Mark Harms

Talking Points

In Harm's Way

Private equity and Global Leisure Partners: Bankers to the industry and a force for the future

BY JAMES RUTHERFORD

London-based Global Leisure Partners and its CEO Mark Harms have emerged as major players in the private-equity financing that is reshaping the gambling industry worldwide. Backed by a team of eight multidimensional professionals in London, including five partners, and another five partners in New York, and with collectively more than 70 current and former senior operating executives as investors, GLP had a hand in most of the significant private equity transactions in the industry in 2005 — most notably Gala Group's epic £2.18 billion leveraged buyout of bookmaking giant Coral Eurobet. GLP was an adviser to Permira on its £200 million investment in Gala, the jumping-off point for the merger, and advised Gala in acquiring Coral, in which an affiliate of GLP co-invested. GLP served as an adviser to HG Capital in outbidding Ladbrokes for Sporting Index, a purchase worth £76 million, while across the pond the firm advised Oaktree Capital Management on the leveraged recapitalization of Cannery Casino Resorts, owners of the Cannery and Rampart casinos in Southern Nevada. GLP also invested alongside Oaktree in a 33 percent stake in CCR. Harms' influence on the expansion and consolidation of the industry goes back more than two decades. He was a founder of the gaming and leisure investment banking businesses of Oppenheimer and CIBC World Markets and was a founding member of the American Gaming Association and the Cross Industry Group in Great Britain. He has been an adviser and financier in more than 60 transactions in the gambling and hospitality sectors.

Looking at a megamerger like Gala and Coral Eurobet, it seems clear that private equity is emerging as a force in the industry. What are the factors behind this in your view?

Harms: The reason that Charterhouse decided to sell Coral to Gala and its private equity sponsors was because it got certainty and speed of execution. One of the key drivers for private equity firms is being able to have velocity of capital. So, to the extent that owners can get out and return capital to their shareholders at a significant profit, they would far rather do that than float a business in the public market where they wind up with a significant residual stake in the business. They'd rather exit cleanly. From Charterhouse's standpoint they got the same valuation they would normally have gotten with an IPO, but with certainty as opposed to uncertainty, which is what you always have in the public markets. The same thing, by the way, applied to Gala because Gala had been considering an IPO back in March and April. And we knew that was being considered so we approached Permira to work together. Because of our very close relationship with the management of Gala we were a natural choice. The Permira team had looked at Gala previously the last time it was being sold, and they were outbid by Candover and Cinven. So they knew the asset. They liked the asset. We believe that the same decision metrics applied for Candover and Cinven. They could have taken the business public, but then there would have been a lot less flexibility. For them it was a flexibility issue. They flirted with the public markets, but they decided to go for the certain route of additional capital, doing a deal with Permira, than the uncertain route of doing the IPO. If they'd done the IPO then they would have been put in a fairly constraining box in terms of additional deals they could do, particularly quickly.

The constraint being access to additional capital?

Harms: The private equity firms have a very significant capital structure advantage over the public markets because you can leverage a business significantly more than you could in the public markets. For example, if a public-market maximum debt-to-EBITDA multiple is 4, 4 and a half times, in the private markets you can leverage businesses to six or seven time EBITDA or more, depending upon the stability of cash flows. With very low-cost debt. In a low-interest-rate environment with a lot of debt market liquidity there's absolutely no way the public markets can compete. The same is true for most strategic buyers — they can't compete with leveraged capital structures because most of them are public.

This would seem to indicate an increasingly significant role for private money.

Harms: The total equity check in the Gala-Coral combination is £1.5 billion. Between Gala's owners — Candover, Cinven and Permira — each of them had written a check for £500 million. And that is, at current exchange rates, a lot of money — 2.7 billion U.S. Five years ago, private equity wouldn't have been in a position to do that. But now, given the size of these funds, they have the ability to write very, very large checks for businesses. And the fact that you have consortiums that are forming, or have formed, means that virtually no company is outside the reach of private equity. And so when one is looking to sell a business the private equity alternative usually will win out over a strategic or over the public market alternative.

The public markets have been such an important part of the evolution of the industry. Attractive alternative that they've become, do you see private equity assuming a similar role?

Harms: I absolutely think there will be a continuing role for public equity. But I see private equity continuing to increase. Right now there is a relatively *de minimus* market share of private capital in the U.S. In the UK, on the other hand, I would say it controls more than half the enterprise value of the industry.

Why such a difference?

Harms: It goes back to licensing. In the UK the licensing restrictions, while robust, are somewhat less onerous in that the funds of institutional equity providers, the principals of those funds, don't have to go through licensing. The managers of the businesses do. And everybody has to pass probity tests. But it's different than it is in the U.S, where literally each of the managing partners of a private equity fund has to undergo Nevada scrutiny.

Do you foresee that changing in the U.S., and private equity, in turn, beginning to play a comparable role?

Harms: I think for the same reason that the private equity alternative in the UK has been so robust you will see that developing more over time in the U.S. As the buyout shops in the U.S. are able to do larger and larger transactions a generational shift takes place. Although there has been a lot of consolidation in the U.S. there is still a lot more to go. You have a fair number of companies that are still controlled by the entrepreneurial founders and their families. Some of those will likely have generational transfer and continue in that mode. Others will likely look to exit. What is happening, because of the licensing restrictions that are in place in various jurisdictions, for example in Illinois, most people are going to start running into problems when they look to buy someone else. So all of a sudden it becomes a complex jigsaw puzzle. And private equity can stand there to mop up the balance. Colony Capital really had the market to

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themselves for a while, and as a result they have a built a very large, very profitable, very successful business under the Resorts International flag. Oaktree is planning to devote a substantial amount of capital to building out its gaming interests and platform. To that end, I think they will be an active acquirer and developer of additional gaming assets, nationally and potentially internationally. They're backing two of the best managers in the business in Bill Wortman and Bill Paulos [majority owners of Cannery Casino Resorts], and they have a lot of firepower. Goldman Sachs has made an offer for Gtech. Who knows whether that deal will happen or not. It's been muted. Bay Harbour, which is a distressed assets investor, took control of the Aladdin. Starwood is getting licensed as part of that. Columbia Sussex has been buying a lot of assets that have come onto the market, like Bally New Orleans and Caesars Tahoe, for example. They're akin to a private equity firm. So you have people like them coming into the industry as well.

What about elsewhere — Europe, Asia, South America?

Harms: There's already significant private equity interest in France. Accor-Barriere, for example. Colony has a significant minority stake in that business. Moliflor Loisirs recently was sold by Legal and General Ventures to Bridgepoint. The Partouche family has been rumored to be a seller to private equity for the last year and a half, two years, and they've gotten close enough that there's been an issue of price. I would expect that at some point that business will end up in private equity hands.

Which would also seem to point up this trend toward consolidation we continue to hear so much about.

Harms: I see several global companies forming over the next five years. Large global companies. Probably 10. Still some regional players, no question about that. It's still a young industry. But Harrah's, MGM, Gala/Coral, Tabcorp, PBL, Genting, those names will be around. It'll be very interesting to see what happens with Venetian and with Wynn because those truly are entrepreneur-driven. And when those guys decide to hang up their spurs, where do they get absorbed? They are so large even private equity might struggle to buy them. I think for Gala/Coral, unless the funds grow at the same rate the company is growing, the most likely exit for Gala is an IPO. Two years from now, hopefully, the enterprise value of the business has grown substantially, integration has set in, some of these reforms in the UK have been delivered in terms of operational performance, and the business will float in an IPO. I think what will happen is, the public markets will be the domain of the largest companies, the $50 billion companies. I think Harrah's will be a $50 billion company. MGM Mirage will be a $50 billion company. They'll be some of the largest enterprises in the world. And not just gambling. These businesses are multifaceted. Casinos happen to be the core. But they can make money a lot of different ways, by providing a consumer experience. So I think you'll see more and more of that.

But not in the UK? You mention the impact of deregulation on operational growth. But given the massive scale-back that has occurred is it conceivable that these companies, even the very large ones, will want to have a presence?

Harms: I would argue that for some of those companies, if they really want to be in the UK, they need to broaden the net and potentially acquire one of the UK operators to understand the model and the market. But having said that, pricing is not advantageous. The UK companies are trading at much higher multiples, much higher than in the U.S. So the math doesn't really work. And I don't see it working for the foreseeable future. One of the reasons for that is the market perception of growth in the UK, of publicly listed casino companies, is significantly higher than the market prospects of growth for publicly traded U.S. companies. Think of the difficulties in Pennsylvania, Florida, all these wonderful markets that just haven't happened yet. No wonder that U.S. companies trade at a discount.

That's interesting. So the climb-down on deregulation has actually helped valuations?

Harms: We figured that even if the Government did climb down there was still going to be a lot of opportunity, and frankly that the opportunity may be better for private equity if that happened. Because if you'd had 30 regional casinos, well, the big guys come in, roll over everybody, and what's the clear opportunity? So from our standpoint it's actually not bad at all, although we would have preferred to see more than one "pilot" regional casino. A more orderly, rational transition to a modernized market is a good thing, from a capital markets standpoint. So we are not unhappy with the way things turned out.

Which would seem to make London a good place to be right now.

Harms: London is the headquarters of global business. You've got a lot of huge regional financial centers, whether it's New York, Singapore, Hong Kong, Shanghai. But most people come cycling through London. Being here, if you're a global business, really helps. So we have offices here, offices in the U.S., and we think that makes us a little bit different. Part of the secret of doing what we do successfully is being able to look with clear eyes at all markets. You know, *The Economist* is a wonderful magazine. It's based here in London. It gives the most clear, unbiased, unvarnished view on the U.S., continental Europe, Asia, from a political and journalistic perspective. We try to do that from a merchant banking standpoint.

From GLP's perspective, then, the thinking is not limited to gaming?

Harms: Wherever there's change there's opportunity, and value to be created from that change. Our domain expertise in gaming is outstanding, but we also have a broader remit, and deep sector knowledge, which includes basically all of the companies that are the leading providers of goods and services to the aging baby boomers and their sons and daughters. Within that demographic umbrella falls gaming, which is a very large leisure category, and hospitality, travel and tourism, leisure products and services, which would include fitness, luxury and lifestyle goods and services, and then the real estate that underpins all of it. That's basically the underlying philosophy: If we can identify those companies that are the leading providers of goods and services to those segments then our investors should make outstanding returns over a long period of time given the built-in growth of those businesses. So we see private equity involvement in the gaming industry globally accelerating. We partner with the leading private equity firms globally. And from our standpoint, sitting in London, with strong ties in other markets around the world, we're well placed to identify the trends and hopefully capitalize on them along with our partners. And we'll do well for all of us and have some fun doing it. **IGWB**

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