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Q2 2023 Melco Resorts & Entertainment Ltd Earnings Call

EVENT DATE/TIME: AUGUST 01, 2023 / 12:30PM GMT

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K. Y. Cheung *Goldman Sachs Group, Inc., Research Division - MD*
Praveen Kumar Choudhary *Morgan Stanley, Research Division - MD*
George Choi *Citigroup Inc., Research Division - Director & Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for participating in the Second Quarter 2023 Earnings Conference Call, Melco Resorts & Entertainment Limited. (Operator Instructions) Today's conference is being recorded. I'd now like to turn the call over to Ms. Jeanny Kim, Senior Vice President, Group Treasurer of Melco Resorts & Entertainment Limited.

Jeanny Kim Melco Resorts & Entertainment Limited - Senior VP & Group Treasurer

Thank you, operator, and thank you all for joining us today for our second quarter 2023 earnings call. On the call are Lawrence Ho, Geoff Davis, Evan Winkler and our property presidents in Macau, Manila and Cyprus. Before we get started, please note that today's discussion may contain forward-looking statements made under the safe harbor provision of the federal securities laws. Our actual results could differ from our anticipated results. In addition, we may discuss non-GAAP measures. A definition and reconciliation of each of these measures to the most comparable GAAP financial measures are included in the earnings release. Finally, please note that our supplementary earnings slides are posted on our Investor Relations website. With that, I'll turn it over to Mr. Lawrence Ho.

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Thank you, Jeanny. The strength in our Macau recovery is evident in the 43% increase in GGR in the second quarter of 2023 compared to the first quarter. Mass drop increased month-to-month and turnover in our premium direct VIP segment continued to exceed 2019 levels during the second quarter. Mass drop further expanded into July surpassing 2019 levels, and daily property visitation in July reached its highest point since Macau's reopening. Labor supply issues in Macau have been largely resolved. We have been able to provide our customers with Melco's full suite of services and amenities. We expect to add another 560 hotel rooms to our portfolio with the opening of the W Macau at Studio City in September and are well positioned to support the continuing increase of customers in Macau. The mass segment is also leading the recovery in the Philippines, continuing to outperform 2019 levels in the second quarter of 2023.

In Cyprus, we opened the City of Dreams Mediterranean to the public in July after a successful soft opening in June, and we are excited for its prospects as we ramp up our operations there. With that, I turn the call over to Geoff to go through some of the numbers.

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Thank you, Lawrence. Our group-wide adjusted property EBITDA for the second quarter of 2023 was approximately \$267 million, a 40% increase compared to our results in the first quarter of 2023. Luck-adjusted group-wide property EBITDA for the second quarter of 2023 came in at \$277 million. A favorable win rate had a positive impact on COD Manila by around \$2 million. While in Macau, unfavorable win rates at COD and Studio City had a negative impact of approximately \$12 million.

Macau OpEx increased to around \$2.4 million per day in the second quarter of 2023 from around \$2 million per day in the first quarter. This increase was largely due to the cost of running the residency concert series at Studio City. If we were to exclude this cost, OpEx per day would have been around \$2.1 million per day. As Lawrence mentioned in his remarks, labor supply issues have largely been resolved. During our first quarter results call, we estimated that we would have approximately 2,000 fewer full-time employees compared to 2019, including Studio City Phase 2. This outlook remains unchanged. This is expected to translate into continued cost savings and increased operating leverage as we move forward.

Depreciation and amortization increased in the second quarter of 2023 due to the additional depreciation associated with the opening of Studio City Phase 2 and City of Dreams Mediterranean. Similarly, the increase in interest expense during the quarter was related to lower capitalized interest after we completed the construction of Studio City Phase 2 and COD Mediterranean.

Turning to our cash and liquidity. As of June 30, 2023, we had around \$1.6 billion of consolidated cash on hand. Melco, excluding its operations at Studio City, the Philippines and Cyprus accounted for around \$800 million. Of this, approximately \$125 million was restricted as collateral required for concession-related guarantees issued to the Macau government. Our total debt balance remained stable from the first quarter to the second quarter of 2023 and net debt decreased by approximately \$100 million. We will continue to place priority on deleveraging with the excess cash generated as our operational cash flow expands.

As we normally do, we'll give you some guidance on nonoperating line items for the upcoming third quarter of 2023. Total depreciation and amortization expense is expected to be approximately \$140 million. Corporate expense is expected to come in at approximately \$20 million. Consolidated net interest expense is expected to be approximately \$125 million to \$130 million, this includes finance liability interest of around \$7 million relating to fees payable in relation to the Macau gaming concession and Cyprus gaming license, and finance lease interest of \$5 million to \$10 million relating to City of Dreams Manila. That concludes our prepared remarks. Operator, back to you for the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of George Choi from Citi.

George Choi *Citigroup Inc., Research Division - Director & Analyst*

I have a couple, if I may. Firstly, on your last earnings call, you guys said you expect about 20% of the OpEx you reduced during the COVID years to become permanent, are you still standing by that guidance? And if so, how many percentage points in EBITDA margin improvement would that translate into? And my second question is an accounting one. I see the corporate expense being a little higher than usual. Was there any one-timer in that figure?

Lawrence Ho *Melco Resorts & Entertainment Limited - Founder, Chairman & CEO*

Geoff, do you want to take both of those?

Geoffrey Stuart Davis *Melco Resorts & Entertainment Limited - Executive VP & CFO*

Sure. So I recall that our guidance on the first quarter call was that 20% to 25% of our cost savings during COVID, we believe, will be translated into permanent savings and we are still comfortable with that guidance. That translates into approximately conservatively 200 basis points of margin improvement. I think that covers your first question, George. And then on the second question for corporate, we do anticipate that coming down in the third quarter to approximately \$20 million. The increase in the second quarter was related to some one-off aviation expense as well as a legal cost as well.

Operator

Our next question comes from the line of John DeCree from CBRE Securities.

John G. DeCree *CBRE Securities, LLC, Research Division - Director and Head of North America Equity & High Yield Research*

Can you guys hear me?

Geoffrey Stuart Davis *Melco Resorts & Entertainment Limited - Executive VP & CFO*

Yes, loud and clear.

Lawrence Ho *Melco Resorts & Entertainment Limited - Founder, Chairman & CEO*

Yes, John.

John G. DeCree CBRE Securities, LLC, Research Division - Director and Head of North America Equity & High Yield Research

Great. Great. Sorry about that. Geoff, I wonder if you could maybe talk about the unfavorable hold -- City of Dreams and Studio City. I think if I caught the number correctly in your prepared remarks, \$12 million impact. I haven't had a chance to go through all the financials yet. Was that all VIP? I know in the 1Q, you had quite a headwind and mass market hold as well. So just curious about the trends you're seeing there.

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Yes. Thank you for that question. All of our hold adjustment is strictly on VIP. So we haven't made any adjustment for mass.

John G. DeCree CBRE Securities, LLC, Research Division - Director and Head of North America Equity & High Yield Research

Got it. And then maybe a follow-up on the residency concert series at COD. So there's been a bit of discussion about entertainment customers and attracting more entertainment customers. I'm curious if you could Geoff or Lawrence, give us a little bit of color on how well you think the concert series is doing in terms of driving additional visitation and what that looks like going forward?

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

John, it's Lawrence. Thanks for the question. We're very happy with the residency series that just ended last weekend, maybe David or Kevin can provide more color. But it has been -- it checked all the boxes for us. On one hand, the Macau government wants the operators who have more entertainment, sporting events. And so that was the key one. But more importantly for us, internally and for Studio City in particular, it has raised the awareness of Studio City, and we have seen firsthand how busy the property becomes once we have those events on site. So maybe David and Kevin can add more color.

David Ross Sisk Melco Resorts & Entertainment Limited - COO of Macau Resorts

Sure, Lawrence. So look, in terms of what we've seen with the -- now we've done 34 shows between what we did with Joey, Leon Lai and with Aaron Kwok that just ended this last weekend as Lawrence said. But if you look at the number of covers that we've drawn in all our restaurants, the number of visitation numbers have gone up quite a bit. We've seen a lot of impact with the -- with our hotel rooms and the packages that we've sold we've seen the spending patterns go up considerably now with the customers that are coming in. So it's been a really nice lift for us. And as Lawrence said, I think the level of awareness that's been built now will continue to drive that level of visitation forward as we go into the third and fourth quarters there.

Operator

The next question comes from the line of Praveen Choudhary from Morgan Stanley.

Praveen Kumar Choudhary Morgan Stanley, Research Division - MD

Can you hear me?

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Yes, we can hear you.

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Yes.

Praveen Kumar Choudhary Morgan Stanley, Research Division - MD

Yes. Just a quick question for Geoff. What will be the OpEx when you're W will be open in September? So let's just say fourth quarter OpEx compared to \$2.4 million. That's the first question. The second question is assuming that your mass revenue is already running at higher than 2019 level, and you just mentioned the cost is much lower, can I assume that in July, you're already making more than 2019 level of EBITDA? Or there are some other drivers or issues that we should be aware of? And then the last question for Lawrence is a lot of people are worried that the grind mass side of the business has not picked up as much as the premium mass. And I understand that you are playing in the premium side. But for overall Macau, do you have any thoughts of plateauing at this level versus keep improving every month towards 2019 and higher.

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Geoff, you want to take the first couple of questions, and then I'll deal with the last one?

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Sure. So on OpEx, I can share call it, an outlook for where we think that will settle in for the third quarter. So on a reported basis, I think you'll see that in around the \$2.5 million per day range if we make the same adjustment that we did for second quarter. By excluding the concert series, I would say that number normalizes into around \$2.3 million to \$2.4 million per day.

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

So sorry, let me answer Praveen's question. On the grind mass and the mass-mass question, the transportation infrastructure is still coming online. It hasn't fully recovered. So if you look at the air lift going into Macau right now, is probably at around 50%. And Macau over the last 6 months since the recovery has started, has become very much a weekend market. So going forward, when the infrastructure improves transportation infrastructure improves, we believe that the grind mass will probably fill out more of the weekday business and tour group. So the tour groups are finally starting, but they haven't fully recovered yet. And so far, the recovery has exceeded everybody's expectations, but it's been driven really by premium mass. So once the [grind] mass layer comes in, I think that will give us incremental growth.

Praveen Kumar Choudhary Morgan Stanley, Research Division - MD

I had one more follow-up for you, but also Geoff's question was also there that we were asking about July being masked better cost lower? Are we already at higher than 2019 EBITDA? So maybe Geoff can answer that. But one question for you, Lawrence, is on the non-gaming side. Is it correct that all the six players have submitted their non-gaming proposal, and that has not been approved and we are going back and forth in terms of what exactly government wants. Can you give a little bit more details of what exactly are you working on? And what will be the final outcome?

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Sure. I think on the non-gaming, first of all, the investment proposal -- the original investment proposal was agreed by the Macau government when we did for the licenses last November, December. So that was the first approval. And then I think by May, and David can probably supplement and give more of a detailed account. I think it was approved again by May, but what we're seeing right now is that there's a lot of reporting on all of the operators' part, monthly reporting, quarterly reporting. So I think there's a lot of negotiations and discussions on -- you do this, you do that? I guess, maybe, David, you can provide a bit more color.

David Ross Sisk Melco Resorts & Entertainment Limited - COO of Macau Resorts

Sure. So Praveen, there's -- obviously, there's two types of things that we're doing related to the tender that was approved for our initial plan. There's certain capital costs that were done for the casino that we're obviously executing on. And again, it's pretty well documented in terms of what we would normally do as we upgrade the casino or replace certain items or things that were going along. The other one is kind of a collection of non-gaming kind of things. With non-gaming things can be in terms of capital or they can be in terms of events, concerts, sporting events, things that we're sponsoring. So everything we've said we're going to do with the government, we've done and what we're executing on. As Lawrence said, there's a very significant measure that goes along in terms of whether it be a quarterly measurement with the DICJ or MGTO or RTIM or something that we do on a monthly basis. But they're monitoring it quite closely, trying to make sure everyone is doing what they're saying. But additionally, as we're going along, there are sometimes where certain things may not make sense that we said we were going to do back in 2022. So we work with the government to go back and make adjustments and slide other things into programs or things that help kind of support some of the things the government is trying to do as we try to attract a lot more international visitation or try to build the MICE business in Macau.

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

But Praveen, I think the most important thing for us as an operator is we're going to stick to the number, based on the investment proposal that we put in when we got our license last December. So we might make changes in terms of events or things that we're going to put in, but we're going to stick to that number.

Praveen Kumar Choudhary Morgan Stanley, Research Division - MD

That's very clear, David. Can I still get the answer on the EBITDA in July, considering mass and costs, please, from Geoff?

Geoffrey Stuart Davis Melco Resorts & Entertainment Limited - Executive VP & CFO

Yes, circling back around to me, Praveen. So I don't want to get ahead of ourselves in respect to the third quarter results. I'm confident that we have taken share from the second quarter into July but we are not quite at the levels of GGR to get us back to 2019 levels of EBITDA.

Praveen Kumar Choudhary Morgan Stanley, Research Division - MD

Very helpful. And congratulations. This is a good result.

Operator

(Operator Instructions) Our next question comes from the line of Simon Cheung from Goldman Sachs.

K. Y. Cheung Goldman Sachs Group, Inc., Research Division - MD

In relation to what you mentioned about (inaudible) success of hosting all these residency shows. I wanted to see whether you can help us to perhaps quantify some of the numbers, perhaps on the visitation number or even any retail sales number you can actually share with us? That would be helpful. That's on the first question. And also in relation to that, obviously, you have done quite well and done quite a lot on Studio City. How you are seeing the -- maybe the potential opportunity to maybe further driving visitation and market share at COD. We've been hearing a lot more competitions or people are giving out a lot of reinvestments in, for example, the [sport parlors] and the other properties. So wondering whether you can also comment about the competition among the premium mass segment as well.

Lawrence Ho Melco Resorts & Entertainment Limited - Founder, Chairman & CEO

Simon. So maybe I'll talk about the competition on premium mass and then hand it over to David to supplement. We're -- obviously, first quarter, we started out slow, but I think we've gained some meaningful share in the second quarter. And so far, beginning in the third quarter in July, we've had the best months -- just like the entire Macau, we've had the best months since the reopening. But I think on mass drop and on premium direct growth, we are at over 100% of Q2 2019 level. So we're quite happy with that. In the market, they are all competitors, especially some newer ones who are probably more aggressive in terms of the reinvestment and the referral fees that they pay. But at the same time, we are very comfortable with the product that we have and our sales team and the structure that we built. But I guess, maybe David can talk more about that.

David Ross Sisk Melco Resorts & Entertainment Limited - COO of Macau Resorts

Sure. Thanks, Lawrence. So I think if you kind of look at what's happened with the residency concert series, one thing we've seen is a really nice pickup, obviously, on the visitation to the property, particularly Studio City. That visitation, as I said before, has driven certainly a huge number of covers for us on both on that as we go through on that weekend, but even up to the time leading up to that period on the -- let's call it the shoulder period for the concert series. So on that we get that Thursday, Friday, we start seeing a large pickup on that. The occupancies we're seeing right now are running probably at Studio City in the high 90s to sometimes where we're completely sold out. This is also happening during a lot of the weekdays as that level of awareness has been built. Further, we were starting to see more traffic in our retail areas. I don't have the specifics on that in terms of how much our retail sales have gone up but we are seeing more traffic, more customers going in and spending. We're seeing a lot more traffic in a lot of our, let's say, our food and beverage outlets that are, let's say, our third-party outlets to hold those restaurants. They've seen a huge increase in the number of covers and they're quite happy. I think one of the nice things that we've seen now as well is it's really kind of ignited our water park as well. The water park during the month of July was running at over 1,900 people a day. So again, we've seen a really nice lift in overall in terms of the visitation, the level of spend over at Studio City. So it's doing some good things for us.

Additionally, we've also seen as we've kind of gone from month to month here since we've opened up Epic back in April. We've also seen a nice increase in the players that are coming in as well as we started seeing a recapture of some of the market share to where we're now over 4% of market share with Studio City. So again, just a nice level of increase. We think that will continue to build as we get into the second -- or excuse me, as we get into the third and fourth quarters.

Operator

I am showing no further questions. I would now like to turn the conference back to Jeanny for closing remarks.

Jeanny Kim *Melco Resorts & Entertainment Limited - Senior VP & Group Treasurer*

Thank you, and thank you all for participating in our conference call today. We look forward to speaking with you again next quarter.

Thank you.

Operator

Thank you. That does concludes today's conference call. Thank you for participating. You may now disconnect.

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