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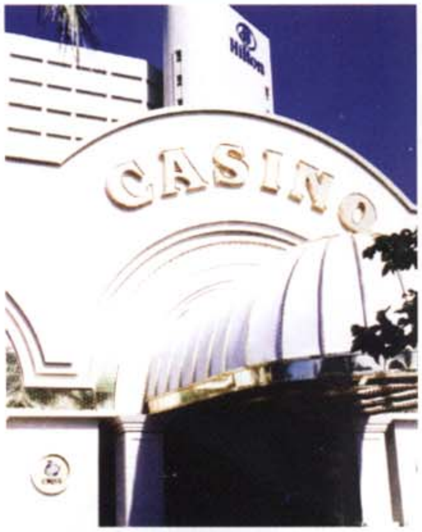
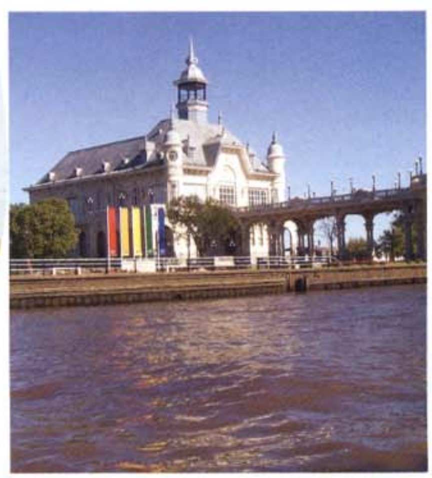
GLOBAL Gaming Business

Vol. 6 • No. 10 • October 2007 • $10





SOUTHERN STATUS

The latest on casinos and gaming in Latin America

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A Region in Flux

A Casino Developer's Guide to Latin America

By Dino C. Guiliano and Jorge Bazán

Strong and uncharacteristically sustainable fundamentals are driving the prospects for entertainment sector growth in the collection of markets making up Latin America.

In most cases, these markets suffer from an inadequate and/or outdated stock of casino operations (though there are, of course exceptions). Opportunities, however, are generating the interest of some seasoned and familiar players, and mixed with increasing political stability and a fairly universal trend of institutional reform across sectors, today's Latin America has managed to present a case for its entertainment/leisure markets that is increasingly difficult to resist—not that you should really want to.

A spot estimate of the Class II/III casino gaming market conservatively places immediate potential for the region (excluding Caribbean islands) ranging between US $10 billion and $12 billion-plus. It is estimated that 40 percent to 50 percent of this has yet to be realized by existing operations.

The Latin American Gaming Association (ALAJA) estimates there to be 300,000 electronic bingo and Class III-type gaming machines in operation throughout the region (a number of which are operating outside the law, and all of which are of varying age, quality and condition).

As interest in these markets continues to grow exponentially, and frustration with inadequate or dysfunctional gaming laws grows, governments will look to keep the industry in check with new and better strategies that will wholly welcome the sector into the region's formal economy while protecting legitimate operations from illicit competition. With this will come a large focus on proactive legislation and mechanisms for preventing and dealing with gambling addiction, white-collar offenses, illegal business operations and money laundering issues, making the region ripe for continued growth.

Fundamentally Speaking

Heavy international media coverage of Latin America's most negative extremes, combined with strong memories of what was termed the region's "lost decade of the '80s," as well as several more recent currency crises, historically (and incorrectly) substantiated poor macro economics, poverty, massive corruption, extreme leftist politics and other negative issues as "Latin" risks, rather than the specific country risks they are.

This false generalization has continued to blind many to the opportunities offered by select Latin American markets. In reality, the 22-plus independent countries and territories that make up this dynamic region represent a cornucopia of market types, ranging from the downright despondent to those that are emerg-

'The activity must be regulated or banned, but it must not continue like this, because we will never achieve transparency the way it is right now.'

—Brazilian President Luiz da Silva

Brazilian President Luiz Inacio Lula da Silva is in favor of regulating gaming in his country.

ing, have emerged, or are even labeled robust.

The United Nations Economic Commission for Latin America/Caribbean indicates that sub-regions within the region showed highly distinctive behaviors between 2003 and 2006, thus contributing to the common description of Latin America as "islands of wealth amid a sea of poverty."

As a whole, the region is experiencing a surge in household incomes, which, combined with a growing availability of credit, has resulted in boosted levels of overall consumer confidence. Together, these three factors contribute largely to the burgeoning middle class found in major population centers, as well as growth seen at more affluent income levels—both of which are spreading beyond major metro areas and into second-tier cities throughout the region.

Not expected to slow anytime soon, these trends indicate a shift in the marketplace that will continue to spread and evolve, underwriting increased levels of personal consumption (including increased levels of entertainment/leisure spending) and economic growth in affected markets as it does so.

The emerging middle class, while not equal in magnitude or velocity from place to place, is manifesting itself nonetheless across all leading growth economies throughout the region (Mexico, Brazil, Venezuela, Argentina, Uruguay, Chile, Peru, Colombia and Panama) at a time when what could be described as a young, scaled-down version of the U.S. boomer generation in many of these countries is just now approaching the age of financial independence.

Assuming job creation can keep pace with the impending glut of able workforce supply, we have only just begun to witness the results of the region's exploding growth in purchasing power.

Meanwhile, the region continues to flourish as an international destination, though not nearly close to its potential. International tourist arrivals in the region account for 7 percent of the world's total, and are growing at nearly twice the rate of global tourism volumes, a trend expected to continue through 2020.

Fix It or Get Rid of It

A monumental shift is taking place across Latin America in the public sector's mindset and approach regarding gaming activities.

The external situation, combined with a ripe internal environment, has enabled governments to take accountability for the social ills that had previously ignited and flourished as a consequence of an industry long left untamed by the public sector. The people, long aware of an issue governments are just now finding the resolve and capability to fight intelligently, by and large welcome the move away from futile policy approaches toward the eradication of gaming devices. Instead, they are embracing the new opus of a cleansing and institutionalization of the gaming industry, as is occurring globally.

In his battle cry earlier this year against the nebulous existence of Brazil's 130,000 gaming devices, Brazilian President Luiz Inacio "Lula" da Silva invoked the tone of an agitated father reeling in his out-of-control child, giving a loud voice to the regional sentiment:

"The activity must be regulated or banned, but it must not continue like this, because we will never achieve transparency the way it is right now."

Today it is estimated that those 130,000 machines (comprised of both e-bingo and traditional slots) are housed in 1,200 bingo parlors that operate throughout the country, though constitutionally no casinos have been allowed in Brazil since 1946.

This reality is due to a series of on-again/off-again court rulings passed in the 1990s through 2002 which favored the larger proliferation of bingo (both traditional and video versions) throughout the country, though traditional slots are not permitted.

Permitted yet constitutionally illegal, there was and still is no set of rules governing the games' existence, and no mechanism in place to monitor the operations. Traditional slots, though they operate under the guise of legality, are in fact not covered by the court's rulings, making them wholly illegal in Brazil. That they are present nonetheless is likely for no other reason than the fact the public eye doesn't know the difference between Class II and Class III, and in an unregulated environment, some operators have used this to their advantage.

We can leave the reader to muse on other political and economic opportunism that fomented on all sides of the equation due to the inadequacies of the guidelines in place and lack of regulation.

And, yes, while the involvement of the courts served the immediate purpose of filling a general policy gap over an industry which had evolved despite its constitutional illegality, court involvement proved ineffectual because of its inherent inability to address the larger issue of keeping all of the industry's many

The Palácio Quitandinha in Petropolis, Brazil, once contained the largest casino in Latin America, but it operated for only two years (gambling was banned in Brazil in 1946). Today, it is a convention center.

Casino Vina del Mar, Vina del Mar, Chile

Casino Central in Mar del Plata, Argentina

moving parts in check.

Bearing witness to an industry out of control, two years after the most recent court ruling on the subject, in February 2004, a presidential decree attempted to override court rulings by prohibiting bingo. This led to the closure of 1,100 bingo halls.

Brazil banged its chest at gaming that year, but the industry would not wince. In May of the same year, the Senate completely overturned the decree, reinstating the legality of the operations as they existed prior to the decree, and thus protecting the employment of over 320,000 of its people, for whom the industry supplies jobs, in spite of the legislative attempts to enforce the 1946 law. It is a telling story about the existing strength of the activity in Brazil, and one that is not uncommon across the region.

Thus, in Brazil, the courts have implicitly acknowledged a fact that until recently legislative branches have been unable or unwilling to face until now: that casino gaming, by way of ill-conceived, ill-defined or poorly enforced legislation, has proliferated throughout the country and integrated itself into the society—creating both demand and dependence. And it is clear that the proverbial chest-banging approach without adequate follow-through just doesn't fit anymore, if it ever did.

In the greater region, we are largely talking about societies that, until recently, have gotten all of gaming's potential bad with very little of its possible good. Keeping their eyes on the prize and no longer concerning themselves with previous flailing attempts to eradicate the activity, it is clear that a tipping point has been reached in Latin America, prompting the recognition of an industry with complex dynamics that if properly implemented can offer society a great deal more than social ills.

It wouldn't be the first time a government looked to gaming for the potential to fill its coffers. In the words of the late U.S. President Ronald Reagan: If it moves, tax it. If it keeps moving, regulate it.

By and large, this is the playbook now being followed in the region.

As for Brazil, Carlos Eduardo Canto, president of Brazilian Bingo Federation (Febrabingo) and Pro-Bingo Movement (MPB) is looking for a hint of defining legislation to come before fall is over. The rapid timeline seems optimistic, given the years it has taken to get to this point, but the continuing force of the movement is not likely to drive the results he is looking for in the very near future.

Regulate it

Of course, it is important to realize that Brazil didn't start the trend of industry formalization. In reality, today's operations are more representative of what we will call, for the purposes of our article, a second wave of such movements in the region—involving much larger markets than the first—namely, Mexico and Brazil.

However, to look at the first generation of major markets that took a comprehensive view of the sector's direction is to see the largely formalized sector that exists in pockets throughout the region. Though surely not coming without setbacks, the future is bright for the continuing evolution of the sector within the region's formal economy.

The following paragraphs should serve to overview the accomplishments of the region's larger pioneers on this front.

Argentina

With an established structure, a central power and a federal government that seeks to empower regional governments, Argentina is the place with the most longstanding and elaborate governing and regulatory system. Every province has a local gaming regulator (Instituto Provincial de Loterías y Casinos) and local laws are in function and visibly enforced. The resulting clarity and transparency suits well its 135 casinos and game rooms (home to 45,000 slots and video bingo machines), enabling the fairly straightforward existence of what is presently estimated as a $2.5 billion industry across the country. Jurisdictional issues over tax incomes and labor union debates are the greatest problem currently affecting this market, a fact that goes far to show the maturity of the country's industry.

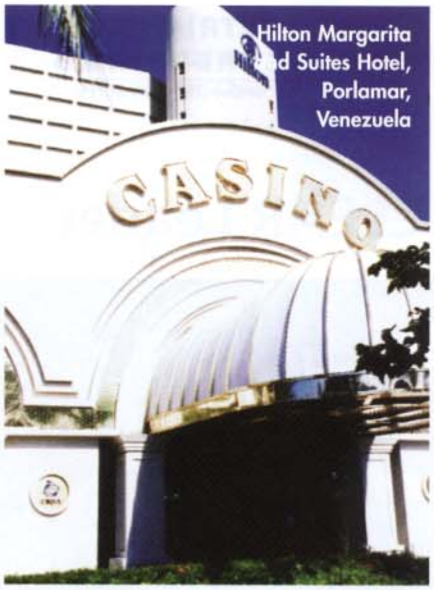
Panama

Panama's 15 casinos and 27 slot halls are governed by Decree Law No. 2 set in 1998, which set out detailed regulations for the gambling industry in Panama. ASAJA (Panama's gaming trade association) is looking for the further improvement of the law, demanding that government apply a strict financial investigation of new operators, to avoid the entry of irresponsible companies in an attempt to fortify the health of the Panamanian industry. Casinos in Panama are permitted in any hotel of 300 rooms or more, a policy intended to boost development of its tourism sector.

Colombia

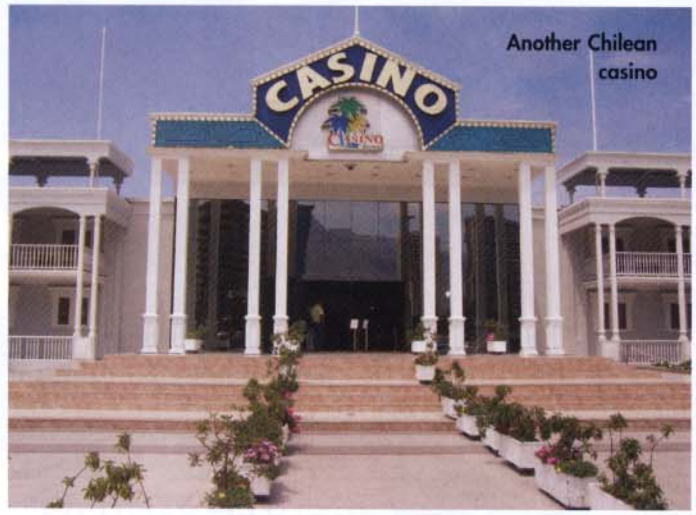
In Colombia, Law 643 of 2001 initiated a system of control against illegal gaming which also improved management of resources earned from all types of gaming. Since then, gaming has proliferated rapidly throughout the country, represented by 17 casinos and nearly 3,200 gaming rooms registered in the country, supplying 60,000 to 70,000 electronic slots and bingos (60 percent of which is estimated to be outdated or severely outdated), and approximately 2,000 roulettes and other table games. There are 56 Colombian companies legally dedicated to the industry, generating 730,000 jobs.

Colombia's dedication to enforcing Law 643 is verifiable. Five thousand illegal gaming rooms have been closed in the past four years. Three thousand of these closures have occurred in the past two years, resulting in the seizure of more



Hilton Margarita [illegible]d Suites Hotel, Porlamar, Venezuela

The casino at El Tigre Amusement Park, Buenos Aires, Argentina



Another Chilean casino

than 80,000 gaming machines.

Still, according to Fabio Villa Rodríguez, manager of Lotería de Bogotá, the illegals may have up to an incremental 30 percent to 40 percent of the market—as much as $1.6 billion—an issue which will continue to decline by natural market forces with the greater participation of international operators.

Chile

Law #19.995 and its instructions, Decree #287 of 2005, govern Chile's attempt to re-create its gaming identity. Through this, the Superintendence of Casinos is given the tools and authority to govern, regulate and enforce the letter and intent of the law. The legal body can only license a maximum of 24 casinos, 22 which have already been licensed. Of those 22, seven predate the 2005 decree, and 15 resulted from it.

Of these, one has begun operations and the other 14 will be coming on line between now and the first calendar quarter of 2009.

The eight facilities in operation represent approximately 4,000 slots and just under 200 tables. However, in an official statement to the Chilean Senate (April, 2006), Polla Chilena (the state lottery company) estimated that there are some 10,000 "clandestine" slot machines in Chile, 5,000 located in the city of Santiago—where all types of casino gaming are strictly prohibited by the 2005 legislation. While efforts to rid the country of underground operations are under way, it is uncertain how much progress has been made since the 2006 assessment.

Continuing to Evolve

If you've been following news bytes from the region over the past six months, the torrent of scandals uncovered may have fit well with your pre-established notions of the region's gaming sector.

It is important to recognize that, in the context of the broader situation, these are merely outward signs of the industry's growing pains, an indicator of progress in many ways that instill a confidence in those within the industry with the region's continuing dissolution and further prevention of poor practices and deplorable acts associated with the unregulated industry.

There is an avid understanding now across the region that there is no need to reinvent the wheel here—that other places have been through this and tackled it with success, all the while reaping societal benefits. The challenge will come largely in the task of retrofitting lessons learned elsewhere to these transitioning markets, which are simply waiting for the public sector to catch up with reality.

In this second round of formalization, Brazil, which we've discussed at length, is accompanied in this quest for change by countries like Mexico, Venezuela, Peru and Uruguay. This second wave is likely to be more comprehensive than the first, the second generation of entrants benefiting from lessons learned elsewhere, not only in Latin America, but from trends in gaming markets across the globe.

Brazil and Mexico, representing the lion's share of market opportunity in the region, are taking the largest leaps forward at the moment. This is not going unnoticed by regional and international players, who are now beginning to align themselves to capitalize on the wave of legitimate opportunities sure to ensue. The paragraphs following take a brief glimpse at these markets and their progress in generating such real opportunities for investment.

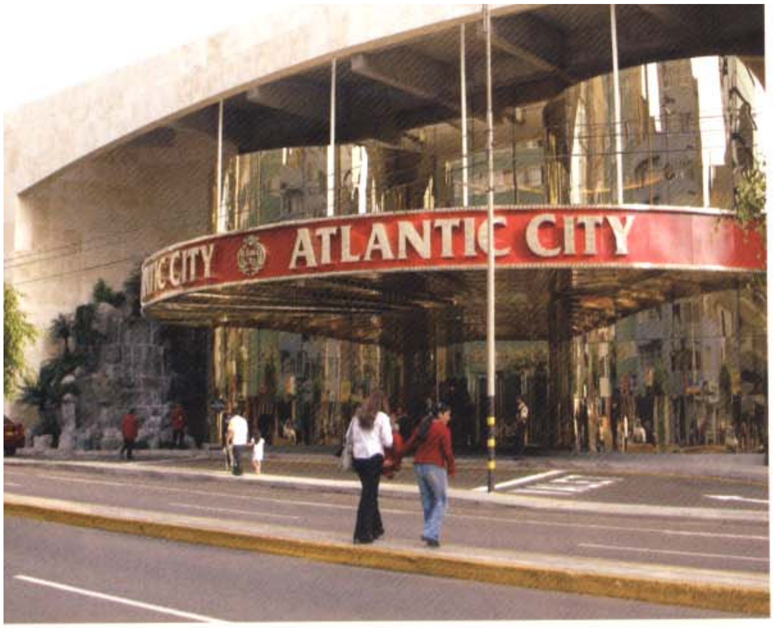
Mexico

In Mexico, no cards, craps or roulette betting are allowed. However, sports betting and numbers games (such as bingo) are permitted under the 1947 Gaming and Raffles Law. A subsequent modification and expansion of the 1947 law in 2004 basically allowed for the 2005 issuance of 206 permits to operate Class II facilities, though it met with more than a little contention.

Those issues were quelled earlier this year when the Supreme Court finally ruled in favor of the controversial decision made by the ex-Department of Interior head, Santiago Creel, to grant the betting licenses in September 2004. The judges making the ruling were adamant that the operation of casinos was still illegal under Mexican law but that Mr. Creel had not gone above his powers in granting the licenses.

Today, some 15,000 electronic bingo machines in licensed and registered facilities operate in the country's top 20 metropolitan areas. It is conservatively estimated that another 10,000 to 15,000 machines are operating unlicensed, either under protection of district judges motivated to grant appeals or in a completely illegal manner.

A recent report submitted to Mexico's Department of Interior by the political



The Atlantic City Casino in Lima, Peru. There is also a New York, New York Casino in Lima.

party Partido Convergencia showed that 90 percent of gaming operations in Monterrey, a major metropolitan area in the country, were operating unlicensed—representing 74 out of 81 operations and housing over 4,500 of the city's 6,000 machines. Like Brazil, the government has been called to purge the city (and others) of the illicit operators, and is seeking to do so.

At press time, the Economy Commission of the House of Legislators agreed on a proposal to implement a 20 percent fee on the performance of bets and draws, taking it from a loosely enforced 1-2 percent assessment. The document on the "Law of the Special Tax on Production and Services" proposes more accuracy in the description of activities that would be taxed, as to remove doubts regarding who is liable for these burdens.

And while the possible tax hike is sure to agitate some local operators, the market will greatly benefit from the definition and clarity to be imparted by the federation, previously an inconsistent and unpredictable force in the administration and enforcement of a nebulous collection of governing decrees.

This represents another step toward a much anticipated and sought-after comprehensive revision to the gaming law, which could serve to open up the market for the development of Class III casino gaming in the country, not presently permitted in this market.

Venezuela

Venezuela's National Gaming Commission was established in 2005, and has since been involved in an epic battle with illegal gaming operations. Through its "Zero Illegal Gaming" campaign, the government has been on a search-and-destroy mission that has been meeting with mixed results.

Further regulatory measures were sought by SENIAT (Integrated National Service of Customs and Tax Administration) to capture historically elusive tax revenues from the industry. After several changes, a full gaming text came into effect very recently, on July 1. Now, lotteries, horse races, sporting bets, slots, bingos and casinos will be taxed.

The tax entity will demand operators to have account books, records and special documents for tax control, and will have to register the number of table games installed in casinos as well as bingo halls.

Today, it is estimated that 12 casinos and 40 bingo parlors house as many as 20,000 slot machines generating over $1 billion in annual revenues. New gaming laws are being contemplated to further refine Venezuela's gaming industry.

Peru

After having refused to sign a law forbidding gaming activities in Peru, the Executive Power signed 2005 Act No. 27796, which in turn amends Act No. 27153 that regulated the management of casino games and slot machines. Among other features, this new statute extends the operation of casinos and slot machine arcades to new premises, modified the tax regime for this industry, and created a governing body to regulate it.

Investigations by the Internal Control Department of the Attorney General's Office earlier this year found a provincial judge in the northern city of Cajamarca to have committed administrative crimes and acted beyond her capacity, issuing favorable judgements to several local gaming companies, thus enabling several slot operations that had been closed down on licensing grounds to be reopened—cir-


The Conrad Hotel & Casino in Punta del Este, Uruguay

cumventing established gaming regulations.

The habeas corpus judicial resolutions enabled slot halls to operate without concern for new legislative direction and, for the most part, without paying any gaming tax. Firms under the form of judicial protection frequently entered into partnerships with other businessmen to open more gaming rooms under the same scheme.

The country's eight casinos and 930 game rooms house 56,000 slots and employ over 12,000 people. However, of those game rooms, 897 are illegal (up from just 214 in 2002), due largely in part to activites such as those of the Cajamarca judge. MINCETUR, the country's tourism body, continues to crack down on illegal operators, and is continuing with a formalization process established earlier this year. The municipalities have agreed to work together with MINCETUR to bring the illegal operations under the law, and with 771 form applications submitted by 246 companies to formalize their position in the industry, it appears things are moving in the right direction. Law 28945, set to redress some of the more malleable segments of previous legislation, will become active December 24.

Uruguay

Uruguay presently has 15 casinos and 26 gaming rooms which house an estimated 5,600 slots. The local government in Montevideo, the country's capital city, has started the process to allow private investment in the region's municipal casinos, which have long been unprofitable.

Privately owned projects in Punta del Este, a major tourism destination, and the Maronas racetrack have seen the emergence of profitable gaming operations, which have provided substantial benefit to local economies. This situation has exacerbated frustrations with state-run facilities, leaving many calling for the voluntary retirement of casino and administration personnel and a more rapid privatization of the state's remaining facilities.

This pressure is not likely to subside anytime soon, in part because of ongoing suspicion of possible scandal concerning an overly significant decrease in reported state gaming revenues in 2006. The Uruguayan parliament is considering the creation of an investigative commission to examine the accusations and review the municipal operations in general.

What's Next?

Already in Chile, the prevention of money laundering has become a premier focus of the administration. Operators will have to create a record on player transactions of $3,000 or more. Casino Superintendent Francisco Javier Leiva said the measure is "a very positive leap forward according to international recommendations."

The Special Administrative Unit of Financial Analysis Information, a control entity of the

Colombian Financial Ministry, takes this a step further: Casinos must now report all cash transactions greater than $4,545 or those which, over the course of a rolling month, exceed in aggregate $25,545 when made by the same person within one or more gambling centers run by the same company over the respective time period.

Similarly, all Uruguayan casinos will have new controls related to money laundering by the end of the year, which will be similar to those made by banks. Compliance officials are currently in a training program in Chile and partaking in regional activities organized by GAFISUD (Group of Financial Action of South America).

'The region continues to flourish as an international destination, though not nearly close to its potential.'

In Brazil, police officers from the city of San Pablo have already seized 19,391 illegal slots this year, a tribute to the success of the current administration's "Operation Hurricane," which endeavors to purge the country of illicit gaming devices, adding to successes in this area by both Colombia and Mexico.

As governments look to keep the industry in check, protect legitimate operations from illicit competition, and most importantly, benefit from the presence of the gaming activity, we will see a large focus on proactive legislation and mechanisms for preventing and dealing with gambling addiction, embezzlements, white-collar offenses, illegal business operations and money laundering.

A landmark event that will soon be occurring will bring together regional industry leaders and association heads for the exchange of experiences and goals related to casino gaming across the different countries of the region. The ultimate goal of this meeting will be to comprehensively understand the needs of both the public and private sectors, what is being done to meet them, and what more can be done.

The results of such an exercise should go far to aid in the institution and modification of legal frameworks across the region that would support the long-term growth and development of a healthy, secure and transparent gaming industry.

It is apparent that the region could take some lessons from Chile in regards to its gaming sector—a fine example of what can happen when the public sector adequately aligns the wants of the private sector with the needs of the region.

In places such as this, independent developers/operators with small to medium-sized projects are finding increased access to equity through private investors and funds, whereas the interest of big opportunity funds playing in the region goes to large-scale projects that utilize recognized brands, guarantee high-yields and have a defined exit strategy. We would also expect that pension funds and U.S. REITs will become more active players in the years to come, as things become more predictable.

In fact, this is exactly the type of dynamic that supports the companies backing investment in the 15 gaming projects under construction in Chile, where total investment as licensed was $550 million and later escalated to approximately $650 million following a first round of project modifications. Today, confidence in the market (and its potential) is reaching even greater levels than before, and as any modifications to the project as licensed are subject to the approval of the Superintendent of Casinos, investors have practically been begging the administration to let them spend more and build more.

The latest approvals on such modifications imply an increment in invested capital across the 15 projects of $120 million, resulting in an additional 550,000 square feet of construction over what was initially planned.

When all is said and done, it goes back to the fundamentals. And, as we've demonstrated, the fundamentals are strong throughout the region. The emergence of the formalized sector is simply the enabling factor which can allow you to partake in the opportunities that inherently exist in the marketplace, a situation which is rapidly becoming a regional norm.

This dynamic leads us to expect significant developments throughout the region in the coming 12-18 months, and into the long term.

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