

Company Research: NagaCorp (3918 HK)

Buy / Price Target \$8

**Updated thoughts from our
recent property visit**

We recently returned from a property visit to NagaWorld. Herein are our updated thoughts. We would highlight our continued excitement about Naga's transformational VIP initiatives, its declining exposure to the Vietnamese mass market consumer (important in the event Vietnam were to legalize locals gaming) while still growing overall mass GGR in the mid-teens or better; and the positive events that will impact the slot/ETG floor beginning later next year.

Asian Nations already adding an incremental 40% to RC volume

Over the early weeks of the Asian Nations junket bringing players to Naga, we believe the run rate is approximately USD150mm in monthly rolling chip volume, or nearly 40% incremental rolling chip volume relative to the existing junket volume on property. Asian Nations is a China-based junket that does not have exposure to Macau, but rather sends players to jurisdictions outside of Macau. We note that the incremental rolling chip volume driven by Asian Nations comes without the benefit of Naga's two A320 aircraft.

Suncity could begin sending volume as early as December

We expect Suncity to begin sending volume to NagaWorld as early as December. While the company has not given any indications as to what magnitude of volume to expect, we would think the volume Suncity brings to NagaWorld is at least inline with what Asian Nations is already bringing. To put this in perspective, we estimate that USD150mm in monthly rolling chip volume is the equivalent of only 1% of Suncity's typical rolling chip volume in Macau. We believe it is realistic to think that a junket like Suncity could allocate the equivalent of a low-single-digit share of its VIP volume to NagaWorld.

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Estimates and Valuation (US\$)

2014 EPS (US cents)	6.41
2015 EPS (US cents)	6.99
2014 P/E	12.4x
2015 P/E	11.4x
2014 EBITDA (\$m)	181.5
2015 EBITDA (\$m)	220.9
2014 EV/EBITDA	8.7x
2015 EV/EBITDA	8.4x

**Source: Union Gaming Research
Macau**

Issue Data (HK\$)

Last Price	6.15
52wk High (1/20/2014)	8.80
52wk Low (10/3/2014)	5.42
P/E (Trailing 12m)	12.5x
Dividend Yield	5.4x
Price to Book Ratio	3.0x
Price to Sales Ratio	4.7x
EV / Trail 12M EBITDA	8.6x
Shares Outstanding	2,282
Market Cap	14,035
Enterprise Value	12,331

Source: Capital IQ

For a description of important disclosures please see Appendix 1

Updated thoughts from our recent property visit; reiterate Buy rating and maintaining HKD8 PT

We recently returned from a property visit to NagaWorld. Herein are our updated thoughts. We would highlight our continued excitement about Naga's transformational VIP initiatives, its declining exposure to the Vietnamese mass market consumer (important in the event Vietnam were to legalize locals gaming) while still growing overall mass GGR in the mid-teens or better; and the positive events that will impact the slot/ETG floor beginning later next year.

Asian Nations already adding an incremental 40% to rolling chip volume without the benefit of aircraft

Over the early weeks of the Asian Nations junket bringing players to Naga, we believe the run rate is approximately USD150mm in monthly rolling chip volume, or nearly 40% incremental rolling chip volume relative to the existing junket volume on property. Asian Nations is a China-based junket that does not have exposure to Macau, but rather sends players to jurisdictions outside of Macau. We note that the incremental rolling chip volume driven by Asian Nations comes without the benefit of Naga's two A320 aircraft, which should be a meaningful driver of incremental volume (relative to the existing USD150mm) going forward.

Suncity could begin sending volume as early as December

We expect Suncity to begin sending volume to NagaWorld as early as December. While the company has not given any indications as to what magnitude of volume to expect, we would think the volume Suncity brings to NagaWorld is at least inline with what Asian Nations is already bringing. To put this in perspective, we estimate that USD150mm in monthly rolling chip volume is the equivalent of only 1% of Suncity's typical rolling chip volume in Macau. We believe it is realistic to think that a junket like Suncity could allocate the equivalent of a low-single-digit share of its VIP volume to NagaWorld. Furthermore, we think this could be repeated several times over with the addition of other notable junkets. By way of example, we estimate that for every incremental USD150mm in monthly rolling chip volume, this equates to a 40% increase relative to the monthly rolling chip volume observed in 1H14, and also a 24% increase in VIP gross profit relative to 1H14 (with an associated lower gross profit margin due to higher economic incentives). Please see Figure 1.

Figure 1: Incremental VIP gross profit on every USD150mm in rolling chip volume

Monthly rolling chip volume (USD)	150,000,000
Annual rolling chip volume	1,800,000,000
Annual GGR	54,000,000
Annual incremental VIP gross profit contribution	16,200,000
Annual VIP gross profit baseline run-rate prior to new junkets	68,000,000
Incremental VIP gross profit relative to 1H14 baseline	24%

Source: Union Gaming Research Macau

Our current 2015 VIP expectations for Naga remain conservative, with an expected increase in rolling chip volume of ~60%, and an increase in associated gross profit of 30%. This effectively contemplates 1) that Asian Nations does not

grow its business beyond the current USD150mm monthly rolling chip run rate, 2) that Suncity also contributes around USD150mm in monthly rolling chip volume, 3) that the existing junket business does not grow, and 4) that there are no other junkets added to Naga's roster. We believe all four of these items are conservative and therefore represent sources of upside to our current expectations.

Other initiatives that should drive incremental VIP volume

We would characterize 2014 as an investment year for Naga, especially as it relates to VIP. In the near-term, as a dual driver of both VIP and mass, Bassaka Air (Naga's two A320 aircraft) should begin Macau to Phnom Penh service by year end, with China (various Tier 2 cities) to Phnom Penh service by Chinese New Year. In addition to the large amount of new VIP rooms and tables already brought online this summer (many new VIP spaces on the 3rd floor) the company expects its rooftop pool deck VIP facilities to open in 1Q15, which includes an incremental 16 VIP tables (on top of the 150 VIP tables already in place). Construction on Naga CityWalk is well underway and should be handed over to the company for fit-out by the end of 1Q15. Assuming a five-month fit-out by the company and China Duty Free, Naga CityWalk should be operational by 3Q15. At the airport, groundbreaking on the company's private air terminal is imminent and we would expect a late 2016 opening. In our view, all of these initiatives are essential elements to Naga's success in the VIP segment, and each should contribute to a critical mass that makes Naga all the more attractive to VIP junkets and customers alike (not to mention serving as a bridge until the purpose-built Naga2 opens).

Mass market (public floor) table games

Naga's public floor business continues to grow in the mid-teens or better, which should be a sustainable growth rate over the coming years. This is driven by a confluence of factors, not the least of which is continued massive amounts of international investment into Phnom Penh, which has positive follow-on effects for local incomes, larger numbers of expats, and tourism growth. In addition, we would expect the company to ramp up its exposure to the growing number of Chinese tourists to Cambodia (+19% YTD and on pace for well over 500,000 visitors this year) by redirecting its luxury coach buses to ply the Siem Reap / Phnom Penh route. Importantly, Naga continues to lessen its exposure to Vietnamese customers, which is prudent in our view given the chatter coming out of Vietnam that suggests the government might finally greenlight locals gaming. With this in mind, we believe Naga's mass market GGR exposure as of today is approximately:

- 40% from the greater Phnom Penh metropolitan area (e.g. expats, persons who have returned to Cambodia)
- 10% from Chinese tourists to Cambodia
- 10% from Vietnamese customers living in Vietnam
- 40% from all other tourists

Slot machines / ETGs

Despite a soft start to the year, we believe that Naga's slot / ETG business has rebounded nicely into 2H14 (including 16% volume growth in 3Q14) and we are currently modeling 14% growth in 4Q14. As we think about Naga's slot floor heading into 2015, it is important to keep in mind that Naga could potentially receive another substantial one-time payment (similar to the USD15mm one-time payment in 2013) for a new slot machine contract as the current 300 machines operated by one of the outsourced slot providers come off contract towards the end of 2015. Based on previous slot machine deals, we would expect Naga to look for a substantial fee that is well in excess of the USD15mm

received last year. This would be additive to our current EBITDA estimate of USD221mm for 2015. Alternatively, should Naga decide to self-operate these games, they would therefore receive 100% of the economics, rather than <70% today, which would also represent upside to our estimates going forward. Looking out into early 2016, the 670 machines operated by EGT also come off contract, which could represent another substantial one-time fee (or superior economics should Naga self-operate).

Vladivostok

The company remains optimistic that they can break ground on an expected USD50mm Phase 1 in early 2015. This right-sized Phase 1 would likely take two years to build, with 25% of capex in 2015, 50% in 2016 and the final 25% in 2017. We are waiting for the Russian government to approve Naga's Phase 1 plans before adjusting our model to account for this capex and to give any valuation credit. Under the assumption that the Phase 1 project moves forward, we would not expect Naga to commit to any further phases until Phase 1 is operational and demand is sufficient to justify further development.

Revising estimates

We are slightly revising our forward estimates for NagaCorp. Our new estimates contemplate a higher VIP rolling chip volume relative to our previous estimate, albeit with a lower associated gross profit margin and higher overall operating expenses owing to increased capacity and higher service standards. This results in our 2015 EBITDA estimate going to USD221mm (from USD226mm) and compares to consensus of USD222mm. Noted above, we believe our 2015 estimates could prove to be conservative given what could be substantial upside from the company's new VIP program. Please see Figure 2 for detailed revenue, EBITDA and EPS estimates.

Figure 2: New estimates and consensus expectations

Capital IQ Company Statistics (FY-Dec)					
52-week high	\$8.80		Annualized Dividend/Share	\$0.33	
52-week low	\$5.42		Dividend Yield	5.4%	
Market cap (\$mm)	\$14,035		Insider Ownership	0.0%	
Shares outstanding (mm)	2,282.1		Institution Ownership	23.3%	
Average daily volume (mm)	9.0		Revenue growth (2-year)	20.2%	
Short interest (mm)	na		EBITDA growth (2-year)	na	
Short Interest as % of float	na		EPS growth (2-year)	2.8%	

Annual Results	2012	2013	2014E	2015E	2016E
Union Revenues (\$mm)	\$279	\$345	\$405	\$533	\$643
Previous revenue estimate	-	-	\$405	\$517	\$632
<i>Change</i>	-	-	\$0	\$16	\$11
Capital IQ revenue estimate	-	-	\$403	\$499	\$586
Union EBITDA (\$mm)	\$138	\$172	\$182	\$221	\$260
Previous EBITDA estimate	-	-	\$182	\$226	\$265
<i>Change</i>	-	-	\$0	(\$5)	(\$4)
Capital IQ EBITDA estimate	-	-	\$184	\$222	\$254
Union EPS	\$0.054	\$0.063	\$0.064	\$0.070	\$0.084
Previous EPS estimate	-	-	\$0.064	\$0.072	\$0.086
<i>Change</i>	-	-	\$0.000	(\$0.002)	(\$0.002)
Capital IQ EPS estimate	-	-	\$0.063	\$0.066	\$0.076
Valuation - EPS Multiple			12.4x	11.4x	9.4x
Valuation - EV/EBITDA Multiple			8.7x	8.4x	6.9x

Source: Union Gaming Research Macau, Capital IQ

Price Target HKD8 (unchanged)

We value NagaCorp using an EV/EBITDA approach on forward earnings in addition to incremental present value associated with the company's Naga 2 project, which should open in 2017. Our 12 month price target remains HKD8.00, based on an 8.5x multiple of our 2015 EBITDA estimate (HKD4.50) in addition to the per share present value for Naga2 (HKD3.50). Our calculations assume a share count of approximately 3,848mm, which accounts for the dilution associated with the company's acquisition of the USD369mm CityWalk and Naga2 complex from CEO Tan Sri Dr. Chen in the form of share issuance / convertible bond. We note that the 8.5x multiple represents a slightly lower multiple than we have previously ascribed (9x), which we would attribute to broader multiple pullback in the gaming space. However, it still remains a discount to its peer group in Macau, to which we ascribe a multiple approximately 3 turns higher. We feel an 8.5x multiple is justified for Naga as the company has consistently executed on its growth initiatives, enabling the company to grow faster than its peer group. It is also in the home stretch of shedding its image as a single-asset story, with Naga2 now under construction in a meaningful way and Vladivostok on the horizon. Our price target, along with an expected dividend yield of 7% in 2015 represents 37% upside to yesterday's closing price.

Risks

Risks to shares of NagaCorp include: country risk (loss of exclusive license, adjustment to the company's advantageous low monthly fixed obligation tax), development risk including delays to Naga2 and the Vladivostok project, incremental regional competition (especially from Vietnam should locals be allowed to gamble), volatility associated with being a single-asset operator (for now) in the context of increasing exposure to the VIP segment.

Appendix 1: Important Disclosures

Additional information is available upon request.

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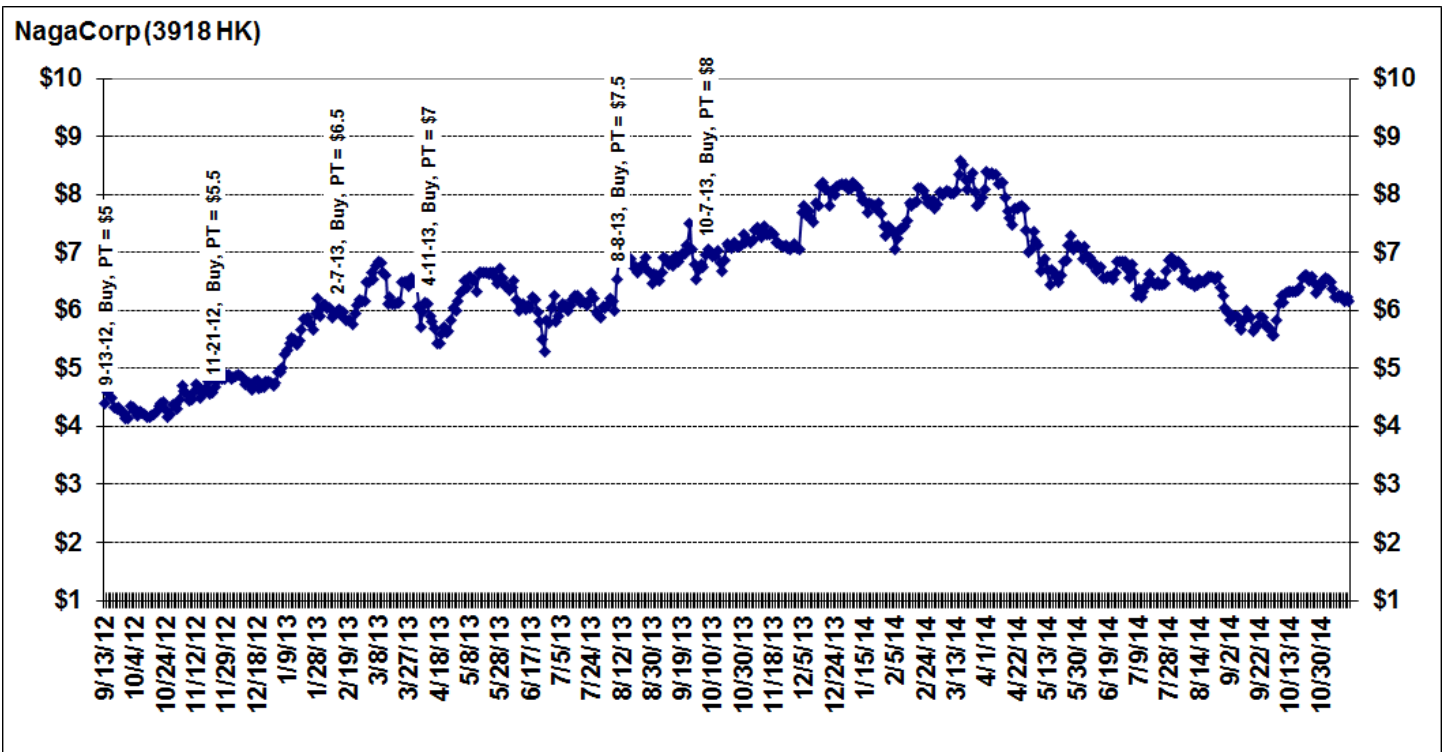
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Source: Union Gaming Research, LLC and Union Gaming Research Macau Limited; Capital IQ

Distribution of Subject Companies' stock ratings

Buy	Hold	Sell
11%	89%	0%

Source: Union Gaming Research, LLC and Union Gaming Research Macau Limited

Distribution of Subject Companies with affiliate banking relationships

Buy	Hold	Sell
50%	50%	0%

Source: Union Gaming Research, LLC and Union Gaming Research Macau Limited

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