MONARCH CASINO & RESORT INC
Form 10-Q
November 08, 2007

United States
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______to______.

Commission File No. 0-22088

[Missing Graphic Reference]

MONARCH CASINO & RESORT, INC.
(Exact name of registrant as specified in its charter)

Nevada	**88-0300760**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3800 S. Virginia St.	
Reno, Nevada	**89502**
(Address of Principal Executive Offices)	(ZIP Code)

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

(775) 335-4600
Registrant's telephone number, including area code:

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x **No** o

14

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, $0.01 par value	19,089,686 shares
Class	Outstanding at November 7, 2007

14

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Monarch Casino & Resort, Inc.
Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Revenues				
Casino	$ 29,936,988	$ 27,716,814	$ 84,512,978	$ 77,621,373
Food and beverage	11,011,808	10,889,609	32,084,196	30,769,768
Hotel	8,002,564	8,101,167	21,857,687	20,580,811
Other	1,229,521	1,254,264	3,703,972	3,648,862
Gross revenues	50,180,881	47,961,854	142,158,833	132,620,814
Less promotional allowances	(6,557,585)	(6,213,477)	(19,192,626)	(17,644,527)
Net revenues	43,623,296	41,748,377	122,966,207	114,976,287
Operating expenses				
Casino	9,232,990	8,991,885	26,970,411	25,483,766
Food and beverage	5,381,681	5,143,751	15,217,367	14,634,537
Hotel	2,161,564	2,206,631	6,416,669	6,312,500
Other	386,056	384,033	1,127,113	1,116,317
Selling, general and administrative	12,731,275	11,681,175	37,054,086	35,156,852
Depreciation and amortization	1,982,184	2,139,592	6,122,600	6,430,831
Total operating expenses	31,875,750	30,547,067	92,908,246	89,134,803
Income from operations	11,747,546	11,201,310	30,057,961	25,841,484
Other income (expense)				
Interest income	568,462	154,230	1,385,883	190,732
Interest expense	-	(15,401)	(152,274)	(74,845)
Total other income (expense)	568,462	138,829	1,233,609	115,887
Income before income taxes	12,316,008	11,340,139	31,291,570	25,957,371
Provision for income taxes	(4,280,000)	(3,969,098)	(10,860,000)	(8,996,000)
Net income	$ 8,036,008	$ 7,371,041	$ 20,431,570	$ 16,961,371
Earnings per share of common stock				
Net income				
Basic	$ 0.42	$ 0.39	$ 1.07	$ 0.89
Diluted	$ 0.41	$ 0.38	$ 1.06	$ 0.88
Weighted average number of common shares and potential common shares outstanding				
Basic	19,079,062	19,058,896	19,080,347	18,965,694

Diluted	19,366,043	19,245,639	19,352,064	19,263,869

The Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

14

Monarch Casino & Resort, Inc.
Condensed Consolidated Balance Sheets

	September 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 52,949,354	$ 36,985,187
Receivables, net	4,590,222	3,268,970
Inventories	1,478,542	1,471,667
Prepaid expenses	3,572,182	2,833,126
Deferred income taxes	1,547,144	965,025
Total current assets	64,137,444	45,523,975
Property and equipment		
Land	10,339,530	10,339,530
Land improvements	3,166,107	3,166,107
Buildings	78,955,538	78,955,538
Building improvements	10,435,062	10,435,062
Furniture and equipment	71,746,192	72,708,061
Leasehold improvements	1,346,965	1,346,965
	175,989,394	176,951,263
Less accumulated depreciation and amortization	(90,245,245)	(84,325,578)
	85,744,149	92,625,685
Construction in progress	10,968,149	-
Net property and equipment	96,712,298	92,625,685
Other assets, net	84,822	231,247
Total assets	$ 160,934,564	$ 138,380,907
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 8,053,256	$ 8,590,669
Construction payable	1,525,987	-
Accrued expenses	8,770,601	9,878,851
Federal income taxes payable	1,371,747	16,457
Total current liabilities	19,721,591	18,485,977
Deferred income taxes	3,708,614	4,248,614
Total Liabilities	23,430,205	22,734,591
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued	-	-
Common stock, $.01 par value, 30,000,000 shares authorized; 19,096,300 shares issued;		

19,067,518 outstanding at 9/30/07 19,065,968 outstanding at 12/31/06	190,963	190,726
Additional paid-in capital	25,285,175	23,205,045
Treasury stock, 28,782 shares at 9/30/07 6,582 shares at 12/31/06, at cost	(678,039)	(24,145)
Retained earnings	112,706,260	92,274,690
Total stockholders' equity	137,504,359	115,646,316
Total liabilities and stockholder's equity	$ 160,934,564	$ 138,380,907

The Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

14

Monarch Casino & Resort, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2007	2006
Cash flows from operating activities:		
Net income	$ 20,431,570	$ 16,961,371
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,122,600	6,430,831
Amortization of deferred loan costs	148,838	15,402
Share-based compensation	1,663,197	2,748,635
Provision for bad debts	242,126	937,762
(Gain) loss on disposal of assets	(6,969)	49,259
Deferred income taxes	(1,122,118)	(1,142,819)
Changes in operating assets and liabilities:		
Receivables	(1,563,378)	(561,759)
Inventories	(6,875)	(33,180)
Prepaid expenses	(739,056)	(653,236)
Other assets	(2,413)	-
Accounts payable	(537,412)	(252,968)
Accrued expenses	(1,108,250)	(523,191)
Federal income taxes payable	1,355,290	1,338,218
Net cash provided by operating activities	24,877,150	25,314,325
Cash flows from investing activities:		
Proceeds from sale of assets	6,969	38,280
Change in construction payable	1,525,987	-
Acquisition of property and equipment	(10,209,214)	(4,235,862)
Net cash used in investing activities	(8,676,258)	(4,197,582)
Cash flows from financing activities:		
Proceeds from exercise of stock options	340,682	2,141,262
Tax benefit of stock option exercise	178,904	613,841
Principal payments on long-term debt	-	(8,100,000)
Purchase of treasury stock	(756,311)	-
Net cash used in financing activities	(236,725)	(5,344,897)
Net increase in cash	15,964,167	15,771,846
Cash and cash equivalents at beginning of period	36,985,187	12,886,494
Cash and cash equivalents at end of period	$ 52,949,354	$ 28,658,340
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 3,437	$ 66,659

Cash paid for income taxes	$ 10,447,923	$ 7,900,000

The Notes to the Condensed Consolidated Financial Statements are an integral part of these statements.

MONARCH CASINO & RESORT, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation:

Monarch Casino & Resort, Inc. ("Monarch"), a Nevada corporation, was incorporated in 1993. Monarch's wholly-owned subsidiary, Golden Road Motor Inn, Inc. ("Golden Road"), operates the Atlantis Casino Resort (the "Atlantis"), a hotel/casino facility in Reno, Nevada. Unless stated otherwise, the "Company" refers collectively to Monarch and its Golden Road subsidiary.

The condensed consolidated financial statements include the accounts of Monarch and Golden Road. Intercompany balances and transactions are eliminated.

Interim Financial Statements:

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management of the Company, all adjustments considered necessary for a fair presentation are included. Operating results for the three months and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2006.

Use of Estimates:

In preparing these financial statements in conformity with U.S. generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the respective periods. Actual results could differ from those estimates.

Self-insurance Reserves:

The Company reviews self-insurance reserves at least quarterly. The amount of reserve is determined by reviewing the actual expenditures for the previous twelve-month period and reviewing reports prepared by third party plan administrators for any significant unpaid claims. The reserve is accrued at an amount needed to pay both reported and unreported claims as of the balance sheet dates, which management believes are adequate.

Inventories:

Inventories, consisting primarily of food, beverages, and retail merchandise, are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis.

Property and Equipment:

Property and equipment are stated at cost, less accumulated depreciation and amortization. Since inception, property and equipment have been depreciated principally on a straight line basis over the estimated service lives as follows:

Land improvements:	15-40 years
Buildings:	30-40 years
Building improvements:	15-40 years
Furniture:	5-10 years
Equipment:	5-20 years

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment and Disposal of Long-Lived Assets," the Company evaluates the carrying value of its long-lived assets for impairment at least annually or whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable from related future undiscounted cash flows. Indicators which could trigger an impairment review include legal and regulatory factors, market conditions and operational performance. Any resulting impairment loss, measured as the difference between the carrying amount and the fair value of the assets, could have a material adverse impact on the Company's financial condition and results of operations.

For assets to be disposed of, the Company recognizes the asset to be sold at the lower of carrying value or fair market value less costs of disposal. Fair market value for assets to be disposed of is generally estimated based on comparable asset sales, solicited offers or a discounted cash flow model.

Casino Revenues:

Casino revenues represent the net win from gaming activity, which is the difference between wins and losses. Additionally, net win is reduced by a provision for anticipated payouts on slot participation fees, progressive jackpots and any pre-arranged marker discounts.

Promotional Allowances:

The Company's frequent player program, Club Paradise, allows members, through the frequency of their play at the casino, to earn and accumulate point values, which may be redeemed for a variety of goods and services at the Atlantis Casino Resort. Point values may be applied toward room stays at the hotel, food and beverage consumption at any of the food outlets, gift shop items as well as goods and services at the spa and beauty salon. Point values earned may also be applied toward off-property events such as concerts, shows and sporting events. Point values may not be redeemed for cash.

Awards under the Company's frequent player program are recognized as promotional expenses at the time of redemption.

The retail value of hotel, food and beverage services provided to customers without charge is included in gross revenue and deducted as promotional allowances. The cost associated with complimentary food, beverage, rooms and merchandise redeemed under the program is recorded in casino costs and expenses.

Income Taxes:

Income taxes are recorded in accordance with the liability method specified by SFAS No. 109 "Accounting for Income Taxes." Under the asset and liability approach for financial accounting and reporting for income taxes, the following basic principles are applied in accounting for income taxes at the date of the financial statements: a current liability or asset is recognized for the estimated taxes payable or refundable on taxes for the current year; a deferred income tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and carryforwards; the measurement of current and deferred tax liabilities and assets is based on the provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated; and the measurement of deferred income taxes is reduced, if necessary, by the amount of any tax benefits that, based upon available evidence, are not expected to be realized.

Allowance for Doubtful Accounts:

The Company extends short-term credit to its gaming customers. Such credit is non-interest bearing and due on demand. In addition, the Company also has receivables due from hotel guests, which are primarily secured with a credit card at the time a customer checks in. An allowance for doubtful accounts is set up for all Company receivables based upon the Company’s historical collection and write-off experience, unless situations warrant a specific identification of a necessary reserve related to certain receivables. The Company charges off its uncollectible receivables once all efforts have been made to collect such receivables. The book value of receivables approximates fair value due to the short-term nature of the receivables.

Stock Based Compensation:

On January 1, 2006, the Company adopted the provisions of SFAS 123R requiring the measurement and recognition of all share-based compensation under the fair value method. The Company implemented SFAS 123R using the modified prospective transition method.

Concentrations of Credit Risk:

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of bank deposits and trade receivables. The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer base. The Company believes it is not exposed to any significant credit risk on cash and accounts receivable.

Certain Risks and Uncertainties:

A significant portion of the Company's revenues and operating income are generated from patrons who are residents of northern California. A change in general economic conditions or the extent and nature of casino gaming in California, Washington or Oregon could adversely affect the Company's operating results. On September 10, 1999, California lawmakers approved a constitutional amendment that gave Indian tribes the right to offer slot machines and a range of house-banked card games. On March 7, 2000, California voters approved the constitutional amendment. Several Native American casinos have opened in Northern California since passage of the constitutional amendment. A large Native American casino facility opened in the Sacramento area, one of the Company’s primary feeder markets, in June of 2003. Other new Native American casinos are under construction in the northern California market, as well as other markets the Company currently serves, that could have an impact on the Company's financial position and results of operations. The State of California has approved compacts with primarily Southern California located Native American tribes that increases the total number of Native American operated slot machines in the State of California. Opponents to the compacts are working on a referendum to overturn the new gaming compacts to be voted on at the February 5 presidential primaries. Certain tribes in favor of the compacts have sued to block the February referendum, claiming that signatures obtained by opponents were not gathered within the required time frame.

In addition, the Company relies on non-conventioneer visitors partially comprised of individuals flying into the Reno area. The threat of terrorist attacks could have an adverse effect on the Company's revenues from this segment. The terrorist attacks that took place in the United States on September 11, 2001, were unprecedented events that created economic and business uncertainties, especially for the travel and tourism industry. The potential for future terrorist attacks, the national and international responses, and other acts of war or hostility including the ongoing situation in Iraq, have created economic and political uncertainties that could materially adversely affect our business, results of operations, and financial condition in ways we cannot predict.

A change in regulations on land use requirements with regard to development of new hotel casinos in the proximity of the Atlantis could have an adverse impact on our business, results of operations, and financial condition.

The Company also markets to Reno-area residents. A major casino-hotel operator that successfully focuses on local resident business in Las Vegas announced plans to develop hotel-casino properties in Reno. The competition for this market segment is likely to increase and could impact the Company’s business.

NOTE 2. STOCK-BASED COMPENSATION

The Company’s three stock option plans, consisting of the Directors' Stock Option Plan, the Executive Long-term Incentive Plan, and the Employee Stock Option Plan (the "Plans"), collectively provide for the granting of options to purchase up to 3,250,000 common shares. The exercise price of stock options granted under the Plans is established by the respective plan committees, but the exercise price may not be less than the market price of the Company's common stock on the date the option is granted. The Company’s stock options typically vest on a graded schedule, typically in equal, one-third increments, although the respective stock option committees have the discretion to impose different vesting periods or modify existing vesting periods. Options expire ten years from the grant date. By their amended terms, the Plans will expire in June 2013 after which no options may be granted.

A summary of the current year stock option activity as of and for the nine months ended September 30, 2007 is presented below:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of period	1,121,199	$16.49	-	-
Granted	59,963	25.78	-	-
Exercised	(33,662)	10.12	-	-
Forfeited	(20,000)	18.53	-	-
Expired	-	-	-	-
Outstanding at end of period	1,127,500	$17.14	7.9 yrs.	$12,753,150
Exercisable at end of period	329,867	$12.95	7.2 yrs.	$ 5,114,026

A summary of the status of the Company’s nonvested shares as of September 30, 2007, and for the nine months ended September 30, 2007, is presented below:

Nonvested Shares	Shares	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2007	774,330	$18.14
Granted	59,963	7.66
Vested	(16,660)	4.54
Forfeited	(20,000)	7.45
Nonvested at September 30, 2007	797,633	$ 8.83

Expense Measurement and Recognition:

On January 1, 2006, the Company adopted the provisions of SFAS 123R requiring the measurement and recognition of all share-based compensation under the fair value method. The Company implemented SFAS 123R using the modified prospective transition method. Accordingly, for the nine months ended September 30, 2007 and 2006, the Company recognized share-based compensation for all current award grants and for the unvested portion of previous award grants based on grant date fair values. Prior to fiscal 2006, the Company accounted for share-based awards under the disclosure-only provisions of SFAS No. 123, as amended by SFAS No. 148, but applied APB No. 25 and related interpretations in accounting for the Plans, which resulted in pro-forma compensation expense only for stock option awards. Prior period financial statements have not been adjusted to reflect fair value share-based compensation expense under SFAS 123R. With the adoption of SFAS 123R, the Company changed its method of expense attribution for fair value share-based compensation from the straight-line approach to the accelerated approach for all awards granted. The Company anticipates the accelerated method will provide a more meaningful measure of costs incurred and be most representative of the economic reality associated with unvested stock options outstanding. Unrecognized costs related to all share-based awards outstanding at September 30, 2007 is approximately $3.2 million and is expected to be recognized over a weighted average period of 1.36 years.

The Company uses historical data and projections to estimate expected employee, executive and director behaviors related to option exercises and forfeitures.

The Company estimates the fair value of each stock option award on the grant date using the Black-Scholes valuation model incorporating the assumptions noted in the following table. Option valuation models require the input of highly subjective assumptions, and changes in assumptions used can materially affect the fair value estimate. Option valuation assumptions for options granted during the third quarter of 2006 were as follows (there were no option grants during the third quarter of 2007):

Three Months

	Ended September 30,	
	2007	2006
Expected volatility	-	45.5%
Expected dividends	-	-
Expected life (in years)		
Directors' Plan	-	2.5
Executive Plan	-	8.4
Employee Plan	-	3.2
Weighted average risk free rate	-	5.1%
Weighted average grant date fair value per share of options granted	-	$ 6.59
Total intrinsic value of options exercised	$105,239	$ 28,286

The risk-free interest rate is based on the U.S. treasury security rate in effect as of the date of grant. The expected lives of options are based on historical data of the Company. Upon implementation of SFAS 123R, the Company determined that an implied volatility is more reflective of market conditions and a better indicator of expected volatility.

Reported stock based compensation expense was classified as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Casino	$ 17,865	$ 7,775	$ 53,839	$ 37,553
Food and beverage	14,424	7,579	38,015	39,894
Hotel	9,676	7,404	27,734	36,742
Selling, general and administrative	549,214	465,778	1,543,609	2,634,447
Total stock-based compensation, before taxes	591,179	488,535	1,663,197	2,748,636
Tax benefit	(206,913)	(170,987)	(582,119)	(962,022)
Total stock-based compensation, net of tax	$ 384,266	$ 317,548	$ 1,081,078	$1,786,614

NOTE 3. EARNINGS PER SHARE

The Company reports "basic" earnings per share and "diluted" earnings per share in accordance with the provisions of SFAS No. 128, "Earnings Per Share." Basic earnings per share is computed by dividing reported net earnings by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect the additional dilution for all potentially dilutive securities such as stock options. The following is a reconciliation of the number of shares (denominator) used in the basic and diluted earnings per share computations (shares in thousands):

	Three Months Ended September 30,			
	2007		2006	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic	19,079	$0.42	19,059	$0.39
Effect of dilutive stock options	287	(0.01)	187	(0.01)
Diluted	19,366	$0.41	19,246	$0.38

	Nine Months Ended September 30,			
	2007		2006	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic	19,080	$1.07	18,966	$0.89
Effect of dilutive stock options	272	(0.01)	298	(0.01)
Diluted	19,352			