

# TheStreet

## Bankruptcy Watch: 8 Risky Casino Stocks

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NEW YORK ([TheStreet](#)) -- Is the casino sector in dire threat of going bankrupt over the next two years?



According to the Altman Z-Score ... maybe.

The Altman Z-Score, a formula developed by New York University professor Edward Altman in 1968, measures several aspects of a company's

financial health to forecast the probability of it going bankrupt. Since its inception, the formula has been 72% accurate in predicting corporate bankruptcies two years prior to the filing.

On a general basis, companies with a Z-Score higher than 3 are considered safe, while those with a score of 1.8 or lower are considered distressed. Anything in between is a gray area. Using I-Metrix, *TheStreet* has determined that [of the eight casino operators with a market cap over \\$200 million](#), all have a score below 3, and seven of the eight are residing in the danger zone, with a score lower than 1.8.

Logically, of course, the demise of the entire casino sector is highly unlikely. Despite most of the casino operators holding a Z-Score of less than 1.8 over the past five years, all remain alive and kicking. Indeed, the primary reason casino stocks are plagued with depressed Z-Scores is that casinos were entangled in an arms race for several years,

during which time they attempted to see who could build the biggest and most expensive casino. Thus, the entire sector is highly leveraged, which drives up their financial risk.

**"Casinos believed they could put \$1 billion into the ground and would get \$3 billion return, but that's not what happened," says Alex Calderone, who provides turnaround and crisis management services for the gaming sector at Conway MacKenzie. "Most companies won't make enough to service the massive amount of debt they incurred as a result of these developments."**

	TTM	2009	2008	2007	2006	2005
LAS VEGAS SANDS CORP	1.11	0.86	0.56	2.81	4.58	4.67
PINNACLE ENTERTAINMENT	-0.02	-0.06	-0.13	1.25	1.77	1.31
WYNN RESORTS	2.15	1.59	1.16	2.34	2.78	1.45
AMERISTAR CASINOS INC	0.65	0.8	0.46	1.26	2.03	1.92
BOYD GAMING CORP	0.44	0.64	0.41	1.39	1.83	1.68
ISLE OF CAPRI CASINOS INC	0.71	0.81	0.9	0.61	0.87	1.19
MGM RESORTS INTERNATIONAL	-0.13	0.14	0.46	1.74	1.16	0.86
PENN NATIONAL GAMING	0.89	0.96	1.06	1.66	1.55	0.99

Consider that the Altman Z-Score is a snapshot of the financial health of a company at that exact point in time, ignoring future earnings prospects. Then note that several casino operators have been aggressively expanding into Asian territories like Macau and Singapore -- and that most of these projects are still under construction or haven't had enough time to generate incremental earnings.

Mammoth casino operators also have strong relationships with banks who don't exactly want to see these companies fail.

Still, this hardly means investors should dismiss the Altman Z-Score completely. For year, investors have shrugged off the piles of debt within the sector by justifying that it's all in the name of expansion. But if these growth plans do not pan out, all that will remain is a mound of debt.

Likewise, the casino sector has seen its fair share of bankruptcy filings over the last several years, including Station Casinos, Trump Entertainment and Tropicana Entertainment. It's likely there will be more casualties. And applying the Altman Z-Score on a company-by-company basis is still a good way to deduce which casino stocks are riskier in relation to each other.

Thus, we offer the following look at the Altman Z-Scores of major casino operators, from the least risky companies to those most most likely to file for bankruptcy over the next two years.



**8. Wynn Resorts**  
**Wynn Resorts**([WYNN](#)) is the safest of the casino stocks, with an Altman Z-Score of 2.15. Since rumors swirled back in March 2009 of a possible bankruptcy,

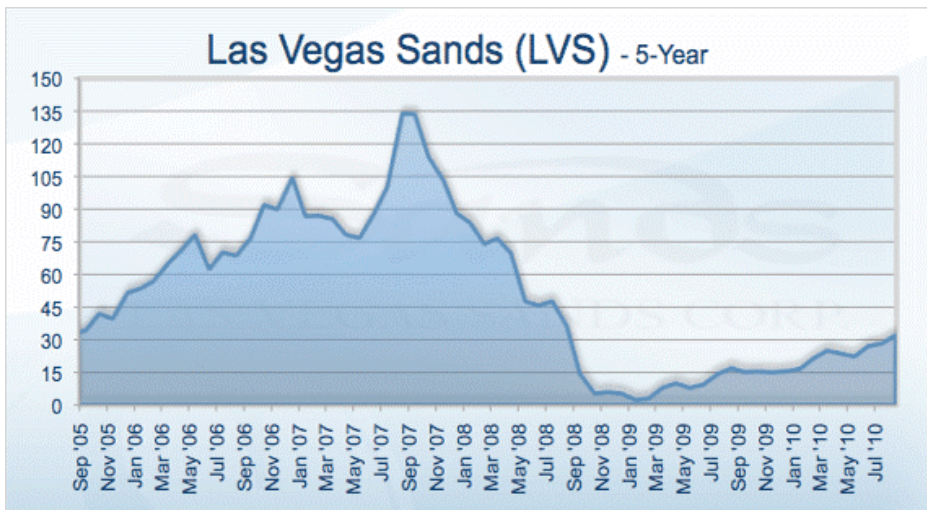
the stock has regained 457%.

Wynn's big story lies in Macau, the Chinese gambling enclave that saw revenue surge 40% in August to \$2 billion. Wynn currently has two Macau casinos in operation, its Wynn Macau and Encore casino, which opened this spring. It is also in the process of developing a third location on the Cotai strip. While Wynn is based in crippled Las Vegas, in the second quarter it saw 70% of its revenue come from Macau.

Wynn's profit in its second quarter doubled to \$52.4 million, or 42 cents a share, receiving a boost from Macau, where revenue soared 74%.

Still, nothing in China is guaranteed, and the market is paying little regard to the risks associated with growth in Asia.

Wynn is also saddled with \$3.2 billion in debt. While it still has about \$1.9 billion in cash, this won't help the company in the long run if potential interest payments pop up.



**7. Las Vegas Sands**  
 Las Vegas Sands has a commendable comeback story. After a bankruptcy scare in 2008, Sands has managed to successfully restructure its debt,

paying down \$1 billion. Its Z-Score has steadily improved, at 1.11 for the trailing 12-months, compared with 0.86 in 2009 and 0.56 in 2008.

Shares have rebounded since their lows of \$1.38 last year, currently trading at \$32.25.

Sands is a prime example of how the Altman Z-Score does not take into account growth opportunities from an aggressive development pipeline.

Its three Macau properties raked in \$1.04 billion in revenue in its second quarter, compared to the \$276.2 million its Las Vegas casinos reported.

Aside from these locations, Sands opened its \$5.7 Marina Bay casino in Singapore this spring. The company has projected that the casino could realize annual cash flows of more than \$1 billion, which the Altman Z-Score does not take into account.



## 6. Penn National Gaming

Penn National Gaming has a disappointing Altman Z-Score of 0.89, but this metric does not take into account the regional casino

operator's significant growth prospects.

The company recently rolled out table games at its West Virginia and Pennsylvania properties, as well as the imminent opening of Maryland's first slot machine casino.

Penn National is also in the process of constructing four new casinos in Ohio, and a development in Kansas that is scheduled to open in 2012.

Still, the company continues to grapple with a difficult domestic gaming business. In its second quarter, profit tumbled 68% to \$9.2 million, or 9 cents a share, and management lowered its full-year forecast.



Penn now expects 2010 earnings of 98 cents a share from prior outlook of \$1.13.

### 5. Isle of Capri Casinos

**Isle of Capri Casino's**([ISLE](#)) Altman Z-Score falls deep into the danger zone, at 0.71 for the trailing 12-months, and has fallen steadily over the past two years, from 0.81 in 2009 and 0.9 in 2008.

The regional casino operator reported a surprise loss in its most recent quarter of 8 cents a share, compared with a profit of 11 cents analysts estimated.

Revenue fell 2.4% to \$252 million, as operations across the business, including room reservations and food and drink, took a hit.

But Isle of Capri isn't blaming its bad luck on any internal issues. "We obviously cannot control the national economy. We were successful in managing costs through this period, and continue to remain focused on keeping our balance sheet strong to wade through this economic cycle and capitalize on opportunities for growth," CFO Dale Black said regarding the results.



#### 4. Ameristar Casinos

Ameristar Casino's([ASCA](#)) Altman Z-Score has declined significantly from last year to 0.65 for the trailing 12-months, from a previous score of 0.8.

Ameristar announced last month that it is exploring strategic alternatives for the company, including a possible sale. Analysts believe there are few potential U.S. buyers, but Penn National and Boyd Gaming were calling out as companies who would be willing to look at the company.

Experts are forecasting if Ameristar can find a buyer, its assets could go for more than \$3 billion.

In its second quarter, Ameristar lost \$24.9 million, or 43 cents a share, compared with a profit of \$14.3 million, or 25 cents, a year earlier. Revenue also dropped 5% to \$293 million from \$308.9 million.

Its St. Charles casino, in particular, was hurt by the opening of **Pinnacle Entertainment's**([PNK](#)) River City Casino nearby. As a result, revue at the St. Charles casino dropped 12% to \$64.8 million during the second quarter.



### 3. Boyd Gaming

**Boyd Gaming** ([BYD](#)) arguably operates in two of the worst gaming markets -- Las Vegas locals and Atlantic City. Thus it's no wonder its Altman Z-Score is so strained, at 0.44, down from 0.64 last year.

It's also not a surprise that Boyd has seen profits decline across all its geographical locations, with second-quarter revenue down 6% to \$578.4 million.

Competition has been heating up for Boyd, which predominantly operates casinos in the Las Vegas locals market, as well as Atlantic City. In Atlantic City, in particular, table games in West Virginia, Pennsylvania and Delaware are expected to further pressure an already decrepit market.

An anticipated recovery in the Las Vegas locals market has also halted, and regional gaming trends remain stagnant.



## 2. Pinnacle Entertainment

**Pinnacle Entertainment**([PNK](#)) is one of the only two casinos with a negative Z-Score, of -0.02. But trends, at the very least, have been improving since its score of -0.06 in 2009 and -0.13 in 2008.

Pinnacle had a much sturdier Z-Score of 1.25 back in 2007, but then the recession hit. On top of the economic downturn, the company also invested in an Atlantic City casino that it walked away from in April, and embarked on several other expansion plans.

In its second quarter, Pinnacle swung to a loss of \$49.3 million, or 81 cents a share, compared with a profit of \$4.7 million, or 8 cents, in the year-ago period. Excluding items, Pinnacle actually lost 14 cents a share, 10 cents worse than analysts' estimates of a 4-cent loss.

Revenue rose 8.5% to \$273.6 million from \$252.3 million, but this too fell short of Wall Street's forecast.

The company was forced to shutter its President Casino in St. Louis, Mo. in June, due to flooding. As a result, it lost the 13th and last available casino license in Missouri, which it is now battling to regain along with other casino operators.

Still, analysts see hope in Pinnacle new CEO Anthony Sanfilippo, who took the reins in March. Sanfilippo made the decision to shelve the Sugarcane Bay project and instead focus on Baton Rouge, a move praised by analysts.

J.P. Morgan analyst Joseph Greff reaffirms his overweight rating on the stock, viewing Pinnacle as a transition story.

Pinnacle also has strong liquidity, with \$200 million in cash and \$375 million of availability under its revolver, with no debt due until March 2014.



### 1. MGM Resorts International

**MGM Resort's** ([MGM](#)) CEO Jim Murren has been quoted as saying the Las Vegas-based behemoth came within mere "minutes" of filing for bankruptcy last year. While MGM was able to navigate the near-death experience and bankruptcy chatter has died down significantly, the casino operator is far from safe, with the worst bankruptcy rating in the sector, a negative Altman Z-Score of -0.13.

One of the biggest drivers of this despairingly low Z-Score is the \$8.5 billion CityCenter development. As of August, the equity value of the complex has fallen to \$2.65 billion from \$4.88 billion in October 2009. But equity value doesn't take into account the value of the buildings, which MGM has not disclosed.

MGM blames \$1.12 billion in impairment charges related to its investment in CityCenter for its biggest loss in its second quarter. During the period, MGM lost \$883 million, or \$2 a share, compared with a loss of \$212 million, or 60 cents, the same quarter last year.

MGM's dominance on the Las Vegas Strip has made it a riskier bet than other casino stocks. Las Vegas has been pressured amid the recession, as traveling for both business and pleasure has drastically declined.

In July, gaming revenue on the Strip remained relatively flat at \$461.3 million. While on the surface this may seem like a step in the right direction, subtract baccarat, which grew 9% year-over-year, and the Strip actually saw a 1.5% decrease in revenue during the month.

MGM also has a much smaller presence in Macau than its competitors, with just one casino-hotel, its MGM Grand Macau, a joint venture with Chinese gambling mogul Pansy Ho.

With the prospects for CityCenter waning and few immediate growth opportunities in Asia, this Altman Z-Score should be closely watched.

Regardless, analysts have become optimistic on the company. Soleil Securities analyst Jake Fuller upgraded the stock earlier this month to buy from hold, citing an attractive stock price and signs of recovery in the Las Vegas convention business. MGM's stock is down 38% to \$10.16 since April.