

Neutral

Target price (HKD)	38.50
Share price (HKD)	35.50
Forecast dividend yield (%)	2.1
Potential return (%)	10.6

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Dec	2013 a	2014 e	2015 e
HSBC EPS	2.42	2.72	1.79
HSBC PE	14.7	13.0	19.8
Performance	1M	3M	12M
Absolute (%)	-18.3	-18.1	-49.7
Relative ^a (%)	-15.9	-21.5	-55.0

Note: (V) = volatile (please see disclosure appendix)

20 March 2015

Charlene Liu*

Analyst

The Hongkong and Shanghai Banking Corporation Limited

+852 2822 4398

charlenerliu@hsbc.com.hk

Scott Chan*

Associate

The Hongkong and Shanghai Banking Corporation Limited

+852 3941 7005

scotttkchan@hsbc.com.hk

Erwan Rambourg*

Global Co-Head of Consumer and Retail Research

The Hongkong and Shanghai Banking Corporation Limited

+852 2996 6572

erwanrambourg@hsbc.com.hk

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Galaxy Entertainment (27 HK)

N: In-line 4Q14; all eyes on Phase 2

- **Margin comes under pressure on higher operating costs**
- **Phase 2 and Broadway to open in May 2015**
- **Stay N, trim TP to HKD38.5 (from HKD39.9) on lower margin**

In-line 4Q14: Galaxy reported HKD2.664bn in group EBITDA, -19%qoq or -25%yoy.

The result is largely in-line with our and consensus' number. 4Q14 top-line was down 8% qoq and 15%yoy, therefore the sharp decline in margin drove the weak results:

1) Deterioration in gaming mix, despite results was buffered by luck; 2) increasing operating cost pressure which stemmed from higher labour costs and players' reinvestment due to keener competition. The company announced HKD0.28/share additional special dividend, FY14 payout is around 30%, which is again in-line with management's guidance.

By segment: StarWorld saw sharp drop in both VIP (-20%qoq) and mass revenue (-14%qoq). For VIP, more normalized luck (4Q14: 2.85% vs. 3Q14: 2.9%) dragged revenue marginally but market share loss could be in part the result of SunCity ramping up capacity at Altira in 4Q14. Higher operating costs put pressure on margin (4Q14: 13.9% vs. 3Q14: 16%) alongside HKD5m negative impact from luck. Galaxy Macau benefited in VIP (+2%qoq) despite rolling volume slightly underperformed market (-11%qoq). Mass segment (-12%qoq) also saw market share loss to other Cotai properties. Margin was down 2.7%qoq to 18.9% despite the result was helped HKD40m by luck, gaming mix and higher operating costs from labour are the key reasons for the decline. Performance of the CityClub and the construction business came in line with expectations.

Project pipeline: Broadway and Phase 2 will collectively add ~1,600 rooms. They will open on 27 May 2015 and have begun taking bookings. Management confirmed they have submitted request for additional tables for the two upcoming projects and will be in discussion with the government to finalize the table count. Management did not share how many junkets they plan to engage for the new opening but suggested that there are fewer well positioned candidates available now. Management reckoned that operating environment remains challenging and they will continue to keep a close eye on costs.

Stock implications: Post sharp drop in share price, the sector rebounded as investors tried to bottom fish. However we believe fundamentals remain weak and operating trend will continue to take time to see improvements. We maintain Neutral rating but trim TP from HK39.9 to HK38.5 on lower earnings and margin assumption. Performance of the new openings will be key in re-rating the share price, in our view.

Index ^a	HANG SENG INDEX
Index level	24,120
RIC	0027.HK
Bloomberg	27 HK

Source: HSBC

Enterprise value (HKDm)	136,345
Free float (%)	38
Market cap (USDm)	19,459
Market cap (HKDm)	150,944

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (HKDm)				
Revenue	66,173	72,350	63,839	65,517
EBITDA	12,393	13,232	10,982	12,142
Depreciation & amortisation	-1,950	-2,013	-3,746	-3,715
Operating profit/EBIT	10,444	11,219	7,237	8,427
Net interest	-383	278	348	368
PBT	10,037	11,652	7,745	8,959
HSBC PBT	10,037	11,652	7,745	8,959
Taxation	18	-71	-47	-54
Net profit	10,052	11,577	7,695	8,902
HSBC net profit	10,217	11,568	7,685	8,892

Cash flow summary (HKDm)

Cash flow from operations	13,709	14,693	13,176	14,318
Capex	-7,596	-8,136	-5,636	-1,236
Cash flow from investment	-2,481	-7,826	-5,256	-836
Dividends	-2,954	-3,099	-2,690	-3,112
Change in net debt	-6,067	-1,971	-6,699	-10,760
FCF equity	5,414	6,835	7,887	13,450

Balance sheet summary (HKDm)

Intangible fixed assets	1,715	1,500	1,312	1,147
Tangible fixed assets	28,938	35,276	37,355	35,040
Current assets	14,230	16,396	22,839	33,650
Cash & others	11,752	13,722	20,421	31,182
Total assets	46,257	54,691	63,175	71,661
Operating liabilities	12,314	14,032	16,007	18,278
Gross debt	643	643	643	643
Net debt	-11,109	-13,080	-19,778	-30,539
Shareholders funds	32,441	39,155	45,662	51,874
Invested capital	20,817	25,418	25,078	20,378

Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Y-o-y % change				
Revenue	16.4	9.3	-11.8	2.6
EBITDA	27.6	6.8	-17.0	10.6
Operating profit	32.6	7.4	-35.5	16.4
PBT	35.2	16.1	-33.5	15.7
HSBC EPS	34.2	12.5	-34.2	15.7

Ratios (%)

Revenue/IC (x)	3.6	3.1	2.5	2.9
ROIC	58.2	49.7	29.7	38.1
ROE	37.6	32.3	18.1	18.2
ROA	23.5	23.0	13.1	13.3
EBITDA margin	18.7	18.3	17.2	18.5
Operating profit margin	15.8	15.5	11.3	12.9
EBITDA/net interest (x)	32.3			
Net debt/equity	-33.6	-32.9	-42.7	-58.2
Net debt/EBITDA (x)	-0.9	-1.0	-1.8	-2.5
CF from operations/net debt				

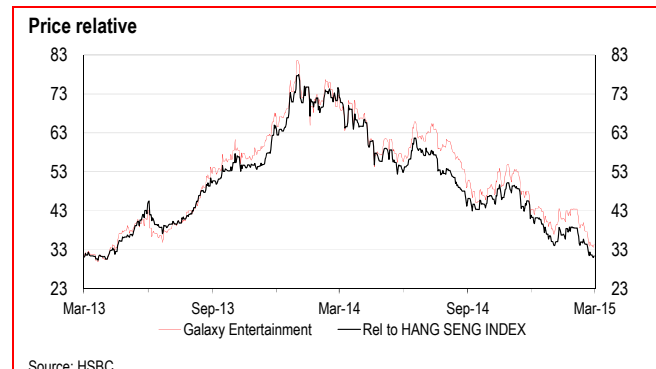
Per share data (HKD)

EPS reported (fully diluted)	2.38	2.73	1.79	2.08
HSBC EPS (fully diluted)	2.42	2.72	1.79	2.07
DPS	0.70	0.73	0.63	0.73
Book value	7.71	9.25	10.70	12.10

Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	2.1	1.9	2.0	1.8
EV/EBITDA	11.2	10.3	11.8	9.8
EV/IC	6.7	5.4	5.2	5.8
PE*	14.7	13.0	19.8	17.1
P/Book value	4.6	3.8	3.3	2.9
FCF yield (%)	3.6	4.6	5.3	9.0
Dividend yield (%)	2.0	2.1	1.8	2.0

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 19 Mar 2015

Results at a glance

Galaxy – 4Q14 results

	4Q13	3Q14	4Q14	QoQ	YoY
Gross revenues (HKDbn)					
StarWorld	6.3	5.7	4.6	-18%	-27%
Galaxy Macau	11.8	11.1	10.8	-2%	-8%
CityClubs	0.0	0.0	0.0	-20%	-15%
Construction Materials	0.8	0.5	0.5	2%	-32%
Other	-	-	-	na	na
GEG	18.9	17.3	16.0	-8%	-15%
EBITDA (HKDm)					
StarWorld	1,036	904	645	-29%	-38%
Galaxy Macau	2,518	2,397	2,045	-15%	-19%
CityClubs	39	41	33	-20%	-15%
Construction Materials	159	114	164	44%	3%
Other	(204)	(185)	(223)	21%	9%
GEG	3,548	3,271	2,664	-19%	-25%
EBITDA margin					
StarWorld	16.4%	16.0%	13.9%	-2.0%	-2.5%
Galaxy Macau	21.3%	21.6%	18.9%	-2.7%	-2.5%
CityClubs	100%	100%	100%	0.0%	0.0%
Construction Materials	21.1%	22.6%	31.9%	9.3%	10.8%
GEG	18.8%	18.9%	16.6%	-2.3%	-2.1%
StarWorld	4Q13	3Q14	4Q14	QoQ	YoY
Gross revenue (HKDm)	6,314	5,664	4,629	-18%	-27%
VIP	4,964	4,412	3,527	-20%	-29%
Mass	1,193	1,116	964	-14%	-19%
Other	157	136	138	1%	-12%
Rolling VIP turnover (bn)	182	150	124	-18%	-32%
VIP win rate	2.7%	2.9%	2.9%	0.0%	0.2%
Mass drop	2.94	2.66	2.42	-9%	-18%
Mass win rate	40.2%	41.4%	39.8%	-1.6%	-0.4%
Slots handle	0.78	0.68	0.53	-22%	-32%
Hold %	6.8%	6.6%	6.9%	0.3%	0.1%
Galaxy Macau	4Q13	3Q14	4Q14	QoQ	YoY
Gross revenue (HKDm)	11,798	11,116	10,844	-2%	-8%
VIP	8,143	7,239	7,369	2%	-10%
Mass	2,932	3,070	2,704	-12%	-8%
Other	723	807	771	-4%	7%
Rolling VIP turnover (HKDbn)	237	224	200	-11%	-16%
VIP win rate	3.4%	3.2%	3.7%	0.5%	0.3%
Mass drop	7.3	6.8	6.4	-7%	-13%
Mass win rate	39.9%	44.9%	42.5%	-2.4%	2.6%
Slots handle	7.7	9.3	8.5	-9%	10%
Hold %	4.8%	4.5%	4.2%	-0.3%	-0.6%

Source: Company, HSBC

Changes to our earnings forecasts

	Group total revenue			VIP segment			Mass segment		
	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e	FY15e	FY16e	FY17e
Old									
Revenue (HKDm)	63,842	65,787	63,972	41,126	37,867	34,490	16,124	20,108	21,608
Market share (%)	22.7%	21.5%	19.5%	27.5%	24.9%	22.5%	16.8%	18.2%	16.9%
New									
Revenue (HKDm)	63,839	65,517	63,877	41,126	37,867	34,490	16,124	20,108	21,608
Market share (%)	22.7%	21.5%	19.5%	27.5%	24.9%	22.5%	16.8%	18.2%	16.9%

Financial assumptions

	EPS (HKD)			EBITDA (HKDm)			EBITDA margin		
Old	1.80	2.22	2.16	11,020	12,932	12,670	17.3%	19.7%	19.8%
New	1.79	2.08	2.11	10,982	12,142	12,317	17.2%	18.5%	19.3%
Change (%)	-0.5%	-6.4%	-2.3%	-0.3%	-6.1%	-2.8%	-0.1%	-1.1%	-0.5%

Source: HSBC estimates

We maintain our Neutral rating. However, after factoring in 4Q14 earnings and updating dividend and FY15 assumptions, we lower Galaxy's target price to HKD38.5 (previously HKD39.9) which is based on unchanged SoTP valuation methodology.

Valuation methodology

We value Galaxy stock using a sum-of-the-parts approach. Our new 12-month target price of HKD38.5 (from HKD39.9) is based on unchanged: 1) StarWorld casino at 11x FY15e EV/EBITDA, (2) Galaxy Macau at 13x FY16e EV/EBITDA as we take into account the opening of Phase II in 2015 and full year of operations in 2016, (3) City Clubs at 5x FY14e EV/EBITDA, and (4) the construction business at 10x FY15e EV/EBITDA.

We value properties by categorizing them into (1) below industry growth, at 4-8x, (2) on a par with or marginally ahead of industry growth, at 9-12x which is the historical average range minus 1 standard deviation. Earnings quality which is contingent upon mass versus VIP contribution is also being taken into consideration in setting the multiple.

Under our research model, the Neutral band for non-volatile stocks equals the local hurdle rate (8.5% for Hong Kong), plus or minus 5ppt. Our target price of HKD38.5 implies a potential return of 10.6% (including the forecast dividend yield of 2.1%), which is within the Neutral band; we therefore reiterate our Neutral rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Galaxy – Valuation

Divisions	Valuation methodology	2015e NAV HKDm	Per Share HKD	% comp.
Gaming				
Galaxy StarWorld	11x 2015E EBITDA	21,281	4.96	15%
Galaxy Macau	13x 2016E EBITDA discounted by 10%	118,458	27.63	82%
CityClubs	5x 2015E EBITDA	817	0.19	1%
Construction Materials	10x 2015E EBITDA	4,742	1.11	3%
Gross asset value		145,298	33.89	100%
less net debt	2015E year-end forecast	(19,778)	(4.61)	
Target valuation by end-2015e		165,076	38.50	

Source: HSBC estimates

Investment risks

Key upside risks to our rating include: 1) earlier and more-than-expected macro easing in China, 2) earlier opening in Cotai project and 3) market share gain upon yield enhancement or more aggressive promotion.

Key downside risks to our ratings include: 1) China macro slowdown, 2) substantial delay in its Cotai project, 3) regulatory risks, especially from China, and 4) loss of market share due to competition.

Disclosure appendix

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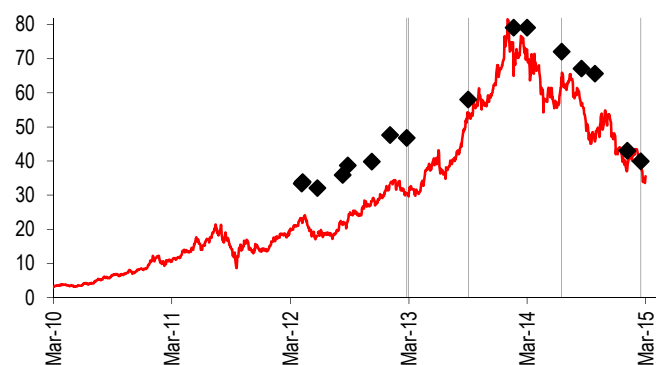
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Neutral (Hold)	40%	(28% of these provided with Investment Banking Services)
Underweight (Sell)	19%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Galaxy Entertainment (0027.HK) Share Price performance HKD Vs HSBC

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	12 March 2013
Overweight	N/A	18 March 2013
N/A	Neutral	18 September 2013
Neutral	Overweight	03 July 2014
Overweight	Neutral	04 March 2015
Target Price	Value	Date
Price 1	33.35	23 April 2012
Price 2	33.86	26 April 2012
Price 3	32.00	10 June 2012
Price 4	35.89	27 August 2012
Price 5	38.64	12 September 2012
Price 6	39.82	25 November 2012
Price 7	47.59	20 January 2013
Price 8	46.76	12 March 2013
Price 9	N/A	18 March 2013
Price 10	58.00	18 September 2013
Price 11	79.00	05 February 2014
Price 12	79.00	19 March 2014
Price 13	72.00	03 July 2014
Price 14	67.00	03 September 2014
Price 15	65.50	14 October 2014
Price 16	43.00	22 January 2015
Price 17	39.90	04 March 2015

Source: HSBC

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
GALAXY ENTERTAINMENT	0027.HK	35.50	19-Mar-2015	6, 11

Source: HSBC

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Issuer of report

**The Hongkong and Shanghai
Banking Corporation Limited**

Level 19, 1 Queen's Road Central
Hong Kong SAR

Telephone: +852 2843 9111

Fax: +852 2596 0200

Website: www.research.hsbc.com

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Global Consumer Brands & Retail Research Team

Europe

Consumer Brands & Retail

Antoine Belge
Head of Consumer Brands and Retail Equity Research
+33 1 56 52 43 47 antoine.belge@hsbc.com

Anne-Laure Jamain
Analyst
+44 207 991 6587 annelaure.jamain@hsbcib.com

David McCarthy
Head of Consumer Retail, Europe
+44 207 992 1326 david1.mccarthy@hsbcib.com

Andrew Porteous
Analyst
+44 20 7992 4647 andrew.porteous@hsbc.com

Jérôme Samuel
Analyst
+33 1 56 52 44 23 jerome.samuel@hsbc.com

Emmanuelle Vigneron
Analyst
+33 1 56 52 43 19 emmanuelle.vigneron@hsbc.com

Paul Rossington
Analyst
+44 20 7991 6734 paul.rossington@hsbcib.com

Graham Jones
Analyst
+44 20 7992 5347 graham.jones@hsbc.com

Damian McNeela
Analyst
+44 20 7992 4223 damian.mcneela@hsbc.com

CEEMEA

Consumer Brands & Retail

Bulent Yurdagul
Analyst
+90 212 3764612 bulentyurdagul@hsbc.com.tr

Jeanine Womersley
Analyst
+27 21 6741082 jeanine.womersley@za.hsbc.com

Specialist Sales

David Harrington
+44 20 7991 5389 david.harrington@hsbcib.com

Asia

Consumer Brands & Retail

Erwan Rambourg
Head of Consumer Brands and Retail Equity Research
+852 2996 6572 erwanrambourg@hsbc.com.hk

Christopher Leung
Analyst
+852 2996 6531 christopher.k.leung@hsbc.com.hk

Lina Yan
Analyst
+852 2822 4344 linayjyan@hsbc.com.hk

Catherine Chao
Analyst
+852 2996 6570 catherinefchao@hsbc.com.hk

Charlene Liu
+852 2822 4398 charlenerliu@hsbc.com.hk

Alice Chan
+852 2996 6535 aliceptchan@hsbc.com.hk

Karen Choi
Analyst
+822 3706 8781 karen.choi@kr.hsbc.com

Jena Han
Analyst
+822 3706 8772 jenahan@kr.hsbc.com

Permada (Mada) Darmono
Analyst
+65 6658 0613 permada.w.darmono@hsbc.com.sg

Ananita M Kusumaningsih
Analyst
+65 6658 0610 ananita.m.kusumaningsih@hsbc.com.sg

Thilan Wickramasinghe
Analyst
+65 6658 0609 thilanw@hsbc.com.sg

Amit Sachdeva
Analyst
+91 22 2268 1240 amit1sachdeva@hsbc.co.in

Chloe Wu
Analyst
+ 8862 6631 2866 chloe.c.wu@hsbc.com.tw

North & Latin America

Consumer & Retail

Richard Cathcart
Analyst
+55 11 2169 4429 richard.cathcart@hsbc.com

Stewart Ragar
Analyst
+55 11 3847 9342 stewart.h.ragar@us.hsbc.com

Ruben Couto
Associate
+ 55 11 2169 4615 ruben.c.couto@hsbc.com.br

Food & Beverage
James Watson
Analyst
+1 212 525 4905 james.c.watson@us.hsbc.com

Agricultural Products
Alexandre Falcao
Analyst
+55 11 3371 8203 alexander.p.falcao@hsbc.com.br

Ravi Jain
Analyst
+1 212 525 3442 ravijain@us.hsbc.com

Gustavo Gregori
Analyst
+55 11 3847 9881 gustavo.h.gregori@hsbc.com.br