



February 10, 2014

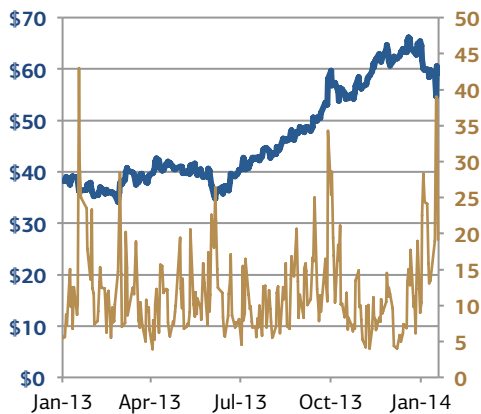
China | Gaming

Sands China Ltd. (1928 HK)

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Sands China Ltd. (1928 HK) one-year share price in HKD (blue) and volume (gold, in mln shares)



Source: Bloomberg, February 10, 2014

Sands China Ltd. (1928 HK)

Price	HKD 59.20
Rating	BUY
Price Target	69.04
Difference	17%
Market Cap	HKD 477.34 bln
Simple Moving Avg.	20.55 mln
P/E	35.4x

Source: Bloomberg, February 10, 2014

Visitor growth is back

+ **Border expansion allows more crossings**

After stalling in 2012, mainland visitor growth to Macau picked up to 10% in 2013, and visitor growth is the best indicator for Gross Gaming Revenue. The acceleration seems to be driven mainly by infrastructure build-out, including the Gongbei border expansion and the Zhuhai-Guangzhou rail link.

+ **Galloping ahead**

Chinese New Year saw tourist growth of roughly 15%. This is an extremely favorable leading indicator for 2014 gaming revenues.

+ **PT HKD 69.04; rating: BUY**

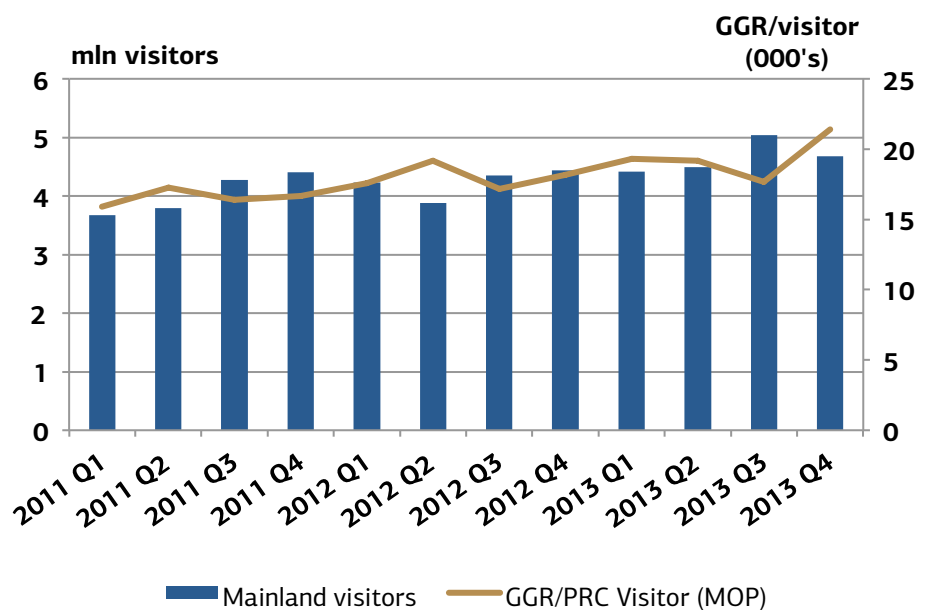
We raise our price target for Sands China to HKD 69.04, and give it a BUY rating.

Galloping forward

Acceleration of visits to Macau numbers is the most positive indicator the gaming industry has seen in years. Gross Gaming Revenue (GGR) growth is driven by two factors: visitor growth and spending per visitor.

Visitors up 10% in 2013.

Chart 1. PRC visitors vs. GGR/PRC visitor



Source: Macau DSEC, Macau DICJ, J Capital Estimates

Spending per visitor generally goes up as a function of increases in minimum bet sizes and the mainland money supply; it is akin to a price raise. Since price raises consist of the same set of rich people spending more money than last year, they are generally considered not as sustainable over too long a period of time as increases in foot traffic.

Table 1. GGR growth: Growth attributable to spending vs. growth attributable to visitors

	GGR Growth	Attributable to spending	Attributable to visitors
2012 Q1	27%	10%	15%
2012 Q2	13%	11%	2%
2012 Q3	6%	5%	2%
2012 Q4	10%	9%	1%
2013 Q1	15%	10%	4%

2013 Q2	16%	0%	16%
2013 Q3	20%	3%	16%
2013 Q4	24%	18%	5%

Source: Macau DSEC, Macau DIC, J Capital estimates

Growth in 2012 depended almost entirely on rising spending per visitor. But in 2013, visitor growth soared: mainland visitors increased 10%, with visitation from the interior provinces accounting for 67% of arrivals growth.

Infrastructure build out

Infrastructure appears to be driving visitation growth. The major infrastructure improvements in 2013 were the HSR link from Guangzhou to Zhuhai completed in January, and the expansion of the Zhuhai-Macau Gongbei border gate, completed in October. The provinces driving growth are Hunan, Henan, Sichuan, Chongqing, Hubei, Liaoning, and Shandong.

Data on visitation by province and port of entry indicates infrastructure build out is driving visitor growth.

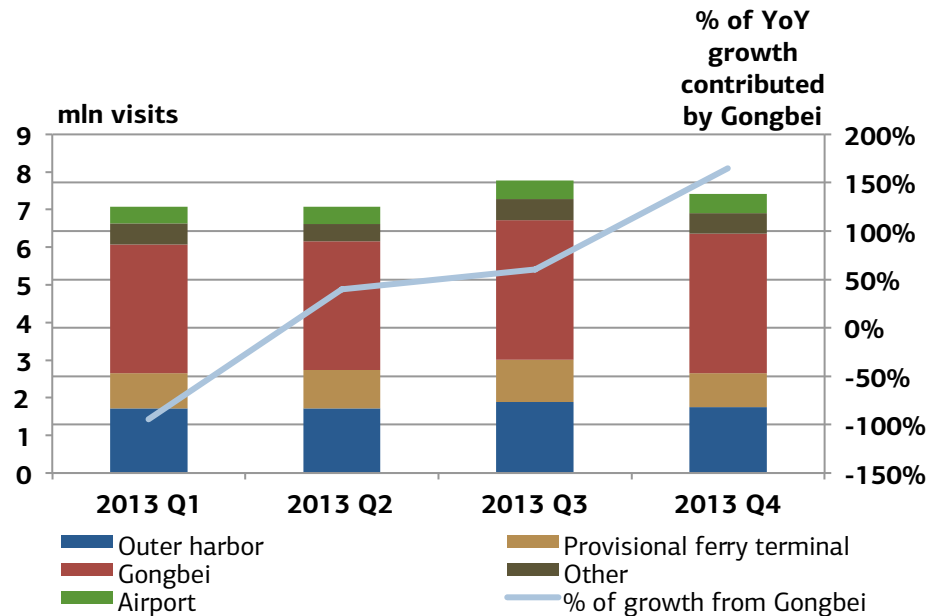
Table 2. Visitor growth: top provinces

	2012	2013	YoY growth
Hunan	587,904	655,432	11%
Henan	317,391	365,956	15%
Sichuan	342,861	378,532	10%
Chongqing	194,420	221,894	14%
Hubei	486,321	553,959	14%
Liaoning	263,020	292,874	11%
Shandong	217,900	268,247	23%

Source: Macau DSEC

With the exception of Shandong, Liaoning, and Chongqing, these provinces benefited greatly from the opening of the Zhuhai-Guangzhou HSR in Jan 2013 by allowing travelers to take the train directly to Zhuhai, rather than going to Shenzhen and transferring to a ferry. The numbers bear out the influence of infrastructure build out. Visitor growth is attributable to increased traffic from the expanded Gongbei border gate.

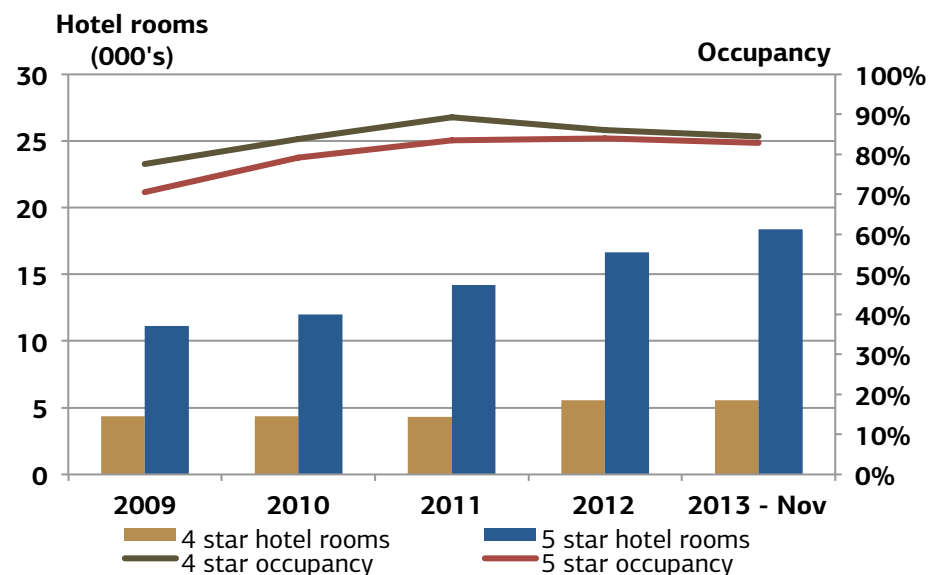
Chart 2. Visitors by point of entry vs. visitor growth attributable to Gongbei



Source: Macau DSEC, J Capital Estimates

Visitor growth is especially beneficial to Sands. Growth from price increases is distributed more equally. But with hotel constraints, visitor growth redounds to whoever can supply the rooms.

Chart 3. 4/5-Star Hotel Rooms vs. Occupancy



Source: Macau DSEC

The above chart shows that, despite five-star hotel rooms growing at a rapid clip—by 17% in 2012 and 11% in the first 11 months of

In 2013 H2, occupancy rates in five star hotels breached 90%.

2013—occupancy rates have still hovered around 85%. Even the dip in four-star occupancy and flattening of five-star rates is deceptive. In the second half of the year, occupancy rates climbed steadily, breaching 90% for five star hotels for the first time in over a year.

Table 3. Macau Hotel Occupancy

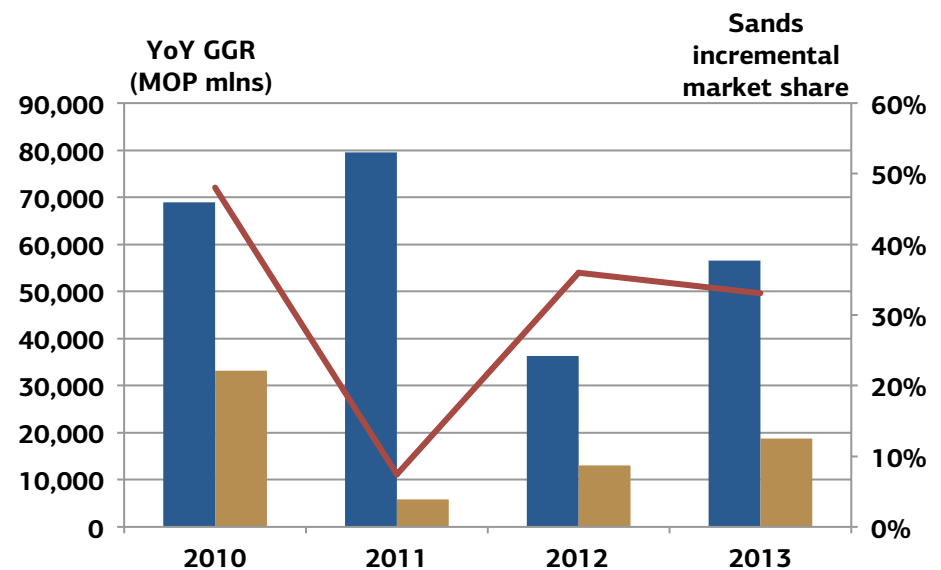
	2012 (4 Star)	2013 (4 Star)	YoY (4 Star)	2012 (5 Star)	2013 (5 Star)	YoY (5 Star)
July	90.08%	87.18%	-2.90%	85.24%	84.45%	-0.79%
August	90.59%	90.87%	0.28%	88.45%	91.45%	3.00%
September	82.87%	85.83%	2.96%	80.98%	82.55%	1.57%
October	80.32%	82.52%	2.20%	82.67%	84.39%	1.72%
November	90.10%	90.80%	0.70%	87.54%	88.37%	0.83%

Source: Macau DSEC

Sands China accounts for 38% of Macau's 4/5 star hotel rooms.

With its over 9,000 hotel rooms and 38% of Macau's 4/5 star hotel rooms, Sands China has a dominating control of the hotel market. Even as the Macanese gaming market grows at 18%, Sands, thanks to its control of hotel rooms on Cotai, is still managing to take share. It is therefore not surprising that Sands plans to build the St. Regis tower with 400 additional rooms, and the Parisian with 3,000 rooms, to be completed around 2015.

Chart 4. Macau GGR growth vs. Sands incremental market share



Source: Macau DICJ, Company filings

Note: USD 1 = 7.99 MOP in 2014

An 8% increase in market GGR would still translate to Sands EBITDA growth of fully 20%, and we estimate a 15% GGR growth in 2015.

While it is difficult to quantify the advantage of controlling hotel rooms, we can approximate it based on Sands's incremental share of GGR. For every additional 100 MOP of gaming revenue, approximately 33 MOP goes to Sands.

The implication of Sands's positioning is that, if Macau GGR increases 8% in 2014, Sands revenue can be expected to increase by approximately 13%. Owing to Sands's operating leverage, incremental EBITDA margins are roughly 50%. Investors became nervous when January GGR YoY growth fell to 8%. But an 8% increase in market GGR would still translate to Sands EBITDA growth of fully 20%.

Strong outlook

We believe 2014 growth will far exceed January's 8% increase. Local media report a surge of mainland tourism coming at the tail-end of Chinese New Year. According to authorities at the Gongbei border gate, from February 2 until at least February 6, the gate was operating at peak throughput for 14 hours a day. In those five days, 1.25 mln people passed through it. This represents a growth of 6% YoY. Since casinos should be able to realize at least 8% price increases over last year, we estimate 15% GGR growth in 2015.

Other media reports are even more optimistic. One report said that of the 2.1 mln tourists exited and entered from Gongbei over the full seven days of Chinese New Year; 1.3 mln were PRC passport holders. This represents 30% growth from last year.¹ Macau tourism bureau authorities claimed that new year's tourism increased by 19% when compared to last year. We believe this contains a lot of "noise," probably from Southeast Asian countries whose numbers can fluctuate a lot year in and year out. But Macau authorities also leaked that mainland tourists are up 55% from the last new year.² Although this number appears exaggerated, it is certainly a positive indicator.

Risks

- High volatility in the Chinese market and unclear outlook for 2014.
- Macro headwinds for China and Macau coming from the U.S. Fed taper.

¹ <http://www.zhnews.net/html/20140206/082923,403711.html>

² <http://finance.takungpao.com/q/2014/0206/2258780.html>

Pro-forma financials

Table 4. Income statement

USD 000's	2011	2012	2013	2014e	2015e	2016e	2017e	2018
Revenues	4,880,787	6,511,374	8,852,081	10,634,130	11,870,472	13,695,054	15,564,051	16,793,965
Gaming tax	2,070,454	2,859,298	3,887,158	4,669,697	5,212,604	6,013,821	6,834,542	7,374,626
Inventories consumed	48,647	69,085	93,920	112,827	125,944	145,303	165,133	178,182
Employee benefit expenses	523,251	761,546	849,160	849,160	934,076	1,263,434	1,326,605	1,392,936
Depreciation and amortization	272,773	354,021	470,460	486,470	572,521	665,662	666,902	643,415
Gaming promoter/agency commissions	259,304	330,025	330,025	417,432	460,022	504,128	536,012	569,958
Other expenses	504,086	856,236	846,507	896,862	947,318	1,128,399	1,204,667	1,255,249
Operating profit	1,202,272	1,281,163	2,374,851	3,201,682	3,617,986	3,974,307	4,830,190	5,379,598
Interest income	7,983	15,547	12,171	0	0	0	0	0
Interest expense, net of amounts capitalized	-52,883	-57,435	-54,931	-82,518	-110,105	-110,105	-110,105	-110,105
Loss on early retirement of debt	-22,051	-1,752	0	0	0	0	0	0
Profit before income tax	1,135,321	1,237,523	2,332,091	3,119,164	3,507,882	3,864,202	4,720,085	5,269,493
Income tax expense	-2,271	-1,842	-7,228	-9,667	-10,872	-11,976	-14,629	-16,331
Profit for the period attributable to equity holders of the Company	1,133,050	1,235,681	2,324,864	3,109,497	3,497,010	3,852,226	4,705,456	5,253,162

Source: Company filings

Table 5. Balance sheet

USD 000's	2011	2012	2013e	2014e	2015e	2016e	2017e	2018e
ASSETS								
Non-current assets								
Investment properties, net	747,126	913,126	913,126	913,126	913,126	913,126	913,126	913,126
Property and equipment, net	6,249,686	6,656,730	6,883,814	8,104,345	9,425,440	9,443,028	9,109,903	8,740,271
Intangible assets, net	31,824	16,202	16,202	16,202	16,202	16,202	16,202	16,202
Deferred income tax assets	30	153	208	250	279	322	366	395
Financial assets at fair value through profit or loss	64	183	249	299	334	385	437	472
Other assets, net	27,039	36,119	49,103	58,988	65,846	75,967	86,335	93,157
Trade and other receivables and prepayments, net	9,297	12,196	16,580	19,918	22,234	25,651	29,152	31,456

Restricted cash and cash equivalents	0	0	0	0	0	0	0	0
Total non-current assets	7,065,066	7,634,709	7,879,282	9,113,128	10,443,461	10,474,681	10,155,521	9,795,078
Current assets								
Deferred income tax assets	0	0	0	0	0	0	0	0
Inventories	10,489	15,069	20,486	24,610	27,471	31,694	36,019	38,866
Trade and other receivables and prepayments, net	557,398	784,808	1,066,931	1,281,719	1,430,734	1,650,648	1,875,916	2,024,156
Restricted cash and cash equivalents	3,448	4,479	6,089	7,315	8,165	9,420	10,706	11,552
Cash and cash equivalents	2,491,284	1,948,414	4,536,012	6,385,008	6,593,305	8,309,329	10,722,048	13,322,854
Total current assets	3,062,619	2,752,770	5,629,517	7,698,652	8,059,675	10,001,091	12,644,690	15,397,428
Total assets	10,127,685	10,387,479	13,508,800	16,811,780	18,503,136	20,475,772	22,800,211	25,192,507
EQUITY								
Capital and reserves attributable to equity holders of the company	0	0	0	0	0	0	0	0
Share capital	80,493	80,554	80,554	80,554	80,554	80,554	80,554	80,554
Reserves	5,435,279	5,505,572	6,435,517	7,679,316	9,078,120	10,619,010	12,501,193	14,602,458
Total equity	5,515,772	5,586,126	6,516,071	7,759,870	9,158,674	10,699,564	12,581,747	14,683,012
LIABILITIES								
Non-current liabilities	0	0	0	0	0	0	0	0
Trade and other payables	20,670	35,542	48,319	58,046	64,794	74,754	84,956	91,669
Borrowings	3,328,843	3,211,668	4,849,168	6,486,668	6,486,668	6,486,668	6,486,668	6,486,668
Total non-current liabilities	3,349,513	3,247,210	4,897,487	6,544,714	6,551,462	6,561,422	6,571,624	6,578,337
Current liabilities	0	0						
Trade and other payables	1,179,875	1,503,274	2,043,671	2,455,090	2,740,523	3,161,763	3,593,256	3,877,205
Current income tax liabilities	2,153	1,953	2,655	3,190	3,560	4,108	4,668	5,037
Borrowings	80,372	48,916	48,916	48,916	48,916	48,916	48,916	48,916
Total current liabilities	1,262,400	1,554,143	2,095,242	2,507,196	2,793,000	3,214,786	3,646,840	3,931,158
Total liabilities	4,611,913	4,801,353	6,992,728	9,051,910	9,344,462	9,776,208	10,218,464	10,509,495
Total equity and liabilities	10,127,685	10,387,479	13,508,800	16,811,780	18,503,136	20,475,772	22,800,211	25,192,507

Source: Company filings

Table 6. Cash flow

USD 000's	2011	2012	2013e	2014e	2015e	2016e	2017e	2018e
CASH FLOWS FROM OPERATIONS								
Profit before income tax	1,135,321	1,237,523	2,332,091	3,119,164	3,507,882	3,864,202	4,720,085	5,269,493
Interest income	-7,983	-15,547	-12,171	0	0	0	0	0
Interest and other	28,013	33,302	54,931	82,518	110,105	110,105	110,105	110,105

financial costs								
Depreciation and amortization	272,773	354,021	470,460	486,470	572,521	665,662	666,902	643,415
Amortization of deferred financing costs	24,870	24,133	0	0	0	0	0	0
Amortization of deferred rent	18,335	7,703	0	0	0	0	0	0
Amortization of other assets	8,384	4,361	0	0	0	0	0	0
Loss on disposal of property and equipment and intangible assets	2,924	96	0	0	0	0	0	0
Impairment loss on property and equipment		143,649	0	0	0	0	0	0
Loss on modification or early retirement of debt	19,092	1,745	0	0	0	0	0	0
Provision for doubtful accounts	41,147	58,213	0	0	0	0	0	0
Share-based compensation expense, net of amounts capitalized	10,007	11,688	0	0	0	0	0	0
Fair value losses on financial assets through profit or loss	1,237	413	0	0	0	0	0	0
Net foreign exchange (gains)/losses	-637	-6,925	0	0	0	0	0	0
Changes in working capital:								
Other assets	226	-13,370	-306,639	-233,453	-161,964	-239,025	-244,844	-161,122
Inventories	-1,760	-4,556						
Trade and other receivables and prepayments	-319,036	-294,472						
Trade and other payables	146,991	360,813	553,875	421,681	292,552	431,746	442,256	291,031
Cash generated from operations	1,379,904	1,902,790	3,092,548	3,876,380	4,321,095	4,832,690	5,694,504	6,152,923
Income taxes paid	-3,846	-2,159	-7,228	-9,667	-10,872	-11,976	-14,629	-16,331
Net cash generated from operations	1,376,058	1,900,631	3,085,320	3,866,713	4,310,224	4,820,714	5,679,875	6,136,591
CASH FLOWS FROM INVESTING ACTIVITIES								
Decrease/(increase) in restricted cash and cash equivalents	774,197	-1,022	0	0	0	0	0	0
Purchases of property and equipment and investment properties	-780,657	-989,241	-697,544	-1,707,000	-1,893,616	-683,249	-333,777	-273,783
Purchases of intangible assets	-3,847	-12,110	0	0	0	0	0	0
Proceeds from disposal of property and equipment and intangible assets	5,400	1,138	0	0	0	0	0	0
Purchase of fixed deposits			0	0	0	0	0	0
Release of fixed deposits			0	0	0	0	0	0
Interest received	7,983	14,930	12,171	0	0	0	0	0

Net cash generated from/(used in) investing activities	3,076	-986,305	-685,373	-1,707,000	-1,893,616	-683,249	-333,777	-273,783
CASH FLOWS FROM FINANCING ACTIVITIES								
Proceeds from borrowings	3,201,535	-532	1,637,500	1,637,500	0	0	0	0
Proceeds from exercise of share options	2,267		0	0	0	0	0	0
Payments for share issuance costs		11572	0	0	0	0	0	0
Repayments of borrowings	-2,845,480	-140,336	0	0	0	0	0	0
Dividends paid		-1,201,488	-1,394,918	-1,865,698	-2,098,206	-2,311,336	-2,823,274	-3,151,897
Repayments of finance lease liabilities	-43,518	-46,013	0	0	0	0	0	0
Payments for deferred financing costs	-86,210	-965	0	0	0	0	0	0
Interest paid	-161,192	-88,870	-54,931	-82,518	-110,105	-110,105	-110,105	-110,105
Net cash generated from/(used in) financing activities	67,402	-1,466,632	187,651	-310,716	-2,208,311	-2,421,441	-2,933,379	-3,262,002
Net (decrease)/increase in cash and cash equivalents	1,446,536	-552,306	2,587,598	1,848,997	208,297	1,716,024	2,412,720	2,600,806
Cash and cash equivalents at beginning of period	1,040,761	2,491,284	1,948,414	4,536,012	6,385,008	6,593,305	8,309,329	10,722,048
Effect of exchange rate on cash and cash equivalents	3,987	9,436	0	0	0	0	0	0
Cash and cash equivalents at end of period	2,491,284	1,948,414	4,536,012	6,385,008	6,593,305	8,309,329	10,722,048	13,322,854

Source: Company filings

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