



Resorts and Gaming Sector

Las Vegas Sands (LVS US); Sands China (1928 HK); VanEck Vectors Gaming ETF (BJK US)

Bottom fishing for cyclical stocks: Part 3

Chen Guangzhi, CFA / 65 6202 1191 / guangzhi.chen@kgi.com

- Las Vegas Sands (LVS US), Sands China (1928 HK), and VanEck Vectors Gaming ETF (BJK US) are our top picks for the gaming sector. We expect them to recover to the pre-COVID levels by the end of 2020, representing a potential upside of 28%, 27%, and 14% respectively.

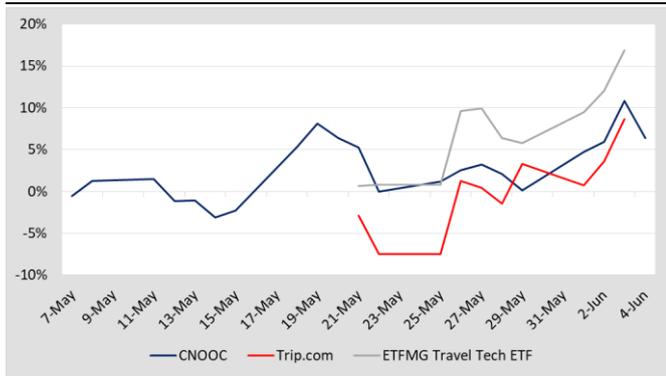
Figure 1: Our top picks in the Gaming sector

	Ticker	Last closing	Enter	Exit	Exp upside by Dec 2020
Las Vegas Sands	LVS US	US\$51.79	US\$50	US\$64	28%
Sands China	1928 HK	HK\$32.3	HK\$31.5	HK\$40	27%
VanEck Vectors Gaming ETF	BJK US	US\$36.9	US\$35	US\$40	14%

Source: KGI Research

In our previous two reports, we recommended oil and tourism sectors for bottom-fishing during the COVID-19 period. The graph below is a review of the performance of our stock picks since the date we published the reports:

Figure 2: Stock picks performance since our reports' published dates



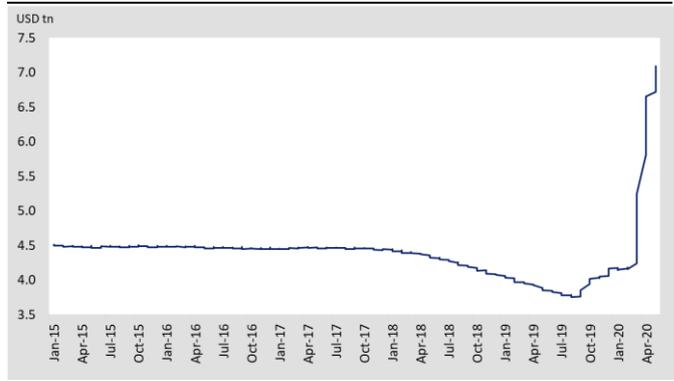
Source: Bloomberg, KGI Research

The steady ascension of the US market from the March-low has been due to several factors: 1) Unprecedented Fed liquidity injection; 2) Progress of COVID-19 treatments and vaccines; 3) Gradual reopening of the economy in the near term; and 4) Expectations of a V-shape recovery in 3Q/4Q20.

Among these tailwinds, the first is a pillar that most retail investors rely on to buy the dip while the rest are just the positive sentiments that drive exuberance during the recession period.

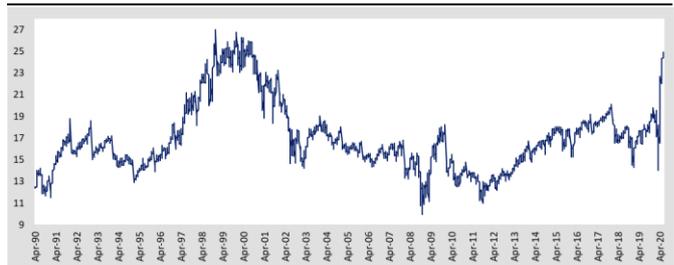
The disconnect between the market and economy re-emerged, evoking a sense of déjà vu from not too long ago (pre-COVID levels in February). Tech stocks have mainly contributed to the rally since mid-March, especially the Big Tech (or FAAMG) who accounts for 20% of the S&P500 index, and remains on a bull trend (up 41% on average as of 3rd June).

Figure 3: Fed assets expanded by a significant 69% since March 2020



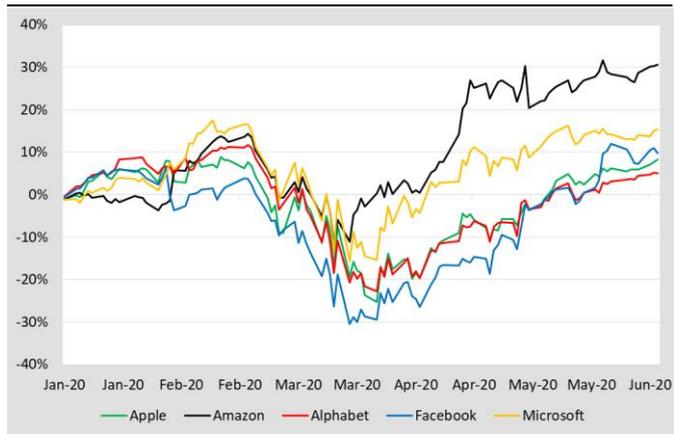
Source: Bloomberg, KGI Research

Figure 4: S&P500 index forward 12-month PER



Source: Bloomberg, KGI Research

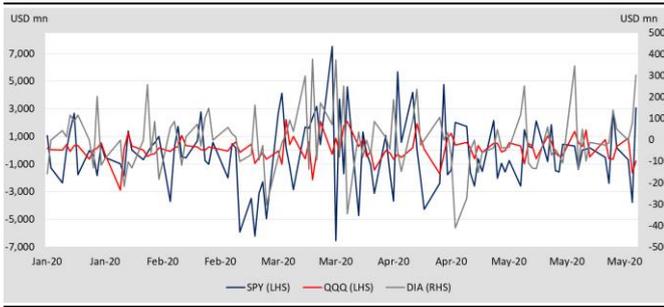
Figure 5: FAAMG price performance YTD



Source: Bloomberg, KGI Research

In contrast, the Dow Jones Industrial Average (DJIA) is down 7.6% YTD (S&P500 down 2.8% YTD), and those included in DJIA are the bedrock of the real economy. Riding on the expectation of better economic conditions in 2H20, there will be investment opportunities in sectors that are catching up with the recovery led by the technology sector.

Figure 6: SPY, DIA, and QQQ fund flows



Source: Bloomberg, KGI Research

COVID-19 only paused gambling but never beat it

Just like travel, COVID-19 lockdown measures disrupted other entertainment activities as well, and the pent-up demand for these have never been so significant, because almost all the entertainments such as movies, sports, and concerts were shut down simultaneously.

Similarly, just as we are upbeat on the tourism sector as we foresee a rapid recovery once the lockdown measures are lifted, another sub-sector that we believe will witness a surge in demand for is gambling. There are three main reasons why we think this niche market is only currently facing a speed bump and which will revive sooner rather than later.

Firstly, gambling has well proven its resiliency throughout time. There are many reasons why people gamble – boredom and loneliness, as a form of escapism from work and life stresses, gambling may even be a form of stimulation and excitement for many – just like any other form of adventure or entertainment activities.

Secondly, gambling is highly regulated and a quasi-monopolised business in every country. Only licenced operators are allowed to run casinos in specific cities. Typically, gaming resorts are subject more to policy risks (i.e. termination of licence) and operational risks (i.e. security problems) rather than public health risks like COVID-19 lockdowns. Therefore, the short-term impact of the lockdowns will hardly result in changes to the unique business status.

Lastly, we do not think that the COVID-19 crisis will bring any substantial paradigm shift on gambling. Some investors could argue that online gambling will gradually overtake the brick-and-mortar owners. However, online gambling has been existing and well-run long before the pandemic. Furthermore, governments that have legalised gambling have been tightly regulating the online betting platforms and restricting the types of plays or flow of money. Whether as a tourist or an avid gambler, visiting a casino is a vastly different experience than clicking buttons to bet online. Simply put, because the consumer experience matters, we believe each camp will not supplant the other.

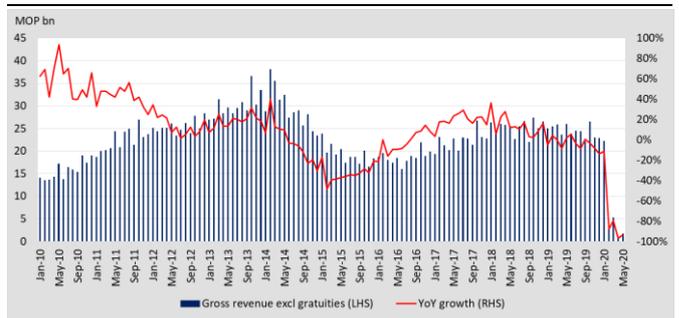
A sharp hit-the-trough

Macau and Las Vegas are the emblematic cities who are the barometer of the wax and wane of the gambling sector. Since the outbreak of COVID-19, gaming revenue have been

freefalling in both cities. This is a record-fast plunge in the business. Macau, the top gaming city in terms of revenue, encountered challenging times in 2014 and 2015 due to the anti-corruption campaign in China, but the decline in revenue then has now been dwarfed by the recent plunge.

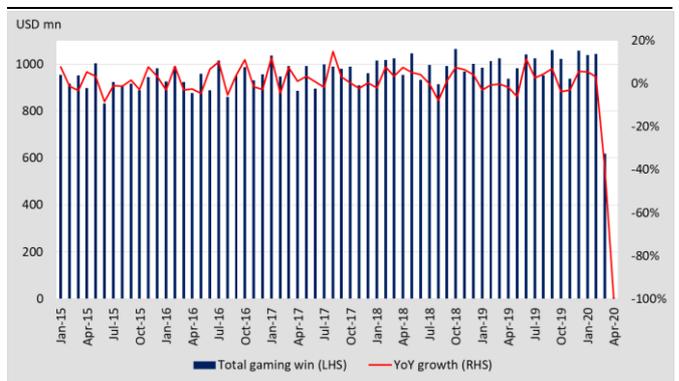
Similarly, Las Vegas, whose revenue is more stable over the years, has almost had its business shut down since March. The whole of Nevada’s gaming sector only recorded a dismal gaming win of US\$3.6mn. Singapore, which releases quarterly figures will also see a trough in 2Q20 as the circuit breaker lasted from April to June. The implication, therefore, is that there is limited downside for the gaming sector, and business will return, and could even be better off after the economy reopens in 3Q20.

Figure 7: Macau gross gaming revenue has disappeared since February



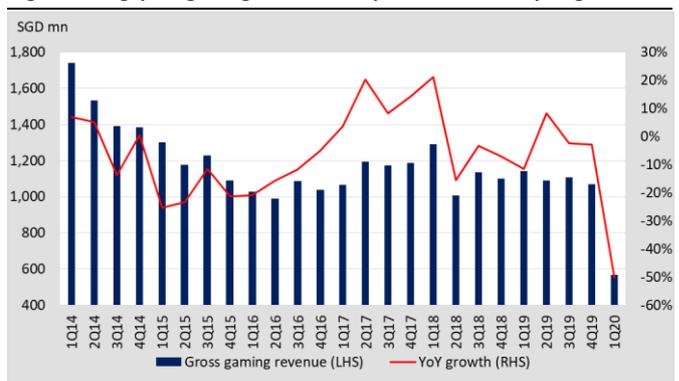
Source: Bloomberg, KGI Research

Figure 8: Gaming in Vegas had almost no business in April



Source: Bloomberg, KGI Research

Figure 9: Singapore gaming revenue is expected to further plunge in 2Q20



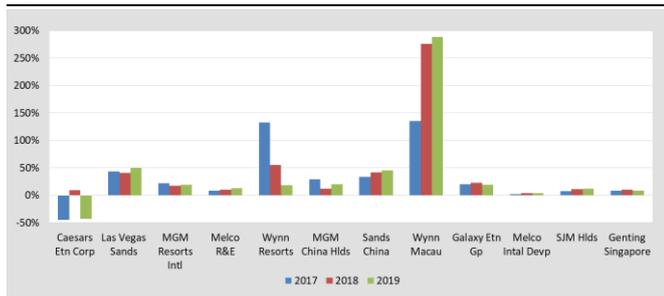
Source: Bloomberg, KGI Research

Gaming peers comparisons

Based on the past three years of financial performance, we find that US brands with operations in Macau achieve better profitability than their headquarters in the US, while the local Macau players tend to lag behind.

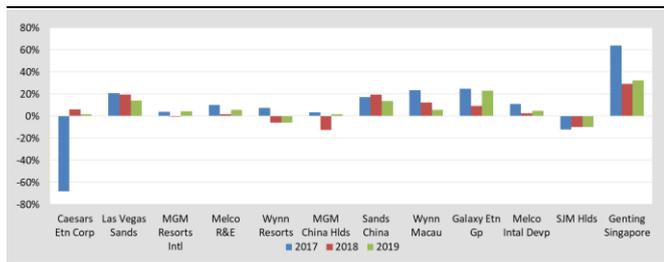
In terms of debt gearing, US players are more aggressive in its leverage than local Macau players. Accordingly, US players are more generous in dividend payouts as they deliver better earnings. It is worth noting that Genting Singapore gives a decent dividend even though their profitability is unexceptional, mainly because it is in a better cash position than its peers.

Figure 10: ROE



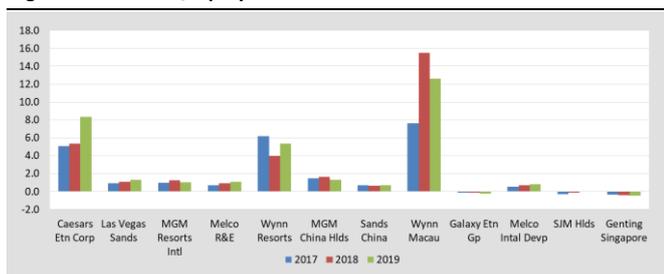
Source: Capital IQ, KGI Research

Figure 11: Levered free cash flow margin



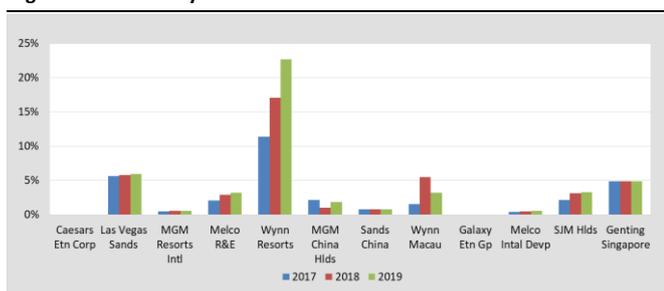
Source: Capital IQ, KGI Research

Figure 12: Net debt/Equity



Source: Capital IQ, KGI Research

Figure 13: Dividend yield



Source: Capital IQ, KGI Research

In terms of valuations, US players with operations in the US have almost reached fair value, but their branches in Macau are still cheap at the moment. The local Macau players are also relatively undervalued. However, their dividends are not as attractive as their US peers.

Figure 14: 5-year average PE comparison

	Ticker	Current	Average	High	Low
Caesars Etn Corp	CZR US	N/A	17.1	56.1	0.4
Las Vegas Sands	LVS US	21.9	20.0	27.1	11.6
MGM Resorts Intl	MGM US	119.1	30.7	123.1	8.3
Melco R&E	MLCO US	N/A	32.1	69.1	14.4
Wynn Resorts	WYNN US	N/A	25.6	67.6	11.6
MGM China Hlds	2282 HK	19.3	24.4	62.5	7.8
Sands China	1928 HK	16.6	21.9	32.0	10.9
Wynn Macau	1128 HK	14.5	27.0	67.9	10.3
Galaxy Etn Gp	27 HK	18.5	21.6	35.0	12.7
Melco Intl Devp	200 HK	35.9	57.3	217.7	1.0
SJM Hlds	880 HK	16.4	15.4	32.4	6.4
Genting Singapore	G13 SG	N/A	64.9	445.0	8.9

Source: Bloomberg, KGI Research

Recommendation

For the US listed gaming stocks, we recommend Las Vegas Sands (LVS US) given its stable and decent profitability and relatively low gearing. Meanwhile, it maintains a consistent dividend yield of about 5%.

For the HK listed gaming stocks, we recommend Sands China (1928 HK) given its stable profitability and low gearing.

Meanwhile, investors who want a diversified portfolio can consider VanEck Vectors Gaming ETF (BJK US).

Figure 15: Top 10 holdings of VanEck Vectors Gaming ETF

Company	% of total net asset
Galaxy Entertainment Group Ltd.	8.05
Las Vegas Sands Corp.	8.04
Aristocrat Leisure Ltd.	6.22
Sands China Ltd.	6.22
Flutter Entertainment PLC	6.16
MGM Resorts International	4.42
Wynn Resorts Ltd.	4.31
VICI Properties Inc.	4.22
Stars Group Inc ORD	3.52
Evolution Gaming Group AB	3.36
Total	54.52

Source: Bloomberg, KGI Research

Trading strategy

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Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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