

Macau becomes a not so sure bet

Hong Kong – For the past five decades, a Macau casino concession has been licensed to print money. In the past few months, printing money has become less profitable and less satisfying.

This week's opening of Cirque du Soleil's new Zaia show at the Venetian Macao is a reminder that Macau has gone from a sure thing to a risky high-wire act. Casinos in the former Portuguese enclave are facing plunging growth and tumbling share prices, while squabbling with each other over their shares of the golden goose. Gaming revenue is still on track to obliterate records again this year, yet it feels as if Macau's winning streak is over.

The streak started off strong. Stanley Ho's Sociedade de Jogos de Macau (SJM) ran gambling in the city for 40 years, with a handful of casinos making Ho one of Asia's richest men and a leading figure in Macau, Hong Kong and mainland China. But after Portugal returned Macau to Chinese sovereignty in late 1999, Beijing decided to bring competition to the market.

Time of Sands

US casino giant Las Vegas Sands (LVS), one of five new post-monopoly players joining SJM, opened Macau's first Vegas-style casino in 2004. The Sands Macao casino recouped its USD 240 million construction cost within a year of its opening. That may have set expectations unrealistically high for all the players, but, oh, those were the days.

In this year's second quarter, Sands Macao's casino revenue fell 30% to USD 262 million, and its operating income plummeted 58% to USD 40 million. Still, that left LVS a winner for the quarter: fellow US gaming giant MGM Mirage and

Australia's Crown reported losses in their Macau operations, ironically, each a partnership with Stanley Ho's offspring.

Overall, Macau's gaming revenue fell 3% in the second quarter compared with the first quarter, the first such drop since liberalization began. The take, 28.9 billion patacas (USD 3.6 billion), was up 48% from the second quarter of 2007. But Macau's Chief Executive Edmund Ho warned legislators that gaming revenue – which produces 75% of Macau's tax revenue – may fall next year. This gloomy outlook replaces earlier long-term forecasts of perpetual sunshine.

Crunch and squeeze

Some of the problems facing Macau trace to the global credit crunch and squeezed consumers. „The [gaming] industry may be recession resistant, but it is not recession proof,“ PricewaterhouseCoopers Gaming Practice director David J Green says. „Disposable incomes are being pressured by rising energy and food costs, and in some countries, rising or high interest rates. This should be cyclical, but it is a damaging combination for highly geared businesses like casinos, which produce nothing, have no saleable inventories, and rely entirely on the velocity of money played in them.“

Las Vegas' revenue is declining as well, and many stocks in the gaming sector, including LVS and MGM Mirage, have taken haircuts of 50% or more. But there are some factors unique to Macau contributing to local pessimism.

Part of the gloom may be a hangover from 2007, when Macau's gaming revenue of USD 10.4 billion surpassed the take of Las Vegas casinos, aided by openings of three flagship casinos, SJM's Grand Lisboa, LVS's Venetian Macao, and MGM Grand Macau. „When there is a lull in the opening of new properties, Macau will have flattening performance,“ according to Jonathan Galaviz, a partner in Globalysis, a travel and leisure consultancy based in Las Vegas, „This is not too different

from the same dynamic that has occurred in Las Vegas over the last several decades.”

Boom or gloom?

There have been no major openings this year, but the lull won't last. Macau, a city of just 29.2 square kilometers (11.3 square miles), is in the midst of an investment boom of at least USD 12 billion in its tourism sector alone. Population has grown nearly 24% over the past five years in what was already the world's most densely populated municipality to 551,900. Visitor arrivals, nearly 27 million last year, are projected to approach 32 million this year, three times the level of 2001, and doubled from 2004. Macau's gross domestic product grew 32% in the first quarter, after rising 33% last year, 24% in 2006, 12% in 2005, and 31% in 2004.

„The growth has been astonishing and most of the local systems have been impacted so quickly that they have not had time to react properly,” Andy Nazarechuk, dean of University of Nevada Las Vegas Singapore – William F Harrah College of Hotel Administration, says. „Transportation, manpower, regulatory, and social issues are rising to the surface and this has caused Macau to stumble. I think that this is only natural and some bumps along the way are to be expected as Macau creates an entirely new tourism infrastructure.”

Mainland officials have watched the boom with a mixture of pride, envy and concern. Mainlanders visitors account for nearly 60% of Macau's total, thanks in part of loosened government travel restrictions. This year, in cooperation with Macau and Hong Kong, Beijing has introduced new restrictions on Macau visitors that may be slowing growth marginally. But each move, or the rumor of one as heard two weeks ago, produces shock waves among gaming shareholders and lenders.

„I think the indications of continued tightening of visa entry restrictions to Macau for [mainland] residents has the

potential to slow revenue growth more effectively than economic conditions," PWC's Green notes. „I don't know whether these restrictions are long or short term, but the breathing space they afford Macau to build its infrastructure may be a blessing.“

Turning tables

When Sands Macao made its breakthrough, there were 15 casinos in town – 13 run by SJM, the Sands, and one operated by Hong Kong-listed Galaxy Entertainment – with 1,092 gaming tables. Now, there are 30 casinos with 4,277 tables (plus 12,956 slot machines, which unlike their leading role in Las Vegas, produce less than 5% of Macau's gaming revenue). In 2003, there were just 424 tables, one-tenth as many as today, but revenue has increased only four-fold. Annual gaming revenue per table is now 26.2 million patacas, compared with 67.1 million patacas in 2003 and 37.3 million patacas in 2004 after the initial big bang.

„Macau is yet to develop its mass market business to the extent many anticipated," Green says. „This puts a question mark over the appeal which resort offerings may have.“

VIP Baccarat persistently accounts for nearly 70% for overall gaming revenue, and gaming revenue accounts for more than 80% of total revenue at the casino resorts. Las Vegas now derives more than half of its revenue from non-gaming activities, but that trend hasn't reached Macau.

„The idea that US casino companies in Macau are more than just about the gambling business has yet to take full effect on the Asian consumer psyche," analyst Galaviz observes. „It will likely take many more years for the consumer market in Asia to fully understand the large amount of new entertainment options being created in Macau such as retail and live shows.“

Sharpened harpoons

Lack of alternative revenue has led to cutthroat competition for VIPs, also known as whales. Both MGM and Crown have gone whaling, adding VIP tables in hopes of reversing losses; Crown virtually eliminated its mass market tables. Aside from the size of the bets, VIP play differs from mass market because players bet with special chips sold at a discount, called a commission. Commissions climbed in recent years from less than 1% to 1.35% and above, amid acrimony among casinos, each blaming others for the rising costs eating into their profits. This month, the six operators and the government agreed to limit commissions to 1.25%, but many suspect the deal won't hold.

Most VIP business comes through junket operators, middlemen who steer players to a particular casino, sometimes into a VIP room run by that junket operator in a revenue-sharing arrangement with the casino. Junket agents also provide credit to VIPs, while casinos often provide credit to the junket operators. Credit is one likely area for sweetening in place of higher commissions.

Jockeying for VIP players has created new opportunities for junket operators. The past year has featured the rise of the junket consolidator, basically mega-agents. Size provides more potential clout to negotiate better deals with casinos. But the biggest challenge in the VIP segment may come from overseas. Singapore is scheduled to open its first casino resort late next year, featuring lower taxes for VIP play to enable greater incentives.

Odds are that the house will keep winning in Macau. „As the current issues are slowly resolved and as the systems evolve to meet the needs of the current operations, there is no doubt in my mind that Macau will flourish in the future,“ “ UNLV's Nazarechuk says.

For now, though, expect Macau's casinos to keep printing patacas at a slower pace.