

Regulated Online Gambling: A Billion-Dollar Opportunity For Pennsylvania

Projecting the shape and size of Pennsylvania's regulated online gambling market through 2022.



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ONLINE POKER REPORT

OnlinePokerReport.com is an award-winning publication covering regulated online gambling markets in the U.S. and beyond. OPR's reporting is regularly cited by mainstream media, lawmakers, and industry leaders, as are OPR network sites LegalSportsReport.com, EsportsBettingReport.com, and PlayNJ.com.



PlayPennsylvania.com focuses exclusively on the emerging market for regulated online casino and poker games in the Keystone State.

Key numbers

Listed below are some top-line projections for how the Pennsylvania online gambling industry will perform in its first five years, assuming legalization in 2017 and an initial rollout in early 2018.

\$364
million

Our analysis shows that regulated online gambling in Pennsylvania will generate \$230 million in revenue for casinos in year one, growing to **\$364 million by year five.**

\$426.3
million

Assuming a tax rate of 20 percent, regulated online gambling in Pennsylvania will pay \$46 million in taxes to the state in its first year. **After five full years, operators will have contributed \$426.3 million in taxes and fees to state coffers.**

90%

Online casino will account for approximately 82 percent of gross gaming revenue (\$189 million) from online gambling in year one, swelling to just over 90 percent (\$329 million) at maturity.

-14.6%

After a hot start, in which it generates \$41 million in its first year, the industry's online poker arm will struggle. Revenue will dip to \$35 million (-14.6 percent) by year five.

\$126 mil.

We believe the state will collect at least \$126 million in upfront licensing fees, a number that could approach \$140 million under the right conditions.

Executive summary

Pennsylvania is the golden goose of U.S. online gambling

OF ANY STATE that has already legalized some form of online gambling or is actively exploring the idea, Pennsylvania represents the biggest economic upside. Total online gambling revenue is projected to reach \$364 million annually in Pennsylvania at maturity.

Other contenders, namely New York and California, may own a larger population, but are only considering online poker legislation. Massachusetts, Michigan, and New Jersey either offer, or plan to offer, both online poker and casino games, but their populations are a tier lower than Pennsylvania's (12.78 million).

New Jersey offers a good guess at Pennsylvania's potential

MUCH OF OUR OPTIMISM stems from the strong performance of the New Jersey online gambling market. Although New Jersey initially underperformed its exaggerated expectations, the market has grown at a torrid pace, with revenue climbing from \$122.9 million in 2014 to \$196.7 million in 2016: a growth margin of 60.1 percent. And it hardly appears as though New Jersey has reached maturity – in December 2016, industry revenue was up 30.9 percent year-on-year.

There are a number of similarities between Pennsylvania and New Jersey – location, population,

land-based gambling popularity – that lead us to believe New Jersey is a solid comparison model, although not an ideal one.

To clarify, Pennsylvania will possess key advantages at launch that New Jersey did not have. As a result, it's positioned to start off at a higher point, but year-on-year growth will be more tempered. There are also factors, both advantageous and adverse, unique to the state, that will separate it from New Jersey. On balance, we project these variables will combine to elevate per capita iGaming revenue in Pennsylvania slightly beyond New Jersey at maturity.

Tax rate, licensing fees could artificially constrain the market

OUR PROJECTIONS are based on a blend of the tax rates proposed by Pennsylvania House Bill 392 – 14 percent with an additional 2 percent set aside as a local community tax - and Sen. Jay Costa's proposed 25 percent rate. This is relatively in line with the New Jersey iGaming tax rate: 15 percent + 2.5 percent into the Casino Reinvestment Development Authority.

However, the Senate may have different plans. Tax rates reaching into the 40 percent range have been floated in Senate conversations around online regulation. Extraordinarily high tax rates or license fees could change the narrative significantly, especially for prospective online poker operators, who may find the cost prohibitive and choose to opt out of Pennsylvania. Online casino operators too would be forced to tighten their belts, resulting in poorer promotions, tighter games, and (perhaps) fewer operators.

How much revenue will Pennsylvania generate from regulated online gambling?

We project that online gambling in Pennsylvania will generate \$230 million in gross gaming revenue in 2018, rising by 58.3 percent to \$364 million in year five of operations.

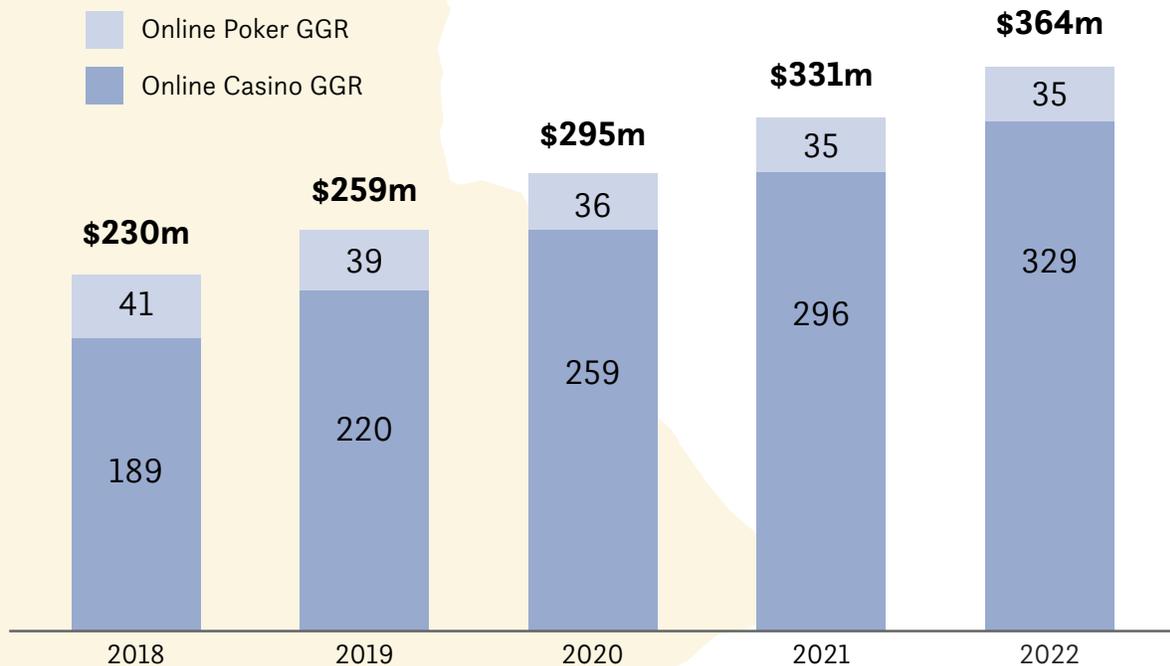
THE GROWTH will be remarkably consistent, with year-over-year revenue never increasing by less than 10 percent, and never more than 13.9 percent.

That said, industry growth margins will be slightly accelerated from 2018 – 2020, for several reasons. Primarily, it is during this span that we’re most likely to see a second wave of regulated operators drip into the market. This would be consistent with the situation in New Jersey, where Pala Casino, Resorts Casino, and Mohegan Sun Casino all launched during the industry’s second year, and Play SugarHouse and PokerStars during its third.

Also, it will presumably be during the industry’s early years that licensed brands dedicate the most marketing spend, and make the biggest strides in several critical areas, including payment processing, game selection, and mobile.

The Pennsylvania online gambling industry will be driven primarily by the online casino vertical. We estimate that online casinos will account for 87.4 percent of market share. This is relatively in line with historical New Jersey online gambling market trends, where online casino comprised 81.7 percent of industry revenue in years one through three, and 86.5 percent last year alone.

Base Case Pennsylvania Online Gambling Forecast



Source: PlayPennsylvania.com

Tax rate controls the outlook for Pennsylvania online gambling

IN JANUARY 2017, State Sen. Jay Costa, in a [co-sponsorship memoranda](#), proposed a 25 percent tax rate for online gambling. Past discussions in the Senate have included even higher tax rates, and debate over the appropriate rate is thought to be one of the primary sticking points for passage.

For **online casino**, a 25 percent rate would likely result in decreased marketing spend, tighter slots, and less than favorable rulesets for table games. In turn, acquisition and retention rates will almost undoubtedly suffer.

Backing this theory, note that land-based slot machine revenue in Pennsylvania, which is taxed at an oppressive 54 percent rate, is down 4.5

percent from 2012 – 2016 (per Pennsylvania Gaming Control Board reporting). As the novelty of the industry continues to wane, it's plausible that this downtrend will continue, as operators are simply ill-positioned to combat it given meager margins.

By contrast, table game revenue (taxed at just 16 percent) continues to thrive, up 24.1 percent over the same time span.

For **online poker operators**, who already rely on razor thin margins, the tax rate may prove untenable. In a bear case scenario, not a single online poker operator enters the market, costing the state tens of millions in tax revenue over time.

Projecting revenue to the state from online gambling

BY ACTING IN THE FIRST HALF OF 2017 (leading to a launch at the start of 2018), we believe that Pennsylvania stands to generate \$426.3 million from online gambling tax and license fees through 2022.

A significant portion of that total (~30 percent) will come in the first year in the form of licensing fees, providing a source of immediate budgetary relief.

[Evidence suggests](#) that online gambling has a complementary impact on brick and mortar

gambling revenue. Thus, we believe the \$426.3 million in state revenues generated directly via online gambling is merely one part of broader uptick for the state's entire gaming industry that will result from regulation of online casino and poker games, an uptick that will drive additional tax revenue via multiple channels to Pennsylvania.

Our analysis assumes a tax rate of 20 percent, a primary license fee of \$8 million, and an operator license fee of \$2 million.

Projected Tax Revenue From Regulated Online Gambling

	2017	2018	2019	2020	2021	2022
Total industry revenue	—	\$230 000 000	\$259 000 000	\$295 000 000	\$331 000 000	\$364 000 000
Tax generated (at 20% rate)	—	\$46 000 000	\$51 800 000	\$59 000 000	\$66 200 000	\$72 800 000
License fees	\$126 000 000	—	—	—	—	\$4 500 000
Total tax revenue	\$126 000 000	\$46 000 000	\$51 800 000	\$59 000 000	\$66 200 000	\$77 300 000

Total tax revenue generated 2017 – 2022

\$426,300,000

Source: PlayPennsylvania.com

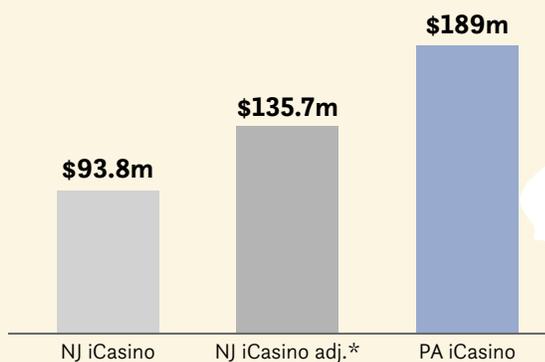
Pennsylvania online casino analysis

Year one outlook

IN YEAR ONE (2014), New Jersey online casinos generated \$93.8 million, or \$135.7 million when adjusted for Pennsylvania's population.

This figure comes up decidedly short (39.2 percent) of the \$189 million projected for Pennsylvania's year one online casino revenue.

Online Casino Revenue Year 1 – PA vs. NJ



*NJ iCasino revenue adjusted for Pennsylvania's population

Source: PlayPennsylvania.com

We believe the difference between these two figures is accounted for by the following key market distinctions.

Operator experience

Compared to New Jersey's online casinos, which were for all intents and purposes the guinea pigs of U.S. regulated online gambling, multiple Pennsylvania online casino suppliers will have had several years' experience operating within the landscape. Notables include 888, which has forged a partnership with Pennsylvania land-based casino Mt. Airy, and Rush Street Interactive, the platform provider for Play SugarHouse in New Jersey, and presumably the operator of a would-be SugarHouse Casino-branded site in PA. The list goes on.

The local marketing effect

Whereas Atlantic City in New Jersey is more of a destination resort, Pennsylvania's land-based casino industry is comprised more of "locals" brands spread throughout the state. Thus, Pennsylvania online casinos should be better equipped to market to their unique databases than Atlantic City brands. Targeted promotional offers could go a long way toward driving online traffic.

Stronger mobile rollout

When the New Jersey online casino industry was in its infancy, most industry mobile products were severely lacking in terms of game libraries and technology. Since, mobile has made strides, but still lags behind the products available in international markets.

By contrast, Pennsylvania will have the advantage of better-developed mobile products from day one. And, because mobile products are generally comprised of a greater percentage of lower return slots compared to their desktop counterparts, Pennsylvania online casinos will average a higher hold, and thus reap more revenue.

Better payment processing

In 2014, the New Jersey industry was severely hindered by poor payment processing. Options were typically limited to e-Checks, Visa/MasterCard (which were subject to high rejection rates), and third-party processors that weren't entirely familiar to U.S. customers (Skrill, Neteller). Cash at the casino cage was also available, but only provided a realistic option for either AC locals, or frequent AC visitors.

Since, the situation has improved dramatically. Today, credit/debit card transactions boast higher success rates (although this has more to do with the emergence of alternative methods and less to do with issuing banks loosening their policies), prepaid card options are available on most sites, PayPal is becoming more prevalent, and PayNearMe allows users to deposit funds using cash at outlets such as 7-Eleven.

Thus, Pennsylvania online casinos will presumably launch with much stronger payment processing vehicles. This is a critical component of industry success, as it will enable Pennsylvania online casinos to establish strong relationships with customers when acquisition rates are at their highest.

Furthermore, cash at the cage is a more viable cashing vehicle in PA, as more of the customer base is likely to be within reasonable distance of a casino.

The disparity between New Jersey's adjusted year one online casino revenue and our projections for Pennsylvania would be even wider if not for **a few negative comps** between New Jersey and PA.

Absence/pushback of Sands Bethlehem

In fiscal 2015/16, Sands Bethlehem accounted for 12.8 percent of PA's land-based casino revenue (only Parx Casino generated more). Owner Sheldon Adelson has been a vocal opponent of online gambling for the past several years, and is the driving force behind an attempt to institute a federal ban on the activity.

The likelihood of Sands participating in online gambling in Pennsylvania is near to nil. Going further, it's plausible that Adelson would dedicate funds to deterring players from participating in Pennsylvania online gambling.

Category 3 casinos

Two of the state's 12 land-based casinos are Category 3: Valley Forge and Lady Luck Nemaquin. Even if they're permitted to apply for an online gambling license, will they want to spend \$8 million or more on it? Both generate well under \$100 million annually, with Lady Luck coming in at just \$29.9 million last fiscal year.

Demographics

New Jersey residents have a higher GDP per capita, and higher median income than their Pennsylvania counterparts. Despite Atlantic City supporting higher return slots, land-based casino revenue per capita is marginally higher in New Jersey than in Pennsylvania. Internet penetration is significantly higher in New Jersey (87.8 percent vs. 77.8 percent in PA).

Size of the Pennsylvania online casino market at maturity

A HOST OF POSITIVE DEVELOPMENTS from 2014 to 2016 triggered the explosive growth of the New Jersey online casino industry. Industry revenue climbed 33.3 percent in 2015, and 36.1 percent in 2016.

As mentioned, Pennsylvania online casinos will be able to take advantage of these developments out of the gate. They'll also launch with the knowledge of what worked and what didn't in New Jersey.

Because of this, we believe Pennsylvania will get off to a rocket fire start, but experience more incremental annual growth than New Jersey. Our analysis shows annual gains of approximately 16–17 percent in years two (\$220 million) and three (\$259 million), followed by progressively smaller spikes each year thereafter.

By year five, our estimates have the industry generating \$329 million in gross gaming revenue, a cumulative uptick of 74.1 percent.

By the time market maturity is reached in year five, Pennsylvania online casino revenue will parallel that of the year five performance of the New Jersey market, after adjusting for population.

This suggests that any advantage Pennsylvania gains over New Jersey from targeted marketing efforts will be offset by negative demographic comps. On a revenue generated per capita basis, we believe the two industries to be nearly identical.

The following variables will likely contribute to the sustained growth of Pennsylvania online casinos.

New brands

The launch of new brands has had an additive impact on revenue in New Jersey. As an example, all three Resorts AC brands (Resorts, Mohegan Sun, and PokerStars) launched after February 2015. Collectively, they now account for a 13.5 percent market share.

The situation stands to be similar in Pennsylvania, where industry latecomers will attract locals and players who spread their gambling dollars across multiple sites. It's worth noting that if too many brands launch late, then Pennsylvania will more likely resemble New Jersey, with a lower starting point and pronounced upticks in years two and three.

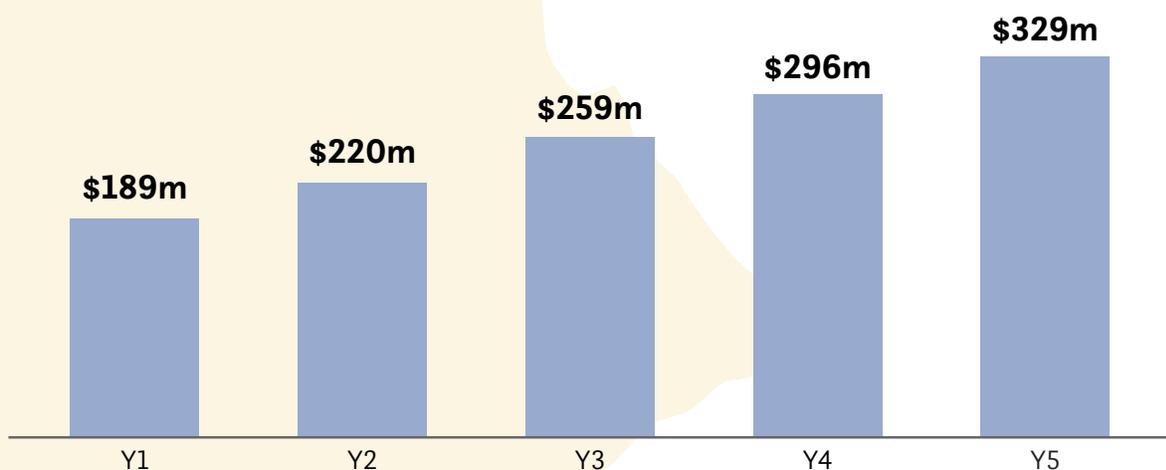
Improvements in payment processing

By year five, Pennsylvania should expect some improvement in payments, either via banks relaxing or operators innovating out of necessity. By year five, PayPal, which to date is only available on a handful of New Jersey sites, should see widespread integration.

Increased awareness

Consumer awareness and confidence are cumulative gains that at this juncture are essentially uncapped. By year five, U.S. regulated gaming sites will probably have successfully lobbied Google and/or Twitter to allow for pay-per-click ads, accelerating growth.

Pennsylvania Online Casino Revenue Year 1 – Year 5



Source: PlayPennsylvania.com

Pennsylvania online poker analysis

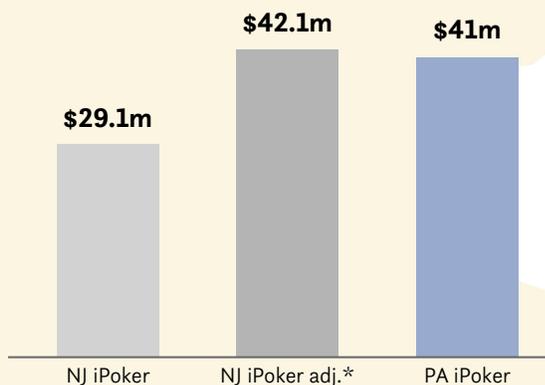
The outlook for Pennsylvania online poker is a decidedly mixed bag. Our analysis calls for a strong start for online poker, with revenue of \$41 million in year one. But, in the absence of an interstate compact, we expect revenue to dip 14.6 percent, to \$35 million, by year five.

Year one outlook

IT MAY SURPRISE SOME that New Jersey online poker had its best year before PokerStars was part of the equation. In 2014 (the first full year of regulated online poker in New Jersey), the industry generated \$29.1 million, attributed primarily to market novelty and high marketing spend.

We project that, adjusting for population, Pennsylvania online poker will generate nearly the same amount of revenue as New Jersey in year one.

Online Poker Revenue Year 1 – PA vs. NJ



*NJ iPoker revenue adjusted for Pennsylvania's population

Source: PlayPennsylvania.com

On the plus side, many of the same variables that will bolster Pennsylvania online casino revenue apply to online poker (e.g., operator experience, stronger mobile products, and better payment processing).

In addition, there are market distinctions unique to Pennsylvania that work in its favor:

The PokerStars impact

In the absence of a so-called “bad actor” clause in any piece of Pennsylvania online gambling legislation, it’s plausible that PokerStars will go live in Pennsylvania either at launch, or shortly thereafter. PokerStars may not have had an otherworldly impact on New Jersey online poker—industry revenue was up 11 percent in 2016, with most of that tied up in the period immediately following PokerStars’ March 2016 launch – but we believe that’s partially because PokerStars was fighting against a general industry headwind.

By contrast, if PokerStars flips the open sign over early, players will be immediately presented with the best online poker platform the industry has to offer. This should bolster acquisition and retention rates during the critical launch period, when novelty stands to be at its highest.

Advances in technology

Server instability and geolocation crashes were highly prevalent on New Jersey online poker sites in 2014, and to some degree, plague the industry to this day. However, the situation is much improved.

Minimizing disconnects is crucial to online poker, arguably more so than to online casino. To wit, a slot player who experiences a mid-game disconnect

only needs to restart the game. Whereas in online poker, disconnects are severely disruptive to game flow. And because liquidity begets liquidity in online poker, just a smattering of disconnects can have a compounding effect.

By supporting what will presumably be more stable platforms at launch, Pennsylvania online poker operators are virtually guaranteed higher retention rates in year one.

But we believe the advantages Pennsylvania will have over New Jersey will be offset, or more than offset, by **several negative comps.**

Weaker marketing push

Having learned a valuable lesson from NJ, Pennsylvania operators will throw the bulk of their marketing spend behind online casino. Expect online poker launch promotions to be solid, but we’re unlikely to see the type of promotional fire sales – like 888 Poker’s 80 percent rakeback offer – that we did in NJ.

Diminished local marketing effect

Interest in online poker is too sparse for land-based operators to only target unique databases. Instead, they’ll have to reach out to the broader Pennsylvania market, resulting in a less focused marketing relationship.

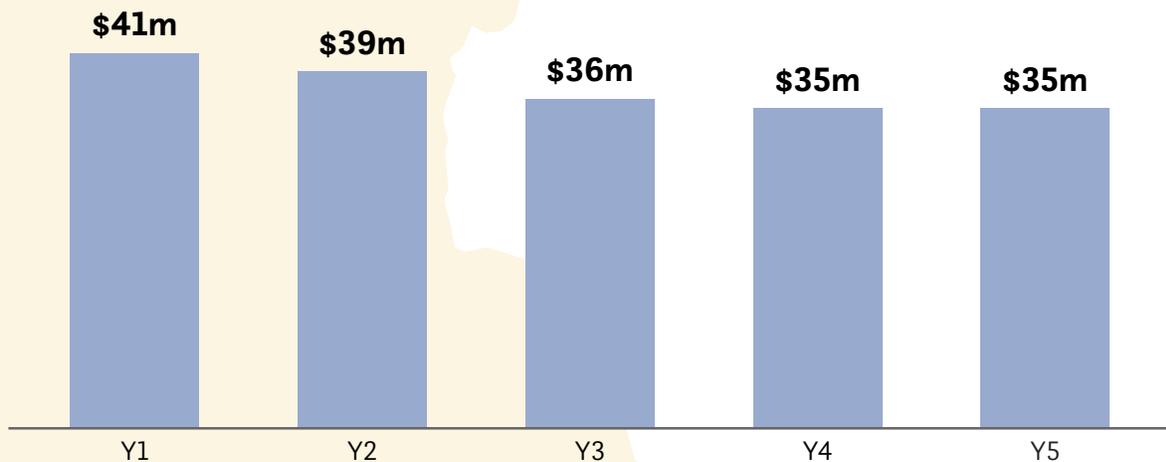
Economic and demographic variables

On balance, Pennsylvania residents make less income, are slightly older, and spend less annually on gambling than in NJ. All these variables could have a negative impact on online poker revenue.

General decline of online poker

The global online poker industry is in the midst of a multi-year decline, one that has forced most operators to radically adjust their business models. The hemorrhaging slowed in 2016, but the industry has yet to find its floor. Simply put, the online poker climate is more hostile now than it was when New Jersey online poker launched in late 2013.

Pennsylvania Online Poker Revenue Year 1 – Year 5



Source: PlayPennsylvania.com

Size of the Pennsylvania online poker market at maturity

IN 2016, New Jersey was the beneficiary of PokerStars' entrance into the market. Online poker revenue temporarily surged in April and May, and held modestly above 2015 levels throughout the rest of the year. The result was an annual revenue uptick of 11.3 percent.

Presuming PokerStars launches on day one, Pennsylvania won't have that surefire means of combating declining revenue. Thus, we project that an intrastate Pennsylvania online poker market will see its revenue decline slowly and steadily, from \$41 million in year one to \$35 million in year five.

We believe that Pennsylvania online poker will follow a similar trajectory to that of New Jersey, adjusting slightly for year two, when New Jersey online poker was crippled by severe marketing cutbacks, and year three, when PokerStars sparked a modest revival.

Key themes that will drive the decline follow.

Weak marketing spend

The drop-off probably won't be as dramatic as in NJ, since Pennsylvania operators will likely cap their launch spend at a lower point. Regardless, over time we do expect brands to shift their marketing

dollars to the more lucrative casino vertical. We've witnessed this phenomenon in New Jersey, where the prize pools of recurrent online poker promotions have been slashed, but online casino promotions have offered increasingly better value.

Market saturation

If Pennsylvania launches with three or four online poker operators (a likely scenario), we believe the industry's long-term growth prospects will suffer for it. Whereas the addition of more online casinos in New Jersey has had an additive impact (at least it has been up to 14 online casinos), the launch of just a third operator had a mostly cannibalistic effect. A bull case emerges where Pennsylvania launches (and sticks with), one or two online poker operators, as market fracturing becomes less of an issue.

The broader decline for online poker

Although there are some indicators that online poker's now six-year downtrend is losing steam, it may be years before it pulls an about face, if ever. One or two clever innovations may save the day, but until that happens, we see the online poker industry in general continuing to decline.

What if Pennsylvania joins other states for online poker?

Our revenue analysis **does not account for the impact of shared liquidity.**

It is presumable, even likely, that a prospective Pennsylvania online poker industry would vigorously pursue a liquidity sharing agreement with one or more states. This would open a slew of opportunities to operators, all of which would likely result in heightened revenue.

The most obvious candidate with which to forge a compact would be New Jersey, as the two industries will share a similar regulatory framework and some overlap between operators. But by 2019, we suspect other candidates will exist.

Interstate online poker 2020: bear case

In a bear case scenario, Pennsylvania will only sign a compact with NJ, and not until 2020. The market will service a population that is 69.5 percent larger (21.7 million). This should allow for the inclusion of at least one weekly six-figure guaranteed tournament, semi-regular \$2 million+ guaranteed tournament events, a greater array of No Limit Hold'em stakes, and some format diversity.

It's unlikely that an industry of this size can support a thriving fast-fold segment, although games should run periodically.

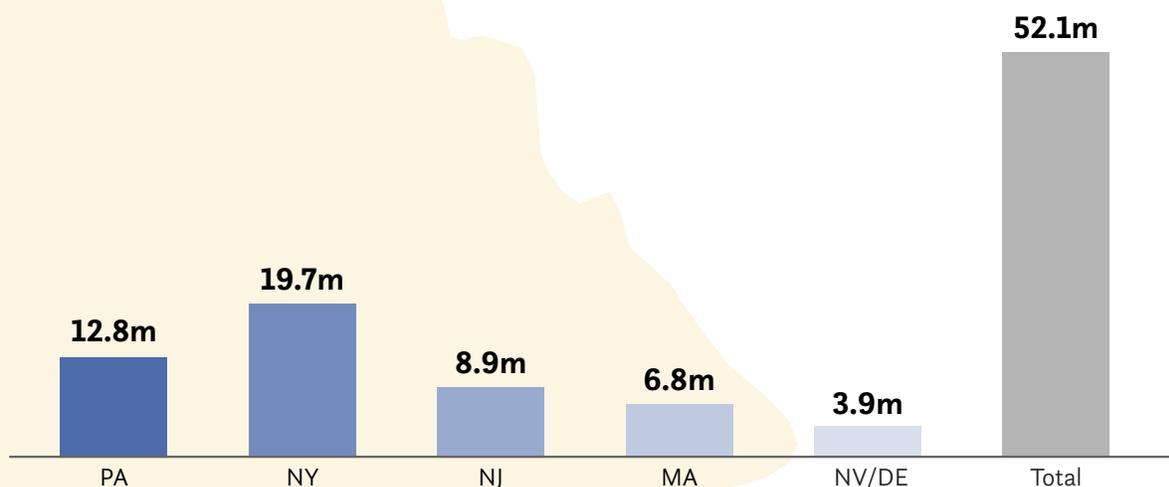
Interstate online poker 2020: bull case

New York and Massachusetts will legalize online poker in 2017. And they, along with New Jersey and Nevada/Delaware (which already share liquidity), will all share online poker liquidity by 2019. Now we're talking about a population of 52.1 million, an increase of 407 percent over Pennsylvania's standalone population.

The newly minted network will service a population nearly as large as Italy and France, two markets that average between 2,000 – 3,000 cash game players per PokerScout.com data. That's enough to support a variety of stakes and formats, including fast-fold, across a multitude of stakes. Multiple six-figure guaranteed (up to \$250k) become viable, as do \$5 million+ one-off series.

Additionally, the presence of NV modestly lengthens the prime-time hours due to the three-hour time differential. And the live WSOP will prove a high time for online poker, as flocks of poker tourists in Nevada will be able to access the entire network.

US State Populations – States With, Or Considering, Online Poker



Source: [Wikipedia](https://en.wikipedia.org/wiki/List_of_states_and_territories_of_the_United_States)

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