CREDO WEALTH

Crown Resorts: The Last Hand

We recently took the decision to sell Crown Resorts from the Best Ideas Portfolio and Dividend Growth Portfolio as well as the Credo Global Equity Fund. On the 14th of February 2022, it was announced that Crown had entered into an implementation agreement with Blackstone, whereby Crown shareholders would get to vote on accepting a cash takeover offer of AUD 13.10 per share. The vote is due to be held in the second quarter of this year and we believe it is almost certain to be approved. Crown's majority shareholder, Consolidated Press Holdings (which owns 35% of the company), has welcomed the offer and the Board has unanimously recommended that shareholders vote in favour.

This is far from the first bid that Crown has received. In April 2019, leaked media reports suggested that the company was in talks to be acquired by Wynn Resorts. Under Australia's continuous disclosure regime, Crown was obligated to release a statement confirming that it has received an offer. Unfortunately, Wynn pulled out of discussions as a result.

In May 2019, Melco Resorts & Entertainment agreed to buy a strategic stake of approximately 20% in Crown from James Packer who previously controlled 45% of the company. At the time, Melco's CEO also said that they would welcome the opportunity to increase the stake subject to regulatory approvals. Unfortunately, despite purchasing the first 10% in July 2019, the second tranche was called off due to the pandemic. In early 2020, Melco was forced to sell its stake to Blackstone due to its own liquidity issues during the Covid lockdown

In the first half of 2021, an all-out bidding war erupted with Crown receiving three separate proposals in the space of six months from Blackstone, Australian rival Star Entertainment, and Oaktree Capital. Crown quickly rejected the Blackstone offer as undervaluing the company.

All of this took place despite Crown being in the midst of regulatory trouble and with questions hanging over the company as to whether it would be found suitable to open the newly built Sydney casino. In the second half of 2019, a media exposé revealed that Crown had allowed Asian "junkets" to operate separate VIP areas within its casinos, catering to Chinese high rollers. The report also alleged that some of these patrons had ties to Asian crime syndicates and laundered money through the Melbourne Casino. This prompted public enquiries in New South Wales (NSW), Victoria and Western Australia, looking into whether Crown was a suitable operator.

In February 2021 the NSW inquiry found Crown to be unsuitable to hold the licence in its then state. However, it did also offer Crown a path to become suitable if it implemented the recommended reforms. During the Victoria inquiry, old revelations were rekindled and new revelations regarding unpaid taxes came to light. In July 2021, the counsel assisting the Victoria inquiry told the commission that Crown was not suitable to hold a licence. In response to the uncertainty surrounding Crown's ability to retain the Melbourne licence, Star Entertainment withdrew its offer. Talks with Oaktree also ended in August 2021.

Whilst this was a worrying period for shareholders, we concluded at the time that, since Crown Melbourne was the largest single site employer in the state of Victoria and contributed over 10% of the state's total tax take, it was extremely unlikely that the casino would be closed down. We believed instead it was much more likely that either a pathway would be set out which would enable Crown to become a suitable licence holder, or the assets would have to be sold to a "suitable" operator.

Given this conclusion, we believed that the market was substantially mispricing Crown's assets, bearing in mind that the company owns both the physical casinos as well as the operating licences. There is no doubt that the casinos themselves are world class, highly profitable, based in attractive locations, near large and growing population centres and operating monopoly or duopoly licences with very long tenures. These assets in and of themselves do not need any turnaround or strategic fix. All that was needed was a change of control and implementation of best operating practices. Fundamentally, the reason that the company had attracted so many bids in the past despite all the negative regulatory revelations was a reflection of these facts. As a result, we decided to continue to hold the shares.

In the end, whilst the Victoria inquiry found failures in governance, risk management and responsible gaming, the economic impact of closing the casino was also taken into account. The Royal Commission recommended that Crown continues to be able to operate under the oversight of a Special Manager whist it undertook a comprehensive reform agenda.

A few months later, Blackstone returned to the table with a higher offer. The offer is subject to several conditions, notably an approval by Australia's Foreign Investment Review Board, approval by gaming regulators at each of the three states in which Crown operates and no material adverse changes to the business.

At the time we decided to sell our holding, the shares were trading at just a 3.5% discount to the offer price. We concluded that given the "no shop, no due diligence, no talk to" provision under the scheme of the arrangement, it was unlikely that we would see further upside to the offer price. On the other hand, we noted the regulatory approvals required and that the Western Australia Commission's review is ongoing. As a result, we believed that the risk reward was unfavourable and took the decision to sell. ■

Important notice