Las Vegas casinos trying to weather economic downturn

Casino companies’ earnings are plummeting by double digits. Debt costs are rising and customers are spending less. In the financial world, in this economy, those are the trend lines of doom. Indeed, a few smaller operators are already close to bankruptcy. But could giants like MGM Mirage and Harrah’s Entertainment be next?

The breathtaking series of Wall Street failures and Washington bailouts of recent months suggests anything is possible – even spectacular failures in Las Vegas. For now, bankruptcy protection remains a remote, if grim, possibility for all but the most damaged companies. Experts say that banks will negotiate with the big casino operators rather than force them into bankruptcy.

„These companies are still generating a huge amount of cash. The banks are going to work with operators that are willing to cut back on capital expenditures,“ said one banker, who requested anonymity.

Yet financial experts say for the casino giants to survive in this economy, they must continue to make smart, sometimes painful moves. They also need a little of that luck so many people come here to find.

Harrah’s recently completed an inter-company loan of USD 200 million to trim the company’s debt. It’s now paying a portion of its interest by issuing additional bonds, saving the company millions of dollars in cash.

Station Casinos will seek some reprieve from its banks, though the company’s debt costs will likely go up, analysts say. Both companies have relatively little cash left after interest payments to pay for upgrades to their properties.

Casino operators are also cutting costs where they can, including payroll, their single largest operating expense. At many companies, this has meant laying off managers and rank-and-file workers in recent months.

As of August, Nevada reported that the gaming industry employed roughly 600 fewer people than a year ago. Although more workers have lost their jobs in that time, these figures reflect that many people who lost jobs have since found work, especially at new casinos that are hiring or have opened.

Some companies have halted construction projects, and analysts expect more plans to be put on hold in the coming months. (The exceptions are big projects too far along to mothball, such as MGM Mirage’s CityCenter and the Octavius hotel tower at Harrah’s-owned Caesars Palace.)

Some executives are putting more cash, or equity, into their companies. Las Vegas Sands Chief Executive Sheldon Adelson, the company’s largest shareholder, recently lent the company USD 475 million of his own money to pay down debt. Companies with wealthy shareholders could do the same, analysts say.

Still, some companies may not be able to wait out the economic downturn. Herbst Gaming and the owners of the Hooters hotel, for example, are not generating enough cash to cover debt payments. A rebound by 2010 would be soon enough for companies to get a reprieve from lenders and weather the downturn, experts say.

Yet with gaming stocks and bonds trading at less than 50 % of their value of a year ago, most investors aren’t hopeful for a quick turnaround. Some experts believe there might be a cultural shift at play with longer-term implications for businesses, especially the Las Vegas resort industry, which encourages escapist, spendthrift behavior.

„Post the era of using homes as ’piggy banks’ and overspending as a nation at every level, we believe a new era of national thrift is before us," Andrew Zarnett, a bond analyst with Deutsche Bank, said in a research report last week. „We believe last week's activities in the stock market have caused too much psychological damage and the general public has been traumatized by these events … We believe Americans will be forced, if not at their own volition, to reduce household debt."

The result, Zarnett says, will be reduced consumer spending and an unprecedented gaming industry recession. For several casino companies, the economy began its slump soon after they took on massive debts. At the tail end of the credit boom, Station Casinos and Harrah's went private with the help of private equity firms that borrowed extensively to make the deals happen.

Ideally, leveraged buyouts rely on cheap loans that are paid down by growing earnings over a longer term than is acceptable to Wall Street. The companies can then be sold back into the public market for more money.

It's hard to blame these companies for taking on debt when they did because few business models would have assumed a decline this deep, according to one Las Vegas casino executive, who requested anonymity.

„Nobody considered a situation where your cash flow goes down by 25 % because that would have been a ridiculous assumption to make a year ago," the executive said. „You would have been laughed out of the room."

Before the economic decline, major casino companies used cheap capital to build expensive properties and acquire others. Lenders gave them money at attractive interest rates on the assumption they would generate enough cash to pay off their ballooning debts, or at least refinance them at lower rates.

The credit crisis, by itself, wouldn't have been too dire for casino companies. As long as casinos generate huge amounts of cash that grow over time, as well-run casinos have throughout history, even monster debts can be managed.

Operators have seen boom-and-bust cycles before, and the Strip has historically functioned with some independence from the broader US economy. Yet in this downturn consumers of all income levels are spending less, contributing to double-digit earnings declines at some casino companies. Those factors have shifted the industry’s economic outlook.

Michael Paladino, senior director of gaming, lodging and leisure companies for bond rating agency Fitch Ratings, calls this an „unprecedented consumer downturn, relative to the size of the industry today.“