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Macau Gaming Sector
A VIP-led recovery

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Rally in Macau gaming names took off in 2H16

Macau gaming share price performance and the key events during 2016

- UnionPay capped insurance products transaction
- Media reported new AML rule
- GGR is expected to resume positive growth in August
- GGR is expected to bottom on seasonally stronger mass-market
- Nov GGR is expected to accelerate from Oct
- SCMP reported new ATM cash withdrawal limit
- Macau proposed cash declaration rule
- Jan GGR +3% yoy
- Feb GGR +18% yoy

Source: DataStream, Credit Suisse Research
2017 outlook: Positioning for a VIP recovery

- **Room for key surprises for 2017:**
  - **(1) VIP-led recovery:** stronger system (junket consolidation completes), improved demand (asset and basic material prices recovery) and credit reacceleration from junkets are drivers.
  - **(2) Return of premium mass players:** mass hold rate jumped to the highest since 1Q15. Return of junkets has brought high-end players back to Macau.
  - **(3) Operating leverage:** we estimate GGR+1% drives +1.6% EBITDA & +3% earnings

- **We may be at the beginning of a new cycle:**
  - Macau GGR started to accelerate in 3Q16. Jan+Feb17 GGR grew 11% and March is on track to reach 15-17% based on market consensus.
  - We argue that we are just at the beginning of a recovery cycle which historically would last 1-2 years as the growth rate accelerates.
VIP driver: A heathier junket system

- According to CS estimates, **junket consolidation** is largely done with the top 5 junkets now controlling 85% of the VIP market.
- **Increased regulatory requirement** post the regulator audits (by DICJ and FAFT) has weeded out weaker and uncompetitive players over the past year.
- **Re-entering of mid-size junkets** is also a positive sign for sector recovery.
- A healthier system and a more rational competitive environment should bode well for a sustainable recovery of VIP revenue, in our view.

**Quarterly VIP revenue and growth trend**

**Macau Top 5 junkets’ aggregate market share (junket rolling chips volume)**

Source: DICJ, Credit Suisse estimates

Source: Credit Suisse estimates
VIP driver: Improved demand on asset prices inflation

China 40-city property prices YoY % chg - Overall

Source: National Bureau of Statistics, Credit Suisse Research

Coking coal prices (HCC-Hebei)

Source: Mysteel, CCTD

Thermal coal prices (QHD benchmark)

Source: Globalcoal, China Coal Mkt Network
VIP driver: Credit extension adds momentum

- After learning the lesson in the past downcycle, junket agents have been getting more prudent in credit extension. This helps improve the collection cycle and reduce bad debts.
- Credit play at junket system has fallen from 80% (1Q14) to below 40% now.
- **RMB depreciation and China capital outflow** further fueled liquidity injection in the junket system and improved working capital.
- We believe credit normalisation and its self-fulfilling momentum are drivers for VIP.

VIP revenue is still 50% below peak

Source: DICJ, Credit Suisse
Mass driver: VIP should lead premium mass

- The pool of VIP players is an **important source** of new players for the premium mass segment. This is because operators are not permitted to market casinos in China, and their ability to source new players is very limited and passive.
- Junkets play an important role due to their local network and knowledge.
- VIP junket agents **provide the infrastructure** for money transfer.
- As high-end players gradually return to Macau, which leads to a recovery in the VIP segment, this will should help stronger premium mass growth.

![VIP and mass shows strong correlation](image)

Source: DICJ, Credit Suisse estimates
Mass driver: Players’ quality also improves

Macau hotel RevPAR has gradually improved

Overnight visitor arrivals (as a % of Mainland visitor arrivals)

Proportion of visitors who have casino memberships in Macau

Gambling budget of members is 2.2x of non-members

Source: MGTO

Source: DSEC

Source: University of Macau

Source: University of Macau
Operating leverage: we estimate GGR +1% drives EBITDA +1.6% & earnings +3%

The potential margin improvement for the sector applying different growth rates, by assuming (1) gaming tax at 39% of GGR, (2) Commission and allowance fixed at 10% of mass revenue and 45% of VIP, and (3) fixed operating cost remaining unchanged.

### Sector EBITDA change sensitivity

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<th>VIP revenue growth</th>
<th>Mass revenue growth</th>
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Source: Credit Suisse estimates

### Sector earnings change sensitivity

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Source: Credit Suisse estimates
The beginning of a new cycle

- Change in VIP revenue growth seldom stays so stationary; this is due to the involvement of credit and trust in the junket/VIP system.
- It is interesting to note that while the YoY growth rate is not steady, the slope of the growth rate has generally been quite consistent.
- Each cycle normally lasts 1-2 years driven by opening/liquidity/policy.

Previous cycles are triggered by credit/liquidity, policy and particular junket incidents

Source: DICJ, Credit Suisse
Q&A Session
Disclosure Appendix

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**Neutral (N)**: The stock’s total return is expected to be in line with the relevant benchmark* over the next 12 months.

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*Relative benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock’s total return relative to the analyst’s coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the least attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2013, U.S. and Canadian as well as European ratings are based on a stock’s total return relative to the analyst’s coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the least attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian ratings are based on a stock’s total return relative to the average total return of the relevant country or regional benchmark; prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock’s absolute total return relative to the relevant country or regional benchmark, prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock’s absolute total return relative to the analyst’s coverage universe. For Australian and New Zealand stocks, the expected total return (ETR) calculation includes 12-month rolling dividend yield. An Outperform rating is assigned when an ETR is greater than or equal to 7.5%; Underperform when an ETR is less than or equal to 5%. A Neutral is assigned when the ETR is between 5% and 15%. The overlapping rating range allows analysts to assign a rating that puts ETR in the context of associated risks. Prior to 15 May 2015, ETR ranges for Outperform and Underperform did not overlap with Neutral thresholds between 15% and 7.5%; instead, Neutral ratings in operation from 7 July 2011.

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