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February 8, 2006

Industry View
In-Line

Gaming

Tribal Gaming Review and Slot Outlook

Conclusion: With tribal gaming facing opposition on four different fronts at the federal level, the casino approval process that can now take more than 10 years could start taking even longer. We maintain our In-Line view of the Gaming industry and our stock ratings.

What Are the Issues? Tribes are facing pressure on four fronts: 1) land acquisitions/off-reservation casinos, 2) Class II game definitions, 3) IRS rules on tax-exempt bonds, and 4) increasing oversight by the National Indian Gaming Commission.

Implications: The largest impact in our coverage universe is on slot manufacturers, as restricted tribal casino expansion could mean fewer future slot sales. Estimates for California expansion are the most at risk, given the Street's near-term expectation for an explosion of slots. By contrast, a change in laws governing Class II games could be a modest positive for Class III manufacturers like IGT and WMS, although it will likely take time for this to play out. Among operators we cover, only STN and HET are seeking to manage new tribal casinos. We see little material impact to HET and a modest impact to STN if the tribes it is working with do not succeed.

California expansion stretched out: The Golden State has been touted as one of two major markets that will grow the installed slot base. Much depends on the November 2006 election and developments at the federal level, but we doubt the market can expand by ~25,000 machines by 2008, and recently pushed out our California forecasts. Our proprietary tribe-by-tribe analysis gives us confidence in our new estimates, barring any significant new political/regulatory changes.

Tribal Gaming 101: We provide a plain English overview of the complex tribal casino approval process, details on market size, numbers of non-gaming tribes, and the potential for new tribal casinos in each state.

Recent Reports

Title	Date
Slot Primer: '06 Not Bad - '07 Offers More Upside Potential Celeste Mellet Brown & Team	February 6, 2006

Companies Featured

Company	Rating
Harrah's Entertainment (HET.N, \$71.66)	Overweight
Station Casinos (STN.N, \$65.02)	Overweight
International Game Technology (IGT.N, \$36.00)	Equal-weight
WMS Industries (WMS.N, \$24.23)	Equal-weight

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Tribal Gaming Review and Slot Outlook

With Many Issues Now Facing Native American Gaming, New Growth Could Slow

At the Federal level, Native American tribes are facing four major areas of opposition: ease of land acquisitions/off-reservation gaming, Class II machine definitions, IRS rules on tax-exempt bonds, and increasing NIGC oversight. This pushback is in addition to public opposition in many states to expanded tribal gaming. Tribes already need years to pass environmental reviews, place land into trust, and negotiate compacts. The potential changes we discuss in this report will likely limit the viability of some projects and lengthen the process for others. However, progress at the federal level will probably be slow, and any changes to the tribal gaming framework could be more modest than those now proposed.

Why Do We Care? Slots, Slots, Slots

This report should be read in conjunction with our *Slot Primer: '06 Not Bad - '07 Offers More Upside Potential*, published February 6, 2006. Native American slots, including Class II games, comprise 31% of the North American installed base, and more than 30% of forecast new units, obviously an important driver of the outlook for slot suppliers. As we detail below, we recently stretched out our new unit forecasts (reflected in the forecast included in the primer), based largely on a delay in our California estimates. For operators overall, any delays in projects or cancellations due to legislative and regulatory changes should have a minimal impact. Only Station and Harrah's in our coverage universe operate or are pursuing tribal management contracts. Given Harrah's size, the success of the tribes it is working with has little bearing on the company's value. For Station, the impact of tribal contract successes or failures is more meaningful, yet still modest, at an estimated 5% of our price target.

Executive Summary

Below we present the major conclusions of this report, and the pages on which you can find more information.

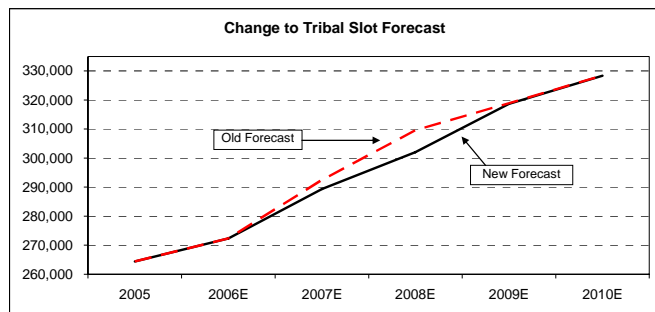
- **Tribal casinos can take more than a decade to approve and build, and this process could lengthen.** Changes discussed at the federal level could result in an even longer bureaucratic path to the opening of a tribal casino. Even if some of the changes proposed are not passed, the increased scrutiny of tribal gaming projects is already slowing development (pages 5-10).
- **We recently spread out our tribal slot forecast.** Given the difficult approval environment, we spread out our estimates for slot installations, driven largely by changes to our California forecast.
- **Now expect 26,000 CA slots installed in 2006-2010, spread out from 24,000 largely in 2007 and 2008.** Based on our tribe-by-tribe analysis, the sluggish compacting process in California, and the likelihood of Congress closing some avenues of approval for tribal casinos, we have spread out our forecast for California, the most significant Native American jurisdiction in terms of both growth potential and current size (pages 11-15).
- **Class II to Class III conversions in Florida are likely.** Only the timing and the size remain open questions (page 16).
- **Industry is maturing, although there are still long-term opportunities for tribal gaming expansion,** with one-third of federally recognized tribes currently not operating casinos. However, any new projects could be smaller than existing casinos, and will likely come on over many years (pages 17-18).
- **Future off-reservation casino projects look unlikely,** and the process to acquire new property for casinos under exemptions like reservation restoration and land claims will likely also become more difficult (pages 5-7).
- **Class II games face challenges.** Any changes to make Class II definitions more restrictive would be a modest positive for Class III manufacturers and a negative for exclusively Class II suppliers, as more restrictive rules would make the machines less attractive to tribes. However, the replacement of Class II slots would likely be spread out over time, and the success of the DOJ's efforts on this front remains highly uncertain (pages 7-8).
- **IRS could end Indian gaming bonds' tax-exempt status.** Increased project funding costs could delay/shrink some projects, although the observable impact will likely be small (page 8).
- **Potential legislation could reduce environmental lawsuits, but appears to be a long shot right now.** Any limitation of legal challenges to tribal casinos would significantly accelerate many projects. We do not expect action in the near term, however (page 8).
- **NIGC could get more teeth.** Congress appears concerned that the agency is under-funded and understaffed, and could give it more resources and more regulatory power (pages 8-9).
- **Given the complexity of tribal gaming law, we review the process in plain English** (pages 19-21).

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Exhibit 1

Changes to Our Tribal Slot Forecast (Reflected in Primer)



Note: Includes both Class II and Class III slots
Source: Morgan Stanley Research

Exhibit 2

Tribal Gaming Fast Facts

Tribal Casino Revenue, 2004 (\$mm)	\$19,408
CAGR, 2000-2004	15%
Number of Tribal Slots, 2004	239,815
CAGR, 2000-2004	15%
Number of Tribal Casinos, 2004	367
CAGR, 2000-2004	4%
Number of Federally recognized tribes	561
Outside of Alaska	336
Tribes with Class III Gaming	182
Tribes with exclusively Class II Gaming	37
Tribes without Gaming (ex. Alaska)	122
Non-gaming Tribes in states w/ Class III gaming	97
Non-gaming Tribes in states w/ Class II gaming	12
Non-gaming Tribes in states w/o gaming	13
Top 5 States, # of Tribal Slots	
California	59,403
Oklahoma	31,242
Minnesota	22,375
Washington	18,213
Wisconsin	15,493
Top 5 States, # of Non-gaming Tribes	
California	52
Nevada	16
New Mexico	11
Oklahoma	9
Washington	8

Note: Most figures exclude Alaskan tribes, which are classified differently by the BIA. Numbers of gaming/non-gaming tribes do not add to total because some tribes operate casinos in multiple classes of gaming.
Source: NIGC, BIA, Casino City, Morgan Stanley Research

How Many Years Does It Take in Normal Circumstances to Open a Tribal Casino? Could Be 5, Could Be 20

Each tribal casino case is different, and every tribe starts from a different point along the approval path, so it is impossible to say how long the steps outlined in Exhibit 3 can take. From start to finish, the process could take up to several decades. Federal recognition is often the most lengthy and variable part of the process, as a tribe must prove a continuous history and political unity over hundreds of years. Assuming a tribe is federally recognized (state recognition does not count for gaming), the process could still take many years. If a tribe has land, an environmental review is sometimes required and could take two to three years. For Class III gaming, the tribe would also need a compact, which could take months in a best case, and many years in a worst case if a state stalls.

If a tribe has no land, the process could take up to a decade more. The process of placing land into trust includes satisfying IGRA (Indian Gaming Regulatory Act) requirements for gaming eligibility (usually through demonstrating some historical ties to the land), obtaining the general BIA (Bureau of Indian Affairs) approvals for placing land into trust, and receiving environmental approvals (which take longer for placing land into trust than for just building a casino).

While any environmental review can be subject to litigation, the land into trust review can introduce additional court challenges. The BIA now requires tribes to go straight to the more stringent environmental impact statement (EIS) review, rather than the shorter environmental assessment (EA), since EIS's are harder to challenge in court and legal challenges of EAs force EIS's to be conducted anyway. Tribes often try to work with local communities during the process to head off lawsuits and reduce the chances of rejection, since the land into trust process is much easier and quicker with local support (although cities, towns, and counties have no formal say in the process). A shortcut for tribes with some influence is to have land given to them by an Act of Congress with an effective date of before October 17, 1988, but this is not necessarily an easy proposition.

We note that this is how the process has worked for the past 17 years. Given the opposition discussed elsewhere in this note, the process could take even longer in the future.

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Exhibit 3

Steps to Open a Tribal Casino

- 1) Tribe must have or obtain federal recognition.
- 2) If the tribe has a reservation, or land held in trust since before October 17, 1988, it can begin gaming but may need a compact (skip to steps 6 and 7).
- 3) If the tribe has no land, or wants to build a casino on land off-reservation, it must acquire it.
- 4) The tribe must have the land put into trust by the BIA, which can happen only if:
 - a) the land is contiguous to the existing reservation, or
 - b) the land a new or restored reservation for a tribe just granted or re-granted federal recognition, or is new land for a landless tribe that is already recognized, or
 - c) the land is part of a land claim settlement, or
 - d) the Secretary of the Interior and the Governor agree that it would be good for the tribe and non-detrimental to the surrounding area.
- 5) The BIA will typically put the land into trust for gaming only if the project passes an environmental review and legal challenges. The vetting process takes about a year after the EIS is finalized.
- 6) For Class II gaming, a tribe can generally begin gaming once it has land.
- 7) For Class III gaming, the tribe must negotiate a compact with the state, and have the compact approved by the BIA (the compact negotiation could come before the land process is finished, but the approval of the compact by the BIA comes after everything else is complete).

Source: Morgan Stanley Research

Exhibit 4

Federal Agencies/Laws Governing Indian Gaming

Agency/Law	Description
BIA (Bureau of Indian Affairs)	Agency that grants federal recognition to tribes; reviews and approves land into trust applications
NIGC (National Indian Gaming Commission)	Agency that regulates Class II gaming, and to a lesser extent Class III; approves Class III compacts and management contracts
DOJ (Department of Justice)	Agency that prosecutes violations of federal gaming law; is proposing Johnson Act changes
IGRA (Indian Gaming Regulatory Act)	Law governing Indian gaming; outlines requirements for gaming on Indian lands and taking land into trust for gaming; created NIGC; specifies different Classes of Indian gaming
Johnson Act	Law banning all slot machines unless governed by a tribal-state compact or state law; Class II games currently exempt

Source: Morgan Stanley Research

New Tribal Gaming Opposition Could Kill or Delay Future Projects

What Has Changed?

In a separate section later in this report, we detail the current legal framework for Indian gaming in plain English; we recommend that investors less familiar with the casino approval process read this section (pages 19-21). More important for the future, however, are the events that have unfolded at the federal level over the past year that threaten the pace of tribal gaming expansion. While individual states have traditionally been the battleground of tribal gaming expansion, the spotlight is now on federal laws and regulations, with much broader and more fundamental implications than compact negotiations or a municipal services agreement may have for individual casinos.

Many changes to the Indian gaming framework have been proposed, and there are many conflicting priorities among constituencies. While many of the bills under consideration would radically change tribal gaming and there is much fear in the industry, the reality is that compromise always happens, and the changes passed will likely be much less severe than the changes proposed. Also note that everything takes time in gaming, and just because something is proposed does not mean that it will happen for many, many years. The implication for tribal expansion, however, is that the increased scrutiny of many projects will likely slow progress, regardless of what laws are eventually passed or amended.

Three developments pushed Indian gaming issues to a national level in 2004 and 2005. In our view, the lobbying scandal surrounding Jack Abramoff, the flap over the Lytton urban casino in the San Francisco area, and the increasing influence of entrenched gaming tribes have all come together to force the US Congress to take a closer look at tribal gaming. The lobbying scandal focused national media attention on Native American casinos. The Lytton project highlighted the potentially controversial nature of the off-reservation casino process and the level of public opposition to urban casinos. Due to the way in which the Lytton Band of Pomo Indians was granted its property for a casino — by an act of the US Congress — the issue was quickly escalated to the federal level. Finally, tribes with existing casinos are becoming increasingly rich and are now aggressively employing lobbyists to thwart new tribal competition, often through the pursuit of more rigorous federal restrictions on off-reservation casinos.

In addition, the rise of Senator John McCain (R-AZ) to the Chair of the Senate Committee on Indian Affairs changed the

political landscape. An aggressive “cleaner-upper,” Senator McCain looked at a growing industry increasingly marred by exploitation of loopholes and pursued changes in the tribal gaming framework throughout 2005.

Four Themes of Change, but Along Many Avenues

Much is threatening to alter the tribal gaming landscape. Below we list the 12 issues/bills/actions that could potentially change the outlook for tribal gaming and slot expansion. However, we see four themes emerging from these issues: 1) making land acquisitions for gaming more difficult, 2) outlawing current Class II games, 3) limiting the tax deductibility of tribal gaming bonds, and 4) strengthening the tribal gaming regulatory framework.

Land Issues: Securing Land for Tribal Casinos Likely to Become More Difficult

Off-reservation gaming under attack in the US Congress. Off-reservation casinos, or “reservation shopping” for better land/areas on which to build casinos, has been the most scrutinized consequence of the Indian Gaming Regulatory Act and the growth of tribal casinos. As we detail in a separate section later in this report, federal law prohibits gaming on lands acquired after October 17, 1988, but with exceptions for things like restored lands and land contiguous with a reservation. However, there are many proposals that seek to take advantage of the “two-part” exception, which allows an off-reservation acquisition for any reason if 1) the BIA and 2) the Governor approve. Even though the bureaucratic barriers to approval are enormous and only three such proposals have ever passed both parts of the two-part test, at least 20 such projects are under discussion (approximately 10 of these have applications in to the BIA). California alone has 11 two-part projects planned, most of which have not yet submitted BIA applications. Driven by the combined forces of public outcry over remote tribes encroaching on urban locations and moving into different states (for example, an Oklahoma-based tribe is trying to establish casinos in Ohio) and opposition from well-entrenched gaming tribes defending their markets, Congress is taking a closer look at off-reservation casinos and how land is acquired for tribal casinos. Several pending bills address the issues:

- Senator McCain’s legislation, S2078, the “Indian Gaming Regulatory Act Amendments of 2005,” would completely eliminate the “two-part” exception. For landless tribes, gaming could only be conducted on newly acquired land if the land is in the “temporal, cultural, and geographic

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nexus” of the tribe. Land claims for gaming would have to be in the same state as the tribe and would need to be approved by Congress. Senator McCain could also propose a role for local communities in the land-into-trust decision process.

- Legislation introduced by Senator David Vitter (R-LA), S1260, the “Common Sense Indian Gambling Reform Act of 2005,” would limit the “two-part” exception in several ways. First, the state legislature would have to approve the project in addition to the Governor and the BIA. Second, a study would need to determine that the casino would have no economic or any other impact on any jurisdiction or Indian tribe within 60 miles. Previously, economic impacts were not considered. Finally, the bill is similar to Senator McCain’s in that a tribe would have to demonstrate ties to the land in all cases.
- Draft legislation sponsored by Representative Richard W. Pombo (R-CA) would completely eliminate the “two-part” exception. In addition, it includes the same “nexus” criteria of the McCain and Vitter legislation, and would require the concurrence of nearby Indian tribes, the county where the land is located, and both the Governor and the legislature of the state before any land could be taken into trust for gaming purposes. In a novel twist, the Pombo bill encourages the consolidation of tribal gaming by allowing non-gaming tribes to build casinos on reservations of tribes that already have casinos, as long as they are in the same state.
- Legislation proposed by Representative Charles Dent (R-PA), HR3431, would eliminate the land claim, initial reservation, and restored land exemptions for gaming on land taken into trust after 1988. The bill does maintain the “two-part” exemption, but similar to other proposals, would require the concurrence of the state legislature as well as the Governor and the BIA.

The chances for passage of each of these bills remain uncertain. There are many common elements among the proposals, including eliminating or severely limiting the “two-part” exception, mandating legislative approval for putting land into trust in addition to that of the Governor and the BIA, and stipulating that land placed into trust must be in the “nexus” of the tribe. Local communities could also have a larger say in the land-into-trust process. However, there are conflicting agendas among members of Congress that could water down many of these elements. We believe it is likely that different bills will be passed in the Senate (by the McCain committee) and the House (by the Pombo committee). These bills will

then go to conference committee, which we believe is possible by the fall, but what comes out in the compromise is highly uncertain. While we expect something to be passed, it will likely be much milder than the elements of any of the individual bills would suggest.

Implication: Passage of any legislation similar to that proposed would impede many gaming projects already in the works. Eliminating the “two-part” exception would render all truly off-reservation projects dead in the water (more than 20 nationwide). Currently landless tribes and, under some versions of the legislation, tribes pursuing land claims would still be eligible to open casinos. However, these tribes could face higher hurdles for their projects, which would slow additional new tribal casino development. Note again, however, that we expect the final legislation to be watered down from the current proposals. In addition, for the exceptions that remain after any changes, the process could become smoother. If the more controversial exceptions are eliminated, the BIA could look more favorably on applications that are based on the “cleaner” justifications of restored land, new reservations, etc.

BIA writing new land-into-trust regulations. While the BIA has made over 30 decisions on gaming land into trust applications since 1988, it has been operating without a comprehensive set of regulations defining the process. Instead, it has relied only on the language in the IGRA. While the BIA had published draft regulations governing the “two-part” determination process in 2000, progress stalled following the change in federal administration in 2001. The BIA is now working on updated regulations, covering not only two-part determinations but also all exemptions under the IGRA. Most of the concepts in the draft regulations are similar to those in proposed federal legislation, including mandatory local consultations and the need for historical ties to the land. The draft also lays out definitions for exactly what comprises a connection to land, what contiguous land is, and other similar points left ambiguous in the original law. The timing of the final regulations remains uncertain, but no action is expected until at least later in 2006.

Implication: The passage of new regulations governing the land into trust process would have similar implications to the passage of any new law. However, the draft regulations do not go as far as some of the proposed legislation in limiting the ability of tribes to place land into trust for gaming purposes. Given that we expect some limiting legislation to be passed by Congress, we believe the impact of new regulations will largely be superseded by legislation, and should have only a modest impact on any casino proposals.

NIGC, BIA, and Congress looking into tribes skipping the approval process for acquiring land for gaming. The BIA has uncovered at least 10 instances of tribes acquiring land for non-gaming use, but then later building casinos on the land, skipping the rigorous approval process required under IGRA to take land into trust for gaming purposes. The NIGC and BIA are working together on a comprehensive national review of Indian gaming lands and will litigate against any casinos found to be in violation. In addition, a bill proposed by Senator Vitter would make tribes explicitly follow the BIA approval process, including environmental reviews, for any conversion of land use to gaming.

Implication: While some tribal casinos could close, there should be little impact on the overall industry, as most tribal casinos appear to be on valid land.

California proclamation against urban casinos. In response to the uproar over the Lytton urban casino, California Governor Arnold Schwarzenegger issued a proclamation opposing urban casinos in May 2005. The Governor indicated that he would not even begin negotiating compacts with tribes without land into trust, and that any off-reservation project requiring his sign-off would also need local approval. Note, too, that in the spring of 2005, the BIA declared that it would not approve Class III compacts before land for the casino is held in trust.

Implication: While the Schwarzenegger administration is in Sacramento, local communities will have effective veto power over any off-reservation projects, and any urban proposal will face an uphill battle.

Legislation proposed to revoke the special status of the Lytton land in California. The Lytton Band of Pomo Indians was able to bypass the normal approvals for gaming on land placed into trust after 1988 through a special act of Congress in 2000. Senator Dianne Feinstein (D-CA) has filed a bill to revoke the special status of this land and has some support in the Senate, although our contacts indicate that the bill could face an uphill battle in the House.

Implication: If the bill is passed, the Lytton Band would need to close its Class II casino in San Pablo, California. More broadly, the legislation signals that Congress is not prepared to issue further special dispositions to tribes anytime soon (it has not done so since several laws passed in 2000).

Courts have said there is an effective statute of limitations for pursuing land claims. Legal rulings at both the Circuit and Supreme Court levels in 2005 severely limited

the ability of tribes to pursue land claims against states that unfairly stole or bought land over the past 200 years. While not putting a specific time limit on the right of tribes to sue or receive damages, the courts appear to be taking into consideration the level of settlement and modern development on the claimed land when making decisions.

Implication: Since the resolution of land claims is one of the exceptions for allowing gaming on property acquired by tribes after 1988, limitation of land claim settlements going forward will likely impair some tribes from opening casinos off their reservations. We believe that the bulk of projects in California and in the western US will be unaffected by these rulings, as these tribes are not pursuing land claims, but that projects in the eastern US, particularly in New York, could be negatively affected.

Class II Changes: Good for Some, Bad for Others

Department of Justice bearing down on Class II machines. The DOJ, after losing numerous court cases against the legality of Class II machines, has proposed legislation to limit the definition of Class II games. While the NIGC has been drafting revised Class II regulations for many years, the more restrictive DOJ proposal would trump the NIGC's efforts. The DOJ intends to modify the Johnson Gambling Devices Transportation Act, which makes slot machines illegal in Indian Country except when covered by a tribal-state compact (Class II machines do not currently fall under the Johnson Act rules). By modifying the Johnson Act, instead of IGRA, which defines Class II games, the DOJ intends to first work with the judiciary committees that may view the legislation more favorably, and then move on to the Indian committees. Currently, Class II games are devices that technologically aid the play of a game of bingo. The key changes the DOJ proposes are:

- Players must compete against each other, not a machine.
- Players must actively participate in the game, meaning no automatic "daubing" by the machine of hundreds of electronic bingo cards.
- Side bets involving Class III-type games would not be allowed.
- Class II games must be distinguishable from Class III games in terms of gameplay, appearance, speed, and graphics.

While technological advances have blurred the lines between Class II and Class III games, the new law would slow down gameplay and require so much user interaction as to make

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Class II games essentially uncompetitive with Class III games. The DOJ effort is still in its early stages, with tribal consultations ongoing. While the government had originally planned to fast-track the legislation, it appears that the bill will need to be reviewed by both the Judiciary and Indian committees in Congress, not just the Judiciary committees as originally hoped by the DOJ, which could delay or weaken the agency's efforts. In addition, Native American tribes are aggressively fighting the legislation as an encroachment on their sovereignty, and the DOJ could face some headwinds in Congress. Right now, we are uncertain whether changes the DOJ proposes will eventually pass; we do not expect final action on the issue in 2006.

Implication: If the proposal is passed, tribes with Class II games would have to remove the machines, modify them to conform to the law, or compact with the state to either allow the current kind of games or, more likely, allow full Class III slots. Oklahoma and Florida are the two major Class II markets, comprising 85% of all 48,000 Class II tribal games in the US. Since Class III slots are now allowed at Broward County tracks, Florida will have to compact with the tribes, so we would expect conversion from Class II to Class III. In Oklahoma, Las Vegas-style games are illegal, but the state has shown a willingness to move in the Class III direction with the recent legalization of "one-touch" games (technically Class III but often called Class 2.5 games), so we expect Oklahoma would also compact to allow Vegas-style Class III games rather than see its Indian tribes seriously hurt. Note that while regulation of the Class II/III distinction in Oklahoma is currently very weak, we expect that the DOJ would more aggressively target tribes with "gray area" machines if its proposal is passed.

New York and California are home to approximately 4,000 Class II games largely operated by tribes that have Class III compacts, so these could be converted to Class III machines if restrictions on Class II machines are tightened. However, we caution that *conversions in all of these states would not be immediate, and the size of the conversions is still relatively modest compared to the entire slot market.* The result would be a benefit for Class III manufacturers spread out over time, and a large negative impact for pure Class II manufacturers, which would likely be left with only smaller charitable markets like Alabama.

Tax Issues: Project Funding Costs Could Rise

IRS investigating use of tax-exempt bonds for casino construction. Tribes have the right to issue tax-exempt bonds for any "essential government function" under a 1982

law. Many tribes have used this right to issue tax-exempt debt to fund casinos, but the IRS is now investigating roughly a dozen such issues, and has already formally objected to at least two.

Implication: If the IRS prevails in its disputes with the tribes, future Indian debt issues for casinos would be taxable instruments. The result would be higher funding costs for future projects, potentially slowing the pace of tribal gaming expansion. Tribes are lobbying for broader bonding authority, but so far with little apparent success. We do not believe that this issue would affect any project to be managed by a public company, however, and think that only marginal projects would be slowed.

Regulation: Giving the NIGC Teeth, but Potential Progress on Shortening Environmental Reviews?

House investigating revisions to environmental review process. The environmental impact studies that accompany gaming projects are not unique to gaming, but apply because tribal gaming approvals often involve "federal actions" for which federal agencies must initiate the reviews. Many agencies have complained that lawsuits unrelated to environmental issues significantly delay projects and are extremely costly. *The BIA alone has had to defend every one of its 30-plus decisions to take land into trust for gaming since 1988, and while it has won every case, it still must face challenges each time.* Opponents are becoming savvier with lawsuits as well, lengthening the process. While Congress is considering amending the National Environmental Policy Act to address some of these problems, this legislation is wide ranging and affects nearly every federal agency, so meaningful action could be slow or even non-existent.

Implication: If federal legislation limits the exposure of federal agencies to environmental lawsuits or streamlines the review process, the land into trust and management contract approval processes could be significantly accelerated. While environmental reviews that take one to two years will still need to be conducted, lawsuits often add several years to the process. We believe that the legislation is in its initial stages, and given the broad scope of the bill, the chances for meaningful reductions in lawsuits or reduced environmental compliance for casino projects are virtually nil.

Legislation proposed to give the NIGC more authority over Class III tribal casinos. Tribes won a round in August 2005 when the US Supreme Court ruled that the NIGC could not inspect or enforce minimum internal control standards

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(MICS) at Class III casinos. However, Senator McCain has proposed legislation to give the NIGC this authority.

Implication: If the bill is passed, Class III casinos would be subject to both state and federal inspections and regulations. Besides another layer of regulation, however, there would probably be little impact on tribal gaming expansion or revenues.

Legislation proposed to plug loopholes in the management contract approval process. Several tribes have circumvented the requirement that the NIGC approve all casino management contracts by structuring the agreements as consulting arrangements. Senator McCain has proposed legislation that would expand the definition of a management contract to eliminate this loophole.

Implication: The change would be significant for tribes and managers using the loophole, since the management contract approval process includes an environmental review that could take years. While we know of no contracts managed by Station or Harrah's that fall under this loophole, other companies with casino management contracts in the works could be affected.

Legislation proposed to increase state control over Class III gaming and limit charitable gaming trigger. Senator George V. Voinovich (R-OH) has proposed legislation, S1518, that would give states more control over Class III casinos. For Class III gaming to be conducted in a state, the bill requires that the state *expressly* allow such activity for any *commercial* purpose. Currently, tribes can have Class III games as long as "any person, organization, or entity" can conduct any type of Class III gaming. This language allows for tribes to open full casinos even if only charitable gaming is allowed in a state, as was the case in Connecticut in the early 1990s. Senator Voinovich's bill would require states to expressly allow the activity for commercial purposes before tribes could open Class III casinos, outlawing this charitable gaming trigger. In addition, the bill would require that any Class III casinos be conducted "in accordance with the applicable laws (including regulations) of the State in which the activity is located."

Implication: Increased state scrutiny and control over Class III casinos would not likely limit Native American gaming expansion. However, if passed, the bill would raise the trigger level for tribal rights to Class III gaming. The bill could limit the ability of tribes in states without any Class III gaming to pursue such casinos going forward, although we are unaware of any states with federally recognized tribes that have

charitable gaming but no tribal casinos. We believe that the bill would not be retroactively applied to existing tribal casinos that became legal through a charitable gaming trigger, although the bill text does not specify.

Overall Chances for and Implications of These Changes?

It is still highly uncertain what will come out of Congress on the tribal gaming front, but we believe that something will be passed. The result will likely incorporate elements of each proposal, including increased restrictions on off-reservation casinos and/or taking land into trust as well as more authority for the NIGC to regulate tribal casinos of all kinds. There could also be a larger role for local communities in the land-into-trust process. Note that legislators have tried to amend IGRA before and failed, however, and the forces resisting changes on the Indian gaming front are strong. Tribes have grown increasingly wealthy and sophisticated, and the Indian gaming lobby should not be underestimated. However, this works both for and against gaming expansion. Tribes with existing casinos will support measures that broadly maintain tribal sovereignty, but may also support legislation that makes it difficult for other tribes to encroach upon their own existing feeder markets. In addition, Congress has a lot of issues on its plate, and bills on tribal gaming are not always the first to be passed in a busy session.

Federal progress could be slow. Strong forces of public opposition are pushing Congress to do something about tribal gaming. When legislators then draft bills in response to make it more difficult for tribes to open new casinos, they face both support and opposition from tribes, whose power has grown significantly. Given the conflicting goals of tribes themselves, and often conflicting goals of legislators from different states/districts, coming to a compromise will likely be difficult. As a result, we believe action, when it does occur, could very well be muted.

As long as uncertainty remains at the federal level, we believe tribal gaming progress will be slow. While no bills have yet been passed, the added publicity about and scrutiny of tribal gaming have already slowed the progress of proposed projects. The BIA is taking a very close look at applications for land into trust before it, and governors are becoming more hesitant to sign compacts that may look bad when publicized.

We are less optimistic regarding the prospects for tribal slot expansion as a result of our analysis. Outside of California, we include very few new Class III projects, and none for tribes without land and compacts. Regardless, any small new expansions would be captured by our baseline 3%

organic growth forecast. In California, we do not include slots at any casino involving a two-part off-reservation proposal (see section on California later in this report), but do reflect projects proposed by landless tribes. For now, we do not reflect conversion of Class II to Class III slots in Florida (or Oklahoma), given the uncertainty of timing, but such an event could represent upside to our forecasts. While the main changes to our forecast are more spread-out sales/placements into California (reflected in our recent Slot Primer), we caution that the potential for adverse legislative changes likely biases the risks to the Native American component of our slot forecast (about 30% of the total) to the downside.

What Happened to the California Slot Expansion?

California Key to the Future of Tribal Gaming Expansion

California is by far the most important jurisdiction for Native American gaming, in terms of understanding its future expansion potential as well as its history. The Golden State is home to 107 federally recognized tribes, nearly three times the number in Oklahoma, and has more tribal slots than any other US state, at nearly 60,000. More importantly, *52 of its tribes currently do not operate casinos*, creating a significant opportunity for gaming expansion if these groups open even modest facilities. From a historical perspective, California was the impetus for the lawsuit that prompted Congress to pass IGRA, *California v. Cabazon Band of Mission Indians*, and is home to many landless tribes due to the California Rancheria Act of 1958 and the Indian Termination Act of 1961, which disbanded many California tribes.

Conclusion: Non-Gaming Tribes Hold the Key to Growth; 50,000+ Slots Proposed, but 26,000 Likely in Next 5 Years

Based on the current environment both in California and at the national level, we believe many projects proposed in California will not be completed, and forecast 26,000 new slots over five years. If we are wrong and every casino is built, 53,400 new machines could be installed in California. However, as we detail below, we believe the risks are weighted toward the downside. Importantly, growth is dependent on new tribes gaining land and signing compacts, as most gaming tribes in the state are up against the slot limits imposed by their compacts (although many of them would not necessarily add new slots if allowed, given intense competition in some areas of the state).

History of California Gaming Legalization Holds Insights Into Future Constraints

California's gaming industry grew essentially unregulated in the 1990s even though the state constitution outlawed slot machines, with the first compacts signed only in 1998. In November 1998, Proposition 5 was passed, legalizing slots on Indian lands; at the time, it was the most expensive referendum in history at \$90 million. The law was struck down less than a year later in August 1999, and the state's gaming tribes signed interim compacts with then relatively new Governor Davis to prevent closure of the casinos. In March 2000, voters passed Proposition 1A, which made Class III Indian gaming legal under the California constitution and validated the 1999 interim compacts.

The 1999 compacts are still the basis for most California gaming, allowing 45,000 to 50,000 slots statewide. In all,

61 California tribes signed compacts in 1999 and 2000. To this day, 50 of California's 57 casinos continue to operate under these compacts. Eight of the original 61 tribes never opened casinos, five have signed amended compacts, and two operate two casinos each. In addition, one new tribe signed a compact, and one tribe operates a Class II facility without a compact.

The 1999 compacts were all based on the same template. If a tribe was operating gaming as of September 1999, it could keep the number of machines it had. These machines totaled approximately 19,000. If the tribe was not operating a casino, it was allowed up to 350 slots. All tribes were allowed up to two casinos each, and on top of the initial slot limits, tribes could apply for additional machines (up to a cap of 2,000 per tribe) if the total number of slots in the state was less than the maximum allowed. The language detailing how many total slots are allowed in California under the 1999 compacts is anything but clear, however, and the reports on the number of slot licenses authorized have ranged from 45,206 to 50,000 or even 62,000 machines. Whatever the number is, all participants agree that all slot licenses have been issued.

Implication: For any existing California casino governed by a 1999 compact to expand, the tribe will need a new compact. There has been a misconception that only tribes that have hit the 2,000-per-tribe limit will need a new compact, but due to the above restriction on the maximum number of slots in the state, at this point *any* tribe that wants to expand will need a new compact.

17 New Compacts Signed Since 1999, but Material Expansion Has Been Slow to Come

While 17 tribes have signed new/amended compacts, five of these have not been ratified by the legislature, one was merely a validation of a casino that was operating without a compact, and five have yet to open facilities at all. The only expansion of the installed base that has occurred in California has been from one new 350-slot casino, and from expansions at five existing properties totaling 2,100 new slots.

Schwarzenegger administration's push for more revenue generated the tribal slot optimism. Governor Schwarzenegger took office in November 2003 with a promise to get the state's "fair share" from Native American gaming tribes that shared revenues with their non-gaming brethren, but not with the state. Faced with a budget deficit of nearly \$10 billion, Governor Schwarzenegger pressed tribes that

needed more capacity to share a portion of their revenues with the state (not required under the 1999 compacts) in exchange for larger numbers of slots. The future looked bright when five new compacts were signed in June 2004 that allowed these tribes to install an unlimited number of slot machines. In return, the tribes agreed to fund a \$1 billion transportation bond and to pay fees for any new machines added under the amended compacts.

High expectations for the future were fueled further by three new and two amended compacts signed in August 2004. Under these compacts, the tribes agreed to pay up to 25% of their revenue to the state on a sliding scale, raising the bar for payments to the state. For the two amended agreements, the tribes were allowed unlimited slots, while for the three new compacts, the tribes were allowed a total of 6,000 machines. This cap of an average of 2,000 slots per tribe was the first sign of a crack in California's new tribal gaming expansion program.

What went wrong? After the August 2004 compacts, a series of events came together to slow progress on new and expanded compact agreements. The five tribes that had rights for unlimited machines collectively installed only 2,100 games, perhaps making other tribes question whether demand was as high as originally thought, and whether the price to pay for added machines to the state was worth it. In addition, the administration became distracted by prolonged battles with two tribes that said multi-station games counted as one device, not multiple units (the tribes eventually relented and removed or reconfigured the machines).

Sovereignty issues and urban casinos became two large roadblocks. The administration's push for a greater role for the state in tribal gaming inspection and regulation threatened many tribes, who were determined to preserve their sovereignty. Then the Lytton casino compact became a focal point for gaming opposition in the state. Located in San Pablo in the heart of the San Francisco-Oakland area, the casino was subject to more opposition than most, but since the US Congress had granted the tribe the land and directed California to negotiate a compact, the state had little choice but to approve the project. The problem was that the state initially authorized a huge 5,000 slots, and while the tribe voluntarily lowered the number to 2,500, the damage was already done. The Schwarzenegger administration had to back away from pursuing large new casino agreements, and issued a proclamation opposing new casinos in any urban area. The spillover from the added awareness also had an impact on rural casinos plans, as proposals surfaced to put a moratorium on any new tribal gaming projects.

Could the situation be stabilizing? While negative public sentiment at the beginning of 2005 likely affected two compacts signed in June 2005, which allowed a total of only 1,450 machines, two new compacts were signed in September 2005 that allow for the tribes to operate 2,250 devices each. This size is not as promising as the unlimited slots agreed upon in 2004, but is still enough to drive meaningful expansion of the California slot market if it becomes a precedent.

Current problem is getting the compacts ratified in the California legislature. The four compacts signed in 2005 are still stuck in the legislature, which reconvened in January. Two forces are stalling ratification: opposition by some anti-gaming legislators, and opposition by gaming tribes threatened by the competition. The outcome in the legislature is anybody's guess, although as with most things in politics, some will likely get done, and some will not. If the current environment persists, however, we believe the compact approval process will continue to be sluggish going forward.

Exhibit 5

Forces Working Against Expanded CA Gaming

Development	Impact
Tribes with rights to unlimited games installed a meager number	Possibly signalled that demand is not strong enough to pay the high price of expansion
Two tribes fought with state over status of multi-terminal games	Distracted administration from negotiating new agreements
California pressured tribes for inspection/regulatory rights at casinos	Tribes pushed back against threats to their sovereignty
Public outcry against urban casinos and expanded gaming generally	Administration had to publicly oppose urban gaming
Gaming tribes campaigning against new casinos to maintain monopoly/ oligopolies	New compacts having difficulty passing the legislature, 0 of 4 ratified in 2005

Source: Morgan Stanley Research

California expansion faces additional hurdles created by a large number of landless tribes. Many tribes in California, in addition to facing compact negotiations, must still obtain land approved for gaming before opening casinos. While landless tribes exist across the nation for various historical reasons, California is home to a greater number than many other states. In 1958, the US Congress passed the California Rancheria Act, which terminated the federally recognized status of more than 40 California tribes and withdrew the special reservation status of their lands. Additional tribes were terminated in California and nationwide through the Indian Termination Act of 1961. Tribal lands that were

formerly held in common and restricted from being sold or transferred were suddenly distributed to tribal members, who often sold the land or lost it to back taxes. In later years, members of many of these tribes and their descendants sued the government to restore their status, or pursued renewed federal recognition through the normal approval process. When the tribes regained federal recognition, they had no land upon which to establish reservations, or rancherias as they are often called in California (*rancheria* essentially refers to a small Indian settlement).

Since federally recognized tribes are sovereign entities, they have a right to acquire land to call their own, and IGRA allows for restored tribes to build casinos on newly acquired land if it is for a new reservation. However, as we detail elsewhere in this report, even for a restored tribe, putting the land into trust to make it sovereign is not a simple or quick process. Federal scrutiny of the process has increased due to the growing number of tribes with land that are pursuing off-reservation casinos under other IGRA exemptions, and regaining lost lands can take over a decade in some circumstances. There are over 20 tribes in California pursuing casinos on lands that are currently not sovereign; 11 of these are seeking off-reservation projects, but 10 are tribes that are currently landless, and therefore have a right to acquire new land and build a casino on it. Both project categories face additional delays beyond the compacting process, but the off-reservation ones are in much greater doubt than the pure landless cases.

So Where's It Going? Depends on Next Administration

The Schwarzenegger administration apparently would like to continue to sign new and amended compacts that add to state revenue, with the impact of increasing the number of slots in the state. Politics in the legislature is the current problem, and if the Governor wins reelection in November 2006, we expect continued slow progress. Mass new compact signings, as had originally been hoped, cannot become a reality unless a new administration comes in that is more friendly toward the tribes' sovereignty wishes, as many tribes have said they can wait Governor Schwarzenegger out (if the demand actually exists).

After November 2005 special election "debacle," a new governor is possible. Governor Schwarzenegger saw his popularity drop over the course of 2005 to the mid-30% range, and his fight with the legislature that resulted in a special election to pass his reforms ended in "an unmitigated political debacle," according to some in the California press. Fighting \$100 million in opposition funding from California unions, the Governor failed to win passage of any of the four propositions

he had sponsored. Still, he faces no likely primary opposition, and the last time a California Governor was removed from office after one term was in 1942. While the popular belief is that Governor Schwarzenegger faces an uphill battle, it is still too early to call. Two Democratic candidates have announced they will run in 2006, Treasurer Phil Angelides and Controller Steve Westly, and two other names have been discussed in the press, Warren Beatty and Rob Reiner. Both Democratic candidates are seeking tribal support. Treasurer Angelides has strong relationships with the card rooms that typically are against tribal gaming expansion, but he is courting the Native American lobby as well. Controller Westly has strong tribal relationships.

California Slot Forecast: 26,000 Machines Over 5 Years

Of California's 52 non-gaming tribes, 28 are in the process of pursuing casinos. If all of these projects come to fruition at their desired sizes, California would add 43,600 slots to its current installed base of 59,000. In addition, seven gaming tribes are pursuing either second casinos or have expansion capacity left under existing compacts (not including tribes that can install unlimited numbers of slots), which could add a further 9,800 slots in the state. Also, five tribes currently operating casinos can install an unlimited number of slots under their existing compacts, but have not announced plans to add more for now. While 53,400 new machines would be a 90% increase in California's installed base and a 6% increase in the total US installed base, we 1) do not expect all of these projects to be completed, 2) do not expect all of the projects to be completed at their desired sizes, and 3) expect the additions that do come on to be spaced out over many years. That said, there are still 24 non-gaming tribes with no announced casino plans that could pursue projects in the future; these would be incremental to our estimates.

Exhibit 6

CA Slot Forecast Summary and Sensitivity Analysis

	Added Slots		
	Low-Case	Base-case	High-case
2006	0	698	2,313
2007	698	5,990	8,925
2008	4,865	7,550	13,750
2009	5,675	9,650	11,350
2010	2,000	2,500	3,400
Total	13,238	26,388	39,738

Source: Morgan Stanley Research

New forecast has a modestly higher number of slots, but with sales spread out over several years. The main conclusion of our detailed California analysis is that new slot installations will likely come not in a burst, but rather more evenly over time. We now assume 26,000 new machines

installed in California between 2006 and 2010; previously, we had reflected 24,000 new machines, largely concentrated in 2007 and 2008.

Tribe-by-tribe analysis. Exhibit 8 presents our tribe-by-tribe estimates for numbers of slots and casino openings, all based off where the tribe is in the approval process (see page 4 for details on the process). This painstaking analysis (done by extensive research using numerous sources for each estimate) leads us to believe that new casino openings will be spread out over the next several years, rather than coming all in a clump in 2007 and 2008. The hype surrounding Governor Schwarzenegger’s push for gaming expansion previously led us to believe that a rash of new compacts would be signed in the near term, unleashing a slot installation boom. Given the obstacles in California laid out above, and the less friendly federal landscape for tribal gaming, we now expect much more measured progress. In addition, we have now completely removed the 11 off-reservation projects that would require a “two-part” determination from the BIA and the Governor, since 1) only three such projects have ever been approved in 17 years nationwide, 2) there is a high probability that the “two-part” exception will be outlawed, and 3) even if not outlawed, Governor Schwarzenegger opposes urban casinos and now requires local support for any “two-part” approval.

Note that these estimates on an individual tribe basis are not meant to be precise; we use these estimates as a guide to reach a base so that ideally deviations from our estimates will average out. Note also that our estimates do not include expansions at casinos that operate under compacts allowing

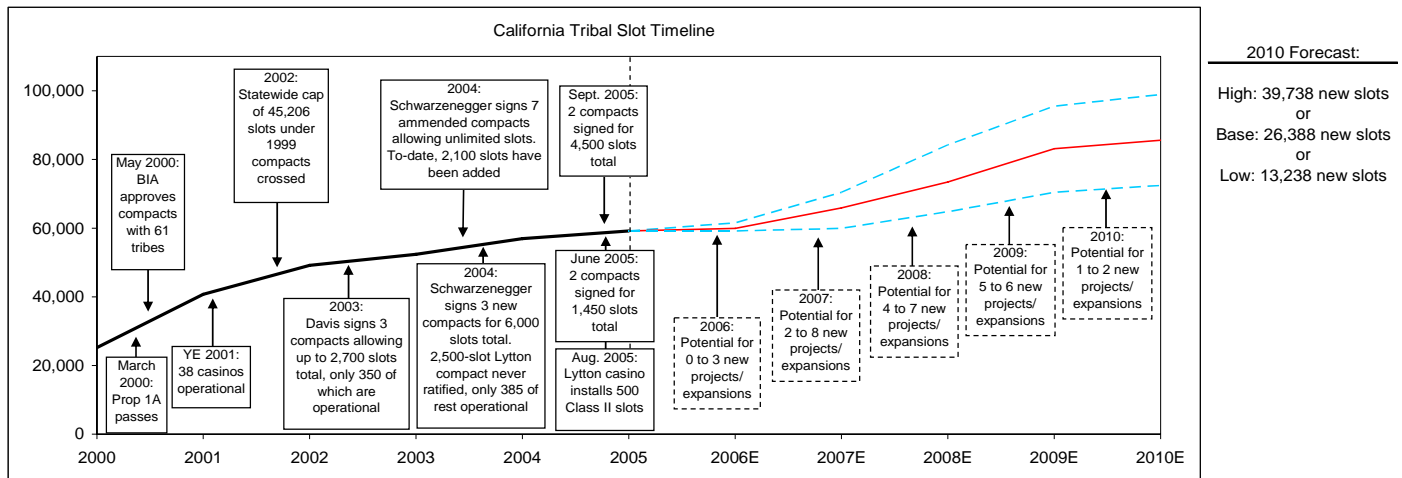
an unlimited number of slot machines. In reality, some of the projects we have included in our estimates will likely be delayed, but some expansions will likely occur. On balance, we believe our overall estimates to be reasonable.

Tribes in California are clustered in two areas, generating saturation concerns. The majority of California’s casinos, both existing and proposed, are concentrated near the San Diego area and northeast of San Francisco. While we believe there is room for up to 40,000 additional slots in California over the long term, some of the proposed projects that do not get done for many years will find their markets saturated, and could install fewer machines than currently planned. There is a cap on capacity in any market, and even though there are 52 non-gaming tribes in California, there may not be room for 52 new casinos.

Expansion timing depends heavily on attitude toward tribal gaming both nationwide and in California. Our expansion estimates for California assume two key points: 1) land into trust and environmental reviews for casinos that do not require a “two-part” exception continue to take as long as they have in the recent past, at two to four years, and 2) California’s administration remains favorably disposed to tribal gaming expansion. If either of these factors disappoints, our estimates will likely be too high, and the number of new machines installed could reach our low-case estimate of 13,000 new units over five years. If California gets a new gubernatorial administration that is aggressive on capturing a portion of tribal revenues, our estimates could be conservative by as many as 14,000 machines. However, we believe the risks are weighted more toward the downside.

Exhibit 7

Forecast Growth in California Tribal Slot Base to Reaccelerate



Source: Casino City, California Department of Justice’s Division of Gambling Control, Morgan Stanley Research

February 8, 2006
Gaming

Exhibit 8

Tribe-by-Tribe Proposed California Casino Projects

Tribe	Steps Remaining	Slots	Class III	Class II if no compact	Projected timing (base case)	Notes
<i>Non-gaming tribes with compacts and land</i>						
Buena Vista	Settle lawsuit, construction	2,000	2,000		2008	Has compact for unlimited slots, lawsuit filed against project. NIGC gave a favorable land determination 7/2005.
Ewiapaayp	BIA approval for casino on Viejas land	2,500	2,500		2010	Proposed a casino on Viejas land. Had 1999 compact, amended in 2004.
Fort Mojave	Has land in trust but needs two-part determination	1,500	1,500		Not Included/ After 2010	Has land in trust acquired in 1991, so will need "two-part" approval. Environmental appears to be done.
Jamul Indian Village of California	Management contract, possibly new compact	2,000	350	1,650	2008	Applying for contiguous land. Broke ground Dec. 2005 on-reservation, but cannot build under compact without municipal services agreement. Will go Class II if has to.
La Jolla Band of Luiseno Mission Indians	Management contract approval, possibly new compact	500	350	150	2007	Had small casino that closed. Began environmental review required under management contract in Dec. 2005
La Posta Band of Diegueno Mission Indians	Construction	349	349		2006	Groundbreaking Jan. '06, completion by end of year.
Santa Ysabel Band of Diegueno Mission Indians	Construction	349	349		2006	Began building May 2005, expected opening May 2006.
Shingle Springs Band of Miwok Indians	Settle lawsuit, possibly new compact	2,000	350	1,650	2007	Received favorable court rulings, but still in appeal. NIGC approved management contract. Will install Class II games without a new compact.
Yurok Tribe	Legislative ratification of compact	350	350		2007	Other tribes holding up ratification, will have new hearings early 2006.
<i>Non-gaming tribes with land but no compact</i>						
Cloverdale Rancheria of Pomo Indians	Plans very preliminary; compact	1,700	1,700		Not Included/ After 2010	We do not include because it is so far away - plans are very preliminary.
<i>Non-gaming tribes with compacts but no land in trust</i>						
Big Lagoon	Land into trust (two-part), compact ratification	2,250	2,250		Not Included/ After 2010	Reservation is an ecological preserve, sued CA for casino; ratification tied with Los Coyotes. (BIA application not filed yet)
Los Coyotes	Land into trust (two-part), compact ratification	2,250	2,250		Not Included/ After 2010	Is off-reservation; ratification tied with Big Lagoon. (BIA application not filed yet)
Manzanita Band of Diegueno Mission Indians	Land into trust (two-part), new compact	2,000	350	1,650	Not Included/ After 2010	Wants 2,000 slots, but would need to renegotiate its compact. Has local support. (BIA application not filed yet)
<i>Non-gaming tribes with no land in trust and no compact, but not off-reservation projects</i>						
California Valley Miwok	End leadership dispute, land into trust (landless), compact	2,000	2,000		Not Included/ After 2010	Question over whether BIA recognizes leadership, was working with investors but recently pulled out. (BIA application not filed yet)
Federated Indians of Graton Rancheria	Land into trust (restored land), compact	2,000	2,000		2009	Congress mandated a casino. EIS scoping started August 2004, but changed land site, expect 1Q06 will finish EIS.
Greenville Rancheria of Maidu Indians	Land into trust (restored land), compact	700	700		Not Included/ After 2010	Has 0.12 acre of trust lands; is unclear if can get new land under restored lands exemption 90 miles from former rancheria. EIS began Aug. 2005
Guidville Rancheria	Land into trust (restored land), compact, settle lawsuit	3,000	3,000		2008	Land into trust application filed in 2005, will do EIS. Tribe has land, but casino would be considered on restored lands. Is in urban area so could be difficult.
Ione Band of Miwok Indians	Land into trust (restored land), compact, lawsuit resolution	2,000	2,000		2009	Land into trust application filed, EIS underway since 2003, lawsuits delaying. City behind it, county opposed.
Lower Lake Rancheria	Land into trust (landless), compact	2,500	2,500		Not Included/ After 2010	Proposal next to Oakland airport, EIS underway, but facing significant opposition. (BIA application not filed yet)
Mechoopda Indian Tribe of Chico Rancheria	Land into trust (restored land), compact	550	550		2008	EA underway, decision expected 2006. NIGC said site will be restored lands once it is taken into trust.
North Fork Rancheria	Land into trust (restored land), compact	2,000	2,000		2009	EIS in process as of July 2005, land decision expected by late 2006. Tribe has land, but only eligible for housing; original rancheria is now privately owned.
Scotts Valley Band of Pomo Indians	Land into trust (landless), compact	2,000	2,000		Not Included/ After 2010	Governor opposes the casino, is in urban area. EIS in process as of July 2004.
<i>Non-gaming tribes pursuing off-reservation projects</i>						
Colorado River Indian Tribes	Land into trust (two-part), compact	900	900		Not Included/ After 2010	Initially looking into off-reservation casino in Blythe, but could do on-reservation. (BIA application not filed yet)
Death Valley Timbi-Sha Shoshone	Land into trust (two-part), compact	2,000	2,000		Not Included/ After 2010	Filed land into trust application early 2005, EIS to be completed early 2006. (BIA application not filed yet)
Enterprise Rancheria of Maidu Indians	Land into trust (two-part), compact	1,700	1,700		Not Included/ After 2010	Lost non-binding county referendum but are proceeding anyway. Land into trust application submitted, EIS underway.
Grindstone Indian Rancheria	Land into trust (two-part), compact	1,000	1,000		Not Included/ After 2010	Has limited land on its reservation and an option for a parcel. Tribe is "nearly landless" but wants exemption under restored lands clause. (BIA application not filed yet)
Karuk Tribe of California	Land into trust (two-part), compact	500	500		Not Included/ After 2010	Has land, but is not eligible for gaming, acquired after IGRA. Plan to try again with different land it looks like. (BIA application not filed yet)
Mesa Grande Band of Diegueno Mission Indians	Plans very preliminary; land into trust (two-part), compact	1,000	1,000		Not Included/ After 2010	Only thinking about an off-reservation casino, city opposes it. (BIA application not filed yet)
<i>Gaming tribes pursuing new casinos/expansions that have land and compacts</i>						
Alturas Indian Rancheria	Environmental review, possibly new compact	750	750		Not Included/ After 2010	Is off primary reservation, EA filed. Unclear land is in trust, even fee ownership of the land is in question.
Big Sandy Rancheria	Settle land dispute, new compact	2,000	2,000		2009	Land dispute with Table Mountain tribe, NIGC to decide.
Quechan Tribe	Legislative ratification of compact	775	775		2007	If get legislative approval will begin building late 2006. Sued state to try to have court approve the compact.
San Pasqual Band	Finish expansion, new compact	750	750		2007	Building \$100mm expansion expected to be complete 2007.
<i>Gaming tribes pursuing new casinos that have compacts, but no land</i>						
Chemehuevi	Land into trust (two-part), compact	2,250	2,250		Not Included/ After 2010	Big Lagoon and Los Coyotes compacts could kill plans. Have historical ties to Barstow, but would still need two-part determination. (BIA application not filed yet)
Torres-Martinez	Municipal agreement, land into trust (Congressional mandate)	1,650	1,650		2009	Federal legislation and compact authorizes casino on specified parcel, but negotiating with county and still needs land into trust. (BIA application not filed yet)
<i>Gaming tribes with room in compacts for expansions of existing casinos</i>						
Coyote Valley Band of Pomo Indians of California	Add slots	1,615	1,615		2007	Timing uncertain, can add slots at will though.

Note: Land into trust step includes BIA approval and environmental review process. Projects labeled "Not included / After 2010" have uncertain open dates or are forecast to open after 2010. Source: Morgan Stanley Research

Update on Status of Class III Slots in Florida

Florida Going Class III After Legislation Passed for Slots at Tracks in Broward County

On December 7, 2005, the Florida legislature passed legislation governing the constitutionally mandated slots at four Broward County pari-mutuel facilities. Now that Las Vegas-style slots are legal in Florida, the state's Native American tribes have the right to Class III games. The question is twofold: How many and when?

Appears Governor Will Negotiate With Tribes

While Governor Jeb Bush (R) is opposed to the expansion of gaming in Florida, he is mandated by the IGRA to negotiate with the tribes for Class III compacts. Unlike many governors opposed to gaming, however, Governor Bush apparently intends not to stall but rather to partner with the tribes in an attempt to limit the expansion of gaming beyond its current locations. The Governor reportedly would like to grant the tribes exclusive rights to operate Class III gaming outside Broward County, in an effort to kill any other county's attempt to legalize gaming in the future. As a result, compact signings should come fairly quickly in Florida, since the debate is down to specifics, not principles. In addition, it appears that the legislature will not have to approve the compacts, which often stalls the process.

Several Issues Need to Be Resolved in Negotiations

While the Governor and the tribes will apparently sit down to negotiate compacts in good faith, numerous details need to be worked out in the process.

What is the revenue sharing with the state? Governor Bush intends to grant the tribes exclusive rights to game outside Broward County, for which the state can collect a percentage of casino revenues. From the tribes' perspective, they are paying both for this exclusivity and for the right to upgrade their games from Class II to Class III. Most market participants believe that the Class III games will be accepted by customers and earn more than the Class II games, justifying their existence. The issue, then, is how much more will the Class III games bring in compared with the already high-earning Class II games? The more Class III games can bring in, the more the tribes will be willing to share with the state. The highest revenue share in the country is 25%, but we believe Florida's percentage will be lower than that.

What games and how many will be allowed? The law governing slots at Broward tracks banned participation

games, although the tribes will likely want the ability to install at least some of these high-end products. In addition, the tribes will probably resist caps on the number of slots per casino or tribe, although we believe the state will likely pursue limits, given Governor Bush's opposition to gaming.

How much authority will the state have to regulate the casinos? Currently, the state of Florida has virtually no control over the Class II casinos, and tribes will likely be opposed to ceding too much sovereignty to the state.

What is the extent of exclusivity? Governor Bush appears to want to guarantee that no slots will be installed off reservations outside Broward County. The tribes will likely look upon this offer favorably, but how does the state enforce it? Under many compacts in other states, the tribes have the right to cease revenue sharing if the exclusivity conditions are no longer satisfied; Florida's solution could be something similar.

Compacts Could Come in 2006, but Timing of Machine Replacements Uncertain

We believe it is likely that compacts can be negotiated and signed within the next year, in-line with timing seen in many other states. Tribes will then likely begin replacing their Class II machines with Class III slots toward late 2006 and in 2007. It is still uncertain how fast they will replace all their machines, however, and much will likely depend on the revenue-sharing percentage they must pay on the Class III slots. We expect that most, if not all, Class II machines will eventually be replaced.

Currently 9,300 Class II Games in Florida, but Expansion is Also Possible

In addition to the 9,300 Class II games that will likely be replaced by Class III machines, there is an opportunity for expansion of the installed base. Florida is home to seven casinos, several of which could easily expand to tap underserved markets. Nobody doubts that Florida is a ripe slot market; the question is, how much expansion will the compacts signed with the state allow? At this time, we cannot answer that question.

Until compacts are signed, we do not include Class II to Class III conversions/additions. Given the uncertainty over timing and numbers of machines to be converted and/or added, we do not include Class III sales in Florida, which would represent upside to our estimates.

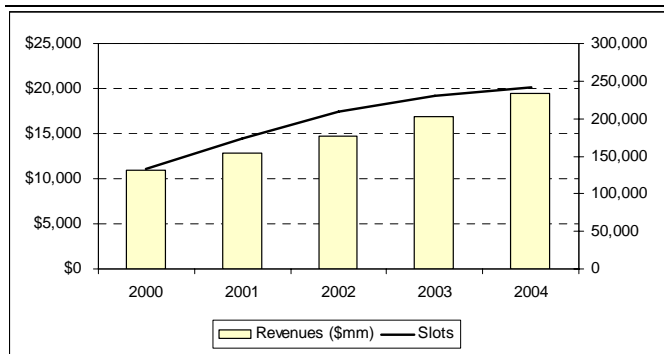
February 8, 2006
Gaming

Tribal Gaming Market Is Maturing

Tribal Gaming Overview: 27 States, 200+ Gaming Tribes, 367 Casinos, 260,000 Slots, and \$19.4 Billion in Revenue
Native American gaming is big business, accounting for 39% of total US casino gaming revenues in 2004, up from 30% in 2000. Both slot growth and revenue growth have been impressive, with slots increasing 78% and revenues rising 77% since 2000. Interestingly, much of the growth has been from expansions at existing properties — the number of tribal casinos grew a more moderate 18%, from 311 in 2000 to 367 by 2004.

Exhibit 9

Tribal Gaming Still Growing, but More Moderately



Note: Data are for NIGC fiscal years ended June 30.
Source: National Indian Gaming Commission (NIGC), Morgan Stanley Research

How Fast Can Tribal Casinos Keep Growing?

Growth in the Native American slot installed base slowed from 32% in 2001 to 6% in 2004. The key question for slot manufacturers is whether this deceleration will continue, or if there are new opportunities that can accelerate growth. On balance, we believe tribal gaming is relatively mature in most markets, and that growth will trend in line with the broader industry at 3%. There are select pockets of opportunity, however, notably California (addressed in a previous section). *We note that for a tribe to have Class II or Class III gaming, gambling must not be specifically outlawed in the state. See details in the next section.*

Exhibit 10

State-by-State Breakdown: Gaming and Non-Gaming Tribes

State	Tribes with Class III Casinos	Tribes with Class II Casinos	Tribes without Gaming	Total Tribes	Slots
Alabama		1		1	1,332
Arizona	15		6	21	12,739
California	54	1	52	107	59,403
Colorado	2			2	1,056
Connecticut	2			2	13,540
Florida		2		2	9,305
Idaho	4		1	5	4,439
Indiana			1	1	0
Iowa	3		1	4	2,632
Kansas	4			4	2,810
Louisiana	3		1	4	6,600
Maine			4	4	0
Massachusetts			1	1	0
Michigan	9		3	12	14,238
Minnesota	11			11	22,375
Mississippi	1			1	4,887
Montana	5	1	1	7	797
Nebraska		3	3	6	390
Nevada	3		16	19	952
New Mexico	13		11	24	12,941
New York	3	1	3	7	10,502
North Carolina	1			1	3,300
North Dakota	5			5	3,137
Oklahoma		28	9	37	31,242
Oregon	7		3	10	6,174
Rhode Island			1	1	0
South Carolina			1	1	0
South Dakota	9		1	10	1,938
Texas		1	2	3	1,000
Utah			7	7	0
Washington	21		8	29	18,213
Wisconsin	11			11	15,493
Wyoming		1	1	2	350
Total	186	39	137	362	261,785

Note: Some tribes cross state lines; there are 336 unique tribes in the US excluding Alaska. Many tribes operate more than one casino. Tribes that operate both Class III and Class II facilities are counted as Class III tribes only.
Source: Bureau of Indian Affairs (BIA), Morgan Stanley Research

Most tribes in most states already have casinos...

Nationwide (excluding the 225 Alaskan Native Villages), there are approximately 340 federally recognized Native American tribes. Of these, 220 tribes have some sort of gaming, the vast majority of which is Class III. Only 37 tribes run Class II games exclusively (two more run Class III games in one state and exclusively Class II games in another), and while the tribes are spread out over nine states, the majority of the slots are in Oklahoma and Florida. Note that we count "compacted" Oklahoma games as Class II here because most are still bingo-based, although 26 of the 28 gaming tribes in Oklahoma have signed compacts to date. In the likely event that the Florida tribes go Class III at some point in the next few years, Class II markets will be almost insignificant.

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...but just over 120 tribes in the continental US do not operate casinos. Several of these tribes cross state lines, so the number of "non-unique" tribes in Exhibit 10 is 137. If all of these became gaming tribes of the same size as current gaming tribes, the Native American installed slot base would grow by nearly 50%. However, we doubt that 1) all will become Class III operating tribes, and 2) the ones that do will open casinos of the same size as existing gaming tribes'. Many of the non-gaming tribes in states that allow Class III gaming are in relatively remote areas, and if and when they do open casinos, these are likely to be smaller than existing properties, we believe.

Details of Non-Gaming Tribe Opportunity, State by State

California has 52 federally recognized tribes without gaming, the largest number of any state (note also that with 107 in all, California has more Native American tribes than any other state, including Oklahoma). After California, only Nevada and New Mexico have more than 10 non-gaming tribes, with 16 and 11, respectively. Oklahoma has nine non-gaming tribes. Given the level of gaming competition in Nevada and Oklahoma, we doubt that any new casinos opened in these states would be large facilities. New Mexico presents an opportunity for expansion through its 11 non-gaming tribes, but its outlook is complicated by lingering hostility between tribes and the state over revenue-sharing issues. Washington is the next state on the non-gaming list, with eight non-gaming tribes, and it has an established gaming industry and approval process. The original Washington compacts capped the number of slots in the state at just over 18,000 — the current number in operation excluding the 800 operated by the un-compacted Spokane tribe — although any new compacts would raise that limit. Apart from the above-mentioned states, there are only 20 non-gaming tribes located in states that have Class III gaming. We expect that these tribes will eventually open casinos, while the chance that the 21 non-gaming tribes in states without Class III casinos will eventually open casinos is a long shot.

Note that we discuss only federally recognized tribes in this analysis, and exclude the 200+ tribes attempting to gain federal recognition. Since recognition could take up to several decades to achieve, and because there is no way to estimate how likely it is that unrecognized tribes will pass the rigorous process, we exclude non-recognized and state-recognized tribes in this report.

So what is the potential expansion size if non-gaming tribes open facilities? We address California in detail below, and believe that in equilibrium the state could handle an additional 40,000 slot machines, but we expect only 26,000 in the near term. Oklahoma and Nevada combined could represent a further 10,000 machines if non-gaming tribes open casinos, although we do not expect a near-term burst in either state. If New York settles its land claim issues and opens three new casinos, 7,500 slots could be added. In Washington, 5,400 slots would be added if all eight non-gaming tribes signed compacts similar to the existing agreements. The New Mexico market could be up to 8,000 machines larger. For the remaining seven states that have Class III gaming but some non-gaming tribes, we estimate 13,000 machines could be added over time. For tribes in the states that currently do not have Class III gaming, we assume that gaming never opens and no new slots are added, although there are possibilities in states including Texas, Rhode Island, Massachusetts, and Maine.

Exhibit 11

Potential Expansion Opportunities from New Tribes Opening Casinos

State	Potential Num. of Eventual Expansion Machines (Maximum)
California	40,000
New Mexico	8,000
New York	7,500
Washington	5,400
Nevada	5,000
Oklahoma	5,000
Arizona	4,000
Michigan	3,500
Louisiana	1,750
Oregon	2,000
Idaho	900
Iowa	700
Montana	150
Total	83,900
Ex. California	43,900

Note: Any possible casino openings would likely be spread over at least several years.
Source: Morgan Stanley Research

Note that all of these estimates are for the longer term, and it is impossible to predict the timing of casino openings, given all of the uncertainties surrounding the approval process. To be clear, we view these figures as maximums.

Tribal Gaming Law 101 — In Terms You Can Understand

Plain English Overview of Native American Gaming Law

The legal and regulatory approval process for building a tribal casino is complicated and involved. Most industry observers know the basics — that you need a compact and both environmental and federal approval. However, the details are important to understand 1) how the proposed changes discussed earlier in this report will affect the industry, and 2) how long it often takes for proposed projects to be realized. As we believe that the details are a mystery to many, below we attempt to lay out the process in plain English.

IGRA defines Native American gaming rights, and splits authority among the feds, states, and tribes. In 1987, the Supreme Court upheld the right of tribal nations as separate sovereign entities to run gaming without state regulation in states where gaming was legal for at least some non-Indian purposes (in *California v. Cabazon Band of Mission Indians*). As a response, Congress passed the Indian Gaming Regulatory Act (IGRA) in 1988, splitting responsibility for overseeing Indian gaming among the Federal government, the states, and the tribes themselves. The law also classified types of slot machines. IGRA effectively gave tribes authority over Class I games, the federal government and tribes joint authority over Class II games, and the feds, the states, and tribes authority over Class III gaming (see gaming class definitions later in this section).

If a Tribe Already Has Land, Getting a Casino is Much Easier

Under IGRA, a tribe is allowed to operate any form of gaming that is permitted in the tribe's state "for any purpose by any person, organization, or entity." Essentially, if a non-Indian can do it, so can Indians. So if a tribe has land and the state where it is located allows bingo, the tribe can run Class II gaming. If the state allows any higher form of gaming, the tribe can run Class III gaming, with the added stipulation that it must fall under a tribal-state compact. IGRA involved states in the Indian gaming process by requiring that tribes negotiate with their states for compacts that govern the regulation of the games. Compacts are documents that are essentially treaties. If a state allows Class III gaming outside Indian lands, it is forced to negotiate a compact — if it does not, the BIA or the courts can approve the tribe for Class III gaming directly (and states lose any potential control or benefit).

Obtaining Gaming-Entitled Land Is Not Easy, However

Native Americans cannot simply acquire lands and declare them sovereign; lands must be placed into trust with the BIA. However, IGRA stipulated that gaming could not take place on Indian lands acquired after October 17, 1988, except in extenuating circumstances. The exceptions to the non-gaming rule are:

- If the land is contiguous to the tribe's existing reservation (this rule would not allow off-reservation casinos)
- If a tribe is landless and the acquired land is within the tribe's last recognized reservation (this rule covers cases like California where tribes were stripped of their reservations)
- If the land is obtained as part of a settlement of a land claim (as in New York, where tribes are in the process of being given new land in place of their former lands, which have now been developed by non-Indians)
- If the land is the initial reservation for a newly recognized tribe (federal recognition is a lengthy and difficult process)
- If the land is restored to a tribe that lost but later regained its federal recognition (as in many California cases)
- If the Secretary of the Interior and the governor of the state where the land is located agree that a casino would be good for the tribe and non-detrimental to the surrounding community (*this is the "two-part" determination* catch-all that could allow off-reservation gaming, but that has been used only three times since 1988)

What Exactly Is Land Held in Trust?

"Land into trust" means that the tribe acquires the land and gives it to the BIA, which then holds it in trust for the benefit of the tribe. Placing it into trust essentially removes the land from the jurisdiction of state and local governments, and while not quite a reservation, land held in trust by the BIA is "Indian Land" under the purview of the federal government. After the land is placed into trust, if the land falls under one of the exceptions listed above, a casino can be opened.

How Does a Tribe Put Land Into Trust?

If a tribe wants to acquire lands for gaming, it could take several years. The BIA, and specifically the Assistant Secretary for Indian Affairs, has the authority to take land into trust for gaming purposes. While there is no formal process

for applying to the BIA, the agency does request detailed information including the proposed benefit to the tribe, the impact on the tax rolls of the jurisdiction where the land is located, and, of course, the environmental impact.

What is the Environmental Review Process?

Whenever an agency of the Federal government proposes a major “federal action,” it must prepare a review of the impact of this action on the environment and alternatives to the action, per the National Environmental Policy Act (NEPA). The taking of land into trust by the BIA and the NIGC’s approval of gaming management contracts fall under “federal actions,” and therefore require NEPA compliance. The burden is on the tribe proposing the casino to do the environmental study, not the BIA or any other federal agency.

There are three levels of review, in escalating order of time and detail: categorical exclusion, environmental assessment/finding of no significant impact (EA/FONSI), and environmental impact statement (EIS). Categorical exclusions apply to actions that will clearly have no environmental impact, and so virtually never apply to casinos. EAs attempt to determine what the environmental impact from a major action will be, and propose actions to mitigate potentially significant impacts. If the EA determines that the impact will be minor, the agency can issue a FONSI. A FONSI is what most tribes and gaming supporters want — it ends the environmental review right there, and the agency can go ahead with the proposed action. However, if the EA indicates that there will be an environmental impact, an EIS must be prepared; this is a more detailed version of the EA.

When the agency makes a decision on an action (such as taking land into trust), it must address how it incorporated the information from the EIS into its decision-making process. The EPA (Environmental Protection Agency) also comments on any actions that are the subject of an EIS. Whether the process stops at the FONSI or the EIS, it is open to legal challenges, but only after the FONSI or EIS is filed. Very often opponents will sue after the FONSI is issued to require an EIS, and for major actions, including taking land into trust, agencies now require an EIS to be prepared from the start.

Comments can delay process. Between each step in the process, people affected by the federal action, including project opponents, can comment and delay the process. Since EIS’s involve many steps with many comment periods, there is ample opportunity to object. The process begins with project scoping, then a draft, then a final report. Between each step there is a comment period followed by written responses.

What Are the Legal Challenges?

If the BIA approves the land for gaming and decides to take the land into trust, objectors to the project have the right to appeal the decision. The first set of appeals is administrative, meaning it falls within the Department of the Interior and escalates up the ladder. If administrative appeals are exhausted without a change in opinion, the BIA publishes its “notice of intent” to take the land into trust in local newspapers. Opponents then have 30 days to file legal challenges, *which has happened in every case to take land into trust for gaming since 1988*. The BIA then has to wait until these play out in the courts, which could take several additional years. If the decision is upheld in the courts, the land is taken into trust and the tribe can develop a casino.

What is the Compacting Process?

If a state allows some form of Class III gaming, it must allow Native American tribes to operate similar games. However, the tribe is required to negotiate a compact with the state. While states are forced to negotiate fairly under IGRA, states sometimes refuse, or at least delay the negotiating process. In those cases, the BIA or the courts can approve gaming directly, but this is rare and takes time. Because the compact process must be a negotiation, the state has significant leverage to at least stall, delaying projects considerably.

Compacts may require state legislative approval. In some states, only the governor needs to sign the compact, and in others, the legislature must approve the compact. In some cases, it has been unclear, e.g., in Michigan, and the issue has gone to court. For states where the legislature must approve the compacts (like California), it can take materially longer to finalize a compact with the state. As a final note, the BIA must approve all Class III gaming compacts, and the Secretary of the Interior recently declared that no compacts will be approved until the land is held in trust.

Why Are There Landless Tribes?

By the late 1800s, the reservation system had been established in the United States. Then, in 1887, the General Allotment Act was passed, authorizing the breakup of reservations into individual parcels for individual Indians. Much of the land was then sold or mortgaged away to non-Indians, creating landless tribes that have ties to particular areas but no reservation territory. In 1934, Congress reversed course with the Indian Reorganization Act, which ended further allotment and authorized the reorganization of Indian territory through the land into trust process. In California, Congress changed the landscape yet again in 1958 when it passed the California Rancheria Act, which disbanded more than 40 tribes. Many of these tribes (over

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20) have regained federal recognition through lawsuits and the standard approval process, but some remain unrecognized and landless. Congress disbanded additional tribes in the Indian Termination Act of 1961. Congress has passed special legislation from time to time recognizing and granting land to specific tribes, but not since 2000.

Types of Native American Slots

IGRA classified the types of gaming that could occur on tribal lands. Slots are also regulated by the Johnson Act, which bars Las Vegas-style slots if they are not covered by a tribal-state compact. While the Justice Department has fought against Class II games numerous times, tribes have consistently won the right in court to operate Class II machines.

- **Class III Gaming (Vegas-Style Gaming):** Defined as “games commonly played at casinos, such as slot machines, black jack, craps and roulette...as well as wagering games and electronic facsimiles of any game of chance,” Class III gaming is legal if it is permitted in the tribe’s state, if the tribe and state have negotiated a compact that is approved by the US Secretary of the Interior, and if the tribe has adopted a tribal gaming ordinance that has received approval from the Chairman of the NIGC.
- **Class II Gaming:** Defined as “the game of chance commonly known as bingo (whether or not electronic, computer, or other technological aids are used in connection therewith) and if played in the same location as the bingo, pull tabs, punch board, tip jars, instant bingo, and other games similar to bingo..., [it] specifically excludes slot machines or electronic facsimiles of any game of chance.” Class II gaming is legal in states where such gaming is not prohibited by the state constitution and where the tribal government submits a gaming ordinance that is approved by the NIGC.
- **Class I Gaming:** Defined as “traditional Indian gaming and social gaming for minimal prizes,” it does not permit any type of electronic gaming.

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