

Are Casino Stocks Tired? - Seeking Alpha

Written by Administrator

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Casino stocks have recently taken a breather after a very strong run based on increased strength in the Macau area. Melco Crown Entertainment ([MPEL](#)) hit a 52 week high intraday of \$7.13 on 11/8, but has since cooled 18.7% to close Thursday at \$5.80. Las Vegas Sands (

[LVS](#)) also hit a 52 week high early in November of \$55.47 and has dipped 15.8% to close at \$46.74. Below is a comparison of casino stocks over the past year taken from Google Finance, which shows just how aggressive the rally has been, especially over the 2nd half of the year.

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Clearly, a great deal of this growth has come from Macau. Since Boyd is missing out on all of the fun over there it has also lagged behind the rest of the group. According to the latest PWC estimates, Macau's gross gaming revenues will increase at a Compound Annual Growth rate of 24.7% until 2014. This is in addition to the 42% year-over-year increase in November showing that growth has been well underway all year.

The concern has to be that a great deal of this growth has already been priced in. Strong revenues are great, but if at the end of the day the margins aren't high enough it won't result in earnings growth keeping up with the perceived strength of the company. Melco over the past 12 months has had a gross profit margin of 21.05%, but an operating profit margin of -1.39%. They turned the corner in the 3rd quarter by turning a profit of \$.03 per share, however analysts are still not projecting a profit going into 2011 even with all of the revenue growth. Las Vegas Sands has rightfully been the leader this year as they have turned in a gross profit margin of 41.11% and 11.34% on an operating basis. This has lead them to a \$.34 profit in Q3 and projected EPS of \$1.66 in 2011.

It is very difficult to try and value what a fair price or multiple is to trade these gaming companies at. While they are very good at churning out revenue how much of that will flow down to the bottom line? Another issue is that continued expansion in Macau may prove more difficult than initially hoped for. In March it was announced that there would be a cap at 5,500 gaming tables for the next 3 years, limiting the growth to another 700 tables from where it is currently. The government has talked about the need to diversify their economy beyond tourism within the area. It became a serious concern when Las Vegas Sands application for land to expand was denied when they claimed to have had a verbal agreement in place. When stocks are pricing in high future growth rates there is the potential to fall hard if something may get in the way of this. Within the past month, the sector has strongly underperformed the S&P 500.

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Disclosure: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

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