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North American Research

Global Gaming Operators

Industry Update

KEY THEMES

- PENN wins 1st of ten available satellite casino (Category 4) licenses in PA for \$50.1m
- We estimate the York license for PENN could yield 12%-15% annual EBITDA return on a standalone basis
- Estimated development cost of \$50m-\$75m (excl. license fee) and annual EBITDA of \$12m-\$20m
- Next license auction scheduled for January 24
- Ten casinos up for bid with a max of 750 slots (300 minimum) and 30 tables each
- Total slot opportunity of 7,500 new units - though we estimate about 60% utilization (4,500 units)
- Public companies with interest in process: BYD, CZR, ERI, LVS, PENN, PNK

PENN First Mover in PA Category 4 Casino License Process

Penn National won the first of ten available Category 4 casino licenses in Pennsylvania this week with a \$50.1m bid for a location in York, PA. The Category 4 licenses allow for a maximum of 750 slots machines and 30 table games and require a minimum of 300 slot machines. Initial bidding is open to each of the ten existing Category 1 and 2 casinos in the state but exclude the state's two Category 3 (resort-based) casinos, including Lady Luck Nemacolin (ERI) and Valley Forge (BYD), which will have a shot at any remaining license opportunities in Round 2. ERI has the opportunity to bid in the first round under its Presque Isle Casino license in Erie, PA. The minimum bid for a Category 4 license is \$7.5m, and if an operator would like to include table games, it is another \$2.5m license fee. Gaming taxes remain the same, including 55% on slots and 16% on tables.

There were three other bidders for the first Category 4 license though submissions were confidential so we are left to speculate who, where, and how much the other contenders may have bid for the first license. Given only four companies out of ten possible contenders bid on the first license, it appears most eligible bidders took a wait-and-see approach. However, PENN went on offense (and defense) to protect its market share at Hollywood Casino at Penn National Race Course in Grantville by procuring the first available license. The York area license will not only protect PENN's existing casino from external cannibalization to the south but also give the company an attractive ROI opportunity on a standalone basis as we view York as one of the more attractive markets remaining in the state.

While potential bidders can choose their location when bidding for a Category 4 license, there are substantial restrictions on where a new casino could be located. First, each existing casino in the state has a 25-mile protective radius. Only the casino located within its own 25-mile circle could bid for a license within the protective radius. Second, over 1,000 municipalities in the state have opted-out of the gambling expansion and no casino is permitted within those municipalities. We have included a map in Appendix 1 detailing the exclusion areas for your reference. There are, however, some attractive market opportunities still in play, including State College, Altoona, and some areas in the Reading market.

The auction for the second Category 4 license is scheduled to commence on January 24 with each auction for the remaining licenses scheduled two weeks apart and ending on May 16. If all ten licenses are not awarded by May 16, a second round of bidding will commence that would permit the Category 3 casinos (Nemacolin and Valley Forge) to participate as well as allow any winners in round one to submit an additional bid for a second license. If after Round 2 there are still licenses remaining, the state could open the bidding for out-of-state companies.

Analysts

John DeCree
Tel: 702-691-3213
john.decree@uniongaming.com

*Please see analyst certification and required disclosures starting on page 4 of this report.

Penn National Takeaways

Overall, we believe PENN procuring the first license in York is a victory for the company as it serves two primary purposes: 1) Protect market share at Hollywood PNR to the south; and 2) Penetrate an attractive standalone market in York.

While it is too early to estimate the net impact for PENN given nine licenses still remain to be awarded, we do think PENN's victory in York considerably reduces the competitive threat. That said PENN still faces some potential risk for cannibalization depending on where the other satellite casinos get awarded. As such, the company is continuing its litigation against the state's casino expansion law that seemingly puts the company at a unique disadvantage to competitive threats given the location of its existing property.

As it stands today, without knowing the potential for incremental cannibalization from the remaining licenses to be awarded, we believe the York casino would be accretive for PENN. We would expect some internal cannibalization between York and Hollywood PNR but this could be offset by more efficient operations given the close proximity of both properties.

We believe PENN's core competency as a development company will foster a favorable ROI even with a \$50.1m license fee. We estimate construction costs to range from \$50m-\$75m for the York property. PENN's ~\$89m development of Hollywood Perryville, which opened in 2010 with 1,500 slots, serves as fair comparison for construction costs.

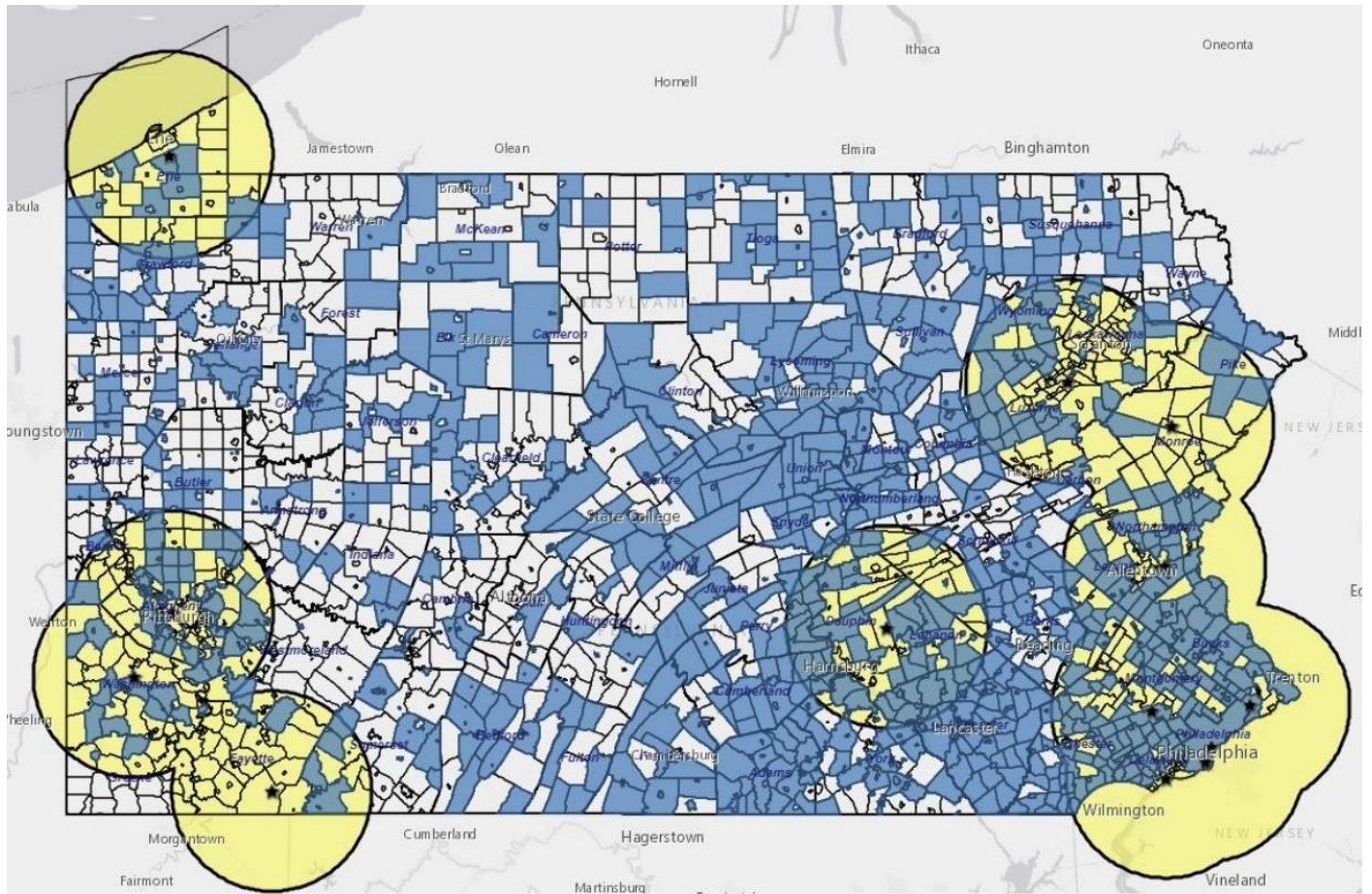
Assuming this level of investment spending, we believe the project on a standalone basis could generate 12%-15% annual EBITDA returns on investment before cannibalization at the existing Hollywood property. Our preliminary estimates are included in the below figure. Our wpd assumptions are based on current trends at Hollywood PNR.

Figure 1. York Licenses – ROI Potential and Estimates

York, PA Category 4 Casino	Low	High
License fee	50.1	50.1
Construction cost	50.0	75.0
Total cost	\$100.1	\$125.1
Slots	300.0	750.0
Slot \$ wpd	225.0	175.0
Slot win	\$24.6	\$47.9
Tables	30.0	30.0
Table \$ wpd	1,500.0	1,500.0
Table win	\$16.4	\$16.4
55% Slot tax	13.6	26.3
16% Table tax	2.6	2.6
Total gaming tax	\$16.2	\$29.0
Gaming revenue	41.1	64.3
Gaming tax	(16.2)	(29.0)
Opex	(13.0)	(16.0)
EBITDA	\$11.9	\$19.4
<i>Margin</i>	28.9%	30.1%
Annual ROI	11.9%	15.5%

Source: Union Gaming Securities.

Appendix 1. Pennsylvania Restricted Locations for Category 4 License



Blue = Municipalities That Have Opted Out (1,017)

Yellow = 25 Mile Exclusion Area Around Casinos (11)

Source: PA Gaming Control Board, Union Gaming Securities.

Important Disclosure

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Buy – the total forecasted return is expected to be greater than 15% within the next 12 months

Hold – the total forecasted return is expected to be greater than or equal to 0% and less than or equal to 15%

Sell – whose shares exhibit downside potential of at least 15% within the next 12 months

Suspended – the company rating, target price and earnings estimates have been temporarily suspended.

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Ratings Distribution (as of 01/12/2018)

Coverage Universe

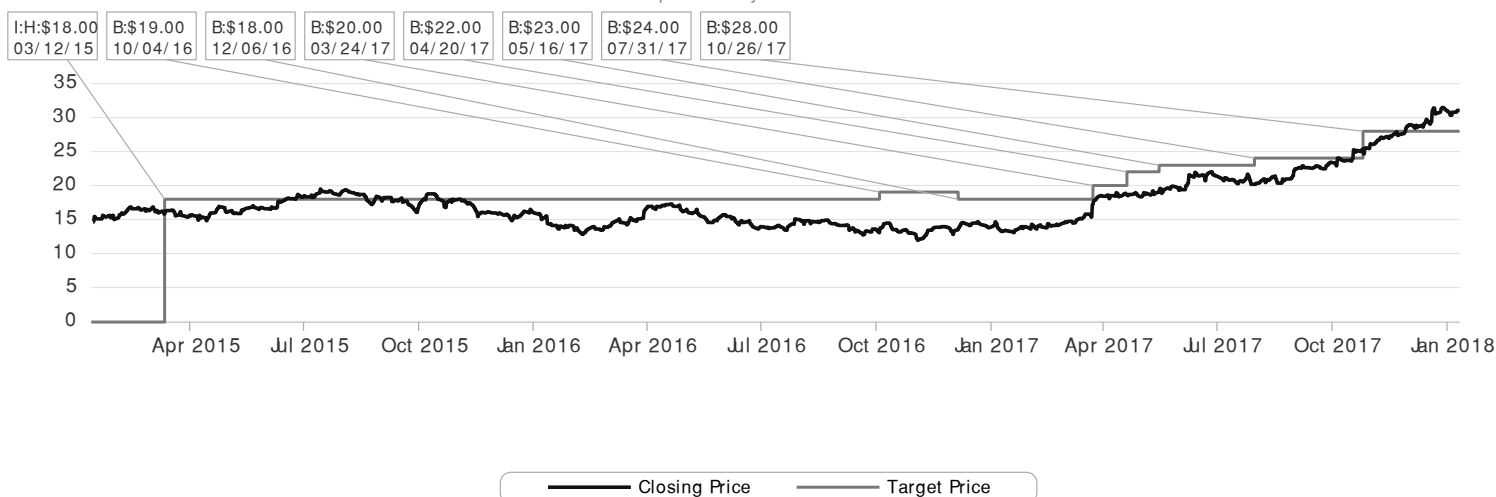
Ratings	Count	Pct.
BUY	16	67%
HOLD	8	33%
SELL	0	0%

Investment Banking Services / Past 12 Months

Rating	Count	Pct.
BUY	5	31%
HOLD	0	0%
SELL	0	0%

Penn National Gaming, Inc. Rating History as of 01/10/2018

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