

Iao Kun Group Holding Co. Ltd.

Guidance revision not surprising, but unhelpful for sentiment; Lowering price target, estimates; LT set-up still strong

Our Call

This morning, IKGH lowered its rolling chip turnover (“RCT”) and EBITDA guidance. We were previously modeled ~11% below its low-end of EBITDA guidance and believe IKGH’s official guidance reduction removes a fairly well-known overhang. Still, given continued estimate revisions (mostly lower), investors may increasingly view IKGH as a “show-me” story. Overall, we continue to favor shares, and see a strong 6-month/LT stock appreciation set-up, though we lower our price target to \$7.60 from \$9.50.

Guidance lowered. IKGH lowered CY13 RCT/EBITDA guidance to \$16.5b-\$18b/\$46m-\$52m from \$19b/\$60m-\$75m, respectively. We were previously below guidance – though our CY13 EBITDA is now \$48.4m from \$53.9m. Reasons for lowered guidance include continued conservatism in its agent credit extension policy until it sees clear signs of a sustainable Mainland China recovery. We believe credit extension restraint is also driven by its anticipated early 2Q14 HK Listing by introduction. Given a vast majority of IKGH’s assets are in its receivable base (cash business), HKSE regulators may give receivables additional focus during the Listing approval process.

IKGH prudence with capital is frustrating at times, but strengthens LT story. All IKGH receivables remain under 90-days and it continues to leave over \$60m in cage capital unused. Industry VIP repayment timelines have been lengthening, in our view. We note one public company with promoter profit sharing agreements recently revealed that 69% of its 2013 receivables are over 90 days old. As such, we believe IKGH credit stance is prudent for LT shareholders.

Looking to grow its cash agent base. IKGH has begun a marketing campaign (October 1st) to more aggressively acquire cash agents. Marketing efforts include Island transportation and restaurant signage, among other methods. Cash agents require no credit risk and augment RCT volume. Higher RCT, in turn, boosts IKGH’s revenue split and interest free credit lines with Macau casino operator partners. As cash agents do not require capital, IKGH pays them higher commissions. We take a conservative stance in our new commission assumptions (primary reason for our EPS adjustments). However, we note these cash agents may ultimately become credit agents, augmenting margins.

We continue to anticipate IKGH’s HK Listing by introduction will take place in early 2Q14, creating a strong 6-month stock set-up in wake of our view for increasing RCT volume.

CY13/CY14/CY15 EPS to \$0.75/\$0.76/\$1.05 from \$0.85/\$0.95/\$1.14. IKGH trades at 4.9x/3.6x CY14/CY15 EPS and below its over \$4 in cash per share.

FYE Dec	2013E (Prev)	2013E (Curr)	2014E (Prev)	2014E (Curr)	2015E (Prev)	2015E (Curr)
EPS (\$)						
Q1 (Mar)		0.32A	0.21	0.16	0.24	0.21
Q2 (Jun)		0.21A	0.22	0.17	0.27	0.25
Q3 (Sept)	0.16	0.14	0.24	0.20	0.30	0.28
Q4 (Dec)	0.20	0.13	0.27	0.23	0.33	0.31
FY EPS	0.85	0.75	0.95	0.76	1.14	1.05
P/E		5.1x		5.0x		3.6x

Buy

IKGH

Price: Last \$3.80

Price Target \$7.60

Leisure & Entertainment

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Company Data

Rating	Buy
Price: Last	\$3.80
Price Target	\$7.60
52-Week Range	\$2.70 - \$5.18
Market Capitalization (M)	\$225.8
Shares Outstanding (M)	44.6
Avg. Daily Vol. (000)	201.0
Dividend	\$0.28
Dividend Yield	7.4%
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 15 Q4:15E	DEC CY15E
REVENUE																
Cage Capital Est.	262.35	300.58	302.96	307.32	321.39	321.39	309.14	318.60	322.26	329.70	329.70	321.13	334.57	342.54	354.67	354.67
Turns per month Est.	5.79	4.83	4.93	5.10	5.60	5.11	5.27	5.57	5.63	5.93	5.60	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	5,342.9	17,987.9	5,063.9	5,267.5	5,429.7	5,823.9	21,585.0	5,550.4	6,038.7	6,332.4	6,692.3	24,613.8
% seq.	-9%	-1%	10%	-8%	30%	-1%	-5%	4%	3%	7%	20%	-5%	9%	5%	6%	14%
% yoy.	-9%	-24%	-5%	2%	30%	-1%	24%	18%	32%	9%	20%	10%	15%	17%	15%	14%
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	5,342.9	17,987.9	5,063.9	5,267.5	5,429.7	5,823.9	21,585.0	5,550.4	6,038.7	6,332.4	6,692.3	24,613.8
% 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	61.1	71.9	230.7	68.1	70.9	73.4	78.7	291.0	75.0	81.6	85.6	90.4	332.6
% VIP hold	2.85%	3.33%	3.15%	3.26%	2.95%	2.85%	2.95%	2.95%	2.95%	2.95%	2.95%	2.95%	2.95%	2.95%	2.95%	2.95%
% revenue share rate	45.0%	45.6%	45.2%	45.6%	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	61.1	71.9	230.7	68.1	70.9	73.4	78.7	291.0	75.0	81.6	85.6	90.4	332.6
Adjustment, including Service Revenue	0.0	2.5	0.0	2.4	2.9	7.8	2.7	2.8	2.9	3.1	11.6	3.0	3.3	3.4	3.6	13.3
% of gross revenue	0%	4%	4%	4%	4%	3%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Revenue from VIP gaming operations	236.3	64.4	63.5	63.6	74.7	238.5	70.8	73.7	76.3	81.8	302.6	78.0	84.9	89.0	94.0	345.9
% yoy.	-6%	-4%	9%	18%	32%	1%	10%	16%	20%	9%	27%	10%	15%	17%	15%	14%
EXPENSES																
Commission to Junket agents	220.6	40.3	47.7	41.8	54.5	184.3	51.7	53.7	54.3	57.7	217.3	54.9	59.2	61.4	64.5	240.0
% of Rolling Chip Turnover	0.83%	0.99%	1.07%	1.02%	1.02%	1.02%	1.02%	1.02%	1.00%	0.99%	1.01%	0.99%	0.98%	0.97%	0.96%	0.98%
SG&A	18.3	5.9	6.3	6.4	6.6	25.2	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%	0.156%	0.124%	0.140%	0.130%	0.125%	0.122%	0.113%	0.122%	0.119%	0.109%	0.104%	0.099%	0.107%
Special Rolling Tax	1.8	0.4	0.4	0.5	0.6	1.9	0.6	0.6	0.6	0.6	2.4	0.6	0.7	0.7	0.7	2.7
% 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	11.0	10.2	48.4	12.0	12.8	14.8	16.9	56.6	15.8	18.4	20.3	22.2	76.7
% margin	26%	24%	19%	17%	14%	20%	17%	17%	19%	21%	19%	20%	22%	23%	24%	22%
% of Rolling Chip	0.34%	0.38%	0.27%	0.27%	0.19%	0.27%	0.24%	0.24%	0.27%	0.29%	0.26%	0.29%	0.30%	0.32%	0.33%	0.31%
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	8.6	7.8	38.7	9.6	10.4	12.4	14.5	47.0	13.4	16.0	17.9	19.8	67.1
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	8.6	7.8	38.7	9.6	10.4	12.4	14.5	47.0	13.4	16.0	17.9	19.8	67.1
% Margin	23%	20%	15%	14%	10%	16%	14%	14%	16%	18%	16%	17%	19%	20%	21%	19%
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	8.6	7.8	38.7	9.6	10.4	12.4	14.5	47.0	13.4	16.0	17.9	19.8	67.1
Adjusted EPS	1.30	0.32	0.21	0.14	0.13	0.75	0.16	0.17	0.20	0.23	0.76	0.21	0.25	0.28	0.31	1.05
% yoy.	-29%	-21%	-38%	-54%	-48%	-42%	-50%	-19%	40%	81%	1%	35%	50%	40%	33%	39%
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 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.

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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.

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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.

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Ratings Distribution:

Rating Category	Count	Percent	IB Serv./ Past 12Mos.	
			Count	Percent
Buy	231	48.53%	31	13.42%
Neutral	227	47.69%	13	5.73%
Underperform	18	3.78%	1	5.56%

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