

UNITEHERE! Gaming Research

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Mystery at 18 Fremont in Downtown Las Vegas

- A new \$1.1-billion casino hotel is being developed in Downtown Las Vegas, and the developer appears to be seeking financing for \$800 million.
- While no financial projections have been disclosed by the developer, we believe the project is likely to generate low- to mid-single-digit returns on investment.
- The lack of institutional investment experience on the part of the developer raises questions about execution risk.
- Given these risks, potential investors in “18 Fremont” should make sure their own due diligence produces detailed and realistic financial projections before they make a decision on whether to commit to the project.

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I. Mystery New Casino Hotel in Downtown Las Vegas

In July, the City of Las Vegas approved the first major ground-up casino-hotel development on Fremont Street in Downtown Las Vegas in decades. A new casino-hotel, yet to be named, is set to rise on a 2.47-acre site along the west end of the downtown avenue and it will have a 459-foot hotel with 777 rooms, a two-story casino with a total gaming area of 111,740 square feet, space for F&B venues, and a rooftop pool deck.¹ The project will also include a new and connected parking garage across the street with 1,187 spaces. Taking advantage of the expansion of legal sports betting, it will also have a multi-level sports book venue with a broadcast studio in partnership with Vegas Stats & Information Network (VSiN), a sports betting news and analysis provider.²

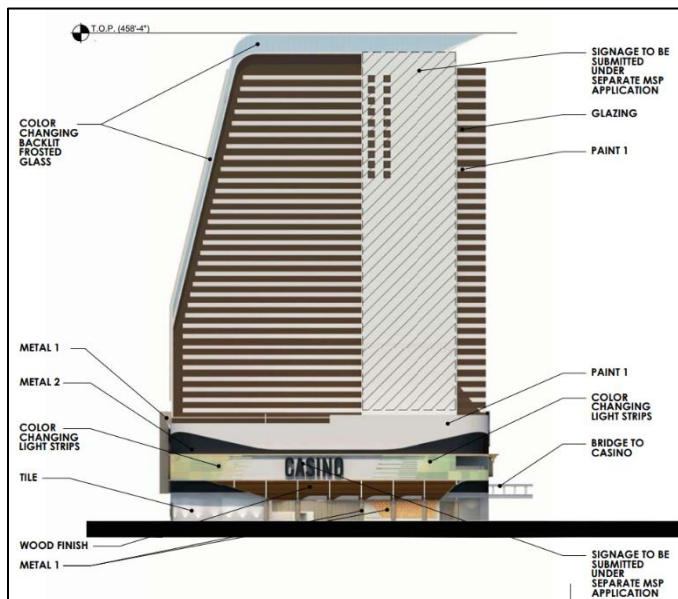


Figure 1. North Building Elevation - 18 Fremont Street, March 22, 2018. From staff report for agenda items 125 et al (SUP-72998 et al [PRJ-72865]) of City of Las Vegas City Council Meeting, 7/18/2018.

That someone is building a new casino in Downtown Las Vegas should not come as a surprise. The city’s historic downtown gaming market has experienced robust growth over the past few years. Boyd Gaming reportedly has filed paperwork to renovate and expand the Fremont Hotel & Casino a few blocks east of 18 Fremont.³ But the sheer size of “18 Fremont” still comes as a surprise. Moreover, while its physical dimensions have been approved and widely reported, the financial shape of “18 Fremont” has remained somehow of a mystery.

The developer, 18 Fremont Street Acquisition, LLC, is owned and controlled by its sole LLC Manager and CEO, Derek J. Stevens,⁴ who is also the majority owner and CEO of two existing casino hotels along Fremont Street, the 629-room D Las Vegas and 122-room Golden Gate Hotel & Casino. At the July 18 city council meeting where the

project was approved, the developer’s representative stated that the company was still seeking financing, which was “going very well,” though not yet finalized.⁵

We believe 18 Fremont is being planned as a billion-dollar development even though the developer has not publicly announced a budget or financial projections. An article published by the City of Las Vegas in March describes the new development at 18 Fremont as a “**\$1.1 billion** construction project” (emphasis added).⁶ A recorded deed of trust from July last year shows that 18 Fremont Street Acquisition LLC has signed certain loan agreements to borrow up to **\$800 million** from another Derek Stevens affiliate.⁷ This looks to be a precursor for the firm to raise money from other investors. For potential investors doing due diligence on the project, we believe the question to ask is: what kind of return on investment can be expected from a \$1.1-billion casino hotel development in Downtown Las Vegas (DTLV)?

II. Unraveling 18 Fremont’s ROI Mystery

If 18 Fremont performs like an average large casino-hotel in DTLV, it will generate low- to mid-single digit ROI in terms of EBITDA/Capex.

The Nevada Gaming Control Board (GCB) provides detailed aggregate data for the many distinct gaming markets in the state, including Downtown Las Vegas.⁸ We know that for fiscal year 2017 (ended 6/30/17), the large DTLV casinos had total revenue of \$1.185 billion from approximately 9,000 available rooms on a daily average and just over 496,000 of total square feet of casino floor space. In addition, their collective occupancy rate for the year was 89.89% with average daily room rate of \$75.29, and their gaming revenue per square foot was \$1,213. Interestingly, the GCB also provides the following revenue productivity (per room) statistics: for large DTLV casinos, average food revenue per room per day was \$54.29, average beverage revenue per room per day was \$38.35, and average “other” revenue per room per day was about \$24.97.⁹ We also know that approximately 8.93% of total revenue was “comped”. If we define “net revenue” as total revenue minus comped revenue (or “promotional allowances”)¹⁰ and “EBITDA margin” as EBITDA divided by net revenue, the EBITDA margin in the large DTLV casino market was about 22.2%. These data allow us to make an informed projection of how much revenue and EBITDA “18 Fremont” should produce, given its planned physical dimensions.

We know 18 Fremont is planned to include a two-level, 111,740-square-foot casino and 777 hotel rooms. From these, we can estimate its casino revenue, hotel revenue, food revenue, beverage revenue, and other revenue, assuming it performs like an average large DTLV casino hotel. Altogether we project 18 Fremont to make total annual revenue of \$195.4 million, which, after deducting 8.93% of “comped” revenue, should result in about \$177.9 million in net revenue. Assuming a typical 22.2% EBITDA margin in line with the large DTLV casino market, we project 18 Fremont to generate annual EBITDA of **\$39.5 million**. That means 18 Fremont is likely generate a **ROI of 3.6%** on \$1.1 billion of investment.

Table 1. 18 Fremont Financial Projections: Base Model

Projected Revenue (\$millions)	
Casino	\$142.8
Rooms	\$19.2
Food	\$15.4
Beverage	\$10.9
Other	\$7.1
Gross Revenue	\$195.4
Less promotional allowances	(\$17.4)
Net Revenue	\$177.9

EBITDA Margin	x 22.2%
EBITDA	\$39.5

Recall that the developer appears to be seeking \$800 million to finance the development. If \$800 million financing is obtained at a consolidated interest rate of 5%, for example, the annual interest expense alone will be \$44 million. **If 18 Fremont is to perform like a typical large DTLV casino hotel, it might not even be able to meet its debt service obligations.**

We note that our projection is similar to what the City of Las Vegas has projected for 18 Fremont, at least in terms of hotel revenue. Back in March, the city said the project was “expected to bring a minimum of 700 new rooms to generate \$2.1 million in room tax annually; \$340,000 of that will come to the city directly.”¹¹ As the room tax rate is 13% room in Clark County, it seems the city was projecting approximately \$16.2 million of hotel revenue for 18 Fremont, with 700 rooms. If we upsize the projected figure proportionally for 777 rooms, we get \$17.9 million of projected hotel revenue, which is rather close to our projected \$19.2 million for the hotel part of the business.

As 18 Fremont will be a brand-new property in DTLV, one might reasonably expect it to outperform its neighbors. But even if the new casino resort somehow *doubles* the current revenue metrics of the large DTLV casinos around it (namely, the casino revenue per square foot, the average daily room rate, occupancy, the food, beverage, and “other” revenues per room), we estimate it will generate net revenue of approximately \$360 million (with a 100% hotel occupancy rate). And if it can at the same time raise expected EBITDA margin by 500 bps to 27.2%, it will produce annual EBITDA of \$97.9 million, which would translate into a ROI of 8.9% for the \$1.1 billion construction.

Table 2. 18 Fremont Financial Projections: Optimistic Model

Projected Revenue (\$millions)	
Casino	\$285.6
Rooms	\$42.7
Food	\$30.8
Beverage	\$21.8
Other	\$14.2
Gross Revenue	\$395.1
Less promotional allowances	(\$35.3)
Net Revenue	\$359.8
EBITDA Margin	x 27.2%
EBITDA	\$97.9

As 18 Fremont is likely to do better than average but unlikely to outperform its neighbors dramatically, we believe the most likely outcome is that it will produce mid-single-digit return of approximately \$55 million a year in EBITDA.

Conversely, if 18 Fremont is to have mid-teens ROI, it will need to generate EBITDA like a casino resort on the Las Vegas Strip.

Recently, the CFO of another Las Vegas gaming company stated that the company would expect ultimately a “mid teens” return on one of its major capex projects (\$312.5 million purchase plus \$620 million renovation).¹² It thus does not seem unreasonable to suggest that investors elsewhere in the gaming industry might demand that level of returns. For \$1.1 billion, the annual EBITDA required for a 15% ROI would be \$165 million. Is that a realistic expectation for 18 Fremont?

For some perspective, we see that the Mirage on the Las Vegas Strip made \$176.5 million in property EBITDA on net revenue of \$617.6 million in 2017. The Mirage has over 3,000 rooms and ADR of \$178 and RevPAR of \$168 for the year 2017. That implies the property had hotel revenue of about \$187 million for the year. To generate that amount of hotel revenue with 18 Fremont's 777 rooms, even assuming 100% occupancy for the year, the average daily room rate will have to be \$658.16. (The Bellagio had ADR of \$283 in 2017.)

How about casino revenue? The Mirage does have a smaller casino floor (at 93,000 square feet) than what has been proposed for 18 Fremont (117,740 square feet), but the Strip also has much higher average gaming revenue productivity than Downtown Las Vegas. For fiscal year 2017, NGCB data show that the large properties on the Strip¹³ generated \$2,300 of gaming revenue per square foot of casino floor space, so we estimate that the Mirage had about \$213.9 million of gaming revenue. For 18 Fremont's casino to generate that amount of gaming revenue, it would have to produce \$1,816 per square foot of casino space, or nearly 50% better than the \$1,213 of gaming revenue per casino square foot at large DTLV casinos. It is not clear how 18 Fremont will be able to achieve that level of casino revenue productivity.

III. Other Risks Surrounding 18 Fremont

It is unclear if the executives affiliated with 18 Fremont have the experience to develop, open and operate a billion-dollar new development. For example, Susan Hitch, the CFO of both the D Las Vegas and the Golden Gate Hotel Casino, 18 Fremont's two existing DTLV casino affiliates, might be expected to play a key role in seeking and arranging for the \$800 million financing for 18 Fremont. However, Hitch does not appear to have any Wall Street background or any experience with large institutional investors.¹⁴ Hitch is a CPA and worked as a Senior Associate with Ernst & Young (Oct. 2000 – March, 2004) and a Senior Accountant with Baker Tilly Virchow Krause LLP (April 2004 – July 2005). Interestingly, her LinkedIn profile shows a 3-plus-year gap between the end of her employment at Baker Tilly and her start at the Golden Gate in December, 2008. She actually spent those years working as Controller at the Cold Heading Company, which is Derek Stevens' family-owned auto parts business in the greater Detroit, Michigan, area.¹⁵ (It is unclear why this part of Hitch's resume has been left out of her LinkedIn profile.)

The Cold Heading Company itself recently had annual sales of \$111.13 million (per D&B)¹⁶ and had a credit balance of \$8,000 in August, 2018, while the highest credit extended to the company was \$694,700 in November, 2016 (per Experian).¹⁷ It does not appear to have had significant Wall Street relationships, either. The company's CFO, Dan Morrell, has worked for that firm since 1993.¹⁸ While he (and Cold Heading Company) have appeared on several documents for real estate transactions in Las Vegas done by Derek Stevens-affiliated entities,¹⁹ it is not clear if he will play a role in arranging for the financing for the 18 Fremont project. The Cold Heading Co. has had a long-term financing relationship with a Comerica Bank branch in Livonia, Michigan,²⁰ as does Desert Rock Enterprises LLC,²¹ the Stevens affiliate which has the \$800 million loan agreement with 18 Fremont Street Acquisition LLC. However, Comerica has not traditionally been a significant presence in the Las Vegas gaming industry.

Derek Stevens himself does seem to have access to a certain level of liquidity that has allowed him to make investment purchases in Las Vegas over the past decade. As far back as 2005, a Stevens affiliate, Mt Hood Holdings LLC, purchased a 35.54-acre parcel in northeast Las Vegas for \$9.55 million, and the property was sold for \$11 million in 2018.²² Another Stevens affiliate, Durango Dorrell Holdings LLC, bought a vacant 0.91-acre parcel for \$4.35 million in 2006 and then sold it for \$2.80 million in 2010.²³ Most recently, in May, 2018, another Stevens affiliate purchased two office buildings across the street from the D Las Vegas for \$39.5 million.²⁴ In 2011, he and his brother, Gregory Stevens, purchased the former Fitzgeralds Casino & Hotel from the estate of Don Barden for \$18 million,²⁵ and then spent a reported \$22 million to renovate the property to turn it into the D Las Vegas a year later.²⁶ These transactions appear to have been done

without the need for any kind of mortgage loan or other types of financing, as we have not found recorded documents for any such debts. Still, it seems that the ambitious financial scale of 18 Fremont has made it necessary for him to seek outside financing. It remains to be seen if institutional investors will be convinced to commit \$800 million (or more) to this new addition to the historical Las Vegas Downtown.

¹ Staff Report for agenda items 125 et al (SUP-72998, SUP-72999, SUP-73000, SUP-73001, SUP-73002, SUP-73003, and SDR-73004 [PRJ-72865]) of City Council Meeting of 7/18/2018.

² Golden Gate Hotel & Casino and the D Las Vegas, "Derek Stevens to Transform Downtown Las Vegas with Three New Sports Betting Experiences," *CISION PR Newswire*, 9/6/18, at <https://www.prnewswire.com/news-releases/derek-stevens-to-transform-downtown-las-vegas-with-three-new-sports-betting-experiences-300707717.html>.

³ Bradley Martin, "Downtown's Fremont Hotel & Casino To Double in Size," *Eater Las Vegas*, 10/4/2018, at <https://vegas.eater.com/2018/10/4/17934980/downtown-fremont-hotel-casino-renovation>.

⁴ See Nevada Business License of 18 Fremont Street Acquisition LLC. Also, Statement of Financial Interest, attached in backup material for agenda items 125 et al (SUP-72998, SUP-72999, SUP-73000, SUP-73001, SUP-73002, SUP-73003 AND SDR-73004 [PRJ-72865]) of City Council Meeting of 7/18/2018.

⁵ Minutes for agenda item 125 (SUP-72998, SUP-72999, SUP-73000, SUP-73001, SUP-73002, SUP-73003 AND SDR-73004 [PRJ-72865]) of City Council Meeting of 7/18/2018.

⁶ City of Las Vegas, "City Council Approves Funding Request to Help the Fremont Street Experience Upgrade the Canopy," *Medium.com*, 3/21/18, at <https://medium.com/@CityOfLasVegas/city-council-approves-funding-request-to-help-the-fremont-street-experience-upgrade-the-canopy-43421d0c3087>.

⁷ Deed of Trust, Assignment of Rents and Leases, Security Arrangement and Fixture Filing, made as of 7/3/2017 by 18 Fremont Street Acquisition, LLC as trustor, Nevada Title Company as trustee, and Desert Rock Enterprises LLC as beneficiary and secured party; filed with the Clark County Recorder's office on 7/5/17. Business entity records from the Nevada Secretary of State's website show that Derek J. Stevens is the sole LLC manager at both 18 Fremont Street Acquisition LLC and Desert Rock Enterprises LLC, and that his address is listed as 1 Fremont St, Las Vegas, NV 89101 (location of the Golden Gate casino) on both corporate filings. On the deed of trust for the loan from Desert Rock to 18 Fremont, however, the borrower's address is shown as 301 Fremont Street, Las Vegas, NV 89101 (the address for The D Las Vegas) while the lender's address is shown as 1 Fremont Street, Las Vegas, NV 89101. Ownership information of Desert Rock Enterprises LLC was filed with the City of Las Vegas as part of the liquor license application of The D Las Vegas.

⁸ Nevada Gaming Control Board, Nevada Gaming Abstract 2017, pp.2-41ff for Fiscal 2017 (ended 6/30/17) aggregate financial data on "Clark County - Downtown Las Vegas Area: With Gaming Revenue of \$12,000,000 and over", available online at <https://gaming.nv.gov/index.aspx?page=142>. Net revenue is calculated as total revenue minus complimentary revenue in Rooms, Food, Beverage, and Other Income departments. EBITDA is calculated as Net Income (Loss) Before Federal Income Taxes and Extraordinary Items plus Depreciation - Buildings, Depreciation and Amortization - Other, and Interest Expense.

⁹ We calculated the per room revenue in "Other" department from the available GCB data.

¹⁰ See, for example, how the term is defined in the 10-K filed by Boyd Gaming on 2/26/2018 (p. 65): "The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as a promotional allowance."

¹¹ City of Las Vegas, "City Council Approves Funding Request to Help the Fremont Street Experience Upgrade the Canopy," *Medium.com*, 3/21/18, at <https://medium.com/@CityOfLasVegas/city-council-approves-funding-request-to-help-the-fremont-street-experience-upgrade-the-canopy-43421d0c3087>.

¹² Transcript of Q3 2017 Results - Earnings Call of Red Rock Resorts, Inc. The CFO of the company said: "Based on our experience of developing and operating high-end hybrid properties at Green Valley Ranch in Red Rock Resorts, as well as our deep experience with the Palms and as potential having been a part owner of the property for nearly a decade, we expect to generate a double-digit EBITDA return on our overall investment in the property going to mid teens return after an appropriate ramping period." See <https://seekingalpha.com/article/4122008-red-rock-resorts-rrr-ceo-frank-fertitta-q3-2017-results-earnings-call-transcript>.

¹³ Nevada Gaming Control Board, Nevada Gaming Abstract 2017, pp.2-17ff for Fiscal 2017 (ended 6/30/17) aggregate financial data on "Clark County - Las Vegas Strip Area: With Gaming Revenue of \$72,000,000 and over"

¹⁴ Susan Hitch, LinkedIn profile, at <https://www.linkedin.com/in/susan-hitch-9a103016/>.

¹⁵ <https://www.freedomsphoenix.com/Media/150712-2014-02-19-02-19-14-paul-snow-all-3-hours-bonus-bitcoin.htm>, accessed 9/28/18.

¹⁶ D&B Duns Market Identifier Plus (US) report on The Cold Heading Co., dated 3/8/17, with "Annual Sales" shown as "\$111,129,527 - Estimate" with the note "Sales Revision Date: July 7, 2018" under the Income Statement section, accessed via LexisNexis on 10/1/2018.

¹⁷ Experian Powered Business Data report on Cold Heading Co., dated 9/15/18, accessed via LexisNexis on 10/1/2018.

¹⁸ Dan Morrell, LinkedIn profile, at <https://www.linkedin.com/in/damorrell/>.

¹⁹ See the grant, sale, bargain deed by Mt. Holdings LLC, recorded on 1/11/2006; grand bargain and sale deed by 8th Street Holdings, LLC, recorded on 12/22/2008; and quitclaim deed by Drock 3rd Street, LLC, recorded on 11/22/2013.

²⁰ There are numerous UCC filings with Cold Heading Co. as the debtor and Comerica in Livonia, MI, as the secured party over the years.

²¹ State of Nevada UCC Financing Statement, documents #2005038602-2 filed 12/08/2005 and #2005038603-4 filed 12/08/2005, both with Desert Rock Enterprises LLC as debtor and Comerica Bank at 39200 Six Mile Road, Livonia, MI 48152-2689, as secured party. Continuations for both were filed on 7/26/2010 and 7/11/2015.

²² Ownership history and documents available at Clark County Assessor's website:

<http://sandgate.co.clark.nv.us/assrrealprop/ParcelHistory.aspx?instance=pcl2&parcel=12327401001>.

²³ Ownership history and documents available at Clark County Assessor's website:

<http://sandgate.co.clark.nv.us/assrrealprop/ParcelHistory.aspx?instance=pcl2&parcel=12520510012>.

²⁴ Ownership history and documents available at Clark County Assessor's website:

<http://sandgate.co.clark.nv.us/assrrealprop/ParcelHistory.aspx?instance=pcl2&parcel=13934210066>.

²⁵ Purchase Agreement, dated as of 8/18/2011, by and among representative of the estate of Don H. Barden and successor trustee of the Don H. Barden Trust Agreement, as sellers, and Desert Rock Enterprises II LLC, as buyer. The document was filed as part of the D's liquor license application with the City of Las Vegas. As disclosed in liquor license and gaming license applications, Desert Rock Enterprises II LLC was 78% owned by the Derek J. Stevens Trust, whose sole trustee and beneficiary is Derek Stevens, and 22% owned by the Gregory J. Stevens Trust, whose sole trustee and beneficiary is Gregory Stevens.

²⁶ <https://www.reviewjournal.com/business/casinos-gaming/downtown-las-vegas-club-to-close-for-renovations/>