新鴻基金融集團
SUN HUNG KAI FINANCIAL

Galaxy Entertainment Group (27.HK)
Gaming Sector

14 January 2013

Research Idea: All-in on China Rouge

We rate Galaxy Entertainment Group (GEG) a BUY with a 12-month target price of HK$40. We like Macau gaming stocks given the sector's solid free cash flow generation and longer-term growth prospects. We believe Galaxy's stock remains attractive supported by its ability to cover expansion plans through steady cash flow generation and an improving balance sheet. Additionally we like the company's margin expansion opportunities.

Three reasons to BUY:

- **GEG arguably has the best upside in EBITDA margin expansion in the sector.** We expect Galaxy to add 260bps to adjusted EBITDA margin over the next 2 years providing operating leverage of 1.7x on 11.4% revenue CAGR and 19.7% EBITDA CAGR. We believe the Street remains conservative on the firm's ability to grow margins and expect this to drive positive estimate revisions over the next couple of quarters.

- **Strong FCF generation has allowed the company to quickly deleverage its balance sheet and build up a strong cash position.** Overall debt to equity has fallen from 102% in 2010 to 65% at the end of 1H12. The company has the capability to fund the entire HK$16.5bn cost of its Phase II construction from its current cash balance and operating cash flows over the next couple of years.

- **We believe Macau gaming and entertainment revenues will continue to be resilient over the longer term.** A number of infrastructure improvements in 2013 should help open the gates of Macau to more mainland visitors while longer term improvements in rail, border and entertainment facilities should make it a leisure and entertainment hub for the region. With urban income growth in China expected to double over the next 10 years, discretionary spending will continue to grow, and we expect GEG to benefit.

Valuation: Our 12m target price of HK$40/share is based on our DCF analysis and implies a 14X/12X EV/EBITDA multiple on 2013 and 2014 EBITDA estimates respectively.

Catalysts: Strong holiday season gross gaming revenues and visitor numbers; completion of Gongbei border gate upgrade and the rail station linking Guangzhou and the border gate to improve visitor numbers to Macau.

Risks: Weaker than expected gaming revenue growth in 2013; smoking ban on 50% of gaming floor impacting revenues; competition eroding Galaxy's market share; higher than budgeted costs for Phase II Galaxy Macau; Regulatory changes impacting Macau gaming revenues.

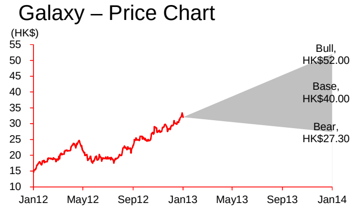
Figure 1: Galaxy – Summary Financials

	2010	2011	2012E	2013E	2014E
Revenue	19,263	41,186	56,846	63,561	70,542
Adj. EBITDA	2,231	5,749	9,666	11,814	13,855
NP Owners	899	3,003	7,261	9,382	11,193
Revenue Growth - %	57.5%	113.8%	38.0%	11.8%	11.0%
Adj. EBITDA Margin - %	11.6%	14.0%	17.0%	18.6%	19.6%
EBITDA Growth - %	-21.8%	234.1%	141.8%	29.2%	19.3%
EPS (HK$/share)	0.23	0.71	1.70	2.19	2.61
EPS Growth - %	(22.5)	216.3	138.0	28.9	19.3

Sources: Bloomberg, Company reports and Sun Hung Kai Financial

Target Price	**HK$40**
12m Rating	**BUY**
	(25% Upside)

Galaxy – Price Chart



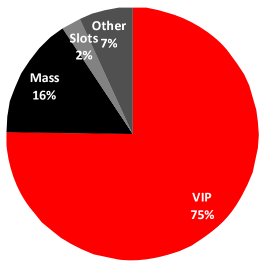
Bull	HK$52.00: 17x 2013 EV/EBITDA
Base	HK$40.00: 14x 2013 EV/EBITDA
Bear	HK$27.30: 11x 2013 EV/EBITDA

Price (HK$)	32.05
52W high/low (HK$)	33.8/14.32
Mkt cap – HK$m (US$m)	134,596.7 (17,362)
Shares in issue – millions	4,199.59
Free float – %	53.80
3M avg. t/o– HK$m (US$m)	517.9 (66.8)
Major shareholder (%)	
City Lion Profits	31.29

Sources: Bloomberg and Sun Hung Kai Financial

The group is engaged in casino gaming in Macau. The company operates 4 casinos including its two flagship properties, StarWorld and Galaxy Macau.

1H12 Revenues: HK$28.3bn



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Forecasts & Valuation

Forecasts

Through the first three quarters of FY12, revenues were up 57%yoy. VIP revenues grew 47% and mass and slot revenues increased 152%. Adjusted EBITDA was up 103%yoy. Strong growth was aided by an extra quarter of operations at the Galaxy Macau property. Comps in 2013 will be much more difficult but the completion of a number of infrastructure improvements in Macau should drive mainland visitors to Macau, thereby supporting continued strength in mass gaming growth in the sector.

In 2013, we estimate VIP revenues to increase 6.9% while mass and slots to grow 23.6%. We expect GEG to grow total revenues 11.8% in 2013 and 11.0% in 2014. We forecast EBITDA margins will expand 260bps from 17.027% in 2012 to 19.6% in 2014.

We forecast diluted EPS of HK$1.70 in 2012, HK$2.19 in 2013 and HK$2.61 in 2014. Compared with consensus, our revenue for 2013 is 3% above while our EBITDA estimate is 11% higher. Our assumptions and model can be found in the appendix.

Figure 2: SHKF Estimates vs. Consensus

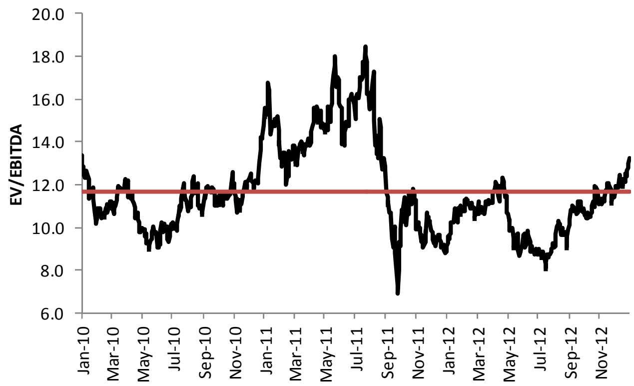
	2012E	2013E	2014E
Revenue	56,846	63,561	70,542
vs. Consensus	0%	3%	4%
Adj. EBITDA	9,666	11,814	13,855
vs. Consensus	1%	11%	13%
EBITDA Margins	17.0%	18.6%	19.6%
vs. Consensus (ppts)	0.1	1.2	1.6
EPS (HK$/sh)	1.70	2.19	2.61
vs. Consensus	-3%	11%	10%

Source: Bloomberg, Sun Hung Kai Financial

Valuation

Galaxy is trading at 12.7X 2013 EV/EBITDA, above its three year average of 11.7X, below its peak of 18X and slightly at the average of its peer group. By year-end we expect a larger divergence in EV/EBITDA valuation spread across the group with the operators with Cotai exposure commanding a premium. These include Sands China (1928.HK), Galaxy (27.HK) and Melco Crown (6883.HK).

Figure 3: Forward EV/EBITDA



Sources: Bloomberg, Sun Hung Kai Financial

Figure 4: Casino Valuation Table

Ticker	Company	Mkt Cap (US$mm)	YTD %chg	P/E (x) FY1	P/E (x) FY2	EV/EBITDA (x) FY1	EV/EBITDA (x) FY2	EBITDA Growth	% Est. Div Yield	ROE	EBITDA MARGIN
Macau Casinos											
1928 HK	Sands China	38,237	8.4	30.8	21.3	21.4	16.3	31.3%	3.1	21.3	26.5
1128 HK	Wynn Macau	15,357	9.5	18.0	16.4	14.4	13.3	8.3%	3.8	97.1	26.4
27 HK	**Galaxy**	**17,361**	**5.6**	**18.3**	**16.2**	**14.2**	**12.7**	**11.5%**	**0.0**	**47.9**	**16.5**
880 HK	SJM Holdings	14,491	12.5	17.0	15.3	12.5	11.2	11.9%	4.3	38.1	9.2
6883 HK	Melco Crown	10,907	19.0	27.1	21.9	13.2	11.8	11.8%	0.0	13.9	22.2
2282 HK	MGM China	7,833	14.0	13.4	13.2	11.2	10.6	5.7%	4.4	114.6	23.9
Average			**11.5**	**20.8**	**17.4**	**14.5**	**12.7**	**11.0%**	**2.6**	**55.5**	**20.8**
Casinos											
LVS US	Las Vegas Sands	43,182	13.6	24.0	19.6	14.2	12.2	17.0%	3.4	16.9	31.0
MGM US	MGM Resorts Int'l	6,198	8.8	n/a	n/a	10.7	10.1	6.8%	0.0	-11.1	17.3
WYNN US	Wynn Resorts Ltd.	12,361	9.3	22.6	20.2	10.4	9.7	7.0%	7.6	38.9	28.1
MPEL US	Melco Crown	10,534	13.2	24.6	21.3	12.8	11.9	7.5%	0.0	13.9	22.2
GENS SP	Genting Singapore	14,552	5.4	27.5	23.9	12.0	10.9	10.0%	0.5	10.7	46.8
CZR US	Caesars Entertainment	887	2.3	n/a	n/a	10.6	9.8	7.8%	n/a	-208.9	23.8
Average			**8.8**	**24.7**	**21.3**	**11.8**	**10.8**	**10.6%**	**2.3**	**-23.3**	**28.2**

Sources: Bloomberg, Sun Hung Kai Financial

Our DCF analysis yields a 12-month target price of HK$40/share and represents 25% upside versus the current share price. Our target price implies a 14X/12X EV/EBITDA to our 2013 and 2014 adjusted EBITDA estimates respectively.

We assume a 15.5% WACC. We expect revenues to grow 11.8% next year and 11% in 2014 versus consensus of 8.5% and 10%. With the opening of Phase II in 2015, we estimate growth will accelerate to 20% in 2015 and 2016. We estimate adjusted EBITDA growing at a faster rate of 19.8% CAGR through 2018 on EBITDA margin expansion of 6.5 ppts (EBITDA margin of 23.5% in 2018 versus expected 17% in 2012) supported by increasing exposure to mass gaming revenues.

Figure 5: DCF Scenario Analysis & Sensitivity

Assumptions		**2012-2018 (HK$m)**	**Base**	**Bear**	**Bull**
Market Cap/Capital	0.93	Revenue CAGR	13.5%	8.0%	17.0%
Beta (52wk)	1.17	EBITDA CAGR	19.8%	12.3%	25.2%
Risk Free Rate	3.5%	Margin Expansion (ppts)	6.5	4.5	8.5
Market Return	14.5%	Δ Non-Cash W/C % of Sales	-1.0%	-1.0%	-1.0%
Cost of Equity	16.4%	CapEx	28,083	25,700	30,053
Cost of Debt	5.0%	Present Value	61,900	43,562	79,951
WACC	15.5%	Terminal Value	103,811	69,810	136,013
Terminal Growth	3.0%	Enterprise Value	165,711	113,372	215,964
Net Debt + MI (HK$m)	(1,519)	Market Cap	167,230	114,891	217,482
Shares Outsanding (m)	4,199				
		Target HK$/Share	**40.00**	27.40	52.00
2012E EBITDA (HK$m)	9,666	Upside	**25%**	-15%	62%
2013E EBITDA	11,814	Implied 2013 EV/EBITDA	**14.0x**	11.0x	17.0x
2014E EBITDA	13,855	Implied 2014 EV/EBITDA	**12.0x**	10.0x	13.6x
		Implied 2013 P/E	18.26	12.51	23.74

	Terminal Growth		
WACC	**2.0%**	**3.0%**	**4.0%**
14.5%	41.00	43.50	46.50
15.5%	37.70	39.80	42.20
16.5%	34.90	36.60	38.60

Source: Sun Hung Kai Financial

In our bear case we assume 3.5% and 7.5% top line growth in 2013 and 2014 followed by 15% and 10.5% growth in 2015 and 2016 respectively. EBITDA expansion of 4.5ppts should drive EBITDA CAGR of 12.3%. Our bull case assumes 17% top line CAGR over six years and EBITDA to grow over 25% per annum on 8.5ppts margin expansion.

We exclude GEG's Phase III expansion plans from our target price and scenario analysis, as construction costs and gaming-table allocations are uncertain at this point. Management said the earliest completion for Phase III would be the end of 2016 with construction to commence at the end of 2013 or early 2014. To us, the stated timeline is aggressive. Additionally, the company will need project financing to meet the HK$40bn-HK$50bn capex estimate. Initial plans are for 4,000 additional hotel rooms and capacity for 600 gaming tables and 2,000 slot machines (pending government approval). We estimate discounted cash flows from Phase III based on our 15.5% discount rate could be worth HK$3-HK$6/share today, but at this point we exclude it from our target price and leave it as a free option. Approval for construction is expected in 2013.

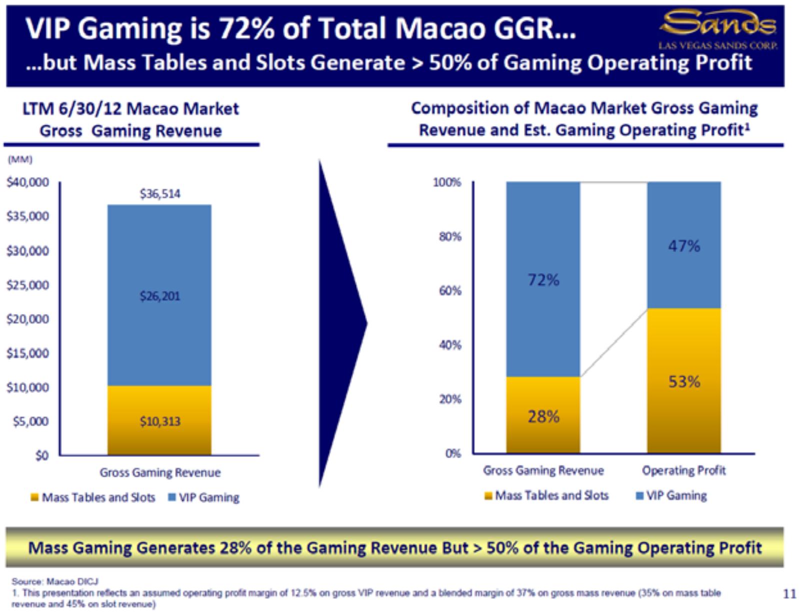
Investment Thesis

We like Galaxy for three main reasons: 1) Growth in mass gaming mix should provide a long-term opportunity for EBITDA margin expansion 2) Ability to fund expansion from strong FCF generation and improving balance sheet. 3) We believe the growth prospects remains resilient for gaming revenues and GEG stands to benefit.

EBITDA Margin upside to provide good operating leverage

One of the better-known investment themes for the industry is that mass gaming revenues provide better margins than VIP gaming revenues. Mass gaming in Macau generates 30% of gaming revenues but accounts for more than 50% of operating profits for the casino operators. The differential between the two is mainly a result of the junket commissions that are paid out on VIP revenues. That cost is 1.25% of VIP rolling chip turnover. Operating profit margin is about 12.5% for gross VIP revenues while blended mass (slots and non-VIP table games) operating profit is about 35%. The slide below pulled from a Sands presentation provides a rough guide in terms of profitability between the two streams of revenues.

Figure 6: VIP and Mass Gaming Margins



Source: LVS Presentation

At close to 80% VIP gaming revenue mix, Galaxy has one of the highest VIP gaming exposures among the six concessionaires in Macau, resulting in one of the lowest EBITDA margins among its peers.

Figure 7: Adjusted EBITDA Margins

	2010	2011	2012E	2013E	1H11	1H12	Q311	Q312
SJM	8.4%	9.1%	9.7%	10.0%	9.2%	9.7%	8.8%	10.2%
Galaxy	**11.6%**	**14.0%**	**16.9%**	**17.4%**	**13.3%**	**16.6%**	**13.5%**	**18.5%**
Melco Crown	18.0%	22.4%	22.4%	23.2%	18.4%	26.6%	23.9%	23.2%
MGM China	22.8%	24.3%	24.8%	24.6%	25.1%	25.1%	22.6%	23.2%
Wynn Macao	26.2%	27.0%	27.3%	27.4%	27.3%	27.3%	31.1%	32.1%
Sands China	29.4%	32.3%	28.9%	30.0%	32.0%	29.9%	32.7%	29.8%
Overall	17.6%	18.9%	19.4%	20.2%	18.6%	19.8%	17.8%	19.6%

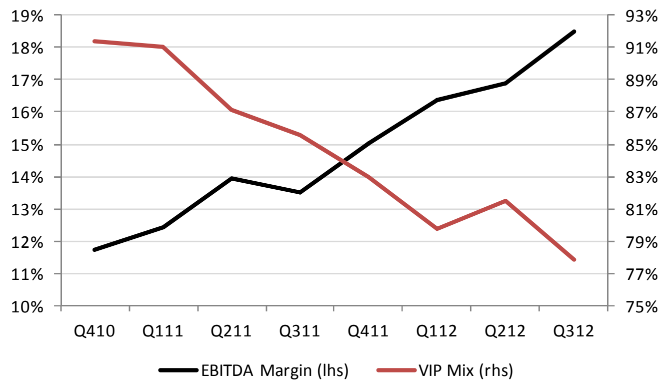
Source: The Company, Sun Hung Kai Financial, estimates are Bloomberg consensus

As a side note, SJM's reported EBITDA margins are the lowest in the sector mainly due to long-term royalty sharing agreements with its satellite casinos for which it receives only 3-5% commission. Adjusted for these royalties, EBITDA margins would be closer to 30%, in line with the general model that a higher mix of mass should result in better EBITDA margins.

We argue that Galaxy has one of the best EBITDA margin expansion opportunities mainly from product mix shift towards mass gaming. The Street is forecasting Macau casino operator revenues to top 11% in FY13 on 20-30% Mass revenue growth and single digit VIP growth. EBITDA margins across the industry in theory should see expansion.

In Q1 2011, VIP accounted for over 91% of the firm's gaming revenues. With the opening of its Galaxy Macau property, the greater mix of mass market gaming revenues has supported EBITDA margin expansion. VIP revenue mix in the latest quarter was 78% of gaming revenues while adjusted EBITDA margins improved to 18.5% in Q3 2012 from below 12% in Q4 2010. We expect Galaxy to decrease annual VIP revenue exposure from 79% of gaming revenues in 2012 to 74% by the end of 2014.

Figure 8: Galaxy EBITDA Margins and VIP Mix



Sources: Company, Sun Hung Kai Financial

We believe the unique qualities of Galaxy's Cotai property can further support growth in mass market revenues for the casino and attract visitors. The resort has the world's largest rooftop wave pool with 200 sq m of sandy beach. The facility also has a cinema with seating for 1,000 and three hotels with 2,200 rooms in total. We were impressed with the facilities during our tour last year. The firm has also aggressively marketed itself catering to the tastes of Chinese clientele.

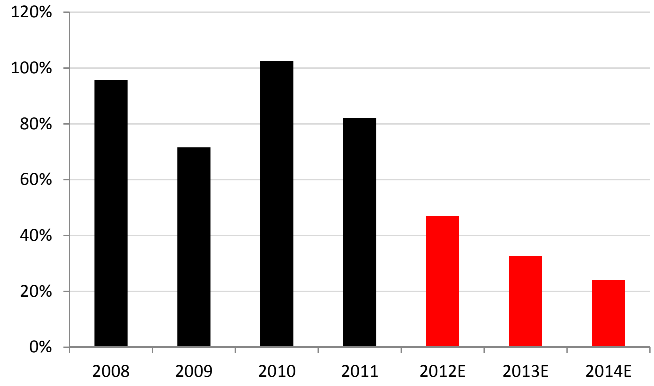
We believe the Street remains conservative on the margin opportunity for Galaxy. Consensus EBITDA margin for 2013 is 17.3%, up only slightly year over year while in Q3 Galaxy already reported EBITDA margins of 18.5%. The improvement is linked to the firm's change in mix. We estimate Galaxy will achieve 18.6% EBITDA margins in 2013 and 19.6% in 2014. On our

11.4% revenue CAGR over the next two years the margin expansion should result in EBITDA leverage of 1.7X.

Improving Balance Sheet and strong FCF

The company's financial position is much stronger than it was just a couple years ago. Solid free cash flow generation from its major properties StarWorld and Galaxy Macau have allowed the company to quickly deleverage its balance sheet. Overall debt to equity has improved from 102% in 2010 to 65% at the end of 1H12 and our forecast of 47% by the end of 2012.

Figure 9: Debt-to-Equity

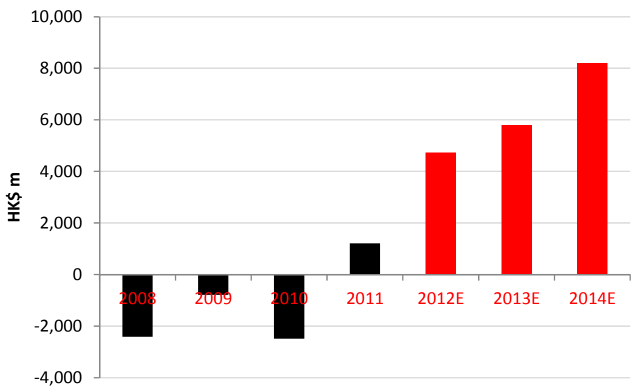


Sources: The Company, Sun Hung Kai Financial

While total debt has increased from HK$6.7bn at the end of 2008 to HK$11.5bn at the end of 1H12, the overall cash position has improved significantly. The firm has gone from a net debt position of HK$5bn in 2010 to net cash of HK$665m at the end of Q3 2012.

In Q3 the company generated HK$2.6bn in EBITDA while its Galaxy Macau property alone contributed HK$1.8bn in EBITDA. Since opening in May 2011, Galaxy Macau Phase I has generated HK$7.2bn in adjusted property EBITDA. Not bad, considering that the property has been in operation less than two years. Going forward, we believe the company can fund the entire cost of its Phase II construction from its current cash balance and operating cash flows over the next couple of years. We estimate GEG will generate FCF of HK$4.7bn in 2012 and HK$5.8bn in 2013, compared with HK$1.2bn in 2011. Galaxy's management has no clear plans yet to return funds to shareholders via dividends, and with significant expansion projects in the pipeline, dividends are unlikely over the next couple years.

Figure 10: Galaxy Free Cash Flow



Sources: Bloomberg, Sun Hung Kai Financial

Gross Gaming Revenue (GGR) Resiliency

Despite VIP gaming revenue volatility, we believe the gaming industry in China will continue to be resilient over the longer term. We highlight our thoughts below.

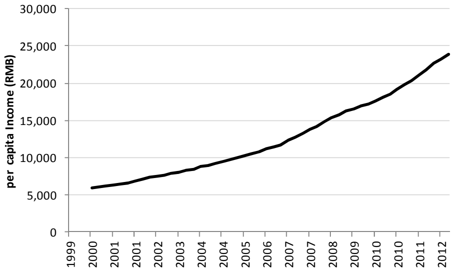
1. Macau gaming is correlated with per capita income in China. And with per capita income expected to double over the next 10 years, Macau casino operators should benefit.

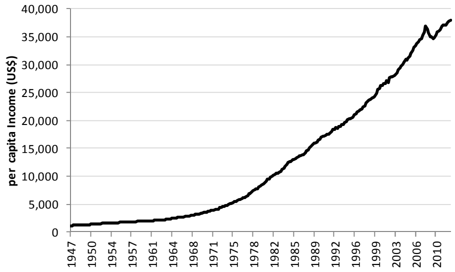
2. The city of Macau is heading towards a more sustainable business model with less dependency on VIP gaming revenues, while increasing exposure to gaming and entertainment for the masses.

3. Infrastructure bottlenecks are being addressed by the city, casino operators and the Chinese government.

Wealth Effect – China's per capita income continues to grow at an exponential rate. From 2000 to 2012, annual per capita income of urbanites grew from RMB5.8K to RMB23.7K. The curve is not dissimilar to the U.S. per capita income over the past 50 years, which suggests room for further growth in China.

Figure 11: China Per Capita Urban Household Income (L), U.S. per Capita Income (R)

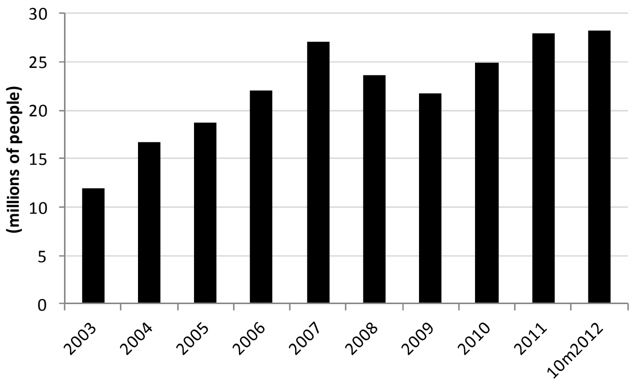




Sources: Bloomberg, Sun Hung Kai Financial

With growth in urban wealth and a rising middle income group in China, discretionary spending has increased and Macau has been a well planned beneficiary. The number of visitors entering Macau has increased from 10m in 2003 to 28.2m through the first 10 months of 2012, with 60% of those coming from the PRC.

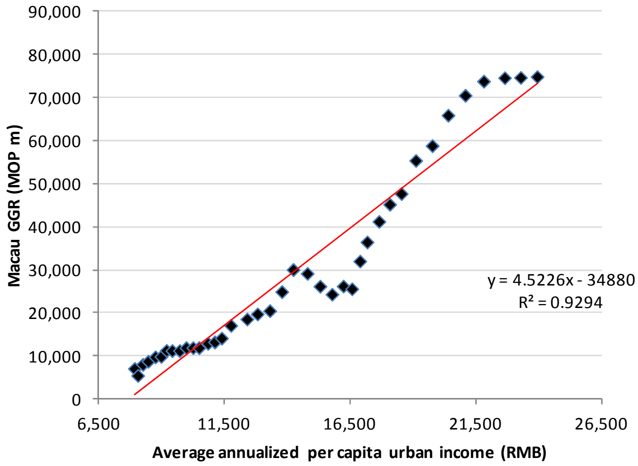
Figure 12: Macau Visitors



Sources: DSEC, Sun Hung Kai Financial

Macau gross gaming revenues (GGR) are correlated to per capita urban income of Chinese households and for illustration we used a linear trend line.

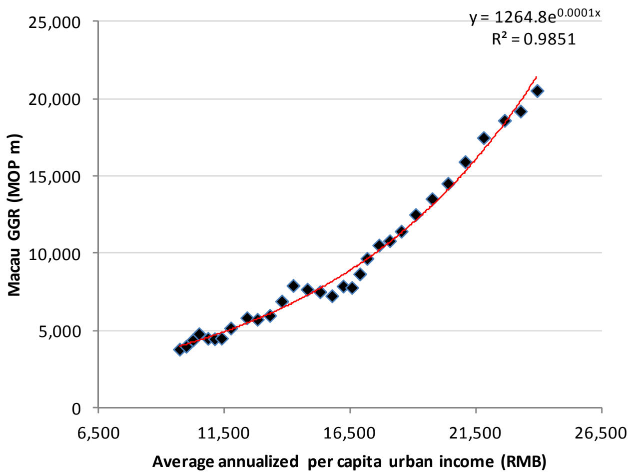
Figure 13: Per Capita Urban Income vs. Macau GGR



Sources: Bloomberg, DICJ, Sun Hung Kai Financial

There have been two periods where there was significant movement off the trend line. The first can be explained by the 2008-09 global financial crisis and Macau visa tightening for PRC visitors significantly reduced Macau GGR. The decline was more significant on the VIP gaming side while mass gaming was less impacted. The strong lift starting in 2011 coincides with the completion of large integrated casino resorts on the Cotai Strip. The recent slowdown in GGR can perhaps be attributed to the increased political scrutiny over illicit funds leaving China via Macau ahead of China's once in a decade leadership change. Again, mass gaming revenues were less impacted and debatably an exponential trend line better reflects the relationship between rising income and Macau mass gaming revenues.

Figure 14: Per Capita Urban Income vs. Macau Mass Gaming Revenues



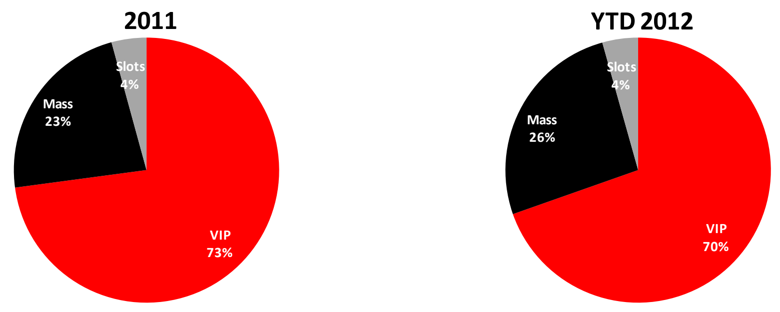
Sources: Bloomberg, DICJ, Sun Hung Kai Financial

The urban population in China in 2010 was 666m and roughly 230m are middle-income earners. The Chinese Academy of Social Sciences forecast that half of the country's urban population will be in the middle-income range by 2023. A growing Chinese middle class and higher per capita incomes both in urban and rural areas will provide significant upside to improving China's consumption and reduced reliance on an export driven economy, all part of China's central party goals. Additionally, the central

Chinese government aims to double its 2010 per capita income by 2020. The goals appear conservative and the PBOC expects China's per capita income will likely double 1-2 years ahead of the Central party's schedule.

More sustainable – VIP Baccarat accounted for 73% of all gaming revenue generated in Macau in 2011. VIP revenues grew at a 38% average rate from 2005 to 2011, mass and slots grew at a 25% clip over the same period. In 2012, VIP gaming growth decelerated ahead of the once in a decade Chinese leadership changeover. Meanwhile, mass gaming growth continued to accelerate. Through three quarters in 2012, mass gaming has grown 33%yoy while VIP has grown 9%yoy.

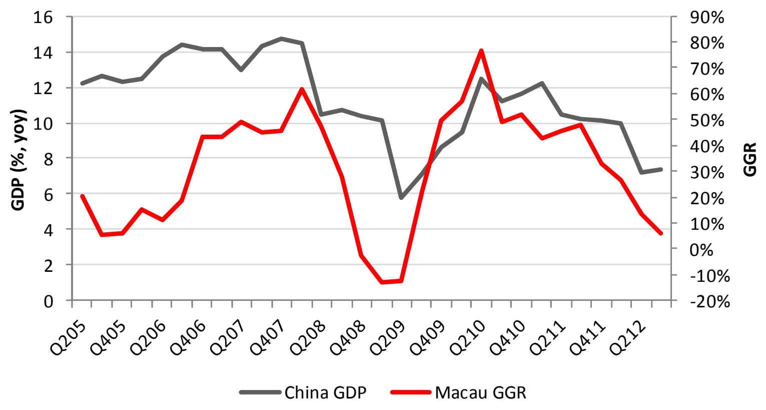
Figure 15: GGR Gaming Mix



Sources: DICJ, Sun Hung Kai Financial

Political and regulatory risk remains a significant overhang for the industry and has been the source of volatility in the sector, especially on the VIP gaming side. For now, Macau remains the only legal place in China for casino gambling, where the flow of tourists is readily controllable by the central government and three centuries of casino operating knowledge is centralized. Our view is that over the longer term, these risks will lessen as casino operators increase exposure to hotel, mass gaming and other revenues and reduce dependence on VIP, something that government officials in Beijing would like to see. For the foreseeable future we believe Macau will operate under a similar framework. Unlikely we will see the 38% compounded growth in VIP revenues seen over the past six years, but VIP growth tracking closer to China GDP of 7%-9% may be a more prudent assumption and with a potential acceleration in Chinese GDP in the final quarter of 2012 and in Q1 2013, VIP revenue growth will see some life again after a poor Q3 2012.

Figure 16: VIP Baccarat Revenues and GDP



Sources: Bloomberg, DICJ, Sun Hung Kai Financial

Casino operators have known that the longer-term viability of gaming in Macau is based on appealing to the masses and less on VIP clients. The result has been large investments in integrated resorts with facilities, hotels and attractions that appeal to a growing middle income class in China. In Macau there are over 90 hotels and guest houses with 25.5K rooms according to Macau's department of statistics. Since the start of 2010, almost 7,000 rooms have been added in the city, and despite the significant increase, occupancy rates have increased from 80% to over 84% while average hotel rates have increased 22%. Demand remains robust.

In theory, operators should prefer setting up a mass gaming table over a VIP table due to better profitability per dollar spent. Logistically a casino operator on any given day can change the number of tables operated for either VIP or mass gaming but table agreements with junket operators and average profitability per table impacts any longer term changes to table mix. Increasing utilization rates, size of minimum bets, premium mass gaming services and velocity of game play on mass market tables are creative methods that casino operators employ to improve per table profitability on mass tables.

Addressing Chokepoints for Mass

Macau visitor growth has increased on average 7% per annum since 2005. The number of visitors from China has increased 10m to 16m per year. In 2008, the Chinese government tightened travel visas granted to Chinese citizens to visit Macau resulting in a significant fall-off in visitations in 2008-09. Since then the government has somewhat relaxed its Individual Visit Scheme (IVS) and growth has picked up. The number of Chinese nationals visiting Macau remains below 2008 peaks, but a number of key infrastructure changes over the next year should make the enclave more accessible to mainland visitors.

Expansion of Gongbei Gate – On the Zhuhai side (north of the Macau Peninsula), the immigration gate will be expanded to handle 350-500K travelers daily, up from 150K and the gate is expected to operate 24hours compared to 17hours currently. The immigration gate on the Macau side can already handle 500K travelers daily. Completion is expected to be early Q1 2013, potentially ahead of Chinese New Year's.

Guangzhou-Zhuhai Intercity MRT – The high speed train from Wuhan to Guangzhou South station to Zhuhai North opened in 2011 and the extension directly to the Zhuhai Gongbei gate with non-stop service in 47 minutes from Guangzhou will be completed in early 2013. The link has a capacity to handle 350K plus passengers daily.

Beyond 2013, there are a number of infrastructure developments that will improve the attractiveness of Macau as a leisure destination.

- The development of a theme park in Hengqin Island across from the Lotus Bridge connecting Zhuhai to Cotai.
- The city is also building a light rail system connecting the Macau Peninsula to Cotai to be completed in 2015
- Upgrading of the Taipa ferry terminal will be complete by 2016.
- The 42-km Zhuhai-HK-Macau bridge is set to be complete in 2016.
- Macau's airport will double capacity to 12m passengers by 2017.

Hotel availability remains a bottleneck in the city. There are 25.5K available rooms in Macau with occupancy rates over 80% and likely at capacity on weekends. Sands China will add 2,100 rooms in Q1 2013 Sands but further supply of rooms won't come online until mid-2015 with the opening of Galaxy Phase II.

Figure 17: Cotai Projects

Company	Description	Est. Completion
Galaxy	Phase II Galaxy Macau - 1,350 rooms at Ritz Carlton and J.W. Marriott, 500 gaming tables, 1,000 slots. HK$16.5bn	mid 2015
	Phase III Galaxy Macau - 4,000 rooms, 600 tables, 2,000 slots. HK$40-50bn	2016-2017
Sands China	Phase IIB - Opening of Sheration tower 2 with 2,100 Hotel Rooms	Q1 2013
	Phase III - Parisian Macao, 3,000 rooms St. Regis Hotel, 450 tables and 2,500 slots. US$2.7bn	Q1 2016
Melco Crown	1,600 room casino resort with 500 gaming tables and 1,500 slots	mid 2015
Wynn Macau	2,000 room casino in Cotai with 500 gaming tables	early 2016
MGM China	1,600 rooms, 500 tables, 2,500 slots	2016
SJM	2,000 rooms, 700 tables, 1,000 slots	2016

Sources: Companies, Sun Hung Kai Financial

Risks

VIP Gaming Risks - In the U.S., a casino operator can provide high-end services and special amenities as well as extend credit to high rollers. In Macau, junket operators perform this role and assume the credit risk. Junket operators will bring their clients to the casino where they can gamble in special VIP rooms. Notably, the only game played is Baccarat. Players prefer this game due to its simplicity and the relatively low theoretical house advantage. The junket operator will pay for special non-negotiable "rolling chips" for their VIP clients. Winnings are paid in regular chips by the casinos which are then cashable. The use of non-negotiable chips enables the casino to track the amount of play turnover. The junket operator gets a commission of the total rolling chip turnover (RCT) usually a percentage of casino winnings or more often, a percentage of the RCT. The percentage of RCT is capped at 1.25%.

Junket operations in Macau are fairly concentrated. There are about 219 operators licensed with the top five operators controlling 50% of all rolling chip turnover in Macau. These include Neptune Macau, Golden Resorts, Suncity, Jimei and David Group, all of which are privately held and run. Operations of these groups are not well known publicly but some public information is available through junket investors that own stakes in tables operated by the junkets themselves. These include Asia Entertainment Resources (AERL.US), A-Max (959.HK), Dore (628.HK) and Neptune (70.HK).

In summary, credit operators referred to as junkets bring high rolling clients from mainland China to Macau. Gaming chips are paid for in Yuan but winnings are cashed out in Hong Kong dollars where they can be taken offshore. The bears worry that the opportunity for monies to leave the PRC illegally through Macau is a serious risks and that government policies to tackle graft and liberalization of the Yuan could hurt VIP gaming revenue in Macau. The following article from The Economist describes it better than we can: http://www.economist.com.hk/node/21541417.

That said, VIP gaming growth in 2012 has slowed considerably. This is attributed to slower growth in China and higher scrutiny from Beijing ahead of the leadership changeover this year, highlighting that the risks are real and the government may flex its muscles from time to time to reduce the grey activity in Macau.

Credit Tightening – VIP gaming growth is based on availability of credit. PBOC policies to tighten credit in China may have a negative impact on VIP gaming in Macau.

Regulatory Risks – 1) Smoking Ban, now that the government of Macau mandates that 50% of all gaming floor space must be smoke free. The change could have a short-term negative impact on gaming revenues. 2) Starting from 2013, the government of Macau will limit table supply growth to 3% per annum. The current number of tables in Macau is about 5,500. This could mean Galaxy may not get government approval to fill its 500 table capacity of its Phase II project.

Competition – With limited supply of gaming table additions over the next couple years, there is a risk that operators may aggressively compete to attract customers and drive up competition which could result in market-share loss for Galaxy. There are other gaming destinations in the region including Korea, Singapore, Philippines, Vietnam and Cambodia. There are also discussions regarding Taiwan, Japan and Korea opening up additional casinos.

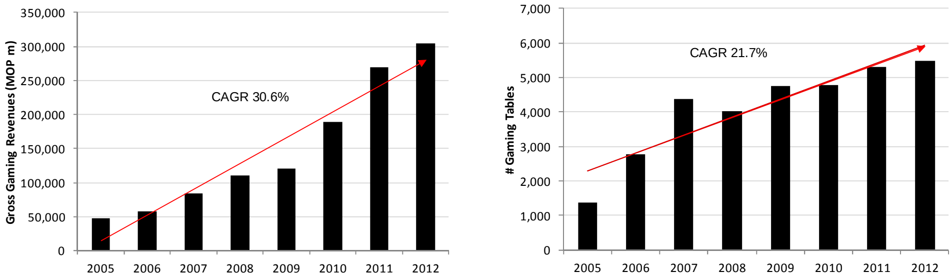
Industry

Macau is a special administrative region of China and gaming revenues are estimated to account for more than 70% of the SAR's fiscal revenues. The city is the largest gaming market globally. Revenues in 2011 were US$34bn, compared to US$6bn in Las Vegas. After growing 58% in 2010 and 42% in 2011, gaming revenues grew 13.5% in 2012. While growth rates have moderated, the longer term potential for the region remains significant.

The gaming history for Macau stretches back three centuries and the city is referred to as the Monte Carlo or Las Vegas of the East. Macau's government in 1847 legalized gaming in response to slowing trade and its status as a port. Prior to 2002, STDM, SJM's parent company held the monopoly rights to operate games of fortune in Macau. After the handover of Macau back to the Chinese government, Macau authorities granted three concessions to SJM, Wynn and Galaxy to operate casinos in the city. Sub-concessions to operate casinos were later allowed to Venetian Macao, MGM Grand and Wynn Melco. Most of the concessions are for 15-year terms expiring between 2020 and 2022. Galaxy's concession expires on June 2022. The concession agreements set out minimum capital expenditure requirements, fees and taxes that must be paid by the concession holders towards the development of Macau.

Post the granting of concessions, Sands Venetian was the first casino to open in May 2004. The number of casinos in operation increased from 17 in 2005 to 35 today. The number of gaming tables also increased from 1,226 to 5,497, while gross gaming revenues rose from MOP47.1bn in 2005 to MOP269bn in 2011. Visitor arrivals to the enclave have risen from 18.7m per year in 2005 to 28m in 2011.

Figure 18: Growth of Gaming in Macau

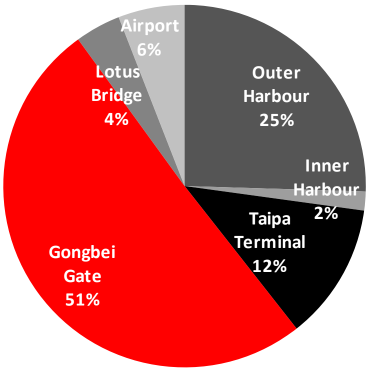


Sources: DICJ, DSEC

Over the past couple of years, casino operators have invested a significant amount in building the city into a gambling Mecca. Based on financial statements of the six concessionaires, more than US$9bn was spent in the past four years in CapEx. With limited land supply on the Macau peninsula, much of the investment has been into large integrated casino resorts on the Cotai Strip.

There are six entry points into Macau. The outer harbor ferry terminal, inner harbor terminal, Taipa ferry terminal, Gongbei border gate, Lotus Bridge and Macau airport. The majority of visitors are from mainland China and enter the city from the Gongbei border gate.

Figure 19: 2011 Macau Border Entry Mix



Sources: DSEC, Sun Hung Kai Financial

Figure 20: Macau Gaming Snapshot

	Galaxy 27.HK	SJM 880.HK	Sands China 1928.HK	Wynn 1128.HK	MGM 2822.HK	Melco 6883.HK
Interim 2012 (US$m)						
Revenues	3,654	5,066	2,921	2,394	1,413	1,965
Adj. EBITDA	4,712	3,812	873	3,932	2,746	482
Adj. EBITDA Margins	16.6%	9.7%	29.9%	21.2%	25.1%	24.5%
Cash	1,556	2,761	1,364	835	659	1,834
Debt	1,481	510	3,269	397	537	2,366
Shareholder's Equity	2,290	2,204	4,772	951	514	3,167
Net Debt	-76	-2,251	1,905	-438	-122	532
D/E	0.65	0.23	0.69	0.42	1.05	0.75
Gaming Mix 3Q12						
VIP	78%	65%	57%	76%	72%	73%
Mass	19%	33%	37%	19%	21%	22%
Slots	3%	2%	6%	5%	7%	5%
Casinos						
Cotai	1	0	3	0	0	2
Penisula	5	20	1	1	1	1
Key Casinos	Galaxy Macau	Grand Lisboa	Sands Macao	Wynn Macau	MGM Macau	Altira
	StarWorld	Lisboa	Venetian			City of Dreams
	City Clubs (4)	satellite casinos (18)	Sands Central Cotai			Mocha Clubs
			Plaza Macao			
Hotel Rooms	2,700	405	>9000	1,008	582	1,300
Tables	694	1,750	1,341	504	419	622
Slots & Gaming Machines	1,454	840	>6000	939	1,247	3,000
Expansion by 2017						
Est. Budget (US$bn)	8.6	TBD	2.7	3.0	2.6	2.9
Rooms	5,350	2,000	5,000	2,000	1,600	1,600
Tables	1,100	700	650	500	500	500
Slots	3,000	1,000	2,500	TBD	2,500	1,500

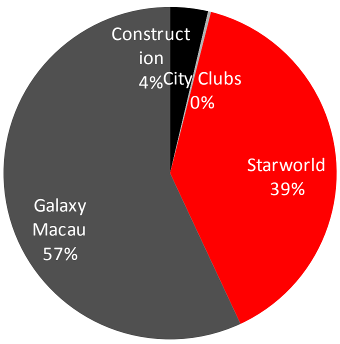
Sources: Company, Sun Hung Kai Financial

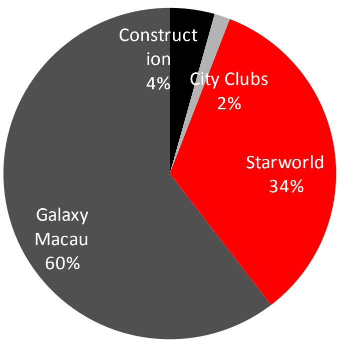
Company

Galaxy Casino S.A. received a concession from the Macau government in 2002 to operate games in the SAR. It is one of six gaming concession holders in Macau. It opened its first casino, Casino Waldo in 2004. Galaxy Entertainment Group ("GEG", 27.HK) went public in 2005, the first gaming operator to list on the Hong Kong Exchange.

Today the company operates a number of casinos and hotels including two flagship properties, StarWorld on the peninsula side and Galaxy Macau on the Cotai strip which account for over 95% of revenues. The company also has four smaller casinos and a construction-materials business.

Figure 21: Overall 9M12 Revenue mix (L) and EBITDA mix (R)

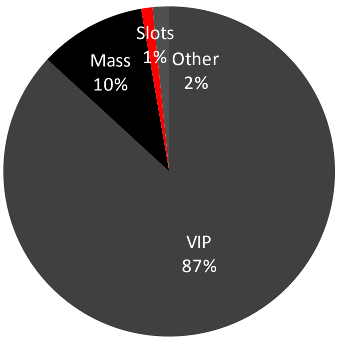


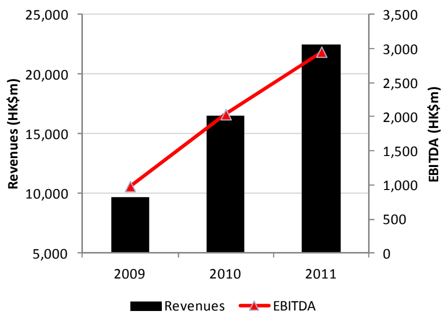


Sources: Company, Sun Hung Kai Financial

The company has invested almost HK$3.5bn in developing its StarWorld property on the Macau Peninsula. StarWorld opened in 2006 with a 500-room five-star hotel, 240 gaming tables and 240 slot machines. The property attracts a significant amount of high-rolling VIP clients with 87% of revenues from VIP tables. In 2011, the property generated HK$22.5bn in revenues and adjusted EBITDA of HK$2.96bn. The property has reported 53% revenue and 73% EBITDA CAGRs over the past two years.

Figure 22: 9M12 StarWorld Revenue mix (L), Revenues & EBITDA (R)



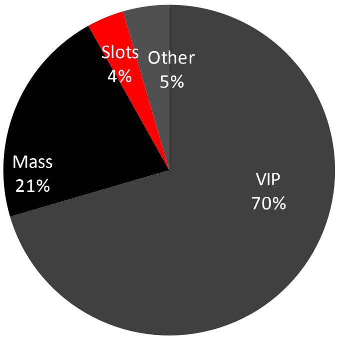


Sources: Company, Sun Hung Kai Financial

Galaxy Macau opened the first phase of its integrated casino resort on the Cotai Strip in May 2011. Investment in the property was HK$16.5bn. The first phase of the resort included three hotels, Okura, Banyan Tree and its self-run Galaxy Hotel, with 2,200 rooms in total. The resort also has the world's largest rooftop wave pool with 200 sq m of sandy beach. The casino houses 600 gaming tables and 1,500 electronic gaming machines and slots.

The facility also has a cinema with seating for 1,000. Galaxy Macau through the first three quarters of 2012 achieved revenues of HK$24.3bn and EBITDA of HK$4.6bn.

Figure 23: 9M12 Galaxy Macau Revenue mix



Sources: The Company and Sun Hung Kai Financial

Construction of phase 2 of Galaxy Macau began in Q1 2012 and it is set to open mid-2015. The company boasts that it owns the largest land bank of 15m sq m for development of hotels and entertainment facilities. The new casino is expected to have 500 additional gaming tables and will have two hotels operated by Ritz-Carlton and JW Marriott with a total of 1,350 rooms. Total projected spending on Phase II is HK$16.5bn, equivalent to what was spent on Phase I of Galaxy Macau.

Appendix – Financial Model

P&L (HK$m)	1H11	2H11	2011	1H12	2H12E	2012E	1H13E	2H13E	2013E	2014E
VIP RCT	359,000	685,305	1,044,305	696,906	673,809	1,370,715	760,957	796,838	1,557,795	1,659,052
%yoy	*55.4%*	*141.3%*	*102.8%*	*94.1%*	*-1.7%*	*31.3%*	*9.2%*	*18.3%*	*13.6%*	*6.5%*
VIP Revenue	10,700	21,622	32,322	21,322	20,209	41,531	21,687	22,710	44,397	47,283
VIP Win%	*2.98%*	*3.16%*	*3.10%*	*3.06%*	*3.00%*	*3.03%*	*2.85%*	*2.85%*	*2.85%*	*2.85%*
VIP %Gaming Revenue	*84.1%*	*84.1%*	*84.1%*	*80.8%*	*76.9%*	*78.8%*	*76.6%*	*76.0%*	*76.3%*	*73.8%*
Mass Drop	6,400	15,295	21,695	16,676	18,924	35,600	20,845	22,592	43,437	52,244
%yoy	*113.3%*	*324.9%*	*228.7%*	*160.6%*	*23.7%*	*64.1%*	*25.0%*	*19.4%*	*22.0%*	*20.3%*
Mass Revenues	1,128	3,387	4,515	4,419	5,259	9,678	5,747	6,243	11,991	14,628
Mass Win%	*17.63%*	*22.14%*	*20.81%*	*26.50%*	*27.79%*	*27.19%*	*27.57%*	*27.63%*	*27.60%*	*28.00%*
Mass %Gaming Revenue	*8.9%*	*13.2%*	*11.7%*	*16.7%*	*20.0%*	*18.4%*	*20.3%*	*20.9%*	*20.6%*	*22.8%*
Slot Handle	3,870	10,295	14,165	10,496	12,855	23,351	13,459	14,440	27,898	33,478
%yoy	*220.6%*	*531.6%*	*399.3%*	*171.2%*	*24.9%*	*64.8%*	*28.2%*	*12.3%*	*19.5%*	*20.0%*
Slot Revenues	233	653	886	691	803	1,494	875	939	1,813	2,176
Slot Win%	*6.02%*	*6.34%*	*6.25%*	*6.58%*	*6.25%*	*6.40%*	*6.50%*	*6.50%*	*6.50%*	*6.50%*
Slots %Gaming Revenue	*1.8%*	*2.5%*	*2.3%*	*2.6%*	*3.1%*	*2.8%*	*3.1%*	*3.1%*	*3.1%*	*3.4%*
Gaming Revenues	12,723	25,710	38,433	26,387	26,271	52,703	28,309	29,892	58,201	64,088
%yoy	*63.5%*	*161.3%*	*132.0%*	*107.4%*	*2.2%*	*39.7%*	*7.3%*	*13.8%*	*10.4%*	*10.1%*
Other Revenues	946	1,808	2,753	1,935	2,253	4,188	2,543	2,817	5,360	6,455
Total Revenues	**13,669**	**27,517**	**41,186**	**28,322**	**28,524**	**56,892**	**30,853**	**32,708**	**63,561**	**70,542**
%yoy	*55.0%*	*59.5%*	*113.8%*	*157.4%*	*107.2%*	*38.0%*	*3.7%*	*8.9%*	*11.8%*	*11.0%*
Gaming Tax	(5,010)	(10,107)	(15,117)	(10,376)	(10,509)	(20,884)	(11,324)	(11,957)	(23,280)	(25,635)
Junket Commissions	(5,123)	(9,871)	(14,994)	(9,438)	(8,943)	(18,381)	(9,542)	(9,992)	(19,535)	(20,805)
Consumables	(276)	(475)	(750)	(384)	(483)	(867)	(507)	(529)	(1,036)	(1,254)
Employee Benefits & Other	(2,396)	(3,356)	(5,752)	(3,617)	(3,637)	(7,254)	(3,872)	(4,023)	(7,895)	(8,994)
DepN & AmortN	(349)	(899)	(1,248)	(906)	(978)	(1,883)	(1,072)	(1,072)	(2,145)	(2,390)
OpEx	**(13,153)**	**(24,708)**	**(37,861)**	**(24,720)**	**(24,549)**	**(49,269)**	**(26,318)**	**(27,573)**	**(53,891)**	**(59,077)**
OpEx/Sales	*-96.2%*	*-89.8%*	*-91.9%*	*-87.3%*	*-86.1%*	*-86.6%*	*-85.3%*	*-84.3%*	*-84.8%*	*-83.7%*
Adjusted EBITDA	**1,818**	**3,931**	**5,749**	**4,712**	**4,954**	**9,666**	**5,607**	**6,207**	**11,814**	**13,855**
EBITDA Margins	***13.3%***	***14.3%***	***14.0%***	***16.6%***	***17.4%***	***17.0%***	***18.2%***	***19.0%***	***18.6%***	***19.6%***
Net Profit to Owners	**381**	**2,622**	**3,003**	**3,447**	**3,815**	**7,261**	**4,392**	**4,990**	**9,382**	**11,193**
Diluted EPS (HK$/Share)	**0.09**	**0.62**	**0.71**	**0.81**	**0.90**	**1.70**	**1.03**	**1.17**	**2.19**	**2.61**
%yoy	*-20.5%*	*461.4%*	*216.3%*	*789.0%*	*44.2%*	*138.0%*	*27.4%*	*30.8%*	*28.9%*	*19.3%*

HK$m **Cash Flow**	Dec-10 **2010**	Dec-11 **2011**	Dec-12 **2012E**	Dec-13 **2013E**	Dec-14 **2014E**
Operating	**2,106**	**5,698**	**9,230**	**11,790**	**14,200**
Investing	**(4,742)**	**(4,913)**	**(4,556)**	**(6,000)**	**(6,000)**
Financing	**3,487**	**1,616**	**(1,435)**	**-**	**-**
Net Cash	850	2,402	3,238	5,790	8,200
FX + Other	(197)	(559)	-	-	-
End Cash	**4,170**	**6,013**	**9,251**	**15,041**	**23,241**

Ratios	**2010**	**2011**	**2012E**	**2013E**	**2014E**
Revenue Growth	57.5%	113.8%	38.0%	11.8%	11.0%
Adj. EBITDA Growth	99.3%	157.7%	68.1%	22.2%	17.3%
NP Growth	-21.8%	234.1%	141.8%	29.2%	19.3%
EBITDA Margin	11.6%	14.0%	17.0%	18.6%	19.6%
NPM	4.7%	7.4%	12.8%	14.8%	15.9%
Net Debt (Net Cash)	4,998	2,719	(1,956)	(7,746)	(15,946)
D/E	102.5%	82.1%	47.0%	32.7%	24.0%
ROA	4.1%	9.9%	18.6%	19.9%	19.2%
ROE	10.4%	25.7%	40.7%	35.8%	30.7%

HK$m **Balance Sheet**	Dec-10 **2010**	Dec-11 **2011**	Dec-12 **2012E**	Dec-13 **2013E**	Dec-14 **2014E**
PPE	16,802	21,991	24,727	28,673	32,363
Intangibles	2,134	1,270	1,151	1,060	980
Total non-current assets	19,650	26,481	29,088	32,944	36,554
Inventories	87	138	165	180	196
A/R	853	1,579	2,336	2,612	2,899
Cash & Equivalents	4,428	8,953	12,057	17,848	26,048
Total current assets	5,536	9,283	13,252	19,334	27,836
Total Assets	**25,186**	**35,764**	**42,341**	**52,277**	**64,390**
A/P	5,244	8,829	9,682	10,216	11,110
ST Debt	2,283	1,142	-	-	-
Total current liabilities	8,008	9,993	9,720	10,254	11,148
LT Debt	7,144	10,531	10,101	10,101	10,101
Total non-current liabilities	7,604	11,128	10,698	10,698	10,698
Total liabilities	**15,612**	**21,121**	**20,418**	**20,952**	**21,847**
Owner's Equity	9,197	14,222	21,485	30,867	42,060
Total Equity	**9,575**	**14,643**	**21,922**	**31,326**	**42,543**

Sources: Company, Sun Hung Kai Financial

Disclosure of Interests

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