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Is There Life After Blackjack? Ask MGM

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LAS VEGAS

JAMES J. MURREN doesn't play the tables or slot machines. But boy, does he love to gamble.

About two weeks ago, Mr. Murren, the president and chief financial officer of MGM Mirage, the $4 billion hotel and gambling behemoth, was holding forth in his office here at the Bellagio, surrounded by antique slot machines and talking about his latest bet the way a high-roller might recount the story of a big hand.

The future growth of his company, he proclaimed, has little to do with gambling. So instead of developing a new megahotel and casino, he is spending some $3 billion of the house's money on a major real estate play to transform 66 acres on the Las Vegas Strip into a mini-Manhattan. Think condominiums, boutiques, restaurants and movie theaters, all within walking distance.

"You won't see a Wal-Mart, but you will see Whole Foods," Mr. Murren said, briefly gazing into his hallway, where part of the movie "Ocean's Twelve" was filmed. "The days of building the Bellagios and the Wynns are over," he added, referring to Steve Wynn's newest hotel and casino, which does not even open until April.

Mr. Murren, whose company is about to complete its acquisition of Mandalay Resort Group and with it control of the city's most celebrated casinos, stands at the epicenter of the gambling universe. So why does he seem so determined to wager on virtually everything but gambling?

The answer reflects a new Las Vegas truism: The house may always win in blackjack, but the margins there aren't nearly as good as they are for $10 glasses of Grey Goose and tonic water or a $125 ticket to a Cirque du Soleil performance. Indeed, a quick look at MGM Mirage's revenue shows that the longtime economics of Las Vegas - give away the food and entertainment to get people gambling - have been turned on their head.

"If you were to look at our company - putting all the pieces of it together - 10 years ago about 65 percent or maybe more of our revenue would have been from gaming and 35 percent would have been everything else," Mr. Murren said. "Today, only about 44 percent is gaming. And I bet that if you give us less than 10 years, the whole thing will have completely reversed: 35 percent will be gaming and 65 percent will be nongaming."

That is not to say that gambling is a losing business proposition - in fact, revenue is up. It is just that nongambling revenue has risen a lot more. Consider that the average visitor to Las Vegas last year spent $193.92 on food and drink, $254.18 on accommodations, $83.53 shopping and $44.79 on shows for a total of $576.72 over about four days, according to the Las Vegas Convention and Visitors Authority.

By comparison, the average visitor who gambled - about 89 percent of visitors, but that number is steadily dropping - had a "gaming budget" of about $500, meaning the maximum amount they were willing to lose. And those figures encompass the entire Strip, not just the high-end properties that offer visitors plenty of other ways to spend their money.

Given the trend, Las Vegas may have to reinvent itself again. Part of the problem is that it may have simply run out of new gamblers. "I think there has been a realization that the market for gamblers coming in on Thursday and flying out on Sunday is finite," said David G. Schwartz, coordinator of the Gaming Studies Research Center at the University of Nevada Las Vegas and author of "Suburban Xanadu: The Casino Resort on the Las Vegas Strip and Beyond" (Routledge, 2003).

As Mr. Murren acknowledged, "No one says, 'Let's go see the next 300 slot machines at Monte Carlo.' "

IN one of the starkest acknowledgements of this new truth, Mandalay's newest property, called The Hotel, which resembles a giant version of a minimalist Ian Schrager boutique, does not even have a casino in the main building. (It's about a quarter-mile away, at the Mandalay Bay.) And blackjack tables and slot machines are conspicuously absent from the blueprint for Donald J. Trump's planned property in Las Vegas, Trump International. (During the finale of "The Apprentice," you will recall, the winner, Kelly Perdew, turned down the opportunity to help Mr. Trump develop that property in favor of working on his development on Manhattan's West Side.)

According to Mr. Trump, who boasted that his building would be - surprise! - the tallest in Las Vegas, real estate prices have jumped so much that it has become more profitable to simply be a real estate developer in Las Vegas than to run a gambling operation.

"The margins on real estate in Las Vegas are much higher," Mr. Trump said. "Gambling is too competitive."

Indeed, real estate prices are booming and appear to be one of the driving forces behind Mr. Murren's goal of creating a dense minicity as opposed to another large hotel and casino complex.

"Steve Wynn bought this land that we're on for less than $500,000 an acre," said Mr. Murren, referring to the land the Bellagio sits on. "That acreage now goes for $25 million an acre. That seven-acre lake out front, if the developers had to do it all over, they would never do that. We've been very piggy with land as a community because it has been so available.

"Look at it this way: to build Bellagio today would cost $2.5 to $3 billion for five million square feet," he added. The net cost of MGM's project will be about the same for 18 million square feet.

The project, called CityCenter, will be the largest privately financed development project in the nation. The site, between the Bellagio and the Monte Carlo, is about the same size as Rockefeller Center, SoHo and Times Square combined. The first phase of CityCenter is to include a 4,000-room hotel-casino; three 400-room boutique hotels; about 550,000 square feet of retail shops, dining and entertainment space; and 1,650 luxury hotel, condominium and private residence club units.

"You go to Aspen, they are selling hotel condos," Mr. Murren said. "You go to Disney, they're selling hotel condos. Las Vegas had none of that product."

But it soon will. MGM is not the only player in the condominium game. More than 30 projects are in the works by an assortment of companies around the area, but most are not directly on the Strip. (Mr. Wynn, too, is expected to develop condominiums on the property behind his new hotel.)

The inspiration for MGM to go full steam into the real estate business came in part from the company's involvement in The Residences at MGM Grand, a high-rise development under construction. For that project, MGM worked with a real estate developer, Turnberry, but the deal was structured in a way that mostly benefited Turnberry when the real estate market took off. This time, MGM will be in charge, though it does plan to seek partners for some of the projects.

Of course, Las Vegas has tried to reinvent itself before, most recently with its failed effort in the mid-1990's to appeal to families with themed hotels and things like the roller coaster at the New York-New York Hotel and Casino.

Mr. Murren, an art history and urban planning major at Trinity College, said this latest effort was not a revived version of that plan. "My personal view is that ship has sailed," he said of family attractions. "We're not going to build more themed hotel-casinos."

For Mr. Murren, CityCenter is his chance to remake Las Vegas into a cosmopolitan city - and just as important, keep the city and his current properties filled from Sunday to Thursday.

"If we create more volume in off-peak periods by having more people live here, you're going to see food and beverage go up in terms of margin," he said. "It will help all of our buildings and everyone else's that's here too."

Mr. Murren, a former Wall Street analyst, describes the project in part as a way to protect the company's investment in its current properties. "We've doubled down here on Las Vegas," he said, referring to the company's acquisition of Mandalay. That deal will give MGM more than half the 72,000 hotel rooms and gambling tables along the brightly lighted boulevard that snakes through the city, including some of its most celebrated properties - like Bellagio, MGM Grand, Mirage, Mandalay Bay, Luxor, Excalibur, New York-New York. Circus Circus and Treasure Island.

By building a minicity, he is hoping that one day those properties will be thought as valuable as the Waldorf-Astoria or the Pierre, two storied Manhattan hotels. "When Wall Street gets that -- ," he says, ending his thought in midsentence.

In the meantime, he harbors hopes that Wall Street will applaud the company's efforts to diversify its income.

Investors typically ascribe significantly higher multiples to luxury retailers and hoteliers than to gambling operations, which have always had a sort of sin discount associated with them, despite the 87.5 percent rise in MGM's shares this year.

Just this May, Sheldon Adelson, the owner of the Venetian, sold the Grand Canal Shoppes, a 500,000-square-foot shopping, dining and entertainment space within the Venetian, to an affiliate of General Growth Properties for $766 million, 20 times its annual cash flow. MGM trades at about nine times annual cash flow.

THERE'S no question that one of the collateral benefits of the direction we're going could be a revaluation of our security," Mr. Murren said. He acknowledged that when management makes that argument, it sounds "shrill," but he said he thought the move would diversify the company's income beyond that of some corporations that are valued more highly than MGM.

"Intuitively, you would think that we might go higher but you never know," he said.

But the real question will be whether having people living on the Strip will be as profitable as having people jet in for the weekend. Mr. Murren, who had McKinsey & Company study the situation for months ("We spent a fortune on those guys," he said), said residents would eventually prove to be more profitable than visitors.

Others are less sure. Mr. Schwartz of the University of Nevada Las Vegas says he goes to the Strip when he has guests in town. "Other than that, it's rare."

More than 40 percent of the Las Vegas population seldom, if ever, goes to the Strip to gamble, according to a survey conducted in 2002 by Las Vegas Perspective, an annual market analysis. And only 25 percent said they had gone to see a show in the last 30 days.

But no matter how Las Vegas locals otherwise spend their leisure time, they still have to eat. According to the survey, 61.6 percent went to the Strip to dine.

And when people actually live on the Strip, they will need more than food - toothpaste, for example. A CVS pharmacy on the Strip may be the best proxy for the potential of MGM's new project: its outlet there is one of the most profitable, if not the most profitable, of all of the chain's stores.