

Interview

Casino Review caught up with **Steve Gallaway**, managing partner at Global Market Advisers, to discuss the opportunities and challenges facing US tribal gaming sector, and whether sports betting will be a game-changer for the segment.

Casino Review: Could you give us your perspective on the state of the tribal gaming industry? I believe there are now Indian casinos/bingos in 29 states?

Steve Gallaway: Tribal gaming is now hitting a general level of maturity. There are not many untapped opportunities that are out there.

We still see a few, for example Boyd Gaming still has Wilton Rancheria to the south of Sacramento, Hard Rock's building a facility just north of Sacramento, and there are a few others around. But generally speaking, in terms of the growth of tribal gaming right now, what we're seeing is that it's following the trend of regional gaming a decade ago, i.e. operators are focused on expanding their non-gaming options.

The question they're looking at now, or should be looking at now, is "how do we attract a new market segment that we're not getting today?"

The answer is by offering a broader entertainment experience. It's not as much about adding more slots and tables, it's about adding additional restaurants, hotel rooms, entertainment venues, retail and spas. It's about broadening their offering, so that they truly create a full integrated resort destination.

Casino Review: So you're really seeing a move towards an IR model?

SG: Absolutely. Our work in Indian Country today is primarily twofold. "How do we grow non-gaming revenue/ how do we grow our market share and what capital improvements do we need to get there?" type of engagements; while the other half is sports betting."

CR: In that context, how lucrative is the tribal sector – I believe Alan Meister at Nathan Associates suggested that just 16 percent of the tribal casinos generate 71.5 percent of the \$31.2bn in revenue the sector produces as a whole?

SG: Without breaking it down on a state by state basis that's a difficult figure to call. Nevertheless, given that Pareto's principle applies to almost everything, it wouldn't surprise me if that estimate was accurate. When we look at the big Native American casinos, there are a decent amount that generate a billion dollars plus in revenue, or close to it. But at the same time, there are many more that are generating around \$10-20m in revenue.

CR: In terms of individual states, what are some of the leading ones for tribal gaming?

SG: The ones that come to mind are California, Florida – which is the Seminoles who do about \$2.5bn a year, Minnesota, Arizona, Washington, Wisconsin, Michigan, and Oklahoma, who has over 100 casinos alone, more than 20% of the total Indian casinos in the United States.

CR: Is there any sort of correlation or general factors that have made those markets so lucrative for tribal gaming?

SG: There are two primary factors, population for demand and a state government which is willing to sign fair Tribal-State compacts.

As an illustration, if you looked at what could potentially be the most valuable market in the US for Native American's on paper, that would arguably be Texas - it's the largest untapped gaming market in the US.

The largest casino in the country is the WinStar World Casino and Resort, which is right on the

Texas-Oklahoma border, roughly an hour and a half north of Dallas. They have over 7,500 slot machines, so that's an indicator of the demand that's there.

However, while there are two casinos in Texas, the Kickapoo Lucky Eagle Casino Hotel and Naskila Gaming, they both just offer Class II machines and are in continual battles with the state that's trying to shut them down.

Flip that over to California, when the then-governor Gray Davis decided to create compacts with the tribes which allowed for a tribe to offer up to 2,000 machines, and there was a small revenue share that tribes had to pay to the state that was then mostly redistributed to other tribes that either didn't operate a casino or had a small facility with less than 350 slots.

That was something which really allowed gaming to flourish and, in that context, it fundamentally comes down to having a state government that wants to work with the tribes.

Another example of that is Connecticut, back in the early 90s the state government did a deal with the Pequots originally, and then the Mohegans later on, where the state receives 25 percent of slot revenue. In return, the tribes received exclusivity and that allowed their facilities to flourish. They were really the first people, outside Atlantic City, to open up any casinos in the northeast. Without a willing government entity as a partner, Native American casinos cannot dominate a market.

CR: In terms of the overall tribal gaming sector, what kind of divide is there between Class II and Class III gaming and roughly how many tribes have opted for a casino resort model?

SG: Again, the machines you're allowed to have ultimately comes down to the terms of the compact a tribe has with the state. We were more concerned about Class II/Class III distribution a decade ago, because at that time, Class II was really an inferior product.

By contrast, the Class II product today is so strong that it's only a very small disadvantage to solely offer those machines.

While the bigger manufacturers were initially hesitant to enter the Class II market as it was considered something of a legal grey area, the NIGC issued a memo clarifying that Class III manufacturers could also offer Class II.

This really opened the door for these larger companies to come in and innovate in the Class II space, and since then the product has been evolving.

Class II also offers up an interesting opportunity for tribes.

There are so many tribes out there that are capacity constrained. However, depending on their compacts, some can alleviate some of that capacity by adding Class II machines without needing a compact amend-

ment. We've seen that occur in certain states, such as California.

However, there's a political caveat as to why every tribe that could do that shouldn't. If you've got a good relationship with the state, it's worth thinking about whether you'd want to jeopardize that relationship. In addition, many tribes care about their nearby tribal competitors and want to respect each other.

So while Class II could be a way to alleviate capacity constraints, doing so could have political implications.

At the end of the day, politics is always a consideration.

CR: What headwinds is the tribal sector facing?

SG: There's always the threat of commercial gaming expanding in certain states which could impede tribes' market share, such as what is happening in the northeast and how the Connecticut tribes are being impacted. When Wynn Resorts' Encore Boston Harbour opens up in Massachusetts, this will likely have a big impact on Mohegan Sun and Foxwoods Resort Casino.

There's also the threat of people being unsuccessful in getting some lands in to trust as we've seen recently in Massachusetts with the Wampanoags.

There's also the reality of the instability of certain tribes. There's a consistent theme in Indian Country that those casinos that do better than their market share traditionally come from more responsible tribes with less infighting.

The most successful of my Native American clients (while of course they do have internal politics to deal with, and an election can change things) generally allow the casino, resort and other commercial operating entities to be stable.

CR: What will be the impact of sports betting legalisation on tribes and what's the biggest factor for tribes considering whether or not to enter the sports betting segment?

SG: One of the biggest issues for tribes to consider is what's allowed under their compact. Assuming a scenario where they'd have to go back and renegotiate their compact, the question is whether the upside is worth it?

One of our common engagements in Indian Country is ensuring that our clients have realistic expectations of how much revenue sports betting will generate.

A big debate for many tribes and states, is whether to limit sports betting to a land-based offering or allow it to be online as well as you really need online to make a decent amount of money.

In light of that, while it's not going to be the panacea that some people had hoped, it is another revenue source, and you can definitely make money on it.

Tribes also see the value in terms of bringing additional people into their casinos. It not brings in a new demographic, but it also gives you the opportunity to hold events. On big game days, instead of people staying at home, they'll go to the casino because now they can place bets and watch the game there.

I don't think we're going to see as many super-books built in Indian Country as we are likely to see

a more modern day look for sportsbooks emerging.

You can see good examples of this at the Linq and the Park MGM in Las Vegas, which offer more of a sports bar-style experience.

Alongside this, even if online betting isn't available statewide, there hasn't been a lot of push-back against the idea of allowing people to gamble from their mobile devices once they're in the casino.

If a state allows that, sportsbooks will move people to download the app versus having numerous windows open as this reduction in payroll and capital expenses allow the books to be more profitable. In that sense, I think we're going to see far fewer large-scale sportsbooks with 100 windows built and instead more of a hybrid sports bar/sportsbook model.

CR: Does this approach to sports betting apply more to the casino resort model rather than the Class II tribal bingo operators?

SG: I think generally speaking it will happen on a state by state basis, so if it does happen, it will happen for all the tribes that are in that state.

Hypothetically speaking, in those states where you have a mix of large and small tribes, the bigger tribal operators will likely build out the type of sports bar/sportsbook type installation that we've discussed, while a smaller tribe, making about \$10m a year for example, are probably not going to take that risk themselves, but they'll instead make a deal with a sportsbook operator such as William Hill, MGM, Boyd Gaming—someone who's actively out there looking to get involved—who already have the back-end infrastructure in place. They'll supply everything the tribe would need for the book and provide them with a share of revenue back.

CR: So it's kind of a franchise model?

SG: Yes, that's correct. The question that's going around now is that, per the NIGC, operators are not allowed to share more than 30 percent of revenues with a third party. When we're talking traditional gaming, slots and tables, that was fine, but when we're talking about sportsbooks, that's a little different.

Doing 50/50 deals is not uncommon by any stretch of the imagination. Particularly from a sportsbook operators' point of view, if a tribe doesn't have the money and you've come in to build it out, I don't know if these operators are going to be willing to do a deal with a small tribe for just 30 percent.

CR: As a consequence of that do you think we might see smaller sportsbook operators trying to enter that space?

SG: The answer is yes. We've been approached by many operators in Europe who are looking to get involved in the US, and logically they see Indian Country as being an opportunity to do that.

But at the same time we have the larger US operators looking to get involved, so it's really a case of waiting to see what happens. I think the market is decently large, but at the same time European operators will need to take into account that it's a different culture here, the gaming habits are different than on the Continent. Ultimately before entering any new market it's essential to understand the local culture.

tribal gaming: Hitting “a general level of maturity”