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Macau Gaming: Recovery, Repositioning, Repurchases and Reallocation



As we review how China's reopening impacted the fixed income market this year, one of the key winners has been the Macau gaming sector as bonds within that sector outperformed the wider Asian High Yield (HY) market to the point that it has become one of the biggest components of the Asia HY index. Indeed, whilst the Asia HY market recorded a negative total return of -1.6% in the first ten months of the year (according to Barclays indices) the Macau gaming segment recorded a +4.8% gain over the same period.

Back in October 2022 this stunning outperformance was certainly not easy to foresee as the sector was experiencing a slew of negative headwinds. Notwithstanding the uncertainty as to how quickly China would exit its radical zero-Covid policies and how fast it would recover to pre-Covid levels, the negative spillover effects from the failing real estate sector was already hurting badly domestic consumer confidence. In addition, the

Chinese government had engaged in a widespread crackdown of junket operators (i.e. the middlemen who facilitate gambling for wealthy Chinese clients) to the detriment of the sector. Furthermore, there also remained a significant lack of clarity regarding the sector's critical gaming license renewals at the end of last year. This uncertainty was the result of the aggressive and unpredictable policy actions undertaken in 2022 by Chinese authorities that hit numerous sectors deemed socially sensitive.

In the fourth quarter of 2022 Macau gaming bonds hit a multi-year low as the market priced in all those uncertainties that could have negatively impacted Macau tourism figures going forward. These measures had the potential to bring credit stress to the relatively highly levered casino operators. However, while 2023 has seen so far a stuttering recovery of the Chinese economy that has largely underwhelmed investors, Macau gaming HY bonds has been a sector that has significantly bucked the trend as casino operators quickly rebuilt their liquidity buffers and positively revamped their image as soon as Covid-restrictions got lifted.

Initially spurred by the award of new 10-year concessions to all six existing casino operators in November 2022 (namely SJM Holdings, Sands China, Wynn Macau, Melco Resorts, MGM China and Galaxy Entertainment), these operators saw faster-than-expected recoveries in gross gaming revenues (GGR) that translated into rapid improvements in EBITDA and cashflows. According to Macau's gaming bureau, Macau's total GGR for the first ten months of 2023 was MOP 148.45bn (USD 18.45bn), or 60.2% of the city's 2019 pre-COVID figures. It was a significant improvement over 2020-22 GGR numbers. In other words, casino operators are gradually getting back to normal.

In addition, Macau gaming operators have started to boost their non-gaming revenues by expanding the mass-market segment and transforming their business models beyond pure gambling. That was a condition put forward by Macau regulators when renewing the operating licenses which likely reflected the will of the Chinese government. Examples include MGM pledging MOP 16.7bn (USD 2.1bn) to build a high-tech theme park and an art museum.

On the liability side, gaming operators also became more active. Recently we saw local operator Studio City repurchase USD 100m of its bonds through a tender offer in a sign that the recovery in the territory's gaming sector was well underway.

Combining all the developments discussed above, the Macau gaming sector is expected to benefit from a gradual fund reallocation away from the China HY property sector. Macau gaming now constitutes a major segment of the investable pool of bonds across the Asia HY universe. Given the ongoing turmoil in the Chinese property sector that led to its relative size and weighting in benchmark indices shrink dramatically, the Macau gaming sector saw its weighting in indices rise significantly. In terms of market value, Macau gaming HY bonds now account for 10% of the Bloomberg Asia HY index whereas the China HY property bonds sector has shrunk to 4%.

We believe the weighting of the Macau gaming sector in HY bonds indices is likely to rise even further given that it is one of the very few sectors in China that can tap various financing channels. Being exposed to this asset class, the Macau gaming sector certainly requires our constant monitoring.



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