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Q3 2020 Melco Resorts & Entertainment Ltd Earnings Call

EVENT DATE/TIME: NOVEMBER 05, 2020 / 1:30PM GMT

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

Edward Lee Engel *Macquarie Research - Analyst*

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

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

Luis Ricardo Chinchilla *Deutsche Bank AG, Research Division - Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Thank you for participating in the Third Quarter 2020 Earnings Conference Call of Melco Resorts & Entertainment Limited.

(Operator Instructions)

Today's conference is being recorded. I'd now like to turn the call over to Mr. Richard Huang, Director of Investor Relations of Melco Resorts & Entertainment Limited.

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

Thank you for joining us today for our third quarter 2020 earnings call.

On the call today are Lawrence Ho, Geoff Davis, Evan Winkler and our Property Presidents in Macau, Manila and Cyprus.

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

In addition, we may discuss non-GAAP measures. A definition and a reconciliation of these measures to the most comparable GAAP financial measures are included in the earnings release. Finally, please note that our supplementary earnings slides are posted on our Investor Relations website.

With that, I'll turn the call over to Lawrence.

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

Thank you, Richard.

During the third quarter, our integrated resorts experienced gradual recovery in business levels, helped by the resumption of IVS visa issuance in Guangdong in late August and nationwide resumption of visa issuance in late September. Despite increased inbound visitation, thanks to the Macau and the Mainland Chinese governments' measured and prudent approach towards border re-opening, we have not seen any new COVID cases after the relaxation of the travel restriction measures.

Benefiting from the resumption of visa issuance, our Macau mass table games operation, which contributes vast majority of our EBITDA in pre-COVID times, saw notable sequential improvements from 2Q to 3Q.

Business trends have also improved in the Philippines, with gaming and hospitality operations at City of Dreams Manila operating on a limited 'trial run' basis, as authorized by PAGCOR.

In the middle of June, operations at Cyprus Casinos partially resumed. We saw a swift return of domestic gaming demand which drove the return of our third quarter gaming revenues to approximately 75% of last year's levels.

Looking ahead, while we are encouraged by the resumption of visa issuance and growing inbound visitation, ensuring the safety and well-being of our colleagues, customers and the communities in which we operate remains our highest priority.

We continue to expect a faster rebound and faster growth in the premium gaming segment, which benefit Melco's portfolio of luxury integrated resorts. To further strengthen our leadership in premium mass, we have made good use of the past few months to accelerate various upgrade projects at COD, with the fully renovated Nüwa hotel tower currently anticipated to re-open before the Chinese New Year.

Despite COVID-19, Melco remains committed to its global development program. Our next major project in Macau will be Studio City Phase 2, where construction is going full-steam ahead. Upon completion, the Phase 2 expansion will increase Studio City's hotel room inventory by approximately 60%, with 2 new hotel towers offering approximately 900 luxury hotel rooms and suites. Gaming space will be expanded. New non-gaming attractions will also be added, which includes a Cineplex, one of the world's largest indoor/outdoor water parks, fine-dining restaurants and state-of-the-art MICE space.

In Cyprus, we're making good progress with the development of City of Dreams Mediterranean, which, upon completion, will be Europe's largest integrated resort, offering over 100 gaming tables, 1,000 slot machines and 500 hotel rooms.

Turning to Japan, we remain unwavering in our commitment to bring to the country the world's leading IR. Our global team continues to monitor the process at a local and national level and engage with key stakeholders. We remain convinced that Japan represents the best potential new gaming market globally. At the same time, we remain patient and will maintain our disciplined approach with respect to all development activities, including Japan.

Last, while I expect demand recovery in Macau to be gradual, I remain confident in Melco's medium- and long-term growth prospects. I believe Macau is still the most attractive integrated resort market in the world. Our balance sheet was also strengthened by our recent capital market transactions, enabling us to overcome near-term challenges, while investing for the future.

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

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

Thank you, Lawrence.

In the third quarter of 2020, we reported negative Group-wide Property EBITDA of approximately \$77 million, while luck-adjusted EBITDA came in at negative \$89 million.

A favorable VIP win rate positively affected EBITDA at COD Macau, COD Manila, Studio City and Altira by approximately \$8 million, \$2 million, \$1 million and \$1 million, respectively. On a consolidated basis, overall results were positively impacted by approximately \$12 million. Details of these adjustments can be found in our supplementary earnings slides posted on our Investor Relations website.

In addition to the VIP win rate fluctuation, our performance was also affected by our bad debt provision. During the third quarter of 2020, we incurred a bad debt charge of approximately \$32 million, as compared to a bad debt charge of approximately \$10 million in the third quarter of 2019. On a year-over-year basis, the change in the bad debt provision negatively affected EBITDA by approximately \$22 million.

Last, to reflect challenges that the company and the global integrated resort industry faced in 2020, we reversed a previously booked bonus accrual, which positively affected third quarter 2020 EBITDA by approximately \$27 million.

On our second quarter conference call, we indicated that our Macau operations could achieve break-even adjusted property EBITDA

upon reaching approximately 30% to 35% of our historical gross gaming revenue levels, which was based on pre-COVID revenues and mix of business.

With improving revenue mix and successful cost controls, we now expect our Macau operations to achieve break-even adjusted property EBITDA upon reaching the mid-to-high-20% range of our pre-COVID gross gaming revenue levels.

Turning to our balance sheet, to optimize our capital structure, Studio City had, in July, issued \$500 million of 6.00% senior notes due 2025 and \$500 million of 6.50% senior notes due 2028. In August, Studio City completed a series of private share placements, raising approximately \$500 million of proceeds to strengthen the balance sheet.

Additionally, Melco, in August, issued \$500 million of 5.75% senior notes due 2028. Taking advantage of favorable market conditions, Melco subsequently tapped the 2028 Notes for another \$350 million, which brought the blended average yield for the entire 2028 notes offering to 5.68%.

Aided by these capital market transactions, as of the end of September, we had approximately \$1.9 billion of cash on hand and undrawn revolving facilities in Macau and Manila of approximately \$1.7 billion.

To provide more clarity regarding our capital structure within our wholly-owned group, we had cash of approximately \$960 million and gross debt of approximately \$4.1 billion at the end of the third quarter of 2020 excluding Studio City, the Philippines and Cyprus.

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 \$145 million to \$150 million; corporate expense is expected to come in at approximately \$20 million to \$22 million; and consolidated net interest expense is expected to be approximately \$94 million to \$98 million, which includes finance lease interest of \$11 million related to City of Dreams Manila and \$3 million of capitalized interest.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

First question comes from the line of Billy Ng of Bank of America.

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

I have a couple of questions here. But first of all, would you mind to provide a bit more color of what you have seen on the ground recently in the last few weeks, especially some of your peers keep mentioning that they see more pickup of the coming volume in the last few weeks? And also a follow-up on that is like we also heard the recovery is largely premium mass-driven. And can you provide a bit more color whether the high-end premium mass or the low-end premium mass are doing better right now?

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

Billy, it's Lawrence here. As we predicted on the last earnings call, we've always anticipated the recovery to be very gradual. And I think it is plotting out to be exactly what we had anticipated. I think for details of what we've seen on the ground, why don't I pass it over to David Sisk to give more color?

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

Sure. Thanks, Lawrence. Billy, so what we've seen essentially is more of our -- let's call it our premium, premium mass, more of our higher-end premium mass players coming back. A lot of our players are coming out of the non-Guangdong region. Guangdong is still kind of messed up, and we're still having some trouble as you kind of heard about probably in some of the other calls, and I think it's been pretty well noted in a lot of the writings, and a lot of things have gone on in terms of IVS and how IVS is currently working right now.

But we've been fairly pleased with what we've seen come back. We're probably about 35% of our mass volumes from what we've had before. But overall, it's actually worked fairly well for us in terms of what's come back. Again, I think we're -- the players we're seeing a little bit right now, just to give maybe a little bit more color is the players are playing down a little bit, meaning that their average bets are a bit lower. They seem to be a bit more cautious. Playing time has not changed that much.

One of the other kind of things that we've seen a little bit is that the players don't move between the properties as much now. So I think that's probably more of a reaction to COVID and just the difficulty as you go through each of the properties and having to go through kind of a check as you're going from property to property or in and out of the casinos.

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

I see. I really appreciate the color. But just a follow-up on that is, you mentioned volume-wise, it's getting back to 35%. Does that mean the company is already back to profitability, given that I think Geoff mentioned the breakeven point is lower now?

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

So this is Geoff. Yes. We played a bit unlucky, but for the month of October on a Theo basis, we are marginally in positive EBITDA territory. And that includes roughly \$10 million of bad debt expense.

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

And just final question. Given the headline news or news flow about Chinese government cracking down on probably junket activities in China. So like is the company changing the strategy for after -- post-COVID? Will you reallocate resources to more premium market segment and takeaway tables or rooms from the junket operations?

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Billy, it's Lawrence. So I think over the last 10 years plus, we've been very focused. And if anything, we pioneered the premium mass segment, anticipating the market to shift. So I think we have a very great team and well-suited product to cater to that segment. And at the current moment in time, of course, with that anti-gaming campaign or anti-junket campaign, I think there will be some long-term positives for Macau because after all, they're focusing on overseas gaming. And so in due course, I think we'll see some of that traffic come back to Macau and be diverted to Macau.

So I guess on the operational level, David and his team and his senior team have always done a great job in terms of managing for what the market is. I don't know, David, if you have more color to add?

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

Yes. I think a couple of things, Lawrence. I think the first thing is we've always -- if you look at our profitability, the junket business or that VIP business represents about 10% of our profitability. So it's not a huge portion of where we drive our revenues. As Lawrence mentioned, we've always made big investments towards our premium mass and our mass plus players. And certainly, that's no exception during this downtime that we've had for the COVID. We made a big investment back in our casino and improving it and again, creating great experiences for our players, both in our rooms and in our dining.

Last thing I'd say to you is as Lawrence was kind of alluding to, we think it's a net positive for us overall. Now whether that business comes back from these other places through the junkets or it comes through our premium direct business, we think, overall, in the long term, we're a net beneficiary of this.

Operator

Next question is from the line of Joe Greff of JP Morgan.

Joseph Richard Greff JPMorgan Chase & Co, Research Division - MD

I've Macau centric 2 questions. One, Lawrence or David or Geoff or anyone who wants to answer it. Can you talk about what you're hearing in terms of Mainland Chinese -- China's efforts to maybe reduce some of the bottlenecks and time lines for mainlanders to get visas under IVS? And maybe what's going on incrementally more recently?

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

David, do you want to give more detail?

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

Sure, I'll take that one. Sure, absolutely. So Joe, it's kind of funny because it's incredibly inconsistent in China between the provinces and cities. One of the things you can see is you can go to a non-Guangdong province, and it can take 1 day. And, in Guangdong, sometimes it can take 14 days. We still haven't seen a real consistent pattern other than just the incredible inconsistency that seems to go on and that would be kind of the inconsistent application of what happens here.

A lot of our Guangdong players that came in early October have been told basically they can't come back for 2 months. So we've really been focusing on trying to get our players back as quickly as we can. We continue to kind of maintain our contact, but it's really kind of hit and miss.

So we are working feverishly, but it really just depends on the province or the city. And honestly, even between the province and the cities, they can get one answer 1 day that says it's going to be 2 months. They can get another answer and then come back on a day. It's just incredibly inconsistent at this point. And I think, again, I think that's just going to be the way it works for a while. Sooner or later, I think things will return to a normal period, but it's just going to be inconsistent for a while.

Joseph Richard Greff JPMorgan Chase & Co, Research Division - MD

Okay. Great. And Geoff, within your comments at the sort of new threshold for EBITDA breakeven, what's the math behind the assumptions with respect to incremental bad debt from here? I know it's something that's been sort of eating away at the EBITDA the last few quarters. Obviously, you mentioned October sort of same level of monthly run rate as the 3Q. What's the assumption behind that mid- to high 20% threshold for breakeven?

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

So I would say on the bottom end of the range, that's excluding bad debts. And towards the top end of the range, that's including bad debts.

Joseph Richard Greff JPMorgan Chase & Co, Research Division - MD

And do you think at this point, I mean, it obviously depends on collections. But when you look back at what you've done the last 7, 8 months, do you think you've sort of taken most of the hits? Or is that sort of maybe an assumption that is maybe from someone like me from the outside?

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

Well, as you know, I think for the majority of this year, we've been very conservative in our provisioning. At some point, as we see visitors come back, we do think that starts to reverse, we start collecting. But that has not been assumed in our breakeven GGR guidance.

Joseph Richard Greff JPMorgan Chase & Co, Research Division - MD

And just one final question on this, the provisioning. How much of that is direct versus junkets?

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

Predominantly direct.

Operator

Next question is from the line of Edward Engel of Macquarie.

Edward Lee Engel Macquarie Research - Analyst

Of the 35% recovery you've seen in October, have you seen the mass business outperforming the VIP business overall? Or have they been generally similar?

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

Lawrence, mind if I take that one?

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Yes, please go ahead.

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

Okay, sure. So honestly, the junket business and that VIP business has been somewhat challenged by the visa process, Hong Kong being closed. So of the 35% that we're seeing, that is coming out of our mass and particularly premium mass.

Edward Lee Engel Macquarie Research - Analyst

Okay. And then, I mean, did you start to see visitation plateau by the end of October? Or were you seeing momentum kind of throughout the month, week by week and then into November?

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

So what we said is the visitation has slowed, and I wouldn't say it's plateaued, but it has slowed. We saw a period and right after we opened up in October once the Golden Week started, we saw a nice pickup. It slowed back that second week and then started picking up in the third week. I think that was more of a result, honestly, of a lot of the visas coming through for the non-Guangdong. We noticed when we opened up in September as we came off with the Guangdong, there's about a 2- or 3-week lag before the visa started coming through. So we saw that happen somewhat again with the non-Guangdong when it opened up.

We're still seeing good visitation, better visitation on the weekends, but it has slowed somewhat. Now again, somewhat is timing typically after we get out of that October period, it does slow down a bit. So it may just be more a function of the calendar and how the calendar works as well. But we're still seeing a small pickup, and it has slowed.

Operator

Next question is from the line of Ricardo Chinchilla of Deutsche Bank.

Luis Ricardo Chinchilla Deutsche Bank AG, Research Division - Research Analyst

Just looking into -- I know that it's probably still a little bit early. But just looking into CapEx for 2021. Can you provide some color with regards to the wholly owned group and the plans for Studio City?

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

Sure. So for 2021, we anticipate roughly \$1 billion. Approximately \$250 million that will be for Cyprus and about \$525 million of that would be more Studio City Phase 2.

Luis Ricardo Chinchilla Deutsche Bank AG, Research Division - Research Analyst

And thinking about the maintenance for the wholly owned properties, it's the balance of that, right?

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

A combination of maintenance, mostly maintenance and then also some small growth projects.

Luis Ricardo Chinchilla Deutsche Bank AG, Research Division - Research Analyst

Great. And can you please comment a little bit on what you have seen from the junket side? Do you guys are seeing any liquidity issues or any impact from some of the capital curves outside of China?

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Hey, David, can you take that?

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

Sure. Again, kind of what we're seeing still is from the IVS standpoint, it's still difficult for players to get in here with Hong Kong being closed. So I think the junkets are just being cautious with the players that they are getting in. I think they are struggling a little bit in terms of collections. But overall, I think it has more to do with IVS and has more to do with Hong Kong being closed.

Operator

And I'd now like to hand the conference back to Mr. Richard Huang. Please go ahead.

Richard Huang Melco Resorts & Entertainment Limited - Director of IR

All right. Thank you for dialing in for our conference call today. We look forward to speaking with you again next quarter.

Operator

Thank you, ladies and gentlemen. That concludes the conference for today, and thank you for participating. You may now all disconnect.

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