Economic Crisis Poised To Remake Casino Industry

New York (Dow Jones)—While privatizations, bankruptcies and crippling debt have already altered the landscape of the casino industry, the brutal recession will likely give it an extreme makeover.

Wall Street is expecting a much different gaming market once the dust settles from the recession, and some investment banks, such as Morgan Stanley, are already dropping equity coverage of casino companies to reallocate resources.

The industry „isn't as lucrative as it used to be and not as fun as it used it be," said Robert LaFleur, an analyst at Susquehanna Financial Group. He noted the casino industry's equity market capitalization was worth more than USD 100 billion at the peak of the market in the third quarter of 2007. The last time he checked in February, it was worth about USD 11 billion.

„Right now, the product is miscast for the times. The capital structure is not capable of being supported," he said. „From Wall Street's perspective, it will be completely different" after the economic crisis ends.

Indeed, experts expect more entrepreneurs like investor Phil Ruffin who recently purchased Treasure Island in Las Vegas from MGM Mirage (MGM) for USD 775 million to take on more casino ownership.

„A lot of casinos on The Strip will go (to) entrepreneurs," said Joseph Greff, an analyst at J.P. Morgan. „You will have reverse consolidation where you'll see the bigger guys get smaller…and smaller, multi-casino operators will emerge."

Concerns about unsustainable debt burdens and severe declines in consumer spending have ravaged stock values of industry titans MGM Mirage, Las Vegas Sands (LVS) and Wynn Resorts (WYNN), which have lost around 83%, 94% and 61%, respectively, in 2008. Such losses occurred amid broader equity market declines with the S&P 500-stock index losing roughly 38% last year.

Wall Street is bracing for a possible MGM bankruptcy as the company struggles to remain in compliance with its debt covenants while major bondholders call for a Chapter 11 filing. Among the notable bankruptcies that already have occurred this year is Trump Entertainment Resorts Inc.'s (TRMPQ) Chapter 11 filing in February – its third such filing.

Station Casinos Inc. recently said it's negotiating a prepackaged bankruptcy plan. And, Harrah's Entertainment Inc., the world's largest gaming company, which went private in 2008, has struggled to meet debt obligations as gambling revenue declines.

„I suspect there will be more fragmentation in the casino industry in order for the…operators to resolve balance sheet issues," said gaming analyst Bill Lerner with Union Gaming Group.

He said as some of the larger gaming companies sell assets to relieve balance-sheet pressures „that will bring about other parties that have had interest in the casino business for some time."

„Gaming companies looking to expand in geography that don't have the exposure they want will probably end up with properties as well," he said.

Indeed, Boyd Gaming Co. (BYD) last month expressed interest again in buying Station Casinos after the company rebuffed an earlier offer.

Although casino stocks have already been beaten up, it's still unclear whether the market has reached a bottom. However, Lerner said there has been „some unwinding of the bankruptcy trade."

He noted recent efforts by MGM, Las Vegas Sands and Harrah's to mitigate balance sheet risks such as debt buybacks, exchanges, cost cuts and good faith negotiations with creditors to extend loan maturities have helped sentiment.

Amid the challenging environment, J.P. Morgan's Greff has a neutral rating on MGM Mirage and Wynn. He upgraded Las Vegas Sands this week to overweight from neutral, citing improving investor sentiment, liquidity position and ability to strengthen its balance sheet.

While the gaming markets across the board have suffered during the downturn, regional casinos in America's heartland are showing signs of stability. As such, stocks of Penn National Gaming, Inc. (PENN), Pinnacle Entertainment Inc. (PNK) and Ameristar Casinos, Inc. (ASCA) have rallied this year up 29%, 31% and 62%, respectively.

These operators tend to focus on local markets that aren't as vulnerable to the weakness in non-gaming areas such as lodging, fine dining and air travel, analysts note.

„These are value oriented properties. They're the Dollar Trees and Wal-Marts of" the industry, Greff said.