

Asia Entertainment & Resources Ltd.

Adjusting Estimates; Maintain Buy

Our Call

Upcoming catalysts, top-line improvements, and a depressed valuation keep us positive on shares. We expect AERL to announce its semi-annual dividend by next week and apply for a HK listing in under 30 days, with an actual listing targeted for late 4Q13. Rolling chip turnover (“RCT”) continues to show fundamental improvement into easing YoY comparisons. Shares trade for 4.1x CY14E EPS and 3.5x FCF. AERL’s FCF yield is 28%.

**Catalysts.** AERL should announce its regular semi-annual dividend of \$0.10 per share within the next week and apply for a HK listing in under 30 days. We forecast RCT to increase 6% YoY in August, and accelerate significantly through the remainder of the year with August through December averaging +29% YoY. We believe RCT improvements will be beneficial as AERL heads into a road show throughout Asia for its year-end Listing by Introduction on the HK exchange.

**Guidance and 2Q13 results.** AERL increased CY13 RCT guidance to \$19b from \$18b and maintained EBITDA guidance of between \$60m to \$75m. 2Q13 RCT and revenue was almost exactly in line with our estimates (AERL releases monthly RCT); SG&A expenses were lower than expected when extracting ~ \$2.8m of extraordinary costs (HK exchange and one-time acquisition fees); while commissions to agents exceeded our estimates.

Commissions to agents, AERL’s largest expense, moved to 1.07% of RCT from 0.99% in 1Q13 and compared to our 0.98% estimate. However, we believe there are offsetting adjustments related to agent services, which lowers the net commission cost closer to 1.01%. Still, the mix toward more cash agents, incentive program for large agents, and lower direct play resulted in 2Q13 EPS/EBITDA (adjusted for one-time items) of \$11.9m/\$0.21 versus our \$14.4m/\$0.32 estimate.

AERL’s mix of high-commission cash agents, which utilize their own capital to extend to players (vs AERL’s), continues to increase. AERL made clear it believes cash agents are driving RCT increases in Macau and it will continue to pursue these agents. Further, no-commission direct play, accounted for less than ~5% of RCT versus ~15% historically. AERL’s direct play targets patrons in a specific region in Mainland China that have been negatively impacted by export and development project weakness. As AERL begins extending more credit to agents and its mix of direct play improves, we expect commission expense as a percentage of RCT to decline over time.

**Estimate adjustments.** CY13E EPS to \$0.85 from \$0.91, mostly to account for 2Q13 adjusted results. Our CY13 RCT forecast goes to \$18.8b from \$18.5b. Our CY13E EBITDA of \$54.1m remains below AERL’s guidance range.

FYE Dec	2013E (Prev)	2013E (Curr)	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)						
Q1 (Mar)		0.32A	0.20	0.21	0.23	0.24
Q2 (Jun)	0.32	0.21A	0.23	0.22		0.27
Q3 (Sept)		0.16	0.25	0.24		0.30
Q4 (Dec)	0.18	0.20	0.28	0.27	0.34	0.33
FY EPS	0.91	0.85		0.95		1.14
P/E		4.6x		4.1x		3.4x

Buy

AERL

Price: Last \$3.89

Price Target \$9.50

Leisure & Entertainment

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Company Data

Rating	Buy
Price: Last	\$3.89
Price Target	\$9.50
52-Week Range	\$2.70 - \$5.18
Market Capitalization (M)	\$162.2
Shares Outstanding (M)	40.5
Avg. Daily Vol. (000)	203.0
Dividend	\$0.28
Dividend Yield	7.2%
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 Q3:13E	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
<b>REVENUE</b>																
Cage Capital Est.	262.35	300.58	302.96	307.52	318.49	318.49	309.08	321.53	327.40	337.17	337.17	330.25	345.21	362.72	376.56	376.56
Turns per month Est.	5.79	4.83	4.93	5.10	5.83	5.17	5.53	5.77	5.83	6.23	5.84	5.58	6.10	6.20	6.37	6.06
<b>Rolling Chip Turnover</b>	<b>18,196.0</b>	<b>4,070.0</b>	<b>4,460.0</b>	<b>4,711.8</b>	<b>5,504.4</b>	<b>18,746.2</b>	<b>5,302.2</b>	<b>5,489.4</b>	<b>5,705.1</b>	<b>6,240.5</b>	<b>22,737.3</b>	<b>5,694.8</b>	<b>6,223.4</b>	<b>6,596.4</b>	<b>7,099.6</b>	<b>25,614.3</b>
% seq.	-9%	-1%	10%	6%	17%	3%	-4%	4%	4%	9%	21%	-9%	9%	6%	8%	13%
% yoy.	-9%	-24%	-5%	17%	34%	3%	30%	23%	21%	13%	21%	7%	13%	16%	14%	13%
<b>Fixed Commission Operation</b>																
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%	100%	100%	100%	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%
<b>Revenue Share Operation</b>																
Win from revenue share operation	na	4,070.0	4,460.0	4,711.8	5,504.4	18,746.2	5,302.2	5,489.4	5,705.1	6,240.5	22,737.3	5,694.8	6,223.4	6,596.4	7,099.6	25,614.3
% 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	63.0	73.0	240.4	70.3	72.8	75.8	82.9	301.7	75.6	82.7	87.6	94.3	340.2
% VIP hold	2.85%	3.33%	3.15%	2.93%	2.90%	2.85%	2.90%	2.90%	2.90%	2.90%	2.90%	2.90%	2.90%	2.90%	2.90%	2.90%
% revenue share rate	45.0%	45.6%	45.2%	45.6%	45.7%	45.0%	45.7%	45.7%	45.8%	45.8%	45.8%	45.8%	45.8%	45.8%	45.8%	45.8%
<b>Gross Revenue Est.</b>	<b>216.6</b>	<b>61.9</b>	<b>63.5</b>	<b>63.0</b>	<b>73.0</b>	<b>240.4</b>	<b>70.3</b>	<b>72.8</b>	<b>75.8</b>	<b>82.9</b>	<b>301.7</b>	<b>75.6</b>	<b>82.7</b>	<b>87.6</b>	<b>94.3</b>	<b>340.2</b>
Adjustment, including Service Revenue	0.0	2.5	0.0	2.5	2.9	7.9	2.8	2.9	3.0	3.3	12.1	3.0	3.3	3.5	3.8	13.6
% of gross revenue	0%	4%	4%	4%	4%	3%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
<b>Revenue from VIP gaming operations</b>	<b>236.3</b>	<b>64.4</b>	<b>63.5</b>	<b>65.5</b>	<b>75.9</b>	<b>248.3</b>	<b>73.1</b>	<b>75.7</b>	<b>78.8</b>	<b>86.2</b>	<b>313.8</b>	<b>78.7</b>	<b>86.0</b>	<b>91.1</b>	<b>98.1</b>	<b>353.8</b>
% yoy.	-6%	-4%	9%	21%	34%	5%	14%	19%	20%	14%	26%	8%	14%	16%	14%	13%
<b>EXPENSES</b>																
<b>Commission to Junket agents</b>	<b>220.6</b>	<b>40.3</b>	<b>47.7</b>	<b>47.4</b>	<b>54.4</b>	<b>189.7</b>	<b>51.2</b>	<b>53.0</b>	<b>54.8</b>	<b>59.8</b>	<b>218.7</b>	<b>54.7</b>	<b>59.5</b>	<b>62.7</b>	<b>67.1</b>	<b>244.0</b>
% of Rolling Chip Turnover	0.83%	0.99%	1.07%	1.01%	0.99%	1.01%	0.97%	0.97%	0.96%	0.96%	0.96%	0.96%	0.96%	0.95%	0.95%	0.95%
SG&A	18.3	5.9	6.3	5.9	6.0	24.1	6.1	6.1	6.1	6.1	24.4	6.1	6.2	6.2	6.2	24.7
% of Rolling Chip Turnover	0.101%	0.145%	0.142%	0.125%	0.109%	0.129%	0.115%	0.111%	0.107%	0.098%	0.107%	0.107%	0.100%	0.094%	0.087%	0.096%
Special Rolling Tax	1.8	0.4	0.4	0.5	0.6	1.9	0.6	0.6	0.6	0.7	2.4	0.6	0.7	0.7	0.8	2.8
% 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%
<b>EBITDA</b>	<b>61.6</b>	<b>15.3</b>	<b>11.9</b>	<b>11.8</b>	<b>14.9</b>	<b>53.9</b>	<b>15.2</b>	<b>16.0</b>	<b>17.3</b>	<b>19.6</b>	<b>68.2</b>	<b>17.3</b>	<b>19.6</b>	<b>21.5</b>	<b>24.0</b>	<b>82.4</b>
% margin	26%	24%	19%	18%	20%	22%	21%	21%	22%	23%	22%	22%	23%	24%	24%	23%
% of Rolling Chip	0.34%	0.38%	0.27%	0.25%	0.27%	0.29%	0.29%	0.29%	0.30%	0.31%	0.30%	0.30%	0.31%	0.33%	0.34%	0.32%
D&A	6.6	2.4	2.5	2.4	2.4	9.8	2.4	2.4	2.4	2.4	9.6	2.4	2.4	2.4	2.4	9.6
Income including pre-acquisition profit	55.0	12.9	9.4	9.4	12.5	44.2	12.8	13.6	14.9	17.2	58.6	14.9	17.2	19.1	21.6	72.8
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	9.4	12.5	44.2	12.8	13.6	14.9	17.2	58.6	14.9	17.2	19.1	21.6	72.8
% Margin	23%	20%	15%	14%	16%	18%	18%	18%	19%	20%	19%	19%	20%	21%	22%	21%
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
<b>Adjusted Income</b>	<b>55.0</b>	<b>12.9</b>	<b>9.4</b>	<b>9.4</b>	<b>12.5</b>	<b>44.2</b>	<b>12.8</b>	<b>13.6</b>	<b>14.9</b>	<b>17.2</b>	<b>58.6</b>	<b>14.9</b>	<b>17.2</b>	<b>19.1</b>	<b>21.6</b>	<b>72.8</b>
<b>Adjusted EPS</b>	<b>1.30</b>	<b>0.32</b>	<b>0.21</b>	<b>0.16</b>	<b>0.20</b>	<b>0.85</b>	<b>0.21</b>	<b>0.22</b>	<b>0.24</b>	<b>0.27</b>	<b>0.95</b>	<b>0.24</b>	<b>0.27</b>	<b>0.30</b>	<b>0.33</b>	<b>1.14</b>
% yoy.	-29%	-21%	-38%	-50%	-16%	-34%	-34%	6%	54%	34%	11%	13%	22%	25%	22%	21%
Ave shares outstanding	42.4	40.7	44.6	60.2	61.3	51.7	61.3	61.3	62.0	63.1	61.9	63.1	63.1	63.7	64.8	63.7

Note: 2Q13 Ajd EBITDA, net income and EPS adds back \$2.8m in one-time expenses related to HK Listing and acquisition costs.

Source: Company reports and Sterne Agee estimates

## APPENDIX SECTION

### Company Description:

*Macau licensed casino operators grant AERL exclusive use of VIP gaming rooms within their casino facilities and AERL promotes and manages its own network of junket agents and players to optimize the casino gaming within the rooms. In return, AERL 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:

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#### Company Specific Risks:

Risks to AERL 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.

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

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**RESTRICTED:** Restricted list requirements preclude comment.

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Rating Category	Count	Percent	IB Serv./ Past 12Mos.	
			Count	Percent
Buy	220	46.91%	30	13.64%
Neutral	228	48.61%	14	6.14%
Underperform	21	4.48%	1	4.76%

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