



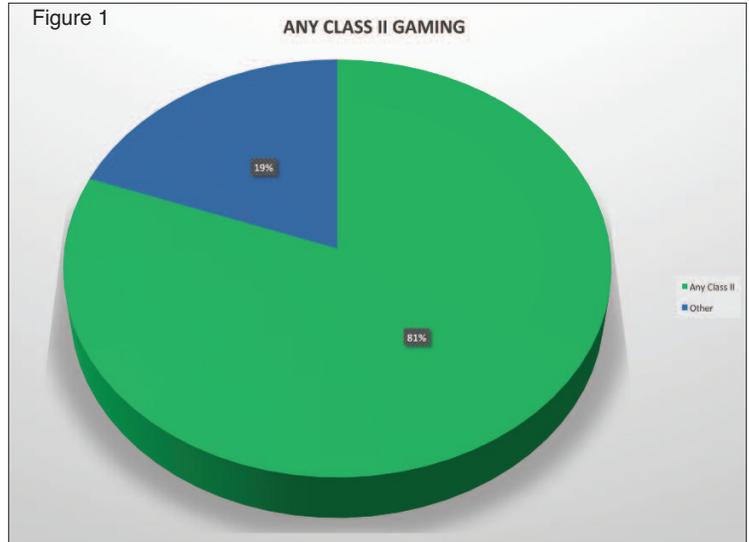
by James M. Klas

Class II - Not Second Class

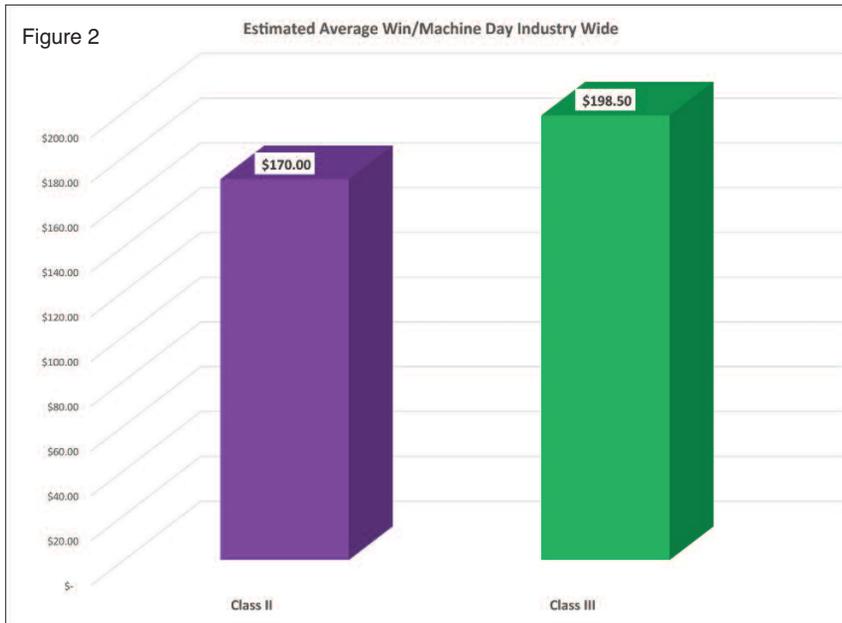
Class II gaming machines have come into their own as a valuable addition to the gaming floor and a viable option for any Indian casino, not just the ones that have no other alternative. Although they were justifiably considered an inferior choice in their early days, slower, less popular with customers, less profitable, and under a legal cloud, the Class II machines of today bear no resemblance to their ancestors and carry none of their drawbacks. Today, Class II machines offer comparable speed of play, a wide variety of game titles (including many of the same titles as Class III), comparable graphics, comparable customer appeal, and most importantly, comparable revenue generating potential, even when in direct competition with Class III machines in Class III dominant markets. In some cases, they even offer certain advantages for many tribes and markets over their more common Class III cousins.

Because of the tremendous improvements in Class II machines, Class II gaming is now remarkably widespread in Indian Country. According to NIGC data, 81 percent of all Indian casinos offer at least some form of Class II gaming, as shown in Figure 1. Indeed, 15 percent of Indian casinos are Class II only.

There are no published counts of the total number of Class II machines in operation or the amount of revenue they capture. Best estimates are that Class II machines comprise an

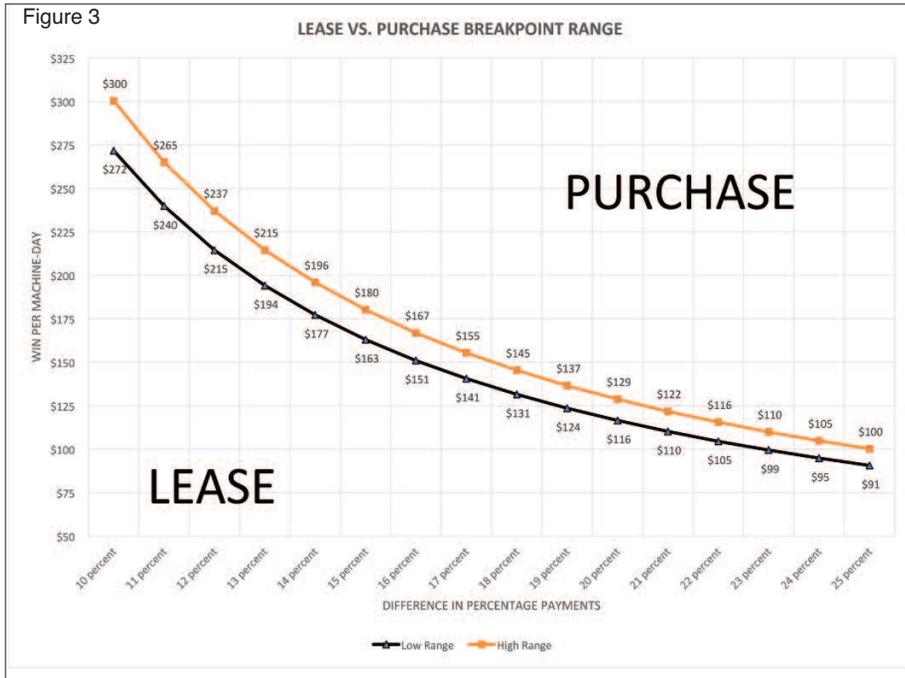


estimated 18.5 percent of the total supply of gaming machines in operation in Indian gaming facilities, representing approximately 70,000 machines. It is estimated that Class II machines capture approximately 15.8 percent of total machine revenue in Indian gaming facilities, representing an overall estimated average win per machine-day of approximately \$170. While this is still somewhat below the estimated average win per machine-day for Class III machines, as shown in Figure 2, it is certainly competitive with Class III averages.



In reality, Class II machines can, and often do perform as well or even better than Class III machines in the same facility or market. The modest remaining performance gap on an overall basis is due to a variety of factors, including the markets and facilities where they have been placed; lesser familiarity in some markets with Class II gaming titles; the impact of lease/participation versus outright purchase on machine selection in high-performing locations; and floor placement and clustering decisions made by gaming floor directors.

The success and continued growth of Class II gaming machines is due to a variety of factors. Most importantly, the speed of play issue has effectively been eliminated, with Class II machines now initiating and resolving as quickly as a typical Class III machine. This is critical to both the profitability of the machine and its appeal to



structures more thoroughly and more quickly than they can from machines sold to the casino.

The lease/participation aspect of Class II machines is even an asset for smaller facilities and less populous markets. When financing, replacement, upgrade and maintenance costs are taken into consideration, the average win per day at which a lease/purchase model is more profitable to a casino operator is surprisingly high. When revenue sharing is also subtracted, or when the choice is between a Class III participation game and a Class II machine, the average win breakpoint can be higher still. The parameters affecting the lease versus purchase decision are worthy of more discussion. However, Figure 3 shows an estimated range of average wins at which point lease/participation is as good or better than buying a machine outright.

the customer. The variety of gaming titles – including a large number of Class III cross-over titles and new licensing of recognizable sports stars – has also increased customer appeal, as have the vastly improved graphics and cabinets, now fully comparable to and competitive with the best Class III machines.

With gameplay and appeal now competitive, the advantages of Class II machines for Indian Country can be fully exploited. Class II machines can be installed in locations without, or in addition to, Class III compacts. Where there is no compact, like the newly opened Four Winds South Bend, the Alabama operations of the Poarch Band of Creek Indians and many others, Class II machines make gaming possible, with significant benefits to the tribes that own and operate the facilities. Where there are compacts, Class II machines do not suffer the same limitations on numbers of devices, betting limits or other factors imposed on Class III machines by the compact terms. Because Class II machines do not require compacts, they provide important leverage to tribal leadership in negotiating compacts for Class III gaming and can reduce the time needed to open a new operation.

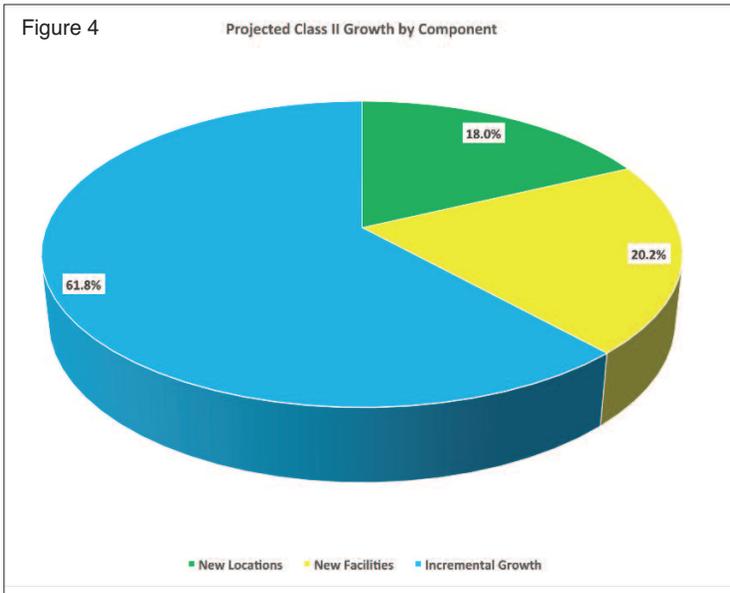
Even machine vendors can gain advantages from Class II machines. Class II machines are virtually all lease/participation installations rather than outright sales due to the nature of the underlying bingo game requirements. On average, revenue per machine is higher for vendors from lease/participation games than from individual machine sales, although that is not always true. Vendors also gain far more rapid and in-depth market information from Class II machines, enabling them to gauge popularity of different prize and game

The growth potential for Class II gaming machines is clear. Estimates are that the number of Class II machines will increase by approximately 30,000 over the next ten years, representing an average compound annual growth rate of approximately four percent. Of course, like the stock market, year to year changes will be more erratic with the possibility that there may even be temporary declines in some years, depending upon compact negotiations and regulatory adjustments. However, the overall pattern will be one of long-term growth. It is anticipated that Class II machines will surpass a 20 percent share of the total gaming machine supply in Indian Country within the next decade.

Figure 4 shows a breakdown of the anticipated components of that growth, including new Class II facilities, new additions of Class II to Class III operations and increases in the total Class II machine counts in facilities where they are already in place.

The greatest potential for growth in Class II gaming would come from achieving the kinds of popularity of proprietary titles that has driven the growth of Class III participation games. Most Class III participation games command that type of revenue stream to the vendor because of their proprietary nature, demonstrated revenue potential and market appeal, including multi-site progressives. Right now, Class II games operate on a lease/purchase model due to the needs of the bingo game mathematics, rather than the inherent popularity of the game title. New licensing and continued creativity in game titles and play may eventually produce the same results for Class II titles.

To date, improvements in Class II machines have come primarily by running away from the underlying bingo game in graphics and appearance to emulate the feel of a Class III slot.



characteristics could easily translate to the types of games popular amongst millennials on their smart phones and video consoles. First person shooters, pattern matching games, real-time strategy games and other similar forms could easily be adapted (on a non-skilled or skilled basis) to the graphic representations and actual play mechanics of Class II machines that rely on bingo models and mathematics that are comparable at their core. As the underlying bingo game daubs numbers on the underlying cards, the graphics on the screen, rather than spinning reels and lines of fruit, could show the highlighting and matching or elimination of figures on a screen, whether zombies, enemy units or types of candy. This represents an intriguing option that would put Class II machines in the driver seat for those titles and styles, leaving Class III machines to catch up. ♣

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It is possible that future growth will be generated by embracing rather than deemphasizing the inherent elements of bingo: pattern identification and elimination. These same

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