

## SA POKIES; RIVERS OF GOLD NO MORE?

### HOSPITALITY



Gaming revenue in South Australia's pubs and clubs has been in steady decline in recent years. To add salt into the wound, a potential outcome in the forthcoming State Election in March could see harsh gaming law restrictions introduced that could further impact the cashflows (and values) of gaming venues. Ferrier Hodgson's local hospitality team looks at the recent gaming trends and what impact tough legislative amendments to the gaming sector would bring.

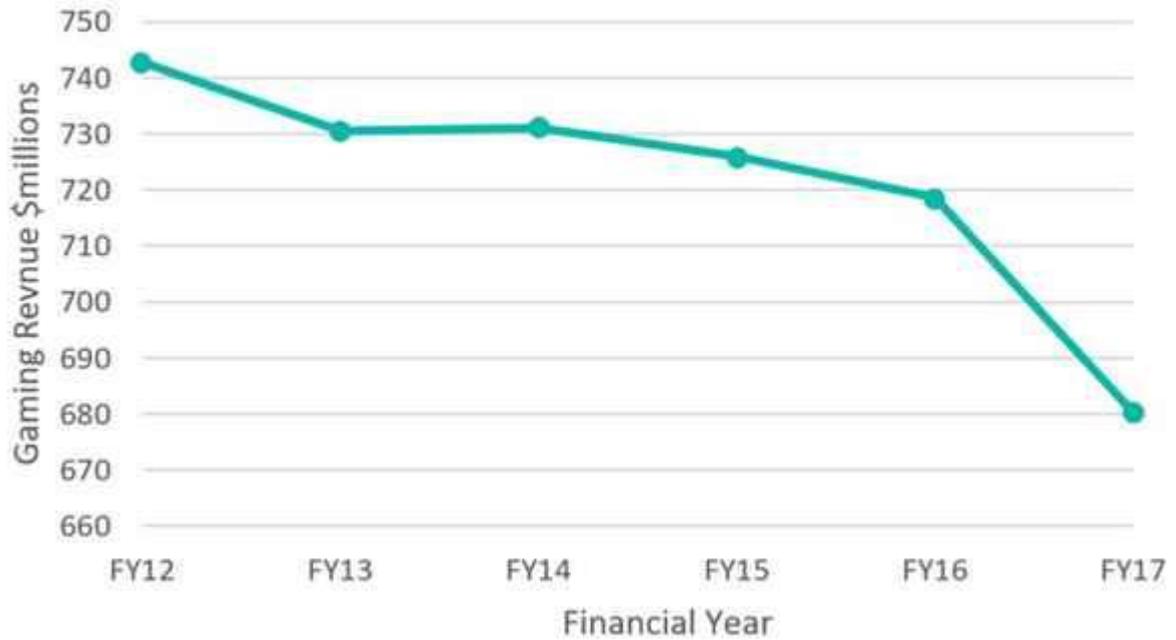
The pubs in South Australia have been generally resilient over many generations but they are now under more pressure than ever before. Whilst operators continue to face challenges including rising power costs, penalty rates, high payroll tax, lower discretionary spending, stagnant population, red tape and new competition (small bars, craft breweries and gastronomical experiences), it is the gaming that is now under the spotlight.

The introduction of pokies in South Australia was the saviour to the struggling industry back in 1994 and was the catalyst for a turnaround and refurbishment of many of the State's hotels and clubs. Now the sector is once again at the cross roads as the pokies "rivers of gold" are under threat from changing consumer gambling preferences (eg internet gaming) and a growing anti-gaming political sentiment. This has left many local operators sweating on the outcome of the State Election.

#### Net Gambling Revenue (NGR) and Gaming Machine Entitlement (GME) decline

Statewide total gaming revenue has been steadily decreasing from its peak of \$793 million in FY07 (pre-smoking laws) to \$680 million in FY17. This decline is also reflected by the shrinking value for the GME's. The latest trading round for GME's reveal that vendors received only \$13,708 per GME compared to the vendor price of \$54,473 in 2012. The graphs below reflect the decline in both gaming revenue and GME sale price over the past five years.

### NGR (inc GST)



### GME Vendor Price (ex GST)



Source: OLGC

#### How do Hoteliers wish to transact GME's and does it matter?

A recent Ferrier Hodgson survey revealed most hotel operators would prefer an open market system as opposed to the current GME trading scheme. We at Ferrier Hodgson believe that in the current environment, demand for gaming assets will continue to remain subdued regardless of the GME trading platform. This demand

pressure obviously also affects the overall value of venues which is concerning for both operators and financiers. We note that subject to legislative change, potential demand for GME's may come from the SkyCity Casino in FY19 as it has 430 GME's less than its current licence capacity and is shortly about to embark on its \$330 million upgrade that has unanimous political support.

### Maximum Bet reduced from \$10 to \$5 on 1 January 2017 - Is a \$1 cap next?

There was an immediate impact following the reduction of the maximum bet from \$10 to \$5 on 1 January 2017 (refer graph below) as particularly evidenced in the first two months of 2017 in which gaming was approximately 6% lower across the State from the corresponding months in 2016.



Source: OLGC

The policy announcement by SA Best party leader Nick Xenophon on 19 February 2018 included further reducing maximum bets from \$5 to \$1 (to all gaming venues) by 1 July 2019 and to remove 4,000 (approx. 36%) gaming machines from the State's gaming hotels (but not community hotels or clubs) over the next 5 years. Should SA Best have influence to implement some or all of their policies following the election then this will have a significant impact on the future performance of all gaming venues and for some, its sustainability for the future.

The gaming harm minimisation agenda amongst some political groups is gathering momentum with the SA Greens recently announcing a hard line position being a total pokie ban in South Australia within 5 years (excluding the Casino), which is in line with the Tasmanian Government's recent policy announcement.

In simple terms, capping the maximum bet to \$1 per spin means punters take longer to lose and therefore lower revenues to the operators (and of course lower tax revenues for the State Government). A Productivity Commission report revealed that a \$10 maximum bet may cause a gambler to lose up to \$1,200 per hour on the pokies but the proposed \$1 cap would reduce losses to a maximum of \$120 per hour.

### Theoretical Impact Analysis of a \$1 cap

In the current publication of the AHA|SA magazine, the AHA|SA suggested the potential impact of a \$1 maximum bet may reduce a venue's EBIT by at least 43% (and possibly up to 69%). In the table below, we applied the AHA|SA estimates

against hypothetical gaming venues (both a going concern and a leasehold) to show what consequences a \$1 maximum bet could have for the venue's cash flows (particularly those with existing high debt) and their values.

Theoretical Impact of Reducing Maximum Bet from \$5 to \$1	Hotel A (Going Concern Hotel)			Hotel B (Leasehold Hotel)		
	No Change	Low Impact	High Impact	No Change	Low Impact	High Impact
Adjusted EBIT (nil / 43% ↓ / 69%)	\$1,000,000	\$570,000	310,000	\$500,000	\$285,000	\$155,000
Annual Interest Coverage (\$400k / \$70k @ 8%)	2.50 times	1.43 times	0.78 times	7.14 times	4.07 times	2.21 times
Debt	\$5,000,000	\$5,000,000	\$5,000,000	\$875,000	\$875,000	\$875,000
Value (7.5x, 7.0x, 6.5x / 3.5x, 3.0x, 2.5x)	\$7,500,000	\$3,990,000	\$2,015,000	\$1,750,000	\$855,000	\$387,500
Loan to Value Ratio	67%	125%	248%	50%	102%	226%

*\*Note: High/Low earnings impact estimates sourced from AHA|SA Analysis*

### What would a \$1 cap do?

- The value of gaming venues would dramatically fall (as indicated above) and this will extend to passive freehold interests when rental income reduces at review.
- Those venues that strongly rely on gaming and have relatively high debt will be vulnerable to failure.
- Many venues would need to replace some of their gaming machines (cost up to \$25,000 per machine) if existing machines are non-compliant for \$1 maximum bet.
- Operators will look to find alternative revenue by growing their food and beverage offerings. This may require innovation and/or capital expenditure (and possibly risk) to revitalise/improve their offering from competitors against a back drop of already low discretionary spending and stagnant population levels.
- Those venues with limited access to investment/funding will risk becoming dated and uncompetitive and resemble the condition of the State's hotels in 1994.

The impact on gaming hotels will be **even more detrimental** should the number of gaming machines be reduced along with a \$1 cap.

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