

Gaming & Casinos

Pennsylvania Comprehensive Gaming Bill – Inches from the End Zone

The Takeaway:

*Both chambers of the Pennsylvania General Assembly have now approved a comprehensive gaming package. To become law, the legislation still needs the signature of Governor Tom Wolf (D), which we think is likely over the next few days. Due to several new revenue opportunities and included protections for existing establishments proposed in the legislation, casinos in Pennsylvania have the chance to make net gains despite facing increased fees and a greater number of entities that will be allowed to offer gaming. We think concerns over the past 24 hours voiced most loudly by **PENN** are a result of the opportunity cost this legislation represents relative to prior versions of the bill (it does not allow for a massive influx of video gaming terminals that PENN could have monopolized). In fact, we expect PENN to benefit from internet gaming legalization and the opportunity to open a satellite casino and run VGTs in truck stops across the state. Other PA land-based casino owners include **LVS**, **CZR**, **PNK**, and **ERI**. Internet gaming operators and vendors we're watching include **TSGI:CN**, **888:LN**, and **GAN:LN**.*

Yesterday in Pennsylvania, the House [approved](#) a package of legislation to finalize work on the long-overdue state budget. The Senate had already approved the bills and therefore they went to Gov. Tom Wolf (D) for his signature. He has yet to sign the legislation into law.

The legislation fills the state's existing \$2.2 billion budget hole for the 2017-2018 fiscal year (running July 1, 2017 to June 30, 2018) through comprehensive gaming expansion to get the first roughly \$240 million and borrowing to achieve the rest. Gov. Wolf had previously implored legislators to turn to other sources of revenue, such as taxing Marcellus shale gas extraction, and we think his hesitancy to sign the bills into law is largely due to the fact they aren't quite what he was hoping to receive. Nevertheless, we think in the end it is likely Gov. Wolf signs the legislation into law to finally end the budget stalemate after more than two years of kicking the can.

Why PENN Hates the Final Gaming Bill

Penn National (**PENN**) already [threatened](#) to sue the state over the gaming expansion legislation if enacted. The company argues that the 10 satellite casinos as envisioned would disproportionately cannibalize their Hollywood Casino's market share relative to all other casinos in the state due to its location and other protections carved out for other casinos in the legislation (see **Figure 1** below).

We don't buy it. Instead, we think it is much more likely PENN loathes the opportunity cost of having lost the fight in PA to legalize a [massive number](#) (40,000 to be precise) of video gaming terminals (VGTs) across the state. PENN was very [well positioned](#) to be the sole operator of these VGTs (it runs video slots in Illinois), and losing that potential business is a significant amount lost future revenues for the company. But VGTs would have posed a real cannibalization threat to all the casinos in PA whereas the strict rules around a new system of satellite casinos, combined with the flexibility for counties to opt-out of allowing VGTs at truck stops, should actually protect existing casinos in the state (including PENN). We include more details on these provisions in the following section.

What Gaming Expansion Entails

PA lawmakers have been discussing "gaming expansion" measures for years at this point. The legislation awaiting Gov. Wolf's signature was developed in large part to drive revenues to the state, and is estimated to [raise](#) \$238.5 million in the current fiscal year. Highlights of the [final bill](#) that was sent to the Governor's desk yesterday:

- › **Legalizes internet gaming and gaming in airports (raises a total of \$115.75 million in FY2017-18 broken into \$110 million in internet gaming licensing fees and \$5.75 million in airport licensing fees).** The legislation would legalize internet peer-to-peer games (poker), non-peer-to-peer games simulating table games, and non-peer-to-peer games simulating slot machines.
 - One-time licensing fees are \$10 million for conducting any internet gaming if paid within 90 days of the legislation being enacted into law after which the fee increases to \$4 million per category.
 - Operators may also service interactive gaming at airports (along the following fee schedule: \$2.5 million for Philadelphia; \$1.25 million for Pittsburgh; \$500,000 for all other international airports; and \$125,000 for all other airports).
 - Tax rate is 54% of daily gross gaming revenue for slot machines and 16% for internet poker and other table games.
- › **Allows video gaming terminals (VGTs) at truck stops (raises \$1 million in FY2017-18).** The legislation would permit up to five VGTs at truck stops throughout the state.
 - Counties hosting a Category 1, Category 2, or Category 3 casino are given 60 days after enactment of the legislation to opt-out (see next section for full details on casino categorizations).
 - Manufacturer application fees are \$50,000. Terminal operator application fees are \$10,000. Application fees are \$1,000 per establishment plus \$500 per key employee or principal. Licensing fees are \$10,000 for a manufacturer or supplier, \$5,000 for a terminal operator, \$250 per VGT per establishment, and \$500 per key employee or principal.
 - VGTs will be taxed at 52% of gross revenue, and the host establishment must receive 15% of gross revenue.
- › **Imposes new, standardized \$10 million annual so-called "local share assessment" (raises \$100 million annually).** The legislation would require Category 1 and Category 2 license holders to pay a \$10 million fee annually to host counties and municipalities.

- › **Creates licensing framework for so-called “satellite casinos” (raises \$100 million in FY2017-18).** The legislation would create a new category (Category 4) of licenses for so-called “satellite” casinos around the state.
 - There may be no more than 10 Category 4 licenses awarded.
 - The Pennsylvania Gaming Control Board (PGCB) must establish a system to auction off these new Category 4 licenses – where the only requirement for the auction established in the legislation is to set the minimum bid at \$7.5 million.
 - Only Category 1 and Category 2 licensees may initially participate in the auction (see **Figure 2** below for additional details on existing casino Category details) whereby the highest bidder will get exclusive rights to place a Category 4 casino in any location barring the following restrictions.
 - Once a Category 1 or 2 licensee obtains a Category 4 license, it cannot bid in the remaining auctions. If there are any remaining Category 4 licenses after all Category 1 and 2 licensees have had an opportunity to bid for them, the auctions will be opened to Category 3 license holders. After that, if all 10 Category 4 licenses have not been awarded, anyone else may bid for the remaining licenses.
 - There must be between 300-750 slot machines and no more than 30 table games at a Category 4 establishment.
 - These slot machines count toward the total number of slot machines a Category 1 or 2 license holder may operate (see **Figure 2** for details). They are taxed at a rate of 54% of gross gaming revenue (50% to the state, 4% to the host county and municipality).
 - The table games are additive to the total number of table games a Category 1 or 2 license holder may operate, but the licensee must pay an additional fee of \$2.5 million. After operating for a year, the total number of table games may be increased to 40. Table games are taxed at 16% (14% to the state, 2% to the host county and municipality).
 - If a Category 3 casino ultimately gets a Category 4 license, that licensee must pay a \$10,000 fee per slot machine at the Category 4 location.
 - Location restrictions include:
 - Category 4 casinos may not be located within 25 miles of another Category 1, 2, or 3 casino.
 - Category 4 casinos may not be located in Pike, Wayne, Fayette, or Montgomery counties (see **Figure 1** below).
- › **Creates a pathway for sports betting regulations.** The legislation instructs the PGCB to create a regulatory regime for sports betting in the event it is legalized federally (which could occur as soon as next year)..
- › **Changes existing licensing regulations (raises \$9 million in FY2017-18).** Makes the following changes to existing licensing requirements (see **Figure 2** below for additional details):

- Category 3 license holders may pay a one-time fee of \$2.5 million to add up to 250 slot machines, and \$1 million for up to 15 table games.

- No additional Category 3 licenses may be granted (two exist currently).

› **Other notable provisions:**

- Provides a regulatory framework for online fantasy sports betting (raises \$775,000 in FY2017-18).
- Legalizes internet lottery games (raises \$100,000 in FY2017-18).

Figure 1: Pennsylvania Licensed Casinos – Locations with Prohibited Category 4 Counties Identified



Source: Pennsylvania Gaming Control Board, Pennsylvania General Assembly, Height Securities

PA Casino Licensing Categories

Pennsylvania statute [currently provides](#) the regulatory framework for following casino licenses:

› **Category 1 – Racinos:**

- Combo racetrack / casinos
- No more than seven Category 1 licenses may be awarded (there are currently six)

- Existing racetracks must host live racing 100 days per year and have hosted live racing for the two years prior to applying for a license

- Permitted up to 250 table games, 5,000 slot machines

Category 2 – Casinos:

- Not permitted to operate hotels on the premises
- No more than five Category 2 licenses may be awarded (there are currently four)
- Permitted up to 250 table games and 5,000 slot machines
- Must be located in major cities / tourist destinations
- Must be at least 30 miles from a Category 1 casino

Category 3 – Resort Casinos:

- Allowed to operate hotels on the premises
- No more than three Category 3 licenses may be awarded (there are currently two)
- Permitted up to 50 table games and 600 slot machines
- In order to participate in table and slot gaming at a Category 3 facility, the individual must have an annual membership at the facility

Figure 2: Pennsylvania Licensed Casinos by Category – Existing vs. Gaming Expansion Regulations

Category 1		
Casinos	Existing Law	Included in Gaming Expansion
Harrah's Philadelphia (parent co: CZR)	Combo racetrack / casinos	Eligible to obtain Category 4 license.
The Meadows Racetrack and Casino (parent co: PNK)	No more than seven Category 1 licenses may be awarded (there are currently six)	Eligible to obtain internet gaming license.
Mohegan Sun at Pocono Downs	Existing racetracks must host live racing 100 days per year, and have hosted live racing for the two years prior to applying for a license	Eligible to obtain airport gaming license.
Parx Casino and Racing	Permitted up to 250 table games, 5,000 slot machines	Owe annual \$10 million fee to host counties and municipalities (so-called "local share assessment").
Penn National Racecourse (parent co: PENN)		
Presque Isle Downs (parent co: ERI)		

Category 2		
Casinos	Existing Law	Included in Gaming Expansion
Mount Airy Casino	Not permitted to operate hotels on the premises	Eligible to obtain Category 4 license.
Sands Bethlehem (parent co: LVS)	No more than five Category 2 licenses may be awarded (there are currently four)	Eligible to obtain internet gaming license.
Rivers Casino	Permitted up to 250 table games, 5,000 slot machines	Eligible to obtain airport gaming license.
SugarHouse Casino	Must be located in major cities / tourist destinations	Owe annual \$10 million fee to host counties and municipalities (so-called "local share assessment").
	Must be at least 30 miles from a Category 1 casino	

Category 3		
Casinos	Existing Law	Included in Gaming Expansion
Valley Forge Casino Resort	Allowed to operate hotels on the premises	May pay a one-time fee of \$2.5 million to add up to 250 slot machines, and \$1 million for up to 15 table games
Lady Luck Casino (parent co: ERI)	No more than three Category 3 licenses may be awarded (there are currently two)	Creates a new ceiling for the total number of Category 3 license holders to no more than two.
	Permitted up to 600 slot machines, 50 table games	Eligible to obtain internet gaming license.
	In order to participate in table and slot gaming at a Category 3 facility, the individual must have an annual membership at the facility	Eligible to obtain airport gaming license.

Source: PA Online Casino, PA Statute, Height Securities

RISKS

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