

## A meaningful recovery in sight

- We expect GGR to improve from late July on fewer junkets with increased liquidity plus a reversion of capital to side-betting
- Based our proprietary research, we assess junket quality and the impact of the upcoming smoking ban, by property and operator
- Reaffirm Positive call and upgrade 4 stocks; now all Buys; new ranking order: Galaxy, MGM, Sands, Melco, SJM and Wynn

## Macau Gaming Sector

- Positive (unchanged)
- Neutral
- Negative



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### ■ What's new

Based on our proprietary research, we now believe the worst is over and GGR could recover from late July, earlier than the market expects.

### ■ What's the impact

We pin our argument on 3 factors: 1) the consolidation in the junket market appears to be mostly over, 2) more liquidity is now being injected into the junkets, and 3) a reversion to side-betting capital, now that the World Cup is almost over.

**1. Junket consolidation.** Due to months of capital outflows and a liquidity squeeze on the junkets, our research indicates that at least 15 junkets have ceased operating.

### ■ Junket closures by operator

Junkets closed		Junkets closed	
Galaxy	0	Sands	5
MGM	1	SJM	3
Melco Crown	3	Wynn	3

Source: Daiwa estimates

**2. Resumption of junket liquidity.** Recent data points lead us to believe that the worst is over in terms of the liquidity squeeze, and that the smaller junkets are expecting fresh capital to be injected by end-July. During our recent Macau trip, we learned that, among the larger junkets, the capital previously withdrawn by key junket principals could be redeployed soon.

**3. Side-betting and World Cup.** We understand that 30-50% of the total capital previously used for side-betting was allocated to sports-betting during the World Cup (more profitable). This indirectly affected the credit available to a number of junkets, which found it hard to extend credit during the last week of the football. We expect a strong reversion of capital to side-betting once the World Cup ends on July 14.

**Junket exposure.** Our research indicates SJM Holdings (SJM, 880 HK, HKD19.56, Buy [1]), MGM China (MGM, 2282 HK, HKD27.55, Buy [1]), and Galaxy Entertainment Group (Galaxy, 27 HK, HKD62.65, Buy [1]) have the highest exposure to quality junkets. Thus, we think they have more stable rolling volumes vs. peers.

### ■ What we recommend

**2Q14 preview.** We forecast sector EBITDA growth of 19% YoY (-5% QoQ), or 2% higher than the consensus. Share prices could dip as a result of sequential declines in EBITDA. Results start in late July.

**New stock rankings.** To factor in 1) the expected recovery in VIP rolling, 2) the operators' exposure to quality junkets, and 3) earnings risk from the smoking ban to be implemented in October, we raise our 6-month target prices for: 1) Galaxy, to HKD76.40 from HKD66.60, 2) Sands China (Sands, 1928 HK, HKD57.55, Buy [1]), to HKD67.70 from HKD66.60, and 3) MGM, to HKD32.80 from HKD29.50. We cut target prices for: 1) Wynn (1128 HK, HKD29.75, Buy [1]), to HKD34.60 from HKD35.80 and 2) SJM, to HKD22.90 from HKD24.70. Galaxy, MGM, SJM and Wynn are now Buys.

Thus, our new ranking is: Galaxy, MGM, Sands, Melco Crown Entertainment (Melco) (MPEL US, USD33.49, Buy [1]), SJM and Wynn (previously: Sands, Melco, SJM, Wynn, Galaxy and MGM). The key risk to our Positive sector call would be unexpected policy risks.

### ■ How we differ

We may be one of the few to expect an early GGR recovery and evaluate the VIP business on junket quality.

### Key stock calls

	New	Prev.
<b>Galaxy Entertainment Group (27 HK)</b>		
Rating	Buy	Outperform
Target	76.40	66.60
Upside	▲ 21.9%	
<b>MGM China Holdings (2282 HK)</b>		
Rating	Buy	Outperform
Target	32.80	29.50
Upside	▲ 19.1%	

Source: Daiwa forecasts.

*Sector stocks: key indicators*

Company Name	Stock code	Share Price	Rating		Target price (local curr.)			EPS (local curr.)					
			New	Prev.	New	Prev.	% chg	FY1			FY2		
								New	Prev.	% chg	New	Prev.	% chg
Galaxy Entertainment Group	27 HK	62.65	Buy	Outperform	76.40	66.60	14.7%	2.946	2.946	0.0%	3.998	3.998	0.0%
Melco Crown Entertainment	MPEL US	33.49	Buy	Buy	40.00	40.00	0.0%	1.729	1.729	0.0%	2.026	2.026	0.0%
MGM China Holdings	2282 HK	27.55	Buy	Outperform	32.80	29.50	11.2%	1.721	1.721	0.0%	1.770	1.770	0.0%
Sands China	1928 HK	57.55	Buy	Buy	67.70	66.60	1.7%	0.434	0.434	0.0%	0.518	0.518	0.0%
SJM Holdings	880 HK	19.56	Buy	Outperform	22.90	24.70	(7.3%)	1.476	1.476	0.0%	1.616	1.616	0.0%
Wynn Macau	1128 HK	29.75	Buy	Outperform	34.60	35.80	(3.4%)	1.704	1.704	0.0%	1.863	1.863	0.0%

Source: Daiwa forecasts

## VIP GGR recovery

*We expect VIP GGR to have remained weak for the first 2 weeks of July and to begin a recovery in late July.*

### What we expect

Our argument that the VIP GGR recovery will happen earlier than the market expects is three-fold: 1) junket consolidation is largely over, 2) a resumption of liquidity in junkets, and 3) a return in side-betting capital into the system post the World Cup.

### Junket closures mostly over

The past few months of well-documented (by us and the media) capital outflows and the liquidity squeeze among junket operators have prompted a rapid consolidation of junket operators by weeding out some of the smaller and lower-quality junkets. We have identified that at least 15 junkets have ceased operations among the properties operated by the 6 gaming operators that we cover. We have also learned that a few other non-performing junket operators are also planning to close; however, consolidation largely seems over at this point.

#### ■ Macau Gaming Sector: estimated junket closures by operator

	Junkets closed
Galaxy	0
Melco Crown	3
MGM	1
Sands	5
SJM	3
Wynn	3

Source: Daiwa

During our most recent visit to Macau last week, we continued to observe vacant junket rooms and tables at Wynn (at least 14 tables) and Melco (at least 8 tables at City of Dreams). Wynn and Melco have also experienced the highest junket closures, just behind Sands (at 5). Sands saw the highest number of junket closures, driven largely by its aggressive table shifts to mass-market and the imposition of stringent know-your-client (KYC) policies by the operator on the junket operators earlier this year.

### Junket liquidity set to resume

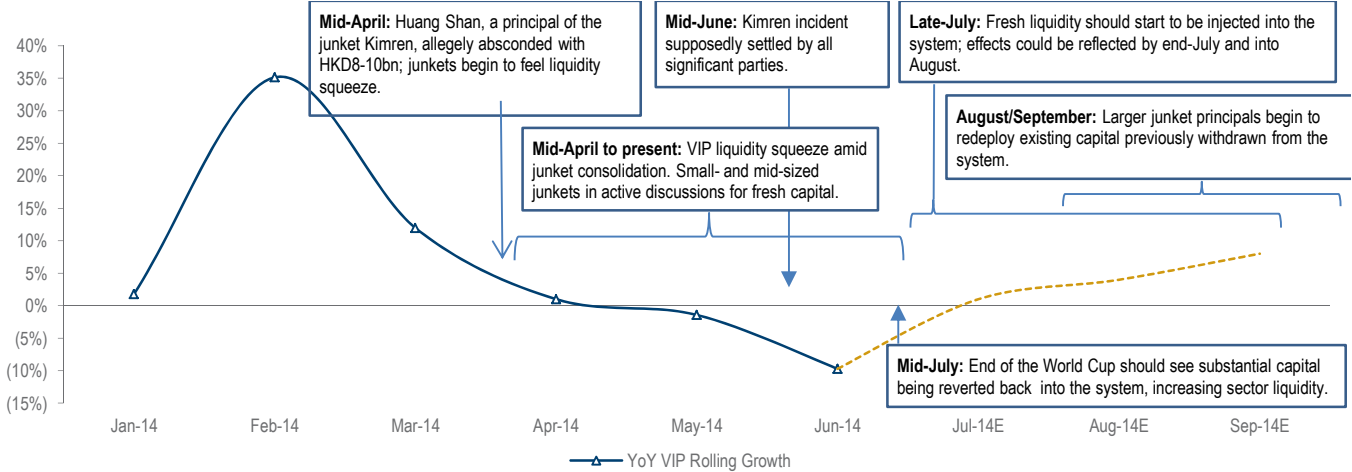
**The worst is likely behind us.** Since the Kimren incident (a principal of this relatively small junket operator allegedly absconded with HKD8-10bn) in mid-April 2014, our talks with industry participants indicate that small- and mid-sized junkets have already been in talks to obtain fresh capital.

Our market research indicates that it usually takes at least 2-3 months for new capital to be deployed at the junket level, which suggests to us that we could see a positive impact on VIP GGR as early as the end of July.

Furthermore, during our recent trip to Macau, we learned that the larger key junket principals withdrew capital from the junkets at the end of May and are now beginning to consider putting funds back into the system. We may see the effects of this in August and September.

We maintain our view that the current VIP GGR softness is a supply issue (ie, liquidity) rather than a demand (ie, customer) one. As such, we expect the injection of liquidity into the junkets to drive the VIP GGR recovery over the next few months.

■ **Macau Gaming Sector: Daiwa's timeline for a recovery in VIP rolling**

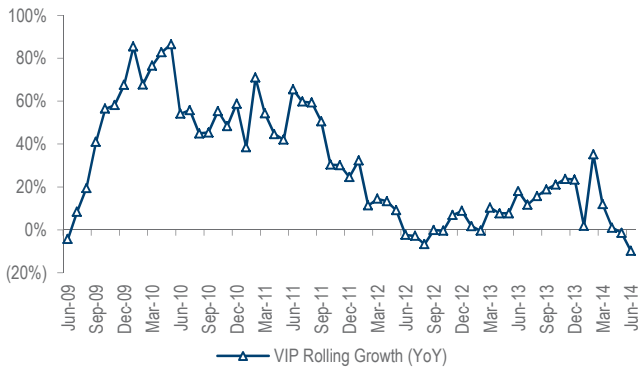


Source: APG, Daiwa forecasts

**Impact of the World Cup**

**Understanding the impact of the football tournament on Macau gaming.** We believe that the impact of the World Cup on VIP GGR has been widely discussed, but not fully explained. Since the World Cup started last month, VIP rolling has declined by 9.7% YoY, marking the largest single-month year-on-year drop for the past 5 years.

■ **Macau Gaming Sector: VIP rolling (YoY)**



Source: APG, Daiwa

We believe the visible decline in VIP rolling in June was driven by the reallocation of side-betting capital into sports betting (as high as 30-50% of the total side-betting capital, based on our market research).

**Sports betting versus side-betting (illegal gaming betting arrangements with a third party).** We believe this reallocation has been driven by 3 distinct factors offered by sports-betting: 1) a lower agent rebate, 2) better spreads/payouts, and 3) a lower risk of collusion/match-fixing between parties.

■ **Macau Gaming Sector: economics of side-betting and sports betting**

	Agent Rebate	Payout ratio	House edge/odds
VIP side-betting	1.8-2.6%	97.5% of bet*	2.85%
Sports betting	1.8-2.0%	80% of bet**	> 2.85%

Source: Daiwa

Notes: \*Assumes 50:50 bets between player and banker. \*\*Average payout ratio

**Anecdotal support for World Cup impact.** Talk in the market indicates that even some larger side-betting enterprises are turning away business from players looking to place large side-bets because there is less credit in the system. We think this provides further evidence of how capital-strapped the side-betting enterprises are, even among the larger businesses.

This draw on capital has also had an effect on the operations of the junket operators, a number of whom had very limited ability to extend credit to players during the last weeks of the World Cup.

We estimate that the Macau side-betting business is 3-5x larger than Gaming Inspection and Coordination Bureau of Macau's (DICJ) reported VIP rolling average. This betting volume requires significant capital investment and the diversion of this capital has a profound impact on overall VIP liquidity. As such, this shift in capital has led to: 1) a further decline in exercisable capital in an already capital-constrained environment, and 2) less motivation for industry participants to drive business, and 3) a consequently natural decline in player flow and betting activities.

Also, during our visits, we learned that VIP gamers are not betting for as long and a lot of them have been focusing on watching the football, when they would usually be gambling.

## Assessing junket quality

Given the past 3 months' junket consolidation and VIP liquidity squeeze, it seems increasingly important to understand operators' junket exposure.

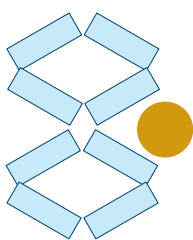
### Classifying the junkets

Junkets can be classified according to 3 broad spectrums: quality, established, and aggressive.

**From quality to risk.** Under our classification, both quality and established junkets have 1) a longer history in Macau, 2) established branding, and 3) a permanent gaming table presence in multiple properties.

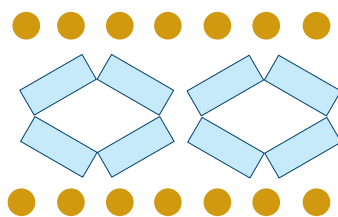
Aggressive junkets would be operators with 1) smaller operations, 2) no established branding, and 3) high agent/player rebates. These smaller operations are usually junkets with a smaller table presence at only 1-2 properties and even smaller junkets that "share" gaming tables in order to collectively meet the necessary minimum table requirements.

#### Types of small junkets



Type 1:

Junket operators with presence in 1 to 2 properties, have dedicated table counts and are responsible for the tables' rolling minimums



Type 2:

A number of smaller junkets set up counters beside a cluster of gaming tables. Each of these junkets operates independently but collectively contributes to fulfill the minimum table rolling requirements

#### Legend

 Gaming Table

 Junket Operator

Source: Daiwa

#### Junket classification

##### Characteristics

	Characteristics
<b>Quality</b>	Industry leaders characterised by: 1) having a large customer base, 2) being well capitalised, and 3) having high sustainable rolling volumes. On a per-table basis, gaming tables operated by these junkets typically achieve up to 100% higher per-table rolling than the other operators.
<b>Established</b>	Large/mid-sized junkets characterised by: 1) having a sustainable capital base, 2) having an affiliation with one of the larger junkets or working in a consortium with other similar sized junkets, and 3) having average rolling volumes. Usually possess certain branding power, an established history of operations in Macau, and a presence in multiple casino properties.
<b>Aggressive</b>	Small/mid-sized junkets (less than 30 tables across all properties) which are typically characterised by: 1) having a lower capital base, 2) more volatile rolling volumes, and 3) higher agent/player commission as means of attracting business. Qualitatively, these junkets usually have a much higher risk appetite with small-scale operations (small presence in only 1-2 properties) and no established branding.

Source: Daiwa

Aggressive junkets represent the riskiest slice of VIP rolling, typically offering very high rolling rebates to agents as a means of attracting businesses. Among these smaller junket operations, agent rebates can account for most of the commission the junket receives from the casino operators. These aggressive junkets' low-margin business, poorer capital base, and high capital risk put them at much higher risk of closures in the event of any future crisis.

#### Junket economics

	Junket commission (as % of rolling)	Agent/player rebate (as % of rolling)	% of commission retained by junkets
<b>Quality and established junkets</b>	1.25%	0.9-1.1%	12-28%
<b>Aggressive junkets</b>	1.25%	1.2-1.25%	nil to 5%

Source: Daiwa

## Operators' exposure to quality and risk

We attempt to break down VIP rolling exposure by junket type for each operator in an attempt to measure each operator's exposure to risk.

This is quantified by extrapolating operators' VIP rolling exposure by examining: 1) table exposure by junket, 2) table exposure by operator, and 2) estimated table rolling per junket operator.

#### Estimated VIP rolling per month

	VIP rolling per table per month	Market share*
<b>Quality</b>	HKD400-600m	40%
<b>Established</b>	HKD250-400m	40%
<b>Aggressive</b>	HKD200-250m	20%

Source: Daiwa

\* Figure excludes SJM's satellite casinos

Based on our analysis, VIP rolling in order of quality (highest to lowest) by operator is SJM, MGM, Galaxy, Sands, Wynn, and Melco.

Our bottom-up analysis roughly supports the difference in rolling decline witnessed by the respective operators over the past 3 months if we strip out the

effects of: 1) last year's irregular base effects, and 2) prominent table shifts between VIP and mass.

■ **Ranking by junket quality vs. 2Q14 YoY rolling decline**

Ranking	Operator	Rolling YoY Growth (2Q14)	Comment	Not e
1	SJM	1%	Considerable exposure to Macau Golden Group, a junket in which Angela Leung On Kei (Macau entrepreneur, Macau Legco member and wife of Stanley Ho) is a partial shareholder	
2	MGM	-14%	High table exposure to Guangdong Neptune Group	(1)
3	Galaxy	25%	Very tight working relationship with Suncity and high table exposure to junkets	(2)
4	Sands	-17%	Lower table exposure to top tier junkets but has high table exposure to a higher number of established junkets	(3)
5	Wynn	-13%	Lower table exposure to top tier junkets but has high table exposure to a higher number of established junkets	(4)
6	Melco	-20%	Higher exposure to smaller junket/ junket counters especially in the Altira (Macau Hotel)	(5)

(1) High base effect in 2Q13 with the addition of a key junket, MGM rolling increased by 34% YoY in 2Q13 v industry's 11% YoY; effects of some table shift from VIP table to mass

(2) 7%YoY/ 5%QoQ table shift from mass to VIP in 2Q14

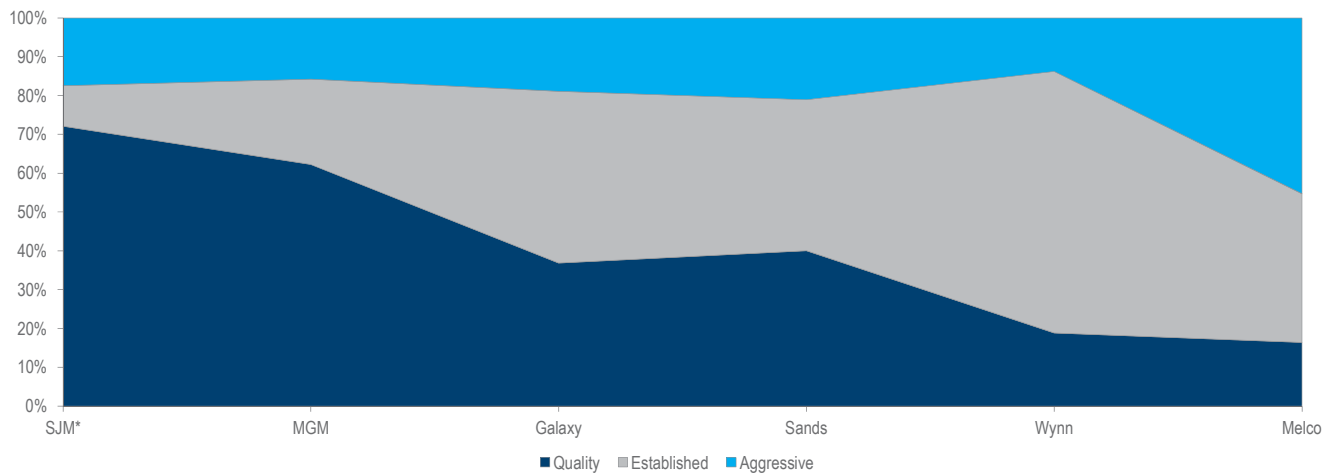
(3) 25% YoY/5% QoQ decline in VIP table count in 2Q14

(4) 7% YoY/5% QoQ decline in VIP table count in 2Q14

(5) 15%/flat YoY/QoQ decline in VIP table count in 2Q14

Source: APG Daiwa

■ **Junket rolling exposure**



Source: Daiwa

\* Figure excludes SJM's satellite casinos

## Impact of upcoming smoking ban

*Smoking will be prohibited on mass gaming floors beginning in October 2014; we assess this impact by property.*

### Details of smoking ban

On 15 May 2014, the Macau Government announced that all casino mass-gaming floors would have to impose a total smoking ban with effect from 6 October this year. On mass-gaming floors, however, smoking will be allowed in designated non-gaming airport-style smoking lounges. Casinos that do not assign designated smoking rooms by 6 October will see a complete smoking ban on their mass floors (so will not even be allowed designated smoking areas on mass-gaming floors). Private gaming areas (which are loosely defined as private gaming rooms with a membership mechanism) are not affected by this decision; the exemption currently includes junket VIP and direct-VIP rooms.

Casino operators are generally supportive of the decision and are planning the necessary changes to their casino floors to comply with the new smoking requirements.

### Premium mass areas to permit smoking

The big overhang with this smoking ban is whether high-limit premium mass areas will constitute “private gaming areas”, which would then also allow smoking.

This issue is especially important given that premium mass-market gaming represents the highest margin gaming business in Macau.

#### ■ Industry EBITDA margin by segment

Segment	EBITDA margin
VIP	7-12%
Mass	25-35%
Premium mass	35-45%

Source: Daiwa estimates

Our recent talks with casino operators suggest that premium mass areas will indeed be classified as private

gaming areas and will permit smoking. Elements of these premium mass gaming areas may include: 1) cash gaming chips unique to the premium mass areas, and 2) invitation-only/members-only access.

Design works are in progress at various casinos to install new glass walls or other enclosures to segregate the regular mass from the premium mass areas.

### Impact of smoking ban on properties

We continue to believe a ban on smoking is unlikely to deter Mainland visitors from gaming. The Macau casino operators we spoke to believe the ban in Macau is unlikely to have as much of a material adverse impact on GGR as it did in the US and Australia (which saw overall gaming revenue decline by an average of 12% the first year ban was implemented).

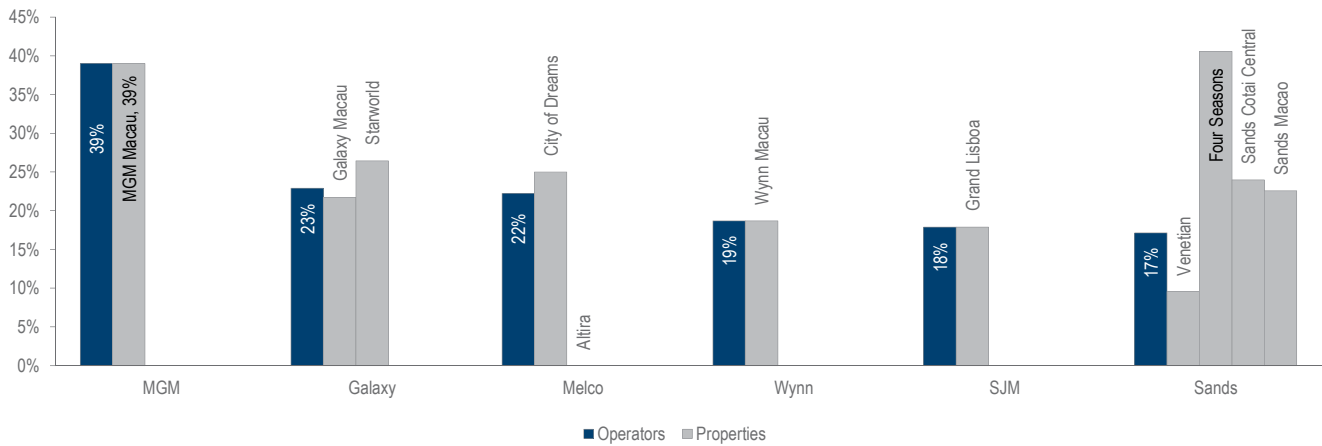
Despite this, we do believe it is important to identify which properties’ gaming revenue may be most at risk to the smoking ban. Our findings suggest that MGM Macau, Galaxy Macau, and Wynn Macau would face the least risk from the smoking ban. The properties facing the highest risks are Sands Macau and SJM’s self-operated/satellite casinos. This conclusion is reached by examining:

**The feasibility of setting up non-smoking areas by property.** Implementing the smoking ban by October represents a tight deadline for the operators. This is the case even for the newer properties in Cotai, which already have the supporting infrastructure installed for this transition. Some casinos will be unable to install airport-style smoking lounges in time, given their lack of a supporting infrastructure, and may therefore face a complete smoking ban.

**Exposure to the grind mass market.** The implementation of a smoking ban on general mass floors could pose a certain risk to the GGR for a property. These grind-mass players will have to resort to smoking in the airport-style smoking lounges set up near the mass gaming areas, which means the operators could lose gaming revenue.

**Exposure to premium mass gamers.** For the premium mass market, tables and areas can be set up to operate in enclosed areas which would allow smoking. As such, properties with higher premium mass exposure face less risk on GGR from October’s smoking ban.

■ Exposure of premium mass table on mass floor by property and by operator



Source: APG, Daiwa

■ Risk assessment of the smoking ban by property

Risk	Casino	Operator	Rationale
Low	MGM Macau	MGM	Highest exposure to premium mass market; elevated premium mass floor can be readily enclosed by glass walls.
Low	Galaxy Macau	Galaxy	Has among the highest exposure to premium mass tables; elevated premium mass floor can be readily enclosed by glass walls.
Low	Wynn Macau	Wynn	Gaming areas are already physically separated by low partitions; sections of the mass-gaming floor can be readily enclosed by glass walls.
Low	Starworld	Galaxy	Low exposure to mass gaming.
Low	Four Seasons	Sands	Low exposure to mass gaming.
Medium	City of Dreams	Melco	Has among the highest exposure to the premium mass market compared with peers, but high ceilings and open mass floor setup increases the difficulty of conveniently enclosing areas for premium mass
Medium	Sands Cotai Central	Sands	Lower-than-peer exposure to the premium mass table mix but segregated premium mass areas can be easily enclosed.
Medium	Grand Lisboa	SJM	Lower-than-peer exposure to the premium mass table mix; current premium mass area can be easily enclosed, but spacing is limited. Mass gaming floor ceiling is too high to be conveniently enclosed for smoking lounges.
Medium	The Venetian	Sands	Has among the lowest exposure the premium mass table mix; open gaming floor and high ceiling is difficult to conveniently enclose premium mass areas. Has among the largest gaming floor area which can be reshuffled and optimised.
Medium	Altira	Melco	Low exposure to mass market; but existing VIP area structurally difficult to enclose or wall off.
High	Sands Macao	Sands	Open gaming floor and high ceiling is difficult to set up smoking lounges conveniently or to enclose premium mass areas.
High	Satellite casinos	SJM	At risk of facing a total smoking ban; aging properties at risk of not having the necessary infrastructure to support airflow requirements for smoking lounges. Low premium mass exposure.
High	Self-operated casinos	SJM	At risk of facing a total smoking ban; aging properties at risk of not having the necessary infrastructure to support airflow requirements for smoking lounges. Low premium mass exposure.

Source: Daiwa



## 2Q14 preview

*We expect falls in QoQ EBITDA growth for the quarter, which may result in share prices softening over the near term.*

### Our and the market's views

#### Sequential decline in GGR

For 2Q14, sector GGR has risen by 5.5% YoY but has fallen by 11% QoQ. The QoQ decline in growth was driven primarily by a drop in VIP rolling, which was due to the combined effects of the VIP liquidity squeeze that started in April and the World Cup that began in June. Mass-market GGR remained relatively robust, growing by 33% YoY.

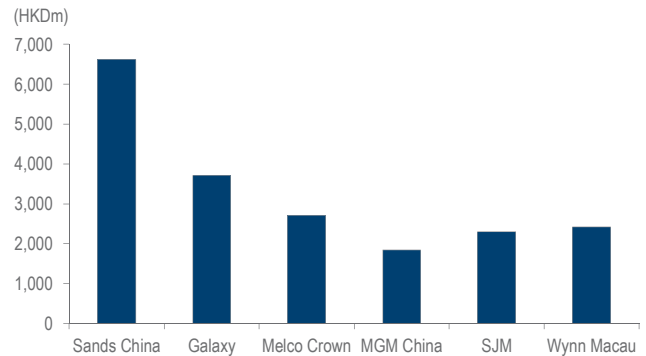
#### We expect a QoQ drop in 2Q14 EBITDA

Consensus earnings forecasts for the sector reached their peak between April and May this year, with cuts of only 1% each for since then to the 2014 and 2015 forecasts.

Even with all the cuts to target prices and earnings over the past 2 months, we believe the market will be disappointed by the sequential drop in 2Q14 EBITDA (the first ever for the sector). Share prices may soften over the near term as a result. For the sector, we forecast 2Q14 EBITDA to drop by 5% QoQ and rise by 19% YoY, compared with a fall of 7% QoQ and rise of 17% YoY forecast by the consensus.

We expect Sands and Wynn to see the strongest YoY EBITDA growth for 2Q14, followed by Galaxy, MGM, MPEL, and SJM.

#### Macau Gaming Sector: consensus EBITDA forecasts



Source: Bloomberg

#### Macau Gaming Sector: 2Q14 EBITDA forecast by operator

Operator	2Q13	3Q13	4Q13	1Q14	Daiwa vs.			
					2Q14E	QoQ	YoY consensus	
Sands China (USDm)	655	785	836	932	893	-4%	+36%	+5%
Galaxy (HKDm)	2,988	3,200	3,587	3,800	3,439	-10%	+15%	-7%
Melco Crown (USDm)	329	311	367	361	360	0%	+9%	+4%
MGM China (HKDm)	1,716	1,555	1,857	2,007	1,833	-9%	-9%	-1%
SJM (HKDm)	2,140	2,043	2,364	2,190	2,219	+1%	+4%	-3%
Wynn Macau (HKDm)	2,249	2,562	2,915	2,999	2,759	-8%	+23%	+14%
<b>Sector (USDm)</b>	<b>2,150</b>	<b>2,296</b>	<b>2,578</b>	<b>2,703</b>	<b>2,567</b>	<b>-5%</b>	<b>+19%</b>	<b>+2%</b>

Source: Daiwa, Bloomberg

#### Our recommendation

We continue to be bullish on the prospects for the Macau Gaming Sector, and believe the worst is over, especially in the VIP segment. However, weakness in 2Q14 EBITDA may be a drag on share prices. We advise investors to accumulate our top picks as we expect a sequential earnings recovery over the coming quarters.

In line with our view of a recovery in VIP GGR starting from late July, we are adjusting some of our SOTP-based target prices after adjusting the multiples we ascribe to each property to reflect each casino's: 1) junket quality and 2) relative risk to GGR, stemming from the upcoming smoking ban. Our earnings forecasts are unchanged.

Given upside potential to our new target prices, we also upgrade 4 stocks to Buy (1) from Outperform (2): Galaxy, MGM, SJM and Wynn.

Our new order of preference in the sector is Galaxy, MGM, Sands, SJM, Melco, and Wynn.

■ **Macau Gaming Sector: new EV/EBITDA multiples in SOTP valuations**

Casino	Operator	Location	New 2015E EV/EBITDA multiple	Previous 2015E EV/EBITDA multiple	Rationale
Sands Macao	Sands	Peninsula	10x	10x	Unchanged
Venetian	Sands	Cotai	14x	14x	Unchanged
Four Seasons	Sands	Cotai	11x	11x	Unchanged
Sands Cotai Central	Sands	Cotai	13x	13x	Unchanged
StarWorld	Galaxy	Peninsula	11x	10x	High-quality junket exposure; removal of overhangs relating to VIP liquidity
Galaxy Macau 1&2	Galaxy	Cotai	13x	12x	High-quality junket exposure; removal of overhangs relating to VIP liquidity
CityClub	Galaxy	Peninsula	9x	9x	Unchanged
Altira	Melco	Cotai	8x	8x	Unchanged
City of Dreams	Melco	Cotai	11x	11x	Unchanged
Mocha Clubs	Melco	Peninsula and Cotai	9x	9x	Unchanged
MGM Macau	MGM	Peninsula	12x	11x	High-quality junket exposure; high exposure to premium mass market faces less risk from smoking ban
Wynn Macau	Wynn	Peninsula	12x	13x	Lower quality junket exposure than peers; table vacancies may affect yield
Grand Lisboa	SJM	Peninsula	11x	11x	Unchanged
Self-operated casinos	SJM	Peninsula	8x	10x	Mass-centric operations with risk of GGR loss from no-smoking ban in Oct 2014
Satellite casinos	SJM	Peninsula	7x	9x	Mass-centric operations with risk of GGR loss from no-smoking ban in Oct 2014
Unopened casinos			NAV basis		

Source: Daiwa forecasts

**By operator**

**Galaxy: strong rolling offset by weakened win rate.** We forecast Galaxy's 2Q14 EBITDA to be HKD3.44bn, down 10% QoQ and up 15% YoY.

We like the operator due to the solid execution of its VIP strategy. We expect a lacklustre 2Q14 GGR performance (we forecast a rise of 16% YoY and a fall of 11% QoQ) as a direct result of a YoY drop in its win rate. Our forecast suggests that the poor luck factor (the win rate declined by 40bps QoQ to 2.9%) shaved about HKD180m from the company's EBITDA YoY for 2Q14. Despite this, the operator's underlying performance continues to be robust (for 2Q14, VIP rolling grew by 25% YoY while for the sector as a whole it dropped by 3% YoY). This translates into a fall of 0.6% QoQ in VIP rolling (compared with a 14% QoQ decline for the sector as a whole).

This outperformance was likely due to: 1) the about 7% YoY and 5% QoQ increases in the VIP table count in April, which included 13 tables for new junkets, 2) robust per-table rolling volume, supported by its high exposure to better-capitalised, quality junkets (as discussed in our analysis of junket quality earlier in this report), and 3) the small impact from the closure of small/risk-taking junkets throughout 2Q14.

That said, Galaxy saw lower mass-market GGR growth, which increased by 20% YoY for 2Q14 compared with 33% for the sector (likely due to tables being reallocated to the VIP segment. However, we believe that its mass-market EBITDA margin will rise YoY due to an increase in the minimum bet (to HKD500 from HKD300), and this will offset partially the softness in mass-GGR growth. We also expect Galaxy to face lower

risk from the smoking ban than its peers (see page 7 for details).

The opening of Galaxy Phase 2, officially due in mid-2015, should also be a share-price catalyst.

We raise our target price for Galaxy to HKD76.40 from HKD66.60 and upgrade our rating to Buy (1) from Outperform (2).

■ **Galaxy: SOTP valuation**

Breakdown	Metrics	2015E SOTP (HKDm)	Value per share (HKD)	% of SOTP
StarWorld	11x EBITDA	48,551	11.2	15%
CityClubs	9x EBITDA	1,718	0.4	1%
Galaxy Macau	13x EBITDA	205,748	47.4	62%
Corporate expenses	10x EBITDA	(1,818)	-0.4	-1%
Galaxy Macau 3	NAV assuming 28% ROIC, 9x target, 10% discount rate	31,020	7.1	9%
Galaxy Macau 4	NAV assuming 28% ROIC, 9x target, 10% discount rate	28,101	6.5	8%
Net cash		18,661	4.3	6%
<b>Target price (HKD)</b>	<b>(4,344m shares)</b>	<b>331,980</b>	<b>76.4</b>	<b>100%</b>

Source: Daiwa forecasts

**Sands: market share fall should be offset by better luck factor.** We forecast Sands's 2Q14 property EBITDA to be USD893m, down 4% QoQ and up 36% YoY.

The company's VIP rolling fell sharply for 2Q14 (dropping by 17% YoY and 24% QoQ, which resulted in a loss of 225bps in market share QoQ to 13.2%). This was likely due to the combined effects of: 1) a 25% YoY reallocation of VIP tables to mass, and 2) it seeing the highest number of junket closures among its peers, on our estimates. However, we expect a better luck factor to help offset the impact, as the 2Q14 group-wide win rate improved by 20bps QoQ to 3.4%.

While Sands's mass-market GGR grew ahead of that for the sector for 2Q14 (35% YoY compared with the sector's 33% YoY), it ceded 1.1pp in market share QoQ to 30.4%. We were disappointed at the low magnitude of GGR given that: 1) there were increases of 14% YoY and 5% QoQ in mass-market table for 2Q14, and 2) the grand opening of the Dragon's Palace premium mass area, with 50 gaming tables, took place in May.

Overall, we forecast the EBITDA margin to see a sequential improvement of 4pp to 38.5%, due to the reallocation of tables from the VIP segment to the higher-margin premium mass and mass segments.

Despite the negatives in 2Q14, we believe that the steps that Sands took in the quarter will improve the quality of earnings growth in coming quarters. In the VIP segment, 1H14's junket closures should result in an improvement in overall junket quality. This should lead to: 1) more stable rolling volume per junket, and 2) an overall rise in per-VIP-table productivity. In the mass market, we expect Sands to begin to capitalise on hotel-room inventory management improvements against the backdrop of accelerating tourist-number growth for Macau (for 5M14, it was 16% YoY compared with 10% YoY for 2013).

We raise our target price for Sands to HKD67.70 from HKD66.60. Our Buy (1) rating is unchanged.

■ **Sands: SOTP valuation**

Breakdown	Metrics	2015E SOTP (USDm)	Value per share (USD)	% of SOTP
Sands	10x EBITDA	4,888	0.6	7%
Venetian	14x EBITDA	31,865	4.0	46%
Plaza	11x EBITDA	5,797	0.7	8%
SCC	13x EBITDA	19,543	2.4	28%
Corporate expenses	10x EBITDA	(709)	(0.1)	-1%
Ferry and other operations	8x EBITDA	(35)	(0.0)	0%
Parisian	NAV assuming 30% ROIC, 12x target, 10% discount rate	8,285	1.0	12%
Net cash		357	0.0	1%
<b>Target price (USD)</b>	<b>(8,067m shares)</b>	<b>69,993</b>	<b>8.7*</b>	<b>100%</b>

Source: Daiwa forecasts \*target price HKD equivalent is HKD67.70

**MGM: refocusing its efforts.** We forecast MGM's 2Q14 property EBITDA to be HKD1.8bn, down 9% both YoY and QoQ. The company's 2Q14 rolling chip volume declined by 14% YoY and 16% QoQ, slightly worse than the sector's 14% QoQ fall. The lacklustre performance in rolling was partially due to high base for 2Q13, with the inclusion of a new junket last year.

The effect of the drop in VIP rolling is likely to be magnified by what we estimate was a 10bps QoQ decline in the win rate to 2.9%, lower than the 2Q14 sector win rate of 3.1%.

MGM's mass-market GGR performance remained robust, likely buoyed by the sustained strength in its premium-mass segment. On our estimates, the company continues to have the highest proportion of high-limit/premium-mass tables (as a percentage of mass tables) among its peers. We are seeing positive results from this, with MGM's 2Q14 mass-segment GGR improving by 8% QoQ (which compared with a decline for the sector of 1.6% QoQ).

As discussed, we believe that MGM faces the least risk to its mass-market gaming business from the smoking ban, as it has the highest exposure among its peers to the premium-mass segment. We expect these premium-mass gaming tables/areas to be enclosed, and designated as "private gaming spaces", thereby remaining smoking areas.

We raise our target price for MGM to HKD32.80 from HKD29.50 and raise our rating to Buy (1) from Outperform (2).

■ **MGM: SOTP valuation**

Breakdown	Metrics	2015E SOTP (HKDm)	Value per share (HKD)	% of SOTP
MGM Macau	12x EBITDA	94,625	24.9	76%
MGM Cotai	NAV Assuming 22% ROIC, 9x target, 10% discount rate	28,670	7.5	23%
Net cash		1,588	0.4	1%
<b>Target price (HKD)</b>	<b>(3,800m shares)</b>	<b>124,883</b>	<b>32.8</b>	<b>100%</b>

Source: Daiwa forecasts

**Wynn: junket closure offset by favourable win rate and robust mass segment.** We forecast Wynn's 2Q14 property EBITDA to be HKD2.8bn, down 8% QoQ and up 23% YoY.

For 2Q14, we forecast the company to see rolling decline by 27% QoQ and 13% YoY, more than the sector's falls of 14% QoQ and 3% YoY. On our estimates, Wynn likely saw one of the highest rolling declines if we exclude the effects of table reallocations undertaken by Sands and Melco. This was probably due to: 1) junket closures, and 2) Wynn's higher exposure to aggressive junkets, for which rolling volume is more susceptible to the credit liquidity squeeze that started in mid-April.

However, we estimate Wynn's 2Q14 GGR will be buoyed by an improvement in the VIP win rate to 3% (up 20bps QoQ and flat YoY), which should help offset the decline in VIP rolling. As such, we forecast 2Q14 VIP revenue to decline to a lesser extent than its rolling, dropping by 22% QoQ and 10% YoY.

On a positive note, Wynn led the sector in mass-market GGR growth for 2Q14, at 6% QoQ and 47% YoY (the

overall market saw a fall of 2% QoQ and a rise of 33% YoY). As a result, the company's mass-market share increased by 60bps QoQ to 7.9%. This was the highest quarterly market share for Wynn for the past 5 quarters. However, the company's renovations over 2Q-3Q14 and the vacant tables we saw on our recent visit may negatively affect earnings in the coming quarter

We lower our target price for Wynn to HKD34.60 from HKD35.80, but raise our rating to Buy (1) from Outperform (2) on upside potential to our new target.

■ **Wynn: SOTP valuation**

Breakdown	Metrics	2015E SOTP (HKDm)	Value per share (HKD)	% of SOTP
Wynn Macau	12x EBITDA	130,854	25.2	73%
Wynn Palace	NAV assuming 28% ROIC, 10x target, 10% discount rate	58,736	11.2	33%
Net cash		(9,531)	-1.8	-5%
<b>Target price (HKD)</b>	<b>(5,188m shares)</b>	<b>180,060</b>	<b>34.6</b>	<b>100%</b>

Source: Daiwa forecasts

**Melco: sequential mass GGR growth ahead of the sector.** We forecast Melco's 2Q14 property EBITDA to be USD360m, flat QoQ but up 9% YoY. The company's VIP rolling-chip volume for 2Q14 fell by 13% QoQ, slightly better than the sector's 14% QoQ decline. On a YoY basis, however, Melco's rolling dropped by 20%, the worst among its peers. We believe this was driven by a combination of: 1) junket closures, as we identified previously (see *Macau Gaming Sector: Behind closed doors: a VIP perspective*, 2) it having one of the highest exposures among its peers to small and aggressive junkets, especially in Altira, the rolling of which is most susceptible to a liquidity squeeze, and 3) a 15% YoY drop and flat QoQ VIP-table count.

VIP revenue for 2Q14 was also affected by our estimate of a 20bps QoQ decline in the win rate to 2.8% for the company. Mass revenue remained robust, rising by 2.5% QoQ (compared with a decline of 1.6% QoQ for the sector), buoyed by its high exposure to the premium-mass segment among its peers. As a result, Melco's mass market share improved by 53bps QoQ to 13.2%.

Our target price of HKD40 and Buy (1) rating for Melco are unchanged.

■ **Melco: SOTP valuation**

Breakdown	Metrics	2015E SOTP (USDm)	Value per share (USD)	% of SOTP
Altira	8x EBITDA	1,497	2.7	7%
City of Dreams Macau	11x EBITDA	17,267	31.4	79%
Mocha	9x EBITDA	348	0.6	2%
Hospitality Corporate Expenses	9x EBITDA	1,824	3.3	8%
	10x EBITDA	(1,183)	(2.2)	-5%
	NAV assuming 14% ROIC, 9x target, 10% discount rate	2,504	2.7	7%
Studio City Philippines	At MCP's market cap	856	1.6	4%
Net cash		(122)	(0.2)	-1%
<b>Target price (USD)</b>	<b>(550m shares)</b>	<b>22,991</b>	<b>40.0</b>	<b>100%</b>

Source: Daiwa forecasts

**SJM: likely to come out on top for 2Q14.** We forecast SJM's 2Q14 EBITDA to be HKD2.2bn, up 1% QoQ and 4% YoY. The company's VIP rolling-chip volume declined by 13% QoQ, slightly better than the sector's 14% QoQ decline. Although we estimate that SJM's 2Q14 win rate rose by 10bps to 2.7%, it is still about 40bps less than the sector average of 3.1%. SJM finished 2Q14 with the highest market share, rising by 1.2pp QoQ to 24.2%.

We like SJM's quality junket exposure in Grand Lisboa, its high dividend yield, and comparatively low valuation. However, GGR from its mass-market-focused self-operated casinos and ageing satellite casinos face high risks from October's smoking ban.

We lower our target price for SJM to HKD22.90 from HKD24.70 but raise our rating to Buy (1) from Outperform (2) on upside potential to our new target.

■ **SJM: SOTP valuation**

Breakdown	Metrics	2015E SOTP (HKDm)	Value per share (HKD)	% of SOTP
Grand Lisboa	11x EBITDA	65,465	11.4	50%
Self-promoted	8x EBITDA	13,964	2.4	11%
Satellite Casinos	7x EBITDA	14,915	2.6	11%
Hospitality	7x EBITDA	2,583	0.4	2%
Lisboa Palace	NAV assuming 16% ROIC, 8x target, 10% discount rate	10,182	1.8	8%
Net cash		24,580	4.3	19%
<b>Target price (HKD)</b>	<b>(5,700m shares)</b>	<b>131,689</b>	<b>22.9</b>	<b>100%</b>

Source: Daiwa forecasts

## Risks, and overplayed issues

With the VIP overhangs on the sector now largely removed, we highlight potential risks to our call and those issues we think have been overdone.

### Transit visas – unlikely to be an issue

In mid-June, the Public Security Police Force of Macau announced amendments to the city's transit visa policy. These amendments came into effect on 1 July 2014. The changes apply to travellers that claim to be travelling via Macau to a third country but never actually leave Macau. The new rule shortens the length of stay for transit tourists to 5 days from 7 days. For visitors entering Macau for a second time within a 30-day period who do not depart for a third country, the maximum length of stay has been reduced to 1 day from 2 days. Those found to have committed a third offence within a 60-day period will be denied entry into Macau.

**Implications.** We expect this policy to have minimal impact on gaming customers, given that the average stay per trip is less than one day for an average mass player and 2 days for an average VIP player.

However, we expect there will be some impact on VIP agents who are Chinese nationals who travel to Macau to support customers. These agents typically travel to Macau to accompany several VIP players over the period of their allowed stay (now 5 days). The shortened period of stay reduces the number of VIP clients each agent can support. We expect this to change the travel behaviour of these Mainland agents, and their working arrangements with local colleagues and other Mainland agents.

That said, it should not have a material impact on GGR, as most Mainland agents should already have

colleagues in Macau, given that most of the credit originates from Hong Kong or Macau parties. In the large junkets, Mainland agents have to work with their Macanese counterparts in order to obtain credit approval. Moreover, the junkets' cost of hiring an additional junket agent in China is about Rmb10,000/month, an amount they should be able to absorb easily in order to increase their employee count to allow for staff rotation.

### China policy concerns – negative sector sentiment

Over the past few months, there have been a number of high-profile media reports, including stories about illegal UnionPay transactions and money laundering. A number of these issues have been thoroughly analysed by the media and the investment community (see *Highlights of on-the-ground research*), and *Impact of UnionPay transactions clampdown overstated*). The China leadership's continued anti-graft campaign and China Central Television's recent claims of money laundering by state-owned banks are ongoing issues.

**Implications.** In our view, many of these issues have been misinterpreted or overblown, or have little or no direct impact on the underlying fundamentals of the Macau Gaming Sector. However, these issues may negatively affect sentiment towards the sector.

### Sequential EBITDA drop in 2Q14: an overhang

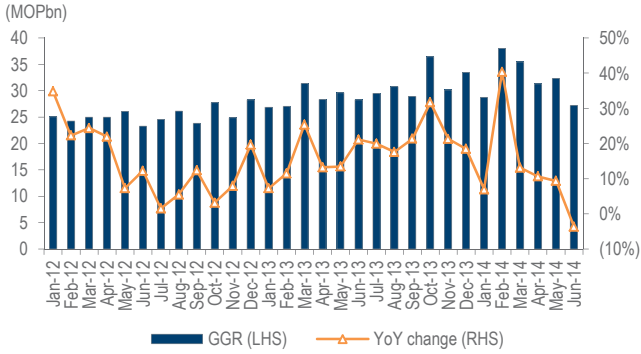
**Implications.** Lacklustre 2Q14 EBITDA results are likely to be a negative catalysts for share prices. We address this in detail earlier in this report.

#### ■ Macau Gaming Sector: monthly GGR market share

	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
<b>Sands</b>	20.4%	21.4%	20.9%	21.9%	20.9%	20.5%	22.8%	22.0%	20.3%	21.9%	23.2%	21.8%	25.1%	22.0%	22.2%	23.2%	22.0%	
Sands Macao	3.6%	3.0%	3.7%	3.0%	2.9%	3.6%	3.6%	2.7%	3.2%	2.5%	2.7%	3.8%	2.3%	3.4%	2.7%	3.5%	3.3%	3.0%
Venetian Macao	8.6%	9.5%	7.7%	8.9%	8.8%	8.0%	8.2%	8.8%	8.8%	9.2%	9.8%	9.9%	9.6%	10.1%	9.5%	8.5%	10.3%	9.3%
Four Seasons	3.0%	2.1%	2.6%	3.9%	3.6%	2.2%	3.5%	3.7%	3.1%	1.8%	1.7%	2.6%	2.5%	4.1%	3.3%	2.9%	1.7%	2.9%
Sands Cotai Central	5.3%	6.9%	7.0%	6.1%	5.6%	6.6%	7.6%	7.5%	6.8%	6.7%	7.7%	7.0%	7.3%	7.5%	6.5%	7.4%	7.9%	6.7%
<b>Galaxy</b>	18.6%	18.4%	18.4%	17.6%	18.8%	19.3%	19.9%	17.1%	18.4%	21.0%	18.7%	17.5%	20.2%	21.0%	20.0%	18.8%	21.2%	21.1%
StarWorld	7.5%	7.0%	7.5%	6.1%	8.0%	7.7%	7.8%	5.8%	6.9%	7.2%	6.3%	6.9%	7.2%	7.5%	7.0%	5.6%	6.6%	7.1%
Galaxy Macau	9.7%	10.3%	9.9%	10.4%	9.6%	10.5%	11.1%	10.3%	10.3%	13.1%	11.5%	9.5%	12.0%	12.5%	11.9%	12.5%	13.6%	12.8%
City Club	1.4%	1.2%	1.1%	1.1%	1.2%	1.1%	1.0%	1.0%	1.2%	0.7%	0.9%	1.0%	0.9%	0.9%	1.1%	0.7%	1.0%	1.2%
<b>Melco</b>	14.3%	12.8%	13.6%	16.3%	14.0%	14.6%	13.2%	14.4%	13.8%	13.4%	13.7%	14.3%	14.5%	12.0%	12.7%	14.2%	12.7%	12.2%
Altira	3.9%	3.0%	3.5%	3.7%	3.5%	3.6%	3.0%	3.0%	3.1%	2.6%	2.7%	3.1%	2.3%	2.3%	2.9%	2.6%	2.1%	2.2%
City of Dreams	10.3%	9.6%	10.0%	12.5%	10.4%	10.9%	10.1%	11.3%	10.6%	10.8%	10.9%	11.1%	12.0%	9.6%	9.8%	11.5%	10.5%	9.8%
<b>Wynn</b>	11.2%	11.8%	11.2%	9.4%	12.0%	10.2%	10.2%	11.6%	11.4%	10.3%	11.4%	11.4%	9.2%	10.9%	11.9%	10.7%	10.5%	9.5%
<b>SJM</b>	26.3%	25.5%	26.9%	25.9%	22.9%	24.5%	24.4%	23.9%	24.7%	26.0%	23.3%	23.8%	23.0%	22.0%	24.0%	24.6%	23.1%	24.9%
<b>MGM</b>	9.2%	10.1%	8.9%	8.9%	11.4%	11.0%	9.5%	10.3%	9.6%	9.1%	11.0%	9.8%	11.5%	9.1%	9.4%	9.4%	9.3%	10.3%

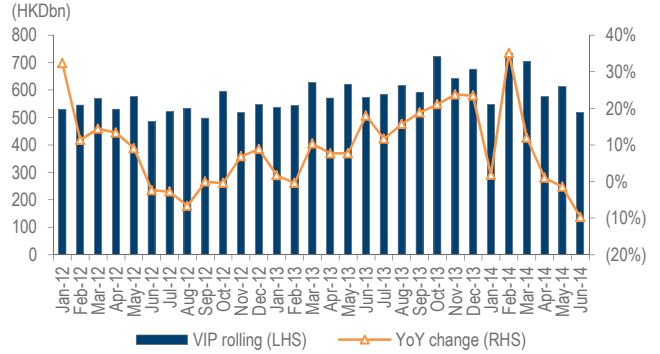
Source: DICJ, APG, Daiwa

■ **Macau Gaming Sector: monthly GGR and YoY change**



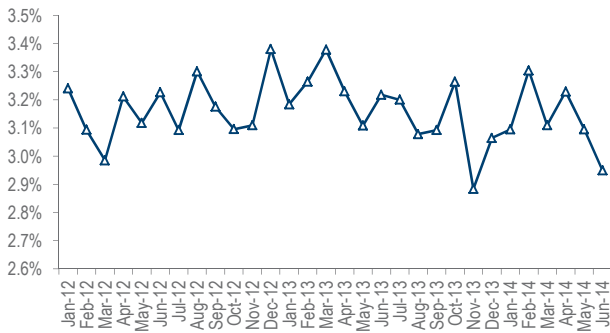
Source: Asia Pacific Gaming Consultancy (APG)

■ **Macau Gaming Sector: monthly VIP rolling chip and YoY change**



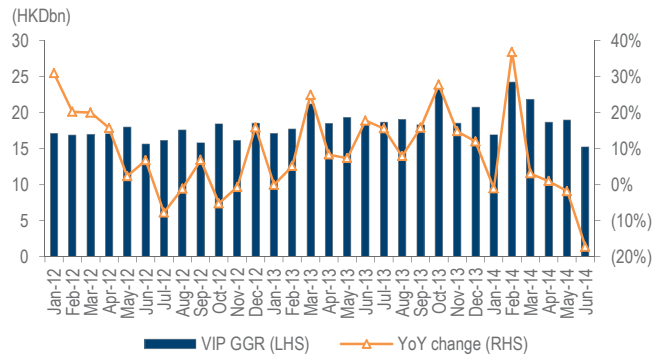
Source: APG

■ **Macau Gaming Sector: monthly VIP win rate**



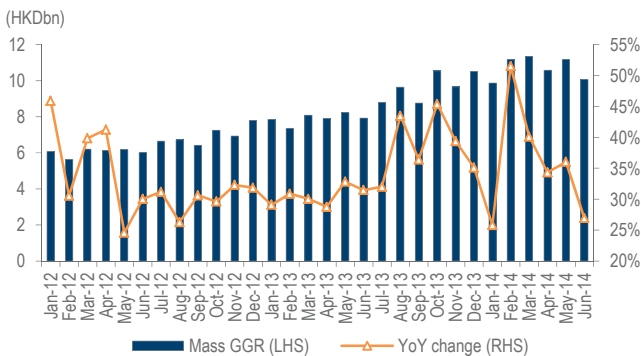
Source: APG

■ **Macau Gaming Sector: monthly VIP GGR and YoY change**



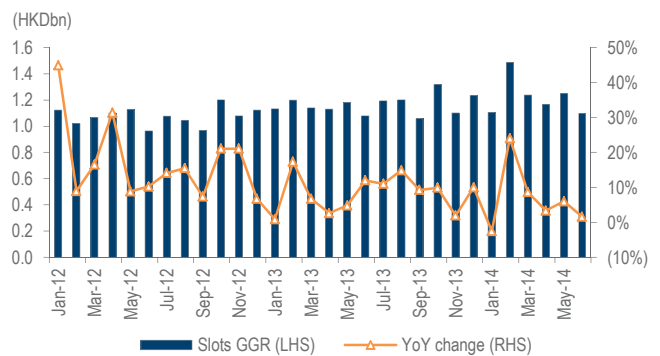
Source: APG

■ **Macau Gaming Sector: monthly Mass GGR and YoY change**



Source: APG

■ **Macau Gaming Sector: monthly Slots GGR and YoY change**



Source: APG

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