

## Macau Gaming Sector

- Positive
- Neutral (unchanged)
- Negative

# Casinos starting to ban phone betting

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- Some casinos are now banning phone betting, which represents about 8% of annual VIP revenue
- Well-known mid-sized junket consolidating operations
- Expect lacklustre mass and further VIP consolidation in 4Q14; maintain Neutral

### ■ What's new

Despite the Macau Gaming Sector's recent strong run-up (+11% vs. the HSI in October), our latest on-the-ground research points to a further deterioration in Macau's VIP business. During our most recent trip, we learned that some operators are officially banning phone betting in their casinos and that one of Macau's top-10 junkets has started closing some of its VIP rooms. We stick with our view that VIP and mass-market fundamentals will likely deteriorate in 4Q14.

### ■ What's the impact

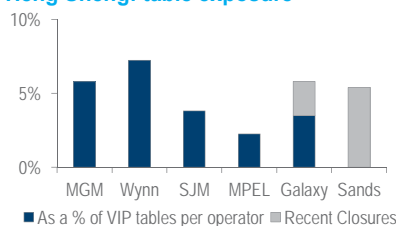
**Some casinos starting to ban phone betting.** Phone betting (also known as tele-betting) takes place in junket rooms and involves bets being placed by a player over the phone through a trusted proxy (usually a junket agent) who is physically at the

gaming table. Junkets usually require phone bettors to make their bets from a private table and require the player to commit a minimum of HKD1-3m in gaming capital. Based on our latest conversations with junkets and other industry participants, phone betting accounts for around 8% of annual VIP betting revenue in Macau.

While phone betting is technically legal in Macau, it is illegal in some other jurisdictions, such as China. We have found out that some casinos in Macau have recently begun banning phone betting – a development that will likely contribute to continuous VIP revenue weakness that we expect for the coming months.

**Another round of junket consolidation in sight.** In our recent sector report (*2015 to be much worse than 2014*, 10 October 2014) we noted that Heng Sheng, one of Macau's top-10 junket operators, with around a 5% market share, plans to consolidate its business. We have now learned that this junket operator recently closed its VIP rooms at Sands Cotai Central, The Venetian and Galaxy Macau (roughly one-third of its table capacity). These closures affect 3% and 5% of Galaxy's and Sands' VIP tables, respectively. We expect further room closures of Heng Sheng at the other flagship casinos in the coming months.

### ■ Heng Sheng: table exposure



Source: Daiwa

This development supports the VIP segment-specific pressures that we have been highlighting for 4Q14 (including junkets likely falling short of minimum table betting volumes, rising bad debts, and tight credit). We expect VIP segment pressures to persist in 4Q14. Signs to watch for include: 1) potential junket commission and table rolling minimum revisions, 2) VIP table reductions per junket, and 3) further consolidation among junket operators.

**Mass-market segment showing weaknesses.** We noted in a recent report (*Emerging trends largely negative*, 22 October 2014) that new players' sign-ups for casinos' own rewards clubs were lacklustre during Golden Week, which is typically a good leading indicator of mass-market performance in the subsequent months post the peak season. The premium mass hosts we spoke with have cited weak mass-market activities post-Golden Week, supporting our view.

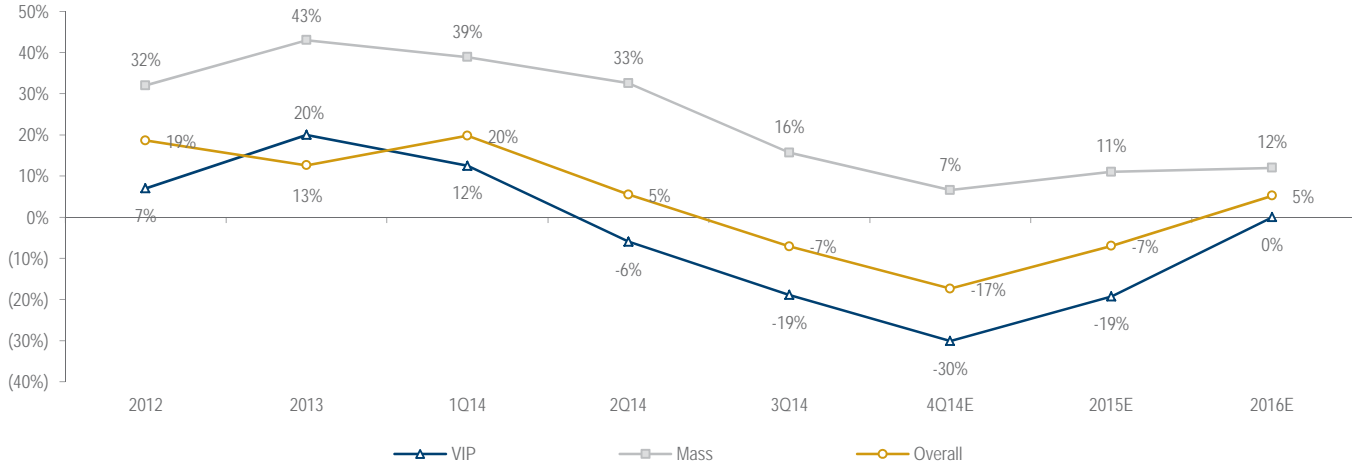
### ■ What we recommend

The underlying trends we observed on our most recent trip support our investment thesis, and thus we maintain our Neutral sector rating. We continue to prefer operators with more defensive cost profiles, and hence **SJM** (880 HK, HKD15.92, Outperform [2]) and **MGM** (2282 HK, HKD23.25, Outperform [2]) remain our top picks.

### ■ How we differ

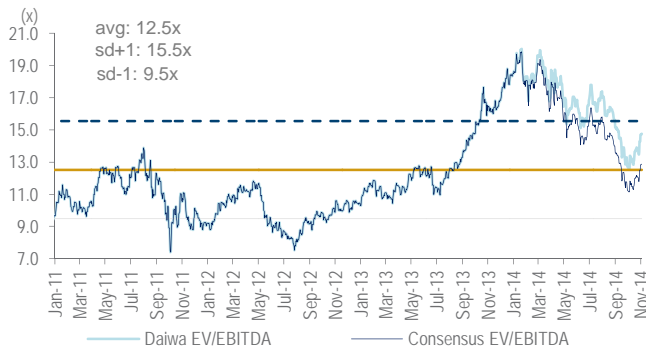
While the market as a whole seems to favour supply-side-driven growth, our stock picks are based on cost defensiveness.

■ **Macau Gaming Sector: 2012-2016E GGR growth expectation by segment**



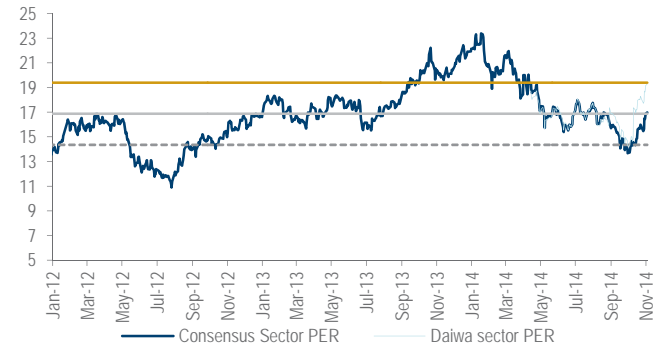
Source: APG, DICJ, Daiwa forecasts

■ **Macau Gaming Sector: EV/EBITDA multiple (Daiwa forecasts)**



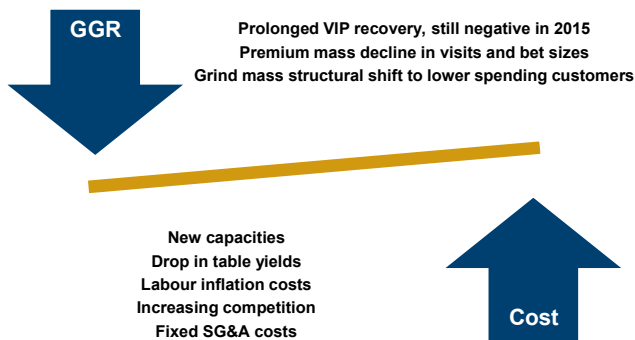
Source: Bloomberg, Daiwa

■ **Macau Gaming Sector: weighted-average 12-month forward PER (x) (Daiwa forecasts)**



Source: Bloomberg, Daiwa

■ **Macau Gaming Sector: 2015E operating leverage**



Source: Daiwa

■ **Macau Gaming Sector: simplified analysis of forecasts**

	2014E (rebased to 100)	2015E	YoY change
<b>GGR</b>			
VIP	60.0	48.9	-19%
Mass	40.0	44.6	11%
<b>Total</b>	<b>100.0</b>	<b>93.5</b>	<b>-7%</b>
<b>EBITDA</b>			
VIP (10% margin)	6.0	4.9	-19%
Mass (35% margin)	14.0	15.6	11%
<b>Total</b>	<b>20.0</b>	<b>20.5</b>	<b>2%</b>
<b>Cost Inflation</b>			
Wage inflation*	8.5	11.5	35%
Advertising and promotions**	3.0	3.7	25%
SG&A	22.0	22.7	3%
<b>EBITDA (cost inflation adjusted)</b>	<b>17.5</b>	<b>16.1</b>	<b>-8%</b>

Source: Daiwa forecasts

Note: \* 7-10% of GGR in 2014E, 20% YoY increase + incremental hiring for new property in 2015; \*\* from 3% of GGR to 4% of GGR

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