



Nagacorp (3918 HK)

Cambodian monopoly casino operator getting ready for a wave of Chinese tourists



ASIAN
CENTURY
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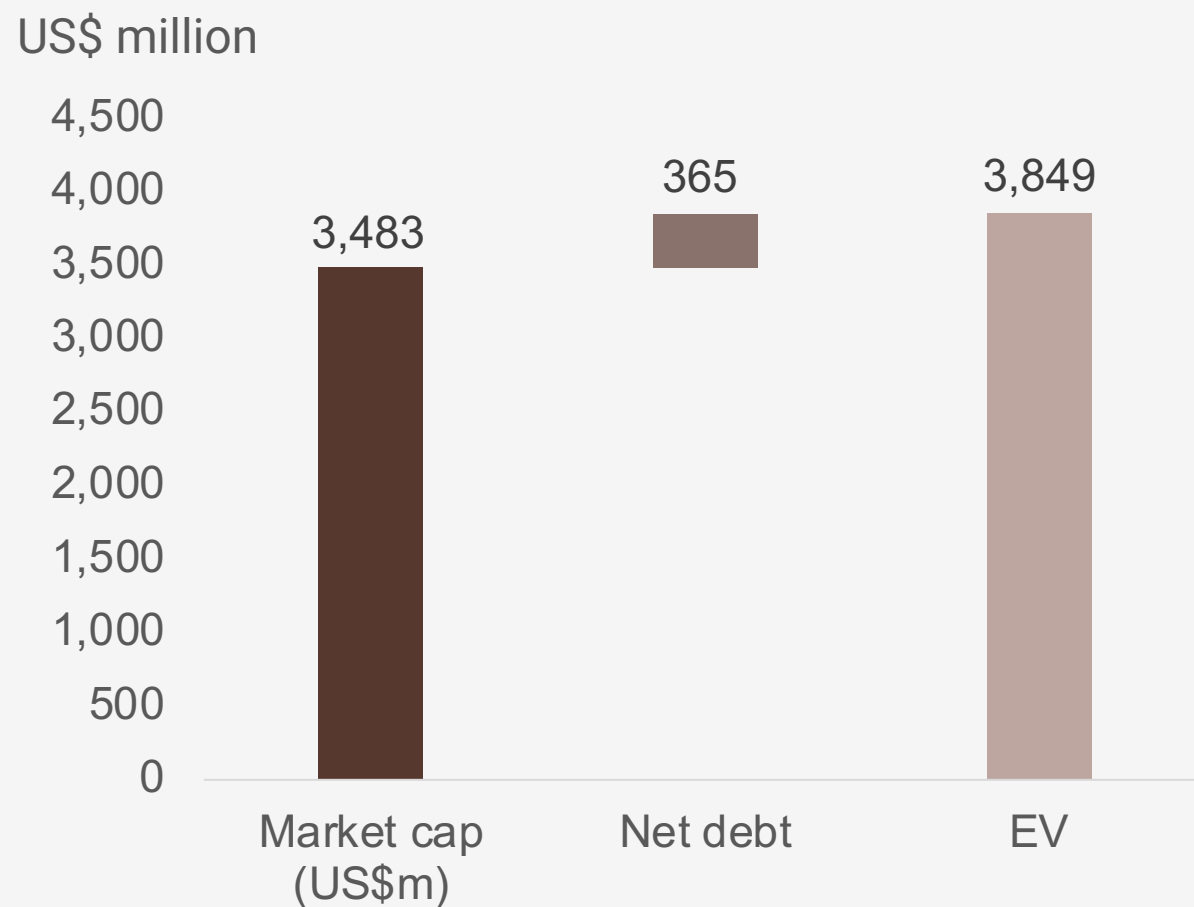
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Summary

- NagaCorp (3918 HK) is the operator of the NagaWorld casino complex in Cambodia's capital Phnom Penh. It owns two casinos with 480 gaming tables and 3,700 slot machines, as well as hotels with 2,700 rooms and commercial properties.
- NagaWorld is a loosely regulated monopoly with the exclusive right to operate casinos within a 200km radius of Phnom Penh until 2045. And its casino license lasts until 2065. Further, the regulatory environment in Cambodia has been exceptionally favourable with low gaming taxes at just 4-7% vs up to 40% in Macau. Cambodia offers visa on arrival to mainland Chinese.
- The bull case is that tourism to Cambodia is in an upwards trajectory. Cambodia is a small developing country in close proximity to China, its now largest trading partner. Chinese FDI represents half of Cambodia's FDI and much of that FDI ends up in NagaCorp's casinos. On the other hand, casinos in Asia are often used for money laundering. So-called junket operators working with Cambodian casinos have often been used to funnel money out of China.
- The founder of NagaCorp is a Malaysian national called Dr Chen Lip Keong, who used to be the economic adviser of Cambodia's Prime Minister Hun Sen. While some question the way new casinos have been injected into the ListCo that caused dilution in the share count, it's also clear that minority shareholders have benefitted. From 2013 until COVID-19, earnings per share grew at a compounded annual growth rate of 15%. And the majority of earnings since the IPO have been paid out as dividends.
- Looking forward, the three major factors for NagaCorp's earnings per share are:
 1. China's borders opened up in January and in February, it was decided that Chinese group travel to Cambodia will resume. In 2019, they represented 1/3 of total visitors.
 2. The construction of new casino Naga 3, which is expected to almost double NagaCorp's capacity. But it will also come at a steep cost of US\$3.5 billion – far above the construction cost of Naga 2's US\$350 million. 50% of the construction cost is shouldered by the ListCo and 50% by Dr Chen, who will inject the asset into the ListCo, causing a 26% share dilution.
 3. In 2019, the Cambodian government to crack down on Chinese online casinos operating out of Cambodia. Chinese junket operators such as Suncity were also shut down. 100,000 Chinese returned from Sihanoukville alone in 2019. While proxy betting is supposedly still allowed at NagaWorld, it's unlikely that VIP business will come to 2019 levels.
- With cautious assumptions on Chinese VIP business returning but a positive boost from Naga 3, I expect a 2027 P/E of 9.6x. On the positive side, Dr Chen is buying shares actively in the open market around the HK\$6/share level. That might suggest optimism around a potential VIP business recovery.

Capitalisation

- Share price: HK\$6.24
- Shares outstanding: 4,382 million
- Market cap: US\$3,483 million
- Net debt: US\$365 million
- Enterprise value: US\$3,849 million
- Daily trading volume: US\$1 million



* HK\$ = Hong Kong Dollar, the listing currency. HKD/USD = 7.85

Business overview

- Nagacorp is the monopoly casino operator of Phnom Penh, the capital of Cambodia, with 2,700 hotel rooms, 480 gaming tables and 3,700 slot machines.
- It has exclusive rights to operate casinos within a 200km radius of Phnom Penh until 2045 with its casino license lasting until 2065. Its monopoly is unrestricted. Nagacorp has the right to operate a casino of any size, any table game or slot machines without additional approvals from the government.
- Its main casinos include the “Nagaworld” casino, which is close to capital Phnom Penh’s landmark Hun Sen Garden and only 30 minutes away from the international airport. There’s also another casino called “Naga2” and a connection between the two called NagaCity Walk.
- New development Naga 3 will almost double the size of the business yet again.
- NagaCorp’s founder Chen Lip Keong, who is a Malaysian citizen, was previously the economic adviser to Cambodia’s Prime Minister Hun Sen and has a close relationship with the Cambodia People’s Party.
- Since NagaCorp’s casinos are only open to foreign passport holders, they were hurt by the border closures as well as the Chinese government’s crackdown on overseas gambling. But Asian borders have now opened up, and that should be incrementally positive.



The Nagaworld casino. Source: NagaCorp

How casinos work

- Casinos set up slot machines and gaming tables on large floors.
- Customers purchase chips from the casino, which they then use on the floors to gamble.
- VIP customers often borrow money from so-called junket operators (=loan sharks) to purchase casino chips. These junket operators organise trips from say China or Vietnam, with rooms, transport, etc.
- Once they've finished playing, they return the chips to the casino in exchange for cash.
- One benefit for VIP customers is that cashing in the chips will give them access to foreign currency. The junket operators will then hire shadow banks to convert say Renminbi to US Dollar to settle the money they lent to the VIP customers. This service is particularly important for Chinese and Vietnamese, whose currencies are subject to capital controls.
- It's unclear how shadow banks are able to convert Renminbi to US Dollar, but potential avenues include smuggling cash across borders, fake invoices or cryptocurrency transactions.

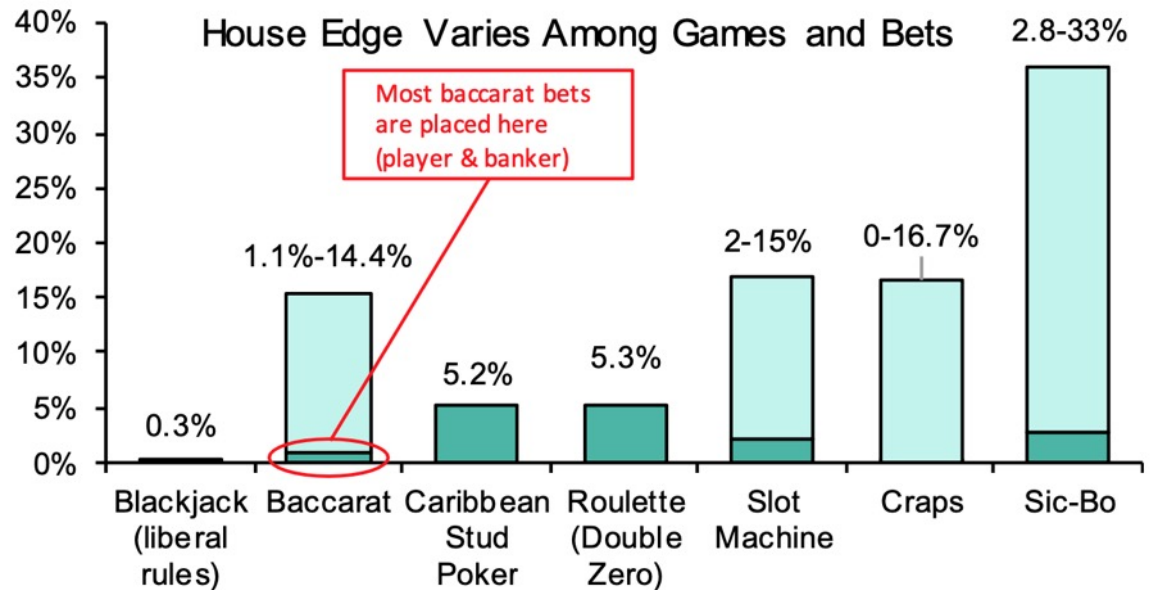


Source: Getty Images

Casino term	Translation
House	Casino
Buy-in	Chips bought on casino floor
Rollings	Chips bought by VIP customers
Win rate/edge	% won by casino for each \$1
Junket	Trip offered to VIP customers

The house always wins

- In Las Vegas, only 1/3 of revenues comes from gaming and the rest from hotels, food & beverages, etc. In Asia, 90% comes from gaming.
- The house edge (how much the casino makes on every dollar on average) is the highest for mass-market games such as slot machines.
- But VIP customers engaged in money laundering or capital flight prefer Baccarat, since it has the lowest house edge and doesn't take much time to play. If you're good at Baccarat you can get back 90%+ after a few rounds. Money launderers usually use casinos as a final step to break the chain of traceability.
- On a long enough timeline, the casino always wins. But gambling can serve other purposes, including enjoyment, money laundering (hiding the fact that money comes from criminal activities) or capital flight.



Source: Bernstein

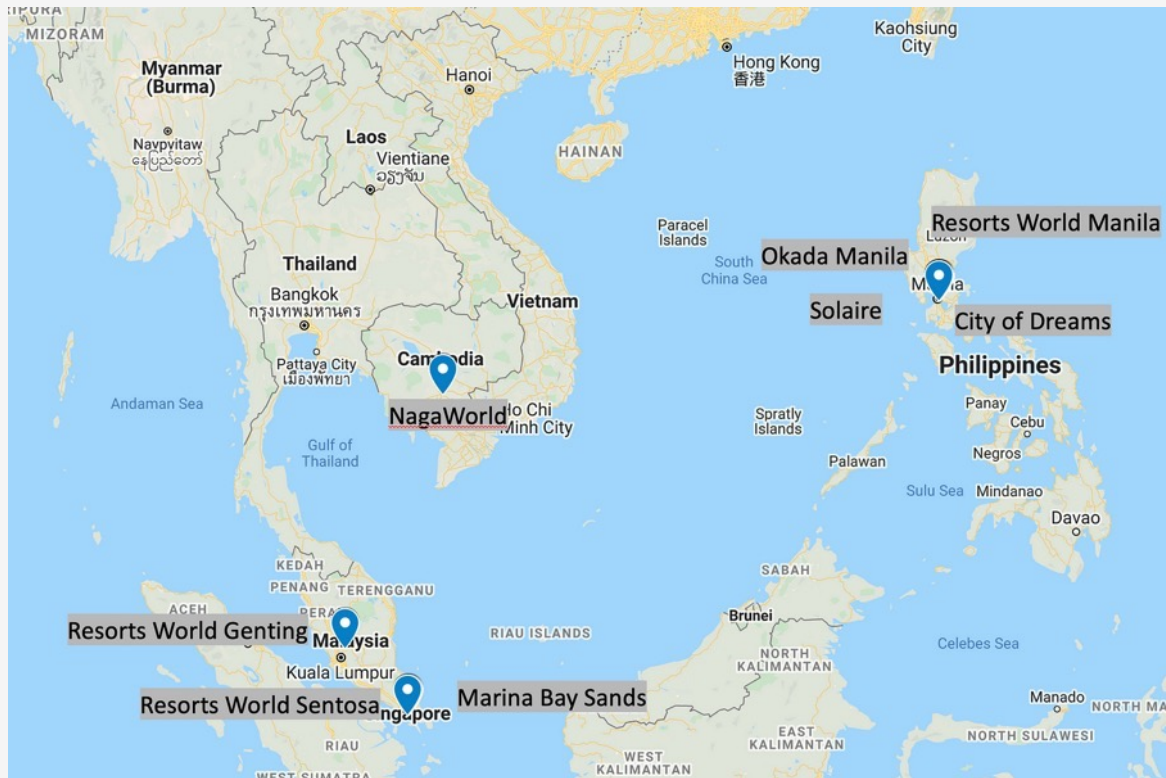
What goes on in private casino VIP rooms

- Most casinos have special rooms where VIP customers can gamble in privacy. Gambling on normal casino floors with large amounts of money would raise eyebrows.
- Typically, these rooms are rented by junket operators that have special deals with the casino, bringing in customers in exchange for commission.
- Outside of Macau, a common practice is so-called proxy betting, which is when the owner of the money makes instructions via video link to his agent inside the VIP room on how to bet. China is trying to crack down on this practice.



A VIP room in Macau. Source: Wikipedia Commons

Cambodia's spot in Asia's casino industry



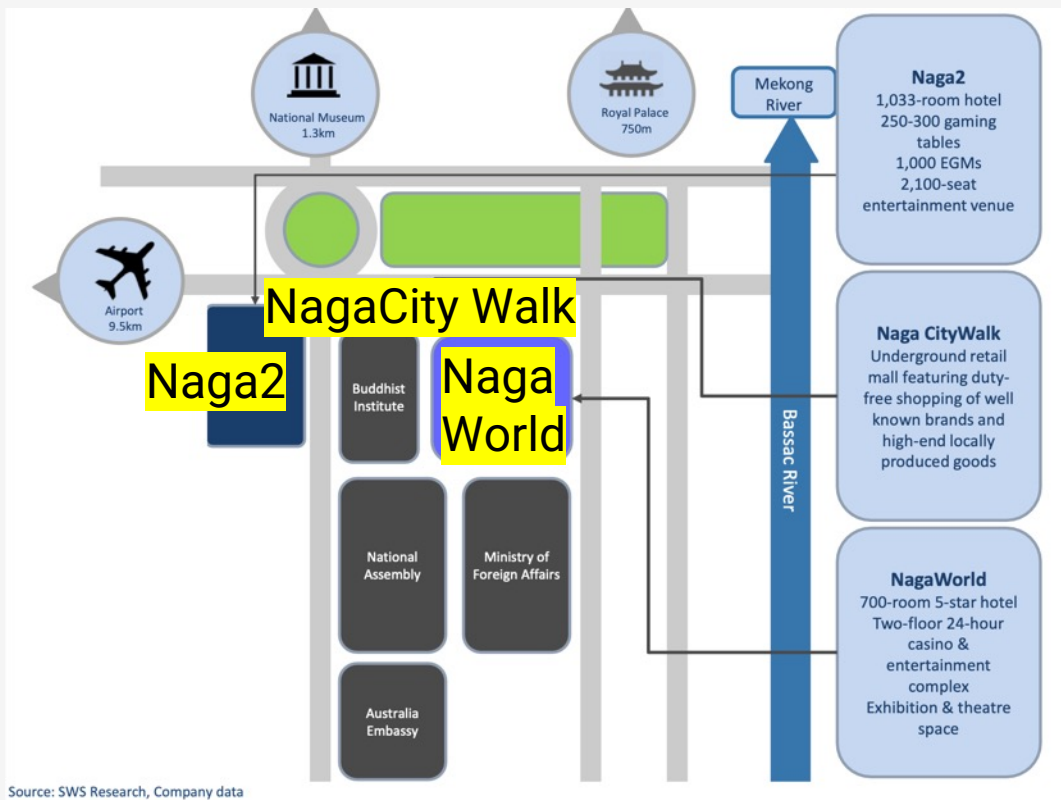
- Cambodia is a small country in Southeast Asia, nestled in between Thailand and Vietnam. It's unique in the way that it maintains a strong relationship with the People's Republic of China, which has a 1.4 billion population.
- The country has a population of 17 million people, and roughly 10% live in the capital Phnom Penh, where Nagacorp is based. While GDP per capita is low at US\$1,700, Nagacorp's customers are all foreign passport holders, either visitors or expats.
- Regional competitors include casinos in Macau, in the Philippines such as Okada Manila and Solaire, as well as in Singapore, including the Marina Bay Sands. There's also a new casino under development in Hoi An, Vietnam.
- Almost half of fixed asset investment in Cambodia comes from China. Expats from China working on those projects are major customers of NagaCorp's casinos.
- While Cambodia doesn't share a border with China, it does have ports with border controls that are allegedly lax, enabling smuggling of cash across the border.

There aren't many domestic competitors for NagaCorp, and none in the capital Phnom Penh

- There have been roughly 150 licensed casinos in Cambodia, but only 1 in the capital Phnom Penh.
- Other major cities include Siem Reap, which is close to tourist destination Angkor Wat. As well as Sihanoukville close to the coast.
- Sihanoukville has been a major centre for the casino industry, with many casinos run by Chinese companies offering proxy betting for mainland Chinese gamblers.
- There are also plenty of casinos in Cambodia close to the Thai border catering to Thai tourists who are unable to gamble in their home country.



NagaCorp's asset overview



Inside NagaWorld's casinos



Ancillary services: accommodation, restaurants, spas, etc.



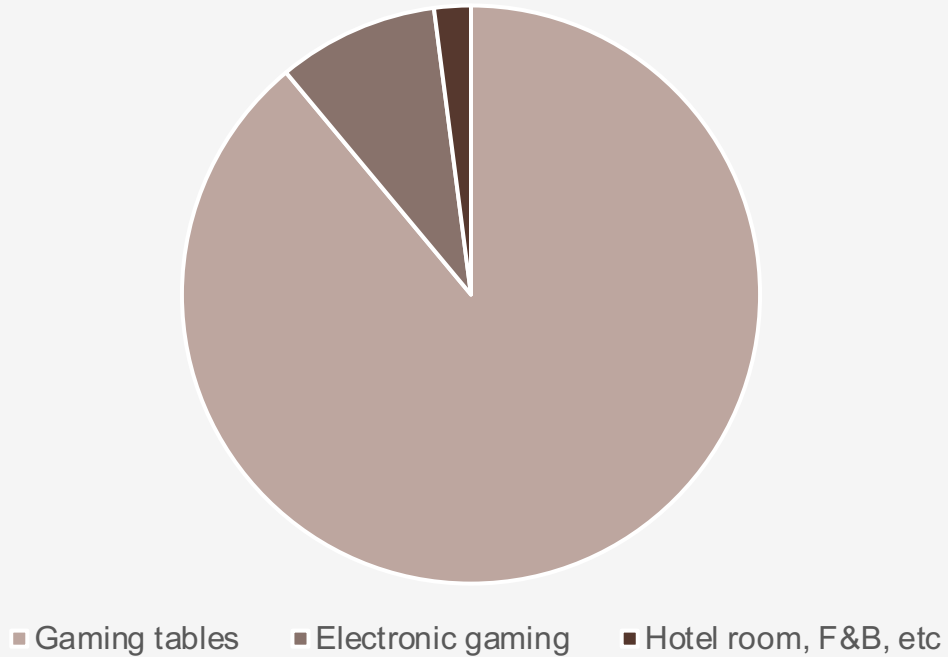
NagaCorp's began as a floating casino on a barge on the Bassac River

- In **2004**, Dr Chen Lip Keong founded the company “Ariston” to bid for infrastructure-tourism assets in Cambodia’s Sihanoukville.
- In **1995**, it obtained a 40-year casino license to operate casinos exclusively across Cambodia for a total payment of US\$103 million over a 13-year period. It was also exempt from paying taxes for eight years, after which it had to pay a fixed-obligation payment to the Ministry of Economy and Finance. Ariston quickly built the Naga Resorts Casino on a barge anchored on the bank of the Bassac River in central Phnom Penh.
- In **2003**, the company relocated the casino from the barge to the ground floor of the entertainment wing of NagaWorld.
- In **2005**, Ariston sold off its Sihanoukville assets and extended the monopoly deal by another 20 years until 2035, but with exclusivity limited to a 200 kilometre radius of the capital Phnom Penh (except the Vietnam border area).
- A restructured company was then listed on the main board of the Hong Kong Stock exchange in **2006**.
- In **2011**, NagaCorp issued US\$369 million worth of convertible bonds to Dr Chen as payment for NagaCity Walk and the Naga2 projects. In **2016**, NagaCity Walk opened for business. A private placement of 190 million new shares at HK\$5.0 each was done to Dr Chen in **2016** to finance the fit-out of the Naga2 casino. The casino finally opened in **2017**, increasing total gaming tables by 50% and hotel rooms by 130%.
- NagaCorp launched its “China Strategy” in **2013**, building VIP rooms, Chinese food establishments etc. to attract PRC high rollers. As part of this strategy, Naga 2 was designed to attract Chinese VIP customers, including junket operators.
- In **2019**, NagaCorp’s license was extended from 2035 to to 2045 for a payment of US\$10 million on top of a yearly payment of US\$3 million from 2036 onwards. Meaning that it’ll enjoy close to zero competition for another 10 years.
- From **2020** onwards, NagaCorp was hit hard by COVID-19, with weak tourism to Cambodia hurting the gaming revenues. Since **2022**, we’ve seen a gradual recovery in NagaCorp’s gross gaming revenues as tourists returned.

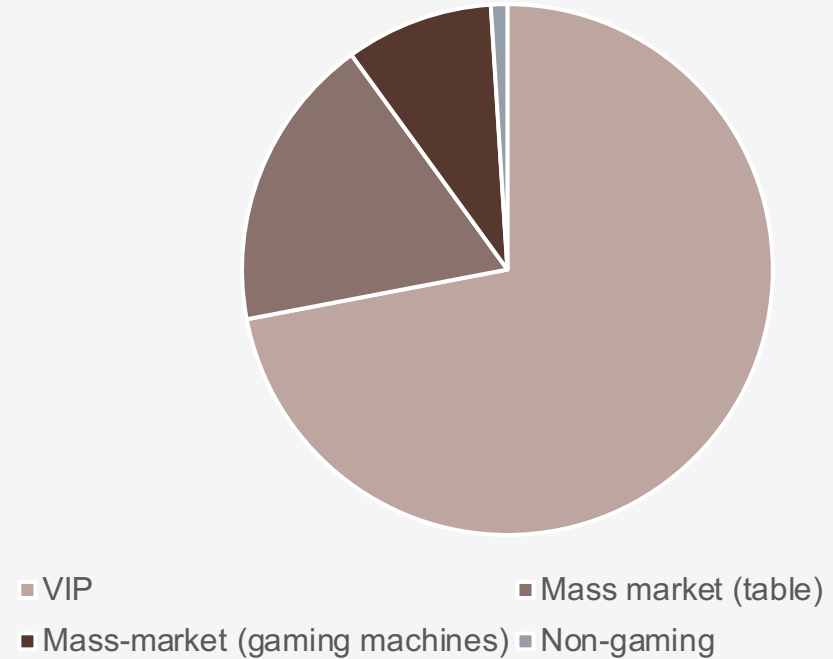


Almost all of NagaCorp's pre-COVID revenues come from VIP customers and specifically from gaming tables (mostly Baccarat)

Revenue split by product (2019, pre-pandemic)



Revenue split by product (1H20)



NagaWorld Phase I (“Naga I”)

- The NagaWorld casino is strategically located near the riverfront district in Phnom Penh and is near tourist attractions such as the Royal Palace, the National Museum and the Independence Monument. It's only 9km away from the airport and the casino offers a free shuttle bus. The ride from the airport takes around 30 minutes
- NagaWorld is a 81,000 square metre property, which includes:
 - 320 gaming tables
 - 1,700 electronic gaming machines
 - 700 hotel rooms
 - As well as food & beverage operations, a shopping gallery, a spa, entertainment services, etc.
- The complex was designed by Wimberly, Allison, Tong & Goo - the same architect that designed several famous Las Vegas landmarks, such as the Venetian Resort Hotel Casino, Palace Tower at Caesar's Palace and Mansion at MGM Grand.



NagaWorld Phase 2 (“Naga 2”)

- The construction of the second phase of NagaWorld began in 2013 and was completed in late 2017.
- The property almost doubled NagaCorp’s overall capacity with an additional 160 gaming tables, another 900 hotel rooms and a theatre with 2,000 seats.
- With NagaWorld Phase 2, NagaCorp has started to engage with Macau junket operators such as SunCity and Venus Group. These have strong relationships with VIP customers in China and help bring in customers that would otherwise choose Macau. Those relationships caused NagaCorp’s aggregate gross gaming revenues to skyrocket.



NagaCity Walk



- NagaWorld 1 and 2 are connected by an underground shopping mall called NagaCity Walk
- It opened in 2016 and has approximately 13,248 square metres of retail and public space
- State-owned “China Duty Free Group” has a strong presence within the NagaCity Walk, providing duty-free shops to casino guests

The new “Naga 3” project

- NagaCorp started planning for NagaWorld Phase 3 in 2017. It has already purchased land for Phase 3’s core area at a relatively low price.
- The new building will be within walking distance of Naga1 / 2. Most of the floor area will be devoted to non-gaming activities. The towers will include:
 - One 75 storey hotel tower
 - Another two blocks of 52 storey towers
- The Naga 3 casino will include 800 gaming tables, 2,500 electronic gaming machines, five hotels with 4,720 rooms, an indoor theme park and MICE facilities including a 2,000 seater ballroom.
- Construction started in 2021 and it will open in 2025.
- The property will be more non-gaming focused, to match the standard of other international integrated resorts and attract mass-market customers.
- The total cost will be US\$3.5 billion for a hotel and casino resort with over half a million square metres of floor space.



Naga Vladivostok

- In 2013, NagaCorp announced the development of a hotel and casino complex close to Vladivostok, Russia – one of the few European style cities in Asia.
- It will be located in the Northeast section of the Integrated Entertainment Zone in Primorsky Krai, in close proximity to China's Northeast and South Korea. It will also target Russians living in the Eastern part of the country.
- Capex was planned at just US\$350 million, out of which US\$150 million would be financed from pre-sale of apartment units.
- The first casino opening in Vladivostok was Summit Ascent's (102 HK) Tigre de Cristal in 2015, and NagaCorp's project was originally due for completion by 2020. But the construction remains suspended amid COVID-19 and sanctions on Russia since its war in Ukraine.



Naga 3 will be a major step up in NagaCorp's development

NagaCorp assets	Naga 1	NagaCity Walk	Naga 2	Naga 3	Naga Vladivostok
Gross floor area	113,307	13,248	96,857	545,000	301,242
Hotel rooms	1,658	n.a.	1,033	4,720	2,719
Gaming machines	320	n.a.	160	800	100
Slot machines	1,700	n.a.	2,500	2,500	500
Project cost (US\$m)	n.a.	94	275	3,500	350
Project cost/sqm			2,839	6,422	1,162

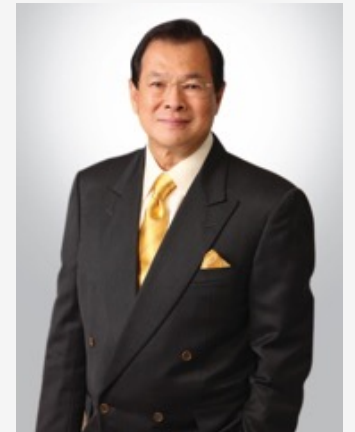
NagaCorp's revenues and expenses

- NagaCorp's revenues are from **casino activities** and **ancillary businesses** such as hotel accommodation, food & beverage, spa, karaoke bars, etc.
- The slot machine business has been outsourced to an independent external company with a profit sharing agreement. NagaCorp itself doesn't need to deal with the repairs & maintenance of the machines. It doesn't seem like this external company is a related party.
- Casino **revenues** can be divided into mass-market, premium mass and VIP. The difference is that VIP customers enjoy privacy in special rooms, sometimes with video equipment. The minimum bet sizes tend to be US\$30-40 for mass market customers and \$5,000 for VIP customers. Customers can only buy casino chips using US Dollars, not Cambodian Riel.
- The **gaming tax** was introduced in 2021 and is calculated as 4% of VIP customer revenues and 7% of mass-market revenues.
- In the VIP business, the casino pays junket operators a commission rate of 1.8%, on top of free accommodation, flight ticket rebates, food & beverages, etc. The same number in Macau is about 1.2%. This commission, on top of so-called GGR rebates to VIP customers are included in **cost of sales**.
- **Other operating expenses** include staff cost (7% of revenues) and depreciation of fixed assets (10% of revenues).

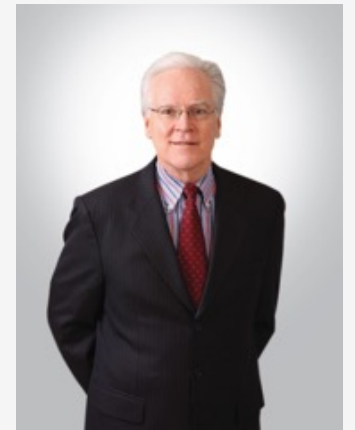
<u>NagaCorp (3918 HK) (US\$m)</u>	<u>FY2019</u>	<u>FY2020</u>	<u>FY2021</u>	<u>FY2022</u>
Revenues	1,755	879	226	461
Gaming tax	0	0	-12	-25
Cost of sales	-909	-452	-70	-60
<u>Gross profit</u>	<u>846</u>	<u>427</u>	<u>144</u>	<u>376</u>
Other income	11	5	6	9
Administrative expenses	-61	-61	-64	-52
Other operating expenses	-224	-205	-189	-201
<u>Operating profit</u>	<u>572</u>	<u>165</u>	<u>-104</u>	<u>132</u>
Finance costs	-20	-33	-37	-24
<u>Pretax profit</u>	<u>552</u>	<u>132</u>	<u>-141</u>	<u>107</u>
Income tax	-30	-30	-6	0
<u>Net profit</u>	<u>521</u>	<u>102</u>	<u>-147</u>	<u>107</u>

NagaCorp was founded by Dr Chen Lip Keong

- NagaCorp's founder and CEO **Tan Sri Dr Chen Lip Keong** (75 years old) is a Malaysian national who also controls Karambunai Corp: a tourism company in Sabah, Borneo, steel pipe producer FACB Industries and property developer Petaling Tin. Dr Chen was also involved in various economic services for the Malaysian government, including in the oil industry and the Malaysian aerospace industry. Dr Chen first entered Cambodia in the early 1990s due to Malaysia's policy of "Prosper Thy Neighbour", encouraging the Chinese business community to invest in neighbouring countries. Dr Chen is highly paid with a salary of US\$5 million in 2022 and US\$6 million in 2021 – two weak years for NagaCorp. He made over US\$10 million per year prior to COVID-19. He also owns as much as 67% of NagaCorp.
- Dr Chen's two sons are now co-CEOs of NagaCorp, and will be taking greater responsibility going forward. A succession plan is in place.
- Chairman **Timothy Patrick McNally** (75 years old) joined the company in 2005. Prior to joining NagaCorp, he worked as a special agent for the US FBI for almost 25 years, including the head of FBI's Los Angeles office. He seems to be based in California, far removed from the action in Cambodia.



Dr Chen Lip Keong, CEO



Tim McNally, Chairman

NagaCorp's competitive advantages

Scarce license

It has exclusive rights to operate casinos and table games within a 200km radius of Phnom Penh until 2035. Its casino license lasts until 2065.

Geography

NagaWorld is only 9km from the airport and offers free shuttle services to the casino. Once the new international airport has been built, it will be 30km from the airport.

Tax advantages

Gaming taxes in Cambodia are low at just 4% and 7% for VIP/mass-market vs 14-21% in Singapore and 39% in Macau.

Regulation

Border controls into Cambodia are lax, enabling smuggling of money. No ATM withdrawal limit. Money laundering laws not enforced. In the past, Cambodian casinos allowed proxy betting, though that may change.

Visa advantages

All visitors from Southeast Asia can enter Cambodia with visa on arrival.

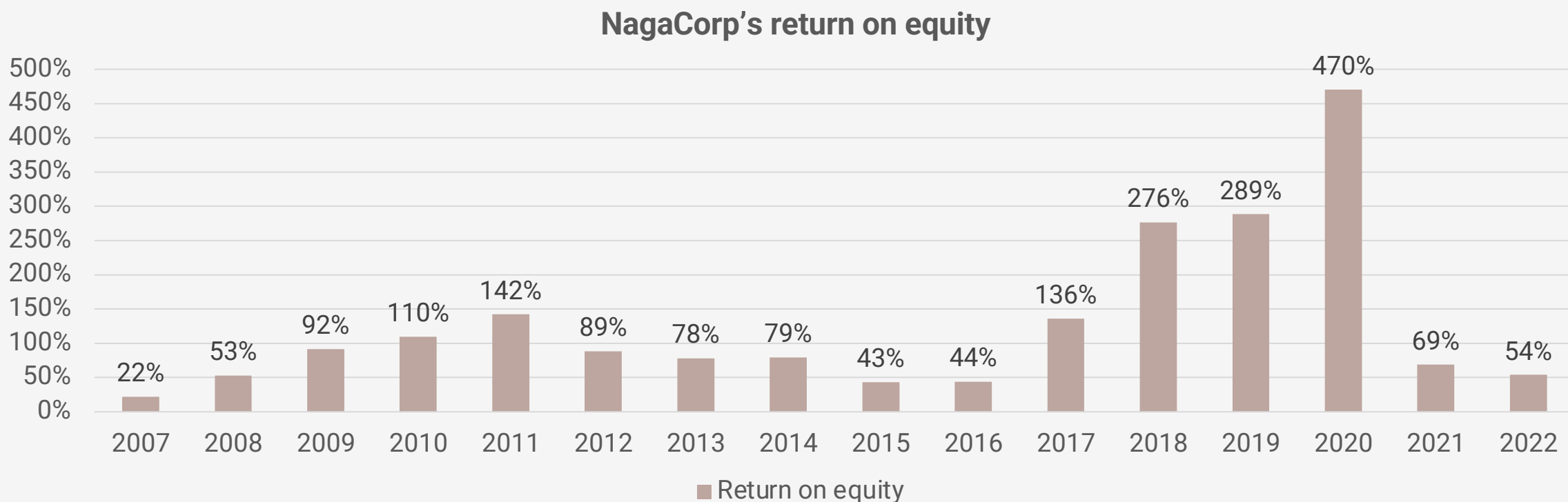
Low labour costs

Salaries of casino staff cost roughly 2/3 of those in Macau.

Junket operators:

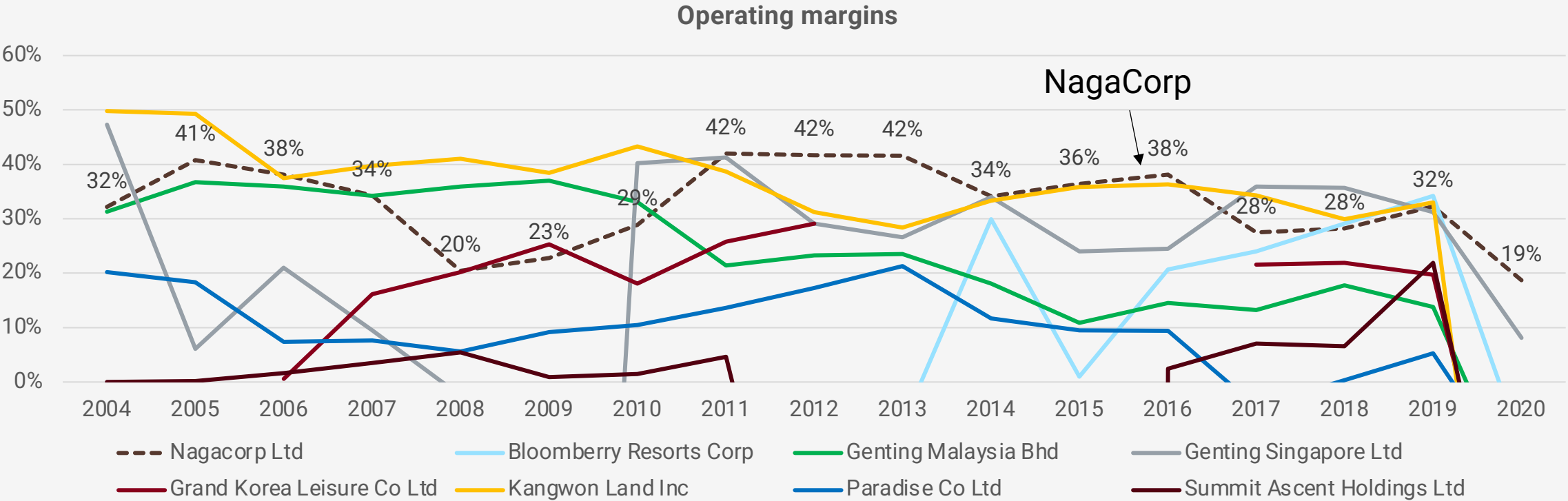
NagaCorp doesn't have its own VIP rooms and therefore doesn't compete with any of the junket operators present there. That's not the case for Bloomberg Resorts' Solaire casino.

NagaCorp's return on equity has been incredible, no doubt thanks to its monopoly. Almost too good to be true?



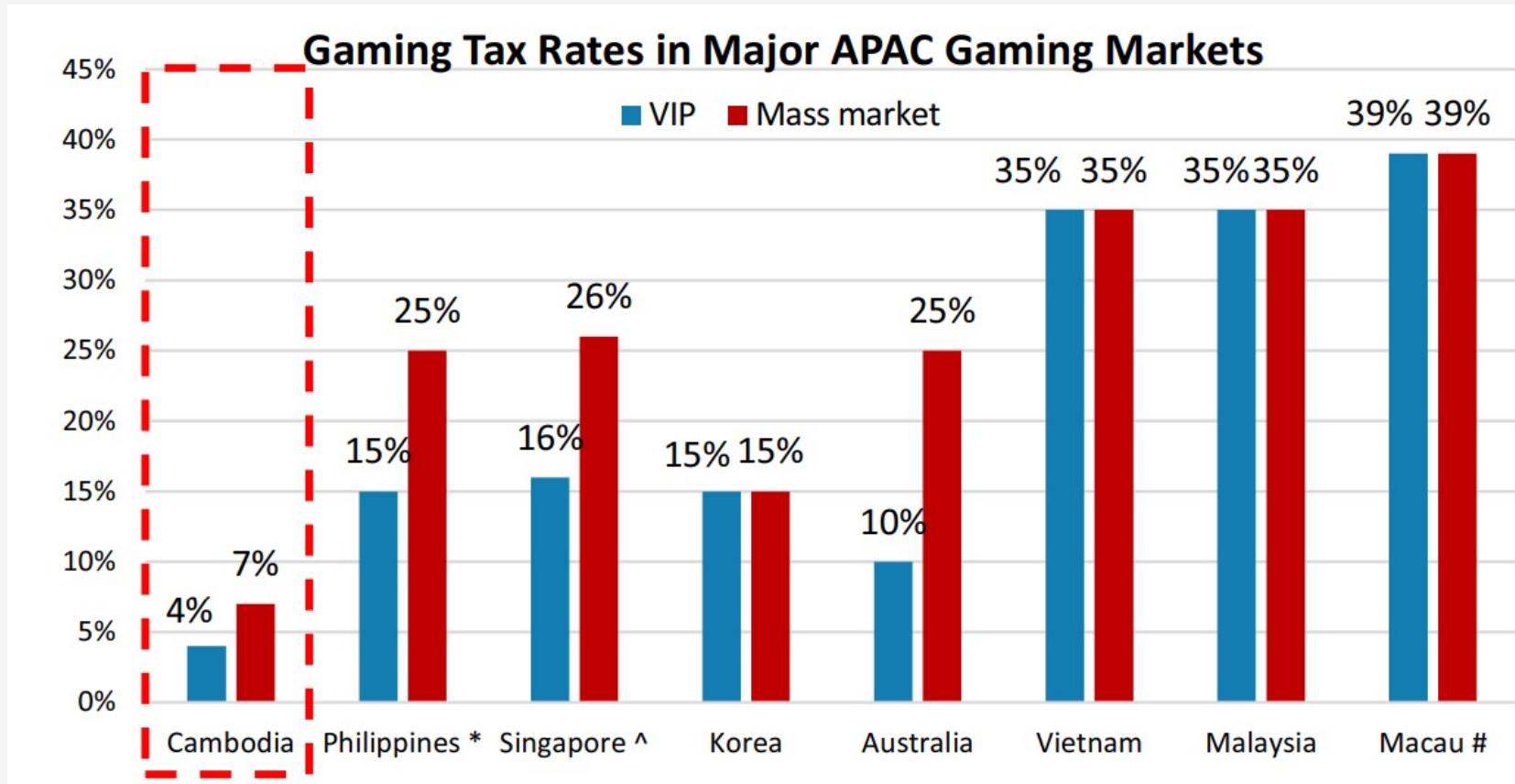
Source: TIKR

NagaCorp's has enjoyed industry-leading operating margins, no doubt thanks to its monopoly



Source: TIKR

Cambodia's gaming tax rates are the lowest anywhere in Asia



Source: Morgan Stanley

Most Southeast Asian countries can enter Cambodia without a visa



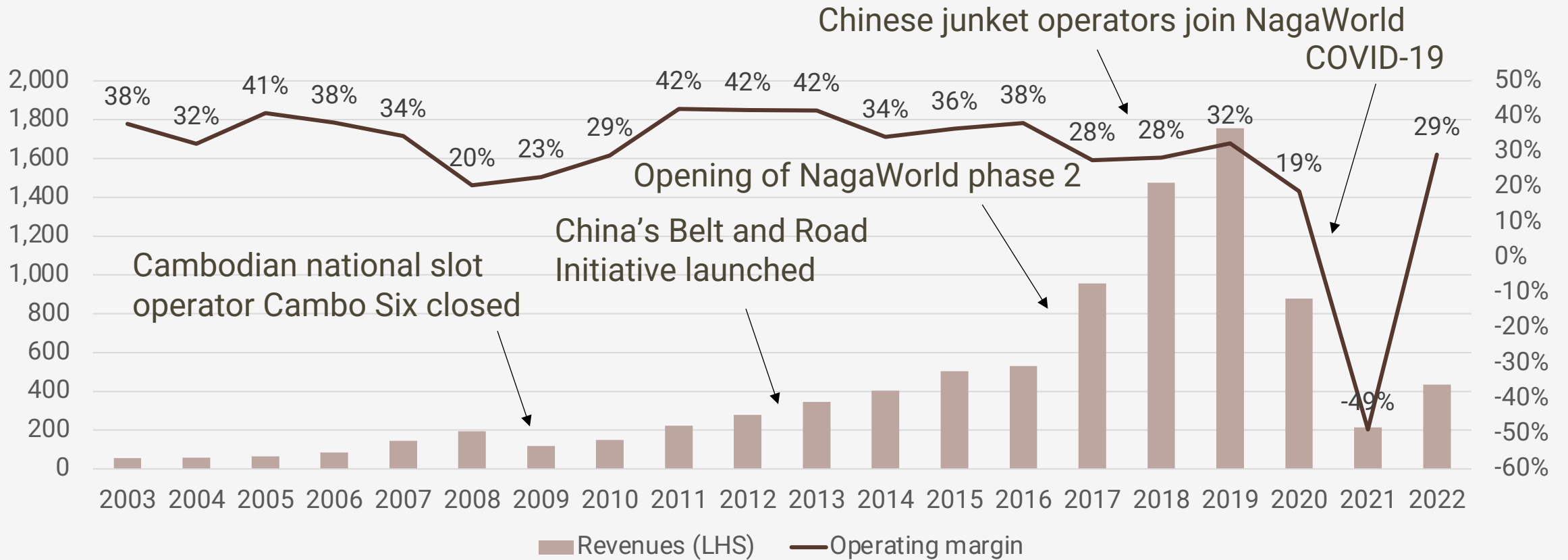
Cambodia's Law on the Management of Commercial Gambling

- Cambodia's Law on Management of Commercial Gambling was introduced in 1996 and has been revised several times since then, most recently in 2019. The industry is regulated by the Ministry of Economy and Finance.
- To get a license, you need a minimum capital of US\$50 million for Phnom Penh casinos (once NagaCorp's exclusivity ends in 2045) and US\$30 million in the rest of the country. Licenses for integrated resorts will last up to 20 years, and for casino-only establishments up to 5 years.
- Casino licenses in Cambodia only allow foreign passport holders gambling at casino tables.
- The latest revision of the casino law was implemented in 2021 and set a gaming tax of 4% for VIP players and 7% for mass customers. Those rates are attractive compared to the 40% gaming tax rate in Macau and 12-22% in Singapore (excluding corporate tax).
- NagaCorp is also exempt from paying corporate income tax on its casino activities. For non-casino revenues, it pays the normal Cambodian corporate tax rate of 20%.



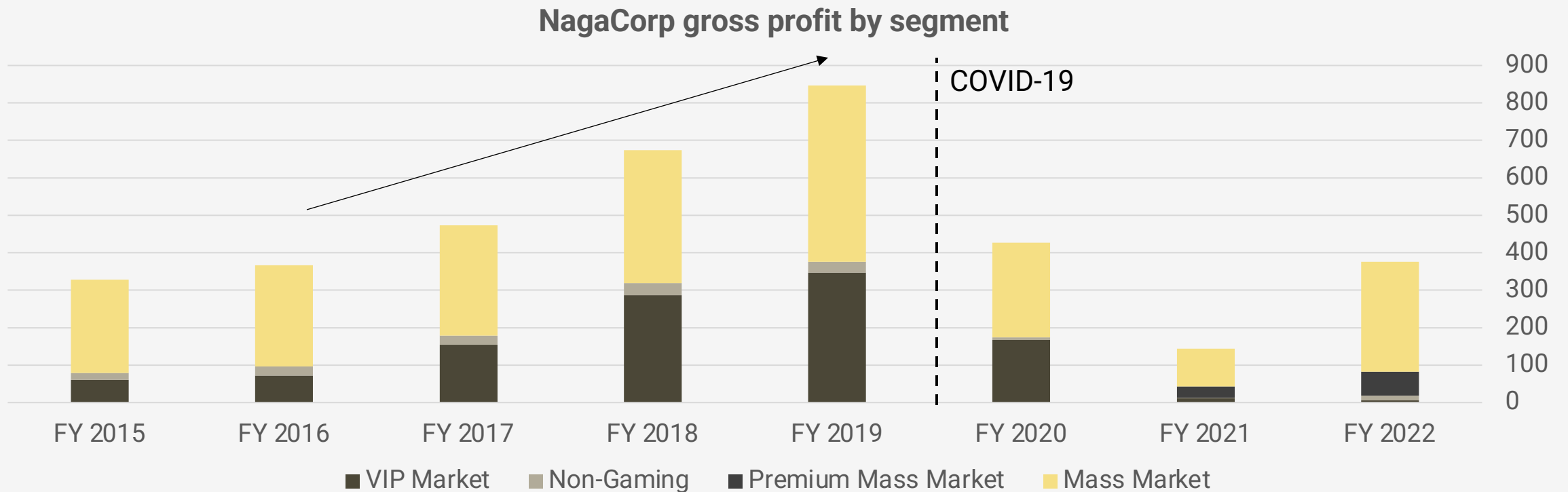
A recent workshop on the Law of Management of Commercial Gambling

NagaCorp enjoyed explosive growth until COVID-19



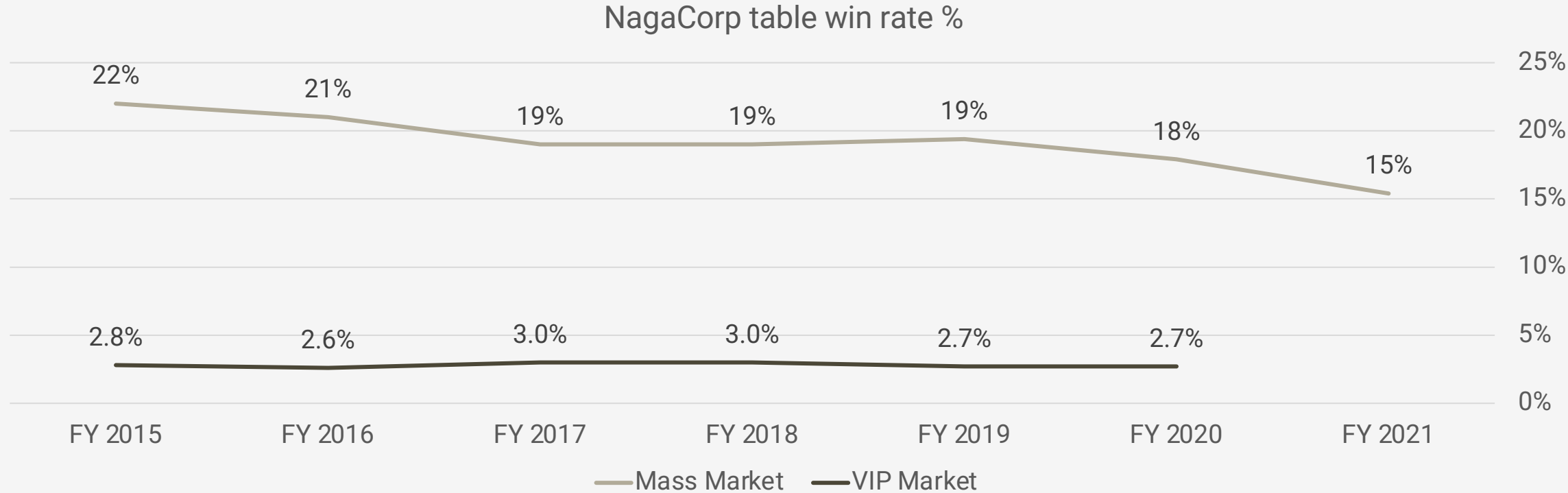
Source: TIKR

COVID-19 hurt NagaCorp's VIP business, whereas mass-market customers are a mix of tourists and Chinese expats in Cambodia



Source: TIKR

Over time, NagaCorp's win rates have dropped in the mass market segment, perhaps due to greater competition or a shift in customers



NagaCorp used to get most of its customers from Malaysia, Vietnam and Singapore. But today, Chinese have become increasingly important.

Exhibit 14:

China has surpassed Vietnam to lead among sources of visitors

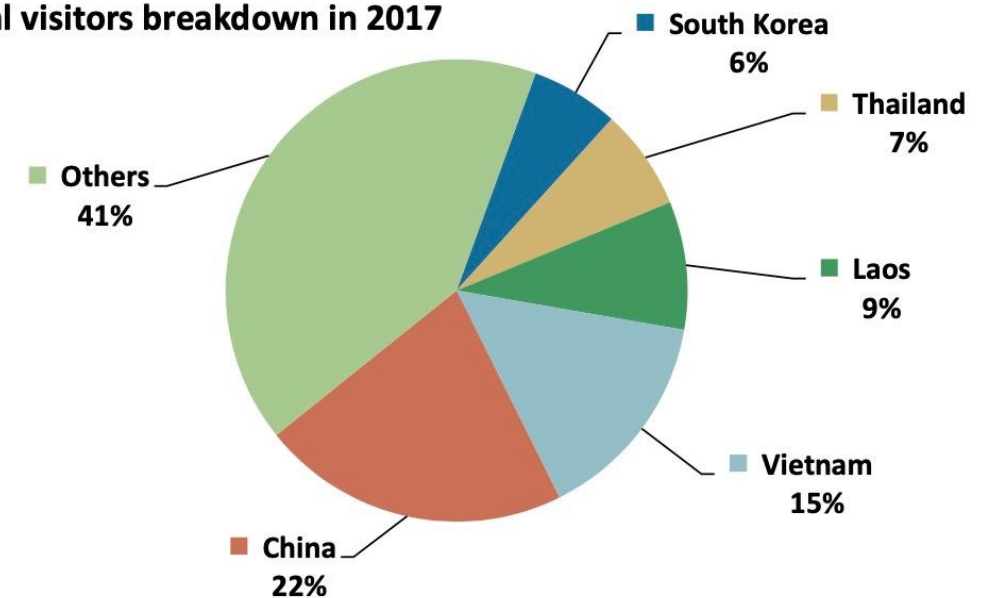


Source: Morgan Stanley Research

Exhibit 13:

2017 total visitor arrivals by counties

Total visitors breakdown in 2017

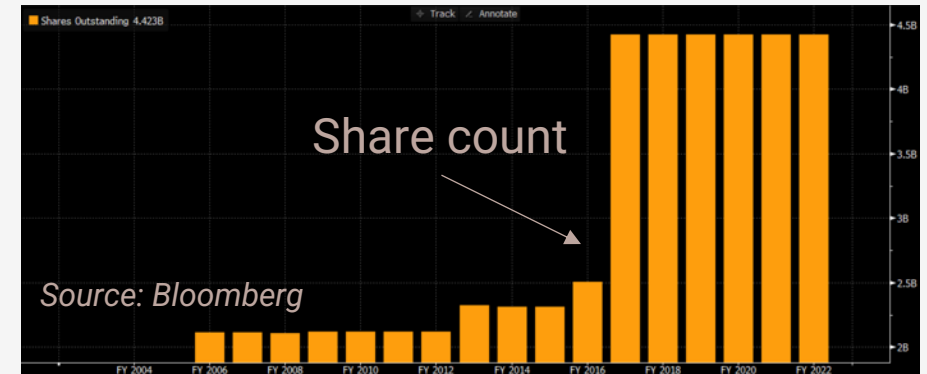


Source: Morgan Stanley Research

Source: Morgan Stanley

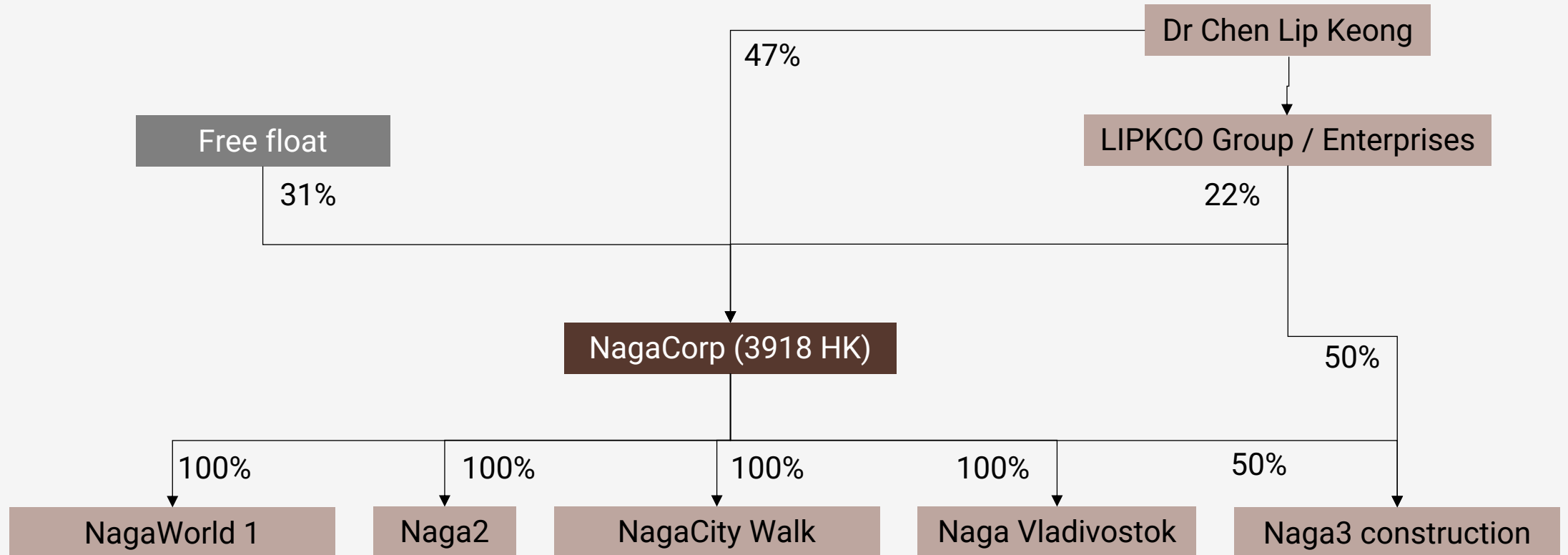
Many related party transactions, yet EPS has kept growing nicely

- NagaCorp has had an excessive amount of related party transactions with its owner Dr Chen Lip Keong. Many of the construction projects were financed by him, and then injected into the ListCo in exchange for new shares or convertible bonds:
 - In 2011, NagaCorp entered into an agreement with Dr Chen's privately owned company to acquire the NagaCity Walk and Naga2 once the capex had been completed. The purchase price was US\$369 million in total across a two-tranche convertible bond. Given that the two assets brought in US\$190 million in EBITDA in 2018, I definitely believe that the ListCo paid a fair price, despite the obvious conflicts of interests in such a related party transaction.
 - The planned construction of Naga3 – while expensive - will be done on more favourable terms. Dr Chen will fund 50% of the development costs and the rest from internally generated cash. Chen will also cover cost overruns. Once the project has been completed, Chen will sell his 50% stake to the ListCo for HK\$1.14 billion at HK\$12 per share.
- In 2008 and 2014, NagaCorp bought back a large number of shares. But those repurchases did not have a significant impact on the total share count.



3918 HK Equity		Actions	Export
Actions for Company		Announced	Effective 05/02/00 - 12/31/24
Filter Actions		Dividends	Splits
		M & A	IPO / ADDL
		Listings	Action Types (6)
Effective Action Type	Ticker / ID	Summary	
09/01/16 Equity Offering	3918 HK	INTL Equity Offering: ADDL	
01/02/15 Stock Buyback	3918 HK	Open Market for Common; 600000 Shares	
12/31/14 Stock Buyback	3918 HK	Open Market for Common; 670000 Shares	
12/29/14 Stock Buyback	3918 HK	Open Market for Common; 560000 Shares	
12/24/14 Stock Buyback	3918 HK	Open Market for Common; 192000 Shares	
12/23/14 Stock Buyback	3918 HK	Open Market for Common; 420000 Shares	
12/22/14 Stock Buyback	3918 HK	Open Market for Common; 488000 Shares	
12/19/14 Stock Buyback	3918 HK	Open Market for Common; 908000 Shares	
12/18/14 Stock Buyback	3918 HK	Open Market for Common; 944000 Shares	
12/17/14 Stock Buyback	3918 HK	Open Market for Common; 1.124M Shares	
12/16/14 Stock Buyback	3918 HK	Open Market for Common; 184000 Shares	
12/15/14 Stock Buyback	3918 HK	Open Market for Common; 2.600M Shares	
12/12/14 Stock Buyback	3918 HK	Open Market for Common; 3.400M Shares	
03/14/13 Equity Offering	3918 HK	INTL Equity Offering: ADDL	
11/20/12 Equity Offering	3918 HK	INTL Equity Offering: ADDL	
04/02/12 Equity Offering	3918 HK	INTL Equity Offering: ADDL	
06/14/11 Acquisition	3918 HK	Target: TSC Inc, Sought: 100.00%	
12/03/08 Stock Buyback	3918 HK	Open Market for Common; 480000 Shares	
12/02/08 Stock Buyback	3918 HK	Open Market for Common; 1.450M Shares	
12/01/08 Stock Buyback	3918 HK	Open Market for Common; 1.350M Shares	
11/25/08 Stock Buyback	3918 HK	Open Market for Common; 950000 Shares	
11/21/08 Stock Buyback	3918 HK	Open Market for Common; 454000 Shares	
04/03/08 Stock Buyback	3918 HK	Open Market for Common; 1.880M Shares	
10/19/06 Equity Offering	3918 HK	INTL Equity Offering: IPO	
09/08/03 Equity Offering	NAGA SP	INTL Equity Offering: IPO	

Dr Chen has some private ownership of the Naga3 casino extension



Dr Chen is somewhat of a gambler...

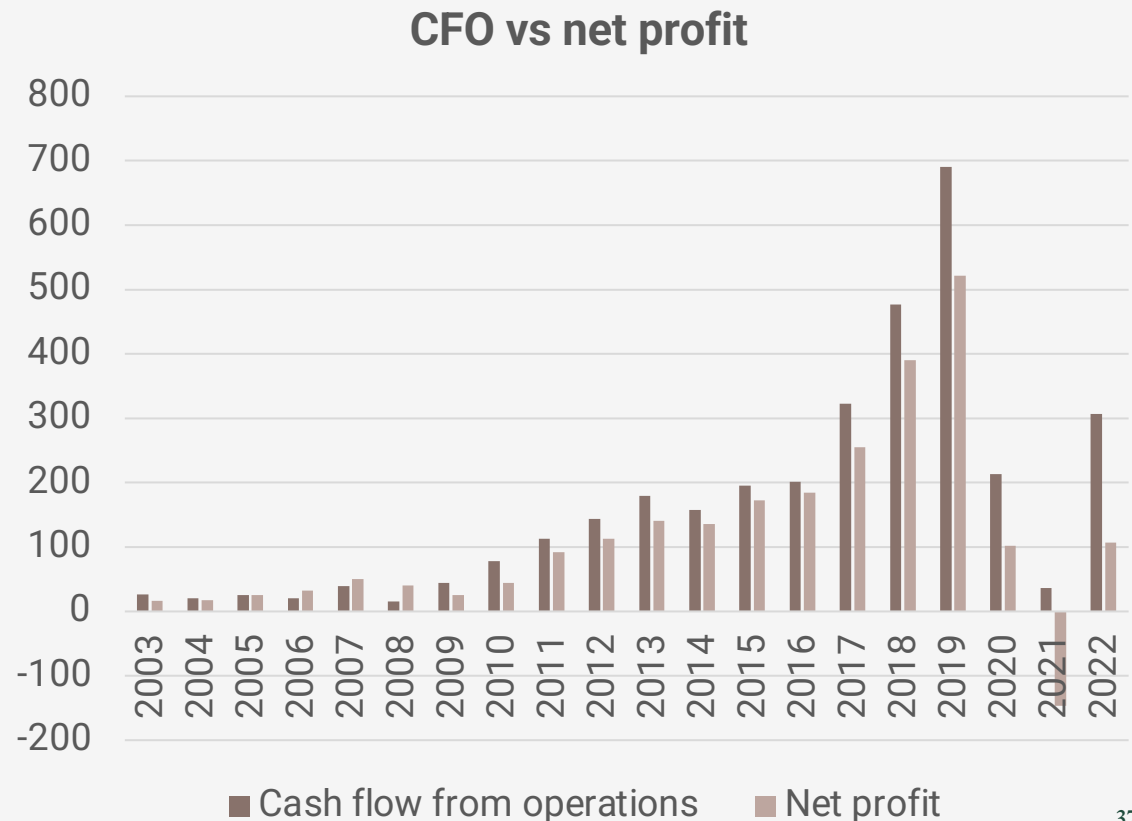
- In 2007, right after the IPO, Dr Chen borrowed roughly US\$15 million from Evolution Capital Management by mortgaging 114 million of his personal shares in NagaCorp (about 5% of the total at the time).
- After NagaCorp's share price fell in 2008, the loan was extended for a year but the lender required Dr Chen to deliver another 27 million shares to maintain the value of mortgaged securities above US\$30 million.
- In 2009, the loan was extended again and another 40 million shares were used for further security for the loan, taking the total to 154 million shares pledged for the loan.
- Eventually, Dr Chen would be found to have violated a term of the loan agreement whereby the lender had the right to sell the shares to Dr Chen at a predetermined price. He failed to do so and was therefore in default of the loan. The case was later tested in court in 2010.
- Dr Chen was also found to have pledged another 148 million NagaCorp shares (7.1% of NagaCorp's shares outstanding) to Yardley Finance and yet another 237 million shares (11.4%) to OSK Investment Bank for further loans.
- In other words, it appears that in the past, Dr Chen borrowed heavily against his shares in NagaCorp. It's possible that he has been financing part of the construction of Naga 2/3 through such margin debt.



NagaCorp's founder Dr Chen Lip Keong

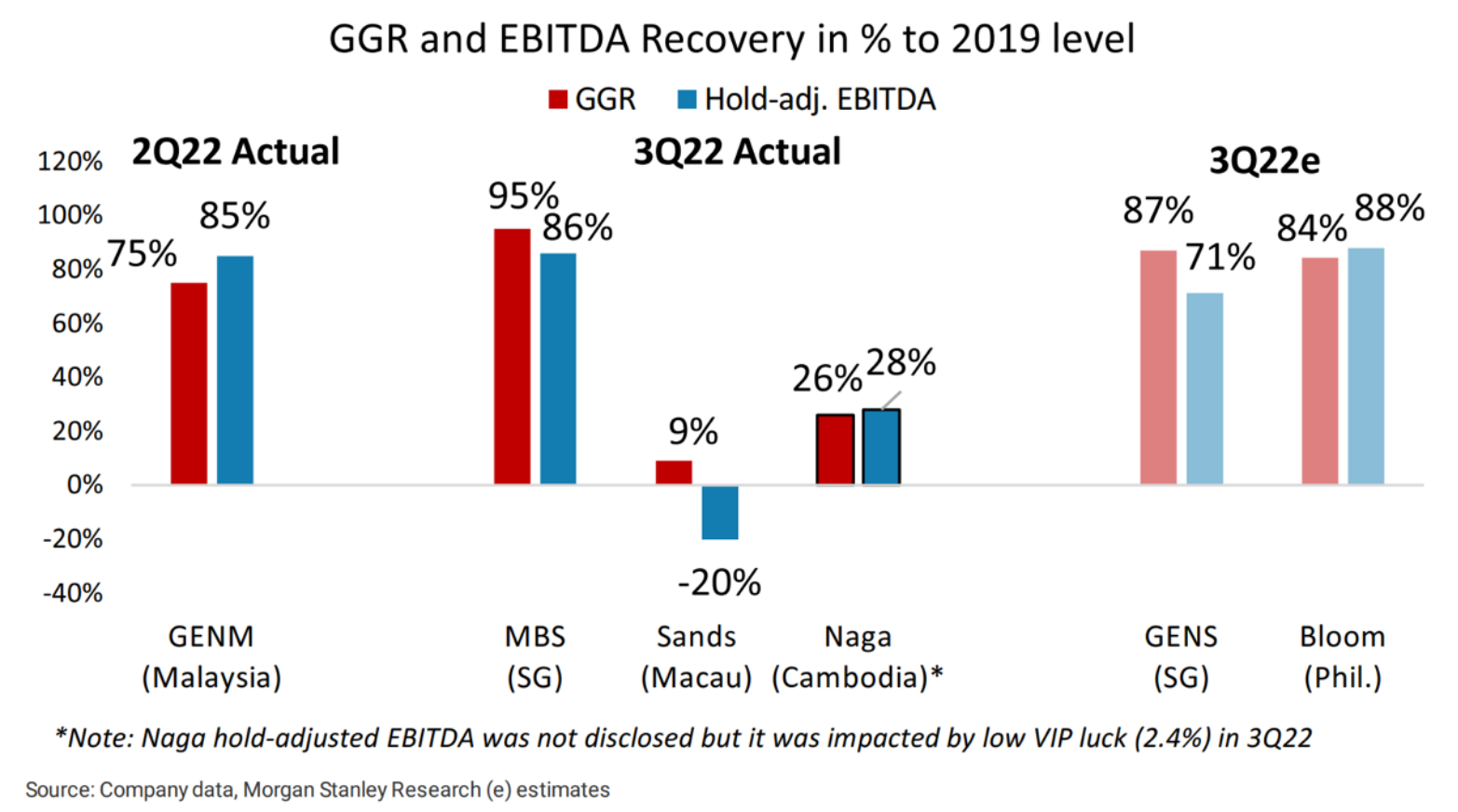
The accounting seems reasonably clean

- The high return on equity of >40% could either be due to incredible advantages given to it by the government through its regulated monopoly. Or it could be due to accounting manipulation.
- NagaCorp has historically not paid any corporate tax, but instead so-called obligation payments of around HK\$0.5 million per month to the Ministry of Economy and Finance, but rising 12.5% per year.
- The free cash flows have been strong historically, with cash flow from operations > net income in most years. The free cash flow after all capex has also been positive and strong in almost all years.
- Insider buying also suggests faith in the company's accounting.
- The auditor BDO is not a Big 4 but it has provided a clean audit opinion in prior years.
- The only warning sign perhaps is that the 2024 bonds trade at a 14.0% yield to maturity.



Source: TIKR

NagaCorp's gross gaming revenue (GGR) recovery has been lagging most of its SEA peers. Cambodia's overall flight traffic was 35% of pre-COVID levels in 3Q.

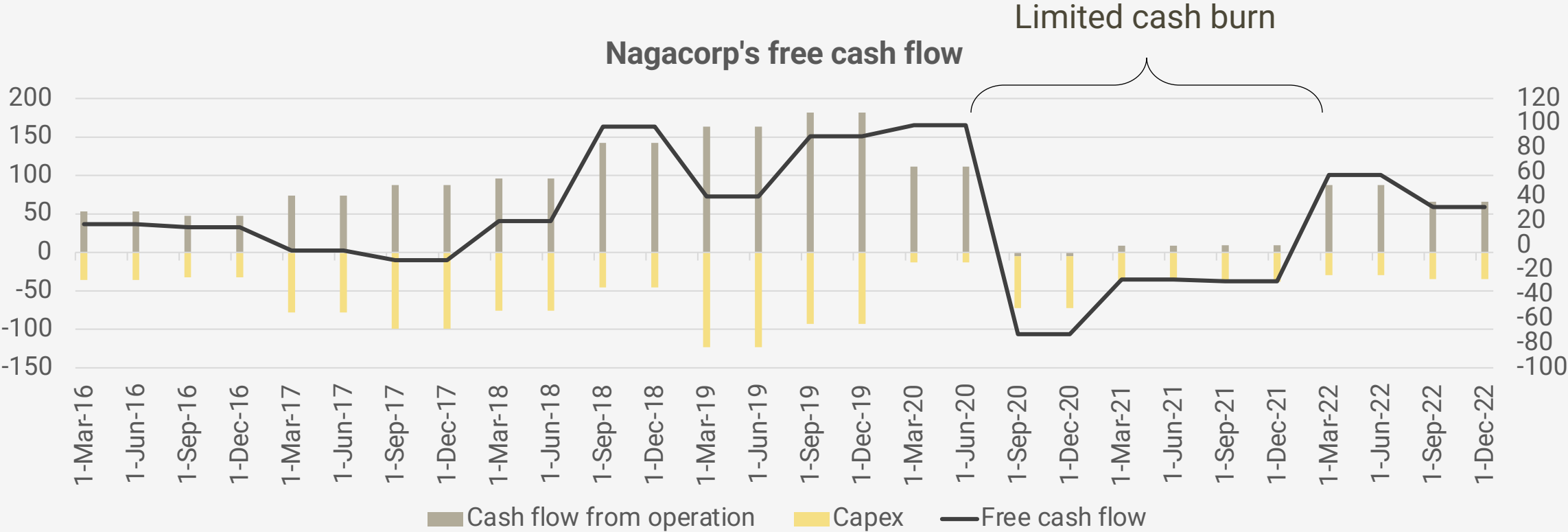


Source: Morgan Stanley

The share price has been weak since the pandemic began

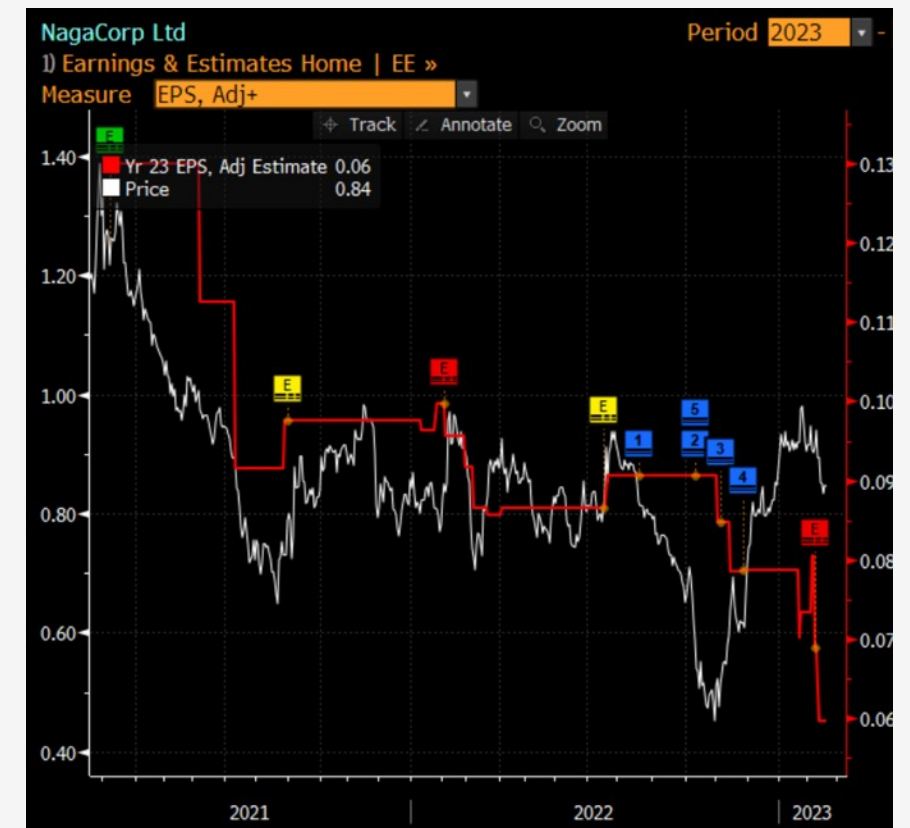


NagaCorp's cash burn was limited during COVID-19



NagaCorp's sell-side estimates have come down due to COVID-19 and weak flight traffic, especially from China

- *"We trim our 2021 revenue and EBITDA forecasts 71% and 85% and trim 2022 revenue and EBITDA forecasts 13% and 17% given suspension casino operations since March 2021 due to COVID resurgence."* - CICC, August 2021
- *"We cut our 2021 revenue and EBITDA forecasts 32% and 85%, and trim 2022 revenue and EBITDA forecasts 21% and 23%, since 1) gaming operations only resumed for 15 days in 3Q21, and 2) slower-than-expected recovery from recent COVID-19 outbreak" – CICC, January 2022*
- *"We cut our 2022 EBITDA and EPS estimates 26% and 44%, respectively, in view of lower Chinese gambling demand in 2022 and more potential cannibalization between Direct VIP and Local Referral VIP business." – Morgan Stanley, February 2022*

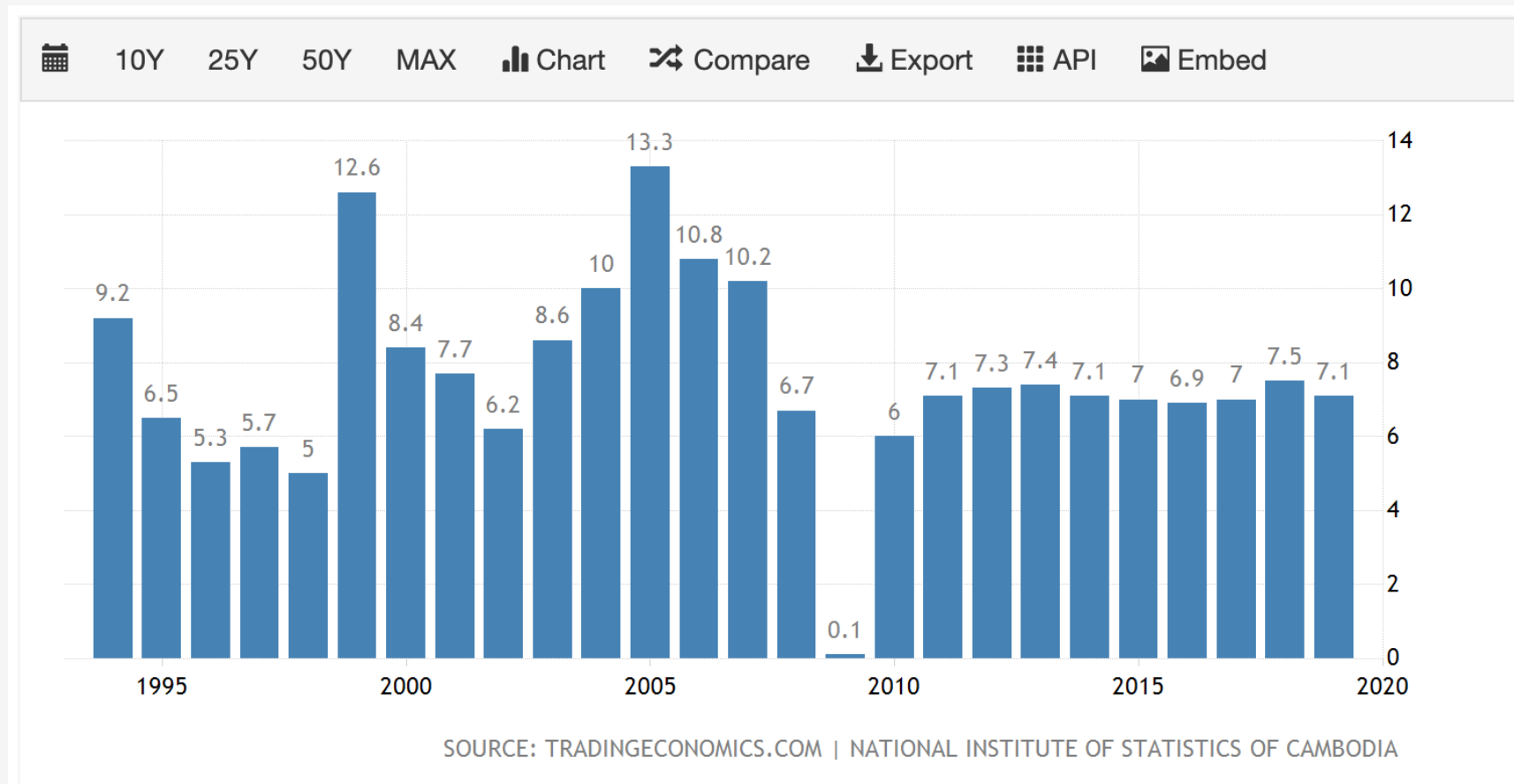


Source: Bloomberg

Trends in the Cambodian gambling industry

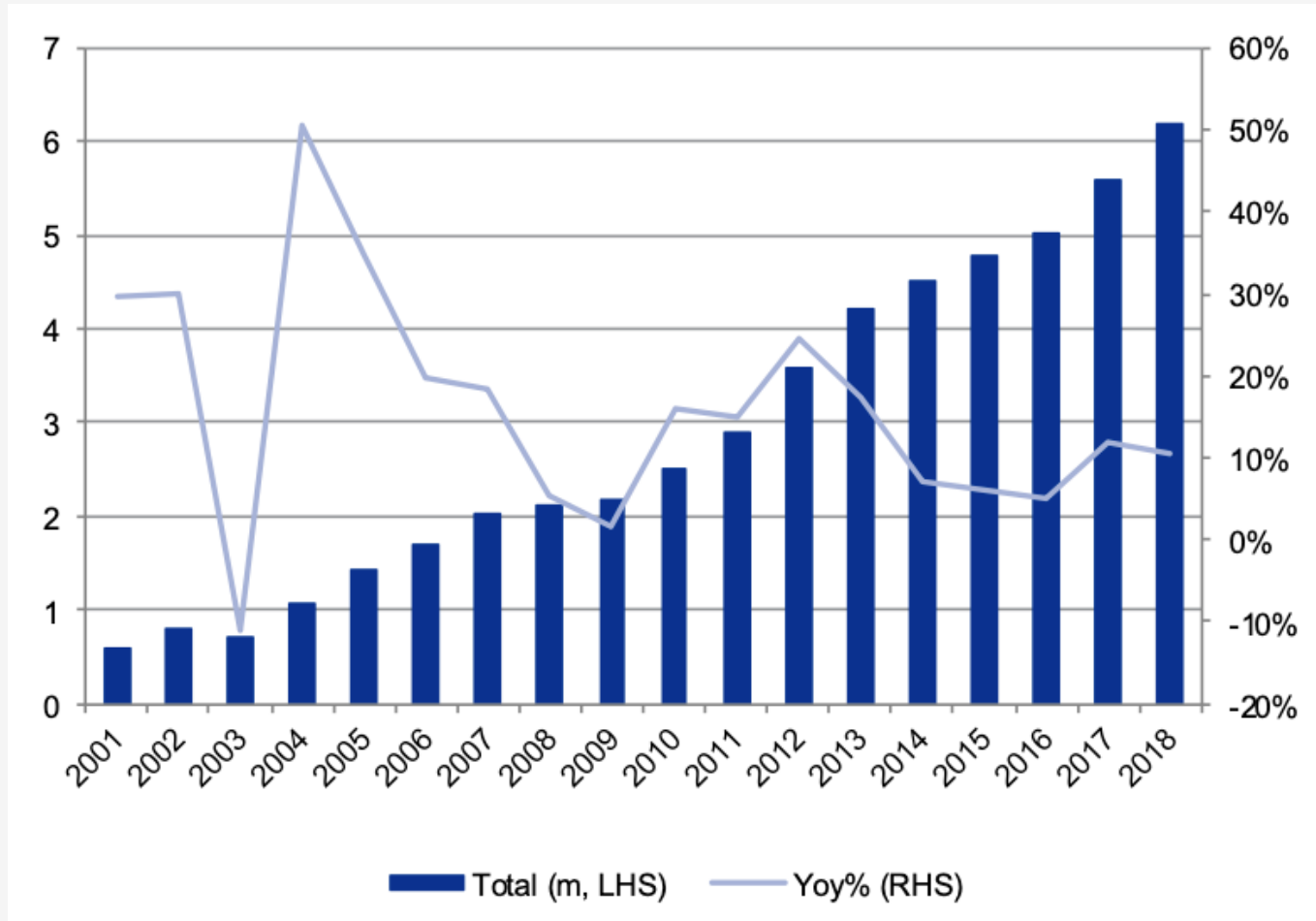
1. **Strong economic growth:** Pre-pandemic, Cambodia has been one of the fastest growing countries in the world benefitting from low-end manufacturing moving from Taiwan and China to the Indochina region. Nearby Vietnam is also developing rapidly.
2. **Tourism growing on a secular basis:** Cambodian tourism revenue was booming prior to the pandemic, and is likely to continue growing once Cambodia's international flight traffic resumes fully.
3. **Foreign direct investment (FDI):** China's FDI into Cambodia has boomed in the past decade thanks to Prime Minister Hun Sen embracing the 2013 Belt and Road Initiative. Cambodia's "China Ready" strategy introduced in 2016 set up goals to attract many millions of Chinese tourists. Today, roughly half of Cambodia's FDI comes from China. A part of that FDI ends up in Cambodia's casinos.
4. **Chinese crackdown on overseas gambling:** Since Xi Jinping became the Chinese Communist Party's General Secretary in 2012, he embarked on an anti-corruption strategy, followed by tightening capital controls. Gamblers then turned to overseas casinos, including Cambodia to launder their money and get their money out of China. Under pressure from Beijing, Cambodian Prime Minister Hun Sen finally cracked down on Chinese online casinos operating out of Cambodia back in 2019.

Cambodia's GDP growth was among the highest in the world, pre-pandemic



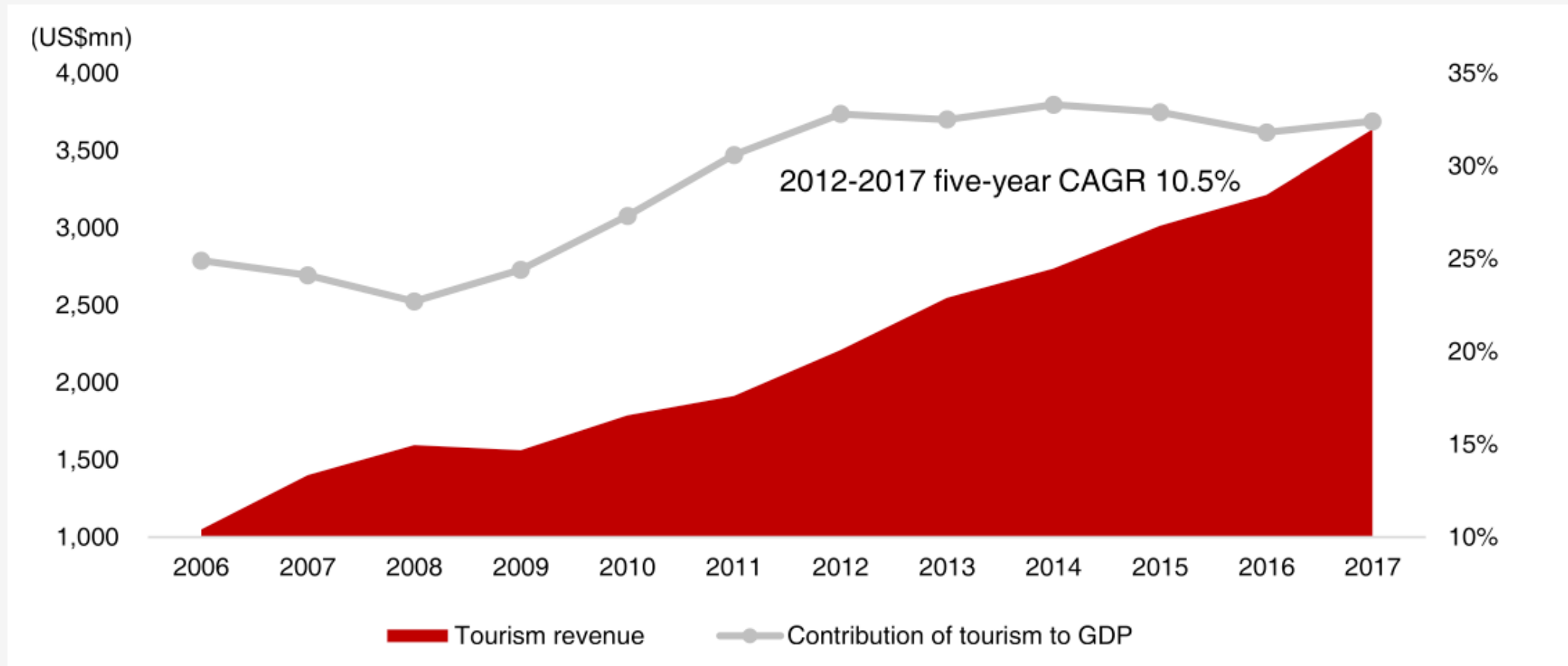
Source: Trading Economics

Cambodian overall tourism grew growing roughly 10% per year



- The Cambodian government announced a new tourism strategy in 2016 called “China Ready”, aiming to attract 2 million Chinese tourists within 5 years
- Tourism is a main drivers of the Cambodian economy so the government is keen to develop key tourism facilities to attract foreign tourists
- NagaCorp itself is trying to adapt to Chinese tourism by VIP room renovations, a swimming pool, Chinese food establishments and hiring Mandarin speaking staff

Cambodian tourism revenue keeps booming



The negative impact from COVID-19 is definitely receding



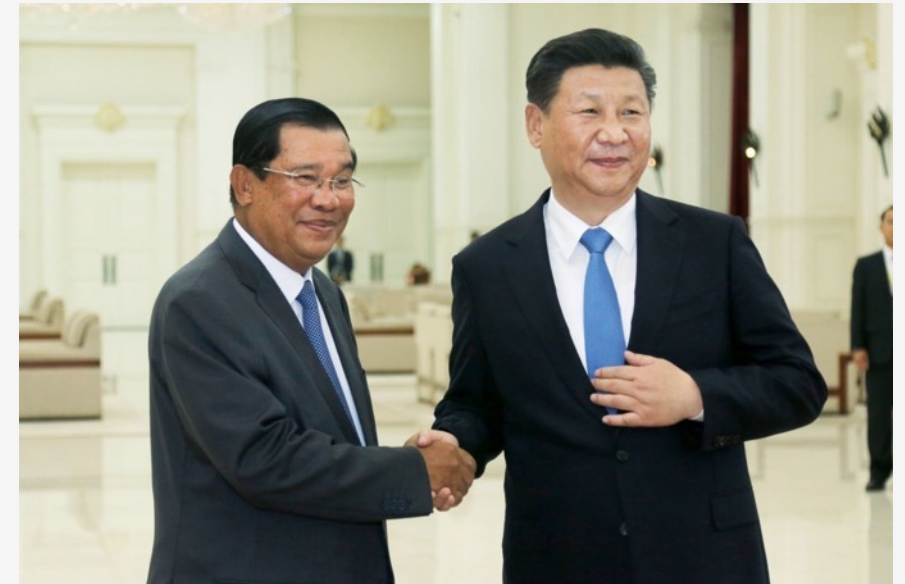
- COVID-19 has Cambodian casinos in three ways:
 - A complete shutdown of Cambodian casinos for a six-month period starting in 2020.
 - Visitor caution out of fear of infection.
 - Border closures, including between China and Cambodia.
- At least 600 workers were laid off to make sure the casino survived the shutdown.
- But the threats from COVID-19 have already passed with most of the population having been infected and zero restrictions, even when it comes to travel. There's no longer a need to show proof of vaccination to get into the country.

What will change for Nagacorp?

- **Recovery from COVID-19:** Cambodia closed its casinos in 2020 and there was minor cash burn during this period. But the casinos are now operating again. And the opening of the Cambodian, Vietnamese and Chinese borders should help gross gaming recover, at least for mass market revenues, which are highly correlated with tourist arrival numbers.
- **China's resumption of group travel:** On 6 February, China's government announced that outbound group travel would resume to a list of 20 countries, including to Cambodia. We haven't yet seen the effect of the group travel resumption on tourist arrival data.
- **New airport:** The Cambodian government is planning to build a new airport to serve Phnom Penh. It will be built 30km south of Phnom Penh on a 2,600 hectare land area six times larger than the current airport, which will effectively be replaced. It is expected to be larger than Beijing Capital International Airport and therefore a major potential driver of Cambodian tourism.
- **New investments:**
 - **Naga3:** In 2019, Nagacorp announced that it would construct a new casino called "Naga3". This building would connect with NagaWorld and Naga2 and expand the existing operation. The table capacity would increase by roughly 100%. Construction has already begun and will finish by late 2025. The cost will be US\$3.5 billion, shared 50/50 between the ListCo and Chen Lip Keong. In early 2022, it had spent US\$280m on the project. The dilution will be 26% when the ListCo purchases the 1.15 million shares from the CEO at HK\$12 each. Dr Chen will end up with 76%, meaning that a share issue will be needed to meet the free float requirement of 25%.
 - **Angkor Wat project:** Near-term, NagaCorp wants to build a new integrated resort (not a casino) near Angkor Wat in Western Cambodia, which will cost US\$350 million to build and not connected to a casino.
- **Chinese efforts to stem capital flight:** In 2019, Prime Minister Hun Sen announced a ban on online gambling – perhaps as the result of pressure from Beijing. Chinese police have also been seen inside Cambodia, being instrumental in the shutdown of casinos in Sihanoukville in 2019. China has also tightened up its enforcement to deal with junket operators. For example, Alvin Chau's Suncity was shut down last year, a junket operator that has been a partner of NagaCorp. Morgan Stanley estimates that 15-20% of NagaCorp's pre-COVID VIP revenue was from Macau-based junkets.
- **Regional competition:** A consortium including SunCity has been building a new casino in Hoi An, Vietnam. Thailand is also planning to legalise gambling, with a plan currently being under consideration and regulation coming in 2-3 years. In the Philippines, several casinos are expanding their footprint.

China's crackdown on overseas casinos

- After Xi Jinping became the Chinese Communist Party's General Secretary in 2012, he embarked on an anti-corruption campaign that hurt the Macau casino industry. In 2016, he started tightening China's capital controls, making it more difficult to get money out of the country. And then followed a crackdown on junket operators in Macau, a special administrative region the CCP controls. And a Macau ban on proxy betting in 2016.
- Junket operators responded by moving to casinos in other countries such as Cambodia and the Philippines. Casinos in Cambodia and the Philippines set up proxy betting operations, enabling gamblers back home in China making bets over a video link with agents physically present at the casinos' VIP rooms.
- It's been difficult to get money out of China. But the Chinese triads hired by junket operators have used a variety of tactics, including buying goods on e-commerce platforms to create fake transactions that are hard to spot. Cryptocurrencies are also used to hide any traces.
- More recently, two of Macau's largest junket operators Suncity and Tak Chun have been shut down. And Chinese police are trying to push Cambodian and Philippine authorities to crack down on proxy betting.
- In Cambodia, China pushed the government to ban online gaming operations which led to a collapse of the Sihanoukville casino industry, with 100,000 Chinese workers employed by online casinos leaving the country in late 2019.



Prime Minister Hun Sen with China's Xi Jinping. Source: Kyodo

Phnom Penh's new airport will be finished in 2024 or 2025

- In 2018, the Cambodian government approved a proposal to build a new airport to serve Phnom Penh. The new international airport will replace the existing Phnom Penh Airport.
- The airport will be 30km south of the city centre, further away than the previous airport.
- The new airport will be roughly 6x larger in terms of its land area – considerably larger than Beijing Capital International Airport, for example.
- The first phase of the airport is expected to be in mid-2024. But it could be delayed until 2025. In early 2023, the construction progress had reached the 43% mark.



An illustration of Phnom Penh's planned international airport

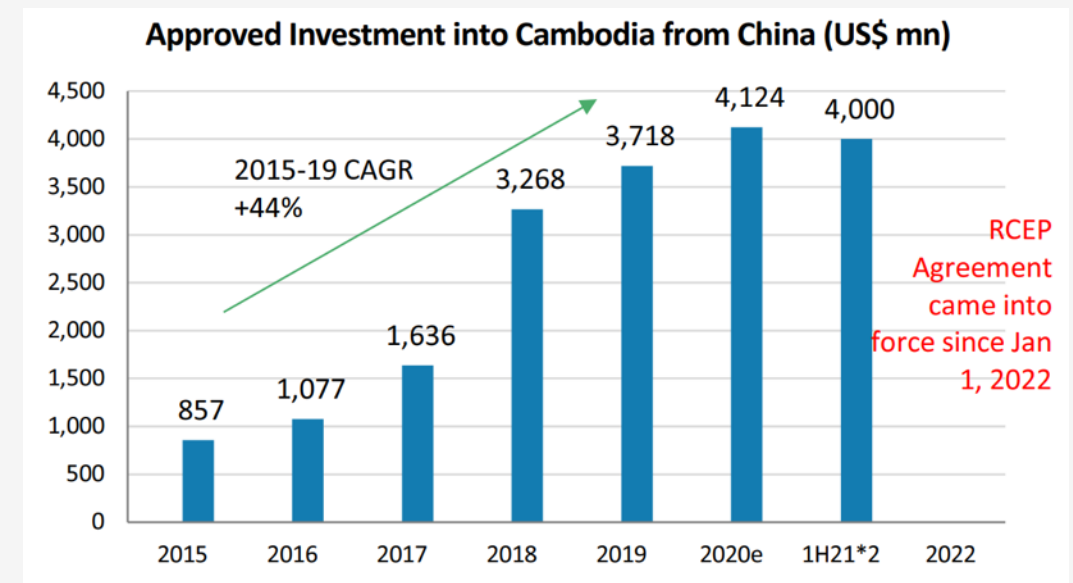
The Naga 3 is in the middle of construction

- Naga 3 is expected to be finished by 2025, at a total cost of US\$3.5 billion, as estimated by Colliers.
- The gross floor area will be about 545,000sqm, a huge increase compared to Naga1/2.
- The project will be financed 50% from internally generated cash flows and 50% from Naga's controlling shareholder Dr Chen.
- Piling has been taking place until early 2023. In mid-2023, building works on tower 1 and 3 will commence and tower 2 should be completed by the end of 2023. Work on the main building should commence by mid-2023.
- Once completed, the combined resort will offer 5,000 hotel rooms, 1,300 gaming tables and 4,500 electronic gaming machines – roughly doubling the total size of the business.



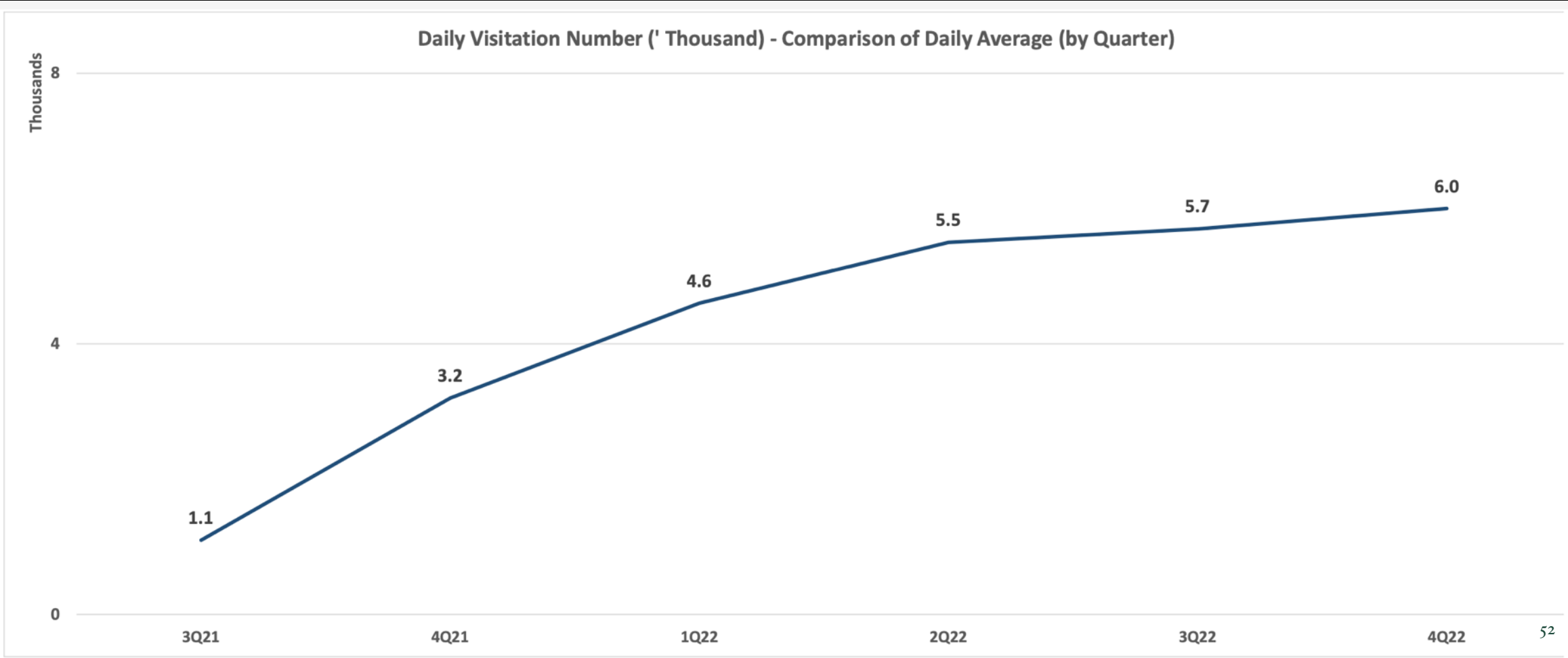
CICC research analysts found 83% correlation between China FDI into Cambodia and NagaCorp's gross gaming revenue

- The correlation between FDI and NagaCorp's gross gaming revenue is because Chinese expats building businesses in Cambodia play in NagaCorp's casinos.
- Cambodia has a close relationship with China, which explains why over 40% of its FDI comes from there. Prime Minister Hun Sen and Xi Jinping are often seen on photos together.
- But in 2022, Cambodia displayed a surprising independence from China by condemning Russia's invasion of Ukraine in the UN General Assembly.
- Whether Cambodia's condemnation of the war in Ukraine represents a shift away from a reliance on Chinese FDI and trade is unclear. It could simply have been a way to build up popular support for Hun Manet's ascent to the Prime Minister position.
- On the positive side, Cambodia signed a free trade agreement with China in 2022, encouraging further FDI.



Source: Morgan Stanley

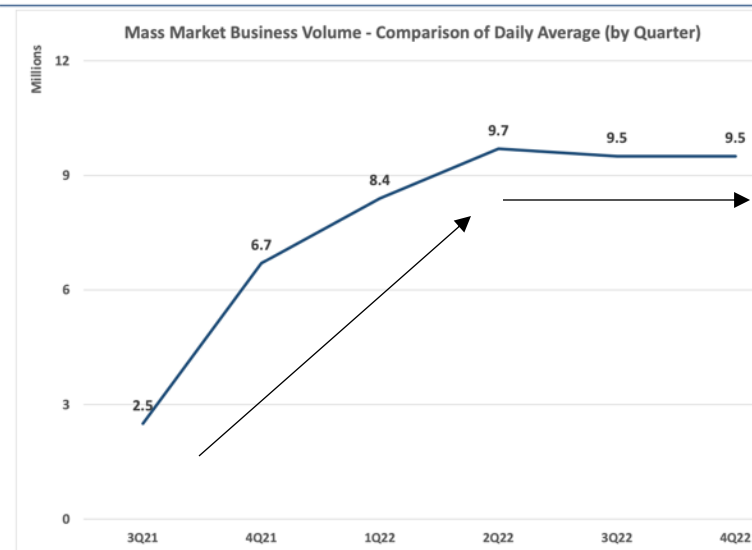
NagaCorp's daily visitation number has kept recovering, though slowly



Source: Crosby Securities

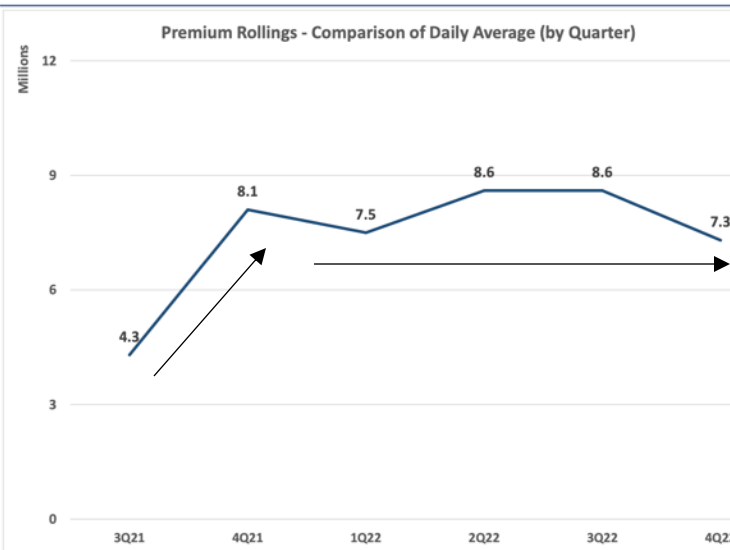
Nagacorp's business volumes have recovered nicely but stalled out in the second half of 2022. The next leg of growth will come from Chinese outbound tourism.

Figure 1 Mass market business volume



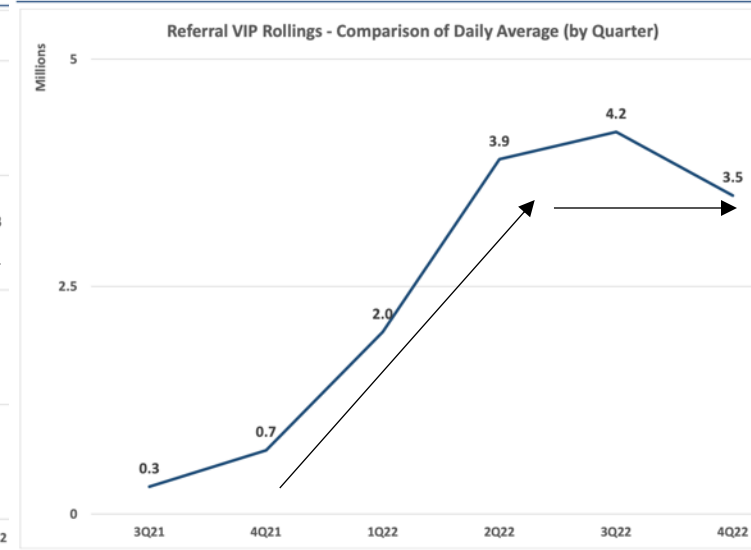
Source: Company data, Crosby Securities

Figure 2 Premium mass business volume



Source: Company data, Crosby Securities

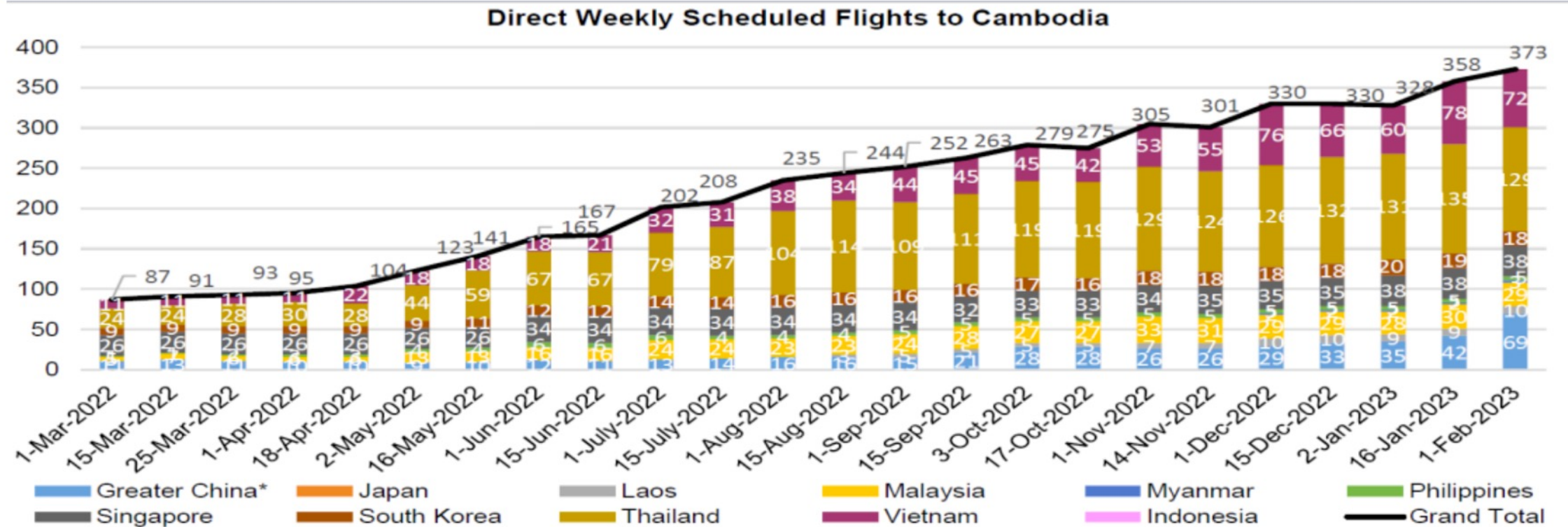
Figure 3 Referral VIP business volume



Source: Company data, Crosby Securities

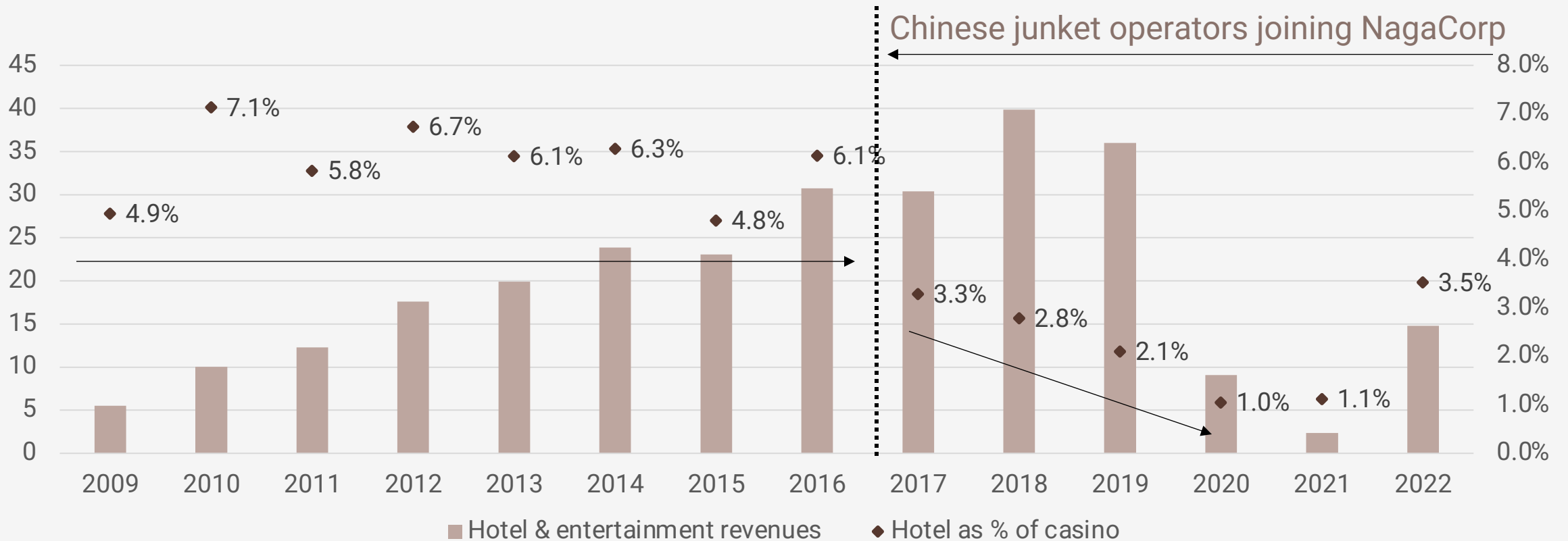
The number of weekly direct flights to Cambodia has quadrupled in a single year. And China's flights have just begun to ramp up.

Figure 5 Weekly direct flights post COVID-19



Source: Company data, Crosby Securities

NagaCorp's hotel revenues could easily double. But a low hotel as a % of casino revenues suggest proxy betting since 2017. Crackdown soon?

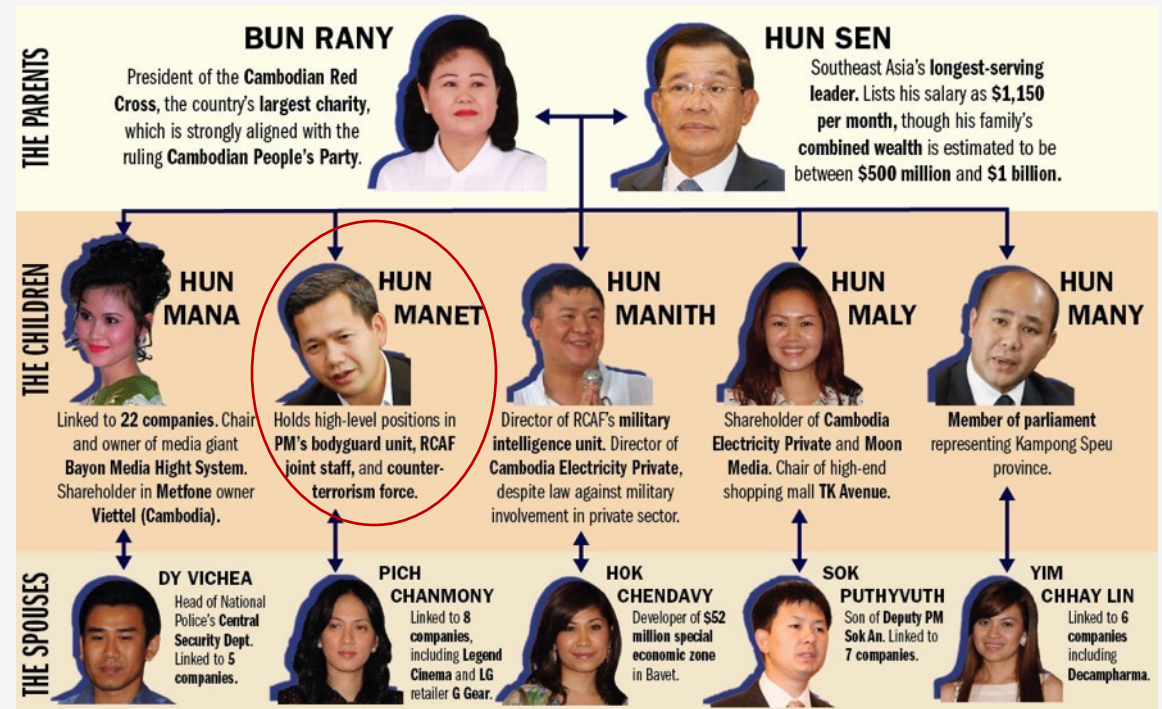


Hun Sen's son might take over the Prime Minister position in late 2023

- There are talks about Prime Minister Hun Sen potentially stepping down after the General Election in July 2023. In his own words:

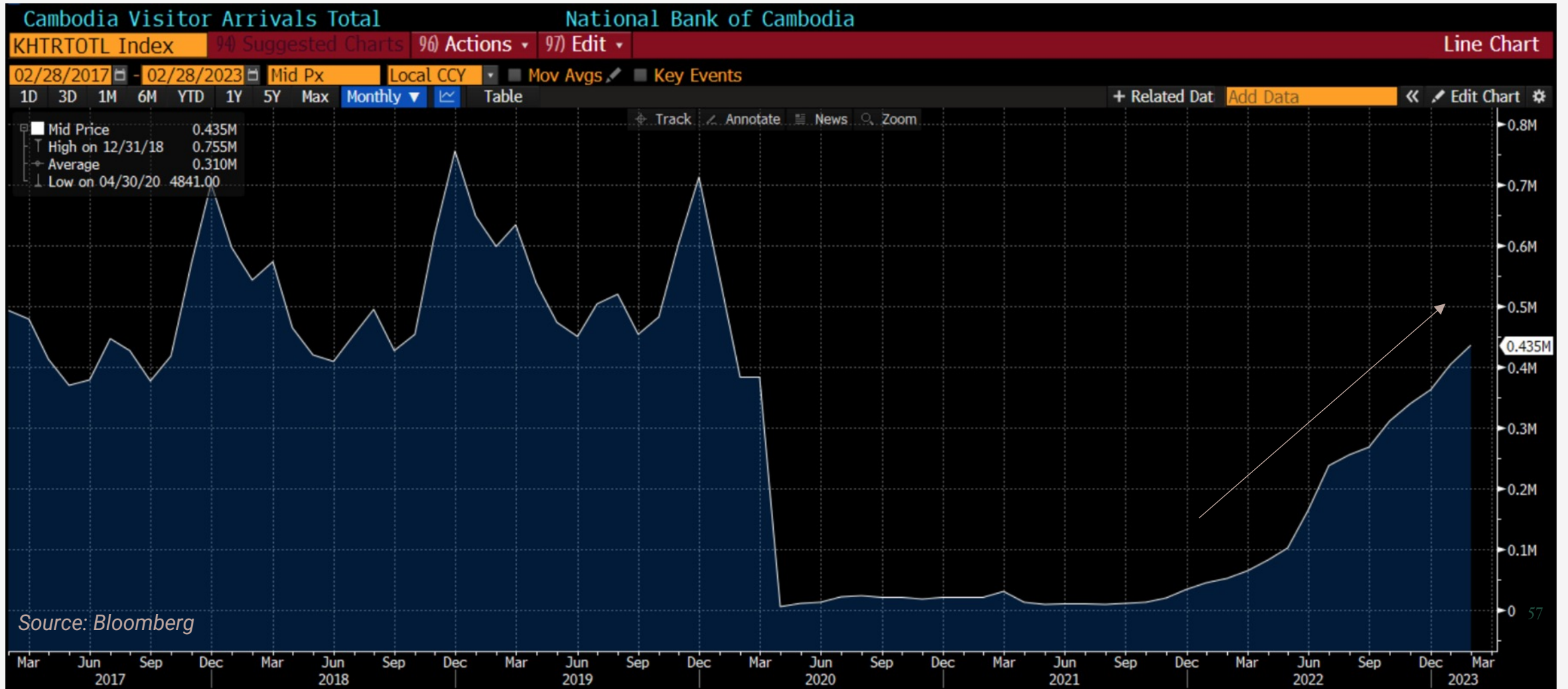
"We have already prepared the plan. When is the right time, that alone matters," he said, adding "We have found potential young successors, and we should better hand over the (baton) to them and just stay behind them."

- But most likely, his son Lieutenant General "Hun Manet" will take over his position, creating continuity of Cambodia's governance.
- Hun Manet is already the commander of the Cambodian army, and therefore holds a strong position in his own right.
- State media has already been running a series of articles lauding Hun Manet's achievements and qualifications as Cambodia's next leader, suggesting he's being groomed as the next leader.



Source: [Khmerization blog](#)

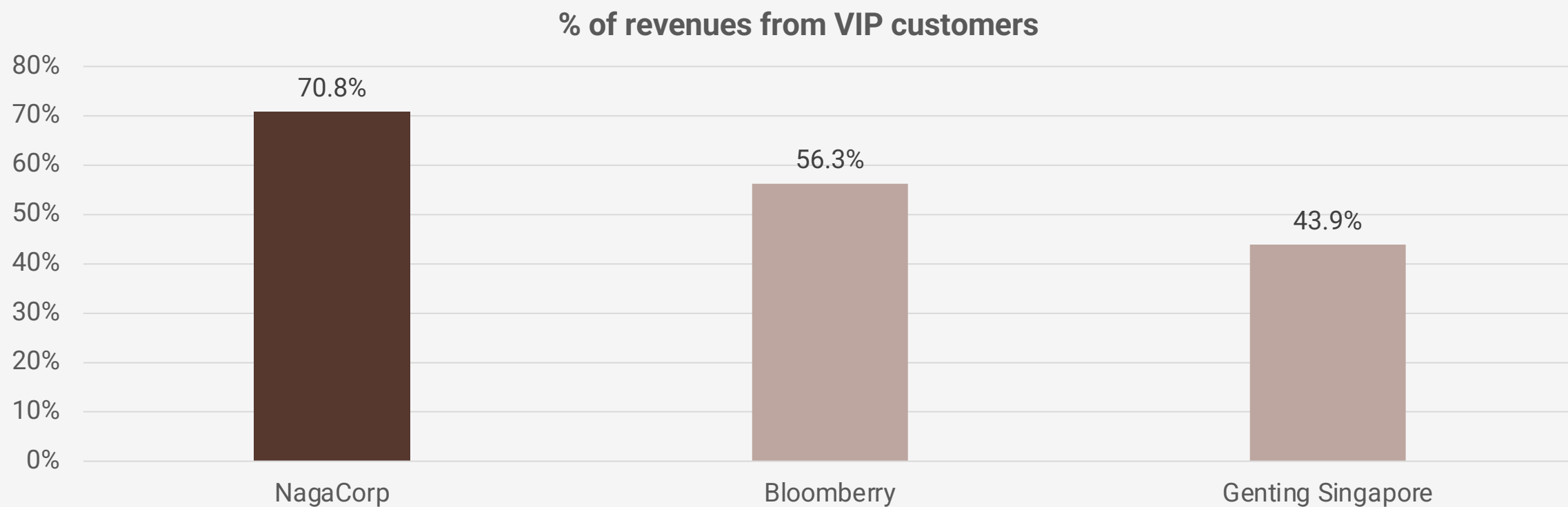
Cambodia tourist arrivals are recovering nicely



The industry trades at median EV/EBIT of 17x, P/E of 18x & 2% yield

2024e	Ticker	Country	Mkt cap (US\$m)	EV/S	EV/EBIT	P/E	Div yield
Nagacorp Ltd	3918 HK	Cambodia	3,483	4.08x	8.4x	9.0x	6.7%
Galaxy Entertainment Group L	27 HK	China	31,613	5.06x	20.1x	19.7x	1.3%
Melco International Develop.	200 HK	China	1,818	2.42x	18.2x	n.a.	0.2%
MGM China Holdings Ltd	2282 HK	China	5,257	2.96x	17.0x	16.4x	1.6%
Sands China Ltd	1928 HK	China	29,177	4.82x	18.0x	16.7x	2.3%
SJM Holdings Ltd	880 HK	China	3,736	1.85x	31.9x	43.8x	1.0%
Summit Ascent Holdings Ltd	102 HK	China	102	1.22x	n.a.	n.a.	n.a.
Wynn Macau Ltd	1128 HK	China	5,746	3.23x	17.6x	23.8x	1.5%
Grand Korea Leisure Co Ltd	114090 KS	Korea	865	1.91x	9.3x	21.8x	3.7%
Kangwon Land Inc	035250 KS	Korea	3,060	1.90x	7.4x	12.0x	4.2%
Paradise Co Ltd	034230 KS	Korea	1,062	2.36x	19.0x	31.4x	0.9%
Bloomerry Resorts Corp	BLOOM PM	Philippines	2,017	2.96x	10.3x	12.6x	0.7%
Genting Malaysia Bhd	GENM MK	Malaysia	3,522	2.28x	12.6x	13.0x	5.9%
Genting Singapore Ltd	GENS SP	Singapore	10,118	3.79x	11.2x	18.4x	3.7%
Average ex-Nagacorp			7,546	2.83x	16.0x	20.9x	2.3%
Median ex-Nagacorp			3,522	2.42x	17.3x	18.4x	1.5%

NagaCorp has disproportionate % of its revenues from VIP customers



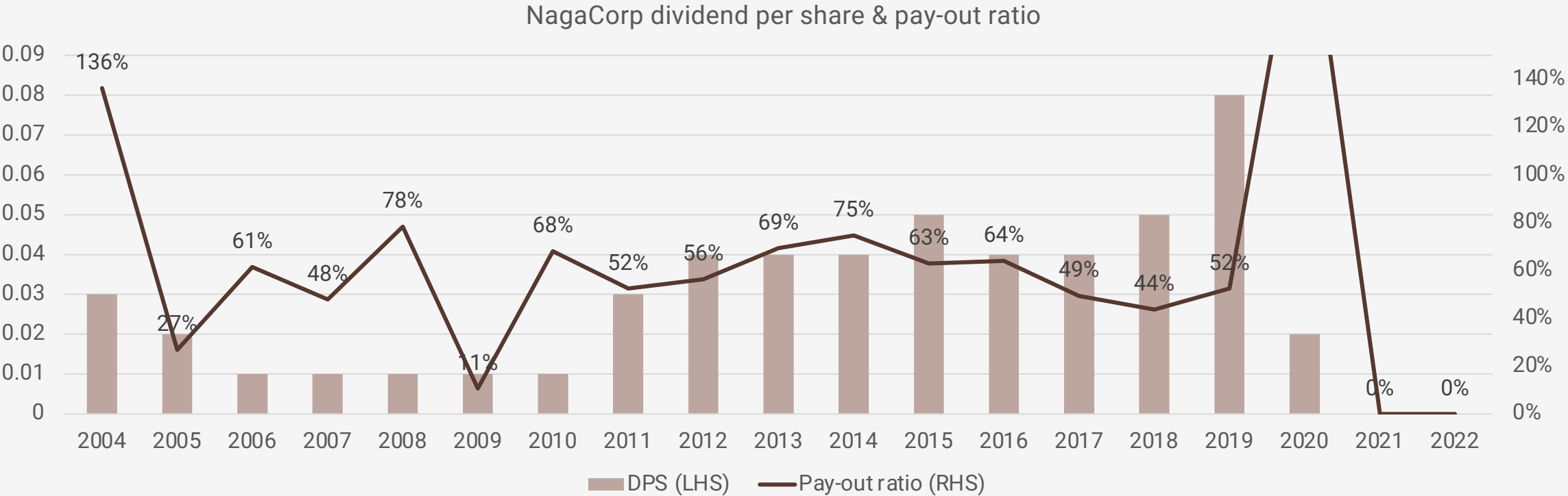
Pre-COVID, Nagacorp traded at 10.6x P/E and 8.3x EV/EBIT



Given China's crackdown on junket operators, it's doubtful that NagaCorp will come back to its 2019 earnings anytime soon.

NagaCorp (3918 HK) (US\$m)	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027
Revenues	956	1,474	1,755	879	226	461	1,133	1,061	1,414	1,653	1,849
Gaming tax	0	0	0	0	-12	-25	-62	-58	-78	-91	-102
Cost of sales	-483	-801	-909	-452	-70	-60	-567	-445	-622	-760	-888
Gross profit	<u>473</u>	<u>673</u>	<u>846</u>	<u>427</u>	<u>144</u>	<u>376</u>	<u>504</u>	<u>557</u>	<u>714</u>	<u>802</u>	<u>860</u>
Other income	8	10	11	5	6	9	10	10	11	11	12
Administrative expenses	-67	-79	-61	-61	-64	-52	-55	-58	-69	-72	-76
Other operating expenses	-150	-186	-224	-205	-189	-201	-212	-222	-303	-318	-334
Operating profit	<u>263</u>	<u>419</u>	<u>572</u>	<u>165</u>	<u>-104</u>	<u>132</u>	<u>248</u>	<u>287</u>	<u>353</u>	<u>422</u>	<u>461</u>
Finance costs	0	-19	-20	-33	-37	-24	-35	-40	-39	-21	3
Pretax profit	<u>263</u>	<u>399</u>	<u>552</u>	<u>132</u>	<u>-141</u>	<u>107</u>	<u>213</u>	<u>247</u>	<u>314</u>	<u>401</u>	<u>464</u>
Income tax	-8	-9	-30	-30	-6	0	-2	-2	-3	-4	-5
Net profit	<u>255</u>	<u>391</u>	<u>521</u>	<u>102</u>	<u>-147</u>	<u>107</u>	<u>211</u>	<u>245</u>	<u>311</u>	<u>397</u>	<u>460</u>
EPS (US\$ cents)	5.88	9.00	12.01	2.36	-3.36	2.45	4.77	5.54	5.58	7.13	8.25
EV/EBIT	14.6x	9.2x	6.7x	23.3x	-37.1x	29.2x	15.5x	13.4x	10.9x	9.1x	8.3x
P/E	13.5x	8.8x	6.6x	33.7x	-23.7x	32.5x	16.7x	14.4x	14.2x	11.1x	9.6x
Dividend yield	4.4%	6.7%	10.4%	2.6%	0.0%	1.9%	1.9%	3.5%	3.5%	4.5%	5.2%

Dividend omission during COVID-19... but in the future, Nagacorp will most likely return to its policy of paying out >50% of earnings



Significant insider buying by Chen Lip Keong around the HK\$6 mark



Potential downside risks

- **Cambodian politics:** Nationalisation of assets is possible in a worst case scenario. Be on the look-out for any change in government control. A loosening of Cambodian People's Party's hold on power could be detrimental for Chen Lip Keong and Nagacorp. In the past, NagaCorp has been accused of paying millions of US Dollars to senior government officials. Cambodia's opposition leader Son Chhay once said that *"Nagaworld was able to obtain a special licence to solely operate in Phnom Penh because it bribed senior government members in the Council of Ministers, in the Ministry of Tourism and the Ministry of Finance"*.
- **Higher gaming taxes:** There is always a risk that Cambodian gaming taxes increase at some point. For example, in 2021, the government started introducing a 4-7% gaming tax after previously charging zero.
- **Reliance on junket operators:** A disproportionate part of NagaCorp's revenues comes from VIP customers, increasingly from China. Some visitors to NagaWorld report the casino being empty, suggesting that a large part of the money is being made in VIP rooms. In the past few years, China's government has cracked down on its domestic junket operators to stop capital outflows, and that may have an effect on NagaCorp, including needing to write down receivables. On the other hand, Macau junket operations have been decimated, and NagaCorp may now serve as an alternative to Macau to evade capital controls and launder money.
- **Competition from outside Phnom Penh:** A new expressway between Phnom Penh and Sihanoukville will be built by 2040, potentially reducing NagaCorp's competitive advantage in monopolising the Phnom Penh casino market. There are tons of casinos in Sihanoukville, and also in Siem Reap but the vast majority of Cambodia's international flight traffic is to Phnom Penh.
- **Naga 3 risks:** Share dilution has been extreme in the past, especially in relation to the construction of Naga 2. The ongoing construction of Naga 3 is estimated to cost US\$3.5 billion, a massive number. There's also a risk that an expensive project such as Naga 3 will lead to a lower return on capital.

NagaCorp has some debt... but the real issue is Naga 3 building costs

Debt	Principal	Currency	Interest rate	Maturity	Outstanding	Price	Yield to maturity
Senior notes	US\$550m	US Dollar	7.95% fixed	July 2024	US\$469m	93.6	14.0%

- NagaCorp only has one bond outstanding, a 7.95% senior note, which was issued in 2020 and raised US\$550 million. Dr Chen personally owns US\$45 million worth of the bonds.
- In 2022, NagaCorp bought back some of the bonds at 91-92 cents on the Dollar and there's now only US\$469 million outstanding. The company also has a cash position of US\$156 million, meaning that NagaCorp has a net debt of US\$313 million.
- Given a projected 2023 NagaCorp EBITDA of US\$370 million, the net debt/EBITDA is less than 1x and therefore not material. At 14% yield-to-maturity, you'd get to an EBITDA coverage ratio of 6.0x.
- But Moody's has placed NagaCorp on a negative watch over its concern that the 2024 bond needs to be refinanced. There will probably be enough cash to refinance the bond, but management hasn't provided any forward guidance so Moody's is being conservative in its estimates. There's also fear that the US\$3.5 billion Naga 3 construction will make it more difficult to refinance the 2024 bond.

Catalysts

- COVID-19 caution receding
- Resumption of Chinese group travel to Cambodia in early 2023
- Greater FDI into Cambodia thanks to RCEP/CKFTA from 2022
- End of US sanctions on Russia
- HKEX review on stocks eligible for southbound trading may include NagaCorp soon

