

Iao Kun Group Holding Co. Ltd.

**Lowering estimates and price target due to market checks citing rising agent commissions**

*Our Call*

Macau checks continue to cite elevated junket agent commission trends. As such, we adjust IKGH forward margins lower. Our CY14/CY15 EPS estimates go to \$0.29/\$0.51 from \$0.45/\$0.71. Our CY14/CY15E free cash flow per share is now \$0.55/\$0.66. We lower our target price to \$5 from \$6.25, based on 9.0x/7.5x CY14/CY15E free cash flow per share.

Island contacts suggest “cash agents” are increasing in mix, as are overall agent commission requirements. Relevant agents are capable of working with several promoters, some of which host VIP rooms in the same casino facility. While strong promoter services and relationships can offset some agent “commission fishing,” they do not completely offset it. As a result, market-wide promoter margins have been thinning as promoters look to maintain/gain market share.

IKGH is not immune to the aforementioned market trend, in our view. Already, IKGH has stated it will seek to work more aggressively with cash agents, paying higher commissions as a percentage of generated rolling chip turnover. IKGH’s cash agent initiative should result in longer-term higher rolling volume, equating to more gross dollars, even under suppressed margins. However, until IKGH also loosens its credit policy toward higher-risk/non-cash credit agents, we see margin compression outweighing potential increases in roll from acquired cash agents. Given days sales outstanding have been growing for most promoters in the Macau marketplace, we do not see a loosening of credit to non-cash agents by IKGH in the immediate future.

Our new CY14/CY15E EPS of \$0.29/\$0.51 compares to consensus of \$0.63/\$0.69. Changes are almost entirely due to an adjustment for higher commissions to agents, though we did temper our rolling chip turnover (top-line generation) until there is evidence that IKGH will loosen credit. 4Q14 EPS goes to (\$0.13) from (\$0.02) and vs. consensus of \$0.09, due to lower than theoretical hold results; IKGH releases hold and rolling chip turnover monthly, so we view our 4Q adjustment as expected.

We retain our Buy rating given IKGH carries: 1) close to \$3 per share in cash; 2) a ~20% free cash flow yield; 3) remains on track for a 1H14 HK Listing by Introduction, a potential catalyst; 4) strong shareholder capital return policies – 15% of EBITDA to be paid as dividends, and we believe, possibilities for special dividends beyond that; consistent share repurchases; 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. We also believe IKGH is in a position to diversify its cash flow into higher stock multiple businesses, should high ROI projects arise, given its financial strength.

FYE Dec	2013E (Prev)	2013E (Curr)	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)						
Q1 (Mar)		0.32A	0.06	0.12	0.13	0.10
Q2 (Jun)		0.21A	0.10	0.04	0.17	0.13
Q3 (Sept)	0.11A	0.12A	0.13	0.05	0.19	0.14
Q4 (Dec)	(0.02)	(0.13)	0.15	0.08	0.21	0.15
FY EPS	0.51	0.41	0.45	0.29	0.71	0.51
P/E		6.9x		9.8x		5.6x

Source: Sterne Agee and FactSet

**Buy**

**IKGH**

Price: Close \$2.84

**Price Target \$5.00**

**Leisure & Entertainment**

**David Bain**

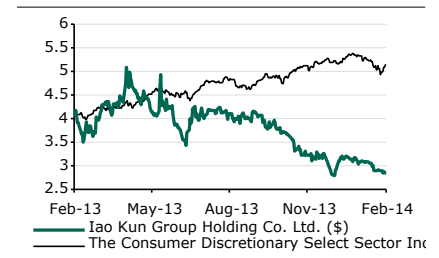
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**Company Data**

Rating	Buy
Price: Close	\$2.84
Price Target	\$5.00
52-Week Range	\$2.65 - \$5.18
Market Capitalization (M)	\$171.1
Shares Outstanding (M)	60.0
Avg. Daily Vol. (000)	174.0
Dividend	\$0.28
Dividend Yield	9.9%
Assets (M)	\$377.5

**Price Performance**



Source: FactSet

Any Important Disclosures regarding Price Target Risks, Valuation Methodology, Regulation Analyst Certification, Investment Banking, Ratings Definitions, and any potential conflicts of interest begin on Page I of the Appendix Section. Past performance is no guarantee of future results.

**Glossary**

CY = calendar year

EBITDA = earnings before interest, taxes, depreciation, and amortization

ROI = return on investment

## 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
<b>REVENUE</b>																
Cage Capital Est.	262.35	300.58	302.96	279.72	276.02	276.02	265.94	269.66	269.20	269.20	269.20	253.85	260.64	263.90	267.02	267.02
Turns per month Est.	5.79	4.83	4.93	4.58	5.17	4.87	4.70	5.13	5.43	5.80	5.27	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>4,115.0</b>	<b>4,370.0</b>	<b>17,015.0</b>	<b>3,915.3</b>	<b>4,132.5</b>	<b>4,384.9</b>	<b>4,681.5</b>	<b>17,114.2</b>	<b>4,459.4</b>	<b>4,726.1</b>	<b>4,879.9</b>	<b>5,079.3</b>	<b>19,144.8</b>
% seq.	-9%	-1%	10%	-8%	6%	-6%	-10%	6%	6%	7%	1%	-5%	6%	3%	4%	12%
% yoy.	-9%	-24%	-5%	2%	7%	-6%	-4%	-7%	7%	7%	1%	14%	14%	11%	8%	12%
<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%	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%
<b>Revenue Share Operation</b>																
Win from revenue share operation	na	4,070.0	4,460.0	4,115.0	4,370.0	17,015.0	3,915.3	4,132.5	4,384.9	4,681.5	17,114.2	4,459.4	4,726.1	4,879.9	5,079.3	19,144.8
% 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	48.7	218.2	58.7	55.6	59.2	63.3	237.4	60.3	63.9	65.9	68.6	258.7
% VIP hold	2.85%	3.33%	3.15%	3.26%	2.44%	2.85%	3.29%	2.95%	2.95%	2.95%	3.04%	2.95%	2.95%	2.95%	2.95%	2.95%
% revenue share rate	45.0%	45.6%	45.2%	45.5%	45.6%	45.0%	45.6%	45.6%	45.8%	45.8%	45.7%	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>61.0</b>	<b>48.7</b>	<b>218.2</b>	<b>58.7</b>	<b>55.6</b>	<b>59.2</b>	<b>63.3</b>	<b>237.4</b>	<b>60.3</b>	<b>63.9</b>	<b>65.9</b>	<b>68.6</b>	<b>258.7</b>
Adjustment, including Service Revenue	0.0	2.5	0.0	0.0	1.9	4.4	2.3	2.2	2.4	2.5	9.5	2.4	2.6	2.6	2.7	10.3
% of gross revenue	0%	4%	0%	0%	4%	2%	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>61.0</b>	<b>50.6</b>	<b>222.7</b>	<b>61.1</b>	<b>57.8</b>	<b>61.6</b>	<b>65.8</b>	<b>246.8</b>	<b>62.7</b>	<b>66.4</b>	<b>68.6</b>	<b>71.4</b>	<b>269.0</b>
% yoy.	-6%	-4%	9%	13%	-10%	-6%	-5%	-9%	1%	30%	11%	3%	15%	11%	8%	9%
<b>EXPENSES</b>																
<b>Commission to Junket agents</b>	<b>223.0</b>	<b>40.3</b>	<b>47.7</b>	<b>45.3</b>	<b>47.2</b>	<b>180.5</b>	<b>42.4</b>	<b>44.4</b>	<b>47.2</b>	<b>49.6</b>	<b>183.7</b>	<b>46.8</b>	<b>49.0</b>	<b>50.3</b>	<b>52.3</b>	<b>198.4</b>
% of Rolling Chip Turnover	0.83%	0.99%	1.07%	1.10%	1.08%	1.06%	1.08%	1.08%	1.08%	1.06%	1.07%	1.05%	1.04%	1.03%	1.03%	1.04%
SG&A	18.3	5.9	6.3	5.1	7.0	24.3	6.6	6.6	6.6	6.6	26.4	6.6	6.6	6.6	6.6	26.4
% of Rolling Chip Turnover	0.101%	0.145%	0.142%	0.124%	0.160%	0.143%	0.169%	0.160%	0.151%	0.141%	0.154%	0.148%	0.140%	0.135%	0.130%	0.138%
Special Rolling Tax	1.8	0.4	0.4	0.4	0.4	1.6	0.5	0.5	0.5	0.5	1.9	0.5	0.5	0.5	0.6	2.1
% of total revenue	0.8%	0.6%	0.8%	0.8%	0.8%	0.7%	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>11.0</b>	<b>\$ (3.9)</b>	<b>34.3</b>	<b>11.6</b>	<b>6.3</b>	<b>7.3</b>	<b>9.0</b>	<b>34.3</b>	<b>8.7</b>	<b>10.3</b>	<b>11.2</b>	<b>11.9</b>	<b>42.1</b>
% margin	26%	24%	19%	18%	-8%	15%	19%	11%	12%	14%	14%	14%	16%	16%	17%	16%
% of Rolling Chip	0.34%	0.38%	0.27%	0.27%	-0.09%	0.20%	0.30%	0.15%	0.17%	0.19%	0.20%	0.20%	0.22%	0.23%	0.23%	0.22%
D&A	6.6	2.4	2.5	4.0	4.1	13.1	4.1	4.1	4.1	4.0	16.3	2.4	2.4	2.4	2.4	9.6
Income including pre-acquisition profit	55.0	12.9	9.4	7.0	(8.0)	21.2	7.5	2.2	3.2	5.0	18.0	6.3	7.9	8.8	9.5	32.5
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	7.0	(8.0)	21.2	7.5	2.2	3.2	5.0	18.0	6.3	7.9	8.8	9.5	32.5
% Margin	23%	20%	15%	11%	-16%	10%	12%	4%	5%	8%	7%	10%	12%	13%	13%	12%
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>7.0</b>	<b>(8.0)</b>	<b>21.2</b>	<b>7.5</b>	<b>2.2</b>	<b>3.2</b>	<b>5.0</b>	<b>18.0</b>	<b>6.3</b>	<b>7.9</b>	<b>8.8</b>	<b>9.5</b>	<b>32.5</b>
<b>Adjusted EPS</b>	<b>1.30</b>	<b>0.32</b>	<b>0.21</b>	<b>0.12</b>	<b>(0.13)</b>	<b>0.41</b>	<b>0.12</b>	<b>0.04</b>	<b>0.05</b>	<b>0.08</b>	<b>0.29</b>	<b>0.10</b>	<b>0.13</b>	<b>0.14</b>	<b>0.15</b>	<b>0.51</b>
% yoy.	-29%	-21%	-38%	-63%	-154%	-68%	-61%	-83%	-55%	-161%	-29%	-18%	243%	165%	83%	76%
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

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.

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#### 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:

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

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

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Rating Category	Count	Percent	IB Serv./ Past 12Mos.	
			Count	Percent
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Neutral	255	50.80%	23	9.02%
Underperform	21	4.18%	1	4.76%

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

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