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News for the Hospitality Executive

Morgans Hotel Group Plans to Team with a Licensed Gaming Company to Operate Hard Rock's Casino; Expects to Bring the Margins at the Hard Rock up to Morgans Standards

By Hubble Smith, Las Vegas Review-Journal
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The Hard Rock Hotel is going to get a little pricier, as the new owner intends to grow earnings from \$40 million to \$50 million a year, the chief executive officer of New York-based Morgans Hotel Group Co. said Friday.

He's going to start by raising room rates, which average \$169 a night at the Hard Rock, compared with \$230 a night at Strip hotels.

"We expect to bring the margins at the Hard Rock up to Morgans standards," Edward Scheetz said in a conference call from New York. "We will attract a more affluent clientele and they will spend more money not just on rooms, but on gaming and restaurants."

He described the 11-story, 650-room Hard Rock Hotel, purchased from Hard Rock co-founder Peter Morton for \$770 million, as a "trophy property" that will never be replicated in Las Vegas because of land values. The Hard Rock pool alone, named one of the top 10 hotel pools by Travel Channel, occupies land valued at \$50 million.

The key nature of the transaction, which is subject to regulatory approval, is the similarity between Hard Rock customers and those at Morgans' high-end, boutique hotels in New York, Miami, Los Angeles and London, Scheetz said.

"These are the same Morgans customers looking for the same chic hotel in Las Vegas," he said. "These are our customers. They may spend money gambling, but they'll spend just as much if not more on entertainment."

While gaming revenue has continued to grow in Las Vegas, gaming itself has become a smaller percentage of tourists' overall budget. Dining, entertainment and shopping expenditures have eclipsed gambling for the past seven years, research by the Las Vegas Convention and Visitors Authority shows.

Morgans will team with a licensed gaming company to operate Hard Rock's 30,000-square-foot casino through a lease agreement with fixed payments, Scheetz said.

"We have a short list of casino partners we're negotiating with, and we'll be able to identify them shortly," he said.

Morgans, founded by Studio 54's Ian Schrager, has already formed a partnership with Boyd Gaming Corp. to develop a 1,000-room Mondrian and 600-room Delano hotel at the \$4 billion Echelon Place, planned for the current site of the Stardust on the Strip.

Scheetz said the company will work out an agreement with the casino operator for comps or gratuities given to high rollers. There are ways of charging comps such as free rooms and dinners back to the casino, he said. Also, Hard Rock's comp-to-cash ratio is lower than most casinos, he said.

Dave Ehlers of Las Vegas Investment Advisors said people stay at the Hard Rock because they're rock 'n' roll fans and may not necessarily be the best gamblers. Hard Rock's slot play is ranked near the bottom of resort corridor hotels, he said.

"Hard Rock's got this magical name they created. Really, it's become a proprietary name," Ehlers said.

Morgans is purchasing the rights to the Hard Rock brand west of the Mississippi River, including Texas, California, Australia and Vancouver, British Columbia, Scheetz said.

Ehlers wondered about Morton's motivation to sell; perhaps he was skittish about the economy and saw this as a chance to cash out. Morton spent \$80 million to build the hotel, which opened in early 1995, and \$100 million to expand it in 1999.

"He gets \$770 million after 10 years. Not bad," Ehlers said.

Morgans Chief Financial Officer Richard Szymanski said the company paid about \$450 million for the Hard Rock hotel, subtracting the land value for the 17-acre hotel site and an adjacent 23 acres that was planned for a \$1.2 billion hotel-condo expansion. The Hard Rock Cafe is valued at \$20 million.

Based on Hard Rock's \$40 million in earnings last year before interest, taxes, depreciation and amortization, the purchase price is 11 times EBITDA, a lower multiple than hotels in other markets that Morgans looked at acquiring, Szymanski said.

Jeremy Aguero, principal of Applied Analysis, an economic research firm in Las Vegas, said the multiple sounds high to him. He said Boyd Gaming Corp. bought Coast Casinos at a 7.4 multiple, Harrah's bought Imperial Palace and Barrick Gaming bought the Golden Nugget in Laughlin at an 8 multiple and MGM Mirage bought Mandalay Resort Group at a 8.6 multiple.

Szymanski said opportunities exist to improve earnings at the Hard Rock through Morgans' management operations, food and beverage services and other synergies between the companies.

Scheetz said the company may form a joint venture to develop the other 23 acres, now home to a 544-unit apartment complex, or may sell the land. There's also plenty of room for significant expansion on the hotel site, including surface parking.

"We are going to extract the maximum value out of all the land, not just the expansion parcel," he said.

Morgans, traded on Nasdaq, reported first-quarter revenue of \$64.1 million, up 2.9 percent from the same quarter a year ago. Earnings before interest, taxes, depreciation and amortization were \$17.4 million.

Morgans shares fell \$1.65, or 9.19 percent, Friday to close at \$16.30.

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