

## MARKET INTELLIGENCE | Coronavirus and the Gaming Industry

The Innovation Group (TIG) has been following the novel coronavirus closely since it entered the global stage prominently in mid-January. The travel and leisure industries are always affected in the earliest stages of global socio-economic crises; travel is among the first areas constrained by individuals, businesses, and governments. The need and desire to gauge the potential impacts of the virus on these sectors is ubiquitous, yet the information available to study its effects remains very limited. This is complicated further by the near daily evolution of information and the situation. To this end, our latest report provides historical context around the impacts of other major events on the gaming and hospitality space, and consideration of how the coronavirus could manifest in today's gaming environment. While we don't want to understate the potential impacts of this outbreak, we are nonetheless encouraged by several bits of favorable data uncovered in our review. Though mitigating the impact of reduced visitation may be difficult, we also share our thoughts on questions operators should be asking today in order to best prepare.

The Innovation Group will continue to monitor developments over the weeks and months ahead, in consultation with operators and analysts.

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### INTRODUCTION

By way of context, there are a few key characteristics that frame the way in which casinos – differentiated at this stage from online and ambient forms of gaming – have generally responded to economic downturns. They can be broken down in terms of geography and form of gaming, and assessed taking the source of socio-economic stress into account.

- **Direct Market Effect:** We see a direct effect when the market where negative conditions are most prevalent suffers a reduction in local and tourist visitation. This is, of course, the case in Macau today, where the high frequency local customer from Mainland China is prohibited from visiting. The effects of wars and natural disasters can create similar impacts.
- **Secondary Market Effect:** Secondary market effects are experienced when destination visitors are reluctant to visit the affected market either due to fear, or to travel constraints imposed by governments. This could result from concerns of contracting an illness or exposure to violence in the case of terrorism or war. Examples include reduced visitation to Macau from other areas of Asia today, or reduced visitation to the Philippines in the early days of the Duterte regime as the war on drugs unnerved the international community.
- **Exacerbated Macroeconomic Effect:** A recession or natural downturn in any economy can reduce demand for casino gaming, in local as well as preferred destination markets; however, sudden crises can have a more chilling effect. The Great Recession began with an identifiable financial crisis, followed by a rapid reduction in volume of play. Constraints on capital followed shortly thereafter. We would also offer that while online gaming has a somewhat limited history, it is in this more general macroeconomic sense that a reduction in spend might be experienced.
- **Reciprocal Market Uplift:** There is often also a silver lining in gaming, where a reduction in air travel can lead to increased regional market play. In minor or short-term economic downturns, where long-haul travel is curtailed but overall economic stability is maintained, these casinos can experience a boost as players exchange destination trips for local casino visits. In the aftermath of 9/11, most regional markets experienced a lift in gross gaming revenue. Again, online gaming could be a disproportionate antidote in a reciprocal uplift given the ability for players to play without travel and in seclusion.

Below, The Innovation Group provides an update on what we know about the impacts of coronavirus in Asian casino markets to date. We also review historical results in casino markets following socioeconomic crises and downturns, and set the stage to track and forecast longer-term effects of the virus in future analyses. Finally, we offer several considerations for the industry's preparation in this rapidly evolving environment.

## THE CORONAVIRUS AND GAMING IN ASIA

On January 22, Macau confirmed its first case of the coronavirus. The next day, Macau's government cancelled all public celebrations of the Chinese New Year and later issued a mandatory 15-day closure of all 41 casinos in the territory to further prevent its spread. On February 19, approximately two thirds of Macau casinos were permitted to reopen with new, stricter safety measures in place. These precautions included body temperature checks for all visitors and workers, a requirement that all guests and staff wear safety masks, and new casino floor operations restrictions – including a certain minimum space between tables in use, safe density of seating for players at gaming tables, and a cap on the number of operating tables in a given gaming area – that effectively resulted in reopened casinos operating at less than half their capacity. According to Macau Gaming Inspection and Coordination Bureau (DICJ), as of March 9, 3,100 gaming tables at 38 of its 41 casinos resumed operations, representing approximately 46% of Macau's total gaming table capacity.

The following table illustrates Macau's monthly gross gaming revenue (GGR), according to the Macau Gaming Inspection and Coordination Bureau (DICJ). Looking at a two-month period from January through February year-over-year (which we do to account for changes in the Chinese New Year calendar), GGR in 2020 stood at only US\$3.1 billion versus US\$6.3 billion in 2019. This represents a whopping 49.9% contraction that can arguably be attributed entirely to the impact of the coronavirus. The latest data shows that Macau's gaming operators recorded GGR of US\$175 million through the first eight days in March, approximately \$22 million per day, down 79% year-on-year.

Monthly GGR in 2020 and 2019 (U.S. Million)			
	Monthly GGR		
	2020	2019	YoY Change
<b>January</b>	\$2,760.8	\$3,112.2	-11.3%
<b>February</b>	\$387.3	\$3,165.6	-87.8%
<b>Jan/Feb Combined</b>	\$3,148.1	\$6,277.8	-49.9%

Source: Macau Gaming Inspection and Coordination Bureau (DICJ), 1 MOP = 0.1248 USD

More broadly, from prominent large-scale integrated resorts in top destinations to regional gaming properties in emerging markets, casinos across the Asia Pacific already have felt some impact from coronavirus. Relatively high incidence in South Korea has driven the temporary closure of Kangwon Land Casino, the only Korean casino where locals are permitted to gamble. Kangwon initially shut down operations for three days from February 23 to February 26, but later extended that closure to February 29 and then again to March 15. It is estimated that this shutdown will forfeit approximately US\$3.2 million in gaming revenue and US\$0.3 million in non-gaming revenue per day.

In contrast, the two largest foreigner-only casino operators in South Korea, Grand Korea Leisure (GKL) and Paradise Co Ltd, have continued operations during the outbreak. Moreover, despite closure of some non-gaming facilities in response to the virus, both companies reported robust year-over-year

GGR growth for February 2020 and for the combined period of January/February 2020, as shown in the following table.

Foreigners-Only Casino GGR YoY Comparison				
	Feb 2020 vs. Feb 2019			Accumulated
	Total GGR	Tables	Slots	Total GGR
<b>GKL</b>	38.1%	50.4%	-32.5%	48.1%
<b>Paradise</b>	16.2%	18.7%	-12.9%	21.8%

Source: GGRAsia

Besides the properties' enhanced offerings, this growth is also believed to have been driven by the displacement of both VIP and premium mass market players from Macau and surrounding markets, similar to what some Las Vegas-based gaming companies have found in their VIP segment from Asia. Macau also has seen some improvement in visitor numbers – from around 5,000 visitors per day in late February to 8,000 at the start of March and 11,000 over the weekend – and a stronger showing in the VIP segment. Additionally, Air Macau is preparing to increase the number of flights to some mainland cities starting March 16, including the gateway tier-1 cities in China (such as Beijing and Shanghai), and the Macau Government is considering easing of entry restrictions from mainland China.

## PAST IMPACT AND RECOVERY PROFILES

The most obvious parallel to the current coronavirus outbreak is the SARS epidemic of 2003, which peaked in April and May, but was largely over by June of that year. Two public reports at the time forecasted major impacts to the gaming industry and economy of Las Vegas, which was thought to be vulnerable because of its reliance on air travel and Asian play. In the end, only a few conventions were reported to have been affected, and there were no apparent impacts to gaming revenue – in fact, both slot revenue and table drop increased during the period.

However, this history should be put into context: the scope of SARS was significantly smaller, by a factor of more than ten, compared to COVID-19 to date. The number of SARS cases in the United States reached just 27, while COVID-19 continues to spread across the country, with California and Washington currently experiencing the heaviest impacts.

SARS vs. Coronavirus Worldwide Cases & Deaths				
	SARS 2003		COVID 19*	
	Cases	Deaths	Cases	Deaths
China & Taiwan	7,429	721	80,932	3,172
United States	27	0	1,323	38
Rest of the World	667	53	45,608	1,508
<b>Total</b>	<b>8,123</b>	<b>774</b>	<b>127,863</b>	<b>4,718</b>
Mortality Rate	9.5%		3.7%	

Sources: WHO, Johns Hopkins; \*as of March 12

Other events that affect people's sense of personal security and view of air travel have also shown up in gaming trends. Following the terrorist attacks of 9/11 there was a sharp decline in air travel and visitation to Las Vegas, which saw gaming decline by 12% in Q4 2001. Regional markets, meanwhile, benefitted from gamers staying closer to home and all state markets except Delaware and Louisiana experienced an uptick in the same quarter.

The greater sensitivity of Las Vegas to events in China can be seen in the following table. The Strip suffered three straight years of decline from 2013 to 2015 while GGR increased in the remainder of Nevada. This decline coincided with a far-reaching campaign against corruption by the Communist Party of China that began in December 2012 and lasted into 2015.

Nevada Trends (MMs)							
	2011	2012	2013	2014	2015	CAGR thru 2014	2014- 2015 Change
Las Vegas Strip	\$6,069	\$6,090	\$6,054	\$5,831	\$5,771	-1.3%	-1.0%
Remainder of State	\$4,624	\$4,766	\$5,091	\$5,185	\$5,343	3.9%	3.0%
Nevada Total	\$10,693	\$10,856	\$11,145	\$11,016	\$11,114	1.0%	0.9%

Source: Nevada Gaming Control Board; The Innovation Group.

While U.S. regional gaming markets largely have been spared impact by epidemics and terror attacks, there are notable precedents to consider if the underlying economy suffers a sustained hit from the coronavirus. During the Great Recession, there was a clear correlation between employment and gaming revenue, with every 1% decline in employment matched by a 0.8%-0.9% decline in revenue. Recovery followed a similar trajectory, which took approximately five years given the severity of the recession (~10 million jobs lost). The credit market crunch also dampened capital investment that could have accelerated recovery.

The corresponding gaming downturn of 2008-2009 had two phases. During the early phase (roughly the first nine months of 2008), marked by rising gas prices and loss of personal wealth caused by collapses in the housing and stock markets, some gaming visitors cut back on the number of casino trips they took and some spent less on the gaming floor or on dining and hotel stays. As a result, gaming revenues started to flatten out or, in some markets, decline slightly during this period. It was not until the second, more severe phase following the collapse of the financial industry that revenues substantially declined on a consistent, national basis.

Initially, we distinguished the period encompassing the Great Recession as distinctively different than today in terms of the credit markets. One major issue faced by the gaming industry, and leisure in general, throughout the Great Recession was the inaccessibility of capital. This constrained greenfield and expansion planning, and upkeep at properties, which set the industry back a decade. Despite reduced interest rates today, there may ultimately be some similar constraints with ongoing stress within the financial markets.

Finally, we would point out that the characteristics of the coronavirus cycle are expected to be shorter term than the Great Recession, and potentially with a sequential recovery. Areas of Asia could cycle through impacts and move to recovery ahead of other parts of the world where it appears the coronavirus could peak months later. Already, we have seen a downgrade in the number of new cases being reported in China, from an average of thousands per day a month ago and 400 per day last week to only 120 new cases on the day of this writing. This should help offset impacts for companies with heavy exposure in Asia.

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## SHORT-TERM CONCLUSIONS

### Operational Considerations

The road ahead may present challenges, but there are steps that operators can take today to ensure they are equipped to handle the situation moving forward. Here are several questions TIG is considering as we discuss the coronavirus and continue to evaluate potential industry impacts:

*Is messaging to guests consistent, realistic, and positive?*

Properties will want to convey that they are still open for business and taking all reasonable precautions to make sure team members and guests are safe and healthy. Have properties adequately trained guest-facing team members to handle these interactions and provide a down-the-middle response?

*Are properties keeping employees and guests safe?*

Is there a policy for sick employees, and is it adequately responsive to the current situation? What is the policy regarding sick guests? Is the process for cleaning dining rooms, the slot floor, and hotel rooms adequate?

*Are employee and guest realities reflected in perceptions?*

Do our guests and employees perceive the facility as safe? And how is the property messaging proactive efforts to each? Is the property getting credit for the extra work it is doing?

*Are properties flexing variable labor, and are there exceptions to forging margin efficiency in the case of a pandemic?*

Many operators today are using volume-based indicators to flexibly schedule. If volumes decline, are properties well-positioned to reduce variable labor commensurate with the volumes? What is the minimum staffing needed for each position? And should health needs and family considerations color the way businesses look at efficiencies?

*Is direct marketing sufficiently dynamic?*

Understanding where softness occurs and responding aggressively but intelligently will yield best results. Advance segmentation and predictive modeling may allow surgical targeting that ADT, recency, and frequency alone cannot.

*In online jurisdictions, can players be quickly migrated?*

Should sign-up bonuses be altered? Can offers become valid on both platforms? Are properties pushing online via email and mobile?

*How is anti-Asian sentiment addressed?*

Already we see businesses in Chinatowns across North America suffering, and we see reports of fear-based anti-Asian sentiment in social settings. Have staff been trained to avoid these biases, and moreover have leaders equipped them to handle situations that may arise on the casino floor or across the property?

### Key Takeaways

- We are learning more and gathering new information every day. The trajectory and relevance of historical trends is still unclear.

- Though the impact has been severe in Macau so far, we may see a partial offset in other parts of Asia. This behavior mirrors the uptick in regional market play we saw after 9/11.
- The longer-term impact of the coronavirus on financial markets should be monitored. During the Great Recession, we saw a tightening of the purse strings from both guests and lenders. But while the industry saw some softness when gas prices increased and the housing market fell, the substantial declines we now associate with this period were not realized until the financial industry collapsed.
- As we absorb the full impacts of the coronavirus, there are ways the industry can be proactive to ready itself for the full complement of scenarios.

The Innovation Group will continue to monitor developments over the weeks and months ahead, and our team – whose areas of expertise range from development and economic impacts to marketing and communications – is committed to ongoing analysis in support of the industry’s necessary response. the industry’s necessary response.