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MLCO - Q1 2018 Melco Resorts & Entertainment Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for participating in the First Quarter 2018 Earnings Conference Call of Melco Resorts & Entertainment Limited. (Operator Instructions) Today's conference call is being recorded.

I would now like to turn the call over to Mr. Richard Huang, Director of Investor Relations, Melco Resorts & Entertainment Limited. Over to you, sir.

Richard Huang - *Melco Resorts & Entertainment Limited - Director, Investor Relations*

Thank you for joining us today for our first quarter 2018 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 discussion may contain forward-looking statements made under the safe harbor provision of Federal Securities Laws. Our actual results could differ from our anticipated results.

I'll now turn the call over to Lawrence.

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Thank you, Richard, and hello, everyone. After several challenging quarters, we've started seeing encouraging trends at our flagship property, City of Dreams, which delivered over 8% sequential mass gaming revenue growth, driving group-wide property EBITDA to an all-time high of USD \$402 million. We anticipate these positive trends to accelerate in the second half of the year, driven by the improving demand environment, completion of the Hong Kong--Zhuhai--Macau Bridge and most importantly, the opening of Morpheus. We could not be more excited about our new opening, which will put an end to the first part of construction disruption at COD, especially on our main gaming floor. It will also give COD the most spectacular offering Macau has ever seen to attract premium customers.

Melco has always aspired to be a leader in everything innovative and luxury. Our leadership position in the premium market was recognized by the 2018 Michelin and Forbes Travel Guide, which rated us as the operator with the most Forbes Star awards and the most Michelin-starred restaurants in Asia.



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The opening of Morpheus will allow City of Dreams to expand its dining and entertainment offerings, which should help widen its lead over the competition.

The 70% increase in luxury hotel rooms from the opening of Morpheus will also enable City of Dreams to more aggressively acquire and retain gaming -- premium gaming patrons, which is key to driving future mass gaming revenue growth.

In addition to expanding our footprint, it is critical to continue to inject freshness into our resorts. That includes redeveloping the Countdown into a luxury hotel concept that better fits the overall positioning of COD.

Additionally, and separate from the refurbishment of the Countdown, we have identified over USD 100 million of targeted enhancement CapEx in the next 12 months to upgrade the gaming areas and the nongaming attractions at both COD and Studio City, which is aimed at maintaining the longer-term competitiveness of these 2 resorts.

Looking further out, we have received Macau government approval to extend the development deadline of Studio City Phase 2 to July 2021, enabling us to continue to develop our detailed designs for the Phase 2 expansion, which offers a significant point of differentiation from our Macau competition.

Moving onto the Philippines, COD Manila continues to enjoy robust year-over-year growth across all gaming segments. The 44% year-over-year increase in mass table GGR was particularly encouraging, highlighting the strong growth potential in the Philippines gaming market and our commitment to drive high-quality earnings.

Finally, in Japan, we believe the Japanese government is diligently making progress towards the passage of the IR Implementation Bill, which suggests that the license bidding process could start in 2019 or 2020.

Our Japan team has been actively engaging potential stakeholders. We believe our focus on the Asian premium segment, high-quality assets, craftsmanship, dedication to robust entertainment offering, market-leading social safeguard system and commitment to being an ideal partner will put Melco in a strong position to help Macau -- Japan to realize the vision of developing world-leading IRs with unique Japanese touch.

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

Geoffrey Davis - Melco Resorts & Entertainment Limited - CFO, Executive VP & Treasurer

Thank you, Lawrence. I would like to start by reminding you all today similar to our peers, new accounting standards in relation to revenue recognition have been implemented starting with the first quarter of 2018, which will result in lower net revenues and higher EBITDA margins.

At a high level, the two primary changes are: the elimination of promotional allowances, which will now offset reported casino revenue; and 100% of junket commissions will also offset casino revenue.

We're happy to discuss the details of this accounting standard change offline after the call.

In our earnings release, the first quarter 2018 figures are presented under the new revenue recognition rules, while the historical first quarter 2017 figures are presented under the prior rules i.e. no restatement for the 2017 numbers.

Moving on to the highlights of our first quarter results, we reported record group-wide property EBITDA of approximately \$402 million in the first quarter of 2018, increasing by 14% from the first quarter of 2017, while luck-adjusted property EBITDA increased by 17% on a year-over-year basis to approximately \$403 million. In other words, there was no material impact from luck in the first quarter of 2018 on a consolidated basis. At the property level, an unfavorable VIP win rate negatively affected EBITDA at COD Manila by approximately USD 6 million, at Altira, EBITDA was positively affected by a favorable VIP win rate by approximately USD 4 million.



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In the first quarter, the luck-adjusted property EBITDA margin in Macau was approximately 30%, up from 29% in the prior quarter and up from 27% in the first quarter of 2017.

I would like to clarify that these are apples-to-apples comparisons as the aforementioned margins are all calculated based on the new accounting standards, including those for the prior periods.

Despite the recent resurgence in VIP, the EBITDA contribution from our non-VIP segments still represents more than 85% of luck-adjusted EBITDA on a Macau-wide basis, highlighting the mass gaming and non-gaming segments' importance in driving group-wide EBITDA and EBITDA margins.

In the Philippines, COD Manila delivered luck-adjusted EBITDA of approximately \$64 million, representing an increase of 18% year-over-year.

The luck-adjusted EBITDA margin expanded by approximately 300 basis points quarter-over-quarter, and increased by approximately 210 basis points year-over-year to 44%. Again, these are all apples-to-apples comparisons reflecting the new accounting standards.

You may have noticed a rather steep sequential reduction on our corporate expense line from 4Q '17 to 1Q '18. Our bonus payments to executive management are discretionary and are designed to reflect overall company performance and align senior management with shareholders. Therefore, to reflect our relative underperformance in Macau in 2017, we have reversed our bonus accrual from the fourth quarter of 2017 by approximately \$6 million. This reversal was taken in the first quarter of 2018 and reduced our first quarter corporate expense by the same amount.

Moving on to capital management. The board has recently approved a new \$500 million share repurchase program, which is consistent with our strategy of returning excess capital back to shareholders.

To provide more clarity regarding our capital structure within our core or wholly-owned group, we had cash of approximately \$650 million and gross debt of approximately \$1.4 billion at the end of the first quarter of 2018, excluding Studio City and the Philippines.

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 \$45 million at Studio City. Corporate expense is expected to come in at approximately \$30 million to \$31 million, and consolidated net interest expense is expected to be approximately \$60 million, which includes finance lease interest of \$10 million relating to City of Dreams Manila and \$12 million of capitalized interest.

For those who follow City of Dreams Manila more closely, our building lease payment for the first quarter of 2018 was approximately \$9 million.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from the line of Joe Greff from JPMorgan.

Joseph Richard Greff - JP Morgan Chase & Co, Research Division - MD

I was hoping you could just dig a little bit deeper on some of the changes that you've made at City of Dreams, Macau and obviously, the mass performance that we saw in 1Q is encouraging relative to the last couple of quarters. Can you talk specifically what changes maybe you're making on the player development incentive side? And then, I'm presuming month 3 in Q1 was better than month 2, and month 2 was better than Q1. So your performance may be even understated in that like coming out of the quarter where the share is presently. And then maybe you can talk a

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little bit about that. And then, I'm presuming -- I look forward to comments in terms of the sustainability of some of these trend changes and encouraging results so far in April of at City of Dreams.

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Joe, it's Lawrence here. Let me hand the ball over to David to go through the details. But I think from my perspective, David has done a good job in rallying the team together on the common goal of getting better, but why don't let David talk about some of the changes that he is seeing.

David Sisk - *Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau*

Sure. Joe, it's a variety of things. It's never just one thing that you do. But first off, we've got great people, we've got a great marketing team, we've got a great operations team. I think when we brought the -- we talked about this on the last call a bit, when we brought the new leadership team in, which was really a part of the old leadership team, I've got sales people that are happy, that are engaged, that are very focused now, while we still maintain a high level of accountability. We've also seen an increase in terms of the players that we used to have. They've come back. They've increased the levels of plays. We've put in new marketing programs that are more tailored and individualized to these players. And then lastly, we constantly are going through and looking on how we can optimize our gaming floor. And it's a focus for us every day that we're out there looking how we can improve our performance. But the team is very, very focused, the team is very engaged. And we share a lot of data now. So people understand what we need to do and where we need to go.

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Joe, it's Lawrence. But I think, at the same time though, I think you can't underestimate the construction disruption that we're experiencing at City of Dreams. Before Morpheus opens up, there is significant work being done on the main gaming floor to make the whole property flow. So I think, this quarter and what we've seen, it is -- it's not easy. I think if people are coming to Macau over the next 2 weeks for G2E, you will see that right before Morpheus opens up, it's getting more difficult to get around in the property. But at the same time, David and the team have done an excellent job in terms of keeping people in house and redirecting them to various parts of our property.

Joseph Richard Greff - *JP Morgan Chase & Co, Research Division - MD*

Great. And do you have a hard date yet that you're circling for the Morpheus Tower opening?

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

We're -- I think we plan on announcing that in the next couple of weeks, but it's certainly going to be in the first half, and I think, a lot of it -- we're currently going through government licensing. So of course, everything is going to be dependent on that. So we'll be giving out a date fairly soon.

Joseph Richard Greff - *JP Morgan Chase & Co, Research Division - MD*

Great. And then my last question is, with respect to Phase 2 at Studio City, can you give us some sense of cost or CapEx ranges and the timing there? And then \$100 million of CapEx that you talked about for the COD and Studio City that's outside of Phase 2. Help us there, we're good to go.

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Yes. I think the \$100 million of CapEx that's outside of Phase II, as we talked about, we have done a lot of work to improve the overall COD experience. And at the same time, I think ever since Geoff Andres has joined us, we have also continued to identify areas to improve and optimize underutilized



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areas at Studio City. So that \$100 million is really for that. In terms of Phase 2, it's a bit too early to say because we are still discussing with our minority investor on that project to build consensus in terms of -- we think what we have come up with and the concept is extremely strong and excited about it. But I think, we just need to work through the details with our minority investors.

Operator

The next question comes from the line of Billy Ng from Bank of America Merrill Lynch.

Hay Ling Ng - BofA Merrill Lynch, Research Division - Research Analyst

I have 2 questions. The first question is related to Japan. And Lawrence, would you mind to elaborate a little bit more your strategy in Japan? Given that, the government already submitted the bill to the diet and it's become a bit more clear that they are focusing on free locations, maybe if you can talk about your preference or overall strategy there? And then the second question, just some housecleaning question. Just wondering, during the quarter, if there is any one-off items or any bad debt reverse flows or any bad debt -- significant bad debt write-down? Anything that we should pay attention to.

Lawrence Ho - Melco Resorts & Entertainment Limited - Chairman and CEO

Billy, so I'll take the first question, I think on the second question, Geoff can give you the details. We've been very focused on Japan for many, many years. And outside of Macau, it is the greatest opportunity in our lifetime. And I think for us, we have been very focused on the major cities. And I think the exact locations haven't been decided, but I think the direction is that potentially 2 major cities and 1 regional city. I think, frankly, the opportunity is so great that we're going to go for all of them. But of course, the preference is to be in the major cities, because ultimately, Melco is about building something premium, luxury and the major cities have more access to much larger number of potential tourists to cater for the offerings that we're going to build. But I think at this stage, it's still early days because the bill is going to be submitted to the Diet, hopefully it gets passed in this Diet session or within the year. And as I said in the prepared remarks, hopefully, bidding will start sometime in 2019 and 2020. So I think over the next 2 years, a lot more information, a lot more details will be unveiled. And I think on the second question, Geoff, please?

Geoffrey Davis - Melco Resorts & Entertainment Limited - CFO, Executive VP & Treasurer

Yes. So Billy, we already talked about one of them. That's the reversal of the bonus accrual that benefited first quarter corporate expense by roughly USD 6 million. And then on your question on the bad debt reversal or on bad debt, we had a reversal in the first quarter of \$3 million, and that compares to about a \$10 million reversal in the fourth quarter of last year. So we had quite a bit of headwind in that respect.

Operator

The next question comes from the line of Karen Tang from Deutsche Bank.

Karen Tang - Deutsche Bank AG, Research Division - Head of Asian Gaming and Hotels Research

It's Karen here. My question is with regards to Morpheus. Maybe, Lawrence, you can give us a taste of what it would like? Previously, you've mentioned that it will be like a relaunch of Studio City Phase 2. So maybe you can give us a little sense of how it would be like with the view on hotel tower and potential gaming?



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Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Sure, Karen, and maybe I'll get my thoughts and then David can fill in on the details. But we've been working on Morpheus for quite some time and what we wanted to do is create an architecturally iconic building. We've always been very focused on awards and Forbes and Michelin. And we really wanted Morpheus to take that through a whole new level, and at the same time, help us relaunch COD. So that it is -- it will feel new and fresh and it is the most stylish property in town. So -- but in terms of the details, I think, ultimately, we're waiting for the Macau government to see if we would get any tables. But even we don't get any tables, we feel that the offering is so strong that it will help the overall business environment for us. I think on that maybe I'll hand it off to David.

David Sisk - *Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau*

Sure. So I think one of the big things about this is the team is incredibly excited to have this new product to sell. And this product, I think, is going to be really stunning for the market and really take the market by storm here. I think if you kind of look at not only the rooms, the suites, but just the -- when you go into the lobby areas or the atrium area and just the way the space envelops you, it's going to be pretty stunning for the market. The team is also very excited about some of the new gaming space that also will come with this in terms of the premium space that will come in our VIP area as well as the new signature gaming space that is being done in conjunction with this on the main gaming floor. We just opened up recently our new signature space for slots, which has been incredibly well received. We think the table game space that we're going to open up at the same time Morpheus opens up is going to offer -- will have that same level of impact and really reenergize and really get our players really excited as well as our marketing teams.

Karen Tang - *Deutsche Bank AG, Research Division - Head of Asian Gaming and Hotels Research*

Excellent, looking for us to visit it in a couple of months.

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Looking forward to having you.

Operator

The next question comes from the line of Harry Curtis from Nomura Instinet.

Harry Croyle Curtis - *Nomura Securities Co. Ltd., Research Division - MD and Senior Analyst*

First of all, condolences on your bonus, but I would guess that, that will be reversed in the next 12 months, so don't despair. The question I had for Lawrence and David. The surprise overall in GGR has been the acceleration in mass. And is it simply capacity-driven much like Vegas was back in the mid '90s when exciting new product came in? Or are there other factors at work, do you think?

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

David, you want to?

David Sisk - *Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau*

Sure. I think it's a bit of both, honestly. Obviously, capacity, new product coming into the market, much likely, we always see in Las Vegas, when the new product would come, would have a tendency to grow the overall market and make it much more competitive but also better for the players as they came in. But I also think in terms of -- that the players have a level of expectation now. And the players are getting much more

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sophisticated. So they are demanding more and more from us. Whether that would be from the service or from the product itself. So again, it's both.

Harry Croyle Curtis - *Nomura Securities Co. Ltd., Research Division - MD and Senior Analyst*

All right. And the -- my second question, maybe, Geoff, can just walk us through the pace of total CapEx including maintenance CapEx this year and next?

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

Sure, Harry. So for remainder of this year, we've got about \$475 million remaining of CapEx, total CapEx, and that number drops down in 2019 to approximately \$250 million. And then in the out years, we've identified more in the \$150 million range. That does not include any CapEx for Studio City Phase 2, however.

Harry Croyle Curtis - *Nomura Securities Co. Ltd., Research Division - MD and Senior Analyst*

Okay. And so given the amount of CapEx remaining for this year, the announcement of the \$500 million repo, is that -- do you feel that you've got room to do both this year?

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

The board authorization was really meant as a standard operating procedure for us to have that in place for our ability to be opportunistic and to be able to move quickly. That being said, it really doesn't change our focus of returning capital to shareholders through the ordinary dividend as the primary avenue. So we have multiple tools on our tool belt. But -- and we would certainly look to deploy capital via share repurchase. But we've listened to our shareholders and for the most part, the feedback that we've received is preference for ordinary dividends. So that's really where we put the focus of our attention.

Operator

The next question comes from the line of Ming Tan from Barclays.

Jit Ming Tan - *Barclays Bank PLC, Research Division - Head of Asia Credit Research*

Okay. Sorry about that. Now -- so my first question is with regards to COD. When you look at the earnings for the quarter and you probably will have to be turn this from the construction of Morpheus. Can you also talk a bit about the impact of competition from your neighbors? That's my first question. The second question is with regards to Studio City. You talked about Phase 2 and the impacts with the minority shareholders. Can you -- to the extent possible, can you talk a bit about the potential funding for the -- for Phase 2? And in that regard -- to the extent you can talk about the IPO application that will expire as well as the fact that your minority shareholders won't expire next year?

Lawrence Ho - *Melco Resorts & Entertainment Limited - Chairman and CEO*

Sure. I think on the -- Ming, on the first question, I think when we first built City of Dreams over 10 years ago, we always knew City of Dreams was the best location in a sense that it's in the middle of everything. It's right between Venetian, Wynn, and MGM and Sands Cotai Central. But I think, since our last quarterly call, MGM has opened up and I think, longer term, MGM is having more properties and having more neighbors is going to improve the cluster effect and benefit us quite a bit. But to be honest, the first month and a half of MGM, we really haven't seen any significant changes for our business for better or worse. But I think longer term it will be great for foot traffic. I don't know, if David, you want to..?

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David Sisk - Melco Resorts & Entertainment Limited - Property President of City of Dreams Macau

I think, Lawrence kind of covered it, but clearly, we were happy to have neighbors. I think, with the more products around us, the more people around us, we think we are the beneficiaries given we're positioned for that business coming across the street, whether it would be from Wynn Palace or from MGM or coming across from the Venetian or Sands Cotai. So we love our location. We're well positioned on those accounts. But as Lawrence said, we've not really seen any impact, one way or the other, from the business that's going on over at MGM to our business at COD.

Lawrence Ho - Melco Resorts & Entertainment Limited - Chairman and CEO

And on your second question on Studio City Phase 2, it's, I guess the discussion with our minority shareholders is ongoing and it's probably too early. I think Geoff, it's too early to review the concept or the potential investment surrounding it, but...

Geoffrey Davis - Melco Resorts & Entertainment Limited - CFO, Executive VP & Treasurer

Correct and regarding the IPO at this point, we don't have any updates for investors beyond what was included in the August public release. We'll provide public updates when appropriate and to the extent permitted by U.S. securities laws. And I think following under that sensitivity is discussions of funding plans going forward as well. And on your last question regarding minority shareholder, what their plans are and how that might be impacted by some of their outstanding debt instruments, I think that's an area where we just can't comment on their behalf.

Operator

There are no further questions at this time. I would like to hand the conference back to the management.

Richard Huang - Melco Resorts & Entertainment Limited - Director, Investor Relations

Thank you for participating in our call today. We look forward to speaking with you again next quarter.

Operator

Thank you. Ladies and gentlemen, that does conclude our conference call for today. Thank you for your participation. You may all disconnect the lines now. Thank you.

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