

April 15, 2024

## Casinos and Gaming

Consumer Discretionary Sector

Industry Rating

Market Weight

### Investment Thesis

### Industry Statistics

Source: FactSet

We recommend a **Market Weight** rating for the Casinos and Gaming industry. The industry is set to navigate through economic cycles by capitalizing on online gaming growth and diversification into non-gaming amenities. Despite facing regulatory challenges and competition from online platforms, casinos are positioned to benefit from the increasing legalization of sports betting and interactive entertainment offerings.

#### Drivers of Thesis

- **Expansion into online and sports betting platforms:** The global online gaming market is expected to increase by USD 75.2 billion at a CAGR of 14.55% between 2023 and 2028, fueled by the surge in sports betting.
- **Investments in luxury amenities and entertainment services:** Physical casinos are investing capital into catering to a broader (and younger) demographic and focusing on ways to enhance the customer experience.
- **Strategic partnerships and technological innovations:** Strategic partnerships and technological innovations in gaming operations to attract a younger audience and international tourists.

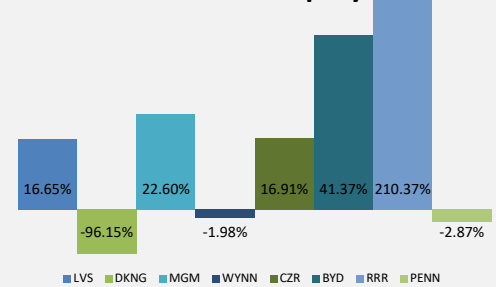
#### Risks to Thesis

- **Economic downturns:** An economic downturn could lead to a decrease in discretionary spending on leisure and gaming activities.
- **Legalization issues:** Regulatory constraints and the evolving legal landscape around online gambling and sports betting.
- **Online vulnerabilities:** Cybersecurity threats and the need for substantial investment (and maintenance) in digital infrastructure and security measures.
- **Competition from online gambling platforms:** Intense competition from online gambling platforms is expected to continue, requiring continuous investments and marketing efforts to retain market share.

Market Cap	\$ Billion
Las Vegas Sands (LVS)	37.44
DraftKings Inc (DKNG)	20.80
MGM Resorts (MGM)	13.58
Wynn Resorts (WYNN)	11.14
Caesars Entertainment (CZR)	8.70
Boyd Gaming (BYD)	6.18
Red Rock Resorts (RRR)	6.17
PENN Entertainment (PENN)	2.48
Industry Total	263.30

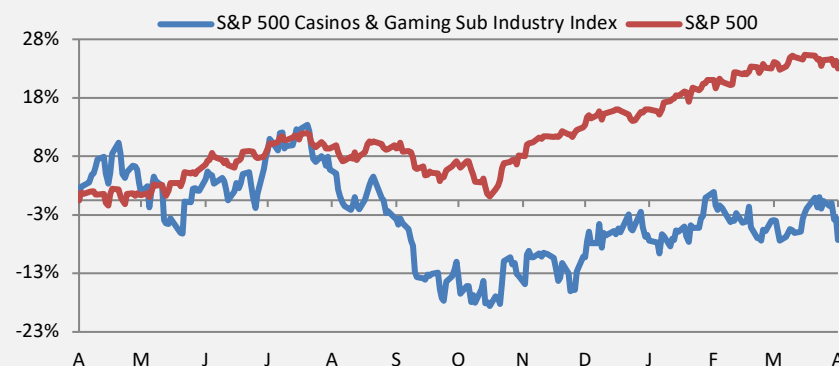
TTM P/E Ratio	(x)
LVS	31.48
DKNG	N/A
MGM	13.43
WYNN	15.37
CZR	11.05
BYD	10.56
RRR	20.37
PENN	N/A
Industry Average	12.72

#### Return on Equity



### 12 Month Performance

### Industry Description



The Casinos and Gaming industry in the US is primarily engaged in operating gambling facilities that offer table wagering games along with other gambling activities, such as slot machines and sports betting. These venues often come with accommodations, dining, and entertainment services, providing a comprehensive leisure experience.

## Industry Overview

Casino and gaming hotels provide not just gaming facilities but also a comprehensive experience. It combines gaming with a variety of entertainment options, including live shows, fine dining, and luxury accommodations, making it a top destination for leisure and tourism. Establishments within this industry are designed to cater to a wide audience, from more casual visitors to high rollers.

Major Industry Players (\$B)			
Company	Market Cap	Sales (TTM)	Net Income (TTM)
LVS	37.44	10.37	1.22
DKNG	20.80	3.67	-0.80
MGM	13.58	16.16	1.14
WYNN	11.14	6.53	0.73
CZR	8.70	11.53	0.79

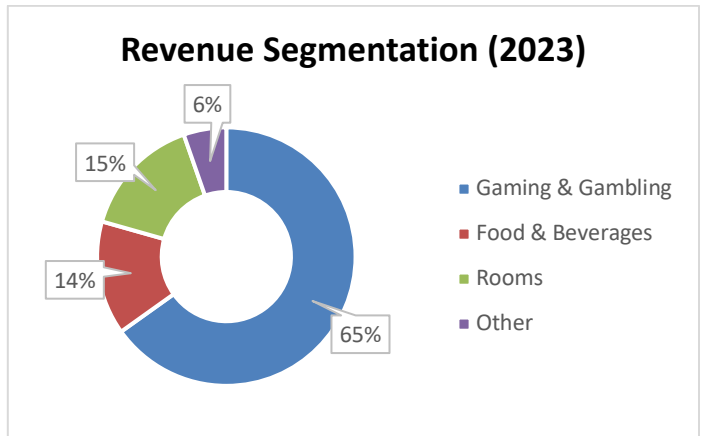
Source: FactSet

The industry faced significant challenges due to the COVID-19 pandemic, with many establishments classified as nonessential, leading to revenue losses. However, the industry has shown resilience through the expansion of online gaming platforms and a focus on diversifying revenue streams beyond gaming, including luxury services and sports betting. Despite a decline in industry revenue by a compound annual growth rate (CAGR) of 0.8% to \$142.85 billion over the past five years, a recovery is underway. This rebound is attributed to the introduction of online gambling, upgrades in gaming machines, the increase of various non-gaming amenities, and a resurgence in both domestic and international travel, bolstered by strengthening disposable income and reduced unemployment rates. Looking forward, the industry is expected to grow at a CAGR of 4.95% to \$150.29 billion in 2024 to USD 191.36 billion by 2029, driven by new casino authorizations to stimulate tourism and capitalize on gaming tax revenue. However, the industry faces challenges from the rising popularity of online gambling and betting, necessitating fresh incentives to attract gamblers to physical locations. Additionally, cybersecurity threats pose new challenges that must be addressed to maintain consumer trust in digital platforms.<sup>3</sup>

### Revenue Overview

The Casino Hotels industry in the US generates revenue through several segments, led by gambling as the primary source, complemented by significant contributions from food and beverage services, and hotel rooms and accommodations. Additional revenue streams include

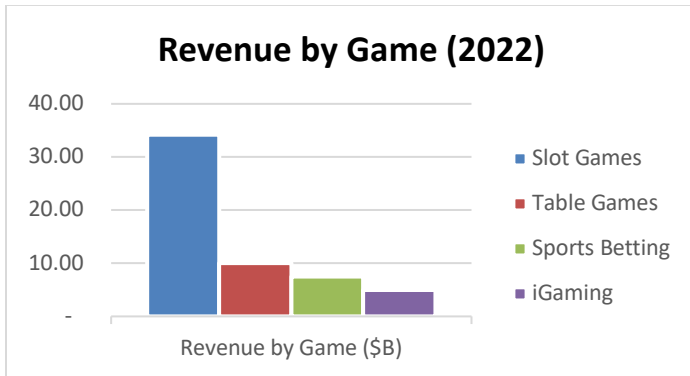
entertainment, valet parking, and niche services like golf courses, reflecting the industry's shift towards offering a comprehensive entertainment experience beyond traditional gambling.



Source: Statista

### Gaming Operations

Gambling machines, particularly slot machines, stand as the cornerstone of revenue generation. These machines not only represent the largest source of income but are also evolving with the introduction of cashless options (in jurisdictions that permit it). The industry has embraced a strategy of regularly updating their gaming machine offerings, with a refresh cycle every two to three years, including lower denomination machines to cater to a broader audience. Table games, including classics like blackjack, roulette, poker, baccarat, and craps, continue to draw high-stakes gamblers, maintaining a steady revenue share. In the future, the gaming segment is expected to further embrace digital innovations, including advanced slot machines with interactive features and table games incorporating virtual reality (VR) to attract younger demographics. The highest margins in the casino industry typically come from gaming operations rather than from hotel rooms, restaurants, or bars. Gaming provides higher margins due to lower operating costs compared to other services that casinos offer. Online gaming, in particular, has seen significant growth and yields substantial margins for operators.



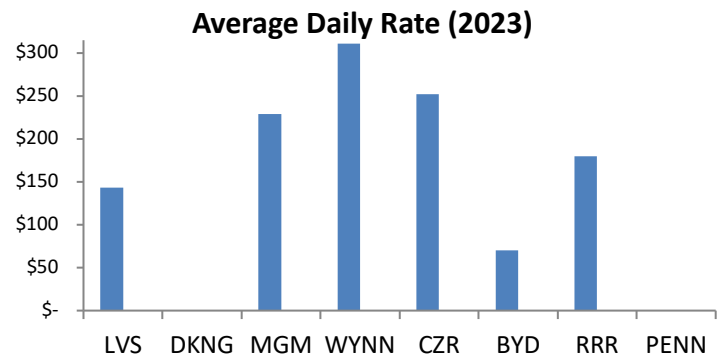
Source: Statista

## Food & Beverage Operations

The food and beverage segment is a significant contributor to the industry's revenue, with larger players incorporating restaurants operated by skilled chefs. For larger players like Caesars, food and beverage operations (which include a wide array of dining venues from buffets to nightclubs) are expected to account for a substantial portion of the company's total revenue. This segment's success is propelled by the increasing consumer interest in premium food experiences.

## Rooms and Hotel Operations

Accommodation and hotel services, the second biggest revenue segment, have increasingly become a focal point for industry operators, positioning themselves as venues beyond just the casino floor. The expansion into non-gaming amenities, including luxury accommodations, has opened up new customer segments and revenue streams. According to the American Gaming Association (AGA), room operating metrics for casino hotels have returned to normal levels. In 2023, compared to the previous year, visitor volume increased by 5.2%, hotel occupancy rose by 4.3% (up to 83.5% from their pandemic lows of 42.1%), the average daily hotel rate grew by 11.9%, and Revenue Per Available Room (RevPAR) surged by 18.0%.



## Other "Entertainment" Operations

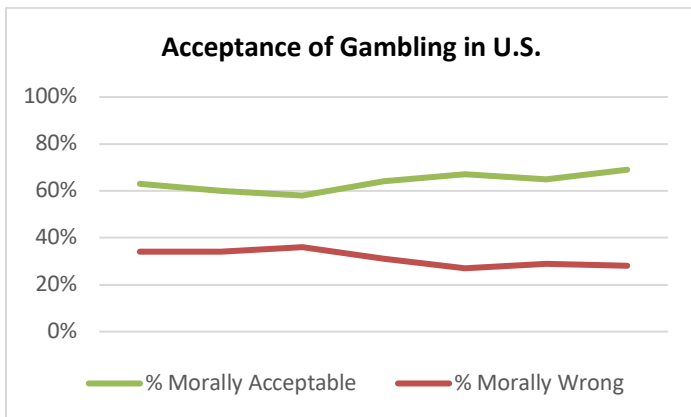
The other revenue streams, encompassing entertainment, valet parking, golf courses, and more, are set to become even more important to the casino and gaming industry's value proposition. Innovations in the entertainment segment, such as augmented reality and interactive performances, could provide new experiences for guests. The expansion of niche services, like luxury spa treatments or sports offerings, will likely cater to a broader range of interests and demographics. As casinos continue to evolve into comprehensive leisure destinations, these additional revenue streams will play a role in attracting visitors beyond traditional gamblers. The increased investments in entertainment and amenities aim to create memorable experiences that encourage longer stays and repeat visits. However, it's important to recognize that these projects are capital-intensive and require significant capital expenditure investments.<sup>3</sup>

## ESG Analysis

The industry's ESG profile is largely shaped by social factors, particularly the stigma associated with gambling. This contributes to the medium risk rating, with companies continually attempting to enhance responsible gaming programs. Gambling's reputation has evolved from a frowned-upon vice to a more mainstream form of entertainment.

ESG Peer Comparison		
Company	Risk Score	Risk Rating
LVS	22.0	Medium
DKNG	N/A	N/A
MGM	24.7	Medium
WYNN	25.7	Medium
CZR	21.9	Medium
BYD	24.5	Medium
RRR	31.3	High
PENN	28.1	Medium
Average	25.5	Medium

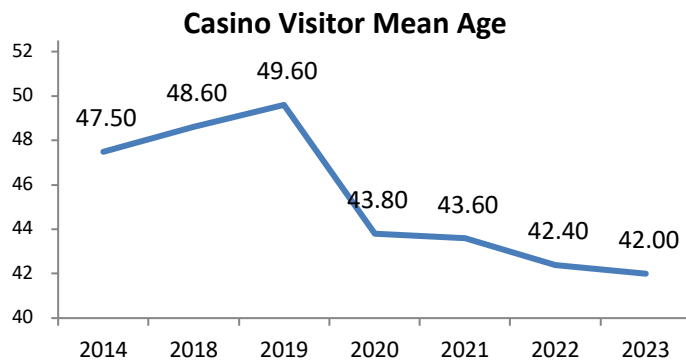
Source: Sustainalytics<sup>18</sup>



Source: Gallup<sup>13</sup>

## Consumer Breakdown

The under-30 age demographic has increased their participation, driven by online gambling and sports betting post-PASPA repeal. This group is setting trends in social and casual online gambling, with growth expected as companies push user-friendly apps. The 30-59 age bracket (the majority of players) prefers physical location gambling, gravitating towards poker and casino games. However, with the legalization wave, they are increasingly favoring the convenience of online platforms. Meanwhile, consumers aged 60 and above, the second-largest segment, have significant disposable income and leisure time making them a key demographic for industry operators.<sup>12</sup>

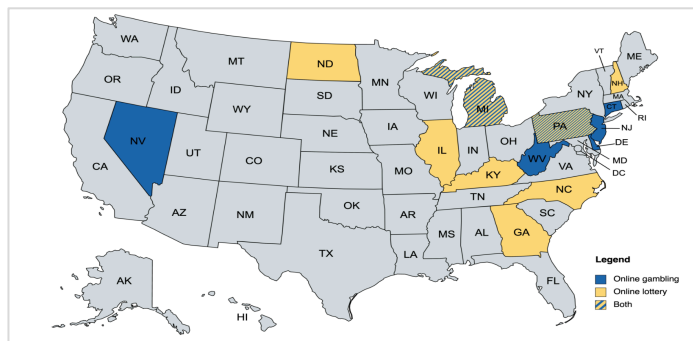


## RECENT DEVELOPMENTS

### Online Gambling Legalization Updates

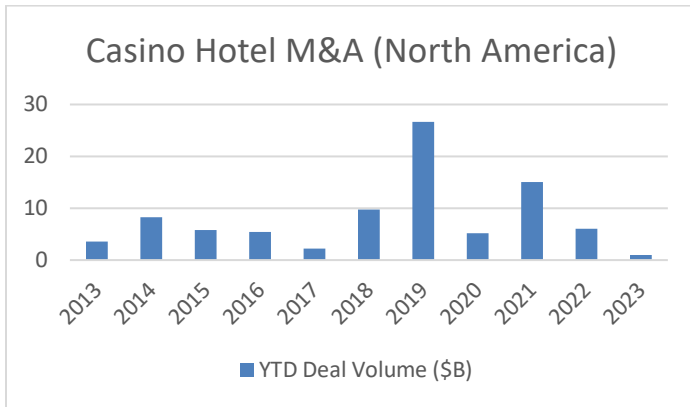
Currently, real money online casino gambling is legal in a limited number of states (7), including New Jersey, Pennsylvania, Michigan, West Virginia, Delaware, Nevada, and Connecticut. Maine, New York, California, Maryland, and New Hampshire are among the states showing interest in legalizing online casinos. Maine is looking into legislation that could bring online gambling to the state, with a focus on offering exclusive licenses to tribes based in Maine. New York lawmakers have previously attempted to legalize online poker and casino gaming. There is ongoing optimism for potential legislation in 2024. California is also on the radar, possibly moving towards legalizing sports betting first, which could pave the way for online casino legalization. Maryland has seen legislative efforts to regulate online poker and casino gambling. New Hampshire had explored online casino gambling legislation; however, a bill was ultimately not passed.<sup>15</sup> Analysts are optimistic about the expansion of the online casino market across the US, recognizing the potential for significant contributions to state revenues.

### Online Gambling Legislation, by State



## M&A Activity

In 2023, the industry experienced some mergers and acquisitions activity, mainly in online gaming, highlighting the shift towards digital expansion. For instance, MGM Resorts International announced the acquisition of game developer Push Gaming Holding Limited. MGM's management hopes this will bolster its subsidiary LeoVegas' content creation. Additionally, Caesars Entertainment reintroduced Tropicana Online Casino in New Jersey, enhancing user experience with online gambling.<sup>3</sup> However, despite achieving record profits for many casinos (and casino hotels), 2023 is to become the most challenging year for mergers and acquisitions in North American real-money gaming in almost thirty years. Elevated interest rates and tight credit conditions have led to a significant decline in the public deals for land-based casinos and casino hotels, with only eight transactions reported, marking the smallest number since at least 1995.

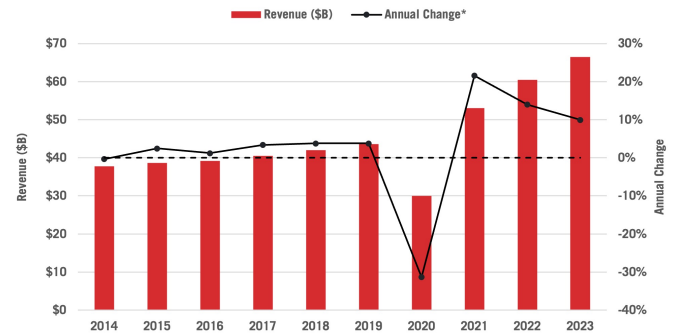


## COVID-19 Impact

One notable trend has been the industry's recovery from the impacts of the COVID-19 pandemic, which had led to widespread closures and a significant downturn in revenue and visitation. As restrictions eased, the industry saw a resurgence in travel, driven by upgrades to gaming machines, the introduction of various non-gaming amenities, and a strengthening in disposable income and

reduced unemployment rates. These factors combined to provide a much-needed boost to the industry's revenue.

### U.S. ANNUAL COMMERCIAL GAMING REVENUE

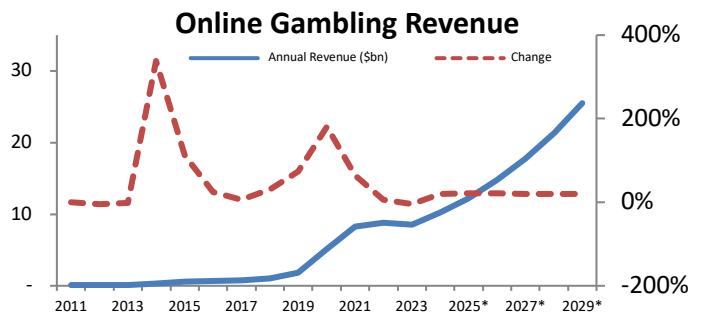


\*2021 compared to 2019.  
Source: American Gaming Association

## INDUSTRY TRENDS

### Tech Advancements

The industry has seen a notable shift towards the integration of technology, which significantly influence operations and customer experiences. The legalization of online gambling across many states has introduced both opportunities and challenges. On one hand, it has expanded the market, allowing customers to enjoy casino games from the comfort of their homes. On the other hand, it has increased competition for traditional casino hotels, placing downward pressure on their profit margins. The adoption of electronic gaming devices and ticket-voucher systems has reduced purchase costs, with purchases expected to represent 19.1% of revenue in 2023, down from 21.4% in 2018. The implementation of advanced gaming technologies and systems not only enhances the customer experience but also improves operational efficiencies.

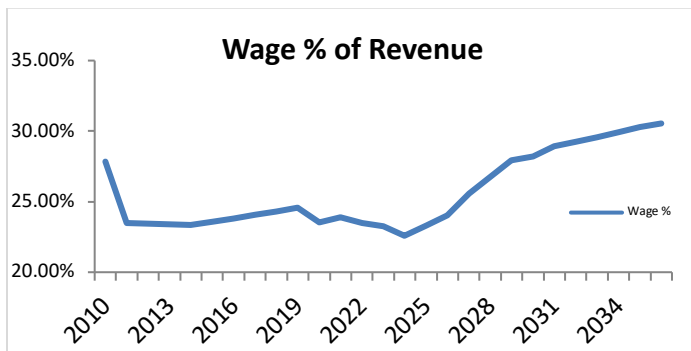


Source: IBISWorld<sup>3</sup>



## Focus on Quality Service

To differentiate themselves in a highly competitive market, casino hotels are increasingly focusing on providing high-quality service, which has led to a jump in wage expenses. Wages are expected to represent 27.9% of revenue in 2023, up from 23.0% in 2018. This trend highlights the industry's focus on enhancing the customer experience. This strategy requires a skilled workforce across all areas of operation, from gaming attendants to hospitality managers. The shift towards quality service aims not only to attract customers but also to foster loyalty and repeat business.



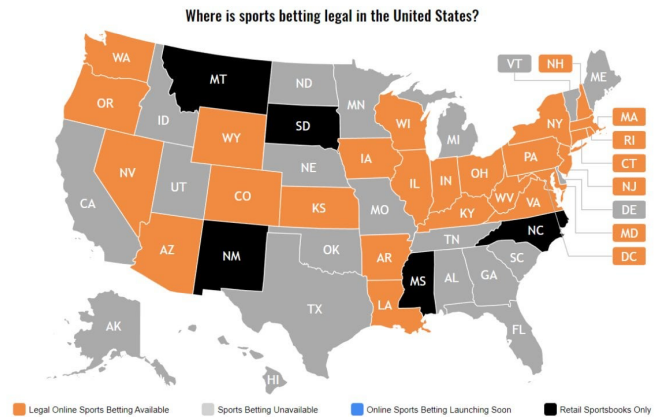
Source: IBISWorld<sup>3</sup>

## Legalization of Gambling

The landscape of sports betting in the United States has undergone a dramatic transformation following the Supreme Court's 2018 decision to overturn the Professional and Amateur Sports Protection Act (PASPA). PASPA had effectively limited legal sports betting to Nevada for over two decades. This landmark ruling granted individual states the ability to legalize and regulate sports betting within their borders. Since then, a wave of legislation has swept across the country, with numerous states legalizing sports wagering in various forms, including retail sportsbooks located within casinos and online betting platforms.<sup>21</sup>

The response has been a rapidly expanding market, with over half of the states now offering legal sports betting. These changes reflect a significant shift in public and legislative attitudes towards gambling. The legalization of sports gambling has been a significant boost for the industry by allowing casino hotels to open sportsbooks within their establishments. This addition has provided another source of gambling revenue and diversifies the offerings of traditional casinos. The legal landscape for

sports betting continues to evolve in the United States, with more states expected to legalize the activity in the coming years. This trend is forecasted to be driven by the increased public acceptance of sports betting, and the growing presence of online and mobile betting platforms.

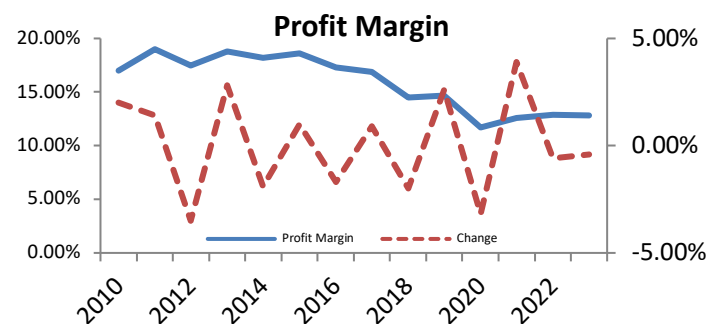


Source: American Gaming Association<sup>19</sup>

## Shrinking Profit Margins

The competitive landscape of the casino and gaming industry is increasingly intense, with traditional casinos facing pressure from both online gambling platforms and international casino operators. This competition has led to a squeeze on profit margins, prompting establishments to find new ways to attract and retain customers. Casinos are enhancing their value proposition by offering incentives such as loyalty programs, promotional deals, and a broader range of entertainment options. However, these investments slash away at their bottom line and have led to less profitable quarters.

In the future, the industry's focus is leveraging technology for operational efficiency with hopes of reducing costs and improving profit margins. This includes adopting data analytics to tailor marketing efforts, optimize the gaming floor layout, and personalize the customer experience.<sup>15</sup>



Source: IBISWorld<sup>3</sup>

## MARKETS AND COMPETITION

### Strengths

The industry possesses substantial strengths, including high barriers to entry due to regulatory and capital requirements. These high barriers safeguard existing operators from new competition. Even online gaming, while potentially facing lower physical and capital barriers, still requires substantial investment in technology, regulatory compliance, and customer acquisition efforts. The industry's ability to generate high revenue per employee indicates efficient operation and resource utilization. Furthermore, the sector typically enjoys higher profit margins compared to the broader hospitality sector. Lastly, the localized nature of casino hotels also protects them from foreign competition.

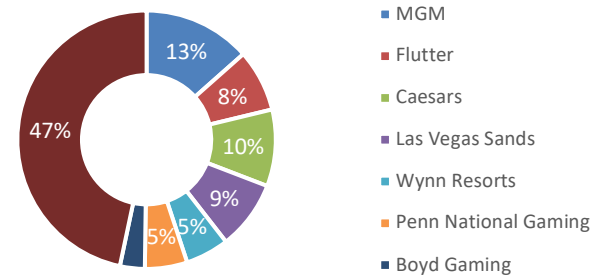
### Weaknesses

Despite its strengths, the industry faces several weaknesses, such as intense competition within the sector and from online gambling platforms. The industry's revenue is highly volatile, influenced by economic conditions and consumer spending habits. There's a high concentration on high-stakes gamblers and discretionary spending. Additionally, the industry's reliance on gaming revenue can be risky if consumer preferences shift. Lastly, the substantial capital requirements for facility upgrades and compliance add financial strain.

### Degree of Competition

The degree of competition within the Casino and Gaming industry is notably high for the sector. Operators compete on various fronts, including gaming, hotel rooms, entertainment offerings, customer service, and promotional activities. The competition is not only from within the sector but also from online gambling platforms, which offer convenience and accessibility, challenging traditional casino hotels.

### Market Share (Public Companies)



Source: IBISWorld<sup>3</sup>

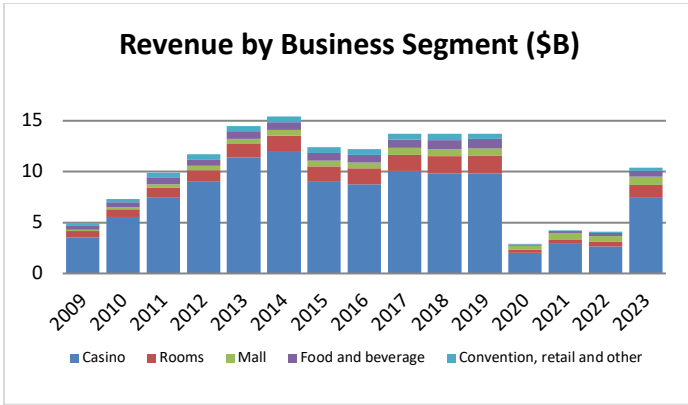
### Peer Comparisons

Company	# of Properties	Square Ft. (Casino)	# of Hotel Rooms
LVS	6	6,500,000	14,000
MGM	31	2,560,000	45,859
WYNN	9	N/A	N/A
CZR	58	3,669,800	48,800
<b>BYD</b>	<b>28</b>	<b>1,723,126</b>	<b>10,751</b>
RRR	15	1,356,000	2,821
PENN	43	2,546,207	7,321

Source: Company 10k's

### Las Vegas Sands Corp. (LVS): -1.75% YTD

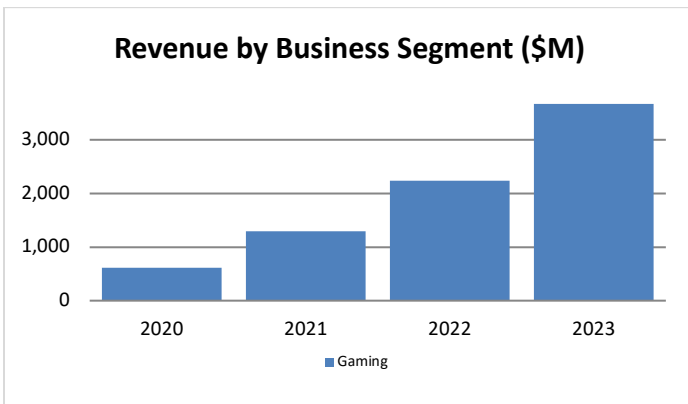
Las Vegas Sands is the largest company (by market cap) in the casino and gaming industry, making up roughly 15% of the industry. LVS stands out in the industry for its focus on luxury resorts and casinos, primarily in Las Vegas, Macau, and Singapore. In its recent financial performance, management placed emphasis on international expansion in hopes of capturing a larger market share. Las Vegas Sands differentiates itself through high-end service, well known properties, and a diversified revenue stream that includes gaming, hospitality, and retail. Recent revenue segmentation indicates a shift towards diversifying income streams, reducing overreliance on gaming revenues. However, the pandemic's lingering effects on international travel directly impact LVS's recovery pace.



Source: LVS – 10k<sup>4</sup>

**DraftKings Inc. (DKNG): 31.69% YTD**

Although DraftKings is not a traditional brick-and-mortar casino operator, the company has emerged as a frontrunner in the online sports betting industry. Its aggressive expansion and user acquisition strategy have quickly increased its market share. However, this growth comes with high marketing and operational costs, impacting profitability. The recent revenue segmentation shows an increased investment in technology to enhance user experience. The company's future success hinges on legislative developments, competitive differentiation, and its ability to maintain user engagement.

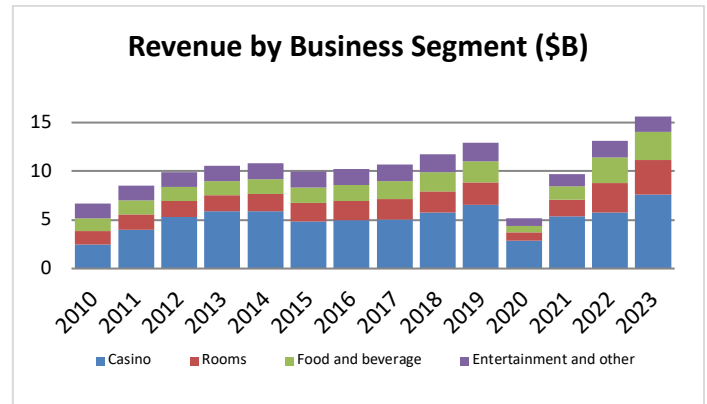


Source: DKNG – 10k<sup>5</sup>

**MGM Resorts (MGM): -6.60% YTD**

MGM Resorts International is a global entertainment company known for its diverse portfolio of destinations in the U.S. and abroad, with over 31 locations. Financially, MGM has shown resilience with a strong recovery in post-pandemic demand. Its growing revenue was supported by its investments in online gaming and sports betting. The company's market position benefits from its brand

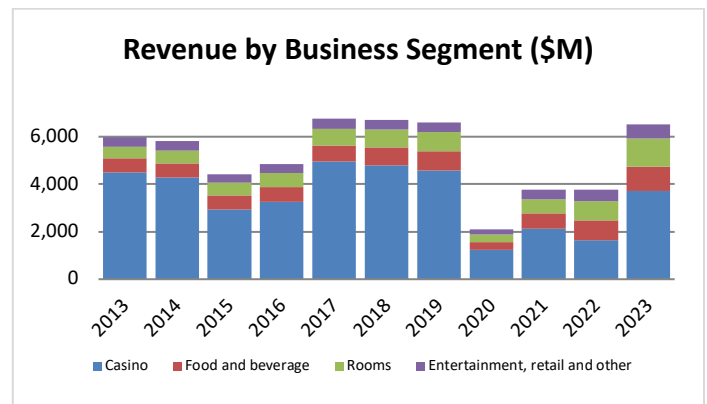
recognition, loyalty programs, and resort model. Future strategies focus on digital expansion and exploring international opportunities (particularly in Asia) to drive growth.



Source: MGM – 10k<sup>6</sup>

**Wynn Resorts (WYNN): 6.96% YTD**

Wynn Resorts differs itself by providing more luxury-focused experiences in Las Vegas and Macau. Its financials reflect the high-end market's volatility but also its potential for high margins. Wynn's differentiation lies in its service quality, amenities, and exclusive gaming environments. The company looks to expand its online presence and leverage its brand to capture emerging tourism and gaming markets. The company's revenue segmentation shows a potential increase in non-gaming amenities, aiming to attract a broader demographic. However, Wynn's financial performance is heavily influenced by its Macau operations, where regulatory scrutiny and competition are intensifying.

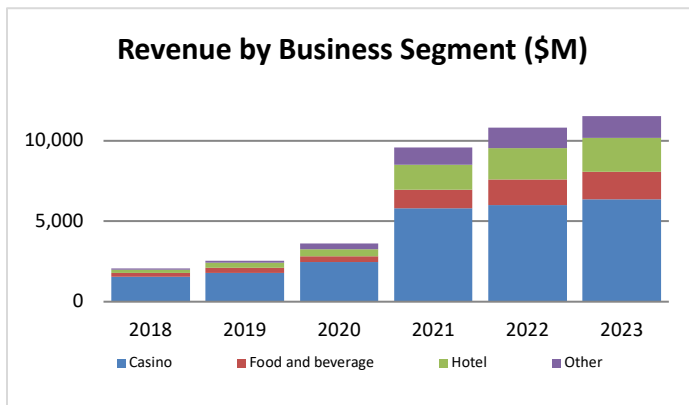


Source: WYNN – 10k<sup>7</sup>



## Caesars Entertainment (CZR): -16.07% YTD

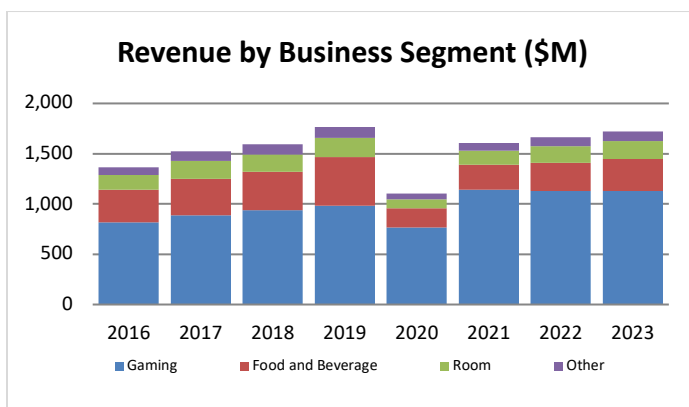
Caesars Entertainment is an American company founded and based in Nevada that operates more than 50 properties across 16 states. Caesars has grown its presence through strategic acquisitions and online sports betting. Financially, the company is navigating the issues from integrating new assets and reducing debt (stemming from the acquisitions), while investing in digital expansion. Caesars' competitive edge is its loyalty programs and brand recognition. Future growth will be driven by leveraging online gaming opportunities and expanding into new regions.



Source: CZR – 10k<sup>8</sup>

## Red Rock Resorts (RRR): 12.06% YTD

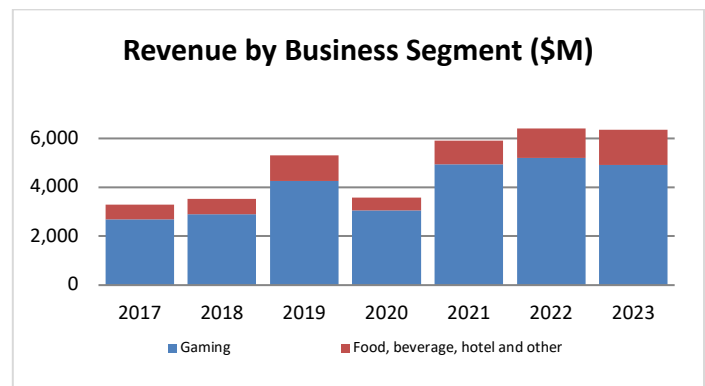
Red Rock Resorts focuses on serving the Las Vegas locals market, differentiating itself with tailored properties. The company plans to further expand in the locals market by leveraging land holdings for new developments, and explore online gaming avenues. Despite strong local patronage, RRR faces challenges in scaling its model and competing against larger national chains, especially in capturing the growing online betting market.



Source: RRR – 10k<sup>10</sup>

## PENN Entertainment Inc (PENN): -35.82% YTD

PENN Entertainment offers entertainment, sports content, and casino gaming. PENN distinguishes itself by operating across numerous states, with a portfolio of 43 properties spread over 20 states and online operations in multiple jurisdictions. PENN is very geographically diverse with five different reportable segments, Northeast, South, West, Midwest and Interactive. Financially, the company is focused on integrating acquisitions and further expanding its online betting operations. PENN also boasts strong brand partnerships such as ESPN and Hollywood Casino.



Source: PENN – 10k<sup>11</sup>

## Profitability Analysis

TTM (%)				
Company	Gross Margin	Operating Margin	Pretax Margin	Net Margin
LVS	39.1%	22.6%	17.1%	11.8%
DKNG	37.4%	-30.1%	-30.0%	-30.4%
MGM	47.9%	0.9%	7.3%	7.3%
WYNN	63.8%	11.6%	-0.3%	0.6%
CZR	53.9%	22.5%	-1.5%	6.2%
<b>BYD</b>	<b>69.7%</b>	<b>27.9%</b>	<b>23.4%</b>	<b>18.9%</b>
RRR	64.0%	34.9%	26.0%	12.5%
PENN	45.3%	12.3%	-0.6%	-1.7%
Industry	50.6%	23.4%	19.5%	15.1%
5 Year Avg. (%)				
Company	Gross Margin	Operating Margin	Pretax Margin	Net Margin
LVS	69.7%	-2.0%	-13.2%	-2.0%
DKNG	46.1%	-84.1%	-101.9%	-101.3%
MGM	44.4%	-3.5%	5.5%	3.2%
WYNN	59.5%	-5.7%	-20.3%	-24.4%
CZR	49.9%	15.1%	-10.7%	-11.1%
<b>BYD</b>	<b>66.1%</b>	<b>19.8%</b>	<b>10.7%</b>	<b>8.3%</b>
RRR	60.3%	24.0%	10.4%	8.8%
PENN	46.3%	14.8%	-0.2%	-0.1%
Industry	41.3%	-5.9%	-23.1%	-25.4%

Source: FactSet

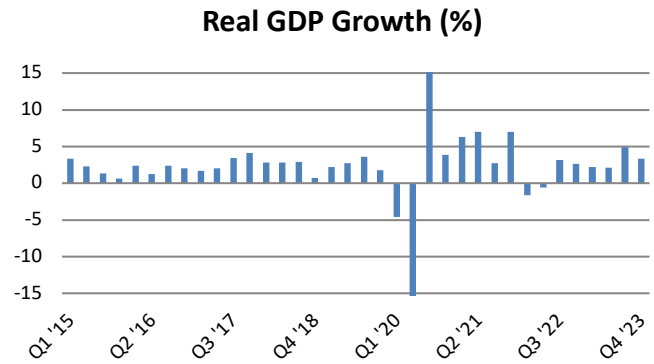
The industry as a whole is working to reverse the 5-year trend of negative net margins caused by the pandemic shutdowns. Las Vegas Sands, despite a significant gross margin contraction over the five-year period, maintains a solid operating margin. In contrast, DraftKings shows persistent net losses, which raises some concerns over its profitability sustainability and aggressive attempts to grow. Caesars Entertainment and MGM Resorts have turned around their operating margins positively, indicating improved operational efficiency and pandemic recovery. Wynn Resorts posts a strong gross margin, though this does not fully translate to the bottom line, as high operational costs and other expenses impacting profitability. Boyd Gaming demonstrates strong net margin performance, standing out for its operational efficiency. In summary, the industry shows a spectrum, from strong performers like BYD to those like DKNB and PENN, who are working towards reversing negative margins.

## ECONOMIC OUTLOOK

As we approach the middle of 2024, the economic landscape remains complex. We believe market performance will likely continue to be driven by macroeconomic crosswinds of the Fed's battle with inflation. Reaching new all-time highs in March, the S&P 500 has finished its best first quarter since 2019 (total return of 3.2% in March). Investors' concerns about a recession have been mostly alleviated, as evidenced by the significant gains in the stock market (up by roughly 9% YTD) as strong company earnings continue to drive growth. Even though investors may be shifting their focus away from early recession fears, New York Fed's recession model still predicts a 58.3% chance of a U.S. recession sometime in the next 12 months. Nevertheless, markets and forecasters are anticipating a soft landing (where inflation slows and growth cools without sliding into recession) for the economy and Federal Funds rate cuts. If monetary policies manage to stabilize the economy without inducing a recession consumer confidence could strengthen, potentially buoying sectors like casinos and gaming. However, should the US economy fall into a recession, consumer discretionary sectors will likely experience significant strain. Additionally, the end of the pause on student loan repayments in October of '23 could further stress consumer finances.

## Economic Growth Projections

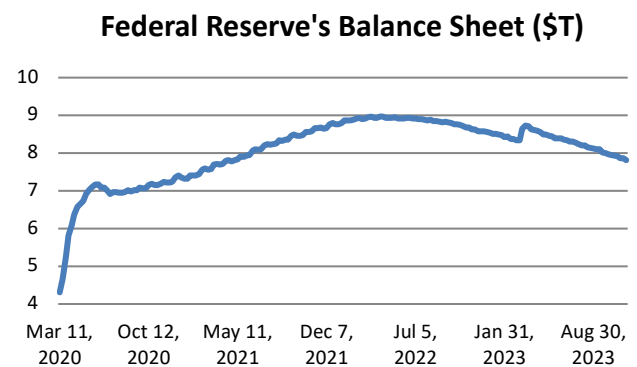
The US economy stands at a crossroads, with real GDP growth expected to decelerate to a slower pace after a better-than-anticipated 2.8% in 2023. This anticipated soft landing suggests a delicate balance between growth and contraction, reflecting caution in consumer spending and a potential decrease in government fiscal contributions.



Source: FRED<sup>14</sup>

## Monetary & Fiscal Policy

The Federal Reserve's interest rate cycle is presumed to have peaked, with rates anticipated to hold at 5.25% - 5.50% until mid to late 2024. Assuming inflation continues to drop, rate normalization could occur with reductions starting in June, potentially easing the Fed Funds target range to 4.75% - 5.00% by year-end. The continued quantitative tightening at \$95 billion per month signals a significant withdrawal from the economy, shaping the fiscal landscape for the year.

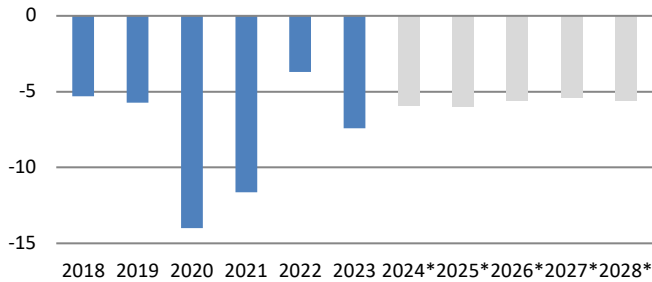


Source: FRED<sup>17</sup>

In 2023, the US fiscal deficit expanded to \$1.84 trillion, making up 7.4% of GDP, a sharp increase from the \$950

billion recorded in 2022 (indicating a higher outflow of government funds compared to revenue). For 2024, the deficit is projected to decrease to 5.9% of GDP, as the government is expected to tighten its fiscal spending, although this will be somewhat offset by increased interest payments on the national debt.

### Fiscal Budget Balance (% of GDP)

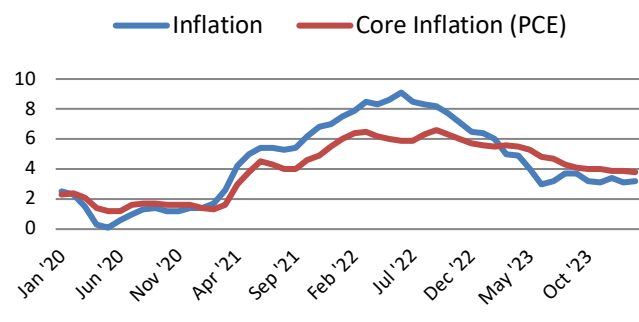


Source: Statista

### Inflation Trends

With inflation having reached a peak in 2022, the subsequent cooling pattern is expected to continue into 2024. Core goods inflation has seen a significant reduction, and while core services inflation remains elevated, it is also on a downward trajectory. Inflation trends are expected to continue cooling but are likely to remain above the Federal Reserve's 2% target through 2024. A cooling inflation environment is likely to increase consumers' real purchasing power, giving them more financial leeway to spend on non-essential services, like gambling and casino hotel experiences.

### Inflation Rate and Core Inflation Rate (%)

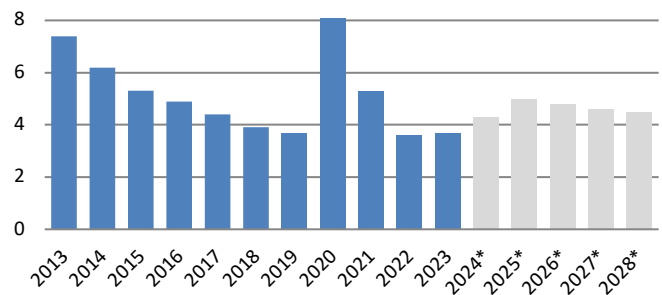


Source: Statista

### Labor Markets

The labor market is showing signs of normalization as we closed out 2023, with a slight uptick in unemployment projected for 2024 (still remaining low by historical standards). The increase in labor supply due to higher immigration and labor force participation, coupled with signs of a cooling job market, points to a potential rise in unemployment rates. However, with the economy's recovery from the pandemic, businesses may be hesitant to reduce their workforce rapidly, possibly leading to a gradual change in unemployment figures. While the casino and gaming industry might benefit from an increased labor supply and potentially lower wage pressures, these advantages will be offset by potential wage suppression due to increased labor supply, which constrain growth in consumer spending.

### U.S. Unemployment Rate (%)



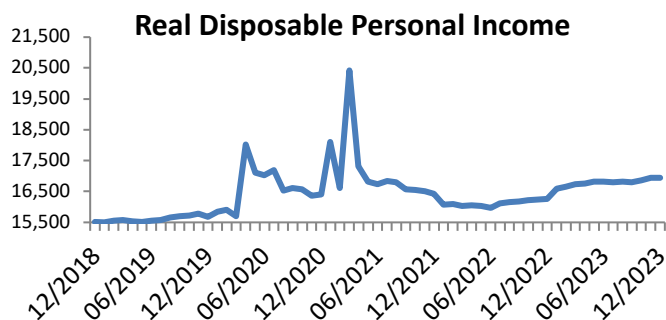
Source: Statista

### Role of Consumer Spending

The casino and gaming industry's performance is closely linked to consumer spending patterns, which are influenced by a variety of economic factors. During periods of economic growth, consumers are more likely to have discretionary income available for entertainment and leisure activities. However, economic downturns or uncertainty can lead to a decrease in consumer spending on non-essential activities. Factors such as labor market conditions, taxation levels, and interest rates significantly impact consumers' willingness and ability to spend. The industry is sensitive to these macroeconomic indicators, as fluctuations in consumer confidence and spending can directly affect casino revenues.<sup>20</sup>

The economic fluctuations of recent years have had a pronounced impact on consumer spending within the

casino and gaming industry. The initial decline in disposable income in 2020, followed by a recovery buoyed by stimulus payments and tax breaks, created a volatile spending pattern among consumers. The Federal Reserve's interest rate hikes in 2022 further tightened consumer budgets, reducing disposable income and discretionary spending. Although 2023 saw a modest increase in disposable income, ongoing inflation and a high cost of living continue to constrain consumer spending power. Looking ahead to 2024, expectations are cautiously optimistic, with income levels projected to rise further, albeit at a slower pace, outpacing inflation.



Source: FRED<sup>16</sup>

## KEYS TO MONITOR

### Catalysts for Growth

- Growth Indicators:** Monitor for consumer confidence rebound and monetary policy effectiveness leading to economic stabilization, potentially boosting discretionary spending.
- Inflation and Spending Power:** Watch for inflation rates aligning with the Federal Reserve's target, which could enhance consumer purchasing power.
- Fiscal Health:** Narrowing fiscal deficit trends could indicate governmental fiscal prudence, supporting long-term investment stability.
- Economic and Spending Growth:** Look for GDP growth surpassing the consensus forecasts and consumer spending defying conservative expectations as positive signals for investment.

### Risk to Thesis

- Economic Pressures:** Watch for the impact of student loan repayments and inflation rates staying above the 2% target, potentially reducing consumer spending.

- Labor Market Cooling:** Monitor unemployment rates exceeding 4.5% and signs of a slowing labor market as indicators of broader economic challenges.
- Inflation and Fiscal Policy:** Core PCE prices rising significantly above current rates or a widening fiscal deficit beyond projections would cause increased economic pressure and an unfavorable environment for the industry.

## Conclusion

We recommend a **Market Weight** rating for the Casinos and Gaming industry. We think the industry's pivot towards online gaming and sports betting, which is expected to experience significant growth in the coming years, will be huge revenue boosters. Additionally, the industry's investment in diversifying into luxury amenities and enhancing customer experience will appeal to a wider and younger demographic, driving long-term value. Boyd Gaming and MGM Resorts stand out as particularly compelling investments. Boyd Gaming, with its strong margins, showcases financial health and efficiency, positioning it well for both current and future growth. MGM Resorts' diversified portfolio, market share, and moves into online gaming present a significant upside, leveraging brand recognition and operational expertise.

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