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MLCO - Q2 2017 Melco Resorts & Entertainment Ltd Earnings Call

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CORPORATE PARTICIPANTS

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

Geoffrey Davis *Melco Resorts & Entertainment Limited - EVP and CFO*

Gabe Hunterton *Melco Resorts & Entertainment Limited - Property President of City of Dreams, Macau*

David Sisk *Melco Resorts & Entertainment Limited - Property President of Studio City*

Geoff Andres *Melco Resorts & Entertainment Limited - Property President of City of Dreams Manila*

Ross Dunwoody *Melco Resorts & Entertainment Limited - VP of Development and IR*

CONFERENCE CALL PARTICIPANTS

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

Billy Ng *BofA Merrill Lynch, Research Division - Research Analyst*

Kenneth Fong *Credit Suisse AG, Research Division - Regional Head of Gaming & Lodging Research and Director*

PRESENTATION

Operator

Ladies and gentlemen, thank you for participating in the Second Quarter 2017 Earnings Conference Call of Melco Resorts & Entertainment Limited. (Operator Instructions) Today's conference is being recorded.

I would now like to turn the call over to Mr. Ross Dunwoody, Vice President Development and Investor Relations of Melco Resorts & Entertainment Limited. Over to you, sir.

Ross Dunwoody - *Melco Resorts & Entertainment Limited - VP of Development and IR*

Thank you, operator. Thank you for joining us today for our second quarter 2017 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 laws. Our actual results could differ from our anticipated results. I will now turn the call over to Lawrence.

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

Thank you, Ross. Hello, everyone. Macau has now delivered its 11th month of year-over-year increase in GGR and is tracking over 17% growth for the first half of 2017, exceeding our expectations for the year so far. It is becoming increasingly evident that Macau has entered into a new phase of growth, one driven by increasing visitation patterns and increasingly well-traveled and sophisticated outbound tourists, particularly from Macau's core feeder market, China.

I believe it is inevitable these trends are only going to continue and Macau is going to be a key beneficiary. Overnight guests and length of stay continues to increase, which is driven by an increasingly mobile outbound tourism market, primarily from Mainland China and supported by new supply of quality hotel rooms and other non-gaming amenities. This, in turn, facilitates greater penetration in what is a very underserved leisure and tourism market across Asia. We believe these trends will accelerate with the imminent opening of the Hong Kong-Zhuhai-Macau Bridge and the ongoing development of Hengqin Island.



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Recognizing these trends several years ago, we designed and built integrated resorts that catered to these evolving customer tastes and preferences, highlighted by City of Dreams, Macau's leading premium-focused integrated resort and Studio City, a unique mass market entertainment focused integrated resort.

City of Dreams Macau is undergoing its final phase of development, which, when completed, will result in the property once again setting new benchmarks in luxury and premium-focused entertainment and hospitality in Asia. Phase 3, which opens in less than 12 months, will add almost 800 incredible luxury rooms, suites and villas to complement a unique array of new restaurant concepts never before seen in Macau.

We experienced some meaningful whole grade issues in premium mass at City of Dreams Macau during the quarter, which Geoff will discuss. However, our mass drop expanded sequentially in 2Q '17 despite the quarter's typical weak seasonality, highlighting the property's leading position in premium mass and direct VIP segments, despite the opening of several major integrated resorts in Cotai. This leadership position is set to continue upon completion of the final development phase of City of Dreams.

Studio City has delivered a strong quarter of results with GGR increasing 27% sequentially and almost 130% on a year-over-year basis, which drove property EBITDA to increase almost 20% on a sequential basis and almost 230% on a year-over-year basis. We delivered these results despite the ongoing construction issues that are evident at the Lotus Bridge immigration border, which we are hopeful will be alleviated in the coming quarters.

In Manila, City of Dreams delivered a sixth straight quarter of record property EBITDA, growing over 70% on a year-over-year basis, with record GGR recorded in the VIP and mass table segments. While we remain fully committed to driving operational and financial performance across our current operations, we also continue to evaluate new markets which we believe will drive long-term value for shareholders. This approach is highlighted by our decision to invest in the Philippines, which is now delivering return on invested capital metrics of close to 30%.

While there are a range of potential opportunities abroad, securing a license in Japan remains our key development objective. We believe that this market represents one of the most exciting integrated resort opportunities in the world.

Japan already offers one of the most incredible tourism experiences with its dynamic modern cities, historical attractions and unrivaled hospitality. However, with the introduction of Japan-style integrated resorts, which offer world-class and high-quality hospitality and entertainment offerings, this tourism experience and inbound visitation will be further enhanced. Given the significantly underpenetrated nature of Asian integrated resort market, we believe that Japan's undoubted success will not come at the expense of other markets, including Macau.

With that, I'll turn to Geoff to go through some of the numbers.

Geoffrey Davis - *Melco Resorts & Entertainment Limited - EVP and CFO*

Thanks, Lawrence. We reported group-wide property EBITDA of approximately \$330 million in the second quarter of 2017, increasing by more than 34% from the second quarter of 2016, while luck-adjusted property EBITDA increased by over 32% on a year-over-year basis to approximately \$315 million. At City of Dreams Macau, our luck-adjusted EBITDA was broadly comparable to our reported EBITDA, while at Studio City, EBITDA was positively impacted by a favorable VIP win rate by approximately \$5 million in the second quarter of 2017. The EBITDA contribution from our non-VIP segments represented more than 90% of luck-adjusted EBITDA at City of Dreams Macau and on a Macau-wide basis.

The luck-adjusted property EBITDA margin in Macau was approximately 25%, down slightly from 26% in the prior quarter and up from 22% in the second quarter of 2016. As Lawrence mentioned, we experienced a lower-than-usual whole percentage in our premium mass operations at City of Dreams. While we do not adjust for this in our luck-adjusted EBITDA calculations, which only adjusts for rolling chip win rates, if we were to hold at rates similar to the preceding 12 months in premium mass, EBITDA would have been over \$20 million higher than reported at City of Dreams.

City of Dreams Manila delivered total property EBITDA of \$63 million, representing an increase of over 70% year-over-year. The property's EBITDA margin was 36% in the second quarter of 2017 compared to 39% in the prior quarter and 30% in the same period last year.

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On a luck-adjusted basis, Manila's property EBITDA would have been approximately \$55 million, representing 57% year-over-year increase with luck-adjusted EBITDA margin expanding by almost 400 basis points on a year-over-year basis to 36%.

To provide more clarity regarding our capital structure within our core group, we had cash of approximately \$650 million and gross debt of just under \$1.5 billion, excluding Studio City and the Philippines, at the end of the second quarter of 2017 on a segment reporting basis.

As we normally do, we'll give you some guidance on nonoperating line items for the upcoming quarter. Total depreciation and amortization expense is expected to be approximately \$135 million to \$140 million, including approximately \$47 million at Studio City. Corporate expense is expected to come in at approximately \$33 million to \$36 million, and consolidated net interest expense is expected to be approximately \$64 million, which includes financed lease interest of \$10 million relating to City of Dreams Manila and \$10 million of capitalized interest.

For those that follow City of Dreams Manila more closely, our building lease payment for the second quarter of 2017 was approximately \$8 million.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have the first question from the line of Billy Ng from Bank of America Merrill Lynch.

Billy Ng - BofA Merrill Lynch, Research Division - Research Analyst

I have questions regarding Morpheus. Can you tell us a little bit more on the gaming opportunities of Morpheus? We understand that there may be additional gaming space, but in terms of gaming tables, roughly speaking, how many tables that we can have depending -- of course, it depends on the government approval process. And also, I want to get a comment on the opening date of the Morpheus.

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

Billy, it's Lawrence here. We are incredibly excited about the opening of Morpheus. Based on what we talked about in the last call, we see Morpheus as a massive catalyst to launch COD 2.0. As of next year, COD is going to be 9 years old. But at the same time, given the improvements that we have made to COD as part of its retail proposition, we recently opened new restaurants and, of course, the centerpiece is going to be Morpheus. And so that will -- COD next year is going to feel like a brand-new property. There is dedicated gaming space within Morpheus at various levels because it is a vertical building. We've always looked at Morpheus as the third and final phase of City of Dreams and it comes with a significant price tag. I don't think any architecture in any building in Macau is remotely close to Morpheus. And so based on the government's track record of rewarding operators for investment in terms of diversification and beautifying Macau, I think we check all of those boxes. Naturally, it's out of our control in terms of how many tables we get. But within the property, we can easily house 50-plus tables. So we have -- we're going to be submitting our relevant documentation to the government and we will see where that goes. And sorry -- and Billy, you wanted to know about opening. We are tracking very well. I think Morpheus had a very unfortunate accident a couple of weeks ago. But I'm pleased to say that our world-class construction team have done their investigation and I think the government is pleased with the efficiency and thoroughness of our investigation and we believe the site will resume activity tomorrow. So that's a very short time. And again, credit to our world-class team. And so the completion date, we don't anticipate any delays and we're still targeting sometime around Q1 or Q2 of next year.

Billy Ng - BofA Merrill Lynch, Research Division - Research Analyst

And one follow-up is how much on spent CapEx for the project?



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

I think for that maybe I hand over to Geoff.

Geoffrey Davis - *Melco Resorts & Entertainment Limited - EVP and CFO*

Billy, overall CapEx for the project is approximately \$1 billion.

Billy Ng - *BofA Merrill Lynch, Research Division - Research Analyst*

And for the expansion, like, how much more we need to put in?

Geoffrey Davis - *Melco Resorts & Entertainment Limited - EVP and CFO*

Well, we anticipate leveraging the existing infrastructure, but given the number of rooms and food and beverage outlets, there will be an increase in headcount as a result of that. We're still going through the finalization of those budgets, but very much in line with what you'd expect for an 800-room hotel. But we do anticipate leveraging the infrastructure to improve margin overall.

Billy Ng - *BofA Merrill Lynch, Research Division - Research Analyst*

Really one last question is, how many additional staff we should expect for the project once it's operational?

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

Why don't we get Gabe to talk about it?

Gabe Hunteerton - *Melco Resorts & Entertainment Limited - Property President of City of Dreams, Macau*

It's Gabe. We don't have a final on that number. It's significantly lower, obviously, than bringing to life a new operation. I would say we will have that probably in another 3 months from now.

Operator

The next question comes from the line of Anil Daswani from Citigroup.

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

With regards to the premium mass hold issue, can you comment if you've seen that rebound at all into July? And what the outlook would be for the third quarter? Should we be expecting that to get back to normal levels? And if you were to look at the margin for COD on a luck-adjusted basis in premium mass as well, how would that have looked?



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

Anil, it's Lawrence. So I think on that, why don't I leave Gabe to talk about that level of details. And also, what we're seeing in July, I think needless to say, we have seen a rebound and we are pleased with what's happening, but the detail -- let me get Gabe and I think on the margin question, Geoff can chime in.

Gabe Hunteerton - *Melco Resorts & Entertainment Limited - Property President of City of Dreams, Macau*

Anil, it's Gabe. Yes, we've seen, in July, the premium mass and overall mass holds are right back up in the expected range.

Geoffrey Davis - *Melco Resorts & Entertainment Limited - EVP and CFO*

Anil, this is Geoff. On margin, at City of Dreams, if you adjust for both VIP and mass hold adjustment that you mentioned, it's approximately a 30% margin, Macau Property overall is approximately 26% and the group-wide margin is approximately 27%.

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

As a bit of a follow-up to the previous question on Morpheus. Can I guess -- if you do get 50 additional tables at the Morpheus, you would assign those to premium mass and that -- given its proximity to your best hotel rooms in the project?

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

Yes, Anil, absolutely. Because Morpheus was designed for our best in-house customers and there is significant work being done at COD over the next few months to integrate Morpheus into the existing building of City of Dreams. And also, there is work being done on the main casino floor to have really the pinnacle of premium mass experiences anywhere in the universe. And so certainly, most of the tables, if we get them -- if we are lucky enough to get them from the government, will be for our bread-and-butter business, which is premium mass.

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

My last question is on the Philippines. Following the nasty event that took place at one of your competitors, have things got back to normal in July? And again, are we back on the trajectory pre- the events of early June?

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

I think before I hand it off to Geoff Andres, our property president in Manila, I think as we said in the prepared remarks, we are extremely pleased and excited about how the Philippines market is developing. It's probably surpassed our initial expectations and a lot of that is thanks to the good work of the team there. So I think, Geoff, maybe you can give a bit more color on what's happening in the Philippines?

Geoff Andres - *Melco Resorts & Entertainment Limited - Property President of City of Dreams Manila*

Thanks, Lawrence. After the tragic events that happened at Resorts World, there was an initial decrease in some of our international hotel reservations, but that is -- that bounced back by the end of the month. And all of our businesses continue to be quite strong and the Philippines overall continues to enjoy double-digit tourism growth across all their major tourist markets: Korea, U.S.A., China and Japan. So it continues to be a very good story here in the Philippines.



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Operator

The next question comes from the line of Kenneth Fong from Credit Suisse.

Kenneth Fong - *Credit Suisse AG, Research Division - Regional Head of Gaming & Lodging Research and Director*

I have 2 questions. One is on the overall competitive landscape. So how do you see this change over the past few quarters, especially when your competitor open gradually in Cotai. And then my second question is how should we think about the potential for further ramp up for Studio City going forward? Have we reached, let's say, 50%, 60% of your projected growth? Or how do we think about its potential over the next few years?

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

Kenneth, let me do the first part. When -- there's been 2 major integrated resorts that win Cotai and Parisian that has opened in the last -- within the last 12 months. So naturally -- and also, you have Studio City and Galaxy Phase 2 ramping up. So naturally, I think, with some of the new properties, we have seen an increase in terms of promotion and marketing. But I think fortunately, they are not crazily out of the normal realm. So all in all, I think that the market is developing nicely. I think for us, speaking on behalf of Melco and also City of Dreams and even Studio City, we have been extremely disciplined in terms of what we're doing with respect to reinvestment. So I think, hopefully, over time, that it will normalize and even some of the properties who are very desperate to ramp up will get back into the normal range. In terms of Studio City, I'll hand it off to David to give us more details, but I still think Studio City is significantly hampered by access issues. Our main access point, which is Lotus Bridge, continues to be blocked off with the construction of the light rail. And so the walk that should be 30 seconds in the future when the footpath is open and the footpath is built and is subject to government when they want to open it. But now that the current -- under the current environment, the walk to Studio City is both -- just unpleasant and hazardous. So I think there are phenomenal days ahead, but in the meantime, maybe I'll let David talk about more on the details.

David Sisk - *Melco Resorts & Entertainment Limited - Property President of Studio City*

Sure, Kenneth. So I think there's a few areas, Kenneth. I think, one is, as you can see and look at our ramp up on the VIP business. We've been incredibly surprised and very grateful in terms of the way it's ramped up and is continued for us. Our junket has performed very well and our premium direct business continues to build. If you look towards our premium mass as we look to optimize in our spaces there and we've kind of done more with the signature space in terms of opening up that entryway and kind of repositioning its tables, we continue to see good growth there and then as we've also down at the main floor, as we looked at some of our table pricing and trying again to enhance the pricing on the floor to take advantage of the track that we have there, we've really pushed up our limits more now to where I'd say we're really attracting a really nice mass plus customer as well as a good overall mass customers we've got coming in. Overall, based on those things, I think we're seeing -- continuing to see growth from our customer base that's coming in. As Lawrence said, as you look out towards the Lotus Bridge entry point, we think there is a tremendous opportunity there once we get that area opened up. We're hopeful that, that will happen sometime late fourth quarter. We continue to petition the government to try to get that opened as soon as possible for us because we see such huge potential particularly with that opening, but also with just the general growth of what's going on in Hengqin. So we're positive on the future. We're very positive on the continued ramp for Studio City.

Operator

There are no further questions at this time. I would like to turn the conference back to the speakers. Please go ahead, sir.

Ross Dunwoody - *Melco Resorts & Entertainment Limited - VP of Development and IR*

Thanks everyone for joining. We look forward to speaking with you next quarter.



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Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you all for your participation. You may all disconnect your lines now. Thank you.

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