T to cross... and a most critical one at that: Technology.

Yes, video gaming may well be a cash cow, but governments can lay an egg if they don't also give their operators the best, most advanced technological arsenal to compete. One of the more important pieces of competitive weaponry today is the video control and monitor system.

There are fundamentally two types of systems, each as different from the other as night and day:

One system requires video lottery terminal (VLT) manufacturers to adapt their implementations to a proprietary protocol. Manufacturers must invest large blocks of time and money to reprogram their gaming software to fit the central system's parameters, which negatively impacts their return on investment. Many manufacturers, as a result, opt out of such jurisdictions, particularly smaller ones, thereby limiting the number of games made available to players. Themes also tend to stay on the floor longer – and thus become stale – because of the cost required to refresh them.

End result: Sales and revenue to both lottery and its venue operators are diminished.

The second system is based on an industry standard protocol known as SAS (Slot Accounting System), which makes it infinitely easier for VLT manufacturers (and lotteries) to bring new games to market. Currently, SAS is the only standard protocol accepted by the gaming industry.

"Virtually every business is moving to a standard industry protocol and that technology has finally come to the lottery industry," says Brennen Lawrence, Vice President & General Manager of Scientific Games Video Gaming Systems. "Our AEGIS-Video™ system is at the vanguard of this emerging trend."

With SAS, costly and time-consuming reprogramming of games is eliminated. Gaming machine manufacturers, thus, can bring their newest and most progressive themes more quickly to video lottery venues, including themes designed by the manufacturers that provide 95% of the gaming machines on casino floors.

"The implementation of SAS and future BOB [Best of Breed] standards offer regulators and venue operators advantages that are not attainable with other systems," says Lawrence. "Our systems easily accommodate these new and emerging standards as well as the pending issuance of IGT's new Super-SAS standard."

AEGIS-Video™ also offers enhanced monitoring capability and superior reliability. Incorporating industry-leading features and functionality that includes 24/7 operations and monitoring of all components on the system, frequent data collection and access, integrated local and wide area progressives, and application downloading, AEGIS-Video means lotteries pay significantly less to provide 24-hour staffing to ensure the same high level of operational integrity provided by the prevailing legacy systems on the market." ♣

– Submitted by Scientific Games

from a political standpoint and the sheer cost and requirements to get infrastructure established."

Competition/Saturation

How long can gaming machine figures be expected to rise? The overall U.S. sales figures should be expected to go up for as long as machines continue to be added. What about average sales for each state? What about the average net win per machine in any given jurisdiction?

In the May 2003 edition of Public Gaming International Magazine, Rhode Island Lottery Director Gerry Aubin estimated that 25 to 30 percent of the Lottery's VLT customers come from Massachusetts, Delaware Lottery Director Wayne Lemons estimated that 70 percent of their VLT customers come from outside the state, and West Virginia Lottery Director John Musgrave estimated that out-of-state attendance at three of his state's four racinos exceeded 80 percent. The fact is, these out-of-state numbers will, at some point, decline as border states implement gaming machines. What's more, states that do add gaming machines can't expect to achieve similar out-of-state customer numbers. The competition for gaming dollars only stands to become more intense.

"I think our businesses are going to have to be run just like any other business," said Arneault. *"We're going to have competition, and we're going to have to make sure that we have the latest product that our customers want. Legislators think sometimes that because you're given a license your revenue stream is protected and guaranteed. It's not, and I think that's going to be proven as these additional states come on line and these additional venues come on line. It's going to be the facility that can be most customer friendly, have the best service and give the product that the customer wants that are going to succeed."*

"I think its going to be the states that are willing to look at this as an industry, that look at their tracks and venues as a business that needs to compete and therefore are willing to change the legislation as needed in order for those venues to compete that are going to be the most successful. I think those that don't go that way are going to have problems."

What makes a gaming venue competitive? Higher payout, better selection of games, healthy competition between content providers, and the ability to reinvest gaming dollars back into the facility in order to create reasons, outside of gaming, for customers to choose that particular venue (entertainment, better restaurants, a nice hotel, etc.)

"The competitive landscape is the issue," said Drummond. *"There's extremely successful programs in Rhode Island with a very high rate of return to the state in whatever form it comes. But that has evolved over time. There are other jurisdictions that have tried to begin the program, like New York, with a very high return to the state initially. It is absolutely key to look at the competitive landscape that is in place. In some jurisdictions you have extremely successful, well developed destination gaming on the Indian Gaming side of things with golf courses and hotels and entertainment. The ability of the venue to compete in that environment is absolutely key to make sure that the state, or the lottery, or the gaming commission has the revenue stream that they require and was the reason the program was put in place in the first place."* ♣