



The New Sportsbook in America

May 2018

The Vice Fund (VICEX) has been investing in Gaming, one of its four core industries, since 2002. We have focused on the potential for legalized sports betting in the United States since before the lawsuit of NCAA v. Christie was granted a hearing by the Supreme Court in 2016. The ruling on May 14, 2018, opens the door to a more robust, domestic sports betting market, and we are excited about the opportunity this presents to the companies we own in the Vice Fund.

What Happened?

The Supreme Court reversed the Third Circuit's en banc decision in favor of New Jersey, striking down the Professional and Amateur Sports Protection Act of 1992, or PASPA. The law was to freeze sports betting where it was in 1992 by limiting states ability to regulate it. Practically, this limited sports betting to Nevada (i.e. Las Vegas casinos) with exceptions in Oregon, Delaware, and Montana. The court declared that the method Congress used to make sports betting illegal was unconstitutional. This ruling removed the federal limitation from the books. Below, the conclusion of the ruling makes this distinction clear.

The legalization of sports gambling requires an important policy choice, but the choice is not ours to make. Congress can regulate sports gambling directly, but if it elects not to do so, each state is free to act on its own. Our job is to interpret the law Congress has enacted and decide whether it is consistent with the Constitution. PASPA is not.

--- Associate Justice Samuel Alito, *Murphy v. National Collegiate Athletic Association*

What does the ruling mean?

The ruling specifically notes that each state is free to act on its own. Many state prohibitions from pre-1992 are still on the books meaning that legalization will not happen overnight. However, given the potential tax revenues that sports betting can provide states, many states were already lining up to change their laws to allow sports betting. Pennsylvania and Connecticut passed laws regulating sports betting last year. According to analysts at Eilers & Krejci, 18 states are likely to introduce bills to regulate sports betting this year of which 12 have a strong chance of passing. Additionally, this changes the landscape for the major sports leagues presenting them with a tremendous opportunity to increase revenue and team value. Their responses were almost uniform.

- The largest betting sport in the United States is the National Football League. The NFL's statement called on Congress to pass laws that regulate sports gambling nationally for the "integrity of sporting contests."
- Major League Baseball said, "Our most important priority is protecting the integrity of our games."
- The National Basketball Association supported a federal framework for a uniform approach to sports betting for states that choose to permit it. However, they stated, "the integrity of our game remains our highest priority."

The term "integrity" is used in these statements. This is no accident. The leagues are angling to charge sportsbooks an "integrity fee". This is usually discussed as 1% of the bet (or hold) going to the league on every wager that is placed. Revenue varies, but for a sportsbook that sees 5% of the bet as revenue, this means that 20% of sportsbooks gross revenue would be going to the leagues. If the leagues are successful, the integrity fee will have a significant impact on the profitability of sports betting for casinos.

How much is at stake?

About \$4.2 billion was wagered on sports in Nevada during 2015. Beyond that, the estimates vary greatly. Economist Jay Zagorsky of Ohio State University compared wagering in Great Britain to the US and gave a quick back of the envelope estimate of \$67 billion. We believe this estimate as far closer to reality than some of the larger numbers tossed around in the wake of the Supreme Court's ruling. Yet even this smaller number is a significant windfall for the gaming industry.

Who wins?

The obvious winners are the casinos and existing sportsbooks, particularly those with operations in states that are likely to quickly move to legalize sports betting. We view Penn National Gaming (PENN) and Boyd Gaming (BYD) as beneficiaries given their heavy presence across these states. Among the larger casino operators, MGM is well positioned with such domestic operations. However, the real opportunity here is on the digital side. In our opinion, most sports betting will occur on your phone while you are watching an event at home or at the local sports bar. Regional and international casinos should be able to leverage their physical offerings with comps and incentives to make sure that bettors use their systems for sports betting. As a result, we would view any domestic casino operator as a potential beneficiary of the ruling.

Less directly, we expect media providers to benefit as well. Sports betting is likely to experience a bit of a land rush as sportsbooks and casinos vie for betting business. A likely boon to smaller sports blogs and websites, but also for larger outlets as significant spending on advertising should be expected. Disney's ESPN, Fox Sports, and Comcast's NBC Sports can potentially expect to see an uptick in ad revenue and more consistent viewership.

We will limit our thoughts on players that are less investable. The private online gambling organizations with the digital infrastructure in place to operate successfully abroad just gained legitimacy. They will need to move quickly to secure their positions domestically, and it is likely larger players will be prime candidates for acquisition. The leagues themselves just gained value without the

integrity fees as gambling strongly promotes interest in their sports. From a governmental perspective, this is a huge windfall for the states. They will tax gaming revenue. The increased tax receipts will likely to push states on the fence to change their opposition and expand the sports betting opportunity further.

Finally, this ruling is a win for states' rights. The ruling fractured the liberal side of the Supreme Court but its implications for other issues will likely have impacts to both liberal and conservative legislative agendas going forward. We would suspect that wide-ranging issues from sanctuary cities to cannabis decriminalization will have significant long-term impacts from this ruling.

Conclusion

The Vice Fund is positioned in Gaming as one of our four core industries. We have focused on this Supreme Court ruling as one of three major trends in gaming that should support growth in the space for the next five to ten years. The other two trends are continued growth in Macau, China, and the potential for legalized casino gaming in Japan. With this ruling, we feel strongly that our gaming investments are well positioned to outperform.

If you would like to know more about how we invest or have additional questions about the Vice Fund or USA Mutuals, please contact us at 1.800.MUTUALS, email at FA.sales@usamutuals.com or visit us at www.usamutuals.com.



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