

Iao Kun Group Holding Co. Ltd.

Top-line momentum; Adjusting Estimates; Raising price target; Reiterate Buy

Our Call

Following solid 1Q14 results, we raise our CY14/CY15 rolling chip turnover (“RCT”) estimates to \$19.1b/\$19.8b from \$17.9b/\$18.6b. Our CY14E/CY15E EPS goes to \$0.39/\$0.59 from \$0.46/\$0.51. Our CY14 EPS estimate is impacted by an abnormally low win rate (“luck factor”) in April. IKGH RCT growth has exceeded Macau market results and should increase investor attention to the benefit of shares. We are further encouraged by increasing RCT results into its Hong Kong (“HK”) dual-listing later this year.

1Q14. EPS of \$0.23 compared to consensus of \$0.16 and our \$0.30. The primary differential between our estimates and 1Q14 results was higher than expected commissions to junket agents resulting from an abnormally high win rate during 1Q14 (byproduct of the agent participation program). Adjusted for a normalized win-rate, 1Q14 commissions as a percentage of RCT would have been lower than our modeled assumption (and in-line with 4Q13 commissions as a percentage of RCT), a key positive given IKGH’s successful ramp of higher cost/lower margin cash agents. IKGH repurchased 1.4m shares at an average price of \$2.96 in 1Q14.

Cash agent ramp continues – IKGH has been exceeding Macau VIP market results. IKGH’s marketing campaign to acquire cash agents (initiated October of last year) has begun to take hold, in our view. IKGH’s 1Q14 rolling chip turnover was +17% YoY versus Macau market RCT of +16%. In April, IKGH RCT was +17% versus Macau market RCT of +1%. On its conference call, the Company commented that its process of acquiring cash agents “has just begun.”

No change to HK dual listing timeline. IKGH did not alter its previous projection for a completed HK dual listing by introduction (no share dilution from the offering) by the end of 3Q14. Given several items remain out of Company control (timing of its bankers to finish agent interviews, etc) and management verbiage suggesting the intensity of the process, we believe investors should be conservative and assume its dual listing will be completed by year-end rather than late 3Q14. Either way, we are encouraged by IKGH’s increasing RCT results ahead of its dual listing this year, and continue to believe the HK listing will unlock value for US shareholders by – potentially significantly - broadening its investor base.

Valuation. IKGH trades for 5.4x CY15E EPS. Its CY14E/CY15E free cash flow yield is 20%/23%. Given significantly depressed valuation/strong free-cash-flow dynamics coupled with an improving top-line and its upcoming HK dual-listing by introduction catalyst, we reiterate our Buy. Our price target goes to \$5.90 from \$5.50 based on 10x CY15E EPS and 8x CY15E free cash flow per share.

Buy

IKGH

Price: Close \$3.19

Price Target \$5.90

Leisure & Entertainment

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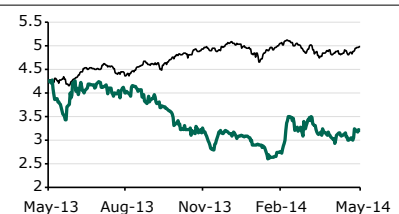
Company Data

Rating	Buy
Price: Close	\$3.19
Price Target	\$5.90
52-Week Range	\$2.57 - \$4.49
Market Capitalization (M)	\$185.8
Shares Outstanding (M)	60.7
Avg. Daily Vol. (000)	147.0
Dividend	\$0.10
Dividend Yield	3.1%
Assets (M)	\$411.8

FYE Dec	2013A	2013A	2014E	2014E	2015E	2015E
	(Prev)	(Curr)	(Prev)	(Curr)	(Prev)	(Curr)
EPS (\$)						
Q1 (Mar)		0.32	0.30	0.23A	0.11	0.14
Q2 (Jun)		0.21	0.05	(0.03)	0.12	0.15
Q3 (Sept)		0.12	0.05	0.09	0.13	0.15
Q4 (Dec)	(0.09)	(0.06)	0.07	0.10		0.15
FY EPS	0.46	0.50	0.46	0.39	0.51	0.59
P/E		6.4x		8.2x		5.4x

Source: Sterne Agee and FactSet

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.

Quarterly Income Statement

(\$millions, except per share data)	DEC CY13	Mar 14 Q1:14	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.	255.06	260.68	254.30	257.58	258.91	258.91	245.32	254.18	257.25	260.53	260.53
Turns per month Est.	4.87	5.67	6.17	6.10	6.20	6.04	6.33	6.53	6.43	6.53	6.46
Rolling Chip Turnover	17,015.0	4,770.0	4,800.4	4,697.0	4,805.2	19,072.5	4,885.3	4,920.4	4,942.9	5,084.0	19,832.6
% seq.	-6%	9%	1%	-2%	2%	12%	2%	1%	0%	3%	4%
% yoy.	-6%	17%	8%	14%	10%	12%	2%	3%	5%	6%	4%
Fixed Commission Operation											
Roll from fixed commission operation	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	100%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Revenue from fixed Commission	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%
Revenue Share Operation											
Win from revenue share operation	17,015.0	4,770.0	4,800.4	4,697.0	4,805.2	19,072.5	4,885.3	4,920.4	4,942.9	5,084.0	19,832.6
% of total rolling chip win	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Gross Revenue from revenue share	235.1	79.9	57.6	64.5	66.0	266.8	67.1	67.6	67.9	69.9	272.5
% VIP hold	3.05%	3.61%	2.63%	3.00%	3.00%	3.06%	3.00%	3.00%	3.00%	3.00%	3.00%
% revenue share rate	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.	235.1	78.5	57.6	64.5	66.0	266.8	67.1	67.6	67.9	69.9	272.5
Adjustment, including Service Revenue	4.5	3.3	2.3	2.6	2.6	13.1	2.7	2.7	2.7	2.8	10.9
% of gross revenue	2%	4%	4%	4%	4%	5%	4%	4%	4%	4%	4%
Revenue from VIP gaming operations	239.6	79.9	59.9	67.1	68.7	279.9	69.8	70.3	70.6	72.6	283.4
% yoy.	1%	24%	-6%	10%	37%	17%	-13%	17%	5%	6%	1%
EXPENSES											
Commission to Junket agents	180.2	55.1	50.7	50.6	51.3	207.6	51.6	51.7	51.9	53.4	208.6
% of Rolling Chip Turnover	1.06%	1.15%	1.06%	1.08%	1.07%	1.09%	1.06%	1.05%	1.05%	1.05%	1.05%
SG&A	23.7	6.5	6.5	6.5	6.5	26.0	6.5	6.5	6.5	6.5	26.0
% of Rolling Chip Turnover	0.139%	0.137%	0.135%	0.138%	0.135%	0.137%	0.133%	0.132%	0.132%	0.128%	0.131%
Special Rolling Tax	1.7	0.5	0.5	0.5	0.5	2.0	0.5	0.5	0.6	0.6	2.2
% of total revenue	0.7%	0.6%	0.8%	0.8%	0.8%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%
EBITDA	34.7	17.9	2.3	9.5	10.4	40.0	11.1	11.6	11.7	12.2	46.6
% margin	14%	22%	4%	14%	15%	14%	16%	16%	17%	17%	16%
% of Rolling Chip	0.20%	0.37%	0.05%	0.20%	0.22%	0.21%	0.23%	0.24%	0.24%	0.24%	0.24%
D&A	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	21.6	13.8	(1.8)	5.4	6.4	23.7	8.7	9.2	9.3	9.8	37.0
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
Net Income Attributable to ordinary shareholders	23.7	13.8	(1.8)	5.4	6.4	23.7	8.7	9.2	9.3	9.8	37.0
% Margin	10%	17%	-3%	8%	9%	8%	13%	13%	13%	13%	13%
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
Adjusted Income	25.7	13.8	(1.8)	5.4	6.4	23.7	8.7	9.2	9.3	9.8	37.0
Adjusted EPS	0.50	0.23	(0.03)	0.09	0.10	0.39	0.14	0.15	0.15	0.15	0.59
% yoy.	-62%	-28%	-114%	-24%	-277%	-22%	-38%	-585%	66%	50%	52%
Ave shares outstanding	51.6	60.7	60.7	61.4	62.5	61.3	62.5	62.5	63.1	64.2	63.1

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:

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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:

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	245	48.71%	34	13.88%
Neutral	245	48.71%	23	9.39%
Underperform	13	2.58%	0	0.00%

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

Other Disclosures:

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