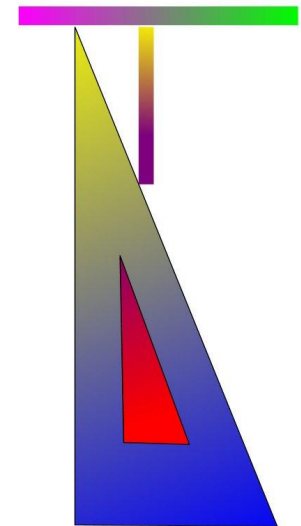


Financial Evaluation Commonalities and Distinctions Expressed by 10-Ks with Two Libertarian Hospitality Segments: Casino Gaming and Gentlemen's Clubs



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Two Underexposed Hospitality Management Fields

- Just as with a striptease artiste's strategic cloth coverings or the dealer's tucked hole card in blackjack, what is shown is often less interesting than what is left unknown.
- Two fields, in academia and in practice, have been underexposed to the discipline of hospitality business management's rigor.

Two Libertarian Hospitality Businesses

Gentlemen's Clubs



Casinos



Premise

- Libertarian hospitality ventures are significantly and fundamentally different than current common hospitality fields such as lodging and restaurants due to their **distinct business model composition**.

Purpose

- The purpose of this paper is not to randomly disburse non-associated facts gleaned from the respective 10-Ks of the casino gaming companies Boyd, Pinnacle, and Penn and the publicly traded gentlemen's clubs corporations of VGC Holdings, Ricks, and Scores; rather, it is about finding patterns from a “lucky 13” discerned, unique commonality variables so as to develop a conceptual construct.



Methodology

- As with the majority of finance focused hospitality research, secondary data was utilized for purposes of analysis.
- Since this paper is more conceptual (i.e., identifying a research/knowledge/application gap), six of the most appropriate (in terms of substantive information provided) SEC filed 10-Ks were chosen to represent the numerous (but still relatively **limited number**) of publicly traded casinos and gentlemen's clubs: Boyd Gaming, Penn Gaming, Pinnacle Gaming, Ricks Gentlemen's Clubs, Scores Holdings, and VGC Holdings (Boyd, 2011; PENN, 2011; PINNACLE, 2011; RICKS, 2011; SCORES, 2011; VGC, 2010).
- Note: VGC numbers are derived from the 2010 10-K as VGC Holdings went private prior to 2011.

Secondary Research Resource: 2012 10-Ks of Publicly Traded Gentlemen's Clubs & Casinos

BOYD
GAMING



Spot the Differences

- There are enough **similarities** between casinos and gentlemen's clubs in terms **of business structures, terminology, and evaluative methods** (as codified within 10-Ks), that theory and application comparisons may be made.



Highest Hospitality Industry ROI Potential

- Ironically, these two niche sectors, **all too often conducted without the benefit of “scientific” management** (that would provide a capability to maximize yield), also provide the greatest proportional net profit margins to equity holders
- While a lodging facility is fortunate to experience a 10% net profit margin and the highly unstable; high failure-rate restaurant business weighs in around 3.5% to 6% net profit margin, **gentlemen’s clubs and casinos boast average (and overall traditional equity market return trouncing) net profit margins of ~30% and ~24% respectively.**

Hospitality Universal Attributes

- Gentlemen's clubs and casinos maintain the same challenges and business concerns as more traditional hospitality ventures such as optimizing debt load/leverage, liquidity, and cash flow for sustainability

RFM is Not Sufficient for Analysis

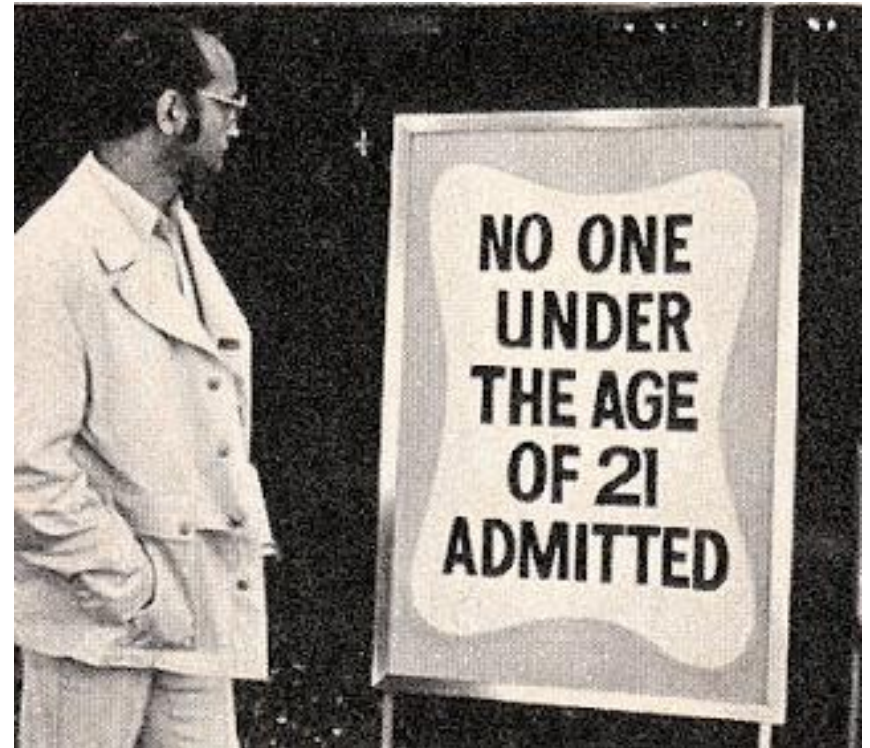
- Unlike the perishable “inventory” of the lodging industry or the capacity constraint and shift differential weighted “turns” with the dining sector, patronage’s incremental contribution to these establishments should not only be evaluated via the model limited, traditional RFM marketing loyalty/satisfaction metric.

“D” is for Duration

- Rather, the measurement paradigm for libertarian hospitality should also incorporate the critical prediction of time at activity
- The variable of “D” can reflect duration of gaming with “time on device” (TOD) or, in gentlemen’s club, “Time Experience at Stage Environment” (TEASE)©.

1) Libertarian Hospitality Venues are Populace Exclusive

- Gaming and Casinos serve a legislatively, and some might argue ethically and morally, limited populace.
- While restaurants and hotels serve the hospitality needs of all ages, gentlemen's club and casinos (G&C) provide entertainment only for those who have reached the age of majority

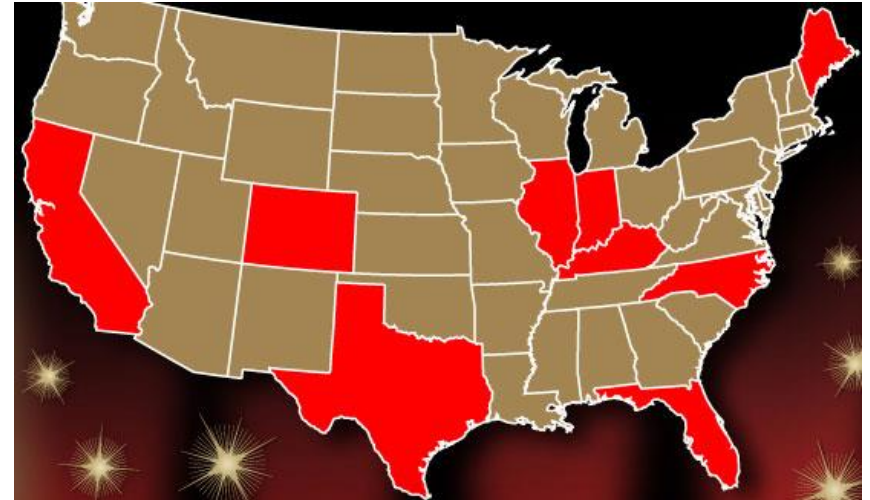


2) Usage of Discretionary Income

- Monies expended with libertarian hospitality are almost purely from discretionary in lieu of disposable expenditure
- Discretionary expenditure is that which is not necessary for personal or familial maintenance. If a person chooses to gamble or patronize a gentlemen's club, then he or she is disposing of what is "left-over" after immediate and secondary needs are met.
- Unfortunately, under the "new normal," discretionary spending is one of the first behaviors to be extinguished by income uncertainty.

3) Geographic Dispersion and Clustering

- (G&C) corporations practice geographic dispersion as well as geographic clustering to minimize some risk factors while maximizing efficiencies



From Rick's 10 K

- *We currently operate clubs under the name —Rick's Cabaret in Houston, San Antonio and Fort Worth, Texas (2); Minneapolis, Minnesota; New York, New York; Austin, Texas and Indianapolis, Indiana. We also operate a similar nightclub under the name*
- *Tootsie's Cabaret in Miami Gardens, Florida. We also operate a total of four nightclubs (one in Houston, one in Dallas, one in Charlotte, North Carolina and one in Philadelphia, Pennsylvania), as —Club Onyx, upscale venues that welcome all customers but cater especially to urban professionals, businessmen and professional athletes.*

4) Segmented Brands

- (G&C) corporations are comprised of “brands” within their primary line of business that intentionally segment patron bases.
- Boyd gaming, for example, has Sam’s Town, a “local’s casino”; The California, a casino catering to the wants and needs of the niche Hawaii recreational gambler; the Diamond Jo in Dubuque, IA that serves a regional and rural population, and the Borgata, an ultra-high end facility meant to appeal to the urbane taste of East Coast patrons.

5) Mostly Brick & Mortar Experiential

- Core businesses are heavily reliant on “brick and mortar” physical space and immediate stimulation of senses, but complementary operational extensions have found advantages in **cyberspace** where a “**continuation of experience**” may occur.
- Casinos are now offering state sanctioned and regulated, legalized on-line gaming.
- Gentlemen’s clubs, extending their voyeuristic reach, allow, among other Internet services, individuals to watch what is happening in the club and even remotely tip by a “make it rain” option with torrents of \$1 bill dropping out of a machine controlled from their computer at home. (George, 2012)

Unique Barriers to Entry

- Barriers to entry include:
 - Zoning matters
 - Egregious excise taxes
 - Legislative restrictions
 - Ability to obtain and maintain licensing
 - Working within hostile host communities
- A paramount of example of this is present in Texas as reported by the New York Times,
 - “In 2007, state legislators passed the Sexually Oriented Business Fee Act, which imposed the fee on nearly 200 establishments that feature live nude performances and allow the consumption of alcohol.
 - The \$5-per-customer entrance fee, which is imposed on the business and not the patron, is intended to raise money for sexual assault prevention programs and health insurance coverage for low-income people” (Fernandez, 2011).

Business Operational Stability May Be Contingent on Whims

- Jurisdictions have a vested interest as recipients of tax revenue and other fees levied.
- In short, there is a considerable level of risk with investment assumed by G&Cs that other businesses do not face in terms of being adversely affected by the whims of varying regulator and community interests.

7) G&Cs maintain, almost exclusively, cash based business models

- A plethora of regulations, including those focusing on anti-Rico and money laundering stoppage, affect G&Cs on a daily basis. With both businesses, “Cash is King.”
- While the rest of the commercial society has moved towards the increased use of debt and credit, hard currency is still the choice means by which to make transactions.
- C&Gs historically report negative working capital, where current liabilities exceed current assets. This is consistent with other businesses that report a working capital deficit, which increases net cash provided by operating activities.
- This is because the companies receive immediate cash payment for sales, while inventories, accrued expenses, and other current liabilities normally carry longer payment terms.

Access to “King Cash” as a Revenue Stream

- A significant amount of cash (i.e., currency) is drawn from ATMs using either checking / banking debit cards or the usurious procedure of credit card advances.
- Actually, participation ATMs (a euphemism for the “chop” the house of the C&G’s take from the private or bank ATM providers) are a major contributor to the bottom line for G&Cs
- Most of these ATMs have higher than normal withdrawal fees and lower than normal (e.g., at a typical bank branch ATM) withdrawal limits to increase frequency of visitation and thus increase revenues.



8) Diversified portfolios of revenue sources are becoming more important to ensure financial viability

- **G&Cs are no longer financially one-trick ponies that rely on the sub-optimization to either the casino gaming floor or dancer derived money.**
- As with any investment, while some returns may be lessened, as long as the overall return is greater than the hurdle rate, then the company is proceeding in the right direction.
- **Even though gaming and dancing might be the primary sources of income, they are certainly not the only revenue streams.**



The Mirage Model; Leveraging Auxiliary and Ancillary Revenue Streams

Wynn was right!

- Ever since the “Mirage Model” was introduced during 1989 in Las Vegas, many casino properties find the contributions to the bottom line come more from auxiliary (e.g., food and beverage, hotels) and ancillary (golf, showrooms, retail) streams.

Hustler's Roof Top Karoake



9) G&Cs in select, key markets have become hyper-competitive

VGC Holdings

- *We believe maximum profitability and sustained growth in the industry is obtained by owning and operating upscale adult nightclubs. Our current strategy is to acquire upscale adult nightclubs in areas that are not market saturated and where the public is open to these types of establishments.*

Pinnacle Entertainment

- *We face significant competition in each of the jurisdictions in which we operate.*
- *Such competition may intensify in some of these jurisdictions if new gaming operations open in these markets or existing competitors expand their operations.*
- *Our properties compete directly with other gaming properties in each state in which we operate, as well as in adjacent states.*
- *We also compete for customers with other casino operators in other markets, including casinos located on Native American reservations, and other forms of gaming, such as lotteries and Internet gaming.*

10) Labor for G&Cs is comprised of both full-time employees (with associated benefits) and independent contractors and equivalent “on-board” staff

Tip Out

- Like hairdressers, dancers serve legally as **independent contractors** and colloquially “pay to play”.
- Except for at unionized clubs in California and some establishment in Minnesota where all workers must receive a wage by legislation, most “talent” pays a sliding fee (based on basically a regression equation comprised of variables that predicts their potential earnings for a shift) to set-up shop and practice their craft.

On Board Status

- The respective “fee” “on-board” dealers pay **is their sacrifice of a standardized wage and benefits. Like entertainers, these dealers hope that the gratuities will compensate for the foregone and more traditional sources of income** derived from the combination of salary and benefits.

11) Unlike in manufacturing and certain other service-based entities, intangibles are highly valued and considered key resources by owners and management.

- With the advent of computer-based loyalty programs and increased adoption of multi-channel direct marketing, casinos have capitalized on the benefits provided by CRM.
- Not surprisingly, gentlemen's clubs, because they have not become as ubiquitous or socially acceptable as gaming halls, do not, with any regularity, cross the relationship mote between facility and patron's personal or professional life with one-to-one marketing efforts.

12) The Workplace “Jail”

- Besides legalized prostitution in Nevada, prisons, and some high security operations, G&Cs are the only two businesses that can, with legislative backing, demand personnel be confined to facilities during working “shift” hours as well as being subject **to the waving of some personal rights**, such as having to submit to personal and property inspection; what in other business scenarios might be considered “unreasonable search and seizure”

13) Investment Challenges with Marginal Industries

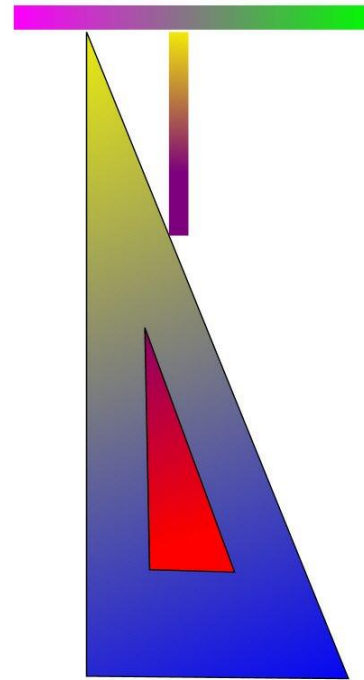
- Publicly traded stocks have numerous challenges due to the hesitance of investors to become involved with “marginal industries”.



Thank You

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