

HD Winners And Losers In Australian Gaming

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-Can Oz casinos recapture share? -Key to VIPs is in revamped properties -Wagering competition intensifying -Tabcorp better placed than Tatts

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By Eva Brocklehurst

Australia's gaming market has been soft of late but Deutsche Bank observes expenditure is now starting to improve across gaming machines, casinos, wagering and lotteries. The better gaming environment is attributed to improving consumer confidence and retail sales, with the evidence being seen in the **company** trading updates and gaming machine expenditure on the east coast, in particular. One area of recent weakness is the VIP sector, where both Crown Resorts ((CWN)) and Echo Entertainment ((EGP)) have lost market share to Macau and other international casinos. **Chinese** New Year for the casino operators was strong, with Deutsche Bank noting gross gaming revenue in Macau strengthened in February after a weak January.

Deutsche Bank observes Crown is using the decline in Australian turnover to argue for more competitive tax and regulatory regime. Echo's activity levels also declined in both Sydney and Queensland. Echo's management remarked at the results briefing that the underlying VIP rebate market potential in Queensland is unlikely to be fully realised until the necessary capital investment is made. Upgrades to **property** are the key to a turnaround in domestic fortunes, in Macquarie's view. Casino operators in Australia have significant capex intentions which, despite the current soft environment in Australia, Macquarie believes will provide opportunity for operators to increase their share of the VIP market and premium mass segments from Asia.

Macquarie notes many players are being priced out of visiting Macau and this factor, along with a limited supply of integrated resorts, means Australian operators Echo Entertainment and Crown are well placed. Macquarie highlights surveys which show Asian travellers continue to view Australia as a preferred destination. Visitor arrivals from **China** rose by 14% in 2013. Sydney and the Gold Coast rank as the top destinations, boding well for Echo as it already has resorts in both cities. The key to monetising this demand will be effective marketing of the **company**'s properties throughout Asia, in Macquarie's view. The broker has upgraded medium term earnings forecasts for Echo by 3-4% and retains an Outperform rating on both casino operators.

The proof of the pudding will be in the eating, so to speak. JP Morgan has expressed growing concern about the Australian casinos' ability to maintain share of the Asian VIP market and will be on the look out to see if the increased competition from Asia maintains that slowing trend. For now, this broker retains an Overweight rating on Crown but an Underweight rating on Echo. Echo just has too much uncertainty for JP Morgan. The Brisbane exclusivity issue and questions over the returns from the **property** expansion plans cloud the stock. Deutsche Bank retains **Buy** ratings for Aristocrat Leisure ((ALL)), Crown and Echo. The former is considered well positioned in the gaming machine market, with a sound balance sheet. Crown is benefitting from strong business in Macau, offsetting any Australian weakness, while Echo appears to have seen a nadir in its earnings and domestic gaming revenue is improving.

The Australian wagering market is a different kettle of fish. The game is being played hard and competition is intensifying. English player William Hill has announced an upgraded offering will be launched in Australia before the end of the month which, in CIMB's view, will put the heat on Tabcorp Holdings ((TAH)) and Tatts ((TTS)). CIMB observes William Hill has reported solid numbers for its

Australian businesses in the FY13 results. These businesses are Sportingbet, Centrebet and Tom Waterhouse. The **company** stated that all three brands will be maintained but Sportingbet will be the priority. Tom Waterhouse has to be maintained until 2015 as per the earn-out agreement. It will be integrated into Sportingbet and a new Sportingbet website will be launched. The improvements that are key to the **site**'s success, in CIMB's view, are easier player registration and placing of bets, with better display and navigation.

This spells out why the broker has a cautious stance on Tabcorp and Tatts. CIMB thinks William Hill will have a significant impact and the theme emanating from the local operators' results season is that online wagering is cannibalising the retail business. This signals to CIMB that William Hill can continue to operate on considerably lower margins than Tabcorp or Tatts and, along with more product and an improved platform, suggests the latter two are losing market share. CIMB's ratings stance: Reduce.

While accepting there is litigation hanging over Tatts and Tabcorp in Victoria, as well as the racefield product fees deductibility issue in Queensland for Tatts, Deutsche Bank is not so negative. The broker thinks Tabcorp is executing well in the competitive environment and upside could come with the potential licence fee refund in Victoria. This stock carries a **Buy** rating for the broker. Deutsche Bank has a Hold on Tatts as, while the performance is robust, the broker is concerned about the lagging wagering business and the Queensland racefield product fees. Macquarie's ratings reveal a similar pattern, with an Outperform rating for Tabcorp and Neutral for Tatts. Tatts is suffering from the uncertainty over the Queensland wagering exclusivity which diminishes its strong performance in lotteries. Macquarie's more positive on Tabcorp for similar reasons to Deutsche Bank and also thinks there's scope for a review of that stock's dividend policy over the next 12 months.

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