

THE FINANCIAL EVALUATION PROCESS OF RFPs IN THE GAMING SELECTION PROCESS

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ABSTRACT. Many new gaming jurisdictions with limited licenses have used "Request For Proposals" (RFPs) process to select casino operators. Bids are evaluated in terms of the viability of the proposal and the benefits that will accrue to the governmental entities and the operators. The financial projections and the viability of the bidding entities are emphasized during the evaluation process. The authors discuss the problems that can arise when comparing financial information supplied by the bidders. They identify a basic foundation to be used for the evaluation process and provide suggestions for improving both the RFP process and the subsequent evaluation.

INTRODUCTION

City and state governments across the United States are continuously looking for ways to restructure their economies in an attempt to raise their revenues. One option that many of these city and state governments have embraced is gambling in the form of casinos or riverboats. The development of this new industry within a state is seen as a relatively

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quick economic fix in terms of job creation and potential for abundant tax revenues.

Associated with the growth of this new industry is a learning curve for dealing with problems associated with it. Experiences with new casino gaming in South Dakota, Colorado, and Mississippi have shown that unlimited licensing of casinos will produce a boom and bust cycle with many negative effects. For example, both Colorado and South Dakota have found that, within the initial two year period of time, more than 50% of the properties have changed ownership, with approximately 33% closing down completely. Mississippi is currently starting to find properties with similar problems. As a result, many of the new gaming jurisdictions are limiting the number of casinos that can operate within a given geographic location. This has led to a selection process whereby a "Request For Proposal" (RFP) for building and operating a gaming establishment is issued by a governmental agency.

The RFP results in submitted bids that are evaluated in terms of the viability of the proposal as well as the benefits that will accrue to the governmental entities and the operators. There are currently 10 states that have embraced some form of casino gambling (not counting Native American Casinos). There are another 12 states that are introducing legislation for possible casino gambling (Taube, 1994). Each of these new jurisdictions may use an RFP in its selection process. The objective of this paper is to provide information about RFPs that can help the new jurisdictions make quick and efficient decisions in the selection process.

The process for evaluating the bids can be very complex. It can include analysis of feasibility studies, fiscal impact studies, architectural designs, physical layout designs, corporate citizenship, viability of the operators, and financial projections. While many factors are involved in the evaluation process, a large number of evaluation teams place heavy emphasis on the viability of the bidding entity and the analysis of financial projections.

An appraisal of the total evaluation process would take substantial time and effort and is beyond the scope of this paper. This paper limits itself to identifying and discussing the relevance of financial information used in the selection process. This includes the role of financial information in evaluating RFPs, inherent problems in using financial

information in the evaluation process, and recommended steps for making the evaluation process more efficient.

REQUESTS FOR PROPOSALS

Common Elements

RFPs are not new; governmental agencies have been issuing them for a substantial number of years. RFPs can range from the specifications for the purchase of supplies, to garbage disposal services, to the installation of new computers and software. No matter what type of RFP is issued, there are typically three problems that must be resolved:

- Is the RFP written clearly enough to identify the product to be bid on?
- What evaluation process will be used to select the winning bid? and
- Does the RFP provide enough guidance so that the proponent can provide relevant information for the selection process?

Rather than reinventing the wheel, any governmental agency interested in entering an RFP casino negotiating process should start by reviewing prior RFPs. A review of these can provide an overview of the type of information required for the selection process.

Table 1 provides a list of eight cities that have recently issued RFPs with the intention of selecting an owner/operator to build and run a casino/riverboat at a specific site. Five of the RFPs are for riverboat gambling development opportunities. The other three are for casino development in the cities of New Orleans, Sydney and Windsor. Only the Davenport, Shreveport and Windsor facilities are up and running. The others are still in the negotiating stages or currently under construction, therefore the total costs of these projects are unknown. However, initial riverboat and facility costs in the early 90's were in the \$15 to \$25 million range. More recent estimates of entry costs for riverboat projects range from \$40 to \$80 million and higher (Szapor, 1994). For example, one of the bids for the Gary, Indiana riverboat project estimates a cost of \$109 million just to develop the area around the riverboat (*Reno Gazette Journal*, 1994).

TABLE 1
Cities Submitting Requests for Proposals

Davenport, Iowa
Kansas City, Missouri
New Orleans, Louisiana
Shreveport, Louisiana
St. Joseph, Missouri
Sydney, Australia
Windsor, Ontario
Newport News, Virginia

The land based casinos have major price tags associated with them. The Windsor casino is the cheapest at \$350 million; the Sydney estimate is approximately \$400 million, while the New Orleans figures are \$600 million and rising. Of course, the New Orleans casino is expected to be the largest in the world at over 200,000 square feet. As of July, 1994, none have broken ground for construction.

The time and effort needed to make an evaluation of the bidders responses to an RFP will increase as the cost of the projects and the risk of getting the project operational increase. The risk of business failure will also increase as more gaming comes on line. Governmental agencies will need to spend more time and energy ensuring that they have selected the best possible proposal for their project. While the following analysis is more relevant for larger land based projects, it can be used for riverboat projects particularly as the cost of these projects increases.

Defining the Product in the RFP Offering

The RFP must be clearly written so that the bidders will have some idea of the project to be bid on and be able to respond within these guidelines. The broader the guidelines, the more diverse the projects will be. The more diverse the project, the longer it will take to make the decision process work.

When any RFP is being developed, a primary rule should be that the governmental parties involved have a full understanding of the authority each possesses in the selection of the winning RFP. New Orleans is an excellent example of a situation where the different governmental authorities did not understand their respective roles in the selection process. The City of New Orleans issued an RFP for building and running a casino on a specified block in New Orleans, however the City did not have the right to issue the license to the winning bidder of the property. The State of Louisiana issued its own RFP for the same site based on its ability to issue the license. The end result was that the city awarded the project to a joint venture controlled by Hemmeter, while a joint venture controlled by Harrah's received the winning bid from the state. The resulting chaos forced the two winning bidders to spend close to six months negotiating a separate joint venture. In the process, Hemmeter dumped its original partner, Caesars, which has now sued both Hemmeter and the State of Louisiana, arguing that Hemmeter's original bid is no longer valid because the city has accepted major changes in it.

Diversity of Proposals

A perusal of the various RFPs finds that many of the cities issuing the requests already had a potential site for the proposed gaming establishment. However, it appears that the governmental agency issuing the RFP did not give much thought to the type of development wanted on its respective property. In many cases, no precise information on the proposed property or casino was provided in the RFPs.

For example, the City of New Orleans' RFP was issued with no direction in terms of the type of property, casino size or style that should be built. It stated that the casino would be developed on the 6.47 acre Rivergate Site in downtown New Orleans. This site already contained a convention center. The RFP suggested that a "respondent may wish to renovate the existing improvements. However, it is envisioned that the selected Developer will remove the Exhibit Center and construct new facilities that would include a casino/gaming facility or a mixed use project." It also included a statement which said, "the City encourages proposers to provide monetary benefits or bonus bid items" to enhance the proposals.

The result of the New Orleans RFP process was a wide range of designs and sizes from the operators. Half the proposals renovated the property while the other half demolished it and built a new structure. Casino square footage ranged from 120,000 to 250,000. The entertainment area ranged from 0 to 120,000 square feet. The restaurant space went from 0 to 55,000 square feet. The total property ranged from 300,000 to 450,000 square feet. Projected costs of the project ranged from \$210,000 to \$475,000 but were not comparable on a total square footage basis because of different additional contributions or "enhancements" being made for non-casino projects (Office of the Mayor of the City of New Orleans, 1992: 4).

Hemmeter's winning bid from the city was based on the complete demolition of the old structure and construction of an entirely new structure. Harrah's winning bid from the state was based on a proposal that would have renovated the old building. After further negotiations between Hemmeter and Harrah's, the bid was modified to allow for the demolition of the existing structure and construction of an entirely new complex. After an agreement was reached between Hemmeter and Harrah's, the Attorney General of Louisiana threw out the bid because the original bid had been modified and reopened the bidding process. Fortunately, no additional bids were received, however it did add another month to the process. Substantial time and effort on everybody's part could have been saved if the decision concerning the existing structure had been made and clarified before the original RFP was issued.

The original RFP for the New Orleans' casino was dated April 22, 1992. The original bid has gone from \$475 million to \$790 million due to various delays and additional payments to the city and the state. A report in the August 25, 1994 edition of the *Nevada Journal* indicates that a new snag with the city would delay until at least November 10, 1994, plans to sell \$570 million in high yield bonds. The article indicates that new potential road blocks, such as higher interest rates, escalating costs caused by delays and a bond market that is turning cool to casino projects, may sink this project.

Compare the New Orleans process to the approach taken by the Windsor Ontario Community. Substantial time and effort were taken to

limit the parameters of the property on which bids were accepted. The proposal specified that the casino complex would include:

- An equipped gaming area of a maximum of 75,000 square feet,
- An entertainment facility,
- Three restaurants (coffee shop, popularly priced and upscale),
- A hotel with a maximum of 300 rooms,
- Lounges and/or bars,
- A child care facility for children of employees,
- A gift shop, and
- Parking Facilities, tour bus drop-off facilities and other related infrastructure.

The Ontario Casino Project group had a response date of June 30, 1993; selected a short list of four bidders by October 1, 1993; and made the final selection by November 30, 1993. Final negotiations have been completed and a temporary casino opened by March 1, 1994.

The riverboat proposals have also been highly variable. For example, the latest RFP was issued by the Mayor of Newport News, Virginia, dated June 30, 1994 and sought proposals and proof of qualifications from developers to design, build and operate a riverboat gaming facility. No other information was provided thereby leaving the possibilities up to the developer. Submission requirements were stated as follows:

"Provide a written and visual summary of your proposal identifying the property necessary for your development and the various physical components of the project (e.g. size and amount of parking, square footage of structures, linear footage of waterfront improvements, size and type of boats, extent of dredging, etc.)" (The Industrial Development Authority of the City of Newport News, 1994: 1).

The Newport News proposal also indicates that gaming has not yet been approved and that the city council is in the process of determining definitive proposal selection criteria and process. While the Newport News government must be commended for looking forward and trying to move ahead of other towns and cities in Virginia, more attention may

have been given to the RFP if it had been more clearly written with selection criteria defined.

A more definitive RFP was issued by the Port Authority of Kansas City, Missouri. It included two possible sites for the Riverboat casino operation as well as providing a Master Plan for the Redevelopment of the Riverfront. The Port Authority also provided comprehensive selection criteria in its RFP, as shown in Exhibit 1.

EXHIBIT 1
City Of Kansas City, Missouri, Selection Criteria

The Port Authority reserves the right to reject any and all submissions. The Port Authority will give preference to proposers which:

- a. Are publicly traded companies.
- b. Currently hold gaming licenses in Nevada or New Jersey and currently have gaming operations in one or both of these localities.
- c. Have been in the gaming business for 10 years or longer.
- d. Currently have riverboat gaming operations.
- e. Make the strongest possible commitment to MBE/WBE participation in the planning, design and construction of the operation and as vendors to the operation.
- f. Make the strongest commitment to Kansas City, Missouri resident and minority hiring.
- g. Demonstrate the strongest financial capability.
- h. Provide significant lease income to the Authority.
- I. Demonstrate and commit to high quality land side developments and amenities and which have a detailed plan for sufficient landscaped parking and careful traffic organization.
- j. Commit to the continuation of the pedestrian pathway established in the Sasaki waterfront park plan through the proposed development.
- k. Detail and commit to programs dealing with underage and problem gambling.
- l. Detail and commit to a security plan for the entire gaming complex.

THE SELECTION PROCESS

Selection Criteria

Once the governmental entity has clearly defined the parameters of the proposed casino project, the next step is to specify the criteria that will be used to make the selection process. A clear specification of the criteria that will be used in the selection process is essential in establishing the information that must be submitted by the bidders.

Table 2 provides a summary of the financial evaluation criteria that were included in the 8 RFPs reviewed. Table 3 includes a list of required financial information that the agencies wanted for making the selection of the casino operator. These tables show that while there is a wide range of evaluation criteria and financial information requested, there appear to be common elements of information across all the RFPs.

A review of the financial evaluation criteria (Table 2) shows that while nine different evaluation criteria are used by one or more of the entities, three basic criteria are used by most, if not all, of the evaluators. The obvious criteria are that the bidding operator have the financial capability to get the project developed and operational, and is capable of funding the project through the initial start up phases. Six of the eight

TABLE 2
Use of Financial Evaluation Criteria

Financial Evaluation Criteria	# Requested
1. Experience in Gaming Operations	6
2. Financial Capability	8
3. Operating Projections and Assumptions	6
4. Operator Financial Investment	1
5. Litigation Disclosure	2
6. Licensed in New Jersey or Nevada	1
7. Define Lease Income to Authority	4
8. Contributions in Aid to City	2
9. Length of Commitment	1

RFP proposals wanted firms to have experience in gaming operations. Six proposals also include operating projections and assumptions in the evaluation criteria.

Each of these criteria appear to be reasonable in helping to select the best possible operator to run a new casino project. The criterion that the operator be an on-going, successful participant in the gaming industry would eliminate any new companies looking to make a quick profit and then abandoning the project. The next criterion, that the operator have the ability to put together a financing package to build and operate a casino in the municipality's jurisdiction, provides assurances that the operation will not fold before it has the chance to open. The final criterion, that the operator has the ability to make financial projections, offers the proposer the opportunity to define reasonable and realistic future earnings forecasts. This provides the taxing entity a means for determining future cash flows to the city, county, etc.

Table 3 enumerates the types of financial information requested to substantiate the evaluation criteria. Again, there appear to be three common elements of financial information across the RFPs. These three elements are: 1) company annual report and/or 10-K, 2) sources and methods for project funding, and 3) financial projections for the proposed gaming operation. While the information requested was common across the proposals, the time periods for information requested was not. For

TABLE 3

Financial Data Required	Terms
- Annual Report and 10-K	1 to 4 Years
- If New Corporation, Pro-forma Balance Sheet	Required by 2 Cities
- Sources for Funding Project	Required by All Cities
- Monthly Financial Projections	Required 3 Cities
- Yearly Financial Projections	Required by 5 Cities, 5 Years
- Proposed Lease Structure	2 Cities Require
- Costs of Other or Proposed Projects	1 Requires
- Current Financials for Each Gaming Property	1 Requires
- Assumptions for Financial Projections	1 Requires

example, requests for annual report information ran from 1 to 4 years of annual reports. On the other hand, most proposals asked for 5 years of financial projection information.

While Table 3 provides a picture of the information governmental entities have requested be used in the financial evaluation process, the real concern should be whether this is relevant information that is actually used in the decision process. The remaining part of this paper provides a foundation for making use of the requested information as well as pointing out the problems that can be associated with the analysis of such information.

EVALUATION OF SELECTION CRITERIA

The winner of any RFP bidding process should be experienced in the gaming industry and have the financial flexibility to build and operate a successful casino. Audited financial reports provide the basis for determining the viability of a corporation. Analysis of prior RFPs show that the bidding companies may have to provide anywhere from 1 to 4 years of financial statements. How many years of financial information should be requested? That decision must be based on how the information is to be used and whether the evaluators understand what is actually included in these annual reports.

Content of Annual Reports

A corporate annual report is composed of two types of information, audited financial information and non-audited financial information. Audited data are verified by a CPA firm as conforming to specified accounting procedures. Such information consists of two or three years comparative data presented in the form of the Income Statement, Balance Sheet, Statement of Cash Flow and notes to the financial statements. Additional financial information, which is not audited, includes a minimum of 5 years of relevant financial information in summary form and a section entitled "Management Discussion and Analysis." While not audited, this information is closely monitored by the Securities and Exchange Commission (SEC). If the SEC finds this information to be misleading, the firm can be sanctioned or sued.

The evaluation of a company's viability and success can be accomplished with its latest annual report by using the five year summary of financial data. The evaluator uses the company's past performance as an indicator of future performance. This does not mean that there is no need for prior years' annual reports. A primary reason for requesting the annual report for more than one year is the dynamic nature of companies. They are continually merging, buying or selling different components or subsidiaries. When the financial statements of all the subsidiaries are consolidated at year end, that combination can be entirely different from the previous year.

For example, assume that the financial statements for year 1 for the company, "Multi-Corp", are the combined information of companies A, B, and C. Multi-Corp sells company C in year 2. The two years of comparative financial statements prepared in year 2 would completely restate the financial statements for year 1 and only include information based on company A and B. It would appear as if Multi-Corp never owned company C in year 1. Therefore, analysis of more than one year's annual report can provide a basis for where the company has come from and where it is heading. Although acquisitions and disposals are also discussed in the "Management Discussion and Analysis" section and the footnote section of the financials, the impact of such transactions may be more visible by the comparison of two consecutive years of annual reports.

Another reason for having annual reports for more than one year is that the five year summary may be too general to develop trends relating to a specific industry such as gaming. For example, Promus is the parent corporation of Harrah's, Embassy Suites, Hampton Inn, and Homewood Suites. The five year summary information is based on the aggregate of all these companies. The annual reports on the other hand do provide comparative information (income and assets) for two years broken down by segments, which in Promus's case consist of casinos and hotels. For the evaluation of RFPs, the important issue is how well the company is performing in the gaming industry.

The company's summary of the previous five years operations or the aggregation of the information from yearly annual reports on a segmental basis provides the necessary information for developing a picture of

possible company trends. For example, determining the effectiveness and efficiency of the company's operations can be achieved by converting the income statement into percentages. The percentage base most commonly used is sales. This provides standard relationships across companies on the basis of components of revenues and expenses such as departmental expenses for hotel, casino and restaurants. This information also can be used to evaluate trends such as whether costs are increasing as a percentage of total revenues. Any comparisons that are made should be based on industry averages, not just the companies that have submitted RFPs.

Ratio analysis can be used to evaluate profitability, liquidity and financial flexibility. Profitability ratios can be derived from the original data and used to measure the degree of success of a company's operations. The current ratio is commonly used to test the capability of a company's short run ability to pay its maturing obligations. Debt to equity ratios are used to evaluate the company's financial flexibility and capability to take on more debt for new projects.

The Management Discussion and Analysis section of the annual report is another source of information concerning the company. In this section, management is required to highlight favorable as well as unfavorable trends and to identify significant events and uncertainties that affect the company's liquidity, capital resources, and results of operations.

The financial statements provide information concerning past transactions. Many of these past transactions result in future potential and real liabilities. The commitments and contingencies section of the annual report discloses events that result in material future cash outflows as well as possible future cash outflows resulting from lawsuits against the business. Examples of possible future cash outflows are such items as operating leases and guarantees for subsidiaries or other parties. The disclosure of the undertaking of new projects or potential future projects that can have a significant impact on future cash flows is normally made in this section.

Financial Viability of the Operator

Ratio and percentage analysis assist in the provision of common elements of comparability across companies in determining which

companies are better than others or which companies have limited financial flexibility. Another important piece of information that must be used is comparative data based on industry norms. Substantial information is available from companies, such as Wertheim Schroder and First Boston, which specialize in providing relevant financial ratios and percentages as well as recommendations for firms within the gaming industry. But the analysis can be distorted if there is no consistency with the ratios used or if joint ventures have been created.

Analysis of companies' annual reports show that many of these reports include commonly used ratios such as current ratios, free cash flow, return on investment, and debt to equity. Using the supplied information can help shorten the time needed for analyzing each company. But, wrong decisions can be made if the evaluator fails to ensure that each company calculates the ratios using the same numbers. The same can be said when making comparisons to industry ratios provided by Dun and Bradstreet. It is not uncommon to find different numbers being used for common ratios. For example, the debt to equity ratio, a commonly used ratio, can be calculated in a number of ways. Some companies use total debt while others only use long term debt. Some companies compare the debt to total equity while others only use stockholders' equity.

Newly formed corporations or joint ventures create some unique problems in terms of evaluating the bids submitted by them. A decision must be made on how much additional financial and nonfinancial information is to be collected on the parties involved in the newly formed corporations or joint ventures. It should include the types of commitments and guarantees being offered by the various parties. For example, in phase II of the New Orleans' RFP process four bids were submitted. Three of the four bids were new companies, while the fourth was a joint venture.

An examination of the three new companies illustrates the issue of commitment. Each of these companies was established to finance and build the project. Since none of these companies had any gaming experience, a casino operator (management team) would be hired under a separate management agreement. Even though the gaming corporations were aligned with the respective bidders early in the process and were to

be active participants in the development stage, they appeared to assume minimal financial risk in the project. The relationship between the Hemmeter/ Robinowitz group and Caesars provides an example of this lack of commitment on the part of the gaming operator. The Hemmeter/ Robinowitz group proposed a property costing \$427 million. The proposed financing had \$160 million coming from equity funding, \$25 million from bank financing for working capital and \$230 million from mortgage notes. Caesars' interest in this project was limited to the contribution of \$10 million to be used for working capital once the operation was on line. If the property never came to fruition, then Caesars assumed no risk and could back out of the project without penalty. It is in fact ironic that Hemmeter turned around and dumped Caesars to form an alliance with Harrah's as a compromise between the city and state bidding process.

The other two bidders put together packages similar to the Hemmeter group. The New Orleans Louisiana Development Corporation consisted of ten stockholders with no gaming experience but a management contract with Showboat, Inc. The group contributed a total of \$5 million of the \$210 million needed. The rest would be generated by debt and equity financing. The Casino Orleans Consortium also had no gaming experience and had a management contract with Carnival Management Services. This group contributed \$8 million of the \$475 million project cost with the remaining coming from both debt and equity financing.

The joint venture bid for the New Orleans RFP illustrates other types of problems. Individually, both firms can be strong contenders for any bid. The real concern is the amount of commitment each company has for a joint venture project. Trouble arises in joint venture situations where the participants have unrealistic expectations as to how rapidly a joint venture development will become self-sufficient. If, as has happened in New Orleans, the time tables fall far behind and additional funding becomes necessary, one or more of the participating organizations may have difficulty coming up with its share of additional cash flows. If major problems arise, there is the possibility that either one or both would choose to back out of the project because a participant may have already risked all the funds on the joint venture that it is willing to risk.

Another problem with joint ventures revolves around an operational aspect: what type of property will be developed and who will have authority over operating decisions. The people in charge of the Ontario RFP process considered these issues before granting their bid to a consortium of Circus Circus, Caesars, and Hilton. Each of these entities had the financial capability to provide the resources necessary for the proposed project. The real question centered on the type of project that would result from a mixture of three different management styles and marketing strategies. Circus Circus targets the low end market, Hilton aims for the middle and upper end, and Caesars addresses the upper end of the market.

Financing Package for New Property

The second criterion in the evaluation of proposals is the cost of the new project and how it will be financed. Evaluators of the RFP proposal should concern themselves with 1) the composition of the project costs, and 2) the financial flexibility to finance the project.

Project Cost Composition

It appears that many of the governmental agencies that evaluate the RFPs tend to concentrate on the design and esthetics of a project and are only concerned with the financing of the total project costs. Creditors, on the other hand, look at a project in terms of the ability to secure collateralized assets in the event of a loan default. With cities expecting the companies to include community projects, the total project costs result in substantial expenditures with no asset backing. Evaluators need to be aware that the ability to finance as well as the type of financing available for any casino project is a function of the mix of soft and hard costs.

Part of the analysis of the costs associated with a new project should be the separation of these costs into three components; 1) Pre-opening costs and bankroll, 2) Property and plant, and 3) Furniture, fixtures and equipment. Such a breakdown provides an indication of the types of financing needed (both debt and equity) and in what amounts. For example, if financing were to be put together for the Casino Orleans project, a classification into the three categories could be presented as shown in Exhibit 2.

This type of cost breakdown shows that of the total project costs of nearly \$475 million, approximately \$170 million represent assets that can be used as collateral; the \$131 million of equipment and the \$39 million of fixtures. The \$131 million for property and equipment could be financed with asset backed mortgage debt, while the other \$39 million for furniture and fixtures could be financed through leasing arrangements.

Many of the other costs represent cash outflows that are unrecoverable from a creditor's point of view. The payment to the city of \$100 million and the mass transit improvement represent necessary capitalized costs but will not generate any future cash flows. These and the other pre-opening costs would probably require some form of equity financing or high yield junk bonds, assuming that projected positive future cash flows could support such payments.

Thus, when evaluating the type of financing proposed by the operator, careful consideration should include whether the financing package matches up with the composition of project costs. If the financing of the project is coming from internally generated funds, this is a minor factor in the evaluation process. However, if funds must be generated externally, then it becomes a very important factor.

Financing Flexibility

The rapid expansion of new gaming jurisdictions along with RFPs that call for bidders with gaming experience has meant that the limited number of experienced casino operators have had rapid expansion. For example, Boomtown, Inc. a small 30,000 square foot casino located outside Reno, Nevada initially went public in September of 1992. The last year has seen this company develop and open new properties in Las Vegas, Biloxi, and New Orleans. Total assets in 1992 were \$55 million. Since then it has raised an additional \$90 million in equity and \$184 million in debt. It is currently exploring other opportunities for expansion.

This type of rapid expansion should make evaluators of RFPs aware that a corporation's financial position can change dramatically between the time the annual report is published and the time that the RFP is being considered. It is not only necessary to look at the viability of the company based on its financial statements, but an additional consideration

EXHIBIT 2
Casino Orleans Project Costs

1. Pre-opening Costs and Payroll;	
City Payment	\$100,000,000
Mass Transit Improvement	20,000,000
Contingencies and Reserves	141,958,487
Training	2,500,000
Pre-opening Costs	30,490,000
Finance Cost	9,944,440
Total	304,892,927
2. Property and Equipment;	
Building Construction Costs	56,647,073
River Cruise Terminal	7,000,000
Park-garden	28,500,000
Interest Carry	20,000,000
Parking	19,974,000
Total	131,121,073
3. Furniture, Fixtures & Equipment	38,610,000
Total Project Costs	\$474,624,000

Source. Developed by John R. Mills from information contained in the Casino New Orleans Proposal, November 1992.

should be the new projects it is involved in, as well as the cost and financing of these new projects. These projects could significantly alter the financial structure and flexibility of the bidder.

It is quite possible that the potential developer and/or operator could overextend itself both in terms of financial resources as well as management resources. When looking at the new projects or potential future projects, relevant information should include the cost of the new project, the mix of debt and equity used to finance the project, and if a joint venture, the percentage of ownership and funding required.

The use of information developed from the annual reports plays a significant role in this process. A company's financial flexibility in terms of its capital structure must be considered when looking at the total cost of the project and the possible financing of the project.

Problems in Evaluating The Financing Package

The major problem associated with the financing of the projects is the likelihood of the financing packages actually coming to fruition. For example, some experts questioned the ability of the Hemmeter/Robinowitz group to raise the necessary financing for the New Orleans project. Hemmeter developed major projects in the past and was able to raise the necessary funds through private financing. But doubts existed about his capability to obtain the funds for this undertaking. David Berkowitz, president of USA Capital Management Group in Las Vegas, which specializes in gaming companies, believed that Hemmeter did not have enough experience in gaming to put such a financing package together. He believed that Hemmeter might have to put up as much as \$200 million in equity before finding lenders willing to provide the other \$200 million (Hughlett, 1992: 1).

Many of the RFPs request information on the capability of financing the project. This typically results in letters of interest of either debt or equity financing from bankers or underwriters. In many cases these represent an interest to back a financing project by going to the market and issuing either debt or equity. Evaluators must be sure to distinguish this type of letter from approved lines of credit or commitments from private investors. Showing interest to put together a package for financing in the market place still carries a risk that such financing will fall through. The uncertainty of such financing should cause any selection committee to place a higher value on those companies having equity contributions and private or bank debt financing over those that must go to the debt and equity markets to raise their funds.

Financial Projections: Base Model for Revenue and Expense Projections

Financial projections, the third evaluation criterion, represent the estimation of future income statement and balance sheet information based

on careful analysis of economic data and the anticipated cost of the proposed casino. The evaluation process must review the projected income statement and determine whether the assumptions used for revenues and expenses are logical and reasonable. Effective evaluation of these projections can only be achieved if the evaluation team has some predetermined model that can be used for comparative purposes.

The evaluation team can find a wide array of figures that each proposer uses to develop the financial projections. The evaluation team needs a starting point for defining which proposers' projections may be reasonable or grossly optimistic. This means that the evaluation team needs two basic models with which to work; one to generate the revenue figures and one to generate the expense figures.

An independent economic impact study, from a reputable source, can provide the number of possible visitor days and the amount of revenue generated per visitor day. The information allows the computation of base revenue figures for testing the reasonableness of the proposals' figures. Additional data from the economic study that should be used by the selection committee includes revenues per visitor or revenues per gaming device based on the latest gaming statistics available. If possible, the gaming statistics should be based on an existing gaming operation which is equivalent to the proposed casino. The selection committee takes this information, factors in the proposed client base to which each company expects to market, and makes a decision as to the reasonableness of the proposed revenue projections of each of the bidders.

Once the evaluation committee is comfortable with the viability of the revenue projections, the next step is to define the expense model to use for comparison. Expense models are based on industry norms and are usually calculated as a percentage of gaming revenues. The models will differ as a result of the demographics of the customer base the casino is trying to attract. For example, Caesars is known for catering to the high end clientele base which will result in higher personnel costs as well as higher hotel and restaurant complimentarys. Circus Circus, on the other hand, is known for low costs and high volume with very few complimentarys given.

The expense projections model must be adjusted by factors such as the cost of the new casino project, financing of the project, and tax and incentive payments made to the governmental agencies.

The actual evaluation of expense items is predicated on the type of payments or participation of earnings that the governmental entity is going to receive. These payments can be a flat fee, a percentage of gross revenues, or possibly a percentage of net earnings. Flat fees and percentage of gross revenues place no emphasis on other type of expenditures. Therefore, the evaluation process would emphasize profit margins and the reasonableness of them. If the governmental entity has some form of participation based on profits, then a full analysis of the various types of expenditures must be made in order to determine those included when arriving at the profit figures. For example, both New Orleans and Windsor will receive a percentage of the operator's net profit.

Problems in Evaluating Financial Projections

Financial projections pose three significant problem areas. The biggest problem is providing comparability across the different proposals. The other two problems are assessing the impact of financing the project costs and the impact of management fees.

Comparability of Financial Projections

Corporations have different approaches for accumulating costs for different departments. For example, some allocate administrative costs to each revenue producing department while others show these costs separately. Because of these different approaches, the evaluation team must be able to ascertain whether each of the proposers' projections must be adjusted in order to properly compare the bids for reasonableness. The multitude of problems revolve around classifying the information into similar types of revenues and expenses across the companies as well as being able to evaluate the information in terms of present value of future cash flows.

Ideally, the evaluation team wants to develop a standardized format and consistency in account titles. The operating financial projections for a gaming property should consist of revenues and expenses broken down

by departments. These departments usually consist of gaming, rooms, food, beverage and other. It also should include general and administrative expenses. Providing this standardized format in the RFP would facilitate a quick and efficient evaluation process. Without providing a standardized format for operators to follow, it is near impossible to determine whether various general and administrative costs are all inclusive or have been allocated to the various departments.

Comparability across bidders is also hampered by different time period projections. Most of the RFPs call for cash flow projections and the present value of such projections. If the bidders do not use the same time frame in making these projections, comparability across the bids is virtually impossible. For example, the New Orleans bidders provided cash flow information which had time frames ranging from 10 to 60 years. Comparison of the discounted cash flows becomes worthless when dealing with companies with cash flows ranging from 10 to 60 years. The Windsor project learned from prior experience and requested that all data be provided which covered a 20 year time period.

The inclusion of different inflation factors can also cause problems in the evaluation process. Different approaches for evaluating proposals include the Net Present Value method and the Internal Rate of Return method. The results can be distorted if companies have already included some type of compounding factor for inflation in the projected figures.

Most RFPs require the bidders to submit anywhere from 5 to 20 years of projected income statements for the proposed casino. While the very nature of future projections for any new development leaves wide ranges in the resulting projected revenues and expenses, comparisons across projections can be further distorted by the inclusion of different inflation factors by the proponents. Some companies did not include indexes in their analysis, others used inflation factors ranging from 1% to 8%, and others used different rates for revenues and expenses.

If no adjustments are made to each operator's cash flows for a common inflation factor, those operators who use no inflation factor or use low inflation factors, will show lower net income and cash flows and therefore lower taxes paid to the regulatory agencies. Since most jurisdictions are trying to maximize their tax revenues, these operators

will appear to be giving the regulatory agencies less, when in fact, the discrepancy may be a function of the inflationary factors.

Management Contract Arrangements

Governmental agencies have become more sophisticated in recent years in the art of extracting additional revenues from business entities. As previously mentioned, one approach is to maintain control over a specific property and then either lease the property for a specified fee or participate in a percentage of either the revenues or profits of the leased property. Jurisdictions in Australia and Canada have gone a step further. In these countries, companies bid for the right to build a casino with title reverting to the state after a specified period of time. New Orleans has a similar arrangement. Companies bidding for the land based casino will build the casino, deed it to the city and then lease it back. The city will also receive a percentage of profits.

Unfortunately, the specifics of such arrangements are seldom spelled out in the RFP. In general, the approach has been to ask the bidding companies to include in the proposal the type of appropriate arrangement. Unfortunately, without a specific indication of the type of management or participation contract in the RFP, the evaluation committee will spend substantial time and effort looking over a diverse selection of possible approaches. These can range from flat fees, to percentages of gross revenues, to percentages of net income. The impact of these different fee structures can only be evaluated by developing a model which provides ranges of revenues and net income with all factors held constant except for the different management or participation fees.

The biggest obstacle facing the evaluation team is determining on what the contract is really based. While these contracts are typically based on a percentage of profits, closer analysis of the definition of profits can produce significant variations in cash flows accruing to the governmental agencies.

A gaming property can conceivably use four different profit figures for defining the percentage that will go toward the governmental agency. These are defined as 1) profits from gaming operations, 2) profits from normal operations, 3) profits after other income and taxes, and 4) net profits.

Profits from gaming operations reflect earnings from the gaming casino departments after taking out the operating expenditures associated only with the running of the casino. It would not include any restaurant, lounge or bar revenues or profits. The major concern with this figure is whether it is derived from direct expenses or whether administrative overhead has also been included. Normally this figure represents direct departmental expenses which do not include the application of overhead.

Profits from normal operations represent the revenues and expenditures associated with all operations of the facilities. It includes gaming revenues, plus hotel, food and beverage revenues. It also includes corporate expenses such as depreciation and selling and administrative expenses.

Profits after other income and taxes include profits from normal operations plus income and expenditures which do not represent everyday type transactions. These include one time events such as restructuring charges or disposal of corporate properties. Examples would be the disposal of a specific chain of hotels without disposing of all the hotels in the corporation or the charges associated with laying off one thousand employees.

Net profits reflect earnings after taking into consideration all revenues and expenditures which includes the disposal of segments of businesses, extraordinary items and accounting changes.

While the above definitions of profits reflect the generally accepted accounting principles definitions, submitted proposals provide many variations for purposes of calculating operating fees and various management bonuses or payments to governmental agencies. The following represent examples of submitted bids of corporations offering proposed profits which would be used for the distribution of additional management fees to the operator or as a basis for which an additional fee would be paid to the governmental agency.

- a) Operating income is defined as being before management fees, interest expenses and income taxes.
- b) Annual pretax cash flow will be distributed between the state and the operator according to a prescribed schedule. Pre-tax cash flow is defined as revenues less all operating expenses, all taxes

- excluding income taxes, a capital replacement reserve, and debt service (including interest and amortization).
- c) The operating fee consists of a base fee of 2% of total revenues and an incentive fee equal to 5% of net operating profit. Net operating profit excludes depreciation, rental expense, and management fees.
 - d) The operator will be compensated with a base management fee of 5% of gross revenues and an incentive fee based on available cash flow ranging from 10% of the first \$10 million up to 30% on cash flow over \$40 million. Available cash flow is defined as income from operations less the base management fees, property and lease payments, and the provision for the property and equipment replacement reserve.

Capitalization and Financing Arrangements

The above approaches for defining participation agreements highlight another problem in analyzing the financial projections: distinguishing regular expenditures from those associated with purchasing, financing and leasing property, plant, and equipment. The financing arrangements of project costs as well as the type and time period for depreciating the property, plant, and equipment can significantly impact departmental and organization costs figures, which trigger significant cost differences across proposers.

These cost differences carry over to any participation agreements which causes further differences. Past evaluation teams attempted to pull all these costs out and use a constant project cost figure across all bidders in their attempt to try to understand the normal expenditures and participation fee structures. When evaluating past selection processes, the evaluation teams were not able to differentiate or analyze these costs without having to go back to the bidder and have them provide new schedules that delineate these figures. Once again, considerable time and effort can be saved if the selection team, when asking for financial projections, also require that all financing, leasing and depreciation costs be separately identified and presented outside the normal operating expenses.

STEPS FOR A MORE EFFICIENT EVALUATION PROCESS

If governmental entities are going to use the RFP process for the selection of limited gaming properties, the entities must take more time determining the type and size of property that is desired. The basis for evaluation must also be determined before issuing the RFP. If the selection criteria can be identified along with the specific information to be used in that selection process, the RFP should provide basic guidelines that can be followed. The following steps are presented for consideration for making the RFP and evaluation process more effective and productive.

1. Obtain a market study on the specific desired location. This study will provide information on the total demand for casino gaming and an estimate of the total revenue that can be generated. This information can be used to define the size of the casino. Since more than 60% of the customers typically come from a 50 mile radius (unless the location can be defined as a destination vacation area), governmental demographic information can be used to identify the market at which the casino should be targeted.
2. Be specific about the size and type of casino that can be expected. The more information that can be identified in an RFP, the more comparable the submitted bids will be. Information requested in the RFP should include the size of the casino, the number and type of restaurants and bars to be included, and the possible size of any hotel.
3. For joint ventures and newly formed corporations, be sure to request information which identifies each party's financial and operational commitment to the project. Financial information from corporations or investors who have formed new corporations only provide information based on old relationships. The selection committee needs a better picture of who is to run the new company and from where the funding will come.
4. Identify the cost of new projects under way and other projects being considered. Include ownership relation. The rapid expansion of gaming has found that many of the current gaming companies are involved in substantial new projects. It is anticipated that many of

the new projects will fail. It is also probable that many of the gaming companies will be overextended. The identification of the new projects and the ownership relation and future commitments associated with each new project has to play a large role in the selection process.

5. Identify the financial projection information required for the decision process and provide a specific format for disclosing this information. This format should include the following;
 - a. Time period for evaluation process;
 - b. Growth and inflation factors to used;
 - c. Departmental expenses to be listed separately;
 - d. Separate disclosure of all financing, ROIs and management fee arrangements; and
 - e. Discount rate used for present value cash flow.

Comparisons across companies means having the ability to identify specific costs and financing arrangements. Without a specific format, the selection committee will continuously need to redirect questions to the bidders. The committee will also find that different companies will aggregate information differently which makes comparison impossible at any level.

CONCLUSION

The evaluation of companies who submit responses to RFPs is best accomplished when the selection committee has taken the time and effort to explicitly define the type of casino desired and the necessary financial conditions. This should include the specific financial information desired and the format of that information.

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