CIBC Wood Gundy

Opportunities in Las Vegas and Macau Casino Stocks

After years of monitoring several publicly-traded Las Vegas and Macau casino companies, we added two to our Total Return Portfolio in early January – Wynn Resorts Ltd. (WYNN-NYSE) and MGM Resorts International (MGM-NYSE). The two companies now have a combined weighting of roughly 4 per cent in the portfolio, which is diversified among various sectors. A combination of positive industry trends and company-specific factors persuaded us to act. The Las Vegas gaming industry is still operating under the cloud of the 2008-2009 recession. Vegas was hit hard by a decline in visitors and a local housing and unemployment crisis. Exacerbating the problems caused by the generalized economic downturn, a significant number of new hotel rooms came online at the same time as the number of visitors was declining.

As for gaming revenue, according to the Las Vegas Convention and Visitors Authority, for the full year of 2007, casinos on the Vegas Strip took in US$6.8 billion. Gaming revenue declined to US$5.6 billion in 2009 and then partially recovered to US$6.1 billion in 2011. Visual evidence of the downturn remains at the north end of the Strip, where Echelon Place and Fontainebleau Las Vegas, two multi-billion dollar hotel and casino projects, stand unfinished today. Despite these difficulties, we believe Vegas has retained its appeal as an entertainment destination. We expect the 2012 data to show that Vegas set an all-time record for visitor volume, narrowly surpassing the 39 million plus figure from 2007. While revenue per visitor is still down in comparison to the peak years, we think this will gradually improve over the next few years along with the overall U.S. economy.

While Las Vegas appears to be slowly recovering, Macau never really slowed down. Macau, a former Portuguese colony, has been operated as a Special Administrative Region of China since 1999. The government ended monopoly control of the casino industry around a decade ago, resulting in a wave of new investment. Since 2007, Macau has been the world's most lucrative casino market. We expect the data to show that Macau had around 30 million visitors in 2012. To put Macau's gaming dominance in perspective, according to the *Las Vegas Review-Journal*, Macau's US$38 billion in 2012 gaming revenues exceeds the US$36 billion collected by the entire U.S. casino industry. Macau's year-over-year gaming revenue growth for 2011 and 2012 was 42 per cent and 13.5 per cent respectively.

While we do not believe that Macau gaming revenue will continue to grow that rapidly, Macau should still be viewed as a growth market. Improvements to air, land and sea transportation infrastructure planned for the next five years support that view. Wynn and MGM each have exposure to both Las Vegas and Macau, but our investment thesis on each company is different. We view Wynn as a high quality growth investment that was trading at a reasonable valuation of less than 20x 2013 analyst estimates of earnings per share (EPS) at our time of purchase. Wynn plans to pay $1 per share quarterly in dividends in 2013, a shareholder-friendly move. Wynn has been profitable on an annual basis since 2006, and is in the design phase for a new casino resort to be located on the Cotai Strip in Macau.

In contrast, we view MGM as a turnaround investment, as it took on too much debt in the years prior to the recession. It has lost money on an annual basis since 2009, in contrast to its consistent profitability prior to the recession. On Dec. 20, MGM announced the completion of a major debt refinancing, anticipated to save it approximately US$230 million of interest expense annually. We believe this transaction could help shift investor focus from the company's debt load to its potential recovery. MGM's growth projects include a plan to build a new casino resort in the Cotai area. We purchased Wynn and MGM with our standard three to five-year time horizon in mind, but as we are active investment managers, our views may change as new information arises. Consequently, we may be buying or selling shares of these companies at any time, both on behalf of clients and personally. These companies should be considered somewhat high risk in nature due to their share price volatility and their categorization as consumer discretionary businesses that will be negatively affected in another economic downturn. Interested readers can contact us for more information or consult their financial advisors.

There are other options worth researching for investors who want exposure to Las Vegas and Macau that we have not purchased to date. Las Vegas Sands Corp. (NYSE:LVS) has properties in Vegas, Macau and Singapore, and analysts believe its growth prospects are strong. Also, a U.S.-based exchange traded fund, the Market Vectors Gaming ETF aims to provide broad exposure to the global gambling industry.

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