

Inside ALPHA Investment Club

Weekly Alert

**Message sent on August 19, 2008 after
market close**

Trades to be executed at tomorrow Wednesday's open

**WE ARE CLOSING THE
BWTR TRADE AND
STARTING A NEW
POSITION IN LVS**

Inside ALPHA Conservative model portfolio

- Cover all Basin Water Incorporated (BWTR) shares at the open
- Sell short 100 shares of Las Vegas Sands Corporation (LVS) at the open, or the equivalent of 1/26th of today's closing account balance (rounding down)

Inside ALPHA Leveraged model portfolio

- Sell short 100 shares of Las Vegas Sands Corporation (LVS) at the open, or the equivalent of 1/13th of today's closing account balance (rounding down)

“Mental Stop” for Las Vegas Sands: \$65.00

Weekly Commentary: Even assuming record profits, Wall St. won't pay taxes before long

INTRODUCTION

Bloomberg's Henry Goldman and David Milken reported last Tuesday that, in New York City, the banks pay tax on 110 percent of earnings in advance as a "safe harbor", protecting against penalties of underpayment.

So what happens when most of the largest financial groups make dozens of billions in losses? Well, they seek refunds from the city on taxes they paid ahead of time, as those losses have cut their tax liability to zero.

As far as state taxes, sixteen of the New York state's largest banks sent taxes totaling \$5 million to the state treasury in the most recent reporting period, a 97 percent decrease from a year earlier, when they accounted for \$173 million in revenue, New York governor David Paterson said.

"YEARS BEFORE WALL ST. PAYS TAXES AGAIN"

"It will be a number of years before Wall Street starts paying taxes again", mayor Michael Bloomberg said at a press conference last week in Manhattan. "They will carry forward all of those losses".

Thus, New York City's deficits are projected to widen to \$2.3 billion in fiscal 2010 beginning next July, growing to \$5.96 billion and \$5.4 billion in 2011 and 2012, city comptroller William Thompson has said.

As for the state, it faces a \$26 billion deficit over the next three years and a \$630 million shortfall in the current year that began April 1, Paterson has said. The governor outlined \$630 million in administrative spending cuts he intends to apply this year, and he called upon legislators to cut at least \$600 million more later in August.

TWENTY YEARS WHEN ALL IS SAID AND DONE?

Financial firms posted \$501 billion in writedowns and credit losses worldwide since the start of last year, a figure the World Bank predicts may rise to \$1 trillion as the credit squeeze sparked by the subprime market collapse worsens; Nouriel Roubini even sees up to \$2 trillion in debt losses.

Companies such as Merrill Lynch are allowed to use current and deferred benefits to get refunds on taxes paid in the prior two years and to offset tax payments going forward for as long as two decades, said Robert Willens, president and chief executive officer of Robert Willens LLC, a tax consulting company in New York.

"They'll try to use that as quickly as they can", Willens said. "If you add up all of the Wall Street losses, you're talking about not paying taxes for five or six years easily". If we assume that Robert Willens' calculation is based on past numbers and that those losses may represent only 25% of the ultimate bill, then perhaps we will see Wall Street paying no taxes for the next twenty years, or until about 2030.

AND SIXTY IN THE UK!

The Financial Times event noted that "if Merrill's U.K. subsidiary were to continue to generate profits at 2006 levels, a record year for the investment banking business, it would pay no UK corporation tax for 60 years". Thus, until about 2070. How old will *you* be by then?

When asked at a press conference whether New York may consider asking public workers to pay more for their health insurance, Michael Bloomberg said it's a trend prevalent among private employers that the city's unions have fought.

"Anybody who thinks that the state and the city are not going to have to look at all these kinds of things to face the new economic reality is just making a mistake", he said.

CONCLUSION

Never mind the numbers; when Wall Street doesn't pay taxes for at least five or six years (resuming no earlier than 2014), it will be bad for cities, states and the government in general. The bad news is that cities, states and federal government were in a rather bad shape to begin with.

A simulation by Standard & Poor's (published in 2006) predicted that, at the current pace, France would get a junk bond rating by 2023 (only fifteen years from now), the U.S. three years later, followed by Germany (2029) and the UK (2034). In reality, it is highly unlikely that governments will allow debt and deficit burdens to spiral out of control.

Once governments are confronted with unsustainably rising debt burdens they do react, however reluctantly, by tightening the fiscal stance and/or reforming expenditure programs. The recent crisis might make this happen much faster than forecasted by S&P; looks like we're in for a few more difficult years...

This week's research: LVS appearing rather overvalued as ADRs plunge as much as 36%

INTRODUCTION

On Wednesday we will take a profit of more than 52% in just ten weeks as we close the Basin Water Incorporated (NASDAQ: BWTR) trade. On June 10, 2008 I wrote that I expected "to see the shares clearly under \$3 apiece before the end of the year". As I write this, we are even under \$2 per share, and it all happened rather fast. Let's be disciplined, take our profits and move on.

This week's pick is Las Vegas Sands Corporation (NYSE: LVS), a developer and owner of casino resort, mostly in Macao and Las Vegas. In preparing this week's report, I came across an analyst who thought, at the beginning of the month, that "Casino Stocks Scream Value Play".

The self-described "personal investor that manages a small family investment fund" bases this assumption on the fact that he is a "frequent visitor of Las Vegas, and in [his] most recent visit [he] noticed that, despite the recent poor performance of the share prices of such companies as MGM Mirage (MGM), Boyd Gaming (BYD) and Las Vegas Sands (LVS), every single casino was still just as crowded as ever".

JULY 14 CALL: BUY SUPPLIERS TO WATER UTILITIES!

The author, long BYD and MGM at the time of the writing (apparently he avoided Las Vegas Sands for some reason), thinks that, within twelve months, LVS should be trading around \$90 per share or more as "casino operators, in the midst of an American economic slowdown, are trading at levels that should make value investors salivate". We'll do the math and find out how valuable this "analysis" is.

But before we do so, it's important to see the analyst's track record. So I found out that on July 14, 2008, the trade of the day was to buy "companies that supply water utilities", like Basin Water. Good call! From \$4.36 on last July 14, BWTR traded all the way down to \$1.29 this month.

So I guess we should be thankful for such people, who will always take the other side of the trade; to tell the truth, we won't be alone shorting Las Vegas Sands, since more than 18% of the float was sold short as of last July 28.

"UNPRECEDENTED LACK OF VISITATIONS"

Those who are bearish about casino stocks cite convention business down almost 20% in Las Vegas, Californians (up to 30% of Vegas customers) deciding that the drive has become too expensive (perhaps around \$150) at current gasoline prices.

JP Morgan cited an "unprecedented lack of visitations" to Sin City, and airlines have cut their flights capacity to Las Vegas (and elsewhere), which obviously also limits people from visiting the gaming mecca.

As a result, average daily room (ADR) rates plunged 16% in June. In his survey of Strip room rates for the week of August 31 to September 6, JPM analyst Joe Greff found that ADRs were down a whopping 28% to \$149, including declines of 21% for weekdays and 36% for weekend stays.

MACAO IS GETTING CROWDED

An observer living around Vegas notes: "I've been receiving promotions from places like MGM that I haven't heard from in several years. \$69 a night during the week-days? But they should rot in hell. The Hawaiians have stopped coming, the Europe-

ans want to come, but the visa and security hassle is turning them away"; I can certainly vouch for that last remark.

"But Las Vegas Sands now makes most of its profits in Macao", I hear you say; correct, so let's take a look at this very market. Gambling has been legal in Macao since the 1850s, but the area really started to heat up in 2001 when casino licenses began to be offered to American operators.

The tiny territory, officially a Special Administrative Republic of China, is now home to about thirty casinos and has been dubbed the Monte Carlo of the Orient. However, as more and more gaming facilities push into this crowded market, it might be tougher for LVS to separate travelers from their dollars going forward.

BAD TIMING FOR SINGAPORE?

Sands president and chief operations officer William Weidner said in a recent CNN interview that the company saw a market share loss among high end clientele in the first quarter of this year; some are blaming this on, or assuming it could be due to the December opening of the MGM Grand Macao.

Last month, Hong Kong-born gambling magnate Stanley Ho announced plans to tear down his flagship Lisboa casino and hotel and build his biggest and most opulent showcase yet, at a cost of HK\$12 billion (US\$1.54 billion). The 86-year-old also pushed through a long-delayed initial public offering for the company he controls, SJM Holdings Ltd, raising \$494 million despite stock-market jitters.

To diversify, Las Vegas Sands is building a facility in Singapore that it plans to open by late 2009. But, as the Financial Times notes, "having reached stratospheric heights, the [Singapore] property market looks set to hit some turbulence that could produce an equally significant fall".

EARNINGS BEFORE ALL THE BAD STUFF

With more than 355 million shares out, the company is now worth more than \$16 billion as I write this. As of June 30, 2008, the net tangible assets represented only \$2 billion, up \$15 million over the last three months.

So far this year, LVS has lost six cents per share, versus a profit of 35 cents for the first half of last year. For the second quarter, cash flow from operations is a positive \$125 million, which translates into a half billion annualized. In a nutshell, one could say that Las Vegas Sands is valued by the market at its net tangible assets plus about 28 years of current cash flows.

Adjusted net income (excluding loss on disposal of assets, pre-opening expense, development expense and loss on early retirement of debt) was \$30.9 million, or adjusted earnings per diluted share of 9 cents; however, analysts were looking for 12 cents per share.

ANALYST MISS AN AVERAGE 58% DURING FOUR QUARTERS

That has been a disturbing trend with the Wall Street crowd covering the casino operator; looking at earnings before all the bad stuff, the consensus was for a \$1.14 profit per share during the last four quarters. The actual "adjusted" profits ended up being 48 cents, i.e. 58% worse.

Thus, if these same people now forecast an adjusted profit of \$1.08 for 2009, I guess that we shouldn't even expect half a dollar before the bad stuff. Add the bad stuff (e.g. the value of the Singapore and Las Vegas properties which seem to come crashing down) and we might even have losses into next year.

In the current environment, a fair value for most companies is at current net tangible assets plus six to eight years worth of current cash flows; for LVS, that translates into a stock price in the twenties or less.

CONCLUSION

From a low of \$30.56 last month, the shares have rebounded 94% on virtually no news; just because oil prices have taken a breather doesn't mean that the worst is over for the world economy.

My assumption is that this month's high might hold, but as an added security I am putting the "mental stop" a bit higher, for a potential loss of about 30%; the bet here is that we will see the stock make new lows this year, which would translate into a better than 40% profit in less than five months.

Because experience has taught us to be prudent, we will still assign a seven month time horizon to this trade; that should allow us to see how the company fares in the third and fourth quarters of this year; needless to say, I believe that the numbers will be rather ugly, and thus hope to see the market (and analysts) react accordingly.

Thanks for reading!

Warm regards,

Marc