

Macau cleans up but is no den of angels

Macau's official tourist map doesn't mention casinos. It highlights its sporting venues, its historical sites – even its karaoke bars and discos – but not the 18 legal casinos that have propelled this tiny, former Portuguese enclave into a multibillion-dollar development frenzy that has ensnared some of the world's biggest casino operators, including James Packer's Publishing & Broadcasting Ltd.

Instead, the map marks each casino site with a discreet Ace of Spades. This is how Macau would like to see itself: as a sophisticated tourist destination, not a seedy backwater where working girls circulate in smoke-filled casinos as desperate punters risk all.

PBL's contribution to Macau's clean-up and transformation into the desired „integrated resort“ – a family friendly combination of gambling, convention facilities and entertainment – will be the USD 256 million (HKD 350 million) Crown Macau hotel, spa and casino.

PBL's joint venture partner in Macau is Melco International Development, the Hong Kong-listed company owned by the Ho family and run by Stanley Ho's favourite son, Lawrence. PBL and Melco are hoping that Crown Macau, billed as the enclave's first six-star hotel and casino, will emulate the gargantuan Sands casino which opened in 2004 and made back its USD 265 million investment within 12 months.

This is the kind of return that has made Macau red-hot and has Hong Kong investors gripped with Macau mania, snapping up anything connected to Macau property and gaming.

Dwarfing the Crown Macau casino is PBL-Melco's even more ambitious USD 1 billion City of Dreams, a huge casino,

entertainment and residential complex. The site, on the so-called Cotai Strip – reclaimed land that now links the former islands of Taipa and Cotai – is fenced off with weathered signs and the giant „City of Dreams“ lettering looks distinctly windblown. The complex was to have included an underwater casino but that part of the plan was quietly dropped last year. Nearby, the USD 2.3 billion Venetian Macau, a replica of Las Vegas Sands' Venetian casino complex, is to open next year.

Construction cranes crowd Macau's skyline and USD 24 billion of investment is expected over the next decade in an area just 27 square kilometres (half of it reclaimed land): \$ 10 billion worth of new casinos, hotels, conference and convention centres, luxury housing, retail and supporting roads, and other infrastructure is already under way.

The reason for all the investment is simple. Macau's gaming revenues, up 11 per cent to USD 5.5 billion last year, are set to pass Vegas's this year. The enclave, returned to China in 1999, is exquisitely positioned. Since China began easing travel restrictions from the mainland to Macau in 2003, tourist numbers have leapt more than 25 per cent a year. At the southern tip of the mainland, it is within easy reach of China's swelling ranks of affluent coastal city dwellers and taps into the pool of 1.3 billion customers. Casino gambling is illegal on the mainland and Beijing has given its blessing to Macau's ambitions to become the regional gaming hub.

Analysts forecast 15-20 per cent growth this year. Deutsche Bank is predicting 20 per cent average growth through to 2008, which adds up to a \$US8 billion to USD 10 billion gaming market.

Looming over any story involving modern Macau is the tall, elegant figure of Stanley Ho. Ho built his USD 6.5 billion fortune on Macau after winning a monopoly right to operate casinos here that lasted for more than 40 years.

His private company STDM, owned by Ho and Hong Kong billionaire Henry Fok, with minority shareholders such as his sister Winnie Ho, once accounted for two-thirds of Macau's GDP. It maintains a substantial role in virtually every aspect of Macau, controlling casinos, hotels, transport and construction. Ho's construction arm is building an extensive Fisherman's Wharf-style entertainment precinct, complete with miniature volcano.

In 2001, Ho transferred all of STDM's casinos into a wholly owned subsidiary called SJM. The way he did this led to a very public falling out with his younger sister, Winnie, who for a quarter of a century ran his Macau casinos. Winnie has accused her brother of enriching himself and his cronies at the expense of minority shareholders, such as herself, when STDM transferred all its casino assets, including the crucial casino concession, into the SJM.

When STDM did so, instead of taking 100 per cent of the shares in the new casino-holding company, it only took 80 per cent. The other 20 per cent of the SJM shares was awarded to Ho and close associates for what Winnie says was a fraction of what they were worth. The effect was to dilute the value of Winnie's STDM shares as STDM no longer had 100 per cent of the casino assets but only 80 per cent.

While fighting his sister, Ho has also faced the toughest competition in his long career. His monopoly ended in 2002 when the new Macau Government issued two more gaming concessions, one to Hong Kong's Lui family, big in hotels and construction, the other to Las Vegas veteran Steve Wynn. Under a formula known as „3+3“, each of the original three concession holders can sell one sub-concession each. The Lui family, through its concession-holding company Galaxy, granted its sub-concession to Las Vegas Sands, Sheldon Adelson's casino company.

STDM sold its sub-concession to Ho's daughter Pansy Ho, who is

in a joint venture with American MGM Mirage for USD 230 million, leaving PBL-Melco to snap up the last sub-concession from Wynn for a massive USD 900 million. Both concession and sub-concession holders are entitled to a virtually unlimited number of casinos or tables or machines until June 2022.

Under 3+3, Stanley Ho will have a stake in only three of the six concessions in Macau but analysts say he still controls 70 per cent of Macau's gaming profits because of his grip on the high-rollers drawn to his casinos' VIP rooms. The VIP rooms are effectively sub-contracted out to so-called junket operators, who find the high-rollers and get them to Macau.

Operations in Macau don't come without risks, given the former colony's long association with Triad gangs.

Stephen Vickers spent 18 years with the Royal Hong Kong Police tracking and breaking up the Chinese gangs known the Triads, such as 14K, Wo On Lok, Wo Shing Wo and Big Circle.

He was head of the Criminal Intelligence Bureau, supervising 280 staff, when he left the force for the private sector. He is now president and chief executive of International Risk, which advises corporate clients about investment risks and provides business intelligence.

Vickers says Macau is being cleaned up but foreign players entering the country should have no illusions about the pace of change. He says organised crime these days is manifest in more subtle ways but remains a real part of doing business in Macau.

Vickers doesn't doubt that the nuts and bolts of running the casino games – dealing the cards, rolling the dice, spinning the wheel – will be strictly conducted but „the real, real threat is the junkets, the secret underground banks, money-laundering through more subtle methods.

„If the money-laundering process is not properly adhered to

and Macau continues as it already is with the huge amount of leakage from the Chinese economy, there is some risk that the Chinese will no longer tolerate this," Vickers says.

In a worst-case scenario, the Chinese could turn off the flow of high-rollers into Macau or impose limits on, for example, daytrippers from the mainland, which could hurt foreign investors.

The other key risk for foreign players is getting too close to Macau's „exotic and colourful“ elements. „It's what we call The Wall Street Journal risk: a front-page story alleging that a major casino – American or Australian or whatever – is engaged in activities which are inappropriate and which could lead to loss of licences back home," Vickers says.

„That is the sword of Damocles that sits over the heads of all the foreign players operating in Macau who have a licence somewhere else that matters to them.“

The Chinese Government, worried about the huge amounts of illicit cash being siphoned out of the mainland, which has strict limits on exporting the official currency and sharpening social protests about rampant corruption, launched a national crackdown on gambling last year, closing illegal casinos on its borders with North Korea, Thailand and Burma and targeting officials who were laundering stolen money through these channels.

Macau was not mentioned in the crackdown but some operators are believed to have expressed concern, rather audaciously, to Beijing about the crackdown reducing the free flow of cash into Macau's casinos.

David Green used to regulate Adelaide's casinos. He came to Macau five years ago to advise its new government on casino liberalisation. Green, now PriceWaterhouseCoopers' director of gaming practice, says PBL-Melco have paid a high price to grab the last casino sub-concession but this gives them their own

casino licences, buying them some distance from Ho and any probity issues that might arise.

PBL-Melco's original Macau arrangement involved the venture building and owning the two casino complexes but having to lease the gaming operations to Ho's SJM. In this form, SJM was entitled to 20 per cent of gross gaming revenue without any risk. (The same deal SJM has with another casino operator, Greek Mythology).

Green says the price seems high but PBL had obviously crunched the numbers and realised that even at that price, they would be better off in the long term because they would no longer have to hand over 20 per cent of gaming revenue to SJM – and it removes any direct association with Stanley Ho.

The new arrangements makes it harder to argue that Ho exerts sufficient control over Melco to be considered an associate, a relationship that would draw regulatory scrutiny and possible disapproval. „It potentially makes an easier path in a regulatory sense for PBL because there is now no direct nexus with SJM,“ Green says.

Since PBL bought the sub-concession, further steps have been taken to distance the joint venture from Ho. He resigned as chairman of Melco, ostensibly to clear the way for a Hong Kong listing for SJM, although he retains about 12 per cent of Melco's shares.

Ho's daughter Pansy is also being put through the regulatory hoops by Nevada gaming inspectors, who control MGM Mirage's Las Vegas licence, because of possible SJM influence.

Apart from possible probity issues, Green also cautions that foreign investors such as PBL face other potential problems, the key one being the assumption that Macau can easily or quickly become a Las Vegas-style resort destination. This is a „blue skies“ proposition based on the premise that „if you build them, they will come“.

With an estimated 15,000 to 20,000 hotel rooms due for completion in the next two years – Macau now has 10,000 hotel rooms, compared with Las Vegas's 135,000 – Green says PBL-Melco might have to revise their view of the market.

„When you've only got 11,000 rooms now and three-quarter occupancy and a question over how much of that is paying occupancy, it just makes me wonder whether people are overcooking things.

„I am not saying they are wrong but the case has still to be proven,“ Green says.

He points out that the punters who made Stanley Ho one of the world's wealthiest men are still predominantly mainland Chinese who stay an average of 1.1 nights in three-star hotels.

„I have trouble with the chicken and egg concept because all these high-end operators are assuming people who come to these casinos want to stay and that's not a proven proposition because the bulk of them are Chinese who want to spend their discretionary money gambling and buying things they can't buy at home,“ Green says.

„Give the average player a choice to spend money on a room and be treated like a king or on the [gaming] floor and they'll spend it on the floor.“