Deutsche Bank Securities Inc.

A Wall Street Perspective on the Current State of the IL Gaming Industry

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Deutsche Bank

It is our intent to provide an independent, objective and honest recommendation on how Illinois can potentially maximize tax dollar generation via the gaming industry

Current overview

- Illinois gaming facilities operate in a challenging and disadvantaged environment. Any revenues over the $250 million threshold are unprofitable at a 70% tax rate, while several facilities remain capacity constrained limiting growth.
- Shareholders of publicly traded gaming companies often demand that operators maximize profits. In this case, the current tax burden translates into reduced revenues generated at unprofitable levels. In our opinion, this reverses the basic principles of economics.
- We expect revenues will show modest growth, limiting incremental tax revenues provided by the current tax structure.
- We see very limited value to the 10th license at a 70% tax rate. The value of the license moves inversely to the tax rate and the potential number of positions.
- Expect minimal revenue growth, capital investment and job creation from the casino industry in Illinois until the tax rate is rolled back. There is little economic incentive to grow the business and/or add jobs. In fact, about 2,000 casino employees lost their jobs following the tax increases.

Illinois is at a competitive disadvantage

- Illinois continues to operate at a competitive disadvantage to Missouri (20% tax rate and unlimited positions), Iowa (22-24% tax rate) and Indiana (35% top rate and unlimited positions).
- Indiana has fostered a more friendly operator environment and continues to reap the benefits of dockside gaming and the implementation of 24-hour gaming. As a result, Indiana casinos have invested significant capital dollars and have aggressively marketed to IL customers, taking market share.
- Missouri, while constrained by the $500 loss limit, operates at a 20% tax rate. This has led to increased market share for the St. Louis (MO) operators and has led to investment of nearly $1 billion, including two new St. Louis licenses.
- Missouri is likely to roll back the $500 loss limit in exchange for a slightly higher tax rate (1% or 2%), which will further disadvantage Illinois operators.
- Capital, jobs and revenues will continue flow to these border states where taxes and the regulatory environment are more reasonable.

What are the consequences of a challenging tax environment?

Unstable Taxes → Lower capital spending → Fewer jobs → Lost customers → Lower revenues → Lower tax revenues

Revenues under pressure

Exhibit 1: YOY change in gaming revenues

	FY99	FY00	FY01	FY02	FY03	FY04
Alton Belle	12.6%	43.2%	13.9%	3.3%	-4.4%	-10.5%
Casino Queen	4.5%	27.7%	0.9%	0.0%	1.2%	3.9%
Casino Rock Island	-9.7%	83.8%	35.8%	9.7%	4.4%	-1.4%
Grand Victoria	8.4%	40.0%	6.6%	5.6%	-9.1%	1.2%
Harrah's Joliet	16.5%	48.1%	9.2%	10.7%	-4.1%	-17.6%
Hollywood Aurora	10.0%	25.4%	4.7%	13.0%	11.8%	-21.1%
Joliet Empress	21.1%	32.9%	11.8%	-0.2%	-5.2%	-7.8%
Par-a-Dice	4.2%	25.6%	5.4%	7.9%	-0.4%	-7.7%
Harrah's Metropolis	-1.7%	31.8%	5.8%	19.8%	0.7%	6.2%
Market	9.9%	35.7%	7.8%	7.1%	-2.0%	-7.6%

- In FY04, Illinois riverboats posted another revenue decline following the second increase to the top tier of the gaming tax rate (to 70%, from 50%), although FY05 is showing modest improvement.
- Six of nine operators reported FY04 revenue declines including three of four in Chicago.
- Under a 70% tax rate (and even a 50% tax rate), Illinois operators are at a severe disadvantage to Indiana (35% top rate), Iowa (22-24% tax) and Missouri (20% flat rate).
- Under the 50% and 70% tax rates operators have been forced to reduce marketing expenses and capital investment to maintain profitability levels, translating to lower revenues and stagnant growth.

Source: Deutsche Bank Securities; Illinois Gaming Board

Incremental taxes fall short of budget

Exhibit 1: FY04 casino revenues, admissions and taxes

FY03 casino revenues ($m)	1,797.9
FY03 admissions (m)	18.3
FY03 gaming & admissions taxes ($m)	683.4
FY04 casino revenues	1,661.8
FY04 admissions	15.2
FY04 gaming & admissions taxes	767.7
Chg. casino revenues	-7.6%
Chg. admissions	-16.9%
Chg. taxes	12.3%
Budget for incremental taxes	200.0
Incremental taxes	84.4
Tax shortfall ($m)	-$115.7

- The tax increases of 2002 and 2003 increased overall gaming tax collections, but operators scaled back operations (including reductions of head counts and reduced admissions) and total gaming tax receipts were substantially less than what had been projected.
- Based on FY03 and FY04 statistics, incremental taxes from the July 2003 tax increase fell more than $115 million short of what the budget projected ($200 million) and we estimate FY05 tax receipts will be $70 million below this initial budget projection.
- Combined with a yet to be realized value for the 10th license, the budget shortfall is even larger.

Source: Deutsche Bank Securities; Illinois Gaming Board

Admissions drop following tax increases

Exhibit 1: Admissions, FY02-FY04

Tax level	Period	Admissions (millions)	Estimated Adm. Tax ($m)
($2 admission)	July 2001 - June 2002	19.1	38.2
Tax inc. 1 (top tax 50%)	July 2002 - June 2003	18.3	54.8
($3 admission)	Chg.	-4.3%	43.5%
Tax inc. 2 (top tax 70%)	July 2003 - June 2004	15.2	66.1
($4-$5 admission)	Chg.	-16.9%	20.6%

- Higher admissions taxes have discouraged marketing to lower quality customers. In addition, casinos have passed on admission fees to customers.
- Competitive bordering states (IA, IN, MO) continue to take business from IL casinos due to lower admission fees.
- Admissions fell 4% year-over-year following the July 2002 admissions tax increase and then another 17% following the July 2003 admissions tax increase.

Source: Deutsche Bank Securities; Illinois Gaming Board

Local municipalities receiving fewer tax dollars

Exhibit 1: Tax collections, FY02-FY04

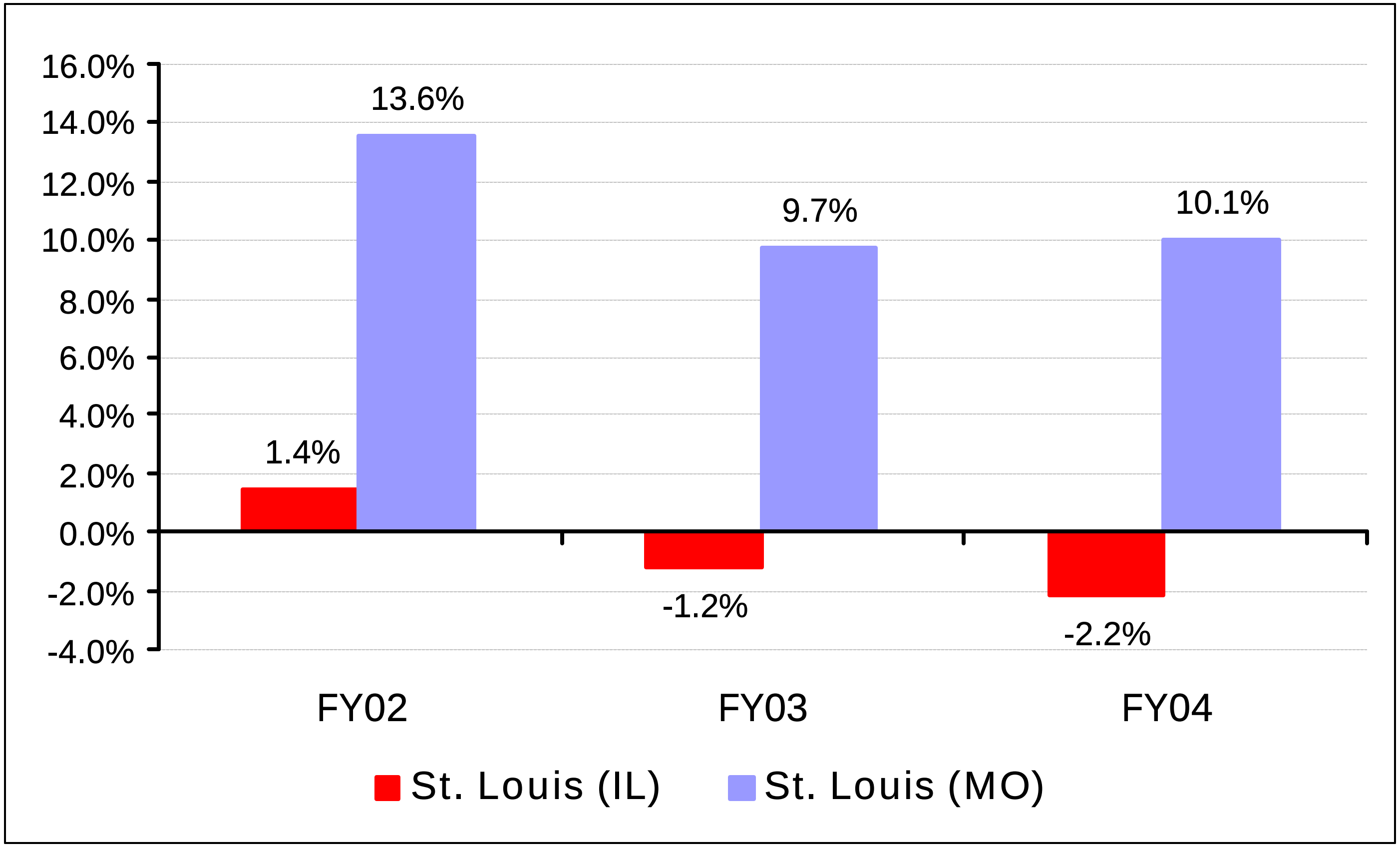
Tax level	Period	Taxes State ($m)	Taxes Local	Taxes Total
	July 2001 - June 2002	$460.5	$110.8	$571.4
Tax inc. 1 (top tax 50%)	July 2002 - June 2003	575.3	108.1	683.4
	Chg.	24.9%	-2.4%	19.6%
Tax inc. 2 (top tax 70%)	July 2003 - June 2004	669.7	98.0	767.7
	Chg.	16.4%	-9.3%	12.3%

- While total gaming and admissions tax revenues have increased sequentially, tax dollars going to local municipalities declined 2% and 9% in FY03 and FY04, respectively.
- This is a result of municipalities receiving a constant $1 per admission, while admissions have declined due to higher overall admissions taxes (usually $4 or $5 per person, up from $3 and $2 before that).

Source: Deutsche Bank Securities; Illinois Gaming Board

The proof is in the numbers
St. Louis gaming revenues

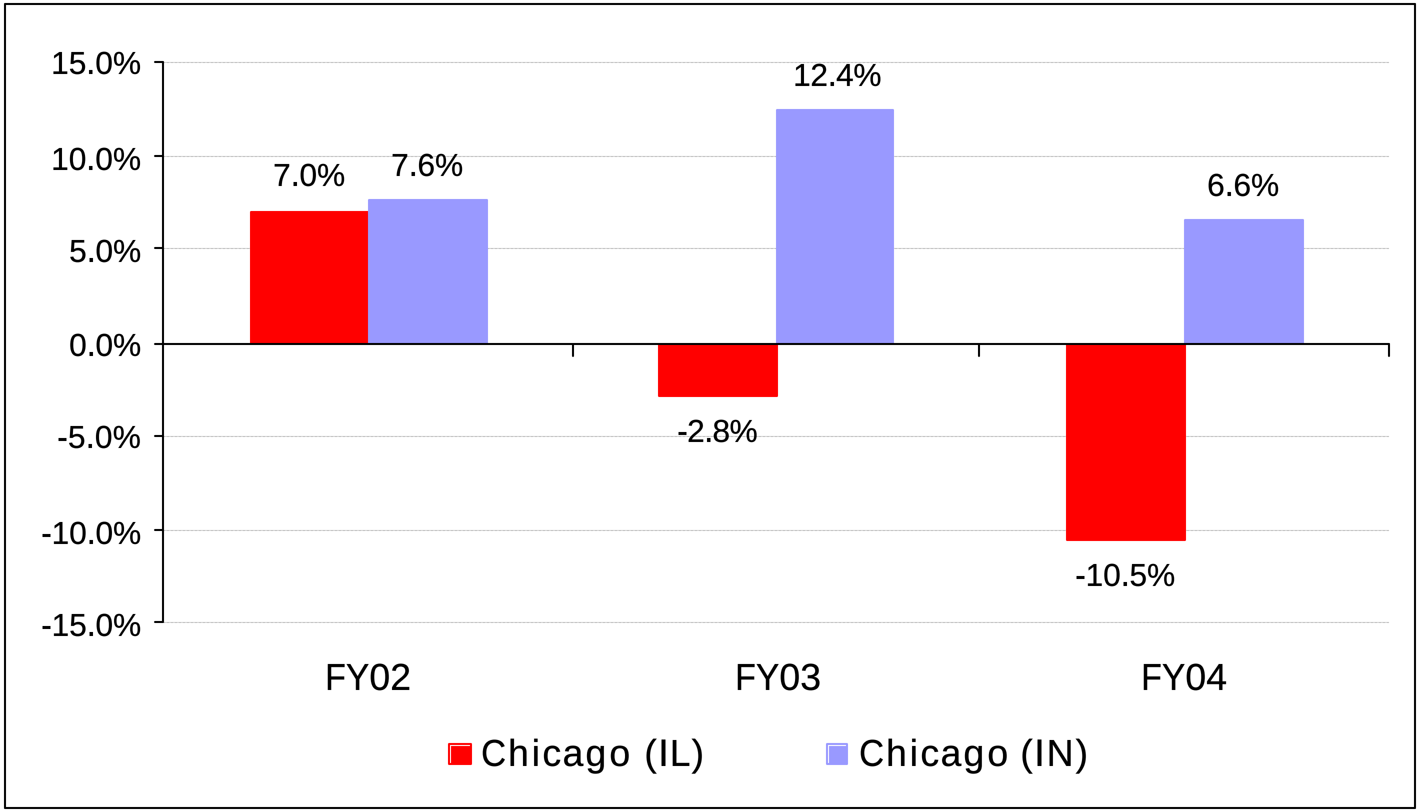
Exhibit 1: Year-over-year change in St. Louis (IL & MO) LTM gaming revenues (through FY04)



Source: Deutsche Bank Securities; Illinois Gaming Board, Missouri Gaming Commission

The proof is in the numbers
Chicagoland gaming revenues

Exhibit 1: Year-over-year change in Chicagoland (IL & IN) LTM gaming revenues (through FY04)

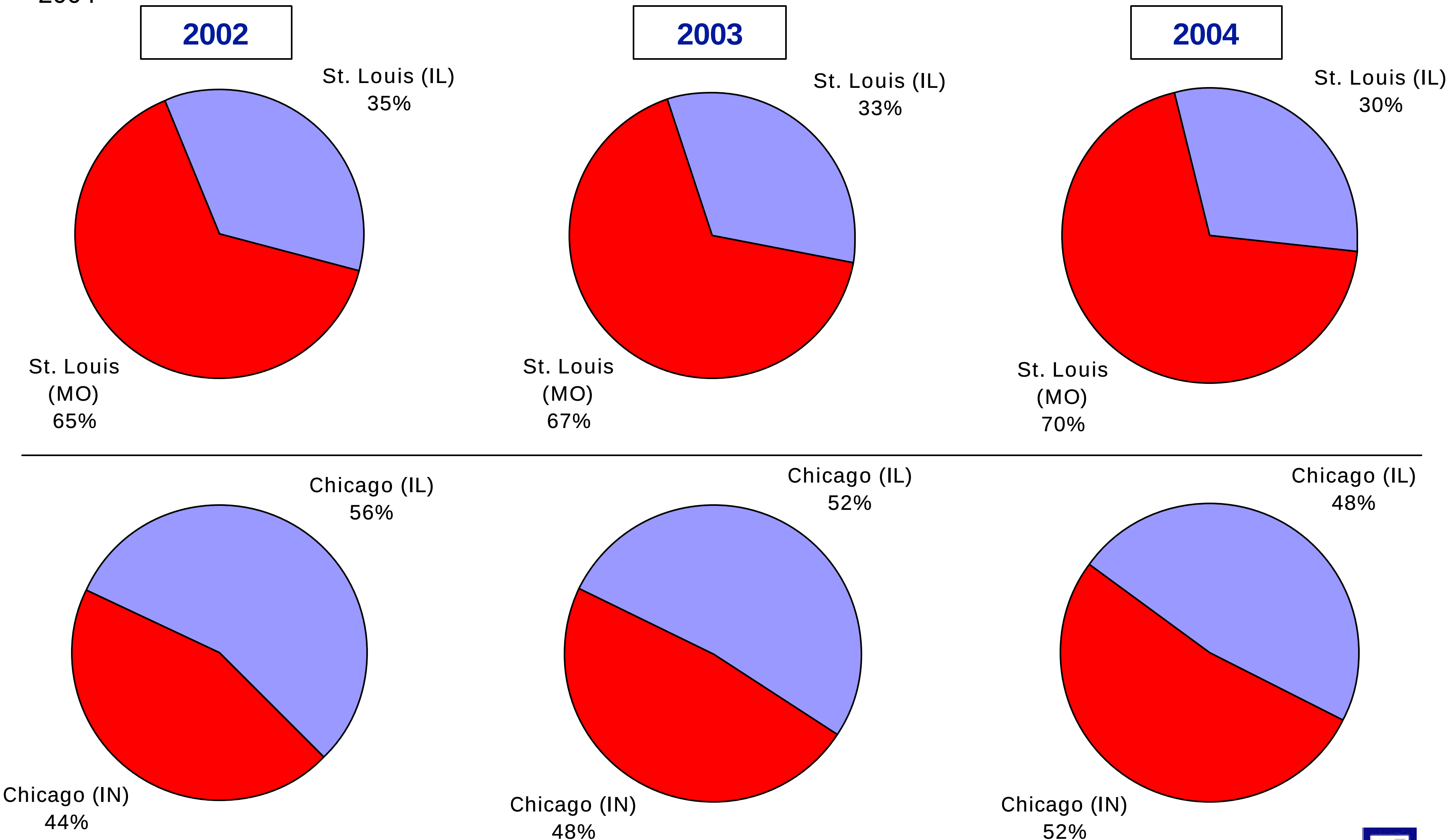


Source: Deutsche Bank Securities; Illinois Gaming Board, Indiana Gaming Commission

The proof is in the numbers

Market shares

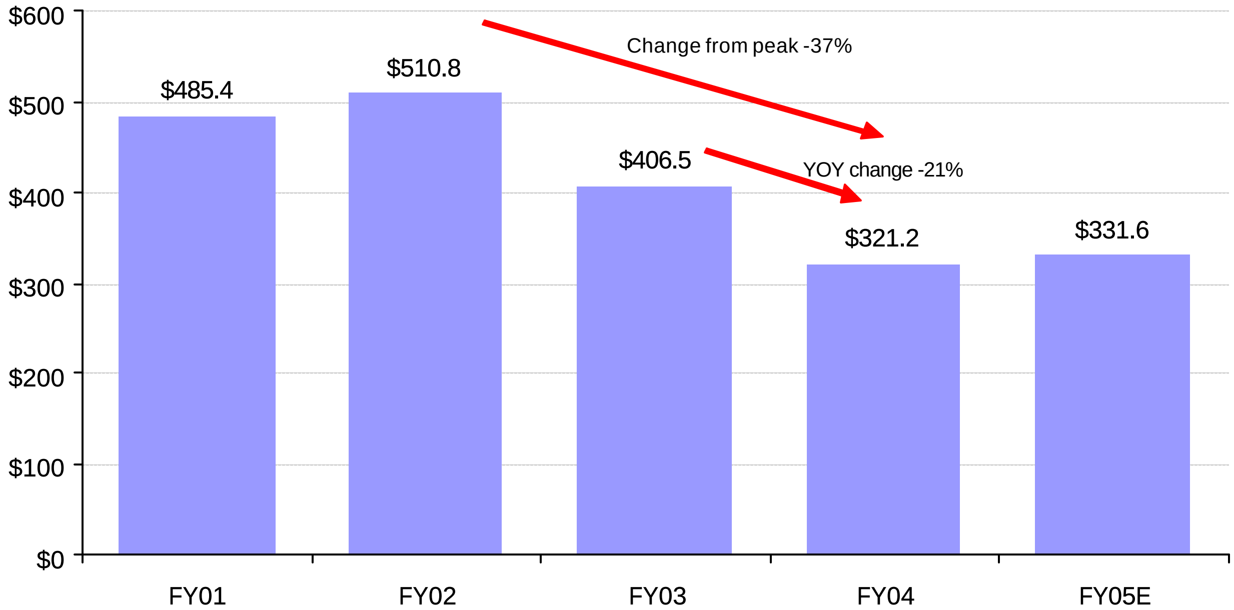
Exhibit 1: Year-over-Year revenue market share comparisons LTM revenues through July 2004



Source: Deutsche Bank Securities; Illinois Gaming Board, Missouri Gaming Commission, Indiana Gaming Commission

Operator profitibility has declined

Exhibit 1: Earnings before Interest, Taxes, Depreciation, Amortization in millions (EBITDA) (1)



- EBITDA declined 21% in FY04 and was about 37% below peak levels for the publicly traded Illinois operators
- The real dollar change in profitability for these operators was about $190 million
- For the shareholders of these companies this amounts to approximately $1.2 billion in lost share value
- No other market has experienced this level of decline in operator profitability due to higher taxes
- As operator profitability in the market declines, there is less incentive to invest capital

Source: Deutsche Bank Securities; (1) Combined EBITDA for Illinois operations of HET, MBG, BYD, PENN, AGY

What are the benefits of a lower and more stable tax environment?

lower tax rates → greater capital spending → more jobs → more promo spending → more customers → higher revenues → more tax $

Tax and regulatory environment are major factors in capital allocation

State	Tax rate	Recent/anticipated development $
Illinois	Graduated to 70%	$62m - Harrah's Metropolis
Louisiana	21.5%	$500m - Pinnacle, Harrah's, Isle of Capri
Indiana	Graduated to 35%	$600m - Boyd Blue Chip, Argosy Lawrenceburg, French Lick
Iowa	22% - 24%	$500-$600m - Isle Bettendorf, two new licenses
Missouri	20%	$1 billion - new licenses, multiple expansions
Michigan	24%	$1 - $1.5 billion - permanent casinos
New Jersey	9.25%	$2.5-$3 billion - Borgata, Resorts, Harrah's, Tropicana
Nevada	6.75%	$25 billion - LV Strip alone by the end of the decade

Missouri	
Argosy Riverside	$105 million
Harrah's North Kansas City	$126 million
Harrah's Maryland Heights	$80 million
Ameristar St. Charles	$100-$150 million
Pinnacle Entertainment (City of St. Louis)	$250 million
Pinnacle Entertainment (St. Louis County)	$300 million
Total Missouri	$1 billion

- If Missouri removes its $500 loss limit, we would expect an additional $500 million in capital projects

Source: Deutsche Bank Securities, company data

It‘s more than just gaming

- Capital investment in gaming enterprises has been increasingly geared towards non-gaming revenue sources. These sources include convention and meeting space, extensive retail offerings, food and beverage facilities and a wide variety of entertainment venues.
- In Las Vegas, the increased focus on non-gaming amenities has reduced gaming revenues from 58%, to just 42% of total revenues since 1990.
- In many jurisdictions, non-gaming revenues continue to increase as a percentage of overall revenues. However, the Illinois tax burden limits its participation in this type of investment.
- We believe non-gaming investments create even more new jobs, stimulate local economies and drive higher volumes and casino revenues, effectively creating multiple sources of tax revenues for the state.
- With increasing numbers of casino patrons looking for a multi-faceted entertainment option, it is more important than ever for Illinois to foster a business environment that is conducive to non-gaming capital investment.

What is the potential value of the 10th license?

Exhibit 1: The value of the 10th license at various tax rates and positions ($m)

	50% rate 1,200 positions	50% rate 2,400 positions	70% rate 1,200 positions
Projected net revenues	$317	$536	$250
Projected gaming and admissions taxes	$132	$243	$113
Projected EBITDA	$101	$169	$37
Capital investment	$225	$400	$225
Required return on investment	15%	15%	15%
Estimated value of the 10th license	$415	$650	$30
Incremental tax revenues to IL	$132	$243	$113

- We estimate the value of the 10th license has been cut to about $30 million at a 70% rate from potentially $600-$650 million assuming a tax roll back and position limit increase.
- We estimate a 15% required return on the total investment which includes BOTH the purchase price of the license and the capital outlay to build the property.
- The 10th license could generate an additional $113 million (at a 70% tax rate) to $243 million (at a 50% tax rate with expanded positions) in incremental tax revenues for IL.
- Recent bids for the 10th license were $475-$525 million given an assumption of a tax roll back.

Source: Deutsche Bank Securities; Illinois Gaming Board

The solution - roll back the taxes & increase positions

- The Chicago market remains one of the best fundamental markets in the country. The state's best option is to ease the taxes and regulation and allow the capital investment and market fundamentals to drive higher taxes for the long-term. However, we believe that in order to be effective, both the gaming tax, as well as the admissions tax need to be rolled back to their prior levels.
- The value of the 10th license moves inversely with the tax rate. Very few companies would undertake construction of the 10^{th} (or any other potential) license without a contractual assurance that the tax rate will be stable.
- Gaming companies are capital hungry and revenue/tax growth is generated by new unit capital investment. This in turn generates significant jobs starting with the construction trades and converting ultimately to service jobs. The long-term ripple effect of capital investment on the local and state economies are rather compelling, in our opinion.
- Allowing existing operators to have more gaming positions is not an expansion of gaming, in our view, although we believe most operators are constrained at current capacity. It is simply a prudent business decision for the state to make.
- Until the tax/regulatory environment becomes more reasonable in Illinois, Wall Street will continue to recommend that public companies invest minimal capital in the state.

The solution - roll back the taxes, increase positions

Exhibit 1: Incremental IL tax revenues based on roll back of taxes and increase of positions

Present Case: 1,200 position limit	Gross Revenues	Gaming Tax	Adm. Tax	Total Tax	Incremental Tax Revenues ($ millions)
70% tax structure	$1,717.3	$736.4	$65.4	$801.8	
Scenario 1: 2,400 positions, 10% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	2,855.7	1,127.2	60.0	1,187.1	385.3
Scenario 2: 2,400 positions, 15% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	2,697.1	1,049.2	60.0	1,109.2	307.4
Scenario 3: 2,400 positions, 20% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	2,538.4	971.7	60.0	1,031.7	229.8
Scenario 4: 2,400 positions, no win/day dilution, modest increase in admissions, no tax roll backs					
70% tax structure	1,856.0	833.5	66.8	900.3	98.5

- Lower taxes and more positions could yield compelling, sustainable growth in tax $.
- At a 70% tax structure, we would expect very few operators to add capacity if at all.
- We estimate the state would generate $230-$385m additional tax revenues under a 50% top tax rate with 2,400 positions than it will under the 70% rate with 1,200 positions.

Source: Deutsche Bank Securities; Illinois Gaming Board

The solution - roll back the taxes, increase positions (admissions tax)

Exhibit 1: IL admission tax revenues based on roll back of taxes and increase of positions, resulting in increased admissions

Present Case: $3-$5 admissions tax	Admissions (m)	Estimated Admissions Tax ($m)
Total state	15.3	65.4
Scenario 1: $3 admissions tax, 30% increase to 2004 admissions		
Total state	19.2	57.7
Chg from 2003 levels	25%	-12%
Scenario 2: $3 admissions tax, 35% increase to 2004 admissions		
Total state	20.0	60.0
Chg from 2003 levels	30%	-8%
Scenario 3: $3 admissions tax, 45% increase to 2004 admissions		
Total state	21.4	64.1
Chg from 2003 levels	39%	-2%

- Lower admissions taxes and increased positions will likely lead to significant increases in admissions.
- Any potential decline in admissions tax receipts would likely be more than offset by increases in total gaming taxes collected if the gaming and admissions tax were to be rolled back and the position limit was lifted.

Source: Deutsche Bank Securities; Illinois Gaming Board

HB1917 – Sound policy making

- It is our opinion that HB1917 makes economic sense for Illinois (tax $, job creation, long-term investments in communities)
- Details (subject to legislative change) of HB1917 include:
  - Rolling the tax structure back to pre-July 2003 levels
  - Require that 3% of all casino adjusted gross receipts be set aside for a "Horse Racing Equity Fund" which will increase $ available for purses and allocate additional $ to track operators
  - Allow an increase in the maximum number of positions to 3,000, from 1,200 at a cost of $20,000 each (in bundles of 100 positions)
  - Allow riverboats to sell or lease positions to other riverboats (taxed at 10%), with a max of 4,500 positions at any riverboat

Source: Deutsche Bank Securities; Illinois Gaming Board

HB1917 – Positive outlook for Illinois

Exhibit 1: Incremental IL tax revenues based on HB1917 details

Present Case: 1,200 position limit	Gross Revenues	Gaming Tax	Adm. Tax	Total Tax	Incremental Tax Revenues ($ millions)
70% tax structure	$1,717.3	$736.4	$65.4	$801.8	
Scenario 1: 3,000 positions, 10% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	3,569.7	1,480.6	60.0	1,540.6	738.8
Scenario 2: 3,000 positions, 15% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	3,371.3	1,382.4	60.0	1,442.3	640.5
Scenario 3: 3,000 positions, 20% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	3,173.0	1,284.1	60.0	1,344.1	542.2
Scenario 4: 3,000 positions, 30% win/day dilution, 35% increase in admissions ($3 tax)					
50% tax structure	2,784.0	1,086.5	60.0	1,146.5	344.7
Plus one-time fees generated from sales of additional positions @ $20,000 each					$324.0

- We estimate the state would generate $345-$740 million additional tax revenues under a 50% top tax rate with 3,000 positions (at all riverboats) than it would under the 70% rate with 1,200 positions.
- In addition, one-time fees associated with the sale of additional positions could yield an additional $324 million in revenue.
- While we do not believe all 16,200 new positions will be purchased or utilized (9 x 1,800 additional positions), we believe that HB1917 will result in substantially increased tax revenues for Illinois.

Source: Deutsche Bank Securities; Illinois Gaming Board

Conclusions
What would Wall Street want to see from Illinois?

- Reasonable and stable regulatory environment
  - Removal of the 1,200 position limit
- Balanced and steady tax environment
  - Rollbacks of tax structure to a reasonable level
- Environment favorable for capital investment, job creation and economic stimulation
- Regulatory structure conducive to the implementation of new technologies
- Final settlement or resolution of the 10th license

Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://equities.research.db.com.

Rating key

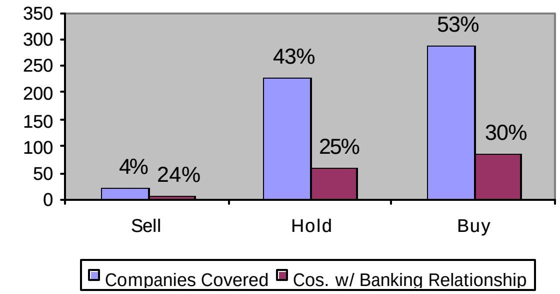
Buy: Total return expected to appreciate 10% or more over a 12-month period

Hold: Total return expected to be between 10% to –10% over a 12-month period

Sell: Total return expected to depreciate 10% or more over a 12-month period

The target prices of shares mentioned in the accompanying text are based on the assumed investment horizon of 12 months. If company notes are published on these shares in the future, the target prices mentioned in the new notes will have priority.

Rating dispersion and banking relationships



North American Universe