

Company Flash

Paradise Entertainment 1180 HK

Ruling Multiple Games!

- *Macau gaming player with exposure to casino management and gaming equipment making*
- *Good growth prospects from LMG and ICHS sales underappreciated*
- *Our sum-of-the-parts (SOTP) approach indicates the base case diluted equity value per share of HK\$3.82*
- *Our conservative assumptions for our case scenarios suggests potential for further upside re-rating*

SBI Research Team

(852) 2533 3700
sbie2research@sbie2capital.com

Stock Data (1180 HK)

Rating	Not Rated
Price (HK\$)	3.57
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	0.76-3.84
Market cap. (HK\$m)	3,612.4
Daily t/o (HK\$)	17,842,832.6
Free float (%)	35.3

Source: Bloomberg

Financial Summary

Year to Dec	13F	14F	15F
Turnover (HK\$m)	944.0	1,327.8	1,675.8
Gross profit (HK\$m)	609.6	872.5	1,112.8
Net Profit (HK\$m)	200.4	431.7	643.2
P/E (x)	11.8	5.5	3.7
P/B (x)	2.2	1.6	1.1
Yield (%)	-	-	-
ROE (%)	18.5	28.5	29.8
ROCE (%)	15.9	25.5	27.5

Source: SBI E2-Capital

Paradise Entertainment (1180 HK), following the completion of disposal of non-core businesses, is engaged in the gaming industry, with the main focus in Macau. Paradise derives its income from two business segments: casino management and electronic gaming equipment. On the casino management side, Paradise operates Casino Kampek Paradise, which is a satellite casino under SJM (0880 HK) and has over 800 Live Multi Game (LMG) seats, over 300 slots and 37 gaming tables. On the electronic gaming side, Paradise develops electronic gaming equipment (mainly LMG), and receives sales and leasing income from this segment. Paradise also shares GGR from LMG machines in certain casinos.

100% LMG market share. Paradise dictates the market of LMG in Macau and its patents have raised the hurdle of entry for competitors. We see strong demand for LMG in years to come due to continued labour shortage in Macau, superior table yield and opening up of new Cotai projects in 2015 and 2016.

Expanding its electronic gaming portfolio. Paradise is about to launch the Intelligent Cash Handling System (ICHS), which is designed to efficiently handle cash redemption for tickets. The error-free and efficient solution is likely to be favoured by casinos as electronic gaming (and hence ticket redemptions) becomes more popular.

Valuation. We employ a sum-of-the-parts (SOTP) approach to value Paradise, using both EV/EBITDA multiple and DCF valuation methods. Our base case diluted equity value per share is HK\$3.82.

Table 1. Valuation Summary

Equity value per share (HK\$)	Bear case	Base case	Bull case
EBITDA Multiple	3.59	3.73	3.87
DCF	3.59	3.92	4.29
Average	3.59	3.82	4.08

Source: SBI-E2 Capital

Surprises weigh on the upside. For the sake of prudence, our base case is assuming no capacity expansion in casino management, nominal overseas LMG sales and ICHS sales. We think risks weigh on the upside given our conservative approach.

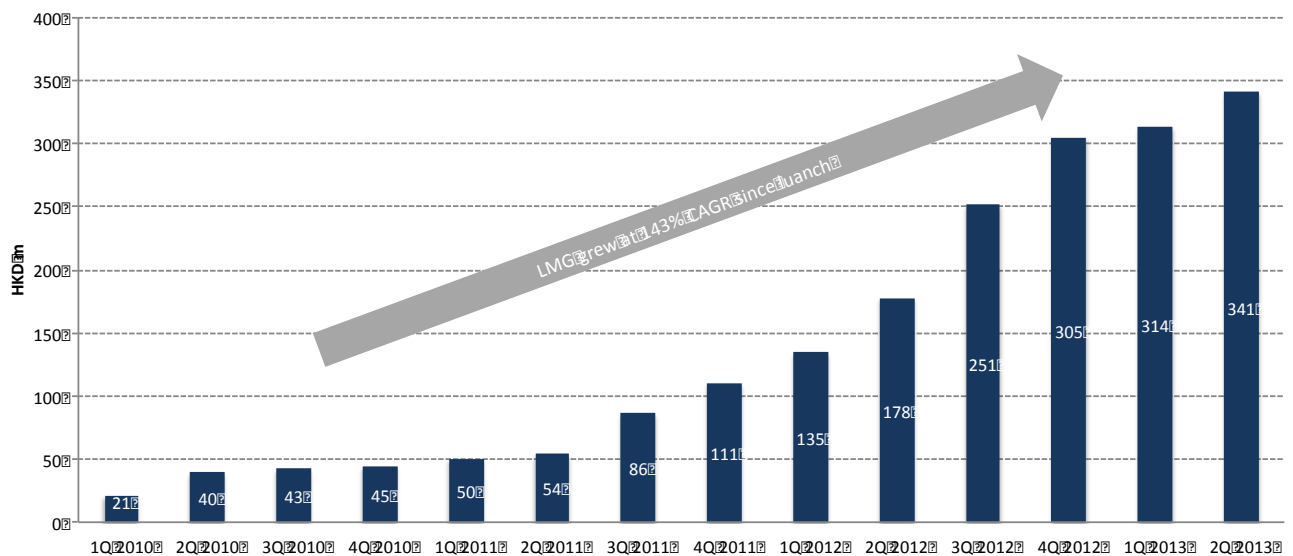
LMG dominance to flourish. Live Multi Game (LMG) is a stadium-style electronic gaming system. A LMG system comprises a stage, on which live dealers run multiple games (Baccarat, Sic Bo and Roulette), and a large number of terminals which allows patrons to participate. Currently, about 60 terminals (or seats) of a LMG system is counted as 1 “gaming table”. We expect continued strong demand in LMG in Macau as: i) the table-counting method of LMG aids the “table” yield by catering more patrons; ii) LMG is a cost effective solution to capture the mass market in labour-constrained Macau; and iii) it maintains more “human touch” than other forms of electronic table games. DICJ’s statistics show GGR from LMG has grown at an impressive 143% CAGR since 2010, signalling a wide acceptance of LMG among mass-market players (See Figure 3).

Figure 2. LMG system and terminals



Source: company data

Figure 3. LMG’s GGR growth in Macau indicating wide acceptance by patrons



Source: SBI E2-Capital, DICJ

Figure 4. Existing LMG systems (as of 31 Aug 2013)

Operators	Seats Sold	Properties	Sharing seats
Sands China	751	Kampek Paradise	685
Galaxy Entertainment	150	Lisoba	200
Melco Crown	423	Grandview	120
Wynn	46	Greek Mythology	60
MGM	59	Total	1,065
SJM (with satellite casinos)	200		
Total	1,629		

Source: SBI E2-Capital, Company data

Paradise has 100% share of Macau's LMG market (about 2,700 seats in total) and it is patent-protected. The company derives revenue from one-off sales of high-margin LMG systems (industry average GPM is about 60%). We expect the dominance of Paradise in this market to flourish as new Cotai projects start opening up in 2015 and 2016. Space, which is usually the largest concern for installation in existing properties, should no longer be an issue. As for existing properties, LMG is likely to continue replacing grind-mass tables, and potentially middle to high limit mass with the introduction of luxurious terminals (e.g. airline concept betting terminal). For our base case, we assumed LMG-to-table ratio will reach 55:100 (vs. 47:100 currently) in Macau and moderate sales overseas, and therefore will sell 3,495 LMG seats for FY12/13 to FY12/16.

In addition, Paradise is looking to expand into foreign markets (including Cambodia, Australia, the US and other Southeast Asia countries) and has recently acquired LMG-related patents in the US. In fact, the sale of LMG seats in Australia has grown 9 times from 20 units in 2012 to 200 units in 2013. Their strong performance in the Australia market is proof that they have successful experience of entering into new markets. We expect to see more growth from the overseas market in the future.

Figure 5. Basis for scenario analysis of LMG sales

		LMG seats per 100 gaming tables in Macau		
		50	55	60
Average selling price (USD per seat)	17,500			
Est. gross profit margin	60%			
		LMG sales for FY12/13 - FY12/16		
		(Bear case)	(Base case)	(Bull case)
		1,980	2,178	2,376
Total no. of gaming tables in Macau (end of 3Q13)	5,748			
Total no. of LMG in Macau (31 Aug 2013)	2,694			
LMG : Gaming table	47 : 100			
		Total sales		
		3,010	3,495	3,981

Source: SBI E2-Capital, DICJ

Figure 6. Base-case P&L for LMG Sales Segment

(HK\$m)	FY12/11A	FY12/12A	FY12/13E	FY12/14E	FY12/15E
Revenue	28.0	115.0	95.6	136.5	163.8
Est. COGS	11.2	46.0	38.2	54.6	65.5
Est. gross profit	16.8	69.0	57.3	81.9	98.3
Est. Operating expenses	16.9	30.5	81.7	87.4	91.5
Est. Operating profit	(0.1)	38.5	(24.4)	(5.5)	6.8
Est. Operating income margin	-0.3%	33.4%	-25.6%	-4.0%	4.1%
Est. EBITDA	12.0	50.6	42.5	61.4	73.7
Est. EBITDA margin	43.0%	44.0%	44.5%	45.0%	45.0%

Source: SBI E2-Capital, DICJ

LMG sharing segment in line with mass-market growth. In addition to the sales of LMG systems, Paradise also installs LMG systems in certain casinos for free, and shares the 22-50% of the related GGR with the casinos. Currently, there are 380 LMG seats under the sharing scheme (200 in Lisboa, 120 in Grandview Casino Macau, and 60 in New Century Greek Mythology Casino). We expect the growth in this segment will be in line with the mass-market growth in Macau.

Figure 7. Base-case P&L Forecasts for LMG Sharing Segment

(HK\$m)	FY12/11A	FY12/12A	FY12/13E	FY12/14E	FY12/15E
Revenue	47.0	69.0	89.2	111.5	133.8
Revenue growth	95.8%	46.8%	29.3%	25.0%	20.0%
Est. Depreciation	7.6	7.6	7.6	-	-
Est. EBIT	39.4	61.4	81.6	111.5	133.8

Source: SBI E2-Capital, DICJ

Casino management business enjoying high productivity. Paradise operates Casino Kampek Paradise via a casino management contract with SJM. The property is a mass-oriented casino located in Macau Peninsula, adjacent to the Lisboa Hotel. It is a 5-storey building which currently has 37 mass market gaming tables, over 300 slot machines and over 800 LMG tables. According to the management contract, Paradise takes 55% of the GGR, 5% goes to SJM, while the rest will be paid as tax to the Macau government.

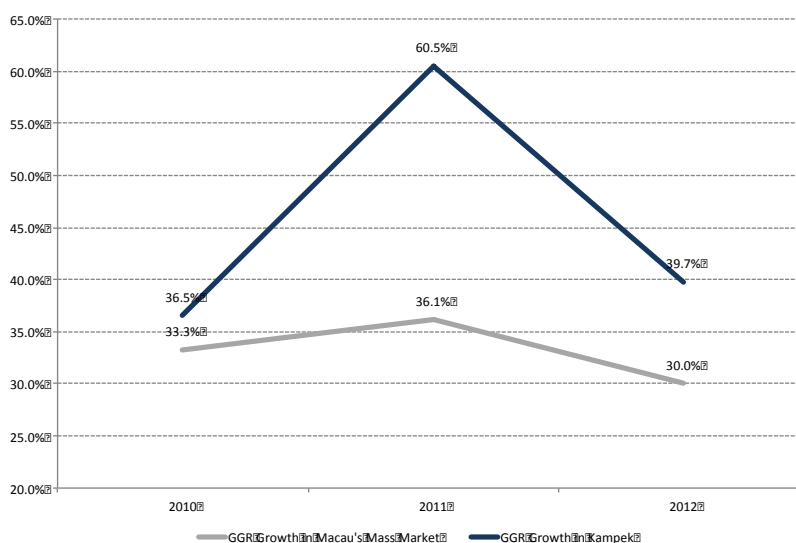
Figure 8. Location of Kampek Paradise Casino



Source: SBI E2-Capital, Google Map

We like Paradise's mass market focus and its LMG offerings (largest in Macau), which enhance the table yield and should allow Kampek to outpace mass market growth as LMG gets wider acceptance. In fact, the GGR in Kampek has been growing at a faster rate than the overall mass market in Macau over the past 3 years (See Figure. 9). We believe the over-performance will continue given: i) a higher table yield is expected to be achieved by Kampek on the back of larger LMG offerings, and ii) Kampek is relatively small compared to the big names, but the low base effect should enable the company to grow above the market rates. Paradise is seeking other opportunities to secure more casino management service contracts. However, we expect the growth in this segment will mainly be driven by Kampek in the next few years, as it takes 1-2 years to ramp up the casino. We expect EBITDA margin in this segment will stay at approximately 20%-21% in the next three years, with EBITDA of HK\$149.4m, HK\$212.4m and HK\$277.2m for FY12/13E, FY12/14E and FY12/15E respectively.

Figure 9: GGR growth comparison (Macau's mass market VS. Kampek)



Source: SBI E2-Capital, company data, DICJ

Figure 10: Base-case P&L Forecasts for Casino Management Segment

(HK\$m)	FY12/11A	FY12/12A	FY12/13E	FY12/14E	FY12/15E
Revenue	390.0	545.0	759.2	1,024.9	1,311.9
Revenue growth	60.5%	39.7%	39.3%	35.0%	28.0%
Est. COGS	161.3	191.2	288.5	379.2	472.3
Est. Gross profit	228.7	353.8	470.7	645.7	839.6
Est. Gross profit margin	58.6%	64.9%	62.0%	63.0%	64.0%
Est. Operating expenses	178.9	275.9	341.6	461.2	590.3
Est. Operating income	49.8	78.0	129.1	184.5	249.3
Est. EBITDA	70.3	98.2	149.4	212.4	277.2
Est. Gross profit margin	18.0%	18.0%	19.7%	20.7%	21.1%

Source: SBI E2-Capital, company data

ICHS segment has potential, but needs traction period. Intelligent Cash Handing System (ICHS) is a new offering of the group to be rolled out in late 2013 or early 2014. ICHS is an ATM-like cash redemption solution that can convert casino tickets into cash, saving the labour of conversion in cages. ICHS eliminates human error and provides a simple and more efficient cashing-out services for ticket-based games (slots and electronic table game), which often involves smaller amounts of cash. There is no similar product in the market now. Paradise receives installation income (USD30,000) as well as a monthly leasing fee (USD100 per month) for each ICHS. While we think casinos will welcome ICHS given the growing size of ticket-based gaming, we make very conservative forecasts as it is difficult to nail down the traction time of an industry changing product such as ICHS. Our base case represents annual sales of 230 ICHS machines, or 1 ICHS for every 100 ticket-based gaming machines, which include ETG and slots, in Macau in FY12/14. We expect the number of ICHS sold to increase further to 269 and 314 in FY12/15 and FY12/16 respectively, as the number of ETG and slots continues to increase in Macau.

Figure 11. ICHS machine



Source: company data

Figure 12: Basis for scenario analysis of ICHS

		ICHS per 100 ticket-based game			
		0.5 (Bear case)	1.0 (Base case)	1.5 (Bull case)	
Forecasted average selling price (USD per ICHS)	30,000				
Forecasted monthly leasing fee (USD per ICHS)	100				
Total no. of slots in Macau (end of 3Q13)	17,730	Annual units sold	115	230	345
Est. total no. of ETG in Macau (end of 2013)	5,300	Selling revenue (HK\$m)	26.9	53.9	80.8
Total no. of ticket-based gaming	23,030	Leasing revenue	1.1	2.2	3.2
		Annual revenue	28.0	56.0	84.1

Source: SBI-E2 Capital, company data, DICJ

Valuation. We employed the Sum-of-the-Part (SOTP) method to value the company. For the EBITDA-multiple valuation, we chose 10.0x FY12/13E forward multiple for LMG sales (vs. about 11x of global gaming equipment makers) and 15.0x multiple for LMG sharing and casino management (vs. Macau gaming operators' 18x). A discount was applied to the industry average in order to take into account the relative size of Paradise compared to other larger players in the industry. The base-case equity value derived from our EV/EBITDA valuation is HK\$3,841.6m, or HK\$3.73 per share (diluted). For DCF valuation, our base-case equity value is HK\$4,037.1m, or HK\$3.92 per share (diluted). Taking the average of the two valuation gives us the diluted equity value per share of HK\$3.82.

Figure 13: Base-case P&L Forecasts for Paradise Entertainment (Gaming segment only)

Revenue	464.6	729.0	944.0	1,327.8	1,675.8
Revenue growth	24.2%	56.9%	29.5%	40.7%	26.2%
Est. COGS	180.1	244.8	334.3	455.3	562.9
Est. Gross profit	284.5	484.2	609.6	872.5	1,112.8
Est. Gross profit margin	61.2%	66.4%	64.6%	65.7%	66.4%
Est. Operating expenses	227.2	325.3	359.7	359.7	359.7
Est. Operating profit	57.3	158.9	249.9	512.7	753.1
Est. Operating profit margin	12.3%	21.8%	26.5%	38.6%	44.9%
Est. EBITDA	97.5	198.9	344.8	607.6	848.0
Est. EBITDA margin	21.0%	27.3%	36.5%	45.8%	50.6%
Est. Shareholders' net profit	39.3	143.3	200.4	431.7	643.2
Est. Net profit margin	8.5%	19.7%	21.2%	32.5%	38.4%

Source: SBI-E2 Capital, company data, DICJ

Figure 14: Paradise Entertainment's SOTP ENITDA-multiple Valuation

(HK\$m)				EBITDA	
FY 12/13E EBITDA from	Bear case	Base case	Bull case	Multiple	Note
LMG sales	40.1	42.5	44.9	10.0	Peers average at ~11x
LMG sharing	78.2	81.6	85.1	15.0	Casino operators average at ~18x
Casino management	144.8	149.4	154.1	15.0	Casino operators average at ~18x
ICHS	-	-	-	n.a.	
Total EBITDA	263.0	273.6	284.1		
Enterprise value of	Bear case	Base case	Bull case		
LMG sales	400.9	425.2	449.5		
LMG sharing	1,172.5	1,224.3	1,276.0		
Casino management	2,171.8	2,241.3	2,310.8		
ICHS	-	-	-		
Total EV	3,745.2	3,890.8	4,036.3		
Net debt (as of 30 Jun 2013)	49.1	49.1	49.1		
Equity value	3,696.1	3,841.6	3,987.2		
Equity value per share (HK\$)	3.59	3.73	3.87		

Source: SBI-E2 Capital, company data, DICJ

Figure 15: Valuation Summary

Equity value (HK\$m)	Bear case	Base case	Bull case	Equity value per share (HK\$)	Bear case	Base case	Bull case
EBITDA Multiple	3,696.1	3,841.6	3,987.2	EBITDA Multiple	3.59	3.73	3.87
DCF	3,696.3	4,037.1	4,415.9	DCF	3.59	3.92	4.29
Average	3,696.2	3,939.4	4,201.5	Average	3.59	3.82	4.08

Source: SBI-E2 Capital, company data, DICJ

Our view. Paradise's investment thesis has two aspects. On casino management side, leveraging upon its knowledge of and insight into own productivity tools, Paradise is capable of achieving above-market growth on its Kampek Paradise Casino. If the company is able to acquire another underperforming satellite casino in the near future, it is likely that Paradise can replicate Kampek's success and generate great return from yield improvements. On the gaming equipment side, Paradise is likely to benefit from strong demand in Macau, particularly from new Cotai projects in 2015 and 2016. Along with their expertise in creating effective gaming machines, we believe Paradise will be able to use its sector knowledge to create operating synergies in effectively managing its casino. Also, overseas sales, which are assumed to be very modest in our base case, is expected to providing further upside potentials to the company.

Key risks. 1) Underperformance of the overall Macau gaming market; 2) slower than expected traction in ICHS; 3) less-than-expected popularity of LMG in Macau and overseas market

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