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Q3 2018 Melco Resorts & Entertainment Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Third Quarter 2018 Earnings Conference Call of Melco Resorts and Entertainment. (Operator Instructions) I must advise that this conference is being recorded today, Thursday, the 8th of November, 2018. I'd like to hand the conference over to your first speaker for today, Mr. Richard Huang, Director of Investor Relations of Melco Resorts and Entertainment Limited. Thank you. Please go ahead, sir.

Richard Huang *Melco Resorts & Entertainment Limited - Director of IR*

Good morning. Thank you for joining us today for our third quarter 2018 earnings call. On the call today are Lawrence Ho, Geoff Davis, and our property Presidents in Macau and Manila.

Before we get started, please note that today's discussions may contain forward-looking statements made under the Safe Harbor provision of federal securities law. Our actual results could differ from anticipated results.

I will now turn the call over to Lawrence.

Lawrence Ho *Melco Resorts & Entertainment Limited - Chairman & CEO*

Thank you, Richard, and hello, everyone. First, before I proceed with my opening remarks, I would like to express Melco's sincere gratitude to the Macau government for how they handled Typhoon Mangkhut this past August. The Macau government provided all operators with advanced warning prior to the typhoon and swiftly cleaned up the debris in the aftermath of the incident. The Macau government's handling of the super typhoon was world-class in every aspect.

Similar to how we paused the construction of Morpheus to reassign 2,000 workers to help with the post-Hato relief efforts, in the aftermath of Mangkhut, many of our colleagues immediately participated in Melco's community-wide cleanup activities. For this, I would like to express my deepest appreciation to our colleagues who volunteered to clear the debris and to minimize the typhoon's impact on our local community.

Moving on to our results. During the third quarter of 2018, Melco delivered solid performance provided by robust mass gaming revenue growth at City of Dreams and Studio City, despite the temporary citywide suspension of all gaming operations during the super typhoon. Since its opening in June, Morpheus has received overwhelmingly positive reception from our guests and has been recognized as a game changer in the global hospitality industry. As the world's first exoskeleton high-rise and an icon for new Macau, Morpheus has achieved global prominence, ranked by Time Magazine as one of the world's greatest places.

The positive reception of Morpheus has helped spur VIP and mass gaming volumes at City of Dreams, with quarter-over-quarter increases of 17% and 13%, respectively, during the third quarter. The addition of Morpheus marks the beginning of the relaunch of City of Dreams. We are currently renovating the VIP area on the second level, which includes a new VIP room that opened just ahead of the



October Golden Week. Right after the Chinese New Year in 2019, we will also start the renovation of Nüwa, which is expected to be finished by Chinese New Year in 2020.

Moving to Studio City, normalization of VIP and mass win rates have allowed for a 22% sequential uptick in property EBITDA. To drive continued growth, we have exciting plans to enhance the entertainment offerings at Studio City. That includes unveiling Macau's first-ever eSports stadium in July and the launching of the world's most electrifying stunt show, Elekron, in December. In 2019, we will open Asia's largest virtual reality zone, a trampoline park and a new dining street with a wide range of exciting food and beverage offerings. Looking further out, we will undertake further expansion of Studio City, which is expected to have 2 hotel towers with approximately 940 hotel rooms, a 12,000 square meter water park, a cineplex and additional gaming space.

Turning to the Philippines, City of Dreams Manila delivered another solid quarter, with luck-adjusted EBITDA growing 20% year-over-year to USD 66 million.

We're also devoting a significant amount of resources on international expansion, with a strong emphasis on Japan, which we have always viewed as the most attractive integrated resort opportunity globally outside of Macau. The license bidding process may start in 2019 or 2020, and we're gearing up for this process. We believe we are well placed in Japan, with a strong local team actively working on the ground engaging with the relevant stakeholders. We also believe our focus on the Asian premium segment, our portfolio of high-quality assets, devotion to craftsmanship, dedication to world-class entertainment offerings, market-leading social safeguard system and an established track record of successful partnerships will put Melco in a strong position to help Japan realize the vision of developing world-leading IRs with a unique Japanese touch.

Lastly, over the years, we have successfully delivered a best-in-class integrated resort experience to our guests. And this is only possible through the hard work and dedication of our employees. To showcase our appreciation and recognition to our team members for their hard work, contribution and commitment, we have undertaken a detailed review of our benefits program, which amongst other things, includes awarding a onetime special gift of 1-month salary to all of our non-management employees in Macau. Geoff will go through the financial impact of that in more details later on. With that, I turn the call over to him.

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Thank you, Lawrence. We reported group-wide property EBITDA of approximately \$295 million in the third quarter of 2018, declining by 26% from the third quarter of 2017, while luck-adjusted property EBITDA declined by 11% on a year-over-year basis to approximately \$333 million. An unfavorable VIP win rate negatively affected EBITDA at COD Macau, COD Manila and Altira by approximately \$22 million, \$11 million and \$6 million, respectively.

As Lawrence mentioned, we have undertaken a detailed review of our benefits program, which involves granting a one-time special gift of 1-month salary to our non-management employees in Macau. The special bonus has negatively impacted our third quarter 2018 EBITDA by approximately \$32 million, of which \$16 million was in relation to COD Macau, \$11 million was in relation to Studio City, and \$4 million was in relation to Altira. Our third quarter performance was also affected by the temporary citywide suspension of gaming operations during the super typhoon, which we estimate to have negatively impacted EBITDA by approximately \$9 million to \$10 million.

In the third quarter, the luck-adjusted property EBITDA margin in Macau was approximately 24%, down from 27% in the prior quarter and down from 30% in the third quarter of 2017. I'd like to clarify that these are apples-to-apples comparisons, as the aforementioned margins are all calculated based on the new accounting standards, including those for the prior periods. If we were to exclude the impact from the one-time special gift and the super typhoon, the luck-adjusted property EBITDA margin in Macau would have been approximately 27%, which is broadly flat sequentially.

Moving on, City of Dreams continued to experience a lower-than-historically usual mass hold percentage during the third quarter. While we do not adjust for this in our luck-adjusted EBITDA calculations, which only adjust for rolling chip win rates, if we were to hold at rates similar to the preceding 12 months, EBITDA would have been approximately \$20 million higher than reported at COD. Despite the recent VIP resurgence, the EBITDA contribution from our non-VIP segment still represents more than 85% of our luck-adjusted EBITDA on a Macau-wide basis, highlighting the mass gaming and nongaming segments' importance in driving group-wide EBITDA and EBITDA

margins.

In the Philippines, COD Manila delivered luck-adjusted EBITDA of approximately \$66 million, representing an increase of 20% year-over-year. The luck-adjusted EBITDA margin at COD Manila declined by approximately 180 basis points quarter-over-quarter and increased by approximately 230 basis points year-over-year to 43%. Again, these are all apples-to-apples comparisons reflecting the new accounting standards.

Moving on to capital management, the board has declared another quarterly cash dividend of \$0.145 per ADS. And since our second quarter 2018 earnings call, Melco has repurchased approximately 23 million ADSs worth approximately USD 490 million. In addition, the board has approved a new \$500 million share repurchase program, which is effective immediately.

To provide more clarity regarding our capital structure within our core or wholly owned group, we had cash of approximately \$550 million and gross debt of approximately \$1.8 billion at the end of the third quarter of 2018, excluding Studio City and the Philippines.

As we normally do, we'll give you some guidance on non-operating line items for the upcoming quarter. Total depreciation and amortization expense is expected to be approximately \$150 million to \$155 million, including approximately \$20 million for Morpheus. Corporate expense is expected to come in at approximately \$31 million to \$32 million. And consolidated net interest expense is expected to be approximately \$75 million, which includes financed lease interest of \$10 million relating to City of Dreams Manila. And for those who follow City of Dreams Manila more closely, our building lease payment for the third quarter of 2018 was approximately \$9 million.

That concludes our prepared remarks. Operator, back to you for the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Joe Greff of JP Morgan.

Joseph Richard Greff *JP Morgan Chase & Co, Research Division - MD*

Last night, obviously, the management team at Wynn discussed some pretty downbeat commentary and trend changes since Golden Week. Maybe in the sort of broader sense, can you talk about your experience since the Golden Week and overall trends in October, and November to date?

Lawrence Ho *Melco Resorts & Entertainment Limited - Chairman & CEO*

Joe, it's Lawrence here. So maybe I'll give my broad perspective, and maybe David or Geoff Andres would want to chip in or Andy. But I think from my perspective, we've always known the second half of this year, we would have tougher comps. I think with what's been happening in the geopolitical and in the macro sense with the trade war and everything, VIP has fallen. In terms of VIP, growth certainly has fallen faster than we had expected. And this is in discussions with our junkets and also with our own premium direct VIP team. In terms of mass, I think, again, the premium mass is seeing probably our customer base spending a bit less than previously, but we're extremely happy that Morpheus is ramping up very nicely, with almost 100% occupancy every night. And we have more and more guests experiencing those rooms. But I think other than VIP and a little bit of premium mass, the market is still very robust. For us, it probably means a bit less, given our reliance on VIP is less than -- as Geoff said in the prepared remarks, less than 15% of our EBITDA. So I think overall, we're extremely positive long-term, especially with the Hong Kong-Zhuhai-Macau Bridge opening recently and the fact that it's being utilized more. I think on that, I don't know if any of my colleagues want to chime in.

David Ross Sisk *Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau*

Yes. Joe, it's David. Hey, yes, I think there's a couple of things that we've kind of picked up on a little bit. One of the things is we've seen more players coming through for us, but some of the players that we're seeing on our premium mass are playing down just a little bit. So we have seen that, but we don't seem to have any trouble attracting players and maintaining the volumes and things that we've seen in the past, and we've seen actually our volumes grow. And lastly, I think kind of to Lawrence's point, Morpheus seems to be helping us in terms of allowing us to attract and maintain our good players. It's been a really nice positive for us.

Joseph Richard Greff JP Morgan Chase & Co, Research Division - MD

That's helpful. And then Geoff, can you just go through CapEx in the 3Q and expectations here for the 4Q? And that's all for me.

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Sure. So for the third quarter, CapEx was \$140 million. Looking at the remainder of this year and then the next couple of years, and this is excluding Studio City phase 2, which is approximately \$1.4 billion. But excluding that, 4Q CapEx should be similar to the \$140 million that we had in 3Q. 2019, again, excluding Phase 2, is about \$350 million, and 2020 is about \$225 million.

Operator

Our next question is from the line of Anil Daswani of Citigroup.

Anil Jeevan Daswani Citigroup Inc, Research Division - MD and Head of Global Gaming Research and Hong Kong Country Research

Despite Morpheus, if we look at hold-adjusted EBITDA for COD, there is still a bit of a decline. How much of that is associated with you guys introducing a smoke-free environment to COD in the middle of August? Is that something you can quantify? And will that be something that impacts the long-term ability to get back to the hold levels you had in the mass business a year ago?

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

That's a good question. I think when you look at it, the change for the smoking came much earlier than we expected. We assumed that we'd have the smoking all the way through to the end of the year. Unfortunately, it came to pass late July, early August that we had that. So it did have some disruption to a lot of our players in pit 11, which is the birdcage and pit 5, which is a pit over there by the Hyatt. Long term, I think everyone kind of adjust to. We've got the other smoking rooms that we're putting in place. We had to rush through those and try to get those done as quickly as we could. But we did not expect this to happen quite as soon as it did. So overall, I think we will be towards back -- let's say, towards a more of a longer-term hold from where we've been in the past. But it did have somewhat of an impact for us, certainly late July, into August, and things kind of started calming down by the time we got to September.

Anil Jeevan Daswani Citigroup Inc, Research Division - MD and Head of Global Gaming Research and Hong Kong Country Research

Okay. My second question is with regards to the 14th-month labor payment. You referred to that as a one-off payment. Is that something that we should expect you guys to be accruing for future years? Or are you going to actually treat it as a one-off payment?

Lawrence Ho Melco Resorts & Entertainment Limited - Chairman & CEO

Anil, it's Lawrence here. So I think on the accounting, I'll let Geoff answer the accounting. But in terms of whether this is a recurring practice for next year and the year going forward, I look forward to having a discussion with my fellow concessionaires to understand their point of view. From our standpoint, it is a onetime -- at this present moment in time, it is a onetime. And it was tied to our pension plan, and I think that's why we gave that gift. We as a company haven't decided for next year, but I'll be looking forward to talking to some of our competitors in terms of how they are positioning it. Because at the end of the day, Melco wants to be one of the best employers in the market, and we will see what our competitors will be doing. But on accounting, I don't know, Geoff, you want to?

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

On the accounting, that will follow further clarity on that decision as to whether or not, we'll see that again next year. So that's still subject to making a final decision.

Anil Jeevan Daswani Citigroup Inc, Research Division - MD and Head of Global Gaming Research and Hong Kong Country Research

Okay. And Lawrence, sorry, last one for me. Could you just give us some color on how October has gone for you guys and if November has shown any material signs of change from the levels that we've been seeing over the last few weeks?

Lawrence Ho Melco Resorts & Entertainment Limited - Chairman & CEO

Sure. Anil, I think as I said earlier on, in terms of VIP, certainly, and talking to our junkets and even with all the direct VIP program, we are seeing some weakness compared to the growth that we were seeing at the first 2 quarters of the year. But at the same time, it affects us, probably, much less than most of our competitors in the market. In terms of premium mass, again, David has mentioned we have strong visitation. But in terms of the average spend per visitor, it's not what it once was. And I think that is to be expected, given the current

tension in the trade war. But at the same time, we're still positive on -- in terms of the rest of the segments, our slot, mass is still very strong. And I think we stand to reap from the benefit of Morpheus and some of the new offerings that we have at Studio City. So I think all in all, we're not nearly as pessimistic as the Wynn call. But at the same time, we're cautiously optimistic for the short and midterm and super bullish for the long term.

Operator

Our next question comes from the line of Billy Ng of Bank of America Merrill Lynch.

Hay Ling Ng BofA Merrill Lynch, Research Division - Research Analyst

I just have one quick question. The company has completed the IPO for Studio City recently. I just wonder in terms how does that going to affect your capital structure and maybe in terms of strategic direction in the next couple of years regarding Studio City? And also, will that platform being used for further fund-raising, let's say, for phase 2 or any other potential expansion?

Lawrence Ho Melco Resorts & Entertainment Limited - Chairman & CEO

Billy, maybe I'll take the -- it's Lawrence. I'll take the first part, and I think on the financial capital structure question, Geoff can follow through. But in terms of strategic direction, it's always been the same. We want our properties to be super competitive and excel versus our competitors. So even though Studio City has been spun out as a separate listed entity, it really doesn't change the operating mentality. Geoff Andres is thinking hard every day how we can kick our other competitors (inaudible). And I think on capital structure, Geoff, you have any?

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Well, I suppose, other than having the public listing, as far as how we would contemplate funding phase 2, we have cash on the balance sheet, cash from operations and we would consider additional financings, whether or not that's in the debt capital markets and or equity capital markets. But we are still in the midst of formulating that plan, and we always look to have the most efficient capital structure. And over time, we've been fairly opportunistic in making sure that we do address capital markets correctly. So that's something that is currently under review.

Operator

The next question is from the line of Karen Tang of Deutsche Bank.

Karen Tang Deutsche Bank AG, Research Division - Head of Asian Gaming and Hotels Research

It's Karen here. Well done on the mass share gains sequentially in a very tough quarter. My question is with regards to 2 diverging trends in Q3 results in your properties. The first one is VIP rolling chips at City of Dreams are up nicely, but at Studio City, it's down, I think, 16% Q-on-Q. How should we read this? Clearly, Morpheus is helping City of Dreams, but is Studio City more representative of the market trend? That's number one. Number two is on slot. Yes, your mass GGR had very remarkable recovery at both Studio City and City of Dreams. But for the slots, GGR for both property sequentially is down 9% to 10%, which is a diverging trend. So how should we read that?

Lawrence Ho Melco Resorts & Entertainment Limited - Chairman & CEO

Karen, so maybe -- It's Lawrence here. So maybe I'll refer to Geoff Andres and David to answer a bit more. But I think on the VIP side, my view is that Morpheus was a great addition to the portfolio, and of course, that helped City of Dreams with a lot of premium direct VIP players wanting to experience it. And so far, the feedback has been excellent, so we're very pleased with that. In terms of Studio City, I think Studio City probably follow more of the market trend in terms of VIP volume. But I think maybe on that, I'll let Geoff and David talk a bit more on VIP and slots.

Geoffrey Philip Andres Melco Resorts & Entertainment Limited - Property President of Studio City

So Karen, this is Geoff. When it comes to VIP at Studio City, we always have to go back that we only have 45 VIP tables. And of that 45, only 9 are ours and the rest go across 3 different junkets. We have 3 good junket partners, and some are performing better than the others. And in 1 particular junket, we had 2 really big players last year that did not materialize for them this year. So that was a big part of it. But I think we're seeing, again, a little bit of softness in that VIP area. But that's really the story for Studio City.

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

Yes. And maybe add one more thing. Karen, it's David. One of the things that we knew when we were doing all the massive renovation for Morpheus and redoing our VIP spaces is that we did shift some players in premium direct over to Studio City. And as Morpheus opened up, they came back to the mother ship, so to speak. On slots, we had an extraordinary -- at City of Dreams, we had an extraordinary second quarter. So I think we're very happy with the nearly \$50 million we generated in the third quarter. So I think that's kind of where -- we're around \$200 million, we're pretty pleased on an annual basis for slot revenue.

Operator

We have Mr. Harry Curtis from Instinet to ask a question.

Harry Croyle Curtis Nomura Securities Co. Ltd., Research Division - MD and Senior Analyst of Gaming, Leisure & Lodging

Just a quick follow-up on VIP. In the last several weeks, you've talked about some weakness. Is the implication that it's -- that like when the VIP is actually contracting, that it's down year-over-year?

Lawrence Ho Melco Resorts & Entertainment Limited - Chairman & CEO

Well, I think -- Harry, it's Lawrence here. I think for us, again, like Karen's question earlier on, COD, we are still tracking ahead. I think Studio City is probably following more of a market trend. But I don't know any additional highlights you guys want to give him?

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

No. I think we've held up. I think, again, it's kind of a tough comparison for us in a sense, because we have Morpheus, which has been very helpful to us. And again, as our suites, our villas over there have been incredibly popular with our higher-end players as well as our best VIP players from both the premium direct and junket side. So again, it's been a plus for us. So we have not seen that same level of contraction.

Harry Croyle Curtis Nomura Securities Co. Ltd., Research Division - MD and Senior Analyst of Gaming, Leisure & Lodging

So following up on that. David, Lawrence mentioned that Morpheus is almost 100% occupied. To what degree has that negatively impacted the occupancy at City of Dreams? And can you talk about maybe the level of customers that you're putting into City of Dreams as you kind of rebuild that platform?

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

Sure. So obviously, we shifted most of our strong gaming business over to Morpheus. That was one of the things we really wanted to do to really as we dug into our database to really push Morpheus. What we've seen now, it's really been more of an impact on the Grand Hyatt, where we basically have taken out about 500 rooms out of the Hyatt now and push those over to Morpheus. So we've been essentially going down deeper into our database and working with, let's say, players that maybe at a little bit lower ADT level than we normally would have put in there. But we've also been backfilling that quite a bit with cash play and working quite strongly with Hyatt to continue to build, let's say, more of a traditional or better base of, let's say, cash revenue over there.

Harry Croyle Curtis Nomura Securities Co. Ltd., Research Division - MD and Senior Analyst of Gaming, Leisure & Lodging

Got you. And just one last item for Lawrence. Going back to the development at Studio City, can you give us just a reminder on just kind of general timing, general cost? And once it's -- once the project is complete, do you think that the objectives of the government -- that Melco will have satisfied the objectives of the government for you to diversify away from kind of strict gaming amenities in your properties?

Lawrence Ho Melco Resorts & Entertainment Limited - Chairman & CEO

Well, Harry, for the Studio City phase 2, the development, we need to finish before July 2021. So we are against a tight timetable, but at the same time, we're working with the various -- many Macau agencies and departments to get the necessary approvals to get moving as fast as possible. But to be honest, in terms of diversification, Melco has always been a leader in that field. I think compared to our competitors, even if we don't build phase 2, we would already have satisfied and more than done our share for diversification in Macau. And I think that was reinforced by the Macau government's midterm review, that's the one that they did in 2015, where, I think, on almost every single category, we came out on top. But still, I think our view of the business for the future is that with the greater integration

between the Greater Bay Area, with the Hong Kong-Zhuhai-Macau Bridge, with Hengqin area development and all of the infrastructure that's going into the area, Macau will be more of multifaceted tourism place. And I think that's why our goal for Studio City phase 2 is to build more hotel rooms and of course, with the water park and other nongaming entertainment attractions.

Operator

Next question is from Jared Shojaian of Wolfe Research.

Jared H. Shojaian Wolfe Research, LLC - Director & Senior Analyst

Can you talk a little bit more about why COD Macau is still holding light on the mass side? And considering it's now back-to-back quarters, it seems like maybe it could be more than just luck. So can you talk about operationally what's different and what might need to change to get those hold rates back up to more of a normalized level?

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

Yes. Sure Jared, it's David Sisk. Hey, a couple of things. I think, one, it goes back to we were somewhat surprised by when we lost our smoking there a little bit. That has a dramatic impact on the players, where the players had to basically get up from the table, break their play if they wanted to run for a cigarette and run to a smoking room out in the main casino area. Again, it's challenging for the players to go on a run or whatever else. So that does have an impact and does create an issue for us. And as we worked hard to get the other smoking rooms available and opened so they were closer to their tables, that has had a positive impact for us, since we've been able to get those smoking rooms done and opened up in September.

Jared H. Shojaian Wolfe Research, LLC - Director & Senior Analyst

Okay. That's helpful. I mean, maybe just a follow-up on that. I mean, if there are more smoking rooms that are, I guess, in closer proximity, I mean, I just wonder if looking back at some of the hold rates from 2016, 2017, if that's realistic? I mean, do you think you can get back there? It seems like 2Q and 3Q may be a little bit lower than what you'd like to see, but is historical norms really the right way to think about it?

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

I think there is somewhat of a new norm in the sense that we're probably more towards the low 30s as opposed to where we were before.

Jared H. Shojaian Wolfe Research, LLC - Director & Senior Analyst

Okay, that's helpful. And one other follow-up, unrelated, just on the VIP side. I mean, how much of the weakness do you think is purely demand-related versus just there's more supply now with more junket rooms opening? And can you just also talk about the promotional environment right now?

David Ross Sisk Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

We've not seen a real heavy thing on the promotional environment. I think much like Wynn on their call, as they talked about it, again, it's really more in terms of credit. As the new operators open up, I think the operators sometimes come -- or the junket operators sometimes move the players around a bit. But we've not seen that same level of impact. Again, Morpheus has been incredibly helpful to us. And as we continue to develop our VIP spaces, it's been very well received.

Operator

There are no questions as of this time. Please continue.

Richard Huang Melco Resorts & Entertainment Limited - Director of IR

Okay. So thanks a lot for dialing in. We look forward to speaking with you again in 3 months' time. Thank you.

Operator

Thank you. Ladies and gentlemen, that does conclude the conference for today. Thank you for participating. You may now all disconnect.



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