Old West Investment Management, LLC

July 10, 2019

Dear Investor,

As we begin the second half of 2019, very different messages are being sent by markets. The stock market is at an all-time high, arguably one of the richest markets in history, matched only by 1929 and 2000. The bond market is also at extremely high levels, which means interest rates are extremely low. Record high equity markets and record low interest rates present a dichotomy that has some of the greatest minds in investing totally perplexed. More on this in a moment.

If you recall my year end letter, it was entitled "Our Time Has Come." As you know, we have underperformed the market over the past few years as we refuse to drink the Kool-Aid and chase ridiculously valued over-hyped stocks. It has been difficult being a value-oriented investor in a world of FAANG (Facebook, Apple, Amazon, Netflix, Google) infatuation, but we will not change our stripes and ignore basic financial analysis.

As you will see in your enclosed statement, we had an excellent first half of the year. The second half of the year might finally separate value-oriented fundamental stock pickers from invest blindly index investors.

So, who has it right, the bond market or the stock market? I will tell you over the long run bond investors have displayed much better forecasting skills than equity investors. The U.S. bond market is expensive with very low yields, but nothing compared to Europe and Japan. There is more than $13 trillion of worldwide sovereign debt yielding less than zero. That's right, borrowers have to pay many of the world's central banks to hold their money. Never before in the history of man have there been negative interest rates. Just the concept totally confounds me. So, what does this mean? It sends a strong signal that the world is headed for much slower growth, or very possibly a recession.

As I have said before, our President is obsessed with the stock market, and he desperately wants to avoid a recession before the 2020 election. Rightfully so, as a recession and stock market downturn could hand the Democrats the election on a silver platter. I thought the market was expensive when Trump was elected, only to watch it go up another 25%. I give him and his administration a lot of credit for creating a more business friendly environment and lower taxes. However, this economic recovery and stock market run are in their eleventh year, and it won't be easy making it another sixteen months to the next election.

Central banks around the world stand ready to come to the rescue of slowing economies. What is frightening about today is interest rates are already low, so central banks have little room to cut rates. That means they will revert to quantitative easing (QE), where they manipulate the once free market in interest rates, and deeper we go down a dark hole. I can give you no better reason why we have stubbornly maintained a large weighting to gold mining companies. You are about to be richly rewarded for owning these companies.

The Fed and other central banks around the world have deemed a 2% inflation rate as desirable. This is groupthink at its worst. What is wrong with 1% inflation? What is wrong with no inflation? Our country had an extended period of no inflation in the late 1800's to early 1900's and there was tremendous growth and prosperity. In fact, going back 500 years, the average inflation rate is 1% and the average interest rate is 6%. This is why I am alarmed by the Fed manipulating free markets to achieve spurious goals.

There is another negative consequence of artificially low interest rates, and that is excessive risk taking and inflated markets. You have seen many IPOs the last few quarters which is very reminiscent of 1999-2000. There were 62 IPOs in the second quarter, raising $62 billion. That's the second most since 2000. Uber, Lyft, Chewy, Slack, and Beyond Meat all went public. Beyond Meat's share price went up 500% since the IPO. New IPOs to come are WeWork, Peloton, and Postmates. 80% of all recent IPOs are losing money, very similar to 99-2000. There is no doubt in my mind this is a bubble, fueled by low interest rates, and it will likely have an ugly ending.

One of our favorite screens for identifying new investment ideas is closely monitoring insider buying. When an insider at a company (corporate officers and directors) buys or sells shares they must file a Form 4 with the S.E.C. within 48 hours of the trade. On May 10 we noticed a Form 4 filed by Paul Salem, a board member at gaming and hospitality company MGM Resorts. Salem purchased $20 million of shares at $25 per share. In June, another board member, hedge fund manager Keith Meister, made a series of purchases totaling $127 million at an average price of $26.50. MGM's stock price had fallen from the mid 30's to the low 20's over the past two years, and clearly these two corporate directors saw something that Wall Street was missing. We decided to dig in and try to figure out what it is they might see.

## MGM Resorts International

MGM Resorts International (NYSE: MGM) owns and operates casino, hotel, and entertainment integrated resorts in the United States and Macau, an autonomous region on the south coast of China. When we first looked at MGM, shares were down 30% since their peak in January 2018. This was due to concerns over declining gambling revenue. Gambling revenue was decreasing in the United States because of self-cannibalization, as resorts were confined to a few areas with high concentrations of casinos, such as Nevada and Native American reserves. Gross gaming revenue had also been decreasing in Macau because of China's declining economic growth rate, implementation of strict gaming policies, restrictions on travel to Macau, and cross-border currency transactions. This past decline contributes to the upside potential in MGM stock because MGM China only accounts for about 15% of MGM's revenue and the self-cannibalization will soon be resolved by reason of a recent Supreme Court decision.

On May 14, 2018, in *Murphy v. NCAA,* the Supreme Court struck down the Professional and Amateur Sports Protection Act and granted states and governmental bodies the ability to make their own laws regarding sports betting and gambling. Many states—Nevada, Delaware, New Jersey, Mississippi, West Virginia, New Mexico, Pennsylvania, and Rhode Island—have already legalized gambling within their borders. And other states—Arkansas, Montana, Indiana, Iowa, and Tennessee—have legalized gambling in certain areas. Finally, on May 3, 2019, Washington D.C. legalized sports betting, setting a precedent for additional states to act.

As states legalize gambling, MGM is prepared to take advantage of the opportunity to expand geographically. On January 18, 2019, MGM gave Keith Meister, Managing Partner and CIO of Corvex Management LP, a board seat and formed the real estate committee to evaluate MGM's real estate portfolio for domestic expansion. The committee consists of Meister, John Kilroy Jr. (CEO of Kilroy Realty Corp), and Paul Salem (Senior Managing Director Emeritus of Providence Equity Partners). This committee will evaluate land in states that have recently legalized gambling for acquisition and construction of new resorts. Building resorts throughout the United States will enable MGM to make gambling more local, particularly on the east coast.

MGM is also positioned to profit from the legalization of sports betting in the e-sports industry, which is growing at 26.7%. In 2018, MGM partnered with GVC Holdings PLC to form Roar Digital LLC, a sports betting and online gaming platform. Roar Digital will include land-based and online sports betting, online real money and free-to-play casino gaming, and major tournament and online poker. This will allow MGM to reach the rest of the US gaming market that may not have the time or means to travel to a resort destination.

We believe that the Supreme Court decision in *Murphy v. NCAA* and MGM's creation of real estate committee puts MGM in a position to take advantage of legalized gambling and expand across the United States. This will increase revenue, expand their market reach, and overcome the past slowing growth.

MGM has been in the capable hands of CEO Jim Murren for the past nine years. Murren owns 1.37 million shares of MGM stock, and he is known as one of the best operators in the business. MGM has a solid balance sheet, especially when compared to their main competitors Las Vegas Sands and Wynn Resorts. It is forecast MGM will produce more than $1 billion in free cashflow next year, and the company has close to a 2% dividend yield. All in all, we think MGM is an outstanding investment opportunity.

## **Summer Intern Program**

As some of you may know, we are now in the sixth year of our summer intern program at Old West. In year three, we posted a job description at my alma mater, USC, which turned out to be a great blessing for our company. The best and brightest in the investing business are often thought to attend schools such as The University of Pennsylvania's esteemed Wharton School, Harvard Business School, and the world renown school for investing taught at Columbia Business School, and for good reason. Investing legends such as Warren Buffet, Leon Cooperman, Bill Ackman, John Paulson and Ray Dalio hailed from these great colleges, and I would expect these academic institutions to continue producing great future investors.

Less talked about though, is the University of Southern California's Marshall School of Business, which has proven to be a "diamond in the rough" when it comes to churning out investment talent. Investing greats such as Bob Rodriguez (CEO, First Pacific Advisors) and Mark Stevens (Sequoia Capital), and rising stars like Carson Block (Muddy Waters Research) all attended USC's Marshall School of Business, and as the University's investment programs have gained esteem, legends such as Sheldon Stone (Co-founder, Oaktree Capital) and Stan Druckenmiller (Duquense Capital) have graciously given their time and talents to the University's investment programs.

In response to our intern posting for the 2016 summer, a number of undergraduate USC students submitted resumes. As a boutique asset manager, we unfortunately don't have the time or resources to teach the basics of investing, and the ideal intern candidate would be someone that already had the knowledge of a Business School graduate and had worked in the industry for several years. Seems impossible! Fortunately for us, we received a few resumes from students that were members of the USC Value Investing Group (VIG). We were so pleased with our interns that worked with us during that first summer that we have recruited from within VIG ever since.

For example, one of our interns during the initial 2016 summer was a young man by the name of William Andreasyan. When William came to interview with us in May 2016, we handed him several of the essential books that any aspiring investor should read such as Seth Klarman's *"Margin of Safety"*, Joel Greenblatt's *"You Can Be a Stock Market Genius"*, Howard Mark's *"The Most Important Thing"*, and a few other essentials such as Warren Buffet's shareholder letters, etc. To my amazement, William had already read all of these classics, as well as several others. His passion and knowledge for investing was incredible, particularly for someone of his age.

Since that summer internship at Old West, William has gone on to intern at Chicago based Harris Associates (summer 2017) and San Francisco based ValueAct Capital (summer 2018). Harris Associates and ValueAct are two of the top investment firms globally, and I'd imagine that William was competing against thousands of applicants for his spot. During his senior year, William was a Portfolio Manager for the Marshall Undergraduate Student Investment

Fund, where he helped manage a small part of the school's endowment. William graduated this spring Summa Cum Laude with a 3.97 GPA, and he recently began his full-time career with Los Angeles based First Pacific Advisors, another globally renown investment company.

In addition to William, eight other summer interns have spent time with Old West's team throughout the past four summers. Each has demonstrated incredible passion for the business and a deep knowledge for analyzing businesses. I'm certain they will all have incredible careers, and I look forward to keeping in touch with each of them as we build our business.

This summer, we have one intern, Kate Donenfeld. Kate became interested in investing during high school while taking a linear algebra class, during which she applied linear algebra to finance and the stock market. As a freshman at USC, Kate was introduced to the Value Investment Group during the Marshall Club Fair, and she has immersed herself in the world of investing ever since. So far this summer, Kate has helped us work on several companies, one of which is MGM. Much of the work detailed in the above write-up is a result of Kate's countless hours of hard work. Thank you, Kate!

We thank you for being a loyal Old West client, and we look forward to a very successful second half of 2019.

Sincerely,

Joseph Boskovich, Sr.
Chairman and Chief Investment Officer