

SPECIAL COMMENT

Las Vegas Strip: Early Signs of Recovery

Table of Contents:

SUMMARY	1
KEY STATISTICS POINT TO BRIGHTER PICTURE	2
EXCESS ROOM SUPPLY WILL SLOW THE PACE OF ROOM RATE RECOVERY	3
INCREASING CONVENTION AND GROUP DEMAND WILL HELP IMPROVE PROFITABILITY	4
OPERATORS HAVE A HIGH MOUNTAIN TO CLIMB	5
CONCLUSION	6
APPENDIX I	7
APPENDIX II	10

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Summary

- » The Las Vegas Strip is showing signs of modest improvement as consumers and businesses are becoming more willing to spend on leisure and business travel. However, while a recovery is now underway, we believe it will remain sluggish at best through 2011. Visitor volume will ramp up slowly in 2011, but it will take another year for the market to absorb the new supply that entered the market since 2007. So, the real upturn in profits will not begin until 2012.
- » The Las Vegas Strip still faces a number of headwinds. They include stubbornly high unemployment, rising state and local taxes, and weak housing prices that are likely to make consumers reluctant to materially increase gaming budgets. In addition, excess room supply will weigh on operators' ability to raise room rates – the second most important source of profitability for casino operators – in the near term.
- » The Las Vegas casinos have a high mountain to climb to grow earnings to anywhere near their previous peaks. Citywide hotel room rates remain below 2005 levels, occupancy rates are less than 1986 levels, and gaming revenue is still far from its previous peak (as outlined in Appendix 1). Additionally, Las Vegas operators have experienced significant declines in same-store revenue and earnings before interest, taxes, depreciation, and amortization (EBITDA).
- » Companies with more international gaming portfolios, lower leverage, and solid liquidity – namely, Wynn Resorts (Ba3, positive) and Las Vegas Sands (Ba1, stable) – are in the best shape to manage through a slow recovery. As casino operators battle for customers, these companies have some measure of financial flexibility with which to compete and maintain market share.
- » Companies with high leverage, less geographic diversification, or new properties to establish, such as MGM Resorts International (Caa1, positive), CityCenter Holdings LLC (Caa2, stable), Caesars Entertainment (Caa3, positive), and Cosmopolitan (unrated), face significant challenges, including the need to establish customer loyalty and grow market share.
- » Operators of mid- and lower-tier casinos, such as American Casino & Entertainment Properties LLC (B3, negative), MGM Resorts, and Caesars Entertainment, continue to face considerable room rate pressure. This will not be relieved until rates at luxury properties increase materially – not likely until 2012 at the earliest.

Key statistics point to brighter picture

Several key market statistics have taken a positive turn in recent months. They suggest the demand environment in Las Vegas is poised for a recovery, although the market has a long way to go before reaching its previous peak. (See Appendices I and II for historical data.)

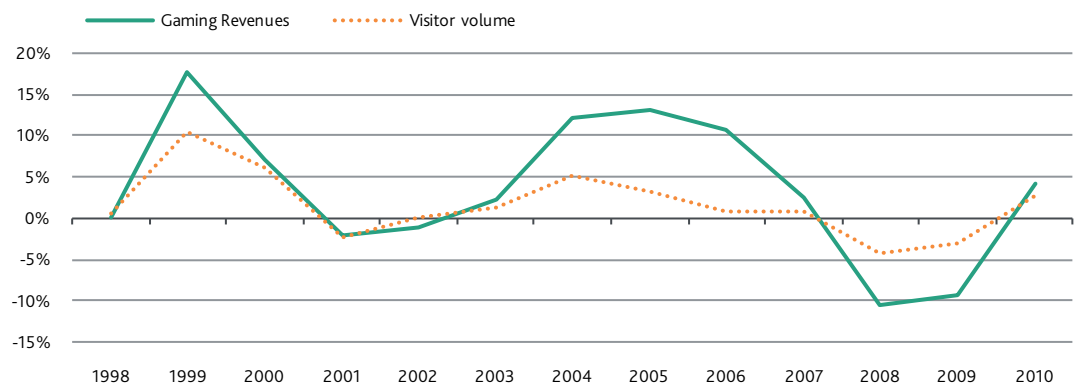
Specifically, through December 2010:

- » Visitor volume is up 2.7%
- » Gaming revenue is up 4.1%
- » Declines in hotel occupancy have decelerated to -1.8%
- » Average daily room rates are up 2%

In addition, despite our expectations for an uptick in leisure travel, higher airfares and fewer flights into Las Vegas may dampen the pace of leisure visitation. Given rising oil prices we expect airfares to continue to rise. Despite improving consumer confidence and higher retail sales, we expect consumers will remain reluctant to dramatically increase their gambling budgets because gaming is a non-essential expenditure and we believe consumers remain concerned that state and local tax burdens will rise, home values will decline, and high unemployment will persist. For these reasons, we don't expect a sharp rebound in room or gaming revenue – the two largest sources of revenues for Strip operators.

As depicted in the following chart, during the boom years from 2004 to 2007, gaming revenue grew at a much faster rate than visitation. Then during the recession, gaming revenue dropped more precipitously relative to visitor volume. Given the discretionary nature of consumers' gaming spending and the economic concerns mentioned previously, we believe gaming revenue will now grow at a slightly faster pace than visitor volume but not to the same degree as during the boom years.

FIGURE 1
Las Vegas Gaming Revenue and Visitor Volume

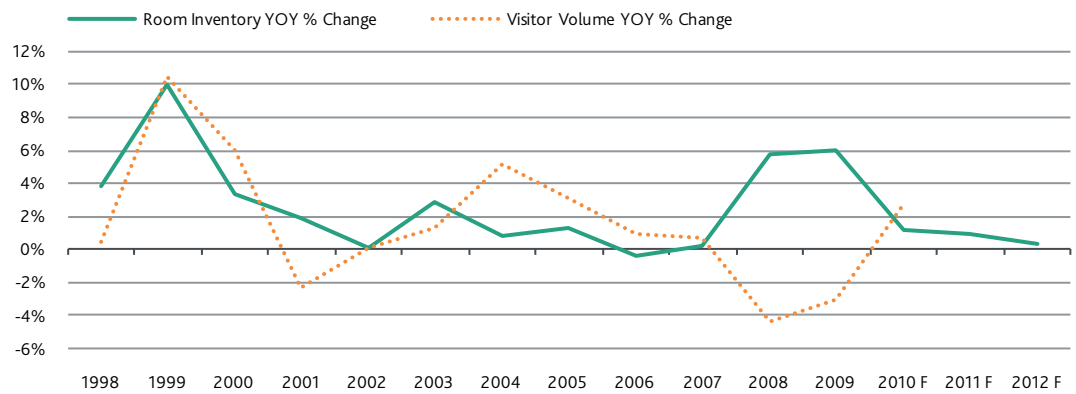


Source: Las Vegas Convention and Visitors Authority

Excess room supply will slow the pace of room rate recovery

The Las Vegas Strip experienced a perfect storm – visitor volume declined due to the recession at the same time significant new inventory entered the market. This drove a steep cut in room rates, decimating profits from high-margin hotel operations. In 2010, the Strip struggled to absorb the more than 4,000 rooms added by CityCenter in late 2009. The market now needs to absorb the 2,000 rooms opened by Cosmopolitan in late 2010, with another 1,000 slated to open later this year. CityCenter and Cosmopolitan must compete with well-established properties (such as Wynn Resorts, Encore, Venetian, and Palazzo) operated by companies that have greater financial flexibility.

FIGURE 2
Change in Room Inventory Versus Change in Visitor Volume

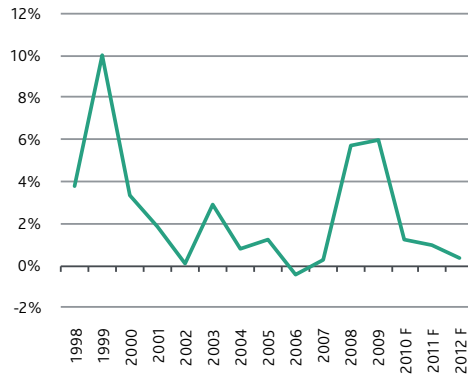


Source: Las Vegas Visitors and Convention Authority

Although we believe visitor volume will ramp up slowly in 2011, it will take another year or so for Las Vegas to fully absorb the supply of hotel rooms that have entered the market since 2007. (See Appendix I.) Therefore, we expect room rates to begin to recover in 2011 and accelerate thereafter. The rebound will be propelled by a decline in new hotel room additions, thereby setting stage for a solid recovery in 2012.

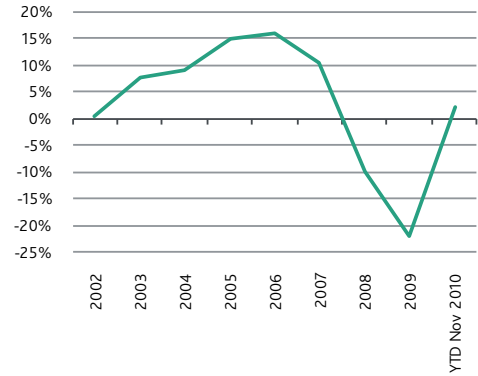
However, the recovery in room rates could experience bumps along the way. When the recession hit, many operators postponed hotel expansions, and some were stuck with unsold condos built during the high times. If operators decide to convert more unsold condo rooms into hotel rooms and if delayed projects such as Caesars Octavius tower eventually open, the pace of the uptick in room rates could slow. Additionally, existing properties that have undergone management changes, such as Planet Hollywood and Tropicana, are likely to become more aggressive with respect to room rates or other promotions to regain lost market share.

FIGURE 3
Room Inventory Year-Over-Year Percent Change



Source: Las Vegas Visitors and Convention Authority

FIGURE 4
Average Daily Room Rate Year-Over-Year Percent Change



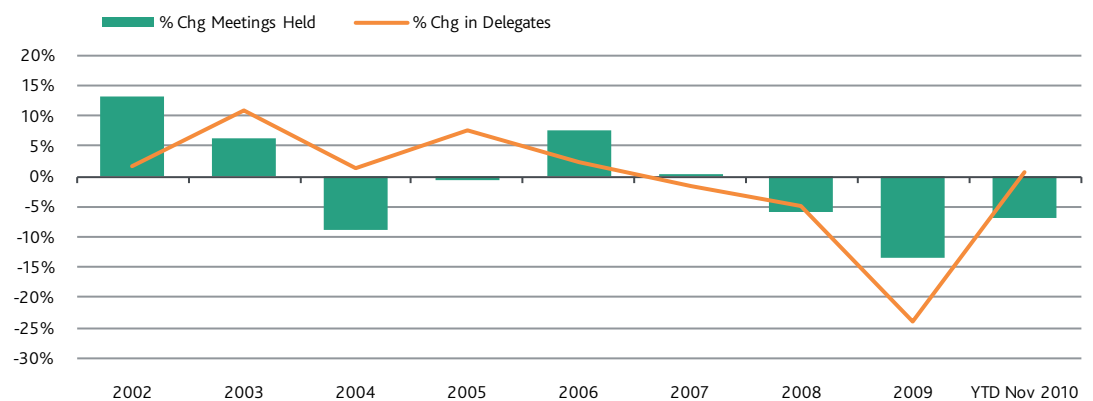
Source: Las Vegas Visitors and Convention Authority

Increasing convention and group demand will help improve profitability

We expect the demand for conventions and group meetings will pick up throughout 2011, which will enable operators to push room rates higher for 2012 bookings. The decline in the number of attendees and in the number of meetings and conventions is decelerating – a good development because improvement in this segment should enable operators to raise room rates. The Las Vegas Strip will need continued improvement in conventions and group demand to help boost profitability from rooms and food and beverage.

Most operators are reporting higher group booking volumes for 2011, but these bookings are being taken at or slightly above extremely low room rates. Therefore, we do not expect a robust flow through to profits in 2011. Additionally, businesses are still keeping a tight rein on the growth in travel expenditures, which we think will temper the pace of improvement in group and convention business.

FIGURE 5
Percent Change - Meetings Held and Number of Delegates



Source: Las Vegas Visitors and Convention Authority

Operators have a high mountain to climb

The Las Vegas Strip has a long way to go before reaching its previous peaks. This also means the fortunes of those operators that are reliant upon the Las Vegas Strip for a material portion of their profits will rest upon the pace of the recovery.

Those rated operators with significant exposure include MGM Resorts, Caesars' Entertainment, American Casino, and CityCenter. They have a high mountain to climb to reach previous levels of absolute profits as outlined in the following table. Therefore, we do not expect the credit profile of those companies with significant Las Vegas Strip exposure to improve dramatically for several more years.

TABLE 1

2007	MGM	Caesars'	LTM 9/30/ 2010	MGM	Caesars'
Casino Revenue	3,239	8,831	Casino Revenue	2,534	7,073
Casino Expenses	1,678	4,595	Casino Expenses	1,407	3,981
Net Casino income	1,561	4,236	Net Casino income	1,127	3,093
Casino Margin	48%	48%		44%	44%
Hotel Revenue	2,131	1,354	Hotel Revenue	1,331	1,130
Hotel Expense	570	266	Hotel Expense	429	250
Net Hotel income	1,560	1,087	Net Hotel income	902	880
Hotel Margin	73%	80%		68%	78%
F&B Revenue	1,652	1,699	F&B Revenue	1,364	1,539
F&B Expense	984	717	F&B Expense	782	623
Net F&B income	667	982	Net F&B income	582	917
F&B Margin	40%	58%		43%	60%
\$ Change 2007 vs LTM	MGM	CZR	% Change 2007 vs LTM	MGM	CZR
Casino Revenue	(705)	(1,758)	Casino Revenue	-22%	-20%
Casino Expenses	(271)	(615)	Casino Expenses	-16%	-13%
Net Casino	(434)	(1,143)	Net Casino	-28%	-27%
Hotel Revenue	(800)	(224)	Hotel Revenue	-38%	-17%
Hotel Expense	(141)	(17)	Hotel Expense	-25%	-6%
Net Hotel	(659)	(207)	Net Hotel	-42%	-19%
F&B Revenue	(288)	(160)	F&B Revenue	-17%	-9%
F&B Expense	(203)	(94)	F&B Expense	-21%	-13%
Net F&B	(85)	(66)	Net F&B	-13%	-7%
Total \$ Change	(1,178)	(1,416)			

Source: Company reports

Conclusion

The Las Vegas Strip is poised for a slow recovery in 2011, and we think it will pick up steam in 2012. Gamblers and conventioners are returning, and the city is finally beginning to absorb the thousands of hotel rooms that came onto the market after the recession hit.

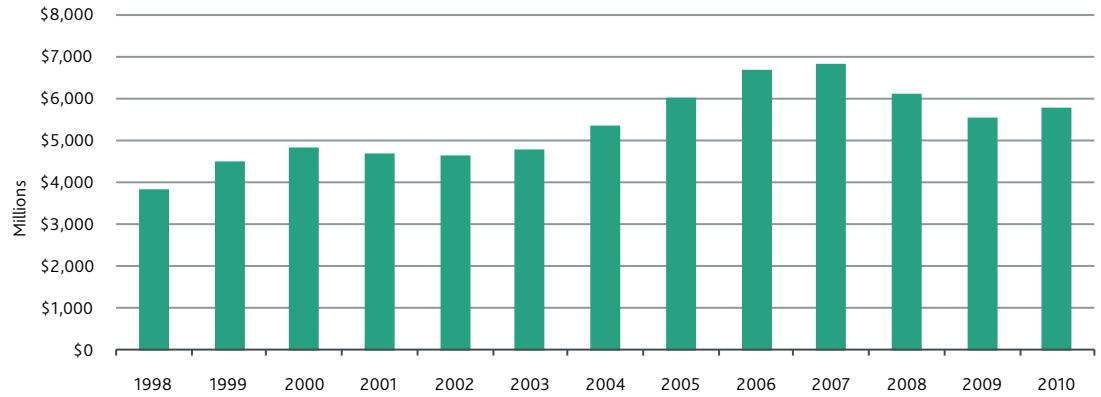
Still, Las Vegas has a ways to go before it can generate the kinds of results it did four years ago. In addition, operators must contend with the recent addition of 2,000 hotel rooms from the Cosmopolitan, which will open another 1,000 rooms later this year. Some operators may also opt to convert unsold condos into hotel rooms, adding further supply to what the city is currently trying to absorb.

Las Vegas-centric companies and operators of mid-and-lower-tier casinos will have the toughest time grappling with the slow pace of recovery. But companies that placed their bets overseas, particularly in Asia, will have an easier time competing.

Appendix I

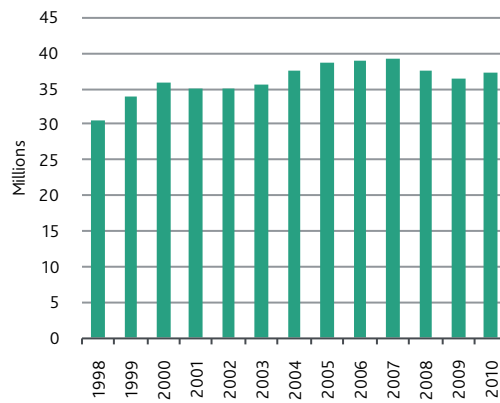
Las Vegas Annual Historic Trends

FIGURE 1
Las Vegas Strip Revenue



Source: Las Vegas Convention & Visitors Authority

FIGURE 2
Visitor Volume



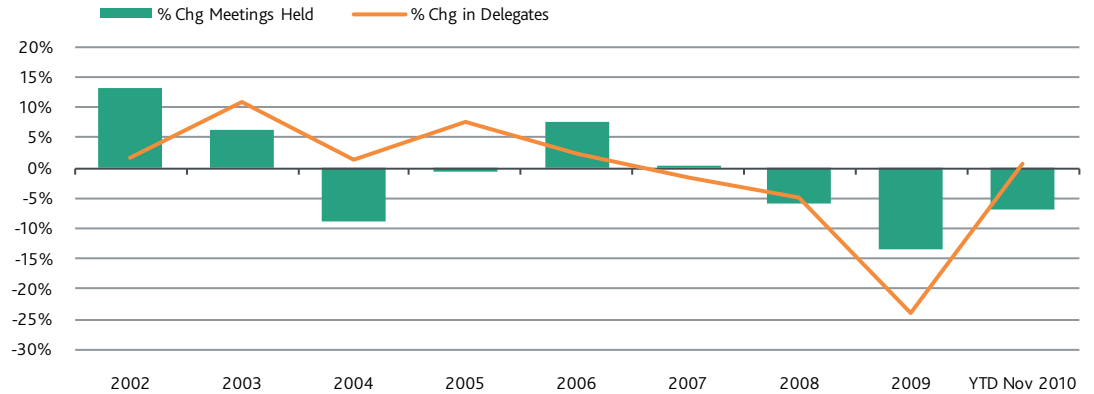
Source: Las Vegas Convention & Visitors Authority

FIGURE 3
Visitor Volume YOY% Change



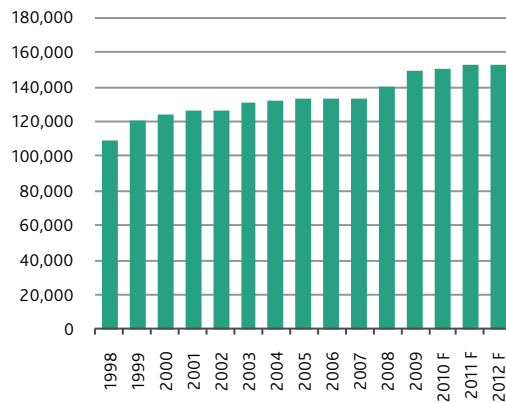
Source: Las Vegas Convention & Visitors Authority

FIGURE 4
% Chg – Meetings Held and # of Delegates



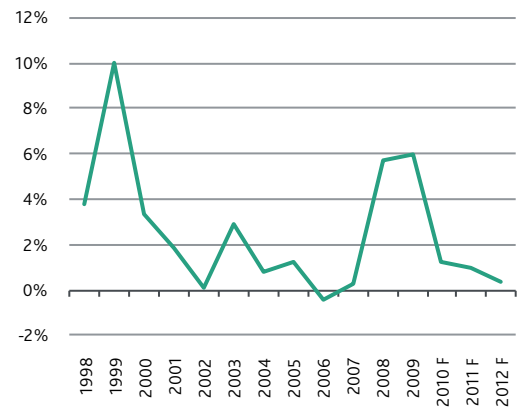
Source: Las Vegas Convention & Visitors Authority

FIGURE 5
Room Inventory



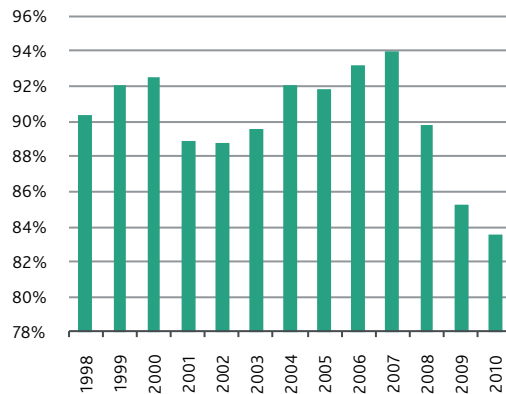
Source: Las Vegas Convention & Visitors Authority

FIGURE 6
Room Inventory YOY % Change



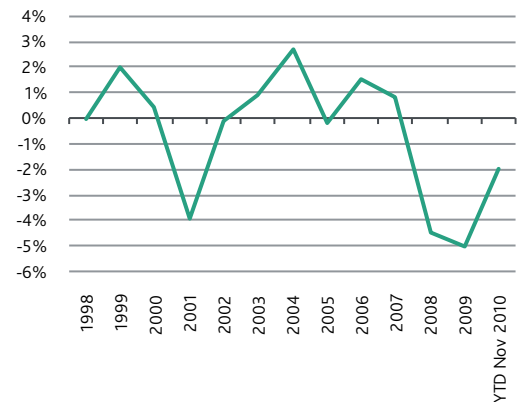
Source: Las Vegas Convention & Visitors Authority

FIGURE 7
Hotel Occupancy



Source: Las Vegas Convention & Visitors Authority

FIGURE 8
Hotel Occupancy YOY % Change



Source: Las Vegas Convention & Visitors Authority

FIGURE 9
Average Daily Room Rate

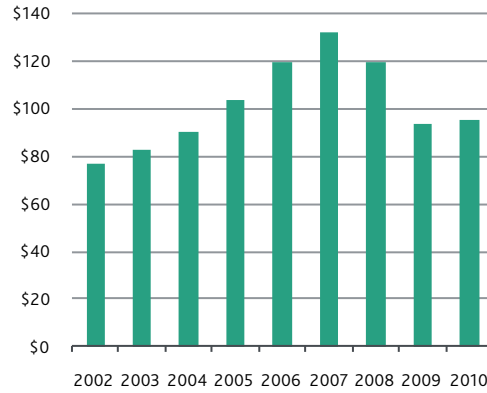
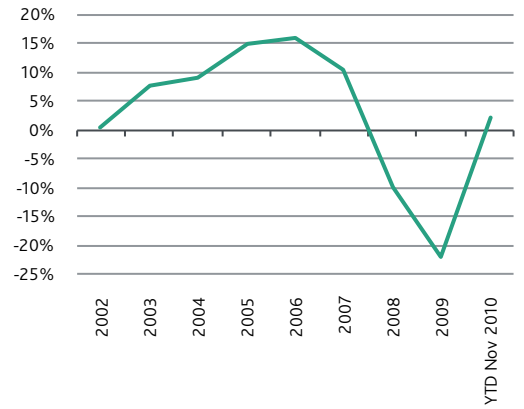


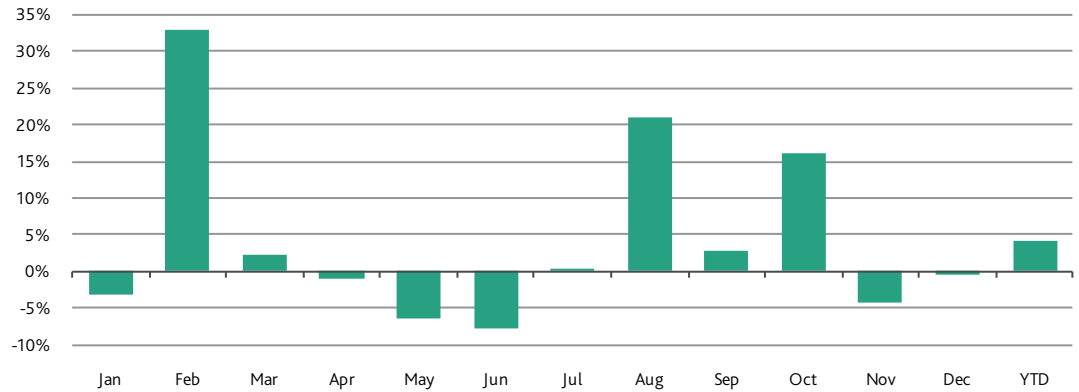
FIGURE 10
Average Daily Room Rate YOY % Change



Appendix II

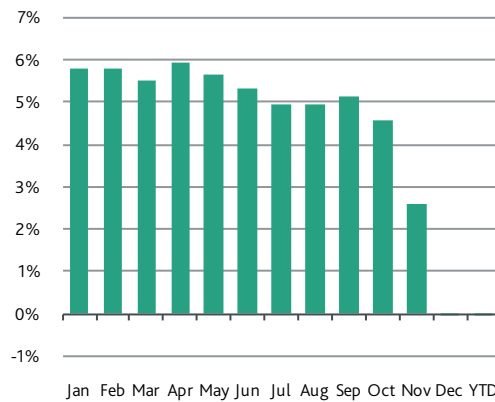
Las Vegas Monthly Trends -- 2009 versus 2010

FIGURE 1
LV Strip Gaming Revenue Year-Over-Year Change
 (2009 vs 2010)



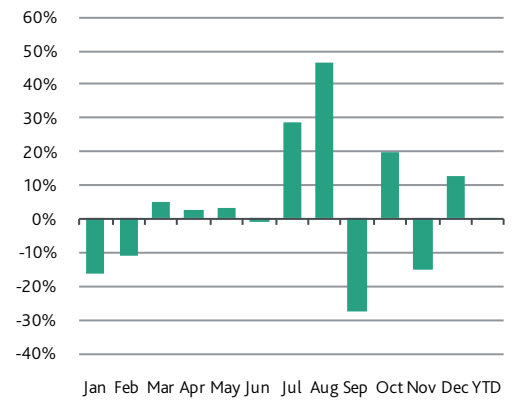
Source: Las Vegas Convention & Visitors Authority

FIGURE 2
Room Inventory Year-Over-Year Percent Change
 (2009 vs 2010)



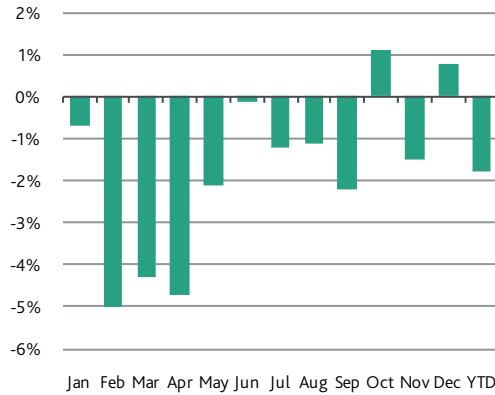
Source: Las Vegas Convention & Visitors Authority

FIGURE 3
Convention Attendance Year-Over-Year Percent Change
 (2009 vs 2010)



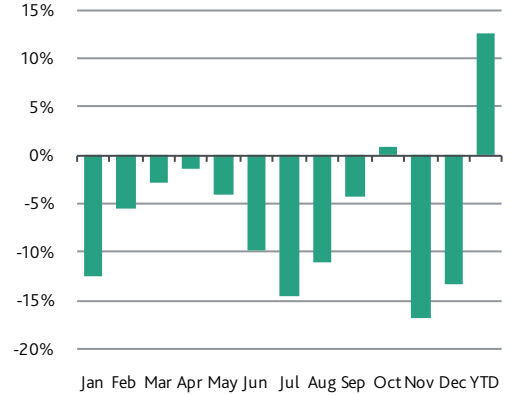
Source: Las Vegas Convention & Visitors Authority

FIGURE 4
Hotel Occupancy Year-Over-Year Change
 (2009 vs 2010)



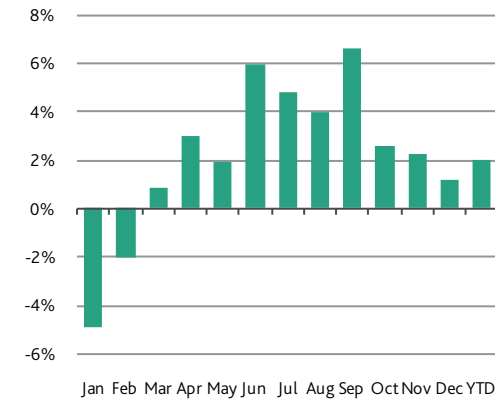
Source: Las Vegas Convention & Visitors Authority

FIGURE 5
Conventions & Meetings Year-Over-Year Percent Change
 (2009 vs 2010)



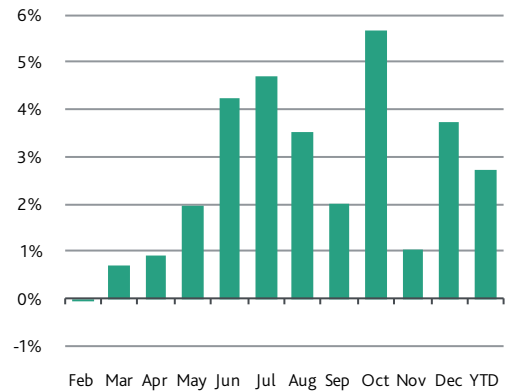
Source: Las Vegas Convention & Visitors Authority

FIGURE 6
ADR Year-Over-Year Percent Change
 (2009 vs 2010)



Source: Las Vegas Convention & Visitors Authority

FIGURE 7
Visitor Volume Year-Over-Year Percent Change
 (2009 vs 2010)



Source: Las Vegas Convention & Visitors Authority

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