

2 October 2019

Asia Research

**Rating: Buy**

**Price Target: HK\$14.50**

Price	HK\$12.98
52wk Range	HK\$6.93 - HK\$12.76
Shares Outstanding (MM)	4,341.0
Market Capitalization (MM)	HK\$56,346.3
Enterprise Value (MM)	HK\$56,524.1
30D Avg Volume (000s)	3,506.5
Short Interest/Float	0.0%
Dividend Yield	4.0%
YTD % Chg	45.6%
YTD % Chg Relative to Index	28.3%
Total Implied Return to PT	15.7%
Pricing Date	October 2, 2019



## NagaCorp Ltd.

### Global Gaming Operators

3918-HK | HKSE | HK\$12.98

Company Update

### Naga - the safe port in the storm; all segments beat expectations; raising PT

**3Q19 recap.** NagaCorp reported unaudited 3Q19 key metrics, which showed significant growth in gaming volumes across all segments. Importantly, the high-margin mass and slots segments continued to demonstrate notable ramping, suggesting to us that Naga2 – nearly two years after opening – still has plenty of runway ahead, which gives us confidence in the company's ability to bridge the supply gap between today and the opening of Naga3 in 2025.

**Volume metrics and sequential trends.** During 3Q19, mass table volume increased an impressive 49% y/y (+14% sequentially), and compared favorably to our full 2H19 expectations of +21% y/y. We attribute the strength in mass table volume to a few key factors, namely that there exists significant growth in the broader Phnom Penh economy (driven in part by continued Chinese investment), along with Naga2 viewed as an attractive destination for customers segments that previously would have eschewed a trip to Cambodia. Importantly, we view the high-margin mass table business as having the most visibility given the close relationship between China and Cambodia (this also gives some comfort with respect to continued VIP out-performance relative to regional peers). Slot volume grew 27% (+5% sequentially) and also compared favorably to our full 2H19 estimate of +17% y/y. Slots, while enjoying some of the same benefits that drive mass tables, are also heavily keyed to general tourism trends, which remain robust. Finally, VIP volume grew 30% (UG at +16% for the whole of 2H19), while declining 29% on a sequential basis. That VIP is still growing on a y/y basis is impressive in the context of regional trends that suggest a weak VIP getting weaker.

**Outlook positive; raising PT.** Very strong demand argues for more supply in Phnom Penh. Based on current trends, we believe Naga should generate enough FCF to support the current ~60% dividend payout ratio and also fund its share of Naga3 development costs. Importantly, we continue to view Phnom Penh/Naga as the most insulated operator/market from the volatility associated with China (i.e. proxy/online crackdown leading to a decline in brick-and-mortar business) driven in part by the close relationship between China/Cambodia. Further, this same close relationship is a key driver of FDI into Phnom Penh, Cambodia and underpins the exceptional growth reported during the first nine months of 2019 and our expectations of continued strong growth over the near, medium, and longer terms. Beyond this there are numerous levers, including strong tourism growth, robust economic trends generating increased wealth, the continuing refurbishment of Naga1 (including converting non-gaming space to gaming space), and various company-specific marketing and efficiency initiatives. Based on our continued bullish outlook on the market and the company, we are raising estimates as detailed herein, maintaining our Buy rating, and raising our price target to HK\$14.50 (from \$12).

#### Analysts

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Year to Dec	Net Revenue	Adjusted EBITDA	EPS
2019E	1,772	635	0.11
Prior	1,801	627	--
2020E	2,120	627	0.12
Prior	2,061	603	0.11

\*Please see analyst certification and required disclosures starting on page 3 of this report.

## Earnings model

We note that our earnings model, as highlighted in the table below, assumes the implementation of a GGR tax in 2020 of approximately 5.5% of GGR. Absent this GGR tax our 2020 EBITDA estimate of \$627mm would be closer to \$743mm (vs. consensus of \$740mm). Therefore, any further delays to the implementation of the GGR tax could yield material upside to our estimates.

Figure 1: NagaCorp earnings model

NagaCorp	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
Year ends December 31									
<b>Revenue</b>									
Casino Operations	223.0	296.8	343.8	355.3	775.0	1,305.1	1,567.6	1,850.0	1,989.9
Income from Gaming Machines	101.9	84.6	136.8	145.5	150.9	129.3	157.6	217.9	235.7
F&B, Hotel and Other	20.0	22.9	23.1	30.7	30.4	39.9	46.9	52.5	58.8
<b>Total revenue</b>	<b>\$344.9</b>	<b>\$404.3</b>	<b>\$503.7</b>	<b>\$531.5</b>	<b>\$956.4</b>	<b>\$1,474.3</b>	<b>\$1,772.2</b>	<b>\$2,120.4</b>	<b>\$2,284.4</b>
Administrative expense	(47.0)	(51.5)	(47.2)	(52.6)	(67.2)	(79.3)	(74.3)	(76.5)	(78.8)
Other operating expenses	(57.9)	(82.5)	(97.2)	(111.8)	(150.2)	(185.6)	(219.0)	(263.6)	(283.6)
Gaming taxes @ 5.5% on GGR	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(116.1)	(125.3)
<b>Total EBITDA</b>	<b>\$171.8</b>	<b>\$176.0</b>	<b>\$228.5</b>	<b>\$256.1</b>	<b>\$319.7</b>	<b>\$511.8</b>	<b>\$634.7</b>	<b>\$627.3</b>	<b>\$679.6</b>
Interest income (expense)	0.0	0.0	0.0	0.0	0.0	(19.5)	(31.4)	(28.1)	(28.1)
Profit before taxation	145.4	142.0	189.0	208.2	263.3	399.4	510.1	513.2	565.4
Taxation	(5.1)	(5.9)	(16.4)	(24.1)	(8.1)	(8.8)	(20.1)	(11.2)	(12.6)
<b>Profit attributable to equity holders</b>	<b>140.3</b>	<b>136.1</b>	<b>172.6</b>	<b>184.2</b>	<b>255.2</b>	<b>390.6</b>	<b>490.0</b>	<b>502.0</b>	<b>552.9</b>
<b>EPS</b>	<b>\$0.063</b>	<b>\$0.060</b>	<b>\$0.076</b>	<b>\$0.070</b>	<b>\$0.059</b>	<b>\$0.090</b>	<b>\$0.113</b>	<b>\$0.116</b>	<b>\$0.127</b>
Shares outstanding	2235.1	2281.9	2270.0	2616.9	4341.0	4341.0	4341.0	4341.0	4341.0

Source: Union Gaming

## Valuation

We value NagaCorp using an EV/EBITDA approach on forward earnings. Our 12-month price target is HK\$14.50 (from \$12) and is based on a 10x multiple of our 2020 EBITDA estimate, in addition to the present value of the company's Naga3. This multiple is slightly higher than the range we have historically assigned to Naga, but is still broadly in line with the regional peer set. We note that our forward earnings forecasts assume that a 5.5% GGR tax is levied upon Naga and is reflected in our earnings estimates and PT. The lack of implementation of a gaming tax, or a differential in the magnitude of the gaming tax could have a material impact on our forward earnings estimates.

## Risks

Risks to shares of NagaCorp include: political risk (loss of exclusive license, adjustment to the company's advantageous low monthly fixed obligation tax), development risk including potential delays to the Vladivostok project, incremental regional competition, and volatility associated with a growing VIP business.

## 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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### Ratings Definitions

#### Current Ratings Definition

Union Gaming Securities LLC and Union Gaming Securities Asia Limited use a traditional ratings construct (Buy, Hold, and Sell) that is underscored by percentage upside/downside from current trading levels along with dividend yields for total return. We exclude special dividends and contemplate regular dividends only in our total return forecasts. These are absolute ratings, not relative or forced ratings. We define a Buy rating as a company whose shares exhibit total return (appreciation and dividends) potential of at least 15% within the next 12 months, and conversely a Sell rating as a company whose shares exhibit downside potential of at least 15% within the next 12 months. A Hold rating is reserved for companies whose shares exhibit total return potential between those parameters.

**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.

### Valuation and Risks

#### Valuation

**Valuation Methodology for Price Target:** Enterprise Value-to-EBITDA, Sum-of-the-Parts Analysis, Price-to-Earnings Ratio, Discounted Cash Flow Analysis, Price-to-AFFO, Net Asset Value.

#### Risks

**Investment Risks:** Union Gaming Securities' equity research team covers the casino, gambling, gaming, lottery and related sectors. The companies operating within these sectors generally have a global presence or significant exposure to China and Las Vegas, among other markets. In addition, the markets that companies in these sectors operate are highly regulated by local and federal governments. Risks across or specific to one or more of these sectors include regulatory or legislative impacts related to licensing, tourism or the competitive landscape. Licenses to operate gaming facilities or supply gaming equipment or lottery services are often governed by regulatory authorities. Additional Risks for investing in these sectors include volatility in consumer discretionary spending and consumer confidence, currency, interest rates, unemployment rates, access to capital, the cost of capital, commodity costs, geopolitical uncertainty, and unfavorable government regulations. Companies operating within our covered sectors rely in part on tourism, and business trends could be impacted by changes or influences to tourism in a given market or markets, including visa policy, transit policies and security, transportation infrastructure, weather and natural disasters.

### Ratings Distribution (as of 10/03/2019)

#### Coverage Universe

Ratings	Count	Pct.
BUY	23	74%
HOLD	8	26%
SELL	0	0%

#### Investment Banking Services / Past 12 Months

Rating	Count	Pct.
BUY	6	26%
HOLD	1	12%
SELL	0	0%

### NagaCorp Ltd. Rating History as of 10/01/2019

powered by: BlueMatrix



## General Disclosures

**Additional information is available upon request.**

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