The Gaming Sector... Yesterday, Today and Tomorrow

The Successful Investor's Guide
To The Gaming Industry

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Table of Contents

Introduction

2018 Portfolio Picks

Introduction

LOOKING BACK ON 2017

In what was a year of tragic events for the global casino industry, hopefully never to be repeated again, the industry ended 2017 with more scars than ever before but hopefully stronger for it.

"...the industry ended 2017 with more scars than ever before but hopefully stronger for it…"

Two senseless attacks affected the industry this past year, both blamed on disgruntled gamblers, something we disagree with but it does make headlines. In Manila, a gambler who had racked up losses at Resorts World walked into the casino, began shooting up the place and then lit some of the gaming tables on fire. In what was a real tragedy, instead of neutralizing the situation, Resorts World security took part in the panic with the result being 38 people losing their lives, not directly by the hands of the attacker, but because they were either trampled or trapped in the fire.

On October 1st the Las Vegas Strip was changed forever as a lone gunman fired onto an outdoor Country Music Festival from a Mandalay Bay hotel room, with nearly 60 people killed and more than 500 injured.

"....we believe the past is not as important now as the future… The events that occurred in 2017 will play an extremely important role in the future…"

Looking at gaming stocks and the magnificent second half of the year rally they took part in, one could say that the industry emerged from all this stronger than ever but we remind you of one of our most repeated sayings. Gaming stocks very rarely trade at the correct levels. They are typically too high or too low. That being said, this was the second year of gains of more than 20% in our Annual Portfolio, coming off the prior two years of single digit gains while the overall gaming sector was in negative territory. Given the global bull market that has accelerated since Donald Trump won the Presidential Election, we see every reason for gaming stocks to outperform the overall market but between the Resorts World Manila and Mandalay Bay tragedies, Hurricanes Harvey and Irma taking its toll on the casino industry in the Southern United States and Caribbean, and Typhoon Hato nailing Macau, one would wonder about how these events barely affected the stock prices of the companies negatively impacted.

What is really interesting is that in this report last year we looked back on 2016 and said "We are ending the year with Caesars Entertainment Operating Company still in bankruptcy, the Macau full smoking ban has still not been decided, Baha Mar is sitting there rotting away, California and Pennsylvania still do not have online poker/gaming, the Seminoles are still making billions in Florida without a gaming compact, Resorts World

and Alon developments in LV have made very little progress, and the Mohegan and Mashantucket Pequot Tribes have still not selected a location in the Hartford area for their satellite casino." By the mid-point of 2017, most of this still had not occurred and the ones that did included Baha Mar opening to 20% occupancy, Crown pulled the plug on Alon while the smoking ban in Macau was pushed down the road but is still a negative.

Despite little change from 2016, our July 3rd Gaming Industry Weekly Report summed up the strong first half of the year for gaming stocks as occurring despite the situation of "What was supposed to happen didn't but what should happen did, if we can use that logic. Regional gaming was supposed to be amazingly strong given the raging stock market and surging consumer confidence but it has been mixed, at best. Macau gaming revenue growth should be good, not great, but instead it has been surging towards 2012 and 2013 growth levels. PA should have easily passed an online gaming bill, Illinois should have already been taken over by a country that outlaws gambling and the Supreme Court should have told NJ to go bet on sports in Nevada."

Despite what seemed to be a messy first half of the year, gaming stocks were higher but nothing like what happened in the second half. On one hand you could say if the stocks were higher despite nothing seemingly going right in the first half, the second half monster surge was justified given how Caesars Entertainment Operating Company completed its bankruptcy, same store regional gaming revenue growth had more consistent rises, Macau gaming revenue surged, Pennsylvania passed a massive gaming expansion bill and the Seminole tribe resolved its compact issues with the state of Florida. Once you add in the attacks in Manila and Las Vegas, the typhoons and hurricanes, all we can say is 2017 was one for the record books. We called 2017 the year of momentum for the overall stock market and nowhere was that more apparent than in the gaming sector. The strategy that quickly showed itself to be the correct one in 2017 was to stay invested in gaming stocks that were higher while putting fresh money into the few laggards. By year end the pickings in the laggard group were small, whether it was a large or micro cap. From Scientific Games rising from single digits in 2016 to over $50 in 2017, or tiny Full House Resorts doubling in price, the only way to lose money in gaming stocks in 2017 was to not be invested.

It all started with the wall of worry in Macau, something that persisted throughout the year even though speaking in bearish tones just made you look foolish. The last chance to get back into Macau at reasonable valuations occurred at the beginning of 2017 when the stocks were weak due to the late 2016 plunge on a South China Morning Post story that wound up being the fakest of fake news. The easiest way we can describe the Macau investment theme would be to say it was pessimistic at the start of the year and irrationally exuberant as we moved into the fourth quarter of the year before flat lining somewhat. In last year's report we said there were still enough non-believers for us to remain confident the strength in the recovery would continue. It was just amazing to watch the remaining bears half heartedly throw in the towel throughout the year only to start growling again at the slightest sign that things could soften. From being bearish because of the declines in VIP the past few years to being bearish because the 30%+ growth in VIP would not be sustainable, we had to admit that even we were surprised that we never saw full blown capitulation from the majority of the gaming analysts that had been wrong on Macau for years. As for what we considered a bit of irrational exuberance in the stocks by the fourth quarter, we can easily see the reason for it.

If Typhoon Hato knocking out the Peninsula properties and impacting the Macau market just as the calendar lapped the Wynn Palace and Parisian openings and comparisons getting tougher could not stop the high teens to more than 20% growth in GGR, what could? From being in denial on the rational reason behind the VIP surge, mainly the Crown arrests showing the Chinese government wanted the VIPs to stay in Macau or friendly gambling countries like the Philippines, the strength of some of the management teams there to keep EBITDA strong, we just could not understand the random outbursts of negativity from some investment firms.

The historical trend for regional casino stocks is to buy them in February and March and sell them in late July and August. That all went out the window in 2017 as the best way to make money was to buy them in January and forget you had them the rest of the year as they rode a wave of momentum that was difficult to understand. We could give you a lot of reasons for the strength in the group starting with little new competition, a surge in consumer confidence due to a surging stock market and still low interest rates, continued M&A rumors hitting the market but the reality is you could poke holes in all that. Going into the year the expectations were that easy comparisons

made the first half of the year a potential bonanza given the stronger economy. Instead, by the middle of July, many were asking where the same store growth was? While there were lulls in the regional gaming stock rally, it did not matter what news was announced, bad news was downplayed, good news was highlighted and expectations were raised. By the second half of the year, same store revenue growth began a more consistent uptrend and by then it was like all bad news was abolished.

We could point to Eldorado Resorts and Monarch Casino and give you a bunch of great reasons for their success this year. First, Reno was probably the best regional-type gaming market in the United States in 2017. Eldorado Resorts was in the honeymoon period with investors, following their acquisition of Isle of Capri Casinos. They showed something that very few analysts were willing to say and that is how poorly ISLE's properties had been run in the past.

Every ISLE property that was acquired by ERI showed revenue declines in 2017, some rather significant. Despite that, EBITDA under ERI management increased. Some would say that it showed the strength of ERI's management, some said this showed the company they acquired really was the Isle of Debris. No matter what, it justified ERI becoming one of the best regional gaming stocks out there.

For MCRI, it starts in Reno and ends in Black Hawk as the company only has to focus on two properties and they did well in both. Reno was easy given the increases, Black Hawk is more challenging given the construction and position as a market which can be influenced very easily by weather.

Then there is the story of Penn National and Pinnacle Entertainment, polar opposites that wound up having the same result by the end of the year. PNK started the year on a high note, continuing the momentum from last year when they captured investor interest by flaunting their powerful cash flow. As we entered 2017 we questioned how long that was going to last as the company reported two quarters in a row with no share repurchases, leading us to believe they felt their shares were not undervalued anymore.

PENN, on the other hand, was a wall flower in the first quarter of 2017, trading in the $12 to $14 level. Between buying back stock, a solid rebound at Plainridge Park and the regional gaming stock surge, shares more than doubled from those first quarter lows.

The two went in different directions in early summer as investors appeared to shift their investments from PNK to PENN after yet another quarter of no share repurchases from PNK and what appeared to be a better outlook from PENN. Then Hurricane Harvey hit Houston, knocking out PNK's top feeder market to their all important L'Auberge du Lac in Lake Charles. It looked at that point that PNK was going to be the only regional casino stock in negative territory as the combination of the lingering impact from the hurricane on the market and Golden Nugget's success in taking business from their next door neighbor in Lake Charles painted a bleak picture. Out of

nowhere a blast from the past rumor about PNK and PENN merging hit the news wires, sending PNK shares surging. It did not matter that it took until the second round of rumors for the two to comment that they were talking, both stocks traded in lockstep hitting consecutive new highs.

Ironically the company with the best same store comparisons in regional markets in the second half of the year was Caesars Entertainment, if you take out the impact of MGM National Harbor on Horseshoe Baltimore. The worst performing regional casinos, not counting the ISLE properties, were those from Boyd Gaming. CZR, weighed down by the Caesars Entertainment Operating Company reorganization that took more than a year too long to be completed, and then the Mandalay Bay shooting impact on Las Vegas, traded in a nearly opposite fashion of BYD for much of the year.

While Downtown Las Vegas went from great to ho hum and BYD's regional casinos continued to lag the rest of the group in performance, BYD was the darling of the sell side analysts for much of the year. We have always marveled at Wall Street's reaction to BYD. Sell side analysts either hate them for a few months longer than they should, wait a very long time to warm up to them and then stay overly positive for extended periods of time, justified or not. You can guess by the chart which way they were at year's end.

In the case of MGM, they continued the love/hate relationship they have with Wall Street as they continue to trade at a discount to the rest of the large cap casino names, even before the tragedy at Mandalay Bay. Ironically, the shares had been weakening into the shooting, following a very large round of insider selling, followed by a large block purchase by the company of shares from Tracinda Corp with management commentary that they were buying them at an attractive price. The problem was that attractive price was very close to where management had just sold off hundreds of thousands of shares. If anything, the shooting and a couple of analyst downgrades after, actually put a bottom in the shares and allowed them to participate in the end of year rally. As we came to the end of November, MGM was the worst performing stock from the original 2017 Portfolio. The good news is the worst performing stock was still up 19%. We told you it was a year for the record books.

In our 2015 Gaming Sector…Yesterday, Today and Tomorrow report we bucked the trend and came out positive on the slot makers. We were contrarians, going against the Wall Street desertion of the group, as the Street believed the prospects were dim with too many companies chasing a slow or no growth business. Despite the mega-mergers by SGMS/WMS/BALLY and IGT/SPIELO, the combinations of Aristocrat and Video Gaming Technologies along with Ainsworth and Novomatic, more attention was given when there were sales of social gaming businesses than real supplier mergers. Despite the supplier stocks being the best performing gaming stocks in 2016 and then really taking off in 2017, there was still more attention given to the casino names and presentations at G2E 2017 than what the slot makers were displaying.

SGMS was put in our 2016 Portfolio at $7.16, IGT at $14.50. We wanted to include Everi Holdings back then but since it was sub $2 and we did not have a Speculative section, so we felt we could not include it. By Thanksgiving 2017, SGMS was at $52, IGT was at $28 and EVRI at $8.85. We could leave it at that given the year of momentum but there were reasons for it. While you could not say these companies were showing explosive growth, they were showing other things, mainly cash flow, a terrific integration of businesses and an appetite to continue growing any way possible. The business had changed and you could no longer just be a slot maker and it was working. At the same time the Pennsylvania gaming bill, while not something we agreed with, was a positive for only one part of the sector, the suppliers/slot/content providers.

While that is a much smaller summary of what occurred in the past year than we typically do in this report, we believe the past is not as important now as the future, given the levels gaming stocks are at and the state of the casino industry. The events that occurred in 2017 will play an extremely important role in the future and that will be explained in depth further in this report.

Online Gaming, Social Gaming, Sports Betting, Skill-based Slots, Daily Fantasy Sports, Esports

2017 was a sobering year for Daily Fantasy Sports and Esports as the realization set in that the hype is not living up to the substance. At the same time, the skill-based slot pioneers proved they won't be like the slot pioneers before them, adapting rather than sticking to their beliefs which has in the past caused the downfall. Online gaming, at least in NJ, proved that it deserves to be in other markets, even as the "experts" that survive only by keeping it in the forefront as the potential cure for all that ails the world, continued to show they don't understand the actual casino industry. As for Esports, if it winds up shriveling and dying as related to the casino industry, you can point to the Global Gaming Expo 2017 as the beginning of the end. It was at that show where some people stood up and said what needed to be said. How does the industry make money on Esports when neither the people taking part in it or those watching will part with gaming or non-gaming dollars?

Of all the things that occurred in this segment in 2017, sports betting gained the most notoriety and legitimacy. Towards the end of 2017 the industry showed off its terrible side, with an attempt, hopefully unintentional, to derail the clear path sports betting is on to spread across the country by tying it to an expansion of online gambling and online sports betting. It started with the director of the NJ Division of Gaming Enforcement saying he felt legalizing sports betting would result in an "explosion" of online gambling which was just the shot in the arm that entire online gaming Internet group of supporters, promoters and "experts" needed. It then spread to Michigan where an attempt at an online gaming measure added online sports betting.

If there is one problem the gambling industry has that they cannot overcome it is self-policing and instilling common sense when it comes to expansion. Whether it is unrealistic projections that they don't know how to tone down, not understanding when it is time to step it up to avoid a potential problem or not fully understanding the psychology of lawmakers and public opinion, the industry has a tendency to shoot itself in the foot more times than not. In 2017, led by a unified American Gaming Association, great inroads were made to repealing PASPA, one way or another. While we would rather have Congress do this and not start the spread of sports betting off in an unregulated manner, that could occur if the Supreme Court rules in 2018 in favor of NJ. What had looked like a means to the end was hyped up to be taking the bull by the horns.

To sum up the Supreme Court decision versus Congress repealing PASPA, we compare it to the situation with the legalization of marijuana by certain states, Nevada being one of them. Despite that state legalization, entities that are licensed by Nevada regulators are not allowed to have any connection with companies or individuals involved in that industry because it remains illegal on a federal level. If the Supreme Court continues the positive momentum that the AGA created this year, they will rule in favor of the state of NJ and against the remaining few hypocritical sports organizations. The Court could rule in favor of NJ when they make their decision sometime in the first half of 2018. While that will be hailed a victory, we are concerned that with no structure in place on a state by state basis in terms of regulation and tax rates the opportunity for licensed casinos may be stunted or even delayed until Congress acts or each state gets their ducks in a row. Racetracks, possibly even some Indian casinos, will benefit from this but for licensed casinos to offer unregulated sports betting it may just be too much of a risk for some.

We felt the momentum had caused widespread, bi-partisan support for Congress to act to eliminate PASPA. There was no Democrat versus Republican issue, there were even some progressive sports organizations like the National Basketball League that were in support of legalizing widespread sports betting. That is why we believe the story that broke right before Thanksgiving about how a favorable ruling by the high court could lead to an expansion of Internet gambling and online sports books could be quite damaging, not for the Supreme Court decision but for progress in Congress.

As everyone must know, the biggest issue in Washington has been the inability for both parties to come together on matters. In some cases there is even enough fighting within the parties to lack consensus on any issue. Having no real opposition to eliminating PASPA is something that you just don't expect to see but also brings up visions of a measure passing quickly if the Supreme Court rules in favor of NJ. Tying the expansion of online gambling to the measure and the likelihood of nationwide online sports betting threatens this. Sheldon Adelson of Las Vegas Sands

is the most outspoken critic of online gambling but he is not the only one. Suggesting legalizing sports betting would expand online gambling could quickly turn quite a few against the measure. Suggesting this would turn into nationwide online sports betting is another issue. Part of the bi-partisan and state by state support of sports betting is that it would benefit the casinos, those who have invested billions and creating millions of jobs. We can tell you with absolute certainty that online sport betting would dramatically dwarf casino sports betting, possibly even damaging the existing business in Nevada.

It was two years ago before football season began when we ran our expose on Daily Fantasy Sports and the horrible business plans from DraftKings and FanDuel. You can say the rest is history but while bruised and battered, after wasting hundreds of millions of investor funds, they are still around. The names of executives and board members are changing, nobody is willing to stand up and shout that widespread legalization of sports betting could render Daily Fantasy Sports useless, sending them back to the dark ages where a small group of loyal wanna-be sports enthusiasts met in secret to "draft" teams. All that being said, the people who invested the hundreds of millions are actually very wise media types, losing value on their investments but getting it back different ways. We would not put it past them to take advantage of an overheated bull market to attempt an IPO of one or more of the names to try to live another day. If all else fails they could just add Blockchain or Bitcoin to their failing business plans and they could easily go public.

Esports, on the other hand, took a big dive this year in hype and casino affiliations. Commentary and some studies were part of the Global Gaming Expo in 2017, showing how more people watch Esports from their rooms at their parents homes than go to the events. Those that do wager usually do it on sites deemed illegal. There were more alleged fixing scandals announced. What this all led to were questions at the G2E show about how the industry can make money on Esports with no definitive answers from those who supported it. There have been a few half hearted attempts for some racinos and casinos to hook up with Daily Fantasy or Esports groups in the past but they seem to be fizzling out. We have a feeling the Esports/casino tie up may survive somewhat but what G2E did was destroy the hype that had been building, forcing those organizations and groups that believed there would be a connection, back to the drawing board to come up with something to try to resurrect the business connection.

For most of 2017 we watched the two main skill-based pioneers, GameCo and Gamblit Gaming mature, doing something their pioneer predecessors like Silicon Gaming refused to do. The two companies showed their maturity by altering their initial business plans, which were not working, towards a more traditional slot machine company strategy, particularly the branding of games. While expensive, we point to Gamblit Gaming's Deal or No Deal Poker which is in essence Gamblit Poker adapted to the theme. To us those games were night and day the same thing as getting the Pac Man brand to adapt other games. On the GameCo side, the modest booth at G2E, the Steve Aoki theme on games, converting games that did not have success to themes like Terminator 2 and above all, coming out with bartop VGMs were all signs that unlike their predecessor pioneers in the business, they were willing to adapt to the industry rather than believing the industry should adapt to them.

It remains to be seen just how successful the pioneering games are or the entire skill-based mantra itself. Not surprisingly we did not jump on the bandwagon when the whole skill-based hype began two years ago believing it would take three to five years for this to play out. At the same time we questioned whether the major slot companies would do what they had in the past, sit back and wait for the pioneer companies to implode, buying the companies for parts and then finally bringing this to the forefront. While the pioneering firms have gone full bore into this and they are getting placements, even if they have been with limited success, the traditional slot companies have taken a more measured approach. Ironically the fact that they are actually taking part in this on their own, rather than waiting for the pioneers to implode, is a good sign. We still believe the logic of attracting millennials with this game is flawed. The change we saw this year to putting the games where the millennials are, the bars and new gaming lounges introduced by MGM and others, is a much better strategy than putting games in the casinos and waiting for the millennials to show up. That being said we do believe the strategy of putting games in as many private and tribal markets as they can is flawed. While we do believe the first games that were launched were quite primitive and very close to being failures, we believe the criticism from Caesars Entertainment at the East Coast Gaming Congress in 2017 was extremely important. We feel that caused the change in the companies' business plan, realizing that at least 50% of the failure was putting games in locations in Caesars casinos in Atlantic City

where the millennials were not and just assuming success. The other 50% was that the games just were not consumer/casino friendly or interesting to customers. We are not ready to say that GameCo and Gamblit Gaming will not go the way of Silicon Gaming in the future because we still are in the early innings. We are comfortable in saying Blaine Graboyes and Eric Meyerhofer are very different than Andrew Pascal in their business sense and entrepreneurial spirit.

Earlier we gave our opinion that if sports betting is legalized across the country, it could be a mercy killing for the Daily Fantasy Sports business. We know we will get push back on that just like we have on our past commentary that the spread of online gaming will cause the decline of social gaming. That is simple math and semantics. We don't think it was a coincidence that social gaming peaked just as online gaming picked up steam in New Jersey. One state is not going to end something as big as social gaming however Caesars Acquisition sold Playtika for $4.4 billion in August 2016. IGT sold Double Down in April 2017 for $825 million. Aristocrat bought social gaming company Plarium in August 2017 for $500 million. Aristocrat then bought Big Fish Games from Churchill Downs for $990 million, just a little bit more than CHDN paid for it. Both Caesars and IGT sold their social gaming business to Asian companies. We don't think it is a coincidence that the non-slot companies buying social gaming sites are from Asia. We believe slot makers have other things, other than trying to generate revenue, as a reason to have social gaming sites. They can test games for casinos while at the same time use social gaming as a preview before they go on a real for-money online gaming site.

Let's look at the former Game Account Network, now called GAN. How much of their business is doing private label social casinos for existing brick and mortars casinos? If online gambling spreads nationwide, why will traditional casinos keep social gaming sites and if they do, how much will they push those customers over to their new real money online casinos?

This will be tested in Pennsylvania in the next year or so. The state of PA passed a huge gambling expansion bill, one that will set an example for the worst gambling expansion bill ever. On the online gaming side, they kept the same tax rates as traditional casinos. The PA casinos pay the highest private casino tax rates in the country. You can look at this one of two ways. Either PA lawmakers are just completely ignorant on online gaming versus traditional gaming and do not understand the need for marketing, the way the payments are structured with providers and suppliers of content or they want to make sure casino companies do not divert customers to their online sites if they had lower tax rates. The latter brings up the question if lawmakers also do not trust the "consultants" they hired to tell them that online gambling would not cannibalize the traditional casinos.

The problem with trying to extrapolate the Atlantic City casino experience with online gambling with PA or other states with geographically dispersed casinos is that you can't compare the two. NJ and Connecticut currently have their casinos in one location, leaving the rest of the state wide open to be cannibalized by closer casinos in other states. In that case online gaming from those casinos make sense because it is an easy way to get back those customers while also giving the opportunity to market to them. Now take a state like PA with casinos in locations all around the state. The PA resident is well served by local casinos in the state. Any online gambling by these people could result in them not visiting their local casino instead of, like in NJ, not visiting the casinos they go to in other states. In addition, with no boundaries in PA, what is to stop a casino in Pittsburgh from having such a good online casino site and such a good marketing strategy that a customer from Presque Isle in Erie gambles online at their site and doesn't make their usual weekly trip to Presque Isle? In other words, the state will make out the same on the gambling since the tax rate is the same but some casinos will have the upper hand in cannibalizing others in the state and the state and casino will lose out on non-gaming revenue in addition to the benefit of having a customer on site, with no family or other distractions that they have at home which could cut their gambling period short.

The problem is that this sets a precedent, just like racinos did with the high tax rates for regional casinos. Racetracks, when faced with either extinction or accepting exorbitant tax rates in return for slots, chose the slots. That resulted in all regional gaming markets having extremely higher tax rates than what Nevada, Atlantic City and Mississippi casinos had been paying. That resulted in satellite casinos being created, low cost properties designed to disrupt feeder markets and capitalize on the reality that most convenience, regional gamblers will go to the

nearest property, not the biggest and most expensive one.

In NJ, online casinos have had a hard time making profits with 15% tax rates. While results have improved nicely since the model changed to a push to play online casinos and not online poker, they are still dramatically lower than expected. NJ will soon be sharing liquidity with Nevada and Delaware online poker sites, a move that is better for DE and NV since even with the death spiral NJ online poker has been in the past year or so, it still is higher revenue than DE and NV combined.

The Future of the Gaming Industry

The gaming industry leaves 2017 and enters 2018 in great shape, both from a business and gaming stock standpoint. There is more momentum in gaming stock prices than same store growth but the lull from new openings allowed the economy to catch up, resulting in most gaming markets either bottoming out or reporting modest growth. The most troubling are the results in new markets as New York has followed Ohio and even the opening of the Massachusetts market in having results from their new private casinos that are well below expectations. The biggest problem is that while this does not bode well for the openings in the next couple of years of Resorts World Catskills, MGM Springfield, Wynn Boston and Twin River Tiverton, it has not resonated with lawmakers or regulators.

The gambling expansion bill that passed in Pennsylvania late in 2017 will most likely go down in history as the worst piece of gambling legislature ever, a title previously held in the state of Illinois. The activity in the last few casino market openings did not seem to penetrate the paralysis of fear that the Mohegan and Mashantucket Pequot Tribes created in Connecticut. Simple common sense will tell you that when your two existing casinos have seen revenue plunge 40% over the past few years, their commentary that they must saturate the market even more with a jointly owned casino near MGM Springfield should have at least caused some lawmakers to stand up and call them to the carpet on why they are doing this now.

We have zero confidence these will be the last of the terrible moves by lawmakers and regulators regarding the casino gaming industry. The regional casino market has turned into, in essence, a war zone where not only do lawmakers believe they must add casinos on borders to keep the revenue in state, much like troops in a ground war, now they even believe they can tap additional gaming revenue sources in state. The 25 mile buffer zone given for the mini-casino portion of the gambling expansion bill in PA proves our point. We believe the safe zone is a 100 mile radius from each casino but in the Northeast, that would result in a halt to gaming expansion. 25 miles for convenience gambling is like a knife in the heart of a casino. 50 miles would result in a modest decline but most could co-exist if expectations were lowered.

The good news in PA is that it looks like more counties and townships will opt-out of the mini casino and possibly the truck stop portion of the legislation. There will be those who take part in the online casino business even though the fees and tax rates leaves little chance for profits if ALL the licenses are spoken for. Given no geographic boundaries, the first couple of online casinos should do very well but each one will dilute that even more, possibly giving the state a double whammy of lower than expected online revenue and higher than expected impact on existing land casinos. That is no different than what has happened in New York with lower than expected casino revenue, higher than expected cannibalization of nearby racinos and tribal casinos with insult to injury when the Seneca Nation ended their payments to the state and local communities, per their compact, and the state giving in and cutting rates and fees for some racinos. The opening of Resorts World Catskills should create even more of an issue as this casino development cost more than the other three combined. Even owner Empire Resorts made a statement that they will be getting business from customers that previously went to Resorts World NY at Aqueduct racino. Genting shareholders, already blindsided by much lower than expected results recently, may not be pleased if this news reaches gaming analysts in Malaysia.

What is done is done but the real issue is what will happen when lawmakers and regulators try to fix things.

Whether it was Revel and the situation in Atlantic City, the prior and current remaking of the Las Vegas Strip or what is now happening in New York, we always wonder why it takes so long for the majority to realize what is actually going on. They always wait too long to avoid the debacle. To constantly read comments from the NY Gaming Commission that it is too early to make a decision on whether the NY casino rollout did not generate what we expected, makes us realize that the reason why there are politicians is because none of them could make it in the private sector. Let's assume the Governor is the CEO and NY State is the company he presides over. If revenue was a hundred million below expectations, a big customer suddenly did not pay $100 million because of a mistake made in the contract, if some vice presidents gave a segment of their customers a big break in price but not everyone in that segment, would there be a major shakeup? You can bet in a real company, the CEO would be firing people left and right so he would not be fired. In NY, Governor Cuomo has not called out the Gaming Commission for failing in their selections and then their handling of this current situation. He has not called Assemblyman Gary Pretlow to his office or criticized him for giving the racinos a break but saying he will not allow the casinos to shirk their responsibilities. Cuomo has not asked his lawyers or compact negotiating team how they missed the details in the Seneca compact under which the Senecas feel they no longer have to make any payments for the rest of that long term.

Illinois has been the poster child for what not to do if you are a lawmaker/regulator in a gaming state. They have crippled their casino industry with tax rates, fees and restrictions while new competition opened in states around them. They responded by allowing VGTs at bars without realizing what the impact would be. The result has been a zero sum game with VGT revenue being offset by the continued downward spiral in casino revenue. Despite that, lawmakers try year over year to legalize more casino licenses which would surely not have the impact they hope for. This same thing just happened in Pennsylvania and we don't believe the state will generate anywhere near what they hoped for while at the same time, they run the risk of damaging a casino business which, while mature, was still one of the better ones in the United States.

Then there is the Maryland casino industry, the one which while not perfect, as three casinos generate over 80% of the revenue, is the one which shows a state that is a true partner with the industry. When MGM National Harbor was being built, a casino that was sure to grow the market while at the same time unavoidably impacting existing ones, the state agreed to help out the existing casinos with a tax break. Maryland Live! Casino, now in the process of becoming Live! Hotel and Casino, also received a big tax break from local and state officials in return for building a bigger convention center and allowing the county to hold events there for free. If more states acted like this, and treated the casino industry as a partner instead of viewing them as a piggy bank that they tap even though many of lawmakers' own moral views make them loath the business, things would be better all around. For many years Illinois has been the only state we felt did not deserve the gaming industry's dollars. You can officially add Pennsylvania to that.

In Rhode Island, the new Twin River in Tiverton has been delayed with the cost of the casino construction doubling. Given the casino is being built on the Massachusetts border, this shortens the time period before they have more competition for Massachusetts residents with MGM Springfield and Wynn Boston Harbor opening in the next year and two years respectively. The Mashpee Wampanoag Tribal casino is still in limbo and given President Trump's view on the tribal casino industry, and especially land in trust casinos, it could stay there for a while. The Mashpee debt to Genting is said to be around $400 million already.

Resorts World Catskills, MGM Springfield, Wynn Boston Harbor, Hard Rock Atlantic City and Twin River Tiverton casino openings are enough to confirm the Northeastern United States will be more saturated than ever in the next two years. Add to that the potential for mini-casinos, online gaming and truck stop VGTs in PA, the East Windsor casino in Connecticut, a possible Mashpee casino in Taunton, MA and anyone believing all this is healthy does not understand the business. There will be bankruptcies and casino closings in the Northeastern United States in the next few years. There will be attempts to try to fix the mistakes and most times they will just make things worse.

Our July 10, 2017 issue of the Gaming Industry Weekly Report was headlined "Potential Quad-State Gaming Disaster" and spelled out a doomsday scenario of what could happen if NY, NJ, CT and/or PA realized what they

had been missing and tried to beat the others to do what should have been done years ago. We have copied the five paragraphs from that issue because we believe it should be required reading.

Instead of a potential Tri-State casino disaster, there is a chance of it being a Quad-State issue with NY, NJ, CT and PA all doing things that could potentially cause a four state gaming disaster. As we mentioned previously, New York and Pennsylvania had been states that we felt were doing things the right way, model gaming states for a while. Unfortunately that all changed in the past few years. NY had a chance to rip the heart out of NJ's chances of a revival but instead they selected the Montreign Resort bid in the Catskills instead of the Penn/Cordish or Genting bid in Orange County, NY. Then NJ had a chance to completely cripple the state of NY's gambling plans and their entire education system but voters listened to lobotomy candidates in Trenton and overwhelmingly voted down a potential casino at the Meadowlands. Now you have Connecticut agreeing to a third casino that will be tied up for years in the courts instead of demanding the two gaming tribes actually learn how to compete or allow a casino where it should be. Of course the situation in PA is developing but not in a good way.

Instead of taking a step back and realizing the mistakes made, lawmakers in these states either do nothing or try to use band aids to try to fix mistakes that obviously need stitches or even an amputation. NY is the easy one as they have moved from doing things the right way to making one mistake after another as they try to fix the leaks in the boat. At one time they had the best racino market in the world, Andrew Cuomo had fixed the tribal gaming mistakes his father had made but then he let it all go to his head or just had ignorant advisors. The situation now is that he has underperforming new casinos, a top gaming tribe who no longer has to pay the state anything under its compact and other tribes giving their communities less. Racinos are showing declines even as the casinos that are competing with them are reporting poor results. They have a potential $1 billion disaster being developed in the Catskills that may only be successful if they take a big part of the business from the top two racinos in the world at nearly half the tax rate. Instead of looking at this entire picture and making some very tough, but real decisions, they are plugging leaks but only after each boat threatens to sink. It is only a matter of time before some or all of the new casinos ask for help and a reduction in taxes. They are months away from everyone in the state finding out the mistakes made will hurt the children as education funding will be the victim.

The simple way to fix this problem is to cut loose the least productive properties by enhancing the revenue potential of the most productive. Giving the racinos table games will ensure the revenue generated by the state remains constant. In return the racinos must make a huge investment which will help the jobs picture and limit it to only the top properties. Let the lowest performing racinos meet their fate which will help the underperforming casinos. Give the Seneca Nation something in return for their agreement to renegotiate the compact. The result will be a reduction in the number of racinos, the sacrificial lamb will have to be the Resorts World Catskills casino which will not be a problem since the people behind that will make back all their money and more with a full casino resort at Aqueduct Racetrack.

The problem is that any changes will cause a ripple effect. By fixing NY the right way, it will destroy NJ's chances of ever being relevant again in the casino space. It will also impact Sands Bethlehem and depending on what PA lawmakers do to fix the situation they are in, it could be devastating to the entire PA casino business. For Connecticut to fix things, they will need a casino to be developed on the Bridgeport side of the state. The problem is that could hurt the racinos at Yonkers Raceway and Aqueduct, Resorts World Catskills and Sands Bethlehem.

As you can see there is a mess in the four main gaming states in the Northeast. If nothing is done things will gradually deteriorate until the powers that be will be forced to make snap decisions that will most certainly be wrong. If one state does the right thing, it will force the other states to act and the end result will be everyone loses. So there could either be a slow death or destruction could occur all at once if certain moves are made down the road. The last one to act will be hurt the most.

For the first time ever, we believe there are more casinos proposed or being developed that could do poorly than those which could succeed. In Connecticut we cannot see how the two existing casinos, an East Windsor one and the MGM Springfield can all prosper. The Bridgeport proposal from MGM makes more sense but thinking it could make up for what the state would lose from Foxwoods and Mohegan Sun no longer paying 25% of their slot revenue is wrong. In PA we have little confidence in the all the mini-casinos being developed or if they do that more than half will be successful while not being offset by a decline in an existing casino. We don't even think

saying Ten/Revel having a chance is worth the effort to type those words. The casino situation in Bermuda is a mess, South Korea may be getting better, in terms of the China visitation situation but supply will easily absorb the resumption in visitation. Vietnam is not getting any better despite the talks of multi-billion casinos in development and locals being allowed to gamble someday.

It probably is a refreshing change that we are not focusing on Macau or Las Vegas as potentially having the most impact on the industry in the coming year. That is because we are not as concerned about those markets as we are about the regional ones. This is a big change that has also taken place with the gaming stocks as regional casino stocks, as well as suppliers, outperformed the large cap casino names even though Macau gaming revenue results showed nearly double the growth than was expected and we got our wish with gaming growth returning to the Las Vegas Strip, sadly overshadowed by the October 1 tragedy.

We feel relatively positive that gaming revenue growth will continue in Macau, albeit there are much tougher comparisons and there is the risk of low hold or even the resumption of visitation by Chinese VIPs to other markets cooling the VIP business in Macau which could impact GGR growth. In Las Vegas, we believe Caesars Entertainment's focus on the gaming side of the business is a nice balance to MGM sometimes seeming to forget they are a casino business first and resort second. Genting's Resort World is being built, slowly, but at least the site is no longer just sitting there empty. Wynn LV is starting their Paradise Park development which seems a bit odd with virtual bumper cars and stuff but are you really going to question a Steve Wynn development in Las Vegas? Wynn is purchasing the Alon LV site, finally ending the disastrous attempts at expansion by James Packer in the United States and hopefully forcing Andrew Pascal to find another industry to be an executive in.

While we believe the first half in Las Vegas and Macau may be different than the second half, with things getting tougher as the year goes on in Macau and July, August and September being a real test for Las Vegas, we believe investors will have an easier time with these markets than what could happen in regional markets in the Northeast. For Macau, Chinese New Year, complete with the opening of MGM Cotai, will be a test and a possible short term peak in Macau gaming stocks if the results are not as good as what could be very high expectations by then, reflected in the stock prices. For Las Vegas, putting the impact of the shooting behind them will be the goal of the first quarter of 2018. While we feel MGM will continue to have issues at Mandalay Bay and Luxor, the rest of the LV Strip should recover to where it was prior to October 1st.

As for the rest of Asia, the Crown arrests and the Chinese standoff with South Korea showed why we feel Macau, Singapore and the Philippines are the best Asian gambling markets. Australia has matured and while the plans continue for further expansion of VIP casinos in various markets, we don't expect much positive movement on this and the realization this year that much of the Asian VIP business is dependent on one country and one country only questions the logic behind new multi-billion dollar gaming palaces not only in Australia but South Korea, Vietnam and potentially Cambodia.

Paradise City became the first of the billion dollar foreigners-only integrated resorts to open in South Korea. Considering the plunge in Chinese visitor arrivals destroying nearly all the resorts in the country, both gaming and non-gaming, it is easy to understand why the opening has been such a debacle. While Paradise City has been a ghost town, the rest of the foreigner-only casinos in South Korea have taken a hit, Landing International has pushed back the opening of their new casino on Jeju but they have to open it soon. Caesars says they are still going forward with their Incheon integrated resort but they moved the head of their Korean gaming operations to Japan. Mohegan Gaming & Entertainment pushed back the groundbreaking and opening date of their billion dollar property in Incheon, while criticizing Paradise City and pointing out the reasons why they feel they were not successful. Never once did they say the obvious that Paradise City, or any other new integrated resort, will not be able to make it without a very strong Chinese presence. This is not like when Bloomberry Resorts opened Solaire in the Philippines and had a tough time at first as the Chinese VIPs were not in abundance like they thought. Removing the management team, bringing in their own and catering to both local customers and Chinese VIPs turned things around. That cannot happen in South Korea, at least not in the near future.

A similar situation in Vietnam is in the process of changing with the government announcing approval of a test

period for locals to gamble. The timing is unclear as is whether they will push this off by allowing casinos that are under development to be the test sites instead of just letting the resort at the Ho Tram Strip entertain locals.

Things to watch in 2018 in Asia include the progress of the IR Implementation Bill in Japan, movement in Cambodia towards being a more diverse, regulated casino resort business, Vietnam clarifying which casinos will be allowed to be the test site for locals gambling, the lessening of tensions between China and South Korea and obviously the North Korea situation as both clearly impact the foreigner only casinos and development, the full opening of Okada Manila and other Philippines casino openings.

In Macau the opening of MGM Cotai will tell us a lot about the depth of the market. Both The 13 Hotel and SJM's Lisboa Palace continue to be delayed and the MGM Cotai opening may determine their progress. The license renewal process should become more clear in 2018 and the VIP smoking ban will be staring the casino business in the face. Both could impact Macau casino stocks as the year progresses as well as the potential for the Studio City IPO which was announced in 2017 but no updates have been given as we closed out the year. In Singapore, we look for clarification on the Marina Bay Sands potential mall sale and what they will do with the money in terms of shareholder returns.

In other parts of the world, gaming is in the news but it seems like one step forward, two steps back. It looked like Bermuda had clear sailing to the start up of casino operations after they selected the group including Century Casinos to open the first property. Then a scandal broke with an obscure gaming systems company that has snowballed into a situation where outgoing gaming commission executive director Richard Schuetz suggested the island seriously consider ditching gaming altogether. He resigned due to his loss of confidence that the government of Bermuda and its legal system can provide the necessary protections to offer well regulated casino gaming on the island.

Baha Mar in Nassau, Bahamas continues the longest soft opening in the history of the casino business but supposedly Chow Tai Fook has closed on the purchase of the property. Notwithstanding the original agreement that the Chinese firm will not officially take over until the property is completed, the Chinese government put restrictions on local companies investing outside of China and one industry on the list to not invest in was the casino industry. Considering how poorly Genting's Resorts World Bimini has performed, the reports that the Atlantis has lost its luster, we see little chance Baha Mar can be successful and the entire Bahamas market could suffer.

Spain continues its on again/off again relationship with integrated casino resorts with no progress. Greece continues to launch its VLTs while still changing the rules mid-rollout. Brazil remains a market of interest to all those companies seeking growth.

Domestically we expect continued attempts to legalize casino gambling in Georgia and Texas with no success in the near term. PA will move to implement the worst gambling expansion bill in history, Florida's gaming opponents have teamed up with the Seminole Tribe on the signature gathering to put a ballot measure in front of voters in November 2018 to strip lawmakers of power to dictate gambling expansion. Voters trounced Shawn Scott in Maine, just like they did in Massachusetts and hopefully we have seen the end of the slipperiest player in gaming. NJ's choice of Governor puts a pro-Northern NJ person in power but he will still have to battle it out with the stubborn South Jersey lawmakers.

All this talk of expansion is good news for suppliers and we believe if the PA gambling expansion bill has any success, the only real beneficiaries will be the slot makers and online gaming providers. The Global Gaming Expo in 2017 had the best selection of new games and products, both from traditional and skill-based providers and we believe casinos will have no choice but to refresh their floors because of how radically different these new games are in terms of cabinets and interactivity.

The merger announcement between Scientific Games and NYX Gaming Group was more important than Wall Street and the media fully understood. It was more than just a traditional slot maker with a decent interactive business buying one of the top online gaming providers. That was very important especially since the PA approval

of online gaming probably means a whole host of other states will study it more than they did the past couple of years since the three states that launched forms of online gaming were all initially disappointed.

In addition, SGMS continues to show they plan to maintain their dominance in the overall supplier space. We had been very positive on the mergers of SGMS with Bally/SHFL and WMS because it created a company that would dominate the floors of all new casinos between systems, slots, progressives, and utility products. This merger would do something similar as SGMS would be prepared for the spread of sports betting with NYX's sports book product as well as the spread of online gambling. It also would give SGMS enough content to keep their engineers busy with new slots for traditional casinos for years.

William Hill's attempt to disrupt this merger, even by threatening to convert their warrants in NYX and lose tens of millions in the process, showed how they understood SGMS' logic and they were pretty scared by it. William Hill has just been a mess since they acquired American Wagering in the US. While it is a coincidence, not the curse it looks like on paper, William Hill has had a lot of issues in the past couple of years and it does look like this follows that same pattern of behavior. SGMS showed that they are not just a supplier but a true deal maker, cruising to victory over William Hill on their way to closing the NYX purchase with majority support.

Our predictions from last year, that PA would be the next state to legalize full online casino gaming and that slot routes could spread beyond markets like Illinois, Nevada and Montana came true in PA, although it took a long and roundabout way to get there. PA also legalized something we have come out very much against, satellite casinos. In fact about the only thing we agree with in the PA gaming expansion bill was gaming at airports. We believe every gaming state should have it at the gates mainly because it is non-competitive with existing casinos since nobody can go to the airport gates just to gamble, and people have a lot of free time there with not much to do.

While the industry should be on alert for other states making these mistakes, mainly Illinois or even Florida lawmakers using PA as an example of why they should make their own gambling mistakes, we think the number of places opting out of the mini-casino and truck stop portions of the bill and what we believe will be a lackluster demand for online gaming licenses, should hold off on any follow through.

All eyes will be on Resorts World Catskills to see whether they will follow the other NY State casinos with a weak debut, followed by the questions of what Governor Cuomo will do to offset a hole they could have in the budget, especially for education. Then MGM Springfield will be opening, with or without the East Windsor casino being under construction.

Mergers & Acquisitions remained in investor focus, mainly on the regional gaming side but there was more debate than actual activity. We can fully understand the mindset with three gaming REITs now looking for deals, regional casino companies looking to either divest assets or buy them and a lot more rumors than fact. There are companies focused on growth, both domestically and internationally including Hard Rock, Caesars, Eldorado Resorts, Golden Entertainment and Melco Resorts. Then there are companies like Las Vegas Sands, MGM, and Wynn that are still growth oriented but want the big play and are more than content with sitting back and waiting while growing their cash flow. The management companies like Pinnacle Entertainment and Penn National are in a situation where they could grow but Wall Street may not like it but it may all depend on momentum. We still believe the REITs will wind up going outside of traditional casinos for their growth. VICI Properties, the spin off from Caesars Entertainment Operating Company, looks likely to be the first to go outside of gaming considering their board is led by hotel veterans. MGM Growth Properties' management also has experience in non-gaming. We believe Gaming and Leisure Properties will continue to look more in gaming than non-gaming but it would not surprise us if they convince Churchill Downs that perhaps their real estate may be worth more than their tracks and some sort of transaction is worked out.

Whether you are a veteran or a novice in gaming stocks, there are things to remember:

♣ **This sector will always be highly volatile and the stocks will rarely trade where they should.**

♠ **For 23 years gaming stocks have either traded at levels which could be considered too high or too low for extended periods of time.**

♦ **In rare cases they remain at levels for a decent period of time, waiting for fundamentals to catch up or for the next catalyst.**

♥ **When you think you have the gaming stocks figured out, 9 times out of 10 you will be wrong. You cannot invest successfully in this sector without updated knowledge of the industry.**

♣ **There will always be times when you are wrong on your investment.**

♠ **The best thing is to be diversified, the worst thing is to be heavily invested in only one gaming stock.**

Equity Market Valuations

The Year of Momentum is the way we had been describing the 2017 stock market and gaming stock performance. It was truly one for the record books as there was one way to make money in gaming stocks, **Invest In Them**. If you tried to analyze them, figure out valuations, you worked too hard as all you had to do was buy them either at the beginning of the year or if you were skeptical, buy the handful of them which did not participate at the beginning of the year.

The Powerful Trump Rally that began on Election Day 2016 with Donald Trump's surprise Presidential Election victory over Hillary Clinton not only continued in 2017, it picked up steam as the year progressed. By the end of 2017, it was moving from Momentum into what we call The Greater Fool Theory of Investing. That is when you buy a stock thinking there will be someone foolish enough to buy it higher.

Now we would not say that gaming stocks were completely in that mindset because there were plenty of reasons for their rally. The Macau stocks ended 2016 around the same place they were in March of 2016, when GGR was still negative. It made little sense except that a South China Morning Post story at the end of 2016 saying the industry would be crushed by Union Pay ATM changes had the bears out in force and investors scared away. That wound up being the last buying opportunity of the year in the group as they bottomed in February and took off, in line with their 20% average GGR gains the rest of the year. Even Typhoon Hato knocking out the Peninsula casinos only provided a modest decline before resuming its rally. Considering two years ago the expectations were for continue declines in 2016 and modest single digit GGR gains in 2017, you could say this rally was justified especially since the group was coming to the end of their cap ex and are expected to be raining dividends again.

Regional casino stocks were the biggest enigma. They had every reason to come out of the gate strong early in the year as easier comps, a surging stock market and consumer confidence along with a pause in new competition opening had everyone believing this would be the best year for regional casinos in a long time. By mid-summer, most were asking where the customers were as same store growth was elusive. That was all forgotten by the 4th quarter of 2017 as good news was good news and bad news would be replaced by something perceived as good news. Regional casino stocks caught fire with just about every name, big or small, trading up to new highs. Pinnacle Entertainment could be the poster child for Regional Casino Stock 2017.

Investors appeared to have had enough as PNK went three quarters without repurchasing stock. Investors appeared to be taking profits in PNK and deploying them into Penn National Gaming, which had not participated much early

in the year but had finally caught fire. Then Hurricane Harvey hit Houston, the feeder market for Lake Charles, Louisiana. While Louisiana is PNK's most important market and PNK had already been rocked by the news they would have a smoking ban in Baton Rouge, L'Auberge at Lake Charles is their top casino. With Houston knocked out of commission just before the final big weekend of the summer, the expectations were that the 3rd quarter would end on a sour note for PNK's business and it would impact the 4th quarter as well. PNK was hit twice in Lake Charles as their primary feeder market was under water and their competition next door, Golden Nugget was taking so much market share that October GGR had GN nearly at the same level as PNK, something that was never expected when PNK sold that nearly finished casino to GN at cost in order to get anti-trust approval to buy Ameristar. PNK not only recovered from the Hurricane Harvey profit taking, it jumped more than 50% from September 12th on a rumor that they were in talks to merge with Penn National Gaming. *

*** Right at Press Time it was announced that Penn National was acquiring Pinnacle Entertainment in a cash and stock deal valuing PNK at around $32 a share. Boyd Gaming will purchase PNK's two Ameristar properties in Missouri and the Belterra branded facilities in Ohio and Indiana. BYD will sign a new lease with Gaming & Leisure Properties.**

Then there were the suppliers, the group that was deserted by Wall Street analysts a couple of years ago and described by investors as just being dead and buried with no chance of growth. Instead for the second year in a row they were the top performing sub sector in the gaming stocks. In 2016 IGT and Scientific Games were the two top performing gaming stocks. In 2017 it was SGMS and Everi Holdings near the top spot. On the fundamental side, the combination of increased cash flow, a G2E that showed casinos have to refresh their floors because the new product was just so radically different than the former, a replacement cycle that was going to finally increase due to a much better outlook for regional casinos and the Caesars Entertainment Operating Company emergence from bankruptcy gave every reason for investor interest. The justification of SGMS going from below $8 to above $50 in 18 months and EVRI going from $1 to nearly $9 is debatable. We felt SGMS was trading way too low in early 2016 as we believed investors were too focused on cash flow and debt and missing the big picture on just how dominant of a supplier of new casinos they had become. That being said, if you had told us in early 2016 that SGMS would be over $50 in 2017 we would have said you probably also believe Donald Trump will be President of the United States.

Even Amaya Inc., with a name change to The Stars Group, put all their troubles behind them and surged, leading the online gaming group. When we said the only way not to make money in gaming stocks in 2017 was to not invest in them, we were not kidding. The suppliers and regional casino stocks were the phenoms, followed by the Macau and LV names, then the REITs but they all shared one thing in common, stock market gains.

Typically when you see a rally/mania like this, you find companies that take advantage of it to pay down debt with equity offerings. The casinos are in much better shape financially than we have ever seen so we are not surprised that they refrained from tapping the market. MGM Growth Properties did what REITs should do, selling stock in order to help pay for their purchase of MGM National Harbor. Century Casinos was able to complete an offering to fund their Edmonton casino development. Melco Resorts & Entertainment filed a mystery SEC offering for their majority owned Studio City development and AGS filed for an IPO to go public, the first supplier to do that in a long time.

It would not surprise us if 2018 brings more companies back to the market. History always tends to repeat itself and gaming's sister industry, the hotel sector, has had numerous companies that were taken private years ago by private equity successfully have IPOs with their sponsors selling out. Station Casinos already did that with Red Rock Resorts and there are others out there. One company we would love to see an IPO from is Golden Nugget, either separate or together with the Landry's restaurants.

2018 promises to be an interesting year but whether the exuberance of 2017 continues throughout 2018 will depend on whether the word "correction" has been abolished from the Stock Market Traders Almanac.

Portfolio Performance

The end result for the 2017 Model Portfolio was a gain of 30%, the second year in a row of gains above our average of around 20% and the 21st out of 23 years of being in positive territory. Despite our concerns last year when we made up the Portfolio, it was a year where as long as you were invested in gaming stocks, you made money. Every stock in the 2017 Portfolio ended in positive territory with Melco Resorts & Entertainment Ltd. getting the top performer spot, with a gain of 60%. They gained the top spot only because we removed Penn National Gaming from the portfolio in late July due to our views on seasonality with a 50%+ gain. If we had just left it in we could have had a double.

That sums up the year we had. You could throw all the old rules out the window and just buy gaming stocks and hold them for the duration. In fact, the Stocks To Watch section we had last year contained six gaming stocks that we liked but given the strong performance in 2016, we were hoping they would come down a little so we could add them to the Portfolio. They never dipped to the level we wanted and in reality those six names - Scientific Games, Everi Holdings, Eldorado Resorts, Pinnacle Entertainment, Boyd Gaming and Monarch Casinos & Resorts outperformed the rest of the Portfolio.

It was two years ago when analysts threw in the towel on the slot manufacturers despite the mergers and potential economies of scale. They just felt the replacement cycle was not coming back (something we never believed was a true replacement cycle anyway) and that the trend of removing slots for table games or non-gaming amenities would continue. For the second year in a row, the shares of the three slot makers in the US - SGMS, EVRI and IGT - had the best gaming stock performance. Ironically despite the Macau casinos registering double the gross gaming revenue growth than expected and regional casinos in the US showing anemic same store revenue growth, regional casino stocks outperformed the Macau names.

The 2017 Model Portfolio contained a sampling of each group with a heavier weighting towards Macau because of the plunge in the Macau stocks in December of 2016 due to a "Fake News" type story in the South China Morning Post. That allowed us to include Las Vegas Sands, Melco Resorts & Entertainment, and MGM Resorts International as shares dropped down to the levels at the end of 2016 they were prior to growth resuming in Macau. We opted to play the regional gaming names through Penn National, which had been lagging, and Gaming and Leisure Properties, while the Las Vegas locals market was represented through Red Rock Resorts.

It is tough to complain about 20% total returns from GLPI, or 37% gains for RRR but even with a hurricane crushing Pinnacle Entertainment's feeder market for their top casino and Boyd Gaming being the worst performing regional casino company, this was the year where momentum and headlines/rumors in the United States topped fundamentals for casino stocks.

The reality is when you think of what the gaming industry went through this year with typhoons in Macau, the Mandalay Bay Massacre in Las Vegas and the Hurricanes ripping through Texas, Florida and the Caribbean, you may wonder how in the world this group did so well?

That alone sums up this year. If you owned gaming stocks, you made money. The ones that ended 2016 with the highest gains wound up doubling and tripling those gains in 2017, fueled by a stock market that was running on adrenaline and momentum. Companies were rewarded for mediocrity (Churchill Downs selling Big Fish for what they paid for) but were penalized for being frugal or conservative. Success, such as in Macau, was yesterday's news and investors would rather hear about rumors or share buybacks and respond positively. In 2014 Churchill Downs was $90 a share. They announced the Big Fish deal, selling it for the same price they paid, and said they would buy back $500 million worth of stock even though it was trading at $250. The stock rose to new highs. That is all we need to give you 2017 gaming stock investing in a nutshell.

The gaming sector has been the greatest group to invest in for 25 years and it is no different today than it was 25 years ago. Knowledge is the most important thing because fundamentals and forecasting does matter. Since we began the portfolio 23 years ago this is only the second year where throwing darts at gaming stocks would have beat out fundamental analysis.

2018 Portfolio

The questions we asked ourselves from the beginning of November until publishing time included : How much longer can this last? How do you prepare a portfolio when every instinct suggests a group that, while not Bitcoin overvalued, is at levels that are difficult to justify in every other market but the Y2K, dotcom and Trump Rally marvels?

The brief swoon in stocks in early December helped out a bit, at least helping us to get more names into the 2018 Portfolio. This Portfolio is a first for us combining what we feel are defensive names including REITs and high yielding casino stocks with some speculative names, including one thinly traded issue that not many know about and an OTC listed REIT that has not even disclosed its yield.

Getting into the fundamental outlook, we suspect the attention will turn back to Macau in 2018. It was somewhat strange to see investors suddenly divert away from the group in the 4th quarter, especially as GGR continued to outperform even the higher expectations. We see little chance for a 20% GGR growth repeat performance in 2018 but half of that will be quite pleasant. With Chinese VIP beginning to return to Australia and South Korean casinos, the opening of the Macau Zhuhai Bridge may be very important as instead of just talking about mass market being the future, it may finally have to happen. During the big down VIP years, mass market grew but not even close to enough to offset the decline in VIP or enough to handle the new supply that was coming on. By now it should be clear that the difference between the lackluster response and performance of Galaxy's expansion and MLCO's Studio City and the Wynn Palace/Parisian openings was the state of the VIP market. With MGM Cotai opening by Chinese New Year and starting with an all mass focus, we are not expecting the same response. That being said, the lack of enthusiasm to Macau in 4Q17 could be blessing if we do get a soft landing in 2017. Then again, the return of attention to Macau, if it is on the negative side, could be brutal for some.

Las Vegas was finally on track to give us what we wanted, sustained GGR growth but then the Mandalay Bay Massacre took place and that all went out the window. Instead of September kicking off what we expected to be a multi-month, possibly even a year of GGR strength, everyone will now have to focus on the first quarter of 2018 to see if that has a chance to happen. We believe those who focus solely on RevPAR growth in Las Vegas will be disappointed as Las Vegas tends to lag the US lodging sector in trends and we expect 2018 to be the second year of flat to 3% RevPAR growth across the US. For a market like the LV Strip which is used to double and triple that, it could be a dose of reality as to why we have warned this day was coming and how cyclical MGM has turned the Strip. The good news is, this is Las Vegas, the most resilient gaming market in the world and the one that ALWAYS finds a way to reinvent itself. Those who have bet against it in the years have wound up leaving the space, going into sectors that were a lot easier to understand. It could be a somewhat rocky first half of the year, although comps are not difficult but there are things happening that have been swept under the rug due to the Massacre concerns. Will Witkoff move forward with their plans for Fontainebleau and will it be a casino resort or a resort with a casino? Will Resorts World LV continue its progress and what will WYNN do with the Alon site across the street? Will Golden Entertainment make drastic changes at Stratosphere? Realistically we could end 2018 with little progress on any of this, a potential bankrupt SLS LV if Meruelo walks, and a lackluster year if it takes longer to rebound. Then again this is Las Vegas and standing still rarely ever happens there.

Regional casinos must increase M&A at current levels. While we know there are arguments that PENN and PNK are undervalued versus other casinos, the other side of that argument is that the other casino companies have real estate. Anyone who has followed lodging stocks knows that asset-light management and franchise companies are valued differently than Lodging REITs and the length and timing of each cycle determines it. The valuations of all the regional names are reflecting merger mania, whether on individual properties, combinations of companies or the REITs cherry picking individual casinos or companies. Seeing two of the three remaining microcap casino stocks - Full House Resorts and Nevada Gold & Casinos - surge in the 4th quarter is either a warning sign of this rally or a signal that regional expansion makes sense again. We are leaning towards the former as we believe the regional casinos have benefited from smarter promotions during a lull in the cycle of new casino openings, showing how there was a real misunderstanding of just how devastating casino promotions can be to margins. Long time readers probably remember our description of suicide promotions in Atlantic City and we all know how that ended. M&A

should be on the minds of all regional casino and casino REIT investors. While there is still no confirmation that any of the REITs will go outside of gaming, we are putting our chips on VICI Properties given a board that is made up of many successful lodging veterans.

Can the suppliers make it three in a row in 2018? For two years two supplier stocks have been the biggest gainers in the gaming group. This is despite or because of the lack of interest from the sell side community and a refusal to buy the bottom by many buy siders. We believe it makes little sense to fight the tape initially but we would be really concerned in the event the overall market finally has a serious correction.

The threat/expectation of a serious correction or worse in 2018 is predominantly why our 2018 Model Portfolio is both defensive and speculative. In 23 years we have never had two years the same, in terms of how active we were in the Portfolio. 2017 was the least active we have ever been, removing one name and adding one. Our expectations of a much more active year suggests our views that 2018 will be a lot more volatile.

2018 Model Portfolio

Caesars Entertainment - ($12.35) - Caesars Entertainment was the only addition to the 2017 Model Portfolio as they endured nearly an entire additional year of the Caesars Entertainment Operating Company bankruptcy before that nightmare finally ended. We believe CZR is attractive for two main reasons. First and foremost, it has been off the radar of most sell side analysts and institutional investors and it is not completely understood as to who has what following the CEOC reorganization. The second is that this is not the CZR of many years ago, the clumsy, mismanaged company that based all their success on how much they promoted to their Total Rewards members. This is a more aggressive, better managed company with a leaner structure, a potential sugar daddy in the VICI REIT, all combining with a hunger to grow quickly. That was shown with their first two moves, the announcement they were going to purchase Centaur Holdings, getting them the two racinos in Indiana, followed by the sale and leaseback of Harrah's LV with VICI. While we think CZR is paying up, initially, for Centaur given they can't get table games for a few more years, the potential of Total Rewards and the synergies, coupled with the Harrah's LV transaction to pay for it, shows what CZR's strategy could be. We believe they are tipping their hand but not surprisingly not many are noticing yet. Then again when CZR formed Caesars Acquisition Company and sold many of the top properties from CEOC to the entity, we felt they were very transparent yet it took a year before the accusations started, leading to the CEOC bankruptcy. We believe CZR is one of the few gaming stocks, big or small, that have not had the opportunity to partake in what has been a magnificent rally. That gives both opportunity for a sizeable gain and a bit of protection in the event of a major correction.

Las Vegas Sands - ($68.22) - Last year we described LVS as a growth company that is a cash flow story also, one that should not be yielding 5.3% at $54.67. A year later it is at $68 and once again yielding near 5%. Following the Parisian opening LVS has a pause in its growth, has even stronger cash flow and the potential to generate billions in asset sales, most of which would go back to their shareholders. If Japan's Diet gets its act together and passes the IR Implementation Bill, LVS becomes a potential growth story again. With the amount of cash they generate, you get 5% insurance just on the dividend and then the potential for share buybacks, dividend hikes or even one time dividends if one of the asset sales (PA, Singapore mall) occur.

MGM Resorts International - ($32.51) - Given our constant criticism of MGM and their actions, we may confuse some when we have them in the Portfolio. The reason is we believe our criticisms are the reason why the stock remains undervalued, in fact MGM has underperformed their peers since the old CityCenter/Dubai investment days. While MGM had a good 2017 considering all that happened to them, it could have been a lot better. Not withstanding the Mandalay Bay Massacre, MGM disappointed investors more than once in terms of results, confused the Street with heavy insider selling and then a buyback of Tracinda's shares near that price, calling it an attractive investment for the company, delayed MGM Cotai again and has had a hard time winning a battle in

Connecticut. Even with that the shares rose nearly 19% in 2017 but on a two year basis they really lag the total returns from Wynn Resorts and Las Vegas Sands. We suspect the opening of MGM Cotai and strength of MGM China shares will help offset another quarter of weakness in Las Vegas and a potentially longer term problem with a Mandalay Bay rebound. Tracinda is one or two more sales away from finally being out of all their shares of MGM, something we believe has been an overhang on the stock.

International Game Technology - ($26.63) - A dip in IGT's share price in early December clinched an entry as after spending most of the year not participating in the rally, IGT came on strong in the 4th quarter, going from being 5 points down from where we entered them December 2016 to giving us a 21% gain for the year. IGT has the wind at its back at the moment with a solid showing at the Global Gaming Expo, a very strong 3Q17 earnings report and some key gaming floor share wins recently. Notwithstanding the recent confirmation of the Scratch & Win extension in Italy that will require upfront payments, 2018 should be a solid cash flow year for IGT. We are entering another period of new casino openings including Resorts World Catskills, MGM Springfield , Wynn Boston Harbor, Twin River Tiverton and Live! Philadelphia in the next couple of years along with plenty of possibilities on the drawing board.

MGM Growth Properties - ($28.52) - MGP gave us a solid 21%+ total return in the 2017 Model Portfolio with little drama, an amazing feat considering how much their business is tied to MGM. At current levels the REIT is yielding 5.5% and with the addition of MGM National Harbor, we would suspect another dividend hike will be in the cards in 2018. With the exception of the potential of an acquisition in tandem with MGM, the only other property that will be joining the fold will be MGM Springfield, most likely in 2019. We believe 2018 will be the year that MGP acts on the acquisition of a non-MGM property. The questions are will it/they be in gaming, be an MGM type resort style property or will they go outside their comfort zone? While we consider MGP to be one of our defensive names, you can't argue with the Macau stock type gains it gave us in 2017.

Gaming & Leisure Properties - ($35.32) - GLPI underperformed its two biggest tenants, PENN and PNK, and MGP, the other gaming REIT, in 2017 but ended the year yielding over 7%. While that makes it defensive, a potential PENN/PNK merger will thrust GLPI in the spotlight. First the two companies will have to satisfy GLPI or the deal can't go forward. In addition, some of the casinos that GLPI owns and PENN and PNK manage may need to be sold, causing GLPI to renegotiate lease agreements. While we can appreciate GLPI's views that they should not go out of gaming for acquisitions because it is outside their comfort zone, there is more opportunity outside of gaming and believe it is inevitable for them.

VICI Properties - ($19.70) - It has been a long time since we have had a non-listed, OTC traded name in the Portfolio but this is a bit of a special situation. VICI is the spinoff REIT from the Caesars Entertainment Operating Company bankruptcy. We believe they will be listed sometime in 2018, they will give their first dividends and we also believe they will be the first Gaming REIT to make acquisitions outside of the casino industry, not counting the golf courses they own. Their management team and board of directors is a very diverse group of gaming, lodging and investment banking/finance experts and that tells us this could be the first cross over REIT in the United States.

Inspired Entertainment - ($8.70) - Even though INSE is on a listed exchange and VICI is not, we believe the risk reward is higher on INSE than VICI. The reason, INSE is a thinly traded issue that was created by their chairman, Lorne Weil, a seasoned executive that we consider a boom and bust guy. In other words, INSE is either going to be a boom or a bust for investors, making it the most speculative name in the oddest Portfolio we have ever created. Virtual Sports has made it to the NJ online gaming market, giving everyone a taste of sports betting. If you know the Historical Racing machines that are popping up all over Kentucky, this is similar but with sports as you bet on virtual sports, not current ones. How far this spreads in the US is questionable but INSE is making inroads on an international basis. This is the kind of stock we would not chase as it moves in a very wide range with minimal volume at times. We would expect their fiscal 2018 to be a lot cleaner than what was a very messy 2017 and that will give us a better idea of whether there is sustainability to their business model.

Stocks To Watch

Only **Red Rock Resorts** did not make the final cut of the names we had proposed for the portfolio. It did not miss by much but the momentum this stock had in the final few months was rather amazing since it was the stock investors loved to hate for the first half of the year. That being said, we would say that every gaming stock out there is on this list because if there is a major correction in the overall market, we have every intention of adding to the Portfolio.

Good Luck and Profitable Investing!

ABOUT THE PUBLISHER

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