

ESG Now Podcast

“High Rollers or Higher Risks? Gambling Goes Digital”

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Bentley Kaplan

Hello and welcome to the weekly edition of ESG Now, the show that explores how the environment, our society, and corporate governance affects and are affected by our economy. I'm Bentley Kaplan, your host for this episode.

On today's show, and to kick off the new year on a bit of a risque note, we are going to be talking about gambling. We'll take a look at the precarious position that one of Australia's biggest casinos finds itself in, and how it landed there, and then we'll look through a sustainability lens to explore whether the rise of online gambling might just be a way for the industry to avoid future such predicaments. Thanks for sticking around. Let's do this.

I want to start right at the beginning, with the apparent contradiction of a sustainability podcast talking about gambling. Let me first clarify that different investors are going to have different priorities and mandates. Some will have specific values or ethics-based guidelines that don't allow for investments and activities like gambling, and that's going to be for a range of different reasons. This segment of investors is going to screen out certain companies from their portfolios, but for other investors that don't have these specific screens or requirements, well, a gaming organization or casino is just another company, one with a potential investment case. Assessing the risk and opportunity of this investment is what it's all about.

Today's episode is going to look at the sustainability risks associated with this industry, how new technology is changing this, and what it might mean for the bottom line. But before we get into new technology, I really want to start with an older problem, or problems. Because problems are what Australian casino group Star Entertainment knows a lot about.

Last week, in early January, the company's Q4 update revealed that it had just \$49 million left to fund its operations. And for context, that's after having spent well more than that to get through the fourth quarter of last year. The company's stock price has been tumbling and things really are looking a bit dire. And there are two key problems that Star has pointed to.

The first is a months-long investigation and related penalties over allegations that criminals infiltrated its operations to launder money. These allegations relate to the company's business with so-called junket intermediaries. These are companies that bring in international high-roller or VIP gamblers. It's a very lucrative segment, but clearly not without risk. And in the interim, having to forego much of this activity is hurting profits. And at the same time, the company's revenue from lower-risk domestic gamblers, think your aunt or uncle, has been squeezed by rising cost of living pressures and falling discretionary spending. It really has been a double whammy.

It's hard to know whether Star will be able to get out of this pickle, but investors may well see the company as a bit of a canary in the coal mine. After all, Australia is not the only market where there are both cost of living pressures and well-funded, but sometimes shady high-roller customers. And if you're an investor thinking about these pressures, well you may be looking for a savior in the form of a brand new segment altogether. And that segment, my friends, is online gambling. Because in really key markets like the US, restrictions in online gambling, and online sports betting in particular, have eased. Back in 2022, my colleague SK Kim out of MSCI's Seoul office spoke to Mike about what was then the very recent rise of sports betting in the US. So three years later, I brought SK back to ask what this influx of new customers looking at new ways of gambling could mean for the industry, not just in the US but globally.

SK Kim

So online gambling has been legalized for a while, even in the US where sports betting was legalized back in 2018. That's probably the year when many of the land-based casinos like the famous ones, the likes of MGM or Wynn Resorts, started to tap into this growing market in the US, and we had the pandemic in 2020. So those companies were heavily hit by lockdowns. It was inevitable for them to transition into online gambling. And that has been continued throughout the past few years. And currently many of the land-based casinos, they are actually expanding into online sports gambling businesses in the US.

It is much more accessible, high penetration of mobile phones. And we were talking about all developed markets, even Asia where you don't really have to be at the casino. You can always

access via apps that you can easily install from the app store. So I think that's one of the big game changer for the industry as a whole.

Bentley Kaplan

Right. So legalization of online gambling, sports betting, and the pandemic have built some serious momentum. And why this really matters is because customers now don't have to make any arduous journeys to a physical casino, because there's now an app for that. There's a bunch of apps. And even if you're not a seasoned gambler, you might be nodding along as I talk about the ease of laying a bet. Mostly because today you can't watch a game of American football, basketball, baseball, rugby, cricket, tennis, MMA, table tennis, darts, you name it, without seeing ads for betting. And these ads are friendly, they're fun. They can offer the first bet for free, and they probably have some of your idols smiling, barbecuing, and generally having an all-round good time. And before you know it, you'll find yourself explaining over-unders to a long-suffering spouse, pacing the lounge, chuckling about how the spread for Saturday's game is a joke, and finally, standing on the sofa shouting about why parlays aren't all that risky if you think about it. And traditional casinos that are looking to diversify their revenue might look at you with a great deal of enthusiasm.

But there's also a catch because if we look at the rise of online gambling through a sustainability lens, then a bigger market and a different medium also means different risks. As SK told me, gambling, gaming is a heavily regulated activity, and just because things have gone online doesn't mean that regulators have suddenly stepped back. And there are two key regulatory areas that I want to talk about today, and they're both going to be ones that investors are keeping an eye on. The first is the potential negative impact that gaming companies or casinos are having on their customers. Regulators want to know whether companies are taking steps to limit addiction. To prevent individuals from making ruinous bets and to prevent access for people below the legal age limit.

Those are just some aspects that fall under the broader umbrella of responsible gambling, and how well companies are managing these risks is something that we assess in our ESG ratings model under the product safety and quality key issue. For casinos and gaming companies, this key issue accounts for nearly one-fifth of their overall ESG rating. So it's a pretty big deal, at least as far as our model is concerned. And having controls in place to ensure that responsible gambling at a physical building like a traditional casino is one thing, but making sure that you're able to do this online is a whole other ballgame.

As SK told me, regulators in more mature online markets have already set expectations for how companies should be ensuring responsible gambling. But in markets where online gambling is relatively new, things are more fluid.

SK Kim

The status of the regulation or the history of the regulation is quite different. In the EU, especially UK, the regulation is pretty strict. So for example, the companies cannot advertise before 9:00 PM on TV shows, or they have to have spending limits, or they have to have cooling off time limits. In the US states have different levels of regulation in place. In general, the US regulation is relatively new, so there are still ways for the industry to utilize tactics that may not be allowed in the UK.

Bentley Kaplan

So companies that are moving into online gambling markets where regulations are still evolving may have a little sunshine in which to make their hay. But if trends line up with more developed markets, then stricter controls may well be in the pipeline, and it'll take a whole new set of expertise to do things like checking the age of a customer, or their financial stability, and traits linked to problem gambling through an online profile, then it would be to do all of that on the floor of a physical casino.

Now, I did mention that there's a second regulatory area that casinos and gaming companies have to navigate. And this is not so much the risk to customers, but rather from their customers. And this has to do with the way that criminally inclined customers will try and use casinos as a way to launder money from illicit activities.

Because the winnings that you take home from a casino, well, it's essentially clean, above-board money. Criminals with big stocks of illegal cash might well be thinking of different ways that they can bring this cash to exchange for chips or to wager. Because if they can do that, then when they cash out it becomes magically clean money with a receipt from a legitimate business.

Now, this risk of money laundering is nothing new for casinos, and it's a risk that has tripped up Star Entertainment, the Australian casino that we spoke about at the top of this episode. Allegations

focus on the use of intermediary companies, or junket operators, that bring international high roller gamblers to casinos or even to offsite VIP rooms where oversight of cash exchanges for chips may not have been as robust as regulators expected. But the allegations that Star is dealing with and the risk the industry has been facing for many years has been from physical customers entering physical casinos, moving gaming and gambling online makes things more convenient for customers, but potentially also for criminals. And as SK told me, tackling the online risks of money laundering is not going to be easy.

SK Kim

We call that know your customer. An acronym, it's KYC, right? It has always been an important aspect to consider for the government because money laundered via those type of gambling business can be problematic because it can be related to fraud, it can be related to human trafficking, it can be related to criminal acts. So that is clearly stated in all of the regulation, either online or physical. It doesn't matter. But it is true that identifying potential money laundering could be tricky just because it is done virtually. And probably that's the reason why there has been discussions around whether to accept cryptocurrency or not. The idea of cryptocurrency that has been part of the reason why it was controversial was because it is decentralized. So it is really hard to know where the source of the funds is.

Bentley Kaplan

Right. Know your customer. KYC. It feels like this is a requirement that has long underpinned the casino and gaming industry, or at least it's what's been expected of these businesses in a highly regulated environment. And look, it might be tempting to maybe know a little bit less about your customer if it means that they're going to gamble a little more than they can afford, or if they're going to do so with a lot of cash from a questionable source. But the downside risk of turning a blind eye is noteworthy, as we've seen. Fines potentially, but also in a worst case scenario, risking the key to the castle, a company's gaming license.

For investors that are assessing financial risks to one of these companies, well, sustainability data could come in pretty handy, especially as a new online market beckons. Assessing things like responsible gambling practices, for sure, but also data privacy controls, an increasingly important area for a virtual casino. And also the structures, practices and individuals that govern the company and what sort of history and track record a casino has when it comes to falling foul of regulators. All of these components fit together to make up a company's sustainability profile or its ESG rating.

And understanding all of this as an industry grows through a major transition may be a way to stack the chips a little more in your favor. That, or you could just blow on the dice for good luck and see where things land.

And that is it for the week. A massive thanks to SK for her take on the news with the sustainability twist. I also want to say thank you very much for tuning in. It's great to be back for a whole new year, and we look forward to bringing you some top shelf sustainability analysis and the occasional dry chuckle. If you like what we're doing, then let us know. Drop us a review, rate the show on your platform of choice, and tell a friend or colleague about this episode. Thanks again, and until next time, take care of yourself and those around you.

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