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MPEL - Q4 2016 Melco Crown Entertainment Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the fourth-quarter 2016 Melco Crown Entertainment Limited earnings conference call.

(Operator Instructions).

I must advise you that this call is being recorded today February 16, 2017. I would now like to hand the conference over to your first speaker today, Mr. Ross Dunwoody.

Thank you and please go ahead.

Ross Dunwoody - *Melco Crown Entertainment Limited - VP IR*

Thank you for joining us today for our fourth-quarter 2016 earnings call. On the call today are Lawrence Ho, Geoff Davis, and our property presidents in Macau and Manila.

Before we get started, please note that today's discussions may contain forward-looking statements made under the safe harbor provisions of the Federal Securities Laws. Our actual results could differ from our anticipated results.

I will now turn the call over to Lawrence.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Thanks, Ross. Hello, everyone.



In the fourth quarter of 2016, our Group-wide property EBITDA increased by approximately 29% year over year, driven by record mass table games revenue in Macau and an increasingly impressive contribution from City of Dreams Manila.

Our strong performance during the quarter comes at a time of significant and exciting change for MCE. We have undertaken a range of management changes that creates a more streamlined and efficient organizational structure, and I have taken greater control of the Company's day-to-day operations. These changes will allow us to be more dynamic and responsive to the rapidly changing needs of the Macau and Manila markets.

I'm confident that the current management team can drive further growth and profitability, realizing the full potential of the world-class properties that we own and operate.

In December 2016, Melco International, one of MCE's founding shareholders and a company of which I am Chairman and CEO, announced the acquisition of a 13.4% interest from Crown Resorts. Following the completion of this transaction earlier today, I'm pleased to say that Melco is now the company's majority shareholder, owning over 51% of MCE.

This significant increase in ownership highlights the strong confidence and commitment I have in this company, including its impressive portfolio of world-class properties in the most exciting markets in the world. As well as confidence in the employees and management team to deliver a unique and multi-faceted gaming and non-gaming experience to our customers.

We also recently celebrated MCE's 10th anniversary on NASDAQ. This is a tremendous achievement for our Company, which has grown from a handful of employees just over 10 years ago to one of the largest global gaming companies, with almost 20,000 employees in some of the best integrated resorts in the world.

Last month, we announced an update to our dividend policy to ensure that we deliver a larger and more stable quarterly dividend payout, and also announced a \$650 million special dividend, which highlights our Company's strong cash position and cash flow generating ability which has enabled us to return surplus capital to shareholders while still investing in our business.

Returning to our recent quarterly results, our Macau property EBITDA increased by 15% year over year to \$254 million, while margins expanded over 150 basis points compared to the prior-year quarter. Our flagship property in Macau, City of Dreams, delivered strong improvements in gaming volumes compared to the prior quarter, resulting in a sequential increase in EBITDA of over 10%.

Our ability to grow both our top and bottom line at City of Dreams in a market that is absorbing new supply is a testament to the property's market-leading position in the premium segments of the market.

We also recently unveiled the Morpheus hotel brand, the latest addition to City of Dreams, which offers a truly unique and groundbreaking hotel concept that will ensure the property remains at the pinnacle of innovative luxury. Morpheus's contemporary design and architecture highlights MCE's ongoing commitment to our customers to deliver a sophisticated, never-seen-before experience, while also delivering on our significant commitment and contribution to Macau by creating another must-see landmark.

At Studio City, we're pleased with the performance of our newly-opened VIP operations which provides a strong complement to the property's expanding mass gaming business. We anticipate a further ramp in the property's VIP operations in the coming quarters.

While the addition of rolling chip operations at Studio City broadens the integrated resort's appeal, the key driver of success will remain the mass market, leveraging the property's entertainment attractions and other best-in-class non-gaming amenities to deliver an exciting experience to a broad spectrum of customers.

In Manila, City of Dreams continued to deliver improved volumes across all gaming segments with our efforts to maximize table yields, optimize reinvestment and manage operating expenses, resulting in an increased share of the VIP and mass gaming markets while remaining disciplined on cost, which in turn has delivered another record quarter.



Our decision to invest in the Philippines, which continues to be the fastest-growing gaming market in the world, is testament to our Company's commitment to identify and commit to new markets or development opportunities that meet our stringent investment criteria, and allows us to expand our gaming and non-gaming network around the region.

With that, I turn the call over to Geoff to go through some of the numbers.

Geoff Davis - *Melco Crown Entertainment Limited - CFO*

Thanks, Lawrence.

We reported Group-wide property EBITDA of approximately \$304 million in the fourth quarter of 2016, expanding by 5% from the prior quarter, and up almost 29% from the fourth quarter of 2015.

Luck-adjusted Macau property EBITDA increased almost 10% sequentially, and by approximately 22% on a year-over-year basis to approximately \$275 million in the fourth quarter of 2016. The luck-adjusted property EBITDA margin in Macau was approximately 25%, up from approximately 24% in both the third quarter of 2016 and the fourth quarter of 2015.

In Macau, we were negatively impacted by a low VIP win rate at City of Dreams by approximately \$15 million; and at Studio City, we were negatively impacted by approximately \$8 million. If we had held at the theoretical VIP win rate of 2.85%, City of Dreams would have generated EBITDA of approximately \$205 million, while Studio City would have delivered a record EBITDA of approximately \$65 million during the quarter.

The EBITDA contribution from our non-VIP segments continues to represent approximately 95% of luck-adjusted EBITDA at City of Dreams Macau, and on a Macau-wide basis.

City of Dreams Manila delivered total property EBITDA of \$50 million, representing an increase of 12% sequentially and 224% year over year. The property's EBITDA margin expanded to almost 35% in the fourth quarter of 2016, compared to 34% in the prior quarter and 19% in the same period last year.

On a luck-adjusted basis, Manila's property EBITDA would have been approximately \$45 million, representing an approximately 25% sequential increase, with luck-adjusted EBITDA margins expanding by approximately 260 basis points sequentially.

As mentioned by Lawrence, following a review of our capital structure and dividend policy, the Board has authorized an increase in the normal quarterly dividend payment to \$0.09 per ADS, beginning from the fourth quarter of 2016, delivering to shareholders a larger, more stable and predictable quarterly return of capital. In addition, we declared a \$650 million special dividend in January of this year.

The special dividend and revised dividend policy reflects our commitment to returning surplus capital while retaining significant flexibility to pursue future growth opportunities, which we believe will deliver long-term value to all shareholders.

We will continue to review our ordinary dividend policy with a view to increasing this regular payout over time, taking into account our levels of cash, future cash flows and development opportunities.

In December of last year, we effectively replaced Studio City's existing bank facilities with a \$350 million three-year and \$850 million five-year senior notes offering, resulting in a capital structure which is more aligned to Studio City's anticipated ramp and cash flows. This new capital structure carries no testing of maintenance covenants and has no amortization.

As we normally do, we'll give you some guidance on non-operating line items for the upcoming quarter.

Total depreciation and amortization expense is expected to be approximately \$135 million to \$140 million, including approximately \$47 million at Studio City. Corporate expense is expected to come in at approximately \$31 million to \$33 million, and consolidated net interest expense is

expected to be approximately \$68 million, which includes finance lease interest of \$10 million relating to City of Dreams Manila, net of approximately \$9 million of total capitalized interest.

For those that follow City of Dreams Manila more closely, our building lease payment for the fourth quarter of 2016 was approximately \$8 million.

That concludes our prepared remarks. Operator, back to you for the Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Karen Tang, Deutsche Bank.

Karen Tang - *Deutsche Bank Research - Analyst*

I have two questions. The first question is probably for David Sisk, as he's on the call.

Welcome to the Melco Crown conference call. I understand that David has a very long history of managing bigger properties in Macau so I understand that this is still early stage for you to be at Studio City, but after a few months, what are -- if there are things that you would like to change, roughly what would those things be? Is it more on the segmentation, or is it on the corporate cost side, more centralization?

My second question is with regards to the upcoming legislature on smoking ban, particularly with regards to City of Dreams. How is the Company looking to make changes to -- after the potential smoking ban?

Thank you.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

David, why don't you answer the first one and I'll take the second one?

David Sisk - *Melco Crown Entertainment Limited - Property President, Studio City*

Great. Hello, Karen. It's David.

I think one of the things I've noticed is, it's really more about getting the team focused. When I was at Sands we did the same thing, but it became more about listening to the team, trying to identify some of the good ideas, whether it was from a cost containment standpoint or revenue enhancement. But it was really more about communication and listening, and putting those things into place, into practice.

And I think we've seen some good results to that in the first few months that we've been doing that. And I think as you go forward here and you look out towards 2017 and beyond, I think you'll see those results even get better.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

And Karen, it's Lawrence here.



Naturally, City of Dreams in Macau isn't the only property where smoking takes place in some of the ground-floor gaming facilities, but I think our competitive edge over the years, and maybe I'll let Gabe elaborate a bit more later on, is that we have the market-leading property in terms of premium mass. And during the year, we've also upgraded our entire retail complex, and next year, we're opening Morpheus as well.

So our goal is to maintain our leading position, and at the same time, we're very happy with the sales team that we have involved. And so ultimately, the market, especially on the high end of the premium mass market, is really about the product and service, and with our market-leading Michelin stars and market-leading Forbes Five-Stars, we're very confident that we can maintain that edge.

I don't know. Anything to add, Gabe?

Gabe Hunterton - *Melco Crown Entertainment Limited - Property President, City of Dreams, Macau*

No. I agree. I think we have a great deal of additional assets at our disposal and coming on line soon, and I absolutely agree that we can maintain that edge.

Unidentified Company Representative

Lovely. That's [our key]. Thank you. And, Gabe, welcome back to Macau.

Gabe Hunterton - *Melco Crown Entertainment Limited - Property President, City of Dreams, Macau*

Thank you, [Karen].

Operator

Kenneth Fong, Credit Suisse.

Kenneth Fong - *Credit Suisse - Analyst*

Congratulations on the very solid results. I have two questions.

First is how to think about in terms of the degree and the pace of ramp-up going forward for Studio City. If we were to put in a percentage, are we 60%/70% done? Or how do we think about in terms of the mass potential going forward for Studio City?

And the second thing is we recently see VIP and also premium mass gradually picking up. What is your outlook over the next few quarters? I know the visibility is quite low, especially for the VIP, but in terms of the player mix spend that you see over the past few months, the drive to recovery, how do you project and think about it in terms of growth rate going into the next two quarters?

Thank you.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Kenneth, it's Lawrence here. So I think rather than answering the question in order, why don't I begin by saying I think everybody knows that for the last six months Macau has had growth, which is very exciting for all of us, but at the same time we've recently had Chinese New Year.



And I would classify Chinese New Year as it was as expected. It wasn't blow-out phenomenal. At the same time, I think Macau has become a much more mature market compared to previously, so you'll see less peaks and certainly less troughs.

And so I think all in all, the market is recovering. We are seeing a broad recovery and we're excited for that. I think some of the key metrics in looking at the fact that in the last six months we've had a significant increase in hotel supply but yet occupancy continues to increase.

So I think these are all very bullish signals going forward, but it's still early. It's only February so we're certainly not going to be revising our forecast. So I think we stick to our thinking, which is for the full year, Macau would be from our standpoint a mid to high single-digit growth rate, which is extremely positive.

In terms of Studio City, maybe I'll hand it off to David to give more highlights in terms of the ramp. But again, Studio City, when we first opened, we were hampered by access, and access in our business is probably the most important factor.

We were blocked on one side by [Parisian], and we're still blocked on other side by the Lotus, the construction of the light-rail station from the Macau Government which blocks the access from the Lotus Bridge to Studio City.

Once that access, and the government is indicatively telling us that hopefully by the end of the year that the light rail station will be completed, and so once that access point is improved, I think there's significant visitation that will come about.

In terms of more details, I hand it to David.

David Sisk - *Melco Crown Entertainment Limited - Property President, Studio City*

Yes. I think, Kenneth, I think one of the key things is, one, we're being fed by two locations really on property; from the back of the property which really is that bus entry, and from the north-east corner which is on the Parisian side. We're missing a big piece in terms of from the Lotus Bridge that Lawrence just talked about. We're really hopeful that the government's going to get that open for us by the end of the year. If not, hopefully some time in the first quarter of 2018.

In terms of the ramp, I think we've still got a ways to go. Part of our ramp process has also been not only bringing players in, but also trying to get more out of those players; increasing playing time, increasing the amount of money that they bet; increasing the level of frequency that we have with these players. So it's really trying to optimize our database more and working within our own team to try to continue to build these players within our Group here.

What we've also tried to look to do too is to take advantage of the traffic that we do have and refocus the casino, improving sight lines, moving tables and identifying locations where we can create some more compression for the players.

Kenneth Fong - *Credit Suisse - Analyst*

Got it. Thank you very much and congrats again.

Operator

Billy Ng, Bank of America Merrill Lynch.

Billy Ng - *BofA Merrill Lynch - Analyst*

First of all, I just want to congratulate also on the very solid results.



I just have one question. I think there's some recent concern about the market trend, namely thinking that the growth is driven more by VIP rather than mass, but can you tell us what you've seen, in particular so far in Chinese New Year, in terms of growth rates between mass and VIP? How much difference are we seeing? Is that really VIP dominant and mass has slowed down, or the growth is not really that significant difference?

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Okay, Billy. It's Lawrence. Let me try and take a crack at that.

I think VIP has surprised in terms of its recovery, but at the same time, ultimately, the future of Macau is going to be pinned on the growth of the mass market. And from our property standpoint, I think both City of Dreams and Studio City have continued to grow mass very nicely.

Yes, in terms of looking at the VIP business, and Studio City has had a very nice ramp up in terms of the VIP business, as has the VIP business at City of Dreams has also picked up, but ultimately, our focus is still going to be on mass going forward.

Billy Ng - *BofA Merrill Lynch - Analyst*

Thanks.

Operator

Jon Oh, CLSA.

Jon Oh - *CLSA - Analyst*

I apologize if there's a little bit of noise from my phone because I'm taking my call from the outside, but I wanted to ask two questions, if I may, first of all, Lawrence, to follow up on the point on some of this recent recovery in VIP that we've seen.

What would you say in your mind are some of the catalysts that's driving this surprise, especially since it only occurred, let's say, since three to four months ago? What's actually really happened within China or within the broader macro in that region which caused this surprise in VIP?

If I can follow up with the second question on your cost structure. Are you guys comfortable with your cost structure across both COD and also Studio City, as in do you see any meaningful room for you to be more judicious with your daily OpEx rate? And if you could also remind us on where you stand right now on your daily OpEx for both MSC and also COD.

Thank you.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Hey, Jon. Why don't I take the first part of your question and then Geoff can handle the cost side?

I think on the main -- for Macau's recovery and the main recovery in VIP, and to a lesser extent premium mass, it's really over the last few months, maybe even the last year, the anti-corruption, anti-extravagant crackdown in China has subsided, and so our customers and the people who really did nothing wrong over these years are -- they don't have a fear of coming to Macau. So we are seeing that and I think that is by far and away the main reason for the recovery.

And at the same time, I think that Macau has gone through significant consolidation in the junket sector, and so the remaining junket operators now all have much better financial base to build upon. And having the confidence of a genuine return of demand from players, we see that the junket operators are also a bit more -- becoming more aggressive in terms of liquidity.

So I think all in all, it's a good story for Macau, both on the mass and VIP side, because the fear from avoiding the aspirational lifestyle in China, we were seeing kind of an end to that.

Geoff Davis - *Melco Crown Entertainment Limited - CFO*

So this is Geoff on the OpEx question. Our daily OpEx sequentially from 3Q to 4Q was roughly flat. That being said, we do see meaningful opportunities for cost reduction. In the same way, we were able to reduce the cost base and overhead earlier in 2016, we see similar opportunities this year in 2017 that will happen over the course of this year, but we do see improvements in efficiency and reduction in overhead.

Jon Oh - *CLSA - Analyst*

Okay. Thank you.

Operator

Jit Ming Tan, Barclays.

Jit Ming Tan - *Barclays Capital - Analyst*

Two questions from me. Firstly, curious to hear your thoughts on the VIP rollout at Studio City. How has that turned out and is there scope to add more tables?

So that's the first question.

The second question is with regards to the Studio City bonds. Obviously, the bond [issuance] since last year has [gone] up very well. Curious to hear what your thoughts on the 2020 bond refinancing.

Thank you.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Maybe I'll take the first question and then --

So on Studio City, I think Studio City's rolling chip operations have outperformed our expectations, particularly on a table yield basis. So given the strength of the rolling chip performance at the property, I think we're open to the possibility of adding more VIP tables to the property.

Geoff Davis - *Melco Crown Entertainment Limited - CFO*

This is Geoff. On the 2020 bonds, as you know, we did a refinancing earlier or late last year. Very successful. That, we think, put Studio City on a much better footing with a good foundation for growth going forward. We're always looking to be opportunistic when it comes to our capital position, but no plans at the moment for any activity on the 2020s.



Jit Ming Tan - *Barclays Capital - Analyst*

Thank you very much.

Operator

Grant Govertsen, Union Gaming.

Grant Govertsen - *Union Gaming Research - Analyst*

Granted that you are generally more of a premium focus across your entire portfolio, could you give a little color on just what you're seeing in terms of relative growth rates between premium mass and what you would consider a lower tier, non-premium mass?

And then a second question I have is just on follow-up on VIP at Studio City. The economics there, are those broadly in line with what you're paying at Altira and COD, or are incentives a little bit higher there?

Thank you.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Geoff, you want to take the Studio City VIP question?

Geoff Davis - *Melco Crown Entertainment Limited - CFO*

Sure. So the economics at Studio City at a property level, as reported, are similar to what we see across the Group. Of course, we have a mechanism in place for the gaming concessionaire to operate all the tables, mass and VIP at Studio City, and certain costs are associated with that operation.

The costs associated with VIP are higher than mass, and that needs to be taken into consideration for Studio City. But outside of that, the economics would be similar to what you see at our other properties.

Lawrence Ho - *Melco Crown Entertainment Limited - Chairman & CEO*

Grant, on the first question, I think the entire market is trending in the right direction. So whether -- and, of course, as I alluded to earlier on, the market is much more mature now. The mass contribution with regards to the market is over 50%. And so if you break down premium mass and general mass, and not all operators break it out, but based on our experience and what we're seeing, both are growing at a similar growth rate.

Grant Govertsen - *Union Gaming Research - Analyst*

Understood. Thank you.

Operator

There are no further questions at this time. I would now like to hand the conference back to the base presenter. Please continue.

Geoff Davis - *Melco Crown Entertainment Limited - CFO*

Thank you, operator. And thank you, everyone, for joining. We'll be back to you in three months.

Operator

Thank you. Ladies and gentlemen, that does conclude your conference for today. Thank you for participating and you may all disconnect.

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