

Gaming Equipment Replacement

COMPANIES: ALL AU, BYI, IGT, KNM, MGM, WMS, 9766 JP

IGT, ALL AU Gain Share

IGT and Aristocrat gained more share of casino replacement spending during 3Q08 as Bally's rally ended and overall CAPX plans continued to decelerate.

- Equipment CAPX deteriorated slightly in 3Q08 yy on lower customer traffic and per-customer spending; no improvement in sight
- IGT retakes top share position, helped by product release timing and new platform; IGT's lone pachisuro title promising in Japan
- ALL AU's new platform pushed spending in its direction
- WMS remained dominant in participation; BYI lost momentum because of saturation
- Server-based gaming still on distant horizon

RESEARCH SUMMARY

Amid lowered industry spending, **International Game Technology** (IGT) improved markedly, regaining top share for 3Q08, with more than one-third of sources increasing spending with it compared with 2Q08. **Aristocrat Leisure Ltd.**'s profile on casino floors had been stagnant, but it introduced a new platform that improved its share. **WMS Industries Inc.** continued to outperform in participation and gained in for-sale machines for one-third of U.S. sources. **Bally Technologies Inc.**, gaining share all year, lost momentum. Industry spending for 4Q08 looks no better, and 2009 spending is in limbo as properties wait to see how the economic picture plays out. Sources still are unclear when server-based gaming will come to their floors, though IGT appears to be advancing in their deployment strategies. The top slot maker also improved in Japan with strong initial sales of its lone 2008 release.

KEY DATA

3Q Share Shifts (number of sources)

	IGT	ARISTOCRAT	WMS	BALLY	KONAMI
91%–100%	2	-	-	-	1
71%–80%	-	-	-	1	-
61%–70%	3	-	1	-	-
41%–50%	2	1	2	1	-
31%–40%	4	-	3	2	-
21%–30%	1	1	1	5	2
11%–20%	1	2	2	3	2
1%–10%	-	3	1	-	1
0%	5	11	8	6	12
Average	37%–42%	14%–19%	6%–11%†	18%–23%	4%–9%
2Q08 average	29%–34%	7%–12%	12%–17%	33%–38%	6%–11%

† WMS average dragged down by 3 large sources not spending with WMS; 8 other operations said WMS gaining share

SOURCES & BACKGROUND

31 senior gaming executives, representing more than \$104 million in direct 2007 spending on gaming equipment

UNITED STATES 26 senior executives from casinos and corporations (10 representing Las Vegas and Atlantic City, 4 representing Native American casinos, and 12 representing other regional casinos); **JAPAN** 5 senior executives with national pachisuro distributors/resellers;

REPEAT SOURCES 27 sources (22 in the United States, 5 in Japan) from OTR Global's June report

INTERVIEWS Late September through early October

AVERAGES Weighted according to each source's 2007 spending on gaming equipment

"We're buying equipment that is available from IGT now. We bought everyone else earlier in the year."

Las Vegas vice president of slot operations

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UNITED STATES

Significant share shifts in 3Q08

Some operators refrained from 3Q08 spending, but the ones that did divided spending differently between manufacturers from 2Q08. Bally had the biggest recipient for most of the year, but it received a lower share during 3Q08. Meanwhile, IGT previous market share slide reversed, with 10 of 24 casinos seeing a gain in IGT spending compared with 2Q08. Product release timing was a contributing factor for some with IGT's new server-based compatible AVP platform showing promise. A large casino's buyer said, "We're buying equipment that is available from IGT now. We bought everyone else earlier in the year." Another added, "The reason IGT is higher than normal is because of [its] new AVP cabinet."

With Aristocrat's new Viridian cabinet in its early stages of rollout, the company was gaining the attention of sources once again. "The new Viridian cabinet looks cool. We've been very lucky with Aristocrat at our property," said a source for a large corporate casino chain.

WMS remains the company to beat when it comes to participation product. While the life span of these games can be short, its *The Wizard of Oz* title continues to bring in impressive per-day numbers. "Right now, *The Wizard of Oz* is doing phenomenal. It is off the charts," an Atlantic City source said. Eight sources also said WMS was gaining share in for-purchase machines. "WMS is definitely making an all-out assault on participation and purchase products," one said.

Although no source reported a deterioration in the quality of Bally products, its marked increase in presence on casino floors this year may have led operators to turn their attention to other vendors this quarter. "We bought a lot of Bally this past year, and there was nothing else we wanted to buy," said a source for a tribal chain of casinos.

Although many sources spoke favorably about **Konami Digital Entertainment's** slot machines, the amount of spending they received during 3Q08 was down compared with OTR Global's 2Q08 findings. One executive for a casino chain said, "Konami continues to come out with impressive machines that our customers like."

Economy continues to affect spending

Although some casinos' customer counts remain largely unchanged, all sources reported decreased 3Q08 spending per customer and many reported their daily traffic down as well. The corresponding drop in revenue meant lower capital spending on equipment for properties, which was down 5%–10% yy. "Not as many tourists are coming in. People don't have the extra funds to travel right now. Local customers are still coming in but not spending and playing the way they used to play," said a vice president of slot operations for a Las Vegas casino. Another Las Vegas source said, "We're tightening our belt and making sure that the money is spent wisely."

Budgets for 2009 in limbo

With 4Q08 spending expected to be down 7%–12% yy, the long-term outlook is in doubt because of continued economic woes. One source said, "We are budgeted to go significantly higher in 4Q08, but that could change due to the credit crunch." Many properties are taking a cautious approach for 2009. "We anticipate spending the same amount in 2009, but it is a wait and see. Just because the budget is

ARISTOCRAT'S NEW CABINET SPARKS SPENDING

WMS STILL DOMINATES PARTICIPATION

BALLY SPENDING DOWN

KONAMI LOSES SHARE

"Not as many tourists are coming in. People don't have the extra funds to travel right now. Local customers are still coming in but not spending and playing the way they used to play."

Vice president of slot operations for a Las Vegas casino

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approved does not mean that it is the right business environment to spend,” a large regional casino’s executive said.

Even if they decide to go ahead with 2009 budgets, sources are not sure the money will be available because of the tightening credit market. “2009 is hard to track. Because our performance has not been stellar, it is on the minds of folks as to what the banks will do,” one said.

Economy affects participation in varying ways

Although casinos continue to limit the number of participation machines on the floor, there are some who feel they may have to re-think their strategy when it comes to the leased product. “I think we went too deep the other way and pulled too much participation units off the floor,” said a large regional chain’s executive. In the past, casino sources have said they would rather limit the number of machines they have to share the revenue with, but continuing budget constraints may force them to reconsider that strategy. “We’re looking at some leased games as an opportunity to save some money,” one said. Another said, “We still offer the key stuff, but we are looking at business differently with the current economy and capturing as much income as we can with our purchase games.”

“We’re looking at some leased games as an opportunity to save some money.”

IGT moving forward on server-based

Although server-based gaming appears to be off the radar for most sources, IGT appears to be eager to advance the discussion. With the anticipated opening of **MGM Mirage’s** City Center in 2H09, IGT has completed testing of its server-based system in one property and told another source it will be ready with its system in 1H09. Another source said, “We got a letter from IGT that they will be saying something about pricing at G2E.” Another said, “IGT has talked about pricing with us where they are looking to price out a certain number of units at a fixed price and then individual prices after that. They would like to go to a subscription model, but they are starting here.”

JAPAN

3Q08 sales still down, but no bloodbath

Japan sales of pachisuro and pachinko machines during 3Q08 fell an average 6%–11% yy, compared with April–June period, in which sales plunged an average 21%–26% yy. Despite the mild recovery in the yy sales growth rate because of the releases of some promising Reg 5 pachisuro titles during 3Q08, sources said many parlors still faced financial difficulties because of the continued decline of the gaming population. The G8 Summit in early July halted the new machine approval process and prevented much of the new machines from being sold and installed on parlor floors before and after the event, sources said, and that also hurt 3Q08 sales. “A number of parlors are still going under, but the rate of parlors going belly up has slowed down a bit,” said a parlor operator in western Japan. “Still, some parlors are having financial difficulties, and they don’t have enough money to invest in new machines.” Sources said many parlors have been buying or renting used machines instead of investing in new ones. As a result, they have been able to replace more machines to keep their customers entertained, while spending a smaller amount of money on machines.

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Sources are becoming mildly optimistic about the sales of Reg 5 Pachisuro machines in coming months and expect 4Q08 spending to be flat—up 4% yy. However, there still are players who are not satisfied with the watered-down versions of Reg 5's gambling factors. "After one year since the full conversion to Reg 5, players are finally getting used to the new machines," a source said.

Betting on cheaper machines more popular

So-called 1-Yen Pachinko or 5-Yen Pachisuro machines (which give players more balls or coins to play with for the money they put in for each gaming session) have become very popular, sources said. "In our business territory of Kanto [including Tokyo], about 30%–40% of parlors have so-called 1- or 2-Yen pachinko machines or 5-Yen pachisuro machines," a source said. The exchange or cash conversion rates of such machines are far worse than those of regular pachinko and pachisuro machines, so they are not for players who want to win big and convert their wins into cash, but they are favored by "those who want to play longer," he said. Another said, "[These machines] have been gradually increasing in number since last year, but the number jumped especially since this spring."

IGT's Nobunaga fares well

In late August, *Nobunaga No Yabo Online* — IGT's only new pachisuro title of the year so far and the pachisuro version of the popular MMORPG (massively multiplayer online role-playing game) by **Koei Co.** — was released. "It's the only title that IGT has released this year, but its reputation has been solid," a source said. "The rental business of this title has also been very strong." Three sources quoted *Nobunaga* sales (which represent the majority of IGT's 2008 sales) as anywhere from 5,207 units to 7,700 units at the end of September. "IGT expects to make some cosmetic changes to the back display panels of the new *Nobunaga* machines in October in order to boost the *Nobunaga* sales and also reduce its rental price to bring in more revenue from the rental business," a source said. In September, IGT conducted a campaign to promote the rentals of *Nobunaga No Yabo Online*, and slashed the four-month rental price to 180,000 yen from 220,000 yen.

Aristocrat Reg 5 popular in 3Q08

Aristocrat continued to do well in a weak Reg 5 market environment because of a solid reception of popular cartoon-themed *Mach GoGoGo: The Classic Speed Racer II*, released in March, and jail-themed *Kangoku Jack* released in May. Sources said those hit titles have been "well accepted by both players and parlors" and have helped Aristocrat "establish a good reputation." Aristocrat's latest title, *Kyojin No Hoshi IV: New Legend*, based on a popular baseball cartoon series, came out in early October, and one source said, "[It] has received excellent reviews so far." Another said, "[Aristocrat] will gain even a better reputation [with the new title]."

Although sources did not know how much Aristocrat's 3Q08 sales were, one speculated the company expects to sell all the initial 20,000 units of *Kyojin No Hoshi IV*. "Kyojin No Hoshi IV alone will record 20,000 units in sales, but such sales may be recorded in 4Q," he said.

"[Aristocrat] will gain even a better reputation [with the new title]."

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Legalization talk quiet

No major progress has been made on casino legalization since February, when the Liberal Democratic Party's (LDP) Casino Entertainment Subcommittee drafted its proposal and brought it to its coalition partner, the Komei Party, encouraging the latter to study the issue further. That is when the LDP also began to discuss its proposal with the opposition, the Democratic Party of Japan, in order to submit a bill to the legislature next year. However, a source said the Tomakomai Chamber of Commerce in the northern island of Hokkaido has established a 13-person study group on casino resorts in September to investigate the pros and cons of casino businesses.

This report was researched and written by **Robert Steelman**, **Michele Yamada** with additional reporting by **Toshiaki Tanaka** and **Caryn Dorfman** for Off The Record Research LLC.

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United States

ON THE ECONOMY

"So far, we haven't seen a tremendous drop-off in customer counts, but we have seen a drop-off in spend."

"Definitely, all customer segments are spending less at our property. There is less walk-in traffic as well."

"This is probably the worst September Atlantic City has had in a long time. We saw a 20% decline in the slot handle."

"We're not getting the crowds that we used to and the higher end is still coming, but their spend is down."

ON THE PLAYERS

"We have [IGT's] NexGen, but I think Bally has leapfrogged past their system, which does not download to the machine at high speed. Right now, it is an expensive place to put marketing, but I think it is essential to the casino."

"IGT is losing and Konami and WMS are gaining floor space. Aristocrat is having the new cabinets that should be getting a lot more attention."

"IGT's new machines are a big hit."

"Bally is gaining. [We] added more machines due to performance and demand."

ON PARTICIPATION GAMES

"We are continuing to reduce our participation. It has been all IGT thus far."

"IGT is still real strong with Wheel of Fortune still the market leader."

"I think IGT's product is in a decline to some degree."

"EBay is not performing as well as expected."

ON SERVER-BASED GAMING

"Each quarter it seems to slip further away. I think realistically, it is four to five years away from significant implementation."

"A lot of people have to make a major financial commitment, and I don't think many are prepared for it at this point."

"New areas of our floor are being wired for it, but from what I understand there is still not a real proven plan of how it will work"

"Nobody is really confident in the product yet."

"We saw a demo of a Bally game. All print goes to IGT, but Bally has a nice product. It is not too complicated for the customer; if it is too complicated, the customer will shy away from it. Bally has addressed this and it will be a work in progress to make it more consumer friendly."

ON 2H08 SPENDING

"We are trying to manage our expenses while riding this economic storm. We want to put good product out, but there has not be a lot of new games out there."

ON 2009 SPENDING

"We didn't spend much this year, so we hope to spend more in 2009, but we haven't heard back from corporate yet."

"We are in the process of putting our budget together, but with the financial market the way it is right now, it could change."

"We scaled back in 2008. We expect 2009 spending to be up 30% to 40% higher."

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ON PRICING AND PROMOS

“Surprisingly, we haven’t been hearing from manufacturers on any promotions.”

“WMS is offering some deferred payment plans and, in some cases, offering to waive royalty fees.”

“Aristocrat is pretty aggressive on Viridian. They are offering a lease-to-own deal where you can pay a daily fee for three years.”

“They are all very aggressive right now. I have been surprised at the offers. They are offering deferred payments, discounts — a lot of things to try and get sales.”

“IGT is always looking for ways to get their product on the floor. We are also looking at creative financing programs with IGT.”

“Aristocrat and Konami are offering different types of payment plans, which is nice for those of us with no money to spend.”

Japan

ON REG 5 AND GAMING MARKET

“Not many Reg 5 machines are earning enough money that parlors have expected from them.”

“Just as before, the reception of Reg 5 machines is no good, but we have to live with the Reg 5 machines now.”

“The number of pachisuro makers seemed to have increased recently, but I don’t know why exactly, and I don’t know the exact number for the increase ... but there should be more than 30 pachisuro makers now.”

“The number of players isn’t increasing, so parlors have to tighten their budget and wait for better timing of buying new equipment.”

“Pricing for both pachinko and pachisuro are remaining almost the same year to year. They are priced around 300,000 yen per unit.”

ON IGT

“One thing for sure is that the sales of Aristocrat titles have been far better than IGT’s this year as Aristocrat has released several new titles and they have done relatively well.”

“Because IGT has released only one title this year, it might be natural to think that its 2009 sales will be better than 2008 sales, but we’re not sure, and it’s too early to tell.”

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United States

1. What are the key issues or factors that will affect the gaming industry over the next 6 months?

Economic issues:	22
Server-based gaming developments:	1
None:	1

2a. Did you add or eliminate any participation or leased games over the past 90 days?

Added:	4
Added and eliminated:	5
Eliminated:	7
No change:	8

2b. Is any manufacturer outperforming or underperforming in participation or leased games?

	OUTPERFORMING	UNDERPERFORMING
WMS:	8	-
IGT:	6	3
Bally:	1	-
AC Coin:	-	2
Atronic:	-	2
None:	8	15
Don't know:	1	1
No response:	-	1

3a. Did your 3Q08 capital spending budget for gaming equipment increase, decrease or remain the same yy and qq?

	YY	QQ
Up 21%–25%:	1†	-
Up 6%–11%:	-	2
Up:	3	2
Flat:	5*	7*
Down:	2	3
Down 1%–5%:	1	1
Down 6%–10%:	2	1
Down 11%–15%:	1	-
Down 16%–20%:	1*	1*
Down 26%–30%:	1	1
Down 31%–40%:	2	2
Down 51%–60%:	1	1
Down 91%–100%:	1*	1*
Not applicable:	3	2
3Q08 average:	Down 5%–10%	Flat
2Q08 average:	Down 2%–7%	Up 1%–6%

* One source not included in the average because of a lack of weighting data

† One outlier not included in the average

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3b. Do you expect your 4Q08 and 2009 capital spending budget for gaming equipment to be increase, decrease or remain the same yy?

	4Q08	2009
Up 91%–100%:	-	1*
Up 41%–50%:	-	1
Up 31%–40%:	-	1
Up 26%–30%:	-	2
Up 11%–15%:	-	1
Up 6%–10%:	-	1*
Up 1%–5%:	-	1
Up:	6	1
Flat:	4	8
Down:	6	2
Down 6%–10%:	1	1
Down 11%–15%:	1	-
Down 21%–25%:	1*	2*
Down 26%–30%:	1	-
Down 31%–40%:	-	1
Down 91%–100%:	1*	-
Don't know:	-	1
Not applicable:	2	-
3Q08 average:	Down 7%–12%	Up 3%–8%

4a. What are your top areas (or priorities) for 2008 equipment spending? (Some sources gave more than one answer.)

Conversion kits:	12
Gaming equipment additions:	7
Gaming equipment replacements:	11
Property upgrades:	1
Table games:	2
New games:	1
Repairs:	1

4b. Whose operating system do you use?

Bally:	14
IGT:	8
Konami:	1
Aristocrat:	1

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5. What percentage of your 3Q08 gaming equipment spending went to IGT, Aristocrat, WMS and Bally?

	IGT	ARISTOCRAT	WMS	BALLY	KONAMI
91%–100%:	2	-	-	-	1
71%–80%:	-	-	-	1	-
61%–70%:	3	-	1*	-	-
41%–50%:	2*	1	2	1	-
31%–40%:	4	-	3	2	-
21%–30%:	1	1	1	5*	2*
11%–20%:	1	2*	2	3	2
1%–10%:	-	3	1	-	1
0%:	5*	11*	8*	6*	12*
No response:	1	1	1	1	1
Not applicable:	5	5	5	5	5
Average:	37%–42%	14%–19%	6%–11%†	18%–23%	4%–9%
2Q08 average:	29%–34%	7%–12%	12%–17%	33%–38%	6%–11%

† WMS average dragged down by three large sources not spending with the company; eight sources from other casino operations reported WMS was gaining share.

6. Which supplier is the most aggressive with pricing or promotions?

Aristocrat:	5
Konami:	4
IGT:	3
Bally:	2
WMS:	2
All the same:	5
None:	2
No response:	1

7a. When do you expect to have server-based gaming on your floor?

1H09:	1
2H09:	1
After 2010:	11
Don't know:	11

7b. Has there been any word on pricing from the manufacturers?

Yes:	1
No:	22
Don't know:	1

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Japan

8. Did your 3Q08 spending on pachinko and pachisuro equipment increase, decrease or remain the same yy? Do you expect 4Q08 spending to increase, decrease or remain the same yy?

	3Q08	4Q08
Up 11%–15%:	1	-
Up 1%–5%:	-	1
Flat:	2	2
Down:	-	1
Down 11%–15%:	1	-
Down 31%–40%:	1	-
Don't know:	-	1
Average	Down 6%–11%	Flat–up 4%
2Q08 average:	Down 21%–26%	

9. How are the new Regulation 5 pachisuro games being received?

	SEPT. '08	JUNE '08	MARCH '08	DEC. '07	SEPT. '07
Above average:	-	-	1	-	-
Average:	3	-	1	1	2
Below average:	2	5	3	4	3

- 10a. How are IGT's new Regulation 5 Pachisuro games being received?

Good:	3	-	-	-	-
So-so:	2	-	-	1	2
Not so favorable:	-	-	4	4	3
Not applicable:	-	5*	1	-	-

* Due to IGT not releasing any new Reg 5 titles.

- 10b. How are Aristocrat's new Regulation 5 pachisuro games being received?

Good:	4	1	3	2	-
So-so:	-	4	-	3	1
Acceptance increased:	1	-	2	-	-
Not so favorable:	-	-	-	-	4

11. Do you expect your 2008 purchases of IGT pachisuro equipment to increase, decrease or remain the same yy?

	SEPT. '08	JUNE '08	MARCH '08
Decrease:	-	5	4
Don't know:	4	-	-
Not applicable:	1	-	1

12. Is pricing (average purchase price) for equipment increasing, decreasing or remaining the same yy?

	SEPT '08	JUNE '08	MAR '08	DEC '07	SEPT '07
Up 6%–10%:	-	-	-	-	-
Up 1%–5%:	-	2	-	2	-
Up:	-	-	1	2	1
Flat:	4	3	3	1	3
Down:	1	-	1	-	1

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