

This too shall pass

Each investment opportunity presents itself in a different way, but there are threads that connect them. Two of these threads are the tendency to think current bad news will last longer than it will and to undervalue things that will happen too far into the future. A contrarian mindset lets you take advantage of the first behavioural challenge and a long-term investment horizon lets you benefit from the second.

A contrarian isn't someone who just takes the opposite view for the sake of it. That is being contrary. A contrarian looks at the information, listens to concerns, and then forms an independent view. Opportunities then present themselves if the general view, factored into the price, overstate the problems.

Crown Resorts is an Australian gaming and entertainment company. Most of their revenue comes from Crown Melbourne and Crown Perth. Gaming also brings in tax revenues for local authorities. 'The house always wins' and the government gets a slice of that through tax. The New South Wales (NSW) government takes 29% on Gross Gaming Revenue (GGR) – a measure of how much the gaming industry takes from gamblers. They have long been irked that Sydney has underperformed relative to the two places where Crown has a monopoly (Melbourne & Perth). The revenue per capita in Sydney brought in by the Star Entertainment monopoly (Crown's competitor) has been lower than expected despite Sydney being a much more attractive tourist destination, especially for "high rollers". It was largely as a result of Star's underperformance in attracting VIP's that James Packer (Crown's largest shareholder) was able to lobby the NSW government and negotiate a 100-year licence to build a new resort in Sydney. Work has commenced for Crown Resorts to build Sydney's first six-star hotel resort on Sydney Harbour. The A\$2bn project is to develop a 275-metre casino, hotel and apartment tower featuring 350 rooms, suites, luxury apartments, signature restaurants, bars, retail outlets and VIP gaming facilities. We believe this opportunity is beyond the time horizon of most investors, who are focussed on the earnings of the next few years.

Even a pair of aces doesn't win every hand. Promoting gambling in China is illegal, even though most of the big companies did it. Since 2015, the Chinese government had been clamping down on corruption and VIP gaming as part of that. In October 2016, Chinese authorities detained 18 Crown employees, without charge. Nobody knows why the government chose to arrest only Crown Resorts employees specifically and nobody else. In response, Crown Resorts ceased all marketing, not only in Mainland China but in the whole of South East Asia, "until the matter is resolved". In June 2017, the Crown employees were eventually charged, found guilty 2 weeks later (in a show trial) and released on 11 August 2017. With their employees safely back in Australia, it seems reasonable to expect Crown will resume marketing in South East Asia but not in Mainland China.

Back in Australia, a lobby group 'Alliance for Gambling Reform' recently released an anonymous video of three former employees making numerous disparaging accusations against Crown, the most concerning being tampering with machine limits and facilitating money laundering. Legally speaking, truth is a defence against defamation, however the politician who released the video is protected from defamation due to "parliamentary privilege". He can therefore say what he likes without fear of prosecution and he has a clear agenda. Crown has denied the allegations and called on the accusers to immediately provide information to the relevant authorities.

The issue of tampering with machine limits seems quite trivial. The regulators are the Victoria state, not the federal parliament. Indeed, the whistle-blowers allege that members of the Victoria regulator knew of problems with Crown's slot machines but took no disciplinary action except to ask that they be restored to their intended condition. Given Crown is a big employer in the state and provides an important source of revenue for the state of Victoria, we do not see this as a material risk. Neither do we see the federal government interfering with the state regulators.

The allegation that Crown staff facilitated money laundering, a federal crime, will be investigated by AUSTRAC, the nation's financial crimes agency. Even if these allegations proved true, criminal charges can be brought only against individual Crown staff, with the company being held civilly liable for non-compliance with anti-money laundering legislation and fined to the extent they didn't have sufficient internal control mechanisms in place. While this eventuality would be negative, the maximum civil penalty for non-compliance with anti-money laundering legislation was A\$45m imposed on TABCORP, a number which would represent a mere 0.6% of Crown's market value and therefore should not materially affect the company's value. We would highlight that this is purely hypothetical as no evidence has yet been presented.

There is an outside possibility that new opportunities will arise for Crown in Japan, who in 2016 announced that they will be legalising casinos. Accepting that the bidders will probably have to partner with local Japanese companies, Crown seem to us near the top of the list of prospective partners. Crown is one of a handful of non-US players with the track record suggesting a capability to successfully develop an integrated resort in Japan. Crown's Perth and Melbourne resorts are city landmarks, with hotels, restaurants, bars, shopping and "MICE" facilities (meeting, incentive, convention and exhibition). Crown also has a track record of successful international developments in Macau and the Philippines, including the participation in JV's.

The last year has been a difficult one for the company and as such the valuation rating has traded near the lowest level in 5 years. Investors with a short-term horizon can believe the recent difficulties will continue, and undervalue the known distant opportunities (Sydney) and lower probability, but high value options (Japan).

We will continue to look for opportunities that reward calm and patience.

Important notice

This document has been created for information purposes only and has been compiled from sources believed to be reliable. None of Credo, its directors, officers or employees accepts liability for any loss arising from the use hereof or reliance hereon or for any act or omission by any such person, or makes any representations as to its accuracy and completeness. This document does not constitute an offer or solicitation to invest or divest, it is not advice or a personal recommendation nor does it take into account the particular investment objectives, financial situation or needs of individual clients and if you are interested in any of the information contained herein, it is recommended that you seek advice concerning suitability from your investment advisor. Investors are warned that past performance is not necessarily a guide to future performance, income is not guaranteed, share prices may go up or down and you may not get back the original capital invested. The value of your investment may also rise or fall due to changes in tax rates and rates of exchange if different to the currency in which you measure your wealth. Credo Capital plc is authorised and regulated by the Financial Conduct Authority, is a member of the London Stock Exchange, and is an Authorised Financial Services Provider in South Africa.