

CHINESE REGULATION LEADS TO ERA OF UNCERTAINTY

by Joe Dimino

At a cost of more than \$5.5 billion, Galaxy Entertainment Group opened the second phase of Galaxy Macau this past May. Only a portion of Galaxy's planned \$13 billion investment in Macau, the development comes ahead of planned expansions of Melco Crown, Wynn, Sands, and MGM properties within Macau. This event marks the first grand opening of a major casino since revenues experienced a downturn last year, with many companies hoping to diversify more into entertainment, shopping, and other non-gaming associated amenities. Revenues have been falling since President Xi began cracking down on many casino practices, and some wonder if Macau will ever return to its record growth that was experienced as recently as February 2014.

Concerned about misuse of public and corporate funds, the Chinese government has instituted a crackdown on Chinese gamblers in Macau, especially in the VIP and Junket segment. This crackdown has scared many gamblers away from Macau which, in February of 2015, suffered its worst drop in gaming revenue ever, falling by more than 48.6% from the previous year. In fact, Macau year-over-year gaming revenue has been declining for the past 12 months, averaging a 23.3% decline each month compared to the previous year.

Many gamers, especially the low-value but higher margin mass gamers, are being scared away because the government has imposed visa restrictions, debit-card monitoring, and a smoking ban on the main casino floor within all casinos. Debit-card monitoring, for example, affects the mass market gamers more significantly as they do not have access to junket operators for funding. Furthermore, a cap has been placed on visitors from mainland China, which limits Macau's ability to attract a higher volume of mass-market gamblers to make up for the loss of VIP revenue currently being experienced.¹

In addition to limiting the number of Chinese nationals that can visit, this crackdown inhibits the ability for junket operators to issue credit to the typical high rollers that visit casinos in Macau. These high rollers, usually elite Chinese businessmen and officials, are estimated to account for 60-70% of total gaming revenue. As a result, many casino operators have attempted to target more mass-market gaming and entertainment revenue to make up for the loss. "This is a very dangerous time," Johnny Foc, a Macau-based junket operator, told Reuters. "It seems President Xi really doesn't want people to come and gamble anymore....Maybe we have to wait seven more years, then, after Xi has left, and only then, we might have a chance for things to go back to the old days."²

Many industry affiliates believe that this crackdown could benefit competing jurisdictions such as South Korea, Philippines, and Australia. Operators such as Paradise Co. in South Korea are hiring Mandarin-speaking staff to attract gamers away from Macau utilizing junket operators and other perks to attract high-value customers. Echo Entertainment Group Ltd. of Sydney and NagaCorp Ltd. in Cambodia cater to junket operators as well, organizing trips for Chinese gamblers with perks such as higher commissions, lower taxes, and private jets.³

According to an article published by Bloomberg Business in March of 2015, "Macau casino revenue fell last year (2014) for the first time and may decline by another 8% this year. By contrast, South Korea and the Philippines will grow 16% and 33% respectively this year (2015), gaining from the spillover of Chinese gamblers..."

Melco Crown Entertainment Limited (MCE) hoped to capitalize on the projected growth in the Philippines with the development of the City of Dreams Manila facility in Entertainment City. Despite these projections, however, the facility has not met expectations as of Q1 2015, generating less than \$43 million in gaming revenue during the first quarter. With operating costs in excess of \$104 million, the first quarter posted a net loss of nearly \$68 million.⁴

Despite these analyst projections, it is believed that these increased regulations are further reaching than Macau. Current indications suggest that these "missing" gamer visits that are no longer going to Macau are not simply changing destinations. The increased regulation on debit transactions outside of China, coupled with the cap place on Chinese outbound tourism, is resulting in Chinese nationals simply no longer gambling internationally as often and, as such, is potentially shrinking the entire Eastern Asia gaming market.

Moving forward, there are numerous questions to be answered. How far will revenues in Macau decline? How far-reaching are these crackdowns, and how will they impact revenues in other foreign jurisdictions? The Innovation Group will continue monitoring and tracking the Asian gaming landscape as the Philippines and other destination markets continue to mature.

¹ <http://www.businessinsider.com/galaxy-macau-openings-could-be-awful-2015-5>

² <http://www.theguardian.com/business/2015/feb/19/chinas-corruption-crackdown-hurts-james-packers-gambling-empire>

³ <http://www.bloomberg.com/news/articles/2015-03-05/asia-casinos-woo-chinese-gamblers-with-nose-jobs-and-peking-duck>

⁴ <http://www.bworldonline.com/content.php?section=Corporate&title=melco-crown-q1-loss-widens-amid-city-of-dreams-soft-opening&id=107593>