

12 February 2018

Asia Research

Global Gaming Operators

Industry Update

Implications for Macau:

While it is virtually impossible to isolate the impact to Macau due to the growth in VIP in other regional markets, we think that Suncity's transition to becoming a casino principal brings with it risks to Macau and brings with it a positive new angle for Suncity as it relates to the potential for obtaining a Macau license.

The reality is that Suncity will be in position to redirect a real amount of VIP volume to Vietnam beginning next year. The scenario we provide herein (US\$15bn in quarterly rolling volume) is the equivalent of 7% of total VIP volume in Macau in 2019E. Of course not all of this play would be diverted from Macau (e.g. some would be from SE Asian customers), but regardless, it could have a several hundred basis point impact on Macau VIP beginning later in 2019.

In regards to the license rebid process in Macau, Suncity's Hoiana will put them in a better position to win a license (in the event a 7th license is issued) not only because Suncity will be a bonafide IR operator with local roots, but that licensing Suncity would also repatriate VIP dollars to Macau where it provides a benefit to the local community (i.e. tax receipts).

Update on Suncity in Vietnam; under-appreciated story; implications for Macau

Hoiana update. We recently visited the Hoiana IR construction site in Hoi An, Vietnam, and met with management. Construction on the Phase 1 portion of the project is meaningfully underway and remains on track for a mid-2019 opening.

Suncity will remain the dominant force in Asian VIP. We estimate Suncity's market share of the Macau VIP junket business is nearly 50%, suggesting they account for ~20% of total GGR in the market. No other VIP junket comes close. Based on conversations we've had with the company they still expect mid-teens+ VIP growth in Macau this year. Early 2018 results, indeed, appear to suggest that VIP remains robust and that upwards of 20% growth is achievable. The company's Macau VIP expectations are underpinned by their ongoing overseas VIP room expansions, including Vietnam (Da Nang), Cambodia (Naga2), and the Philippines (Okada Manila).

Quality supply drives demand. Simply put, Suncity would not be entering markets like Cambodia but for the fact that they find the quality of supply to be attractive enough for their customers. Hence the company's upcoming opening of a room at Naga2, which has won rave reviews as a very high quality asset and one that junkets find as a great alternative for their players. During 4Q17, Naga generated US\$10.1bn in rolling chip volume, primarily as a result of opening Naga2 in early November. We mention the Naga metrics because: 1) this rolling volume was accomplished without the benefit of a dedicated Suncity room, and 2) it demonstrates that Macau-flagship-like levels of rolling chip volume can be generated even in places like Cambodia. With this in mind, and in the context of Suncity being the dominant global VIP junket and Suncity's Hoiana IR being of very high quality, there is no reason Hoiana can't similarly generate Macau flagship levels of VIP volume (if not higher).

Economics of Suncity's Vietnam project. It is important to keep in mind that Suncity's listco (1383.HK, unrated) does not contain any of the Macau junket business. Rather, it will contain a 34% ownership interest in Hoiana and the related management contract, another management contract for one of the first two IRs in Vietnam to participate in the new locals pilot, and a travel agency (key to transporting customers around). That Suncity is transitioning from an agency to principal model makes sense to us, especially in light of strong VIP trends in Macau and regionally. In a scenario where Hoiana generates ~US\$15bn in quarterly rolling chip volume (or 50% higher than the most recent quarter for Naga), we estimate the management fee income (based on percentages of GGR and EBITDA) to Suncity amounts to HK\$369mm (US\$48mm) annually. Mass market management fee, F&B management fee, and the company's share of income derived from its ownership stake would be additive still, as would its management contract for the Van Don IR, which is one of two IRs in Vietnam that will be part of the locals pilot.

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*Please see analyst certification and required disclosures starting on page 8 of this report.

Suncity's Hoiana

We recently visited the Hoiana IR casino site and met with management for an update on the same. Construction on the Phase 1 portion of the project is meaningfully underway and remains on track for a mid-2019 opening (see below photo).

Hoiana, formerly called Hoi An South IR, involves Suncity Group Holdings (1383.HK), local developer VinaCapital, and an independent third party. The details of the project are as follows:

- 7 phases of development over 20 years, with the investment certificate issued 2 August 2016
- Phase 1 land size of 270 hectares (667 acres), with all seven phases at ~986 hectares (2,435 acres)
- Phase 1 is expected to open by mid-2019 at a cost of ~US\$650mm
- Casino to include:
 - 140 gaming tables
 - 1,000 slots/ETG seats
- Non-gaming to include:
 - Mass market hotel with 313 keys
 - All-suite hotel with 136 keys
 - Hotel villa resort with 70 keys
 - 30 villas (for sale and on a timeshare basis)
 - Condo-hotel with 236 keys (for sale and on a timeshare basis)
 - Golf course
 - Various resort-style amenities (F&B, spa, etc.)

Figure 1: Hoiana construction progress (as of January 2018)



Source: company data

Transformational for Suncity

The acquisition of a 34% stake in Hoiana (pending shareholder approval) for HK\$600mm and related management contract will be transformational for the company, making it not only a gaming-centric platform but the only viable Vietnam-centric gaming platform.

The projected cost of Phase 1 of Hoiana is expected to be US\$650mm, of which \$484mm is in the form of already-obtained debt, \$89mm in equity has already been invested, and another \$77mm in equity remains to be invested (of which Suncity will be responsible for 34%, or \$26.2mm). We expect the project cost to be brought down by some amount via residential sales, making the return hurdle significantly lower than the cost of \$650mm would imply.

Economics for Suncity

In addition to what would be Suncity's 34% economic interest in Hoiana, it will also generate fee income via a technical services (pre-opening consulting) agreement and a 10-year management agreement to run the gaming and F&B portions of the IR. The management fee structure is as follows:

- 3% of mass market GGR (net of VAT), plus
- 1% to 3% of VIP GGR (net of VAT) dependent upon rolling chip turnover thresholds (1% @ up to HK\$6bn in monthly rolling chip; 1.5% @ \$6bn-\$10bn; 2% @ \$10bn-\$15bn; 3% @ \$15bn+), plus
- 6% of gaming EBITDA, plus
- 3% of F&B revenue and 6% of F&B EBITDA

As a hypothetical, the following would represent only the VIP management fee income stream to Suncity in a case where the casino generates HK\$39bn in monthly rolling chip volume (e.g. just 50% higher than the most recently reported data from NagaCorp as it relates to 4Q17). On top of this, Suncity would also generate mass market management fee income, F&B management fees, and the income associated with its 34% economic interest in the IR. Based on HK\$39mm in monthly rolling chip volume, we estimate annual management fee income paid to Suncity of HK\$369mm (US\$48mm). To put this in perspective, the market cap of Suncity is HK\$3,974mm.

Figure 2: Hypothetical analysis of Suncity management fee of Hoiana VIP

Monthly VIP volume ranges	0-6bn	6bn-10bn	10bn-15bn	15bn+	Total
Volume (HK\$mm)	6,000	4,000	5,000	24,000	39,000
Win rate	2.85%	2.85%	2.85%	2.85%	
VIP GGR	171	114	143	684	1,112
Management fee % (on GGR net of VAT)	1.0%	1.5%	2.0%	3.0%	2.2%
VIP management fee to Suncity	1.5	1.5	2.6	18.5	24.1
VIP management fee annual total (HK\$mm) - GGR component					289
VIP management fee annual total (US\$mm) - GGR component					37
VIP annual EBITDA (assumes 10% margin on GGR) (HK\$mm)					1,334
VIP management fee annual total (HK\$mm) - EBITDA component					80
VIP management fee annual total (US\$mm) - EBITDA component					10
Total (HK\$mm)					369
Total (US\$mm)					48

Source: company data

Vietnam gaming update

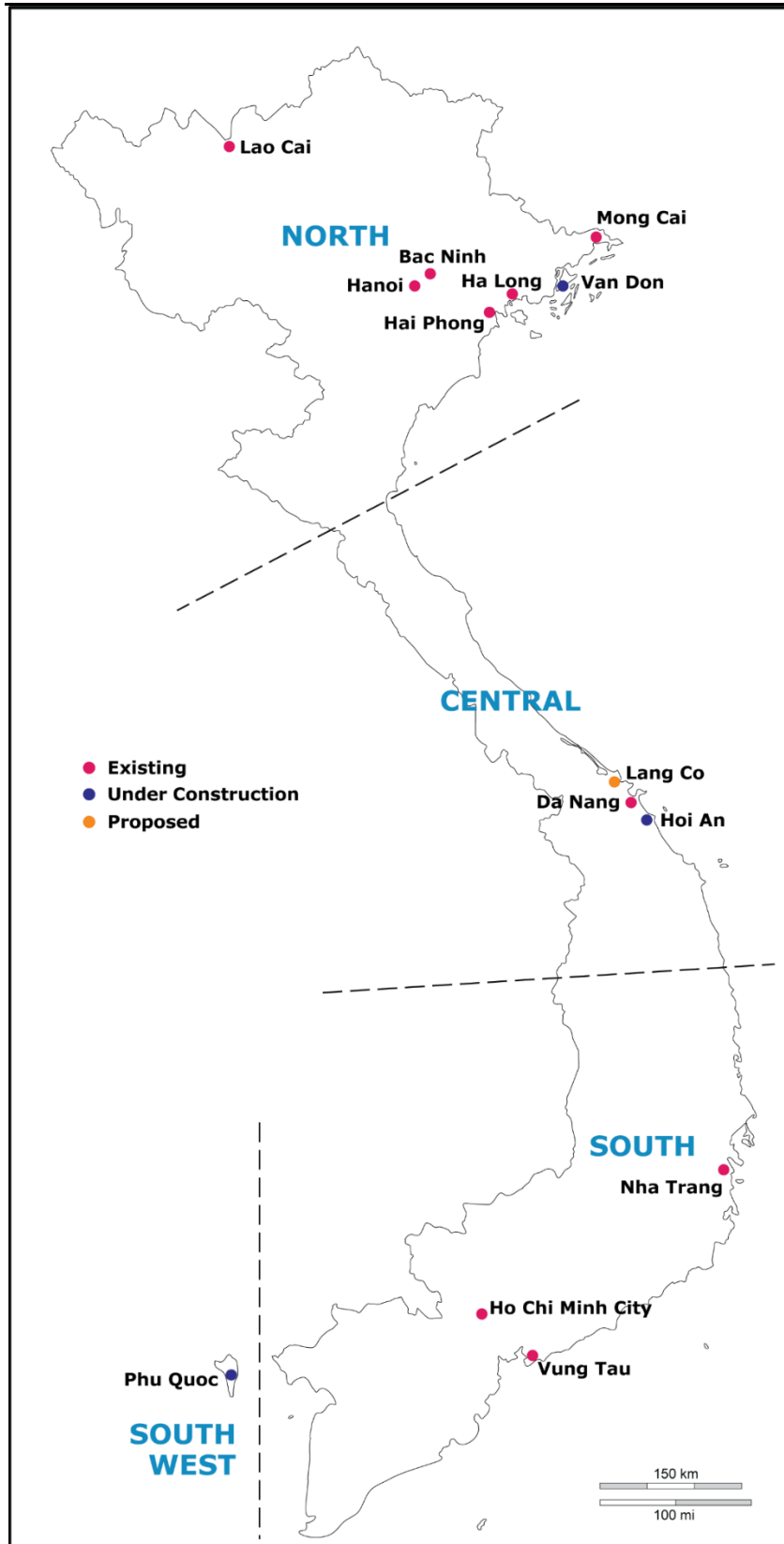
Last year, the government of Vietnam approved a revised gaming decree that established new ground rules including a somewhat timid locals entry program. Relevant portions of the gaming decree include:

- A 3-year locals pilot program whereby Vietnamese citizens who have a monthly income in excess of VND10mm (~US\$450) and pay a daily entry fee of VND1mm (\$45) or monthly entry fee of VND25mm (\$1,100) are allowed to gamble in designated casino IRs
- Two sites are guaranteed to be a part of the locals pilot and both are Vietnamese owned resorts already under construction in each of Phu Quoc island (southwest Vietnam) and Von Don (northeast Vietnam near Ha Long Bay); other IRs that meet the investment requirements could also be eligible to participate in the locals pilot although none have currently been approved
- A minimum capex requirement of \$2bn (down from \$4bn previously), although we generally expect a significant portion of the capex requirement at any given project to be allocated to for-sale residential components, which in turn will buy-down the net capex to more modest levels
- GGR tax of 35% on both mass and VIP, although junket commissions are deductible, which should result in tax on the VIP segment of GGR in the mid to high teens; there is also a 10% VAT applicable to GGR
- In terms of gaming positions, 10 EGM seats and 1 gaming table are allowed per every USD10mm of invested capital (e.g. a \$2bn project would be eligible for 2,000 EGMs and 200 tables)

Vietnam gaming supply

Gaming is already prevalent in Vietnam and can be found in both full-fledged casinos, as well as electronic casinos (i.e. slot parlors). There are currently no IRs in central Vietnam other than the under-construction Hoiana project.

Figure 3: Vietnam gaming supply map



Source: Union Gaming

Da Nang area Infrastructure already good yet improving further

Public infrastructure in and around Da Nang / Hoi An is already good, and includes a new international airport terminal that opened in May 2017. The drive time between the airport and Hoiana is a little under one hour today with the entire journey on well-paved surface streets albeit streets with low speed limits. However, a new highway is already under construction, which will cut the trip time to Hoiana to half an hour or less. This highway, much of which is already completed, is expected to be fully open around the same time next year as Hoiana.

In the map below we highlight four properties, including Laguna Lang Co to the north of Da Nang, which intends to develop a casino (pending final government approval). Closer to the central Da Nang are the Furama Resort, which has a slot parlor, and the Crowne Plaza, which has a small traditional casino. Hoiana is located to the south of Da Nang in nearby Hoi An.

Figure 4: Da Nang area gaming map



Source: Union Gaming

Visitation to Da Nang is booming

Visitation growth to the Da Nang area has been very strong, with total visitation growing at an average annual rate of 21% since 2013, with foreign visitation growing at 33% (primarily driven by Chinese and South Koreans). The 33% average annual growth in foreign visitation is notably faster than foreign visitation to the country as a whole, which only grew a 14% CAGR over the same period. Separately, we would highlight that nearly one-in-five foreign visitors to Vietnam goes to Da Nang.

Figure 4: Da Nang area tourism (in millions), 2013 to 2017

Year	Foreign	Domestic	Total
2013	0.74	2.37	3.12
2014	0.96	2.85	3.80
2015	1.25	3.35	4.60
2016	1.66	3.85	5.51
2017	2.30	4.30	6.60
CAGR	33%	16%	21%

Source: Da Nang Department of Tourism

Da Nang's existing flight connectivity is impressive, with direct flights to 23 cities in mainland China, as well as to both Hong Kong and Macau. There is also significant connectivity to South Korea, which has historically been a large source of international visitors to Da Nang.

Figure 5: Da Nang flight connectivity

City	Country	Airline(s)
Siem Reap	Cambodia	Cambodia Angkor Air, SilkAir
Beihai	China	China Southern
Beijing	China	China Eastern
Chengdu	China	China Eastern, Vietnam Airlines
Dalian	China	China Eastern
Guangzhou	China	China Southern, Hainan Airlines, Sichuan Airlines
Guiyang	China	Vietnam Airlines
Haikou	China	Hainan Airlines
Hangzhou	China	Loong Air, Vietnam Airlines
Jinan	China	Vietnam Airlines
Lanzhou	China	Vietnam Airlines
Nanchang	China	Vietnam Airlines
Nanning	China	China Eastern, China Southern
Sanya	China	Beijing Capital Airlines, Sichuan Airlines
Shanghai	China	Vietnam Airlines
Shenzhen	China	Hainan Airlines
Shijiazhuang	China	Vietnam Airlines
Taiyuan	China	Vietnam Airlines
Tianjin	China	Okay Airways
Wuhan	China	Vietnam Airlines
Wuxi	China	China Eastern
Xi'an	China	Vietnam Airlines
Zhengzhou	China	China Eastern, Vietnam Airlines
Zunyi	China	Vietnam Airlines
Hong Kong	Hong Kong	Cathay Dragon, Hong Kong Express, Jetstar
Ibaraki	Japan	Vietnam Airlines
Osaka	Japan	Jetstar
Tokyo	Japan	Vietnam Airlines
Macau	Macau	Air Macau, VietJet
Kuala Lumpur	Malaysia	AirAsia
Singapore	Singapore	Jetstar, SilkAir
Busan	South Korea	Air Busan, Asiana, Jin Air, T'way Airlines
Cheongju	South Korea	Asiana
Daegu	South Korea	Air Busan, Jeju Air, T'way Airlines
Seoul	South Korea	Asiana, Eastar Jet, Jeju Air, Jin Air, Korean Air, T'way Airlines, VietJet, Vietnam Airlines
Taipei	Taiwan	Jetstar
Bangkok	Thailand	Bangkok Airways, AirAsia

Source: Union Gaming

Important Disclosure

Analyst Certification

The analyst, Grant Govertsen, primarily responsible for the preparation of this research report attests to the following: (1) that the views and opinions rendered in this research report reflect his or her personal views about the subject companies or issuers; and (2) that no part of the research analyst's compensation was, is, or will be directly related to the specific recommendations or views in this research report.

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Buy – the total forecasted return is expected to be greater than 15% within the next 12 months

Hold – the total forecasted return is expected to be greater than or equal to 0% and less than or equal to 15%

Sell – whose shares exhibit downside potential of at least 15% within the next 12 months

Suspended – the company rating, target price and earnings estimates have been temporarily suspended.

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HOLD	9	36%	HOLD	1	11%
SELL	0	0%	SELL	0	0%

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