Littler trouble in littler China

29 June, 2017

Kevin Bertoli, Portfolio Manager, Asian Equities strategies, reports on insights gained from a recent research trip to Macau.

We've just returned from a trip to Hong Kong, where we met with our Macau casino holdings. Macau's had a very strong move over the last 12 months. If you look at Wynn Macau, up 75% over the past 12 months. So it was really important that we went out and stress-tested our longer-term investment thesis.

One of the areas that we think the market is missing when they look at Macau is the short-termism around what they focus on: month-to-month gaming numbers and 2017 earnings. We think looking at 2017 earnings fundamentally misses the opportunity with Macau. Our investment thesis with Macau is focused on a three- to five-year view.

If you actually look at the major operators today, they've just added capacity or are about to add capacity, and they're building into that capacity, so looking at this year's earnings is almost irrelevant. If we look at the expectations for next year's earnings, despite the fact that players like Wynn Macau and MGM have increased their hotel capacity by 100% and table capacity by 50%, the actual expectations for earnings next year are still below the peak in 2013 and 2014. So it was important for us to go back to Macau, back to Hong Kong, speak to these operators, and get a sense that our longer-term investment view hasn't changed. We come back comfortable on things like regulation.

There's been some changes in recent times around withdrawal of cash from ATMs, greater junket restrictions, or oversight, and capital outflow from China. We don't think those have fundamentally changed the equation for Macau. Licence renewal is a longer-term issue that we think the operators and the government understand needs to run smoothly, so we think that's fine. Infrastructure, hotel rooms continue to come through, and they'll be the things that support demand. So we're very comfortable with that longer-term investment thesis.

When we look at valuation today, what we think the market has fundamentally gotten wrong is expectations for earnings. We think there's 30 to 40 percent upslide in EBITDAR expectations. That'll play out over the next three to four to five years. If we look at the operators today, they've gone ex-CapEx or are about to go ex-CapEx. So the clear message from the operators was, "We're going to give that capital back to shareholders." So if you look at the dividend yields today, they're about 5 percent. With a 30 to 40 percent increase in EBITDA over time, we expect substantial increases to the dividends as well. So coming back, despite the strong moves we've had, we're very comfortable in maintaining those positions in Macau.