

Iao Kun Group Holding Co. Ltd.

Lowering estimates due to increased non-cash expenses, commissions to agents; Lowering price target

Our Call

Following a relatively inline 3Q13, we are lowering our estimates, mostly due an increase in non-cash expenses (D&A), but also due to higher commissions to agents. While another downward earnings revision is difficult to swallow, compelling valuation coupled with upcoming catalysts/strong potential stock price upside remains.

Our thesis is still intact, but it has not been pretty. While guidance and earnings projections have been in flux, IKGH cash flow has remained stable and our overall thesis remains: 1) attractive valuation metrics; 2) HK Listing by Introduction acting as a significant catalyst in 2Q14; 3) strong shareholder capital return policies; 4) the likely loosening of its credit policy to agents by 1H14; 5) upside potential from a longer-term mix trend back to credit versus cash agents followed by; 6) increased credit lines and revenue share splits from casinos.

Estimate/target reductions, valuation. CY13/CY14/CY15 EPS to \$0.51/\$0.45/\$0.71 from \$0.75/\$0.76/\$1.05. Most of our changes reflect elevated ongoing D&A costs stemming from its latest acquisition, and increased commission expenses. IKGH now trades for ~4.6x/3.4x CY14E/CY15E FCF per share. Based on its 3Q13 balance sheet results, IKGH has nearly \$3 per share in cash. Our new price target is \$6.25 from \$7.60, based on 9x CY14E FCF per share.

Below guide. After factoring October's lower-than-theoretical win-rate ("luck factor") and higher mix of cash agents, we lower CY14E EBITDA to \$40.3m from \$48.3m and versus EBITDA guidance of \$46m to \$52m - marking the second time this year our outlook has been below the company's.

Near-term. In the near term, we anticipate IKGH will continue its campaign to acquire additional cash agents. Due to relatively easy comparisons, its L'Arch acquisition, and the introduction of additional cash agents, we believe YoY RCT results will demonstrate improvement. We expect the signing of a new sponsor/investment will be announced within weeks, resulting in increased visibility of a 2Q14 HK Listing by Introduction. Finally, we anticipate IKGH will utilize some of its idle capital to repurchase shares. Recall that management recently purchased ~\$14.9m of IKGH at \$4.50 and \$19.3m at \$3 in the company's rights offering.

Medium to long term. Following recent meetings in Macau with IKGH management, we anticipate IKGH will begin to loosen its credit policy to agents in 1H14, coinciding with its HK Listing by Introduction. This should work to augment margins, as the mix of cash versus credit agents shifts deeper toward credit ones. Further, as the velocity of capital grows, upside potential from increased credit lines and revenue share splits from casinos also grows.

FYE Dec	2013E (Prev)	2013E (Curr)	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)						
Q1 (Mar)		0.32A	0.16	0.06	0.21	0.13
Q2 (Jun)		0.21A	0.17	0.10	0.25	0.17
Q3 (Sept)	0.14	0.11A	0.20	0.13	0.28	0.19
Q4 (Dec)	0.13	(0.02)	0.23	0.15	0.31	0.21
FY EPS	0.75	0.51	0.76	0.45	1.05	0.71
P/E		6.3x		7.1x		4.5x

Buy

IKGH

Price: Last \$3.20

Price Target \$6.25

Leisure & Entertainment

David Bain

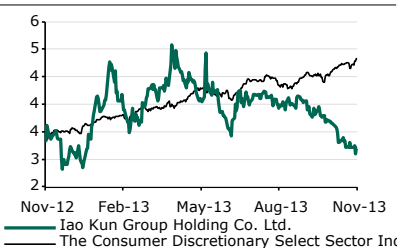
(949) 721-6651

dbain@sterneagee.com

Company Data

Rating	Buy
Price: Last	\$3.20
Price Target	\$6.25
52-Week Range	\$2.70 - \$5.18
Market Capitalization (M)	\$186.1
Shares Outstanding (M)	60.0
Avg. Daily Vol. (000)	202.0
Dividend	\$0.28
Dividend Yield	8.8%
Assets (M)	\$377.5

Price Performance



Source: FactSet

Important Disclosures regarding Price Target Risks, Valuation Methodology, Regulation Analyst Certification, Investment Banking, Ratings Definitions, and potential conflicts of interest begin on Page I of the Appendix Section.

Quarterly Income Statement

(Millions, except per share data)	DEC CY12	Mar 13 Q1:13	Jun 13 Q2:13	Sep 13 Q3:13	Dec 13 Q4:13E	DEC CY13E	Mar 14 Q1:14E	Jun 14 Q2:14E	Sep 14 Q3:14E	Dec 14 Q4:14E	DEC CY14E	Mar 15 Q1:15E	Jun 15 Q2:15E	Sep 15 Q3:15E	Dec 14 Q4:15E	DEC CY15E
REVENUE																
Cage Capital Est.	262.35	300.58	302.96	279.72	280.58	280.58	268.97	279.09	285.14	293.45	293.45	285.12	298.69	308.71	320.99	320.99
Turns per month Est.	5.79	4.83	4.93	4.94	5.63	5.08	5.47	5.70	5.87	6.03	5.77	5.58	6.10	6.20	6.37	6.06
Rolling Chip Turnover	18,196.0	4,070.0	4,460.0	4,115.0	4,720.4	17,365.4	4,592.3	4,715.0	4,977.7	5,261.6	19,546.6	4,946.0	5,381.4	5,678.0	6,048.1	22,053.4
% seq.	-9%	-1%	10%	-8%	15%	-5%	-3%	3%	6%	6%	13%	-6%	9%	6%	7%	13%
% yoy.	-9%	-24%	-5%	2%	15%	-5%	13%	6%	21%	11%	13%	8%	14%	14%	15%	13%
Fixed Commission Operation																
Roll from fixed commission operation	15,628.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
% of total rolling chip win	117%	0%	0%	0%	0%	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Revenue from fixed Commission	160.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
% commission rate	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%
Revenue Share Operation																
Win from revenue share operation	na	4,070.0	4,460.0	4,115.0	4,720.4	17,365.4	4,592.3	4,715.0	4,977.7	5,261.6	19,546.6	4,946.0	5,381.4	5,678.0	6,048.1	22,053.4
% of total rolling chip win	na	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Gross Revenue from revenue share	na	60.4	63.5	61.0	59.3	222.7	62.8	64.5	68.4	72.3	268.0	68.0	73.9	78.0	83.1	303.0
% VIP hold	2.85%	3.33%	3.15%	3.26%	2.76%	2.85%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
% revenue share rate	45.0%	45.6%	45.2%	45.3%	45.6%	45.0%	45.6%	45.6%	45.8%	45.8%	45.7%	45.8%	45.8%	45.8%	45.8%	45.8%
Gross Revenue Est.	216.6	61.9	63.5	61.0	59.3	222.7	62.8	64.5	68.4	72.3	268.0	68.0	73.9	78.0	83.1	303.0
Adjustment, including Service Revenue	0.0	2.5	0.0	0.0	0.0	2.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
% of gross revenue	0%	4%	4%	4%	4%	1%	4%	4%	4%	4%	0%	4%	4%	4%	4%	0%
Revenue from VIP gaming operations	236.3	64.4	63.5	61.0	59.3	225.2	62.8	64.5	68.4	72.3	268.0	68.0	73.9	78.0	83.1	303.0
% yoy.	-6%	-4%	9%	13%	5%	-5%	-2%	2%	12%	22%	19%	8%	15%	14%	15%	13%
EXPENSES																
Commission to Junket agents	223.0	40.3	47.7	45.3	50.7	184.1	49.1	48.1	49.8	52.1	199.1	49.0	52.7	55.1	58.3	215.0
% of Rolling Chip Turnover	0.83%	0.99%	1.07%	1.10%	1.08%	1.06%	1.07%	1.02%	1.00%	0.99%	1.02%	0.99%	0.98%	0.97%	0.96%	0.98%
SG&A	18.3	5.9	6.3	5.1	5.2	22.5	5.3	5.3	5.3	5.3	21.0	5.4	5.4	5.4	5.4	21.6
% of Rolling Chip Turnover	0.101%	0.145%	0.142%	0.124%	0.110%	0.130%	0.114%	0.111%	0.105%	0.100%	0.107%	0.109%	0.100%	0.095%	0.089%	0.098%
Special Rolling Tax	1.8	0.4	0.4	0.4	0.5	1.7	0.5	0.5	0.5	0.6	2.1	0.5	0.6	0.6	0.6	2.4
% of total revenue	0.8%	0.6%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%
EBITDA	61.6	15.3	11.9	10.1	2.9	40.3	7.9	10.7	12.8	14.4	45.8	13.1	15.2	16.9	18.8	64.0
% margin	26%	24%	19%	17%	5%	18%	13%	17%	19%	20%	17%	19%	21%	22%	23%	21%
% of Rolling Chip	0.34%	0.38%	0.27%	0.25%	0.06%	0.23%	0.17%	0.23%	0.26%	0.27%	0.23%	0.26%	0.28%	0.30%	0.31%	0.29%
D&A	6.6	2.4	2.5	4.1	4.0	13.1	4.0	4.0	4.0	4.0	16.0	4.0	4.0	4.0	4.0	16.0
Income including pre-acquisition profit	55.0	12.9	9.4	6.0	(1.1)	27.2	3.9	6.7	8.8	10.4	29.8	9.1	11.2	12.9	14.8	48.0
Prior owners' interest in pre-acquisition profit*	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Income Attributable to ordinary shareholders	55.0	12.9	9.4	6.0	(1.1)	27.2	3.9	6.7	8.8	10.4	29.8	9.1	11.2	12.9	14.8	48.0
% Margin	23%	20%	15%	10%	-2%	12%	6%	10%	13%	14%	11%	13%	15%	17%	18%	16%
Other Comprehensive Loss																
Foreign Currency Translation adjustment	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Adjusted Income	55.0	12.9	9.4	6.0	(1.1)	27.2	3.9	6.7	8.8	10.4	29.8	9.1	11.2	12.9	14.8	48.0
Adjusted EPS	1.30	0.32	0.21	0.11	(0.02)	0.51	0.06	0.10	0.13	0.15	0.45	0.13	0.17	0.19	0.21	0.71
% yoy.	-29%	-21%	-38%	-65%	-107%	-61%	-81%	-52%	21%	-1045%	-11%	124%	64%	43%	39%	57%
Ave shares outstanding	42.4	40.7	44.6	64.4	65.5	53.8	65.5	65.5	66.1	67.2	66.1	67.2	67.2	67.9	69.0	67.8

Source: Company reports and Sterne Agee estimates

APPENDIX SECTION

Company Description:

Macau licensed casino operators grant IKGH exclusive use of VIP gaming rooms within their casino facilities and IKGH promotes and manages its own network of junket agents and players to optimize the casino gaming within the rooms. In return, IKGH is paid on volume-based commission or a share of the gaming win. ~85% - 90% of VIP player chip volume in Macau casinos is generated utilizing the room promoter system.

IMPORTANT DISCLOSURES:

Regulation Analyst Certification:

I, David Bain, hereby certify the views expressed in this research report accurately reflect my personal views about the subject security(ies) or issuer(s). I further certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this report.

Research Disclosures:

Sterne, Agee & Leach, Inc. makes a market in the following subject company Iao Kun Group Holding Co. Ltd.

Sterne, Agee & Leach, Inc. managed or co-managed a public offering of securities for the following subject company in the past 12 months: Iao Kun Group Holding Co. Ltd..

Sterne, Agee & Leach, Inc. provided and received compensation for providing investment banking services for the following subject company within the past 12 months: Iao Kun Group Holding Co. Ltd..

Sterne, Agee & Leach, Inc. provided and received compensation for providing non-investment banking securities related services for the following subject company within the past 12 months: Iao Kun Group Holding Co. Ltd..

Sterne, Agee & Leach, Inc.'s research analysts receive compensation that is based upon various factors, including Sterne, Agee & Leach, Inc.'s total revenues, a portion of which is generated by investment banking activities.

Sterne Agee & Leach, Inc. expects to receive or intends to seek compensation for investment banking services from the subject company and/or companies in the next three months.

Price Target Risks & Related Risk Factors:

Investment risks associated with the achievement of the price target include, but are not limited to, a company's failure to achieve Sterne, Agee & Leach, Inc., earnings and revenue estimates; unforeseen macroeconomic and/or industry events that adversely affect demand for a company's products or services; product obsolescence; changes in investor sentiment regarding the specific company or industry; intense and rapidly changing competitive pressures; the continuing development of industry standards; the company's ability to recruit and retain competent personnel; and adverse market conditions. For a complete discussion of the risk factors that could affect the market price of a company's shares, refer to the most recent Form 10-Q or 10-K that a company has filed with the Securities Exchange Commission.

Company Specific Risks:

Risks to IKGH include softness in the Chinese economy; unanticipated Mainland Chinese government intervention/regulation, including visa controls or other aspects negatively impacting visitation or patron spend in Macau; unanticipated Macau Government legislation; and/or the potential for higher junket operator commissions paid by promoters.

Valuation Methodology:

Methodology for assigning ratings and target prices includes qualitative and quantitative factors including an assessment of industry size, structure, business trends and overall attractiveness; management effectiveness; competition; visibility; financial condition; and expected total return, among other factors. These factors are subject to change depending on overall economic conditions or industry or company-specific occurrences. Sterne, Agee & Leach, Inc., analysts base valuations on a combination of forward looking earnings multiples, price-to-revenue multiples, and enterprise-value-to-revenue ratios. Sterne, Agee & Leach, Inc., believes this accurately reflects the strong absolute value of earnings, the strong earnings growth rate, the inherent profitability, and adjusted balance sheet factors. Additional company-specific valuation methodology is available through Sterne, Agee & Leach, Inc.

Company Specific Valuation:

Our valuation is based on a multiple of earnings per share.

Definition of Investment Ratings:

BUY: We expect this stock to outperform the industry over the next 12 months.

NEUTRAL: We expect this stock to perform in line with the industry over the next 12 months.

UNDERPERFORM: We expect this stock to underperform the industry over the next 12 months.

RESTRICTED: Restricted list requirements preclude comment.

Ratings Distribution:

Rating Category	Count	Percent	IB Serv./ Past 12Mos.	
			Count	Percent
Buy	224	46.38%	32	14.29%
Neutral	239	49.48%	15	6.28%
Underperform	20	4.14%	1	5.00%

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST: Contact Robert Hoehn at 1-212-338-4731.

Other Disclosures:

Opinions expressed are our present opinions only. This material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such. Sterne, Agee & Leach, Inc., its affiliates, or one or more of its officers, employees, or consultants may, at times, have long or short or options positions in the securities mentioned herein and may act as principal or agent to buy or sell such securities.

Copyright © 2013 Sterne, Agee & Leach, Inc. All Rights Reserved.



To receive price charts or other disclosures on the companies mentioned in this report, please visit our website at <https://sterneagee.bluematrix.com/sellside/Disclosures.action> or contact Sterne, Agee & Leach, Inc. toll-free at (800) 240-1438 or (205) 949-3689.



Founded in 1901, Sterne Agee has been providing investors like you with high-quality investment opportunities for over a century. During the early years, our founders prominently established themselves in the financial securities industry in the southeastern United States. Today, we have expanded to serve all regions of the country. Sterne, Agee is headquartered in Birmingham, Alabama with offices in 22 states. Sterne Agee is one of the largest independent firms in the country. Sterne, Agee & Leach, Inc. is a division of Sterne Agee Group, Inc., which also includes The Trust Company of Sterne, Agee & Leach, Inc.; Sterne Agee Asset Management, Inc.; Sterne Agee Clearing, Inc.; and Sterne Agee Financial Services, Inc.—www.sterneagee.com

EQUITY CAPITAL MARKETS

Ryan Medo Managing Dir., Eq. Cap. Mkts. (205) 949-3623

INSTITUTIONAL SALES

William Jump Director of Institutional Sales (404) 814-3960
Jon Schenk Assoc. Director of Inst. Sales (212) 763-8221

INSTITUTIONAL TRADING

JT Cacciabaudo Head of Trading (212) 763-8288

EQUITY RESEARCH

Robert Hoehn Director of Research (212) 338-4731

CHIEF ECONOMIST

Lindsey M. Piegza Mng. Dir. (312) 924-0607

CONSUMER

Broadlines / Health & Wellness Retailing

Charles Grom, CFA Mng. Dir. (646) 376-5373
Renato Basanta, CFA VP, Analyst (646) 376-5317
John Parke Analyst (646) 376-5315

Footwear & Apparel

Sam Poser Mng. Dir. (212) 763-8226
Ben Shamsian Analyst (212) 338-4721

Leisure & Entertainment

David Bain Mng. Dir. (949) 721-6651

Media & Entertainment

Vasily Karasyov Mng. Dir. (646) 376-5362
Kutgun Maral VP, Analyst (646) 376-5372

Restaurants

Lynne Collier Mng. Dir. (214) 702-4045

Specialty Retail

Ike Boruchow, Jr. Sr. VP, Sr. Analyst (212) 338-4756
Tom Nikic, CFA Analyst (212) 338-4784

ENERGY

Exploration & Production

Tim Rezvan, CFA VP, Sr. Analyst (212) 338-4736
Truman Hobbs Analyst (212) 338-4767

Oilfield Services & Equipment

Stephen D. Gengaro Mng. Dir. (646) 376-5331

FINANCIAL SERVICES

Asset Management

Jason Weyeneth, CFA SVP, Sr. Analyst (212) 763-8293

Banks & Thrifts

Matthew Kelley Mng. Dir. (207) 699-5800
Matthew Breese VP, Sr. Analyst (207) 699-5800
Brett Rabatin, CFA Mng. Dir. (615) 760-1466
Nathan Race Analyst (615) 760-1477
Peyton Green Mng. Dir. (877) 492-2663
Todd L. Hagerman Mng. Dir. (212) 338-4744
Robert Greene VP, Analyst (212) 763-8296

Life Insurance

John M. Nadel Mng. Dir. (212) 338-4717

Specialty Lenders and Housing Finance

Henry J. Coffey, Jr., CFA Mng. Dir. (615) 760-1472
Kenneth James VP, Sr. Analyst (615) 760-1474
Calvin Hotrum Analyst (615) 760-1476

Property/Casualty Insurance

Dan Farrell Mng. Dir. (212) 338-4782
Nitin Chhabra, FCAS Analyst (212) 338-4779

HEALTHCARE

Pharmaceutical Services

Gregory Bolan Mng. Dir. (615) 760-1469

INDUSTRIALS

Aerospace & Defense

Peter Arment Mng. Dir. (646) 376-5336
Josh W. Sullivan Sr. Analyst (646) 376-5337

Auto, Auto Parts and Auto Retailers

Michael P. Ward, CFA Mng. Dir. (646) 376-5375

Coal, Metals & Mining, Engineering & Construction

Michael S. Dudas, CFA Mng. Dir. (646) 376-5329
Satyadeep Jain, CFA Analyst (646) 376-5357
Patrick Uotila, CPA Analyst (646) 376-5358

Construction Materials & Diversified Industrials

Todd Vencil, CFA Mng. Dir. (804) 282-7385
Kevin Bennett, CFA VP, Analyst (804) 282-4506

Homebuilding

Jay McCanless VP, Sr. Analyst (615) 760-1475

TECHNOLOGY

Data Networking and Storage

Alex Kurtz Mng. Dir. (415) 402-6015
Amelia Harris Analyst (415) 402-6018
Craig Jones Analyst (415) 402-6024

Financial Technology

Greg Smith Mng. Dir. (818) 615-2029
Jennifer Dugan Analyst (415) 402-6051

Interactive Entertainment / Internet

Arvind Bhatia, CFA Mng. Dir. (214) 702-4001
Brett Strauser VP, Analyst (214) 702-4009

LED Supply Chain

Andrew Huang Mng. Dir. (415) 362-6143
John Shen Analyst (415) 402-6052

Semiconductors

Vijay Rakesh Mng. Dir. (312) 525-8431

TRANSPORTATION, SERVICES & EQUIPMENT

Sal Vitale VP, Sr. Analyst (212) 338-4766