Credit Research Initiative
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Odds stacked against Macau's casinos as revenues plunge

by Lin Jingwen

Macau's casinos have been hit by a sharp drop in gambling revenue as China's anti-corruption measures turned away many high roller visitors from the city. Macau, a former Portuguese colony, was ranked amongst the world's richest cities, according to the World Bank. But the city's GDP has declined since its peak in December 2013 due to a downward trend in gambling revenue, which accounts for four-fifths of the city's economic output. Last week, the government even shocked market observers by announcing that the economy suffered its sharpest contraction in more than a decade during the second quarter.

Gambling in Macau was legalized by the Portuguese government in the 1850s. Since then, Macau has been known worldwide as the "Monte Carlo of the Orient". When Macau was returned to China in 1999, it was the only place in China where casinos were allowed. Millions of mainland Chinese flocked to the tiny island to gamble, resulting in a huge boom for the casino industry. In 2006, the country surpassed the Las Vegas Strip to become the largest gambling center in the world.

Unfortunately, after 2014, anti-graft measures newly introduced to tackle money laundering and tighter immigration rules discouraged many VIP Chinese gamblers, who contributed more than 70% of Macau's gambling revenue, from gambling in Macau. It resulted in a significant drop in revenues for Macau's casinos. In the first half of 2015, sector-wise gambling revenue dropped by 34%. (See Figure 1). Earnings before interest, taxes, depreciation and amortization of Macau's six largest casino operators fell by 40% to just over USD 3bn in the first half of this year, down from over USD 5bn in the same period last year. The shares of six listed casinos – Galaxy Entertainment, Melco Crown, MGM China, Sands China, SJM Holdings and Wynn Macau – dropped 3.2% last Tuesday, reaching a fresh three-year low. The market capitalization of these companies has fallen by nearly a third from their peak in Jan 2014 (Figure 3).

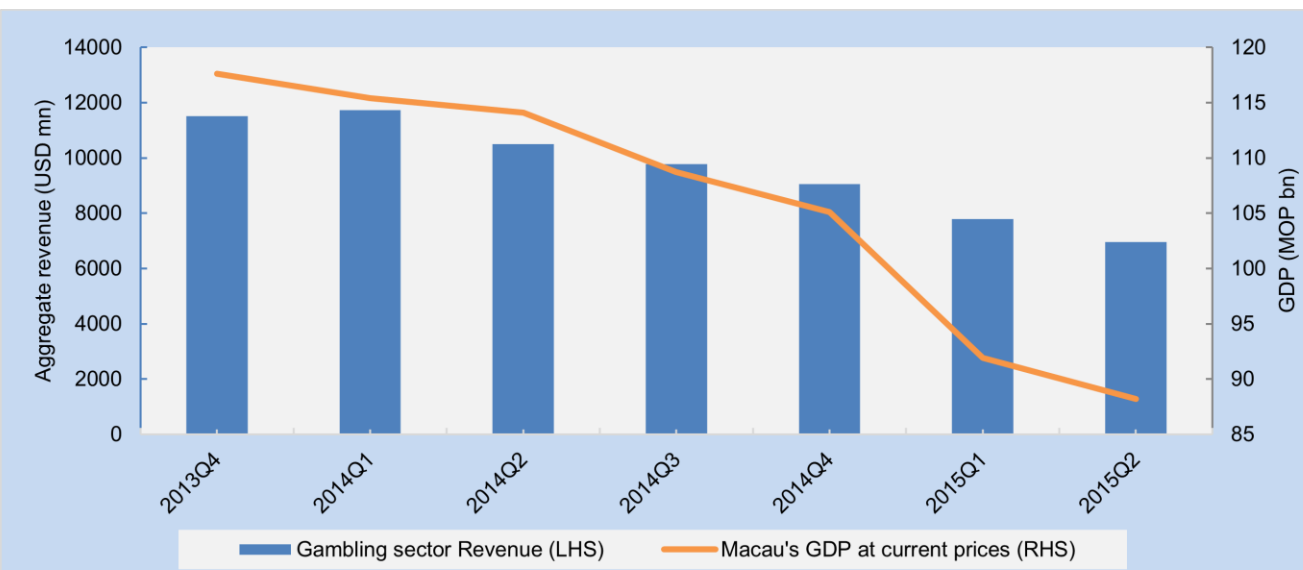

Figure 1: Total revenue for 6 Macau casinos vs Nominal GDP at current prices. *Source: Bloomberg*

Concurrent with the decline in gaming revenue, the median debt to equity ratio of the industry has climbed steadily upwards, hitting 75.7% in June 2015 from just 53.6% at the end of 2013 (see Figure 2). The increase in the leverage was caused, in part, by the step-up in investment activities of these casino operators. In an effort to stem the difficulties in the gaming room, Macau's casinos have poured billions into new resorts aimed at the mass market gamblers and non-gambling tourists. Among the attractions that are being built are a giant Ferris wheel and a replica of the Eiffel Tower.

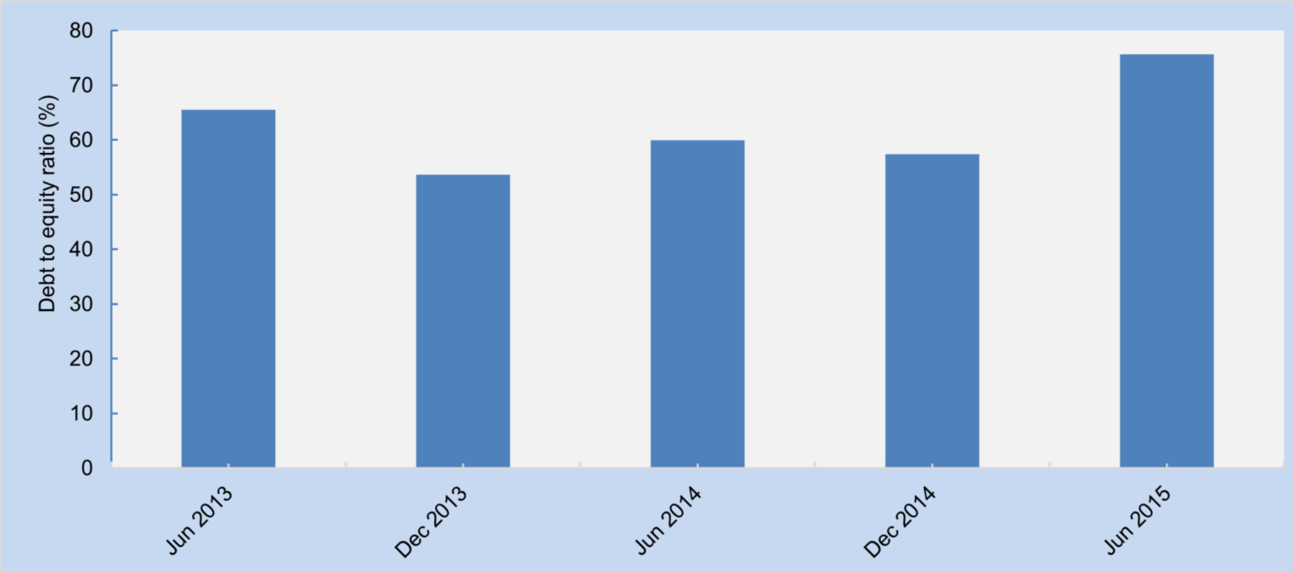

Figure 2: Median debt to equity ratio for 6 Macau casinos. *Source: Bloomberg*

As a result of the erosion in the capital structure of the industry players, the RMI-CRI aggregate 1-year Probability of Default (PD), which is a simple median of the PDs for 6 gaming companies, has also increased. On Sep 4, 2015, the aggregate PD of 7bps was more than six times the value at the beginning of the third quarter of 2014.

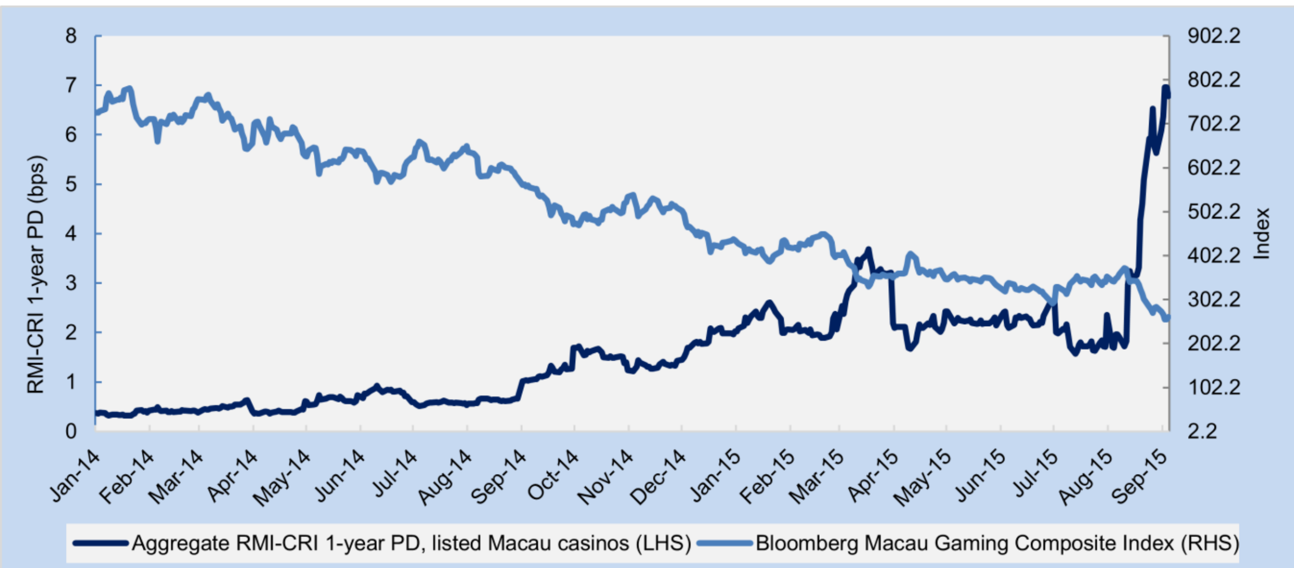

Figure 3: RMI-CRI aggregate 1-year PD for the Macau gaming industry vs Bloomberg Macau Gaming Composite Index. The Bloomberg Macau Gaming Composite Index tracks the overall market cap of the same 6 casinos in the aggregate PD. *Source: RMI-CRI, Bloomberg*

Under Beijing's anti-graft pressure, international rivals, such as Australia, Korea, Philippines and Vietnam, have begun soliciting those high-rollers who had left Macau's casinos. Although a gambling license can no longer guarantee Macau's casinos' revenue growth, these casinos can still better utilize their affluent infrastructure facilities and long-lasting international visibility to generate new revenue. Currently, Macau's non-gambling activities account for less than 10% of the overall revenue of casinos versus 63% in Las Vegas. With the industry already adapting to the new environment by diversifying its business operations, Macau could be on its way to a stronger future although at present, the economy will still have to deal with the short-term pain.

Credit News

Infrastructure debt is hot property

Sep 6. Although the reliable long-term cash flows of infrastructure debt funds offer an attractive alternative to low-yielding government bonds, the supply of investable projects remains constrained despite the growing appetite for infrastructure debt among pension funds and insurers. This leads to pressures on the valuation of infrastructure bonds, which fuels concerns that returns from the sector could prove disappointing as rising demand pushes infrastructure debt prices up and yields down. This is reflected from the yields on the Dow Jones Brookfield global infrastructure corporate bond index, which have fallen steadily over the past seven years, from a high of 6.5% in October 2008 to 3.3% at the end of August. (FT)

US shale industry braced for bankruptcies

Sep 6. Earlier in the year, it was still relatively easy for US exploration and production companies to raise capital by selling debt or equities. However, those sales have now slowed sharply, and the financial strain on the industry is growing. Already 16 US oil production companies have defaulted this year, according to Standard & Poor's. The next round of "borrowing bases" redeterminations is likely to be tougher, draining liquidity away from struggling companies. Eventually, through a lengthy process, supply and demand in the global oil market are expected to come back into balance, sending crude prices higher. (FT)

Sovereign borrowers fall behind on record sums of debt

Sep 6. Sovereign borrowers are lagging on record sums of debt as indicated by new research that reflects global solvency. The study suggested that arrears, default and debt restructuring are an even more frequent feature of public finance than already thought. Even though government debt seems to be on a decline in the early 2000's due to the debt crisis in Latin America and Asia, countries are still unable to fulfill debt obligations. (FT)

Glencore warned to cut debt pile or face downgrade

Sep 3. Commodity company Glencore has been warned it could lose its prized investment grade rating if it does not slash its near USD 30bn debt pile. Credit rating agency Standard & Poor's revised its outlook from stable to negative on the Swiss-based miner-cum-trader on Thursday. Several of Glencore's peers, including Anglo American and BHP Billiton, have also been warned that they face possible rating downgrades. The slowdown of China's economy has depressed prices of many commodities to their lowest since the financial crisis. (FT)

Southeast Asia's biggest companies risk USD 392bn debt burden

Sep 1. The accumulated debt of Southeast Asia's 100 largest listed companies ranked by assets had reached to USD 392bn by June 30. That's up six times from December 1998. Debt loads as a proportion of assets also are climbing back near levels from the crisis at 31.7%, up from 29.5% in 2010. This surge is due to companies' debt-funded expansion, a selloff in ringgit and rupiah sparked by slowing regional growth, China's yuan devaluation, and the outlook for higher US interest rates. Currently, ringgit and rupiah are at their lowest levels since 1998. (Bloomberg)

Gun maker Colt says near deal to exit bankruptcy (Reuters)

Rio Tinto still aims to boost iron ore production despite China slowdown (SCMP)

Brazil struggles to fix fiscal crisis (FT)

Regulatory Updates

UBS diverts USD 5bn of Asia deposits to curb Basel III costs

Sep 4. UBS Group AG has diverted more than USD 5bn of riskier Asia-Pacific deposits into alternative cash investments amid higher costs of holding them, due to new regulations. UBS has typically helped its clients in transferring its cash into assets held in structures, in return for clients to receive securities. While the global implementation of Basel III capital rules has made banks safer, it has also made certain bank deposits more expensive to hold. Several international banks have reportedly informed clients that fees will be charged for their deposits, given that new rules are making deposits less profitable. Currently, the Asia-Pacific deposits that UBS has transferred into alternative structures are in US dollar and Japanese yen. Money managers have plans to offer other Asian currencies later this month. (Bloomberg)

FCA warns on risk of commodity trading market abuse

Sep 4. Financial regulators in UK have raised concerns about the poor awareness of market abuse risk and the lack of effective controls among commodity traders and brokers. Under Markets in Financial Instruments Directive 2, buyers and sellers of commodity derivatives could face tougher restrictions on trading in capital markets. The proposed changes would remove exemptions for commercial users that use instruments such as swaps to offset their risks, forcing them to raise the amount of capital they must hold on their balance sheets. (FT)

Banks to face EUR 61.5bn hit from new accounting rules, says report

Sep 1. Europe's top banks are forced to consider an additional EUR 61.5bn in loan losses, after adoption of new accounting rules. In a report published by Barclays, their analysts have claimed that the new accounting rule would trigger an increase of about 34% in loan loss provisions across the 27 largest European banks, as well as lower bank valuations and more volatile earnings. The rules on financial instruments are a result of a seven-year project to make companies portray a more accurate picture, after concerns about the inaccuracies of banks in accounting for impairments during the financial crisis. Banks will move from using an "incurred loss" to an "expected loss" model as IFRS is due to commence in 2019. (FT)

Derivative trading alarm sends Scandinavia into clearing dispute (Gulf News)

Crunch time for insurers on capital rules (FT)

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