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NOW OR NEVER?

By Steve Rittvo
and David Rittvo

Awaiting the launch of integrated resorts in Japan

As Japan throws itself into the process of legalizing and regulating large-scale casino developments across the country, it's a good time to take stock of the process, provide some insight into the size and scope of the market and address the development opportunities and issues.

The Japanese Diet is in the process of considering the initial draft bill for the legislation of integrated resort development. If the current schedule holds, the initial legislation should get passed in May or June, and the next more detailed legislation will be written and passed in 2015. Once the full legislation is passed, there will most likely be a four-to-six-year process to select the host communities and casino developers, and construct the integrated resorts.

Before we consider the legislative logistics of this market, let's take a step back and discuss the size and potential of the Japanese market.

The Japanese have a penchant for gaming and gambling that is second only to the Chinese. Currently, the only legal forms of gambling in the country are on boat races, motorcycle races and bicycle racing. In 2011, there was approximately US\$50 billion wagered (handle) at these events. This, coupled with estimates that the pachinko market could generate \$40 billion (GGR), starts to give you an idea of the gambling potential within Japan.

Analysts, including Asia-focused CLSA, have stated that even if developments were limited only to Tokyo and Osaka, the Japanese casino market could reach over \$16 billion annually in its initial phase. This would make the Japanese market the second largest in the world, with only Macau generating more revenue. Should the legislation provide for two major casinos in these cities, as well as regional casinos in locations such as Hokkaido, Okinawa, Nagasaki, Akita and/or Aichi, the market totals could be close to \$20 billion-\$25 billion nationwide.

The Innovation Group's analysis shows that the market could reach \$18 billion with just two integrated resort (IR) developments in Osaka and Tokyo, with Tokyo responsible for a majority of the revenue. If two smaller, regional IRs are allowed, we could see the market rising to \$21.5 billion. Once fully ramped up and stabilized, the Japanese market could reach \$33 billion-\$34 billion annually.

As you would expect, the significant potential of Japan is attracting significant interest from the world's leading casino developers and operators. Among the large-cap public companies to openly announce their desire to

operate a casino in Japan are Boyd Gaming, Caesars Entertainment, Genting, Las Vegas Sands, MGM Resorts International, Melco Crown and Wynn.

A number of other operators are expected to surface. It is fair to assume some Japanese pachinko and machine operators such as Sega Sammy and Konami will likely throw their hats into the ring and vie for a leading market role.

In addition to the better-known operators and companies, significant but not publicly traded casino operators are entering the fray for Osaka and Tokyo. Rush Street Gaming, a casino operator with locations in Pittsburgh, Philadelphia and Chicago, is among the more successful U.S. operators exploring opportunities in Japan.

"We are strong and well-recognized operators of urban casinos and an IR in Niagara Falls, and see the potential in the Japanese market," says Greg Carlin, RSG's president. "This market can provide a launching pad for our growth strategy into the international market."

Additionally, while some analysts believe this market is a race among the large-scale operators, the smaller operators have some very interesting potential in Japan. The secondary cities would be a trophy for almost any operator.

Legislative Background

Three political parties and five independent congress members jointly submitted a bill for the draft IR Promotion Law to the House of Representatives on December 5. The three sponsoring political parties were the Liberal Democratic Party led by Prime Minister Shinzo Abe, the Japan Restoration Party, led by former Tokyo Governor Shintaro Ishihara, and the People's Life Party led by Ichiro Ozawa.

It is expected that the bill will be debated with a view to being passed into law at the ongoing ordinary session of the Diet, most likely next month. Should the bill not be passed by then, it will fall to the special session beginning in October.

The IR Promotion Law Bill regulates the establishment and operation of casino facilities, and provides for such matters as the establishment of a cabinet external-affairs "Administrative Committee." The IR Promotion Law will establish the legal framework for a new form of entertainment industry in Japan, initiating detailed discussions in what is expected to be a fairly straightforward process. Strong resolve on the part of the government should help turn this new framework and policy initiative into reality.

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Former Tokyo Governor
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Prime Minister Shinzo Abe



Ichiro Ozawa of the People's
Life Party

The passage of the legislation in the House of Representatives is likely to induce local government initiatives to attract IR investment. Subsequently, this will spur related activities and decisions including feasibility studies, opinion exchanges between affected local bodies, promotional activities and the formulation of requests to central government.

Since local governments will be important stakeholders, they will play a key role in the submission of opinions to central authorities during the detailed planning process. Although the number of individuals and groups opposing the legislation is currently limited, there is nevertheless a strong possibility that a formal public protest movement might develop.

Development Locations

As previously mentioned, the two large-scale developments are in Tokyo and Osaka. Other jurisdictions, prefectures and cities have expressed their interest to be one of the host communities for the smaller, regional integrated resorts.

For the two large-scale developments, it appears Osaka is ahead of the development game. The city government has already identified a team to help steer the development process. Kazuhiro Nose, manager in charge of IR development for the Tourism Division of the Economic Strategy Department for Osaka, is leading the efforts. Nose is well respected in his position, and has completed multiple large-scale development projects in his current capacity.

The proposed development sites for the area are focused around the Osaka Bay area, six miles from downtown Osaka. The development plots range between 49 and 185 acres, and are varying in their format and preparedness for full-scale development. The three development sites are Mai Shima, Yume Shima and Sake Shima.

Nose has categorized the sites based on their scalability and need for large-scale infrastructure improvements, with his clarification that Yume Shima Island has the highest potential for scalability and sizing, although it will require

the largest infrastructure developments. Based on a recent site visit to Yume Shima Island, extensive transportation infrastructure improvements will be required, with the most notable being upgrades to the connections to both the Osaka Subway and JR Train (National Railway) lines.

Japan Integrated Resorts

Until now, Singapore has stood alone when it came to the level of integrated resort product it provided to accommodate patronage of such significant revenues. Despite their magnitude and impressiveness, we believe they will be dwarfed by the properties about to be developed in Japan.

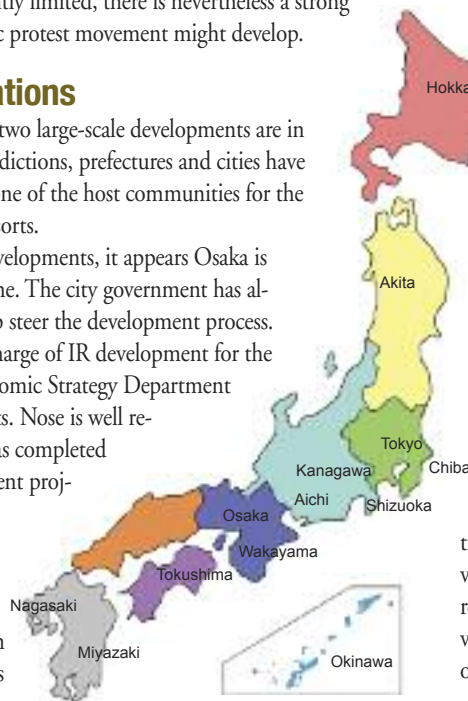
Both Sheldon Adelson of Las Vegas Sands and Jim Murren of MGM have thrown down the \$10 billion gauntlet, and have expressed their willingness to spend that level of funds to bring their IR visions to Japan. Even if there is some potential hype in those numbers, Jay Defibaugh of CLSA recently referenced a cost of \$8 billion for a prototypical facility, a number presumably not incorporating all hard costs if the sites need to be fully assembled and acquired at market rates.

What will these mega-IRs look like? To begin with, the gaming components are likely to be larger than anything experienced in a single complex to date. Based upon Innovation Group's review of the market potential, it is anticipated the facilities in Tokyo and Osaka will require an approximate split of 1,000 tables, with the majority devoted to mass market and the balance (some 250 to 300) designated for VIP play.

Our modeling and the review of the pachinko market envisions a potentially stronger slot market than might be expected. We see some reasonable diversion from the upper level of the existing market as well as the creation of a real slot market in the IRs; we anticipate 4,000-plus electronic gaming devices, including a significant component of stadium seating games within each of the large IRs.

A broad hotel mix will be needed within the IRs. We are anticipating the initial development to come online with at least 2,500 hotel rooms in Tokyo and Osaka and the anticipation is that each IR will have an iconic hotel structure.

Beyond the hotels, the other elements will need to follow the basic plans of large-scale IRs. Given Japan's strongly stated desire to grow its inbound foreign tourist industry by over double (post-Olympics), the facilities will all



The government, at both the national and local levels, will need to develop a selection process and bid procedures. This represents both an opportunity and a potential pitfall. If these activities are not well-designed, it can set the entire development process back.



Early rendering of an Osaka IR

need large and fully integrated convention and meeting facilities, both to support the tourism growth desired by the government and to maximize mid-week utilization. Japan represents a massive potential hub for MICE activities, and its present infrastructure is antiquated and under-sized.

Japan is noted internationally for its respect of culinary greatness as exhibited by the concentration of Michelin-starred restaurants throughout the country. It is also a country where foreign chefs have established a notable and meaningful presence. To compete with other international IRs—but possibly even more important, to bring in the local patrons who are used to outstanding dining—a full cadre of upscale super-premium restaurants will be needed. A rough estimate envisions 40-plus food and beverage outlets in each IR.

Retail is the third leg of the stool, and there is no question Japan is at the epicenter of global consumer consumption. We would anticipate a variety of shopping experiences integrated through the IRs that will offer a broad range of retail price points. These shopping experiences could provide an opportunity for partnering with Japanese companies and developers and help meet the expected need for integration of Japanese ownership as part of the IRs.

Finally, we will see all stops removed in creating unmatched entertainment components integrated into these facilities. A sensitivity to Japanese culture and integrity will need to be melded with innovative shows and inimitable recreational opportunities. This is where we expect the bidders to unleash their creativity and come up with concepts that make the existing IRs in other global gaming destinations appear dull. The anticipated submissions in this area are well beyond our capability to envision, but we are looking forward to some awe-inspiring proposals.

As we look at the regional IRs, we expect to see smaller facilities with similarly outstanding qualities. Candidly, we have not begun to size the regional IRs or to identify the range of the locales they can be developed in, but we are keenly aware that there will be significant variations in size and scope.

Given the number of cities with populations of over 1 million and prefectures with populations of over 5 million, it is fair to assume that many of the regional IRs could generate more than \$1 billion annually in gaming revenues. Assuming this significant baseline, the regional IRs should, at a minimum, also feature the components previously identified.

That said, there could likely be trade-offs such as swapping convention and meeting facilities for more resort-type experiences and elements like marinas, golf courses and more expansive outdoor recreation.

Japan's Recipe for Success

Gaming operators are beating down doors in Japan, and they are prepared to do whatever it takes to ensure the success of IR programs there. But this is a partnership, and Japan needs to carry its share of the load to reach its maximum potential.

First, the Diet needs to pass the legislation in the next few months and allow the government leadership to “put the meat on the bones” via a more formal structure that will allow the IR vision to play out in a cogent manner. The details must be adopted within one year after the initial bill is made into law.

During the period, a tax structure must be developed that is at a level that is competitive or advantageous over other Asian gaming markets. A tax rate in the

realm of 10-15 percent of GGR will allow for the capital expenditures needed for the IRs envisioned for Japan. How Japan addresses tax rates for junket players and how credit is addressed will also need to be resolved in a manner to allow for maximum benefit to accrue.

There is no question Japan will require the highest standards from all bidders, but as can be seen in Massachusetts, creating an overly onerous and complex process can really reduce the number of bidders and seriously postpone the opening of facilities. If Japan wants to meet its proposed schedules and really have the maximum competition to develop the best facilities possible, there are outstanding examples of selection processes that were used in Singapore, Macau, Pennsylvania and Illinois that should serve as a starting point for the process.

The suggestion that the national government should propose standards and conduct probity of bidders selected by the local jurisdiction seems like a very attractive option. This provides for the consideration of the individual local complex issues and the varying size and scope of the full range of IRs in Japan—all while affording the national government the ability to confirm the quality and integrity of the operations.

Finally, at a minimum, the local jurisdiction (and perhaps the national government as well) will need to be sensitive to the need for infrastructure improvements. From road extensions and new roadways to sewer and water services, there is a variety of services that the IR developers will not be able to undertake on their own. There appears to be some thought going to these process and a vision that it can be both a need and an opportunity.

Kazou Ueda, president of the Japan PFI/PPP Association, has taken the bull by the horns and now has had more than one casino operator express opinions on how these issues can be addressed by public/private partnerships. This early but high-level thinking will go far in helping Japan anticipate and resolve the set of concerns.

Japan is without question the most exciting future jurisdiction for gaming companies; the winners will have captured the golden ring on the carousel. The competition to develop and operate one of these facilities is expected to be the fiercest ever witnessed on a global scale.

The crucial legislation has yet to be enacted, and there is much to do before the first card is turned on a baccarat table. The next few years in Japan will be an indisputable focus of our industry.

Stay tuned and enjoy the ride.

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David Rittvo is vice president of international development for the Innovation Group, leading the team to expand the company's presence on an international level, focused on the Asian region.

Educational Action

The 11th annual Japan Academy of Integrated & Gaming Studies was held earlier this year.

By Mikio Tanji

One indication of how long Japan has been considering gaming is demonstrated by an education effort that is now in its 11th year.

The Japan Academy of Integrated & Gaming Studies (IRG) held its meeting at Dai-ichi Hotel Tokyo on February 25, for the first time since the IR Promotion Act was introduced to the Diet at the end of last year.

Toru Mihara, IRG's vice chairman, offered some optimism in his opening welcome.

"Amid introduction of the act in last year which is expected to be enacted during the current Diet session, many new people are joining us at this meeting," he said. "I would like to make this meeting fruitful by exchanging opinions on various future issues, which are of some help for the attendees."

Video messages from the heads of local governments interested in IR development among others, such as Ichiro Matsui, governor of Osaka Prefecture and Harumi Takahashi, governor of Hokkaido, were delivered to the meeting.

After the act was presented to the Diet last December, the city and prefecture of Osaka jointly established the IR Site Preparation Council. Matsui said he was hoping for early enactment of IR-related acts, indicating he would like to accomplish the IR invitation in the Kansai area to prime the economy of Osaka, which is a metropolis comparable to Tokyo.

Takahashi said the IR capitalizing superiority of a local area such as Hokkaido would contribute to Japan becoming a tourism-oriented country. She added that, while she was now conducting various studies with the cities of Otaru, Kushiro and Tomakomai, she would like the government to consider the institutional design for the IR delivering its spread effects to every corner of the country.

The Kansai area, which includes Osaka and Hokkaido, is attracting everyone's attention as strong candidates for IR sites.

Another event held on February 5 was the first meeting of the Establishment Preparatory Committee of the IR Promotion Council, which would provide policy proposals on IR matters.

Influential individuals and business groups across the country were listed as its founders, and 35 prefectures and 19 cities designated by ordinance among local governments participated as observers. It demonstrates that local governments other than Hokkaido and Osaka are also interested in the IR.

Representatives of six casino operators—Melco Crown, MGM Resorts, Las Vegas Sands, Wynn Resorts, Caesars Entertainment and Genting—gave presentations.



Representatives of the companies explained their philosophy and plans, and how their plans would lead to an increase of tourism to Japan. Each suggested a taxation system, proposed non-gaming amenities and other matters important to the Japanese government, and demonstrated enthusiasm to develop an IR characterized by Japanese tradition and cultures.

Transparency and establishment of relationships with regulatory agencies are also important in any IR plan.

At the same meeting, a discussion with Diet members and others was held. The panel included several legislators and gaming experts, including Hiroyuki Hosoda, Sakihito Ozawa, Takeshi Iwaya and Toru Mihara.

Hosoda, representing the Diet Members Alliance, explained a procedural rule by which each fraction of the ruling party and the opposition party would approve or deny a bill requiring a referendum, and emphasized the enactment of the IR Promotion Bill during the current Diet session. In addition, he guaranteed an open application process to foreign operators and a fair hearing.

Iwaya, who serves a chief secretary of Diet Members Alliance, has worked on the IR issue more than 10 years. He talked about both local casinos and metropolitan casinos.

"The Promotion Act has no definition of such casinos, but stipulates the independence of local governments," Iwaya said. "The materials indicating a basic concept of the act define the local area casinos as the IR with a size appropriate for a concentrated area."

Mihara expanded the subject to online gaming, and commented that further discussion would be required, saying, "Discussion should be made in a step-by-step manner, since the discussion may go to unexpected areas under the current gambling ban situation."

He concluded that a giant step has been made by the cooperation of the economic community, national government, local governments, and academic associations.

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