

Smoking Ban May Burn Atlantic City Casinos

Last year, it seemed that investors in Atlantic City casino stocks flopped a winning hand. This year, however, a series of looming negative issues are shaping the city into a „bad beat.“

Later this month, the Atlantic City Council is expected to approve a smoking ban in casinos, which likely will hurt gaming revenue in the short run. Moreover, casinos in the city are now facing heightened competition from rival markets.

„This is going to be a very challenging year for Atlantic City,“ says Joe Weinert, a consultant with Spectrum Gaming Group.

There are a dwindling number of public companies exposed to the region due to the pending private equity buyout of Harrah's (HET) , which owns several properties in the city.

Among the stocks with the biggest ramifications is Trump Entertainment's (TRMP) , since its three casinos are all located in Atlantic City.

Elsewhere, MGM Mirage (MGM) and Boyd Gaming (BYD) are exposed to the area with their jointly owned hip Borgata casino.

Pinnacle (PNK) intends to demolish and rebuild its Sands casino. By the time the new casino opens a few years from now, any smoking ban issue will most likely have been resolved.

Puffed Up Competition

If approved, the Atlantic City smoking measure will take effect in April. Besides any direct revenue loss, the ban also will put a dent in the city's ongoing marketing plans to become the Las Vegas of the East Coast. Nevada recently banned

smoking in bars and taverns but exempted casinos.

The ban will cause a cumulative 20% drop in Atlantic City gaming revenues over two years, according to a PriceWaterhouseCoopers study commissioned by the casino industry.

Critics say the study's conclusion is drastic and that the methodology is flawed. The report heavily relies on the effect of the smoking ban that was implemented in Delaware in 2003, which led to a 19% two-year drop in gaming revenue.

Delaware, however, was a rapidly growing market, whereas Atlantic City is more mature and could better absorb a ban, critics say.

Nonetheless, if a smoking ban is approved, some sort of drop in gaming revenue should be expected, given that Atlantic City casinos will be operating on an uneven playing field with competing casinos in nearby states.

Pennsylvania recently approved slot machines at several race tracks and casinos, and smoking will be allowed there. The Philadelphia area accounts for 10% to 12% of Atlantic City's total visitation, according to estimates from Susquehanna Financial Group analyst Robert LaFleur. The entire state of Pennsylvania accounts for 22% to 25% of visitors, he says.

As well, New York-area residents who smoke could turn to Foxwoods Resort Casino and Mohegan Sun Casino in Connecticut, which still allow puffing.

Aside from these smoking-related threats, the New Jersey state Legislature appears poised to once again consider introducing video slots at the Meadowlands race track. Those gaming machines are being proposed to help New Jersey deal with the introduction of slots competition in Pennsylvania and Yonkers, N.Y., which are expected to hurt overall revenue in Atlantic City.

Paradoxically, though, introducing slots at the Meadowlands should also hurt revenue in Atlantic City.

Industry Battle

The casino industry plans to fight the smoking ban in court if it is approved. One issue is that the state's smoking ban, which went into effect in 2006, exempted the casinos. The state law could supersede a city law.

The Atlantic City council gave preliminary approval to the ban in late December and is expected to issue final approval on Jan. 24. While the industry is fighting the move, the council seems resolute for now.

„The council recognizes they are in the national spotlight,“ says Weinert. „My hunch is that they don't want to be seen as backpedaling or softening their stance.“

Weinert says that if smoking were universally banned across the country, the industry wouldn't be fighting the issue so hard in Atlantic City.

Of the 14 states with a significant casino presence, Delaware is currently the only one that bans smoking in its casinos.

The American Gaming Association once explored pursuing OSHA rules to create a national smoking ban in casinos, according to two people familiar with the group's thinking.

Pursuing an OSHA route could be one of the few ways to level the playing field by forcing Native American casinos to adhere to a ban. Such casinos often operate on tribal land that is outside government jurisdiction for some matters.

For now, the AGA has decided to let companies and local governments decide whether to institute smoking bans.

„Our preference is if nobody smoked. But some of our customers smoke,“ says Holly Thomsen, director of communications with

the AGA.

The question for Atlantic City, of course, is how many of the those customers who smoke will keeping coming to the city once a ban is instituted.