

Gaming In Macau Is Not Busted Yet

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Macau, the former Portuguese colony in the Far East, was returned to the People's Republic of China in 1999 as a Special Administrative Region (SAR). The other SAR in China is Hong Kong, the former British colony which is one hour from Macau by ferry and 15 minutes by helicopter. For decades, the gaming industry in Macau was monopolized and mainly served gamblers from Hong Kong and nearby regions.

Since being handed over to China, Macau has opened up its gaming market and has been cashing in on its unique status as the only jurisdiction in China where casino gaming is legally allowed. Thanks to the booming economy in China and the Vegas-style properties brought in by the new market players, the gaming business in Macau has grown so fast that in less than a decade its gaming revenue has become seven times bigger than that of Las Vegas. In 2013, the per capita gross domestic product of Macau surpassed Switzerland.

However, in the last 12 months or so, investor confidence in Macau gaming stocks has fallen dramatically. The major downturn in business apparently is a combined result of certain measures taken by the Chinese Central government and its slowing economy. More recently, the lobbying for a complete smoking ban in the casinos and news concerning the theft of possibly hundreds of millions of dollars from a junket in one of the major casinos is not helping the situation.

Gaming Operators and Junkets

A casino in Macau offering table games and slot machines must either be operated under a concession or subconcession granted by the Macau government. Currently there are three concessionaires and three subconcessionaires making a total of six operators. These operators are well-known even to the nongaming public because of their luxurious hotels, entertainment facilities, shopping arcades and food

and beverage outlets which are the basic fixtures in a world-class gaming resort.

Junkets, more formally known as “gaming promoters”, are independent companies or individuals who are registered and licensed by the Macau gaming regulator, namely the Gaming Inspection and Coordination Bureau (also known as DICJ because of its name in Portuguese: Direcção de Inspeção e Coordenação de Jogos). While some junkets enjoy some name recognition in the gaming market, they are generally unknown to the public.

Junkets operate VIP or private rooms in casinos, usually for their own clientele. Their patrons can stay at the properties where the junkets operate and make use of the facilities in the resorts. While the casinos operate all junket gaming tables, supply the dealers, supervisors, surveillance and security, the junkets typically are risking their own balance sheet when their patrons gamble. The casino receives a commission from the junkets based on several possible formulas related to either gross gaming win or the junket's turnover.

Legalization of Gaming Credit

Since the opening up of the gaming market in the 2000s, the Macau Legislature has legalized gaming credit. Legalized gaming credit is very common in other gaming jurisdictions such as Nevada. But in Macau before the new law was enacted giving credit for gaming was a crime.

Under the gaming credit law, casinos and junkets may give credit to their patrons typically in the form of non-negotiable chips as opposed to cash chips. If the borrowers do not repay the credit in either chips or cash, the debt may be enforced against the borrowers by legal process in Macau or jurisdictions where the enforcement of gaming credit is recognized (Hong Kong is one of them). The law also permits casinos to give credit to junkets. Some junkets take credit from the casino where they are operating, usually in the form of non-negotiable chips and then lend the non-negotiable chips to their patrons, thus taking the credit risk on their patrons.

In a way, by lending non-negotiable chips the casino lends to its patrons or junkets without giving away cash or cash-equivalent. The cost or potential risk to the casino is that, other than being beaten by the patron with borrowed chips where in such case the casino has to pay the winning in cash chips, the casino has to pay tax on the gross gaming win. In other words, if a patron borrows chips, loses them on the table and defaults on the debt, the casino stands to lose the tax it has to pay on the gaming win. Additionally, the casino has an account receivable which impacts its profit as the casino accrues reserves for the debt and eventually may write the debt off entirely. Any tax paid on the gaming win will not be refunded even if the debt is subsequently written off.

When the casino takes enforcement actions against a borrower, legally speaking they are suing on a loan instead of a gaming win. The gaming win is booked when the chips are seized on the table from the borrower. For practical purposes the casino tends to sue in jurisdictions where the borrower lives and has assets. Unfortunately not every jurisdiction allows lawsuits for recovery of a gaming related debt. Interestingly, China (which has her own judicial system different from Hong Kong and Macau) does not permit this type of lawsuit.

Recent News Concerning a Junket

As junkets operate somewhat independently like a casino within a casino, they may also maintain accounts for their patrons, such that funds can be deposited by the patrons with the junkets. Lately, it

has been reported that as much as \$258 million has been stolen from a junket by its employee. As junkets are independent licensed operators, any money received by the junkets is handled by junket employees and not the casinos. The junket's obligation in honoring withdrawal requests arises from a direct contractual relationship between the junkets and their patrons without involving the gaming operator. The junkets may also face regulatory scrutiny for acting essentially as an unlicensed bank if they take deposits for working capital and pay interest on the deposits.

This may give some comfort to investors who have stakes in one of the six gaming operators. Yet, some Macau junkets are owned by companies listed on the Hong Kong Stock Exchange.

A More Competitive Market

The recent downturn in gaming revenue has put a number of junkets out of business. On a macro level it has caused the Macau Government to cut spending. It has also somewhat put the discussion about complete smoking ban in casinos to a halt.

Riding on the tide from other countries in the region such as Singapore, the Philippines and Korea also have resort-style licensed casinos. In Macau a number of new properties developed by the existing gaming operators are due to open in the coming months. With the market becoming more competitive and supply going to increase, it is anticipated the casinos and junkets in Macau will be more aggressive in giving gaming credit on better terms to attract more business. This will be good news to the high rollers. But even to the nongaming public, a civilized and safe entertainment city with high-end resorts and dining options is always a good choice for a quick getaway.

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