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Special situations corner (2): the Great Canadian Gaming heist

NOVEMBER 14, 2020 / PUPPYEH / EDIT

It's been a fertile environment for special situations/event investing: most of my event-related trades have worked out nicely (SPAC warrant arbs, LGC warrant exchange (touch wood, still ongoing), MET merger arb earlier in the year, etc). I'm going back to the well again as the **Great Canadian Gaming (Toronto: GC)** situation strikes me as another fat, asymmetric pitch and should be realized imminently (that is, before year end). As such I will keep the write-up brief and will be happy to answer questions in the comments.

GC is the owner/operator of a number of casinos in Canada; you can learn more about the business and its footprint here. Before COVID came along, this was a fairly excellent business, growing at above GDP rates, and generating ~30% operating margins (and high 30s/40s % EBITDA margins). There is no rocket science to the casino business: well-placed casinos (that is, in growing geographies and with limited competition) have historically minted cash. The 10yr summary on financials looks like this – note that FY19 (pre-COVID) earnings power was just under $4 a share, and indeed 'normalized' FCF is a good deal higher than this since capex is running ahead of depreciation:

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	384	388	409	407	447	463	566	614	1,180	1,356
Revenue Growth GDP+ growth	*0.3%*	*1.2%*	*5.3%*	*-0.3%*	*9.6%*	*3.7%*	*22.4%*	*8.5%*	*92.1%*	*14.9%*
Gross Profit	384	233	245	247	282	298	364	396	823	925
Gross Margin %	*100.0%*	*60.1%*	*59.9%*	*60.6%*	*63.1%*	*64.4%*	*64.3%*	*64.5%*	*69.7%*	*68.2%*
Operating Profit	78	76	92	92	130	134	145	154	367	390
Operating Margin %	*20.3%*	*19.4%*	*22.6%*	*22.7%*	*29.1%*	*28.9%*	*25.6%*	*25.0%*	*31.1%*	*28.7%*
Earnings Per Share	CA$-0.10	CA$0.31	CA$-0.36	CA$0.90	CA$1.12	CA$1.08	CA$1.20	CA$1.35	CA$2.39	CA$3.78
EPS Growth	*-135.7%*	*410.0%*	*-216.1%*	*350.0%*	*24.4%*	*-3.6%*	*11.1%*	*12.5%*	*77.0%*	*58.2%*
Return on Assets	-0.8%	2.7%	-3.0%	7.1%	8.1%	7.4%	7.3%	7.5%	10.9%	10.2%
Return on Equity	-1.9%	6.4%	-7.9%	21.5%	22.2%	19.1%	19.7%	19.6%	27.7%	35.3%
Return on Invested Capital	-1.1%	4.0%	-4.5%	10.9%	14.7%	13.2%	12.0%	13.2%	17.7%	13.6%

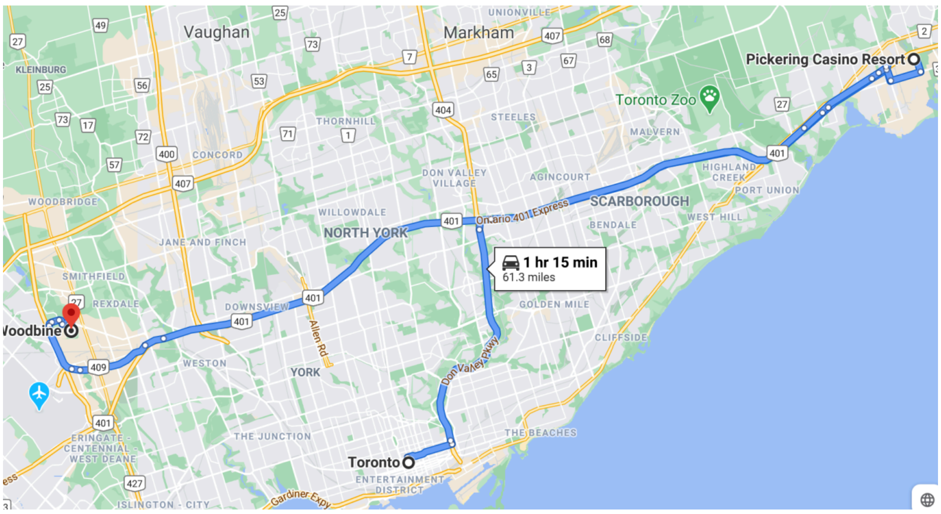
At a high level, pre-COVID, the business generated ~$1.35bn in revenues and $557mm in EBITDA – ie 41% margins, basically best in breed in the casino business, a function of GC's advantaged/near-monopoly positions in most of its core markets:

CONSOLIDATED QUARTERLY RESULTS TREND 557mm in pre-COVID LTM EBITDA

	Q3 2020	Q2 2020	Q1 2020	Q4 2019	Q3 2019	Q2 2019	Q1 2019 (1)	Q4 2018 (1)(2)
Revenues	$ 43.1	$ 62.8	$ 273.8	$ 357.4	$ 341.1	$ 354.4	$ 302.8	$ 331.4
Adjusted EBITDA	$ 8.9	$ 31.8	$ 103.0	$ 152.0	$ 142.3	$ 153.7	$ 109.3	$ 117.8
Adjusted EBITDA as a % of Revenues	20.6%	50.6%	37.6%	42.5%	41.7%	43.4%	36.1%	35.5%
Shareholders' net (loss) earnings from continuing operations	$ (36.5)	$ (31.4)	$ 19.2	$ 45.8	$ 49.7	$ 48.0	$ 30.9	$ 26.3
Shareholders' net (loss) earnings per common share from continuing operations								
Basic	$ (0.66)	$ (0.57)	$ 0.35	$ 0.81	$ 0.85	$ 0.81	$ 0.53	$ 0.44
Diluted	$ (0.66)	$ (0.57)	$ 0.34	$ 0.79	$ 0.82	$ 0.79	$ 0.51	$ 0.42

There are a few other wrinkles here. GC was part of the winning consortium to develop a number of new (really, expanded) concessions in the Greater Toronto Area (GTA) a few years ago – Canada's most populous region; with a large expat Asian population (important for casino businesses); and historically largely under-penetrated relative to other North American cities (you can measure this by looking at things like slots win per day, where Woodbine, one of the key GTA properties, runs at a >50% premium to US regional or GC's British Columbia properties, thus demonstrating large excess demand for more machines).

The regional regulator – the Ontario Lottery and Gaming Corporation (OLG) – wanted to partner with private operators to modernize and expand what had been sub-par and dilapidated casino operations (think old smoke-filled rooms with outdated slot machines, no restaurants/concert/shopping, minimal and poor quality hotel accommodation on site, etc). There are really only a handful of places to gamble in the province of Ontario, and GC's Woodbine and Pickering offerings – just 30-40min drive from downtown Toronto – are location-advantaged in a unique way:



Once modernized and fully developed, these locations should become veritable cash cows for the foreseeable future. Recognizing this, GC – as the local Canadian outfit – partnered with Brookfield, as well as Clairvest (two other Canadian corps) in a number

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of their key concession 'bundles', and got to work investing a bunch of money to capture the opportunity. The total development spend – for all the consortia members, not just GC's share – was pegged somewhere between $1.5bn and $2bn (across multiple years and three different concession bundles), and I think before COVID came along a majority of this money had been spent (Pickering, for example, is basically finished and just waiting to open up post COVID). Still, development capex is ongoing in the GTA today (despite most of the GTA casinos being closed).

Pre-COVID capital allocation: buying back boatloads of stock in the $40s…

The highly cash-generative nature of the existing casino fleet funded not only GC's share of this expansion capex, but also the retirement of large amounts of stock, through buybacks. Indeed in recent years GC has been an avid devourer of its own stock. In 2019 alone, *GC retired ~7% of the outstanding shares*:

Normal Course Issuer Bid

On June 27, 2018, the Company received approval from the Toronto Stock Exchange ("TSX") to renew a normal course issuer bid for up to 4,108,074 of its common shares. The bid commenced on July 3, 2018 and ended on July 2, 2019. During 2019, the Company purchased for cancellation 609,710 common shares at a weighted-average price per share of $43.55 under this issuer bid.

On June 27, 2019, the Company received approval from the TSX to renew a normal course issuer bid for up to 3,971,976 of its common shares, representing approximately 10% of the Company's common shares in the public float. The bid commenced on July 3, 2019 and will end on July 2, 2020, or earlier if the number of shares sought in the issuer bid has been obtained. The Company will not purchase shares during its self-imposed blackout periods and reserves the right to terminate the bid earlier. Pursuant to TSX policies, daily purchases made by the Company will not exceed 64,439 common shares or 25% of the prior six-month average trading volume of 257,759 common shares on the TSX, subject to certain prescribed exceptions. Purchases will be made by way of open market purchases through the facilities of the TSX, and other Canadian market places, and payment for the shares will be in accordance with the TSX's rules. No purchases will be made other than by means of open market transactions during the term of the normal course issuer bid and conducted at the market price at the time of acquisition. All shares purchased by the Company will be subsequently cancelled. Under the current issuer bid, the Company purchased for cancellation 3,799,252 common shares during the year ended December 31, 2019 at a weighted-average price per share of $41.75.

Subsequent to December 31, 2019, the Company purchased 172,724 common shares at a weighted-average price per share of $42.29, which completed the remaining balance available under the current issuer bid.

In early 2020 – when GC stock was trading in the low $40s – the company was so confident about its prospects and the forward valuation of the company that it wanted to acquire even more of the company, issuing a *tender bid for up to $500mm stock, in the $39-46 range:*

February 14, 2020

GREAT CANADIAN GAMING CORPORATION

OFFER TO PURCHASE FOR CASH

UP TO $500,000,000 IN VALUE OF ITS COMMON SHARES AT A PURCHASE PRICE OF NOT LESS THAN $39.00 AND NOT MORE THAN $46.00 PER COMMON SHARE

Great Canadian Gaming Corporation ("we", "Great Canadian" or the "Company") hereby invites holders of the common shares of the Company (the "Shares") to tender, for purchase and cancellation by the Company, Shares for an aggregate purchase price not exceeding $500,000,000. The purchase price per Share (the "Purchase Price") will be determined by the Company in the manner described below but will be not less than $39.00 per Share and not more than $46.00 per Share. The invitation and all tenders of Shares are subject to the terms and conditions set forth in this Offer to Purchase, the accompanying Issuer Bid Circular, the related Letter of Transmittal and the related Notice of Guaranteed Delivery (the terms and conditions found in all such documents, as amended or supplemented from time to time, collectively constitute the "Offer").

This tender lapsed unexercised, of course, when COVID struck, and that is really where our narrative begins.

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COVID changed the equation, at least temporarily, as for most of the past two quarters GC's casino operations have been basically closed, and generating next to no revenue. GC came into the crisis with low leverage but a reasonable amount of committed development capex, and as a result had to renegotiate covenants to maintain a bit of liquidity early in the crisis. That said, in the recently reported 3Q, the company only burnt ~$54mm cash, a function of cost cuts, suspending employments, ongoing support payments from the relevant regional governments:

Cash Flows

	Three months ended September 30, 2020	Three months ended September 30, 2019	Nine months ended September 30, 2020	Nine months ended September 30, 2019
Cash generated by operating activities	$ 27.6	$ 99.5	$ 96.8	$ 303.6
Cash used in investing activities	(61.2)	(96.9)	(241.2)	(161.9)
Cash generated by (used in) financing activities	7.3	(101.9)	286.6	(170.0)
Effect of foreign exchange on cash	-	1.5	-	1.3
Cash (outflow) inflow	$ (26.3)	$ (97.8)	$ 142.2	$ (27.0)

As it stands today, the balance sheet is in reasonable shape: ~$800mm of net debt (excluding leases), and cash burn likely topping out at $50mm a quarter as long as the status quo continues. With the vaccine news from Pfizer last week, though, it is hard to see how the current burn rate continues for much longer than two more quarters (and even that assumption I feel is conservative) – but the overarching takeaway is that *the post-COVID capital structures is unimpaired, and not meaningfully different to where it was pre crisis.*

Takeover: APO bids $39/share, shambolic conference call follows

All that aside, the stock was bumbling along in the mid-$20s until the vaccine news (which prompted a spike to ~$29) – the business, and equity, was going to survive, but the tortuous route to normality had the market pricing this at a low multiple of pre-COVID earnings (around 6x) and giving no credit for the ongoing growth opportunity. But the very next day the company announced an agreed takeover transaction whereby Apollo would acquire the company for $39/share in cash. What followed a day later was quite literally the most bizarre, and shambolic, investor conference call I have ever listened to. After some peremptory opening remarks on the (irrelevant) quarter and some lavish praising of the APO bid from the CEO, the Q&A session almost devolved into a shouting match between irate shareholders and the CEO. During the Q&A, the company admitted, variously, that:

- APO had approached GC with an unsolicited bid;
- GC had not solicited any other bidders or run a full process since APO approached them – *ouch*;
- GC had not offered the opportunity to bid to its JV partner (Brookfield, owning 50% concession in some of the GTA bundles) – *double ouch*;
- management would neither confirm nor deny the existence of a post-close role at newco, assuming the APO bid succeeded – *triple ouch*.

It's worth quoting at length from the 14% shareholder, BloombergSen, whose opening salvo on the Q&A will likely go down in corporate annals as the finance equivalent of the memorable Denny Green rant at an NFL press conference from yesteryear:

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October 2019 (1)
August 2019 (2)
July 2019 (3)
April 2019 (1)
March 2019 (3)

Q - Sanjay Sen {BIO 18779448 <GO>}

Rod, this is a terrible and ridiculous deal. It is taking billions of dollars of shareholder value -- long-term shareholder value in a Canadian-controlled monopoly and giving it to foreigners. You cannot have a company which is this cheap, which earned $4 of free cash flow in 2019, which has enormous growth potential ahead to Woodbine and Pickering. Pickering is already complete. So there is nothing to do other than unlock it. So it's enormous growth potential ahead that $4 earning power is materially higher. It's a monopoly on one of the fastest growing by population cities in North America. No other city and have a gaming monopoly like that. We have that. You know all this. This is why you spent $350 million in 2018 and 2019, buying back the stock at above $45, and you were going to buy back $0.5 billion at north of $39 to $45 this year. So now you're proposing to sell this business to these foreigners for $39. You knew this. You know the value. We don't understand why you want to sell the company at such a depressed price when COVID is a once in a 100-year storm. BloombergSen owns 14% of this company and will be not voting in support of it. We will vote against this transaction. The equity value of the business has not been hurt. (inaudible) isn't burning much cash. We turned the corner. Pfizer has a vaccine. (inaudible) antibody treatments is being authorized. U.S. regional casinos, which are open, are making more money today than they were a year ago. COVID is a natural disaster, which struck this company, a once in 100-year storm, and it's going. And this stock is worth over $100 in a few years' time, and we need to hold on for that. You yourself said on the Macy's conference call, this is a tremendous and unique franchise. So we don't understand how this Board and this management can propose giving away this asset when they were approached by Apollo at the bottom of the market without running any kind of auction and without saying, we don't need you guys. We can run this business for the long term and create loads to shareholder value that way. Can you talk about that?

You really need to listen to the actual call to hear the level of anger in Sen's voice – he is rightly aggrieved at what appears not just to be a crazily-low price (as we shall discuss), but the abrogation of fiduciary duty evident in the board's unwillingness to conduct basic steps to protect shareholders (like run a full auction process). This was brought out in subsequent comments from other shareholders in various ways (the lack of due process; the low price at the bottom of the market; the lack of need to sell now; etc).

Indeed looking at the register (below) and judging from the comments on the call it is probably fair to say the deal, as currently constructed, is dead in the water. Since it is being structured as a Plan of Arrangement, GC needs 66% of shareholders to vote in favor; but per the below, I think at least 30-35% of the company has already publicly suggested they will vote against the deal on current terms:

	Holder Name	Portfolio Name	Source	Opt	Position↓	% Out
			All	All		
1.	CI Investments Inc/Ca...		Alternativ...		8,730,358	15.78
2.	Bloombergsen Inc		Alternativ...		8,007,956	14.47
3.	Burgundy Asset Manag...		Alternativ...		5,251,323	9.49
4.	EdgePoint Investment ...	Multiple Portfolios	MF-AGG		2,298,764	4.15
5.	Vanguard Group Inc/T...		ULT-AGG		1,634,452	2.95
6.	Dimensional Fund Advi...	Multiple Portfolios	MF-AGG		1,331,996	2.41
7.	Hawk Ridge Capital Ma...		Research		1,312,499	2.37
8.	Sentry Investments Co...	Multiple Portfolios	MF-AGG		996,749	1.80
9.	National Bank of Cana...	Multiple Portfolios	MF-AGG		854,600	1.54
10.	Norges Bank	Multiple Portfolios	MF-AGG		802,738	1.45
11.	National Bank Investm...	Multiple Portfolios	MF-AGG		511,537	0.92
12.	BMO Financial Corp		ULT-AGG		502,885	0.91
13.	Royal Bank of Canada		ULT-AGG		381,483	0.69
14.	FMR LLC		ULT-AGG		350,777	0.63
15.	BlackRock Inc		ULT-AGG		319,871	0.58
16.	1832 Asset Manageme...	Multiple Portfolios	MF-AGG		204,838	0.37
17.	Canadian Imperial Ban...		ULT-AGG		177,487	0.32
18.	Invesco Ltd		ULT-AGG		175,170	0.32
19.	Toronto-Dominion Ban...		ULT-AGG		164,048	0.30

The stock today is at $37.8, implying also a very small probability of deal closing at $39 (but also, I think, a low or zero probability of an overbid or bidding war). The real question, then, is what happens next?

Scenario analysis

As I see it, there are three possible outcomes here (but really only two likely outcomes):

- the deal gets voted through at $39; in this case we make a modest 2.5-3% return. As discussed I consider this HIGHLY unlikely, given shareholder opposition;
- the bid price gets bumped up to a level deemed acceptable to 66% of the shareholder base (either through negotiation with APO or from a third-party entering the race): I think this somewhere in excess of $50/share, potentially even $60+/share. But let's say 30%+ upside as a marker for now;
- the deal fails, APO walks away, and no other suitors emerge: the stock probably falls, but by how much and for how long?

Let's unpack some of these scenarios a little more. I won't deal with the first one as I view that as a near impossibility at this stage. As for the second scenario, keep in mind that APO has signed a definitive agreement, and the GC CEO dedicated considerable time to repeating on the call how 'real' APO was ('they are a highly credible bidder', etc etc). This is also a meaningful transaction (>$3bn EV) and a unique/trophy-type asset (since near-monopoly casino assets in growing end-markets don't often come up on the block). As such it's reasonable to expect this was merely APO's opening salvo and not their final bid, and that they were always willing to improve it to get the deal done.

If we accept the contention that they are willing to pay more, the corollary, then, is what kind of price is acceptable to both parties – APO as the buyer and the aggrieved shareholders as sellers? Whilst APO probably knew they needed to bump the bid, they (and I'm just speculating) may not have anticipated the amount of vitriol that was displayed on the call. With major shareholders throwing around $100/share as the right marker for fair value, is there even an acceptable level for both sides to get a deal done?

Figuring out what is 'right' or 'fair' is perhaps more art than science, but I think in this case there's a relatively simple way to benchmark it. If we are confident that GC is an above-average operator (yes), with above-average growth and market prospects (yes), and no large-scale capital structure impairment before the return to normalcy (yes), then it's at least reasonable to ask a bidder to pay near-market price for comparable assets. What are the right comparable assets? I am just going to select a basket of US large cap/regional names – **CZR**, **BYD** and Red Rocks (**RRR**) – whilst throwing out PENN as that is wildly affected by the online gaming boom and MGM given the China exposure. The simple fact is *none of these names trade at less than 8x 2019 EV/EBITDA, they are all wildly more levered than GC, and before COVID came along they were all earning far low returns than GC*:

	2019 Revenue	2019 EBITDA	EBITDA margin %	Sep'20 net debt	Net debt/2019 EBITDA (x)	Market cap	Total EV	EV/2019 EBITDA (x)
RRR	1856	509	27.4%	2893	5.7x	2439	5332	10.5x
CZR	11059	3054	27.6%	13206	4.3x	12034	25240	8.3x
BYD	3326	799	24.0%	3534	4.4x	3730	7264	9.1x
GC.TO (CAD)	**1356**	**557**	**41.1%**	**810**	**1.5x**	**2262**	**3191**	**5.7x**

Looking at the above, its fairly indisputable ~6x 2019 EV/EBITDA is the wrong price – even if we thought the development opportunity wasn't worth much. This alone invalidates Baker's rebuttal, since he spent most of his time justifying the low price on the call by suggesting that redevelopment margins would be a good deal lower than the quick and easy wins enjoyed thus far:

> bunch of years and whatnot. So I heard that. I think you're misunderstanding the delta on not only what has occurred over the short period here, but I think there is many things that are not fully understood in terms of our capital program, the money that's going in and the incremental EBITDA lift that this business can potentially generate in the future as we -- in the earlier years of Ontario, as an example, and I think you're well aware of this, we were very fortuitous and lucky and with some good execution, we were able to turn on some very significant incremental business activity, particularly at places like Woodbine, but others as well, with table games within seven months of closing and 5,000 slot machines instead of 3,500 with a budget that were down a lot of the time. And frankly, we're able to create very significant lifts in gaming revenues at a point in time when we were able, through our threshold commitments to more fully participate in the sharing of the GGR in those early days. Unfortunately, as you go further and there's been much conversation and discussion around thresholds in the future and the several billion-dollar capital program that had to be invested post those early days when we generated those very significant returns based on very little capital in the early days, we had the very significant commitments to build out these assets, which we are in the process of as you're well aware of. And frankly, I know you've made commentary in the past about huge lift we're going to get on the capital because we're smart capital providers, and so we're going to make a bunch more EBITDA on those incremental up to $2 billion of capital. And frankly, that was a little bit erroneous because a lot of the return has already been generated. So it's a disproportionate lower returns on the future of that capital. And so I

But my retort is simply that *the multiple on historical earnings alone is far too low*. A fairer price, based on where inferior competitors trade today, probably begins **at 8-9x EV/EBITDA on 2019 earnings – a level that implies ~$65/share at midpoint**. This level accords a reasonable (but not high) price for current holders, whilst allowing the acquirer to solely benefit from any redevelopment earnings – perhaps a $100-$150mm EBITDA uplift, or more, over time – and any further windfall from online gaming regulation, as well as the structural improvement in margins/earnings through COVID cost-outs that other regionals seem to be enjoying. The current price, however, gives all the upside from everything – earnings normalization; multiple normalization; redevelopment; online gaming – to Apollo.

Even in the $60s, the vote would likely be contested but it would at least be palatable, and, I think would get over the line. Certainly to an acquirer even paying this price would still be quite accretive: for a financial buyer like Apollo (or Brookfield), GC's unlevered balance sheet could easily be re-levered to competitor levels, at attractive rates with credit markets open, so the opportunity to develop the GTA bundles then sell out the business to a North American major in a few years at a near double digit multiple would still generate a strong return. At $65 takeout and reasonable assumptions, I think *APO could still earn a mid-30s IRR on a 3yr turnaround*:

Basic PE returns model		
Entry px	65	
Equity value	3835	
Net debt	810	
Purchase EV	**4645**	
Equity check	1858	assume 40%
Debt portion	2787	
PF lev (x)	5.0x	on 2019
2019 EBITDA	557	
Development EBITDA	150	
Development capex	1000	assume 15% returns
3yr PF EBITDA	795	grow 2019 EBITDA @ 5% pa
Exit multiple	9	still discount to comps
Exit EV	**7153**	
Less dev capex	-1000	assume all GC pay
Less initial debt	-2787	assume no paydown
Exit Equity	**3366**	
Exit MoM (x)	1.8x	
IRR %	35%	

At $60 and a 10x exit, the IRR jump to 58%, and a 2.5x MoM in a few years…so even if $65 looks ambitious against the recent trading history, it is certainly the right context for a true discussion on the value. For strategic buyers the financial logic is less clear given most of them are already quite levered – but given the clean GC balance sheet and the more expensive US-listed stocks for all the obvious guys, a CZR or MGM, perhaps, could take a run at the company and structure a merger via stock transaction: such a deal would still be quite accretive and give those companies a once-in-a-generation type opportunity to acquire trophy Canadian assets to complement their US footprints.

But what about the third scenario? What if APO realizes even a bump to say $50+ isn't enough to get a deal done, and simply walks away? What happens then? Whilst it is quite likely the stock trades lower if this happens, I am comforted by a few things in this 'worst-case' scenario:

- with an effective vaccine on the table, the stock had already rallied back to the high-$20s, and thus even if the deal breaks it is not as if we are due a long purgatory before the market gets a look at a return to normal (1H 2021 event);
- given some of the exchanges on the CC, it seems quite likely some large shareholders would push to remove the current CEO and/or run a full and proper sales process, in the absence of a meaningful overbid from APO – meaning, therefore, that this would remain 'in play' and thus not fully retrace the upside move the initial bid generated.

Thus, some combination of these two means, in my view, the stock would probably trade back to say the low $30s, not the mid-$20s we saw before the vaccine news/deal announcement – and I should emphasize I'd be delighted to own the business outright there, at **around 7x pre-COVID EPS/cash flow with a shot at the redevelopment/new normal upside**. But this still remains, in my mind, the less likely outcome.

What if the new normal is better than the old normal?

But would being long the stock outright in a break scenario even be that bad? There's a reasonable argument to be made that the post-COVID profitability of some of these casinos assets is not only unimpaired – it may well be *higher* than it was pre-pandemic. This is because the operators have used the pandemic to massively cut costs (especially marketing), but those who really want to gamble – the hardcore, tier one customer – will come back anyway, and doesn't need to be enticed by marketing/discount dollars to return to the gaming floor.

Whilst Canada is yet to re-open, this has been amply demonstrated in the US regional market, where the likes of Boyd Gaming (BYD) have put up, incredibly, ***higher nominal EBITDA numbers in 3Q on a year over year basis despite seeing revenues fall 20%***:

BOYD GAMING CORPORATION
SUPPLEMENTAL INFORMATION
Reconciliation of Adjusted EBITDA to Net Income
(Unaudited)

	Three Months Ended September 30,	
(In thousands)	**2020**	**2019**
Total Revenues by Reportable Segment		
Las Vegas Locals	$ 171,076	$ 213,286
Downtown Las Vegas	17,539	60,624
Midwest & South	463,623	545,658
Total revenues	$ 652,238	$ 819,568
Adjusted EBITDAR by Reportable Segment		
Las Vegas Locals	$ 78,900	$ 64,062
Downtown Las Vegas	(1,511)	11,903
Midwest & South	182,502	156,202
Property Adjusted EBITDAR	259,891	232,167
Corporate expense, net of share-based compensation expense (a)	(21,048)	(18,658)
Adjusted EBITDAR	238,843	213,509
Master lease rent expense (b)	(25,914)	(24,665)
Adjusted EBITDA	212,929	188,844

Of course this was alluded to on the GC call, as a (valid) rebuttal point to the idiotic decision to sell to APO now. Speaking on the recent 3Q call, the BYD CFO had this to say about the massive margin expansion in the business:

> segment for a second, obviously both the Locals margins up 1,600 basis points year-over-year, and the Midwest and South up a little over close to 1,100 basis points. Would you guys, like, I think Josh said most of the savings operational you would expect to keep. If we looked at those two growth rates in the margins and kind of assumed more than half of them on a go-forward basis. Is that in your eyes at similar run rate levels to what we are looking at right now reasonable and could you maintain 800 basis points and 500-plus basis points in Midwest and South EBITDAR margins on a go-forward basis?
>
> **Josh Hirsberg**
>
> So I think that it's more in those ranges of a ballpark than either at the upper end or the lower end. If you think about kind of the drivers of expense of our business, the biggest components are obviously labor and marketing, and the changes that we have made to those categories in particular in a large way are largely permanent in the way we think about those.
>
> Now there's a certain aspect of marketing that will naturally come back potentially based on consumer demands or competitive pressures potentially, but that's nowhere near the order of magnitude of what we have removed from the business in terms of marketing.
>
> And I think on a much smaller case the same thing you could say about, labor and many of the other categories where we have made and I am sure our peers in the industry are doing the same thing. They have taken a fresh approach and we have taken a fresh approach in looking at our expenses across the Board and largely taking -- made decisions that are permanently removing many of those costs.

Simply put, good operators have learnt to do more with less: they are clearly signposting that the business on a go-forward basis should be much more profitable than it was before, as they stripped costs, stopped chasing unnecessary low-value customers, and focused only on the premium, local, repeat guest. Caesars (CZR) echoed much of this tone in their recent 3Q, where – despite worse YoY performance due to a heavier Las Vegas exposure – they talked up the mid-term margin potential of the regional market in no uncertain terms:

> reduce as gaming revenue goes down. Our run rate cost reduction is about $2 billion from pre-COVID levels. There's obviously a lot of talk about what will come back, what won't come back.
>
> A lot of those costs are never coming back as I said, over the last several quarters. None of that has changed. As I said, I think, we're going to get to 35% to 40% EBITDA margins in a minimum. It's enjoyable from my seat to see our peers in the space reporting the same types of cost savings opportunities that we've been talking about for many years and to see Las Vegas locals margins in excess of 40% for the quarter and a couple of our peers. That's a road map to what's coming.

There's no reason to think GC can't replicate this playbook in the BC and Ontario markets once they re-open – and of course they are in a structurally faster-growing market, with a near-monopoly position to work from too.

The final point to make re the 'new normal' is that online gaming is essentially a zero today in Ontario: there is one online outlet – operated by the OLG – that is sub-standard and extremely small, and garners almost no attention from the gambling populace. However there is an ongoing discussion in the local parliament regarding progressing towards a legalization/regulatory framework that would allow private operators to begin to open up the market. None of the details have been decided yet, but it seems reasonable to expect the shape of legislation to follow that of other regional US states, where land-based casinos are heavily advantage through the issuance of specific licenses ('skins') to operate online businesses. Given the likely explosion in growth that would occur if this were to happen, and GC's near-monopoly position in Ontario, its hard to see how this wouldn't be anything other than a big net positive for GC over time (and of course for how the stock is perceived in the market, judging by the evolution of CZR/PENN/MGM stock prices to online exposure in the US). This, too, is another reason why the 'new normal' may actually end up being better mid-term than it ever was before COVID.

Summing it all up

To conclude, we have a highly desirable trophy asset trading below deal price with the likelihood for an overbid/bidding war non inconsiderable, potentially pushing 30-40% near-term upside (the vote is scheduled for December 23, so this needs to unfold quickly). In the event that doesn't happen, we would still likely see board change/a full process run to maximize value from an aggrieved and irate shareholder base that had almost had the business sold out from under them at the worst possible moment. And if that doesn't even happen we are paying maybe 8x pre-COVID earnings with a number of shots on goal to see both the earnings, and multiple, expand in the mid-term, on an unimpaired and under-levered balance sheet, coming out of the crisis. All in all, I like those odds!

Disclosure: long GC.TO

Uncategorized

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← Betterware de Mexico: time to pound the table

Some more updates across the board →

33 thoughts on "Special situations corner (2): the Great Canadian Gaming heist"

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