

Strong Sector

Casino Stocks Continued to Outperform in 2006



Andrew Didora

The year 2006 was a great time to have owned gaming-related stocks as the group significantly outperformed the market. Nine stocks in the sector, or over 40 percent of the gaming group, were up over 30 percent. As a point of comparison, the Dow Jones Industrial Average, the S&P 500 and the NASDAQ were up 16.3 percent, 13.6 percent and 9.5 percent, respectively, during the year. Large-cap operators were up 67.6 percent while mid/small-cap operators increased 11.8 percent. Las Vegas Sands was not only the top-performing company in the space, increasing 126.7 percent during the year, but was also the top performing large-cap stock in the U.S. Meanwhile, Aztar Corporation, the target of a takeover bid, had the second-largest return with a 79.1 percent increase. The manufacturing group, which was the second-best performing sector in gaming last year, increased 25.7 percent, led by a 50.1 percent increase in IGT, a 43.5 percent increase in Bally Technologies and a 38.9 percent increase in WMS Industries. Returns in the manufacturing space could have been stronger if not for only a 4.2 percent increase in Shuffle Master and an 8.1 percent decline in Progressive Gaming. Overall, it was a very strong year for gaming stocks.

From our viewpoint, the sector was bolstered by the growth of the Macau market, increased M&A and takeout activity, and the increasing social acceptance for gaming nationally. In 2006, gaming revenues in Macau surpassed those of Las Vegas. We believe the inflow of new, exciting offerings encompassing food, entertainment and rooms, coupled with Las Vegas-style casino floors, should drive growth for the next several years similar to how Steve Wynn's Mirage drove growth in Las Vegas years ago. We also expect an additional 3.1 million square feet of retail space and over 4 million square feet of convention space to be added by Las Vegas Sands alone, which should draw additional visitors to Macau and boost the market growth rate even higher. Due to this growth potential, Macau-based operators were among the strongest performers on the year. As mentioned above, Las Vegas Sands was the top performer in the group while Wynn Resorts

Company	Ticker	52 week Hi/Lo	Cap (\$ mil)	12/29/06 Price	12/31/05 Price	Chg.
Large Cap						
Harrah's Ent.	HET	\$58.22-\$84.25	15,411	\$82.72	\$71.29	16.0%
Las Vegas Sands	LVS	\$38.44-\$97.25	31,785	\$89.48	\$39.47	126.7%
MGM Mirage	MGM	\$34.20-\$59.52	16,589	\$57.35	\$36.67	56.4%
Wynn Resorts	WYNN	\$52.44-\$98.45	9,430	\$93.85	\$54.85	71.1%
Average			18,304			67.6%
Mid Cap						
Ameristar	ASCA	\$16.73-\$33.41	1,758	\$30.74	\$22.70	35.4%
Aztar Corporation	AZR	\$28.82-\$54.42	1,967	\$54.42	\$30.39	79.1%
Boyd Gaming	BYD	\$33.10-\$54.72	4,015	\$45.31	\$47.66	-4.9%
Isle of Capri	ISLE	\$18.98-\$34.30	825	\$26.58	\$24.36	9.1%
MTR Gaming	MNTG	\$7.36-\$12.49	351	\$12.22	\$10.41	17.4%
Nevada Gold & Casinos	UWN	\$3.47-\$10.89	49	\$3.79	\$10.39	-63.5%
Penn National	PENN	\$29.48-\$43.83	3,603	\$41.62	\$32.95	26.3%
Pinnacle Entertainment	PNK	\$23.69-\$37.40	1,644	\$33.14	\$24.71	34.1%
Trump Entertainment	TRMP	\$15.85-\$23.80	736	\$18.24	\$20.13	-9.4%
Dover Downs Entertainment	DDE	\$9.33-\$20.60	438	\$13.37	\$14.15	-5.5%
Average			1,628			11.8%
Venue Management						
Magna Entertainment	MECA	\$3.75-\$7.55	484	\$4.51	7.14	-36.8%
Churchill Downs Entertainment	CHDN	\$35.25-\$44.21	553	\$42.74	36.73	16.4%
Lottery/Venue/Pari-mutuel						
Scientific Games	SGMS	\$26.40-\$40.63	2,855	\$30.23	27.28	10.8%
Manufacturing						
Bally Technologies	BYI	\$12.62-\$20.92	999	\$18.68	\$13.02	43.5%
Intl Game Tech	IGT	\$30.12-\$46.76	15,957	\$46.20	\$30.78	50.1%
Progressive Gaming International	PGIC	\$6.51-\$11.40	314	\$9.07	\$9.87	-8.1%
WMS Industries Inc.	WMS	\$24.08-\$37.38	1,133	\$34.86	\$25.09	38.9%
Shuffle Master Inc.	SHFL	\$22.49-\$40.75	944	\$26.20	\$25.14	4.2%
Average			3,869			25.7%
Indices						
SPX	SPX			\$1,418.30	\$1,248.29	13.6%
INDU	INDU			\$12,463.15	\$10,717.50	16.3%
COMP	COMPQ			\$2,415.29	\$2,205.32	9.5%
Average						13.1%
Dow Jones Casino	^DJUSCA			\$696.53	\$485.65	43.4%

returned 71.1 percent and MGM Mirage increased 56.4 percent.

Another major driver of share prices in 2006 was M&A and takeout activity. There was aggressive bidding on Aztar (which increased 79.1 percent during the year) early in 2006, an LBO of Harrah's Entertainment (which returned 16.0 percent, lagging the large-cap segment) by two major private equity groups, and two management lead take-outs of Kerzner International and Station Casinos. Over the past several months, these transactions have fueled a flurry of speculation on which gaming company could be the next candidate for a takeover. Going forward, we believe hostile takeovers could be more difficult given that what is left in the public gaming market has significant inside ownership.

Finally, the increasing need for tax dollars has made states more dependent than ever on gaming revenues. Fifteen states receive substantial tax revenues from casino gaming and these numbers are likely to increase as Pennsylvania, Maine, Florida and New York (still a market in its infancy) all add casino gaming. If gaming is becoming more and more popular, whether through new jurisdictions, expansions or new game trends and tech-

nology, this will only attract more investors to the space, in our opinion. Further, as these new jurisdictions and expansions come online, all of the third-party benefits spill into the gaming equipment suppliers.

In summary, 2006 was a very strong year for the gaming space. Heading into 2007, we continue to believe gaming investors will be rewarded given growth in Macau, continued strength in state gaming revenues, continued takeover speculation, the potential growth of new jurisdictions and the sale of individual casinos (for example, Harrah's new owners could sell non-strategic properties). On the downside, we believe the smoking ban in Atlantic City and the potential for video lottery terminals at the Meadowlands could slow growth in that market. ■

GAMING INDUSTRY

STOCK PRICE PERFORMANCE

For Week Ending January 8, 2007

TOP 5	Price on 1/8/07	% Change
MGM Mirage (MGM)	\$59.80	3.9%
Wynn Resorts (WYNN)	\$98.71	2.5%
Boyd Gaming (BYD)	\$46.55	1.3%
Las Vegas Sands (LVS)	\$93.08	1.2%
WMS Industries (WMS)	\$36.53	0.6%
BOTTOM 5		
Pinnacle Entertainment (PNK)	\$30.79	-7.5%
Ameristar Casinos (ASCA)	\$28.55	-5.5%
Scientific Games (SGMS)	\$29.49	-4.2%
Progressive Gaming (PGIC)	\$9.01	-3.0%
Shuffle Master (SHFL)	\$25.03	-2.9%
THE MARKETS		
S&P	1412.84	-0.3%
Dow Jones	12423.49	-0.4%
Nasdaq	2423.16	0.6%

Andrew Didora is a vice president in the Jefferies & Co. Gaming, Lodging and Leisure group covering the lodging stocks and working with the group on the gaming stocks. Didora can be reached at adidora@jefferies.com.