



N/R
103.5p

Property development in Macau

AIM	MPO
Reuters/Bloomberg	
No. of shares in issue (m)	105
Market Cap (£m)	108.7
Pro forma net debt (£m) ¹	23.3
EV (£m)	132.0
Website	www.mpofund.com

¹ – see page 5

NAV (p)	136
Discount to NAV (%)	24

Shore Capital NPV (p)	155
Discount to NPV (%)	33

Performance	1M	3M	12M
Absolute (%)	6	19	76
Rel Index (%)	6	6	8

Relative to FTSE AIM All-Share

Research analysts

Jon Bell

0207 647 8130

Gavin Jago

0207 647 8121

Macau Property Opportunities Fund

Asian tiger back with a roar

Buoyed by rising visitor levels and gaming revenues, Macau has staged a dramatic recovery. Despite this, Macau Property Opportunities Fund* ('MPO') still trades at a large discount (c24%) to its NAV. We expect this to narrow further as investors warm to the exciting period that lies ahead. MPO is now in possession of its units in Tower Six of One Central, where design improvements are expected to further enhance Macau's most desirable address. Elsewhere, strong progress is being made and the company is poised to unlock significant value from its developments.

Economic and other developments augur well. Macau's incoming Chief Executive is expected to provide a welcome boost to the region, leveraging off his strong connections with Beijing. In recent months, visitor numbers, gaming revenues and property prices have all risen (high end residential prices rose by c10% in the third quarter, mirroring the trend in Hong Kong). The recent IPOs of Wynn Macau and the Macau assets of Las Vegas Sands Corp in Hong Kong raised in excess of \$4bn, heralding the return of institutional interest and providing the region with a welcome injection of new capital.

MPO now entering an exciting new phase. Following the early handover of Tower Six, MPO appointed the illustrious interior design company, *Glamorous*, with the intention of enhancing its already well-appointed apartments into the most desirable in Macau (*Glamorous* is based in Japan, which has huge kudos in China, and should help to attract tenants). The company's development portfolio is also making strong progress. The Rua da Penha residential project is expected to break ground this year and planning is advancing at the Rua do Laboratório site.

Attractive valuation. Despite a strong recent performance (from a low base), MPO's share price stands at a large discount (24%) to its last reported NAV (136p). We expect this to narrow further as it progresses its developments and enjoys the continued (but sustainable, in our view) growth of Macau. We believe there is scope for further NAV uplifts and value the company at 155p per share, a 50% premium to the current share price. The company's manager, Sniper Capital, sees attractive value too and now owns 4.5% of MPO's share capital.

Summary

MPO floated on AIM in June 2006, raising £105m

Macau Property Opportunities Fund ('MPO') is a dedicated property developer in Macau, a 'special administrative region' (SAR) of China, and the surrounding Pearl River Delta region. MPO floated on AIM in June 2006 and currently has a market capitalisation of c£109m. The company's strategy is to take advantage of niche property opportunities, which it believes have been overlooked by larger investors.

Investment opportunity

We believe MPO provides a compelling investment opportunity, highlighting the following:

- **Long term drivers of strong economic growth remain intact** – the economy of Macau has rebounded in recent months, buoyed by a rise in the number of tourists and gaming revenues (Macau is the only region of China in which gaming is legal). We understand that the continuation of strong gaming revenues during the final quarter would result in 2009 setting a new record.
- **Highly experienced management team** with a proven track record, established local presence and strong banking relationships. Sniper Capital, the company's manager, has established an excellent reputation in the local market and has generated high returns from its activities in the region. The team has garnered strong institutional support for MPO as a result of the frequency and transparency of its updates and its professional approach.
- **Rigorous approach to acquisition opportunities** – since its inception, MPO has evaluated a large number of investment opportunities. Only a small number of these have proceeded to completion as management has adopted a prudent and highly selective approach to capital deployment.
- **Enviably portfolio of projects** – this cautious and discerning investment approach has left the company with a high quality, diversified portfolio of projects in Macau and the Pearl River Delta. We also believe that the company is well placed to deliver new projects at attractive prices, generating further upside for investors.
- **Attractive valuation** – we adopt a sum-of-the-parts approach and value the company, using assumptions we believe to be conservative, at 155p per share, a c50% premium to the current share price.

The long term drivers of economic prosperity in the region are firmly intact and provide a helpful backdrop to the company's activities. Indeed, we believe that MPO is well placed to extract significant value from its existing projects and extend its current portfolio, generating high returns for shareholders. In our view, the share price discount to NAV is unwarranted and provides an outstanding investment opportunity.

Recent developments in the region

The appointment of a new Chief Executive is expected to herald the start of a new era for Macau

Appointment of new Chief Executive – in December, as the territory celebrates ten years as a special administrative region (SAR), Fernando Chui Sai-on ('Chui') will take over as the region's Chief Executive. Chui has strong links with Beijing and is expected to further diversify the region's economy.

Renewed confidence and institutional interest in the region – in recent weeks, the IPOs of Wynn Macau (the fourth largest IPO in the world this year) and the Macau assets of Las Vegas Sands Corporation have taken place in Hong Kong raising in excess of \$4bn. In addition to confirming the return of investor appetite, these new funds will provide a helpful injection of capital into the region and serve to restart mothballed projects. According to press reports, Galaxy Entertainment Group is also seeking to raise \$1bn to finance the construction of its Cotai Strip resort project.

"The quarter saw a pick-up in investment activity, with recently completed projects such as One Central Residences...being particularly sought after" (Source: Jones Lang LaSalle, Asia Pacific Property Digest, Q3 2009)

Rising visitor numbers, gaming revenues and property prices – tourist numbers began to increase in the second half of 2009. In September, they increased by c4% from a year earlier and gaming revenues reached an all time high of \$1.6bn the following month. According to Jones Lang LaSalle, capital values of high end residential properties rose by over 10% in Q3 of 2009.

Major bridge building programme commencing soon – The Hong Kong–Zhuhai–Macau bridge will be c29km long (one of the longest in the world) and is expected to reduce road travel time between Macau and Hong Kong from 4.5 hours to 40 minutes (a boost to hauliers and casino operators alike). Construction is expected to commence in December and completion is expected in 2015.

Construction of the new rail system expected to break ground next year – The Macau Light Rapid Transit (LRT) system will serve the Macau Peninsula, Taipa and Cotai. It will connect all of the region's major entry points, casinos, entertainment centres and residential areas. Construction is expected to commence in 2010 with the first phase to be completed in 2014.

Neighbouring territories are also receiving assistance from Beijing and should further enhance economic conditions in the wider region

Regeneration of Hengqin Island – Hengqin Island, which is part of Zhuhai, has been chosen as China's third new strategic zone after Pudong (Shanghai) and Binhai (Tianjin). Initial proposals for the regeneration of the island include an ocean themed entertainment centre and a branch of Macau's university. The population of Hengqin is expected to rise from c4,000 to 280,000 by 2020 (Source: Guangdong Provincial Government).

Pragmatic implementation of controls – the Macau government has proposed a number of initiatives in order to prevent the overheating of the domestic economy, including restrictions on the number of gaming tables. In addition, there are some suggestions that the government could increase the minimum age limit for gaming from 18 to 21 years of age. We believe these measures are pragmatic and designed to promote the sustainability of the region, rather than stymie its growth.

Recent developments for MPO

Tower Six has been handed over and the company is planning to further enhance the value of its apartments

Handover of apartments in One Central Residences – In August, ahead of schedule, Tower Six (which comprises 54 standard units and 5 duplex/simplex units) was handed over to MPO in a fully-fitted and well-appointed state. In addition, the company has taken possession of its 25 other apartments in the development, which are of an equally high standard of finish. In order to finance the purchase, MPO has drawn down on its \$82m loan with a consortium of international banks led by HSBC[^] (Buy at 745p). The loan facility extends until mid 2012.

Appointment of the Glamorous design agency – Immediately following the handover, the company appointed the illustrious design agency, *Glamorous*, in order to enhance the already high standard of fit out of the apartments. *Glamorous*, which is run by Yasumichi Morita, is based in Japan (Japanese products and design have huge kudos in China) and has won an enviable collection of awards since it was established in 1996.

Creating the most desirable residential location in Macau - It is the intention of the company's manager that Tower Six becomes the premier residential address in Macau and we see the appointment of the *Glamorous* design agency as a key milestone in achieving this aim. We estimate that the company will invest a further \$4.3m in this respect and that work will commence shortly.

Other projects are progressing through the planning system and are expected to break ground soon

Development programme entering an exciting new phase – MPO is now entering an exciting period with its low-rise Rua da Penha project (see pages 6-7) scheduled to break ground this year, and planning progressing at its Rua do Laboratório (see page 11) project. In addition, planning in relation to the company's Senado Square project (see pages 12-13) is now at an advanced stage and significant progress has been made in respect of the Zhuhai logistics project (see pages 14-15).

Discussions with lenders for project finance are at an advanced stage. We understand that management is in advanced discussions with lenders in order to finance its development project portfolio at competitive rates. In the context of constrained project finance (at a global level), we believe this provides a strong endorsement of management's banking relationships and look forward to learning further details in due course.

Sniper Capital, the company's manager, now owns 4.5% of its share capital

Increase in Sniper Capital investment – We note a slew of recent share purchases by Sniper Capital, the company's manager, which now owns c4.5% of its share capital. In our view, this provides a strong endorsement of the company's future prospects.

Shore Capital's valuation of the portfolio

We value the company at 155p per share using our sum-of-the-parts approach

MPO's current portfolio is summarised in the table below.

Fig 1: Portfolio valuation

Project	Type	\$m
Rua da Penha	Residential (niche)	24.1
One Central ¹	Residential (premium luxury)	180.5
Rua do Laboratório	Residential (entry level)	40.9
Senado Square	Mixed-use	38.4
Zhuhai logistics site	Industrial	13.8
Other assets	Various	10.3
Pro forma cash/(debt) ²		(39.0)
Net present value (NPV)		269.0
Shares in issue (m)		105.0
Shore Capital NPV per share (\$c) ³		256
Shore Capital NPV per share (p)⁴		155
Current share price (p)		103.5
Shore Capital NPV premium to share price (%)		50

Source: Shore Capital Stockbrokers

¹ – Tower Six (comprising 59 luxury apartments) and 25 additional units in other towers

² – based on a current cash balance of c\$43m, adjusted for committed consideration in relation to One Central

³ – before any accrual for performance fees

⁴ – using £1 = \$1.65 as at 24th November 2009

Our analysis uses a number of assumptions, including:

- A cost of debt of c2.6% (a 240bps premium to 3-month HIBOR, which is currently c0.2%). With the exception of the Zhuhai logistics site (where we use a 50/50 debt equity ratio), we apply 2.6% as the weighted average cost of capital (WACC), as the company intends to finance construction costs of its other projects entirely by debt (land spend, which is a relatively high component of total costs, has been financed entirely by equity).
- Yields of 2.5% and 3.0% on prime residential, and 6.0% and 10.0% on retail and logistics properties, in line with prevailing rates.
- The disposal of properties held within special purpose vehicles (SPVs) results in no liability to taxation. We believe this would apply to the company's interest in properties in Tower Six of One Central, where we assume any disposal would be undertaken *en bloc*. We assume that the sale of other residential units gives rise to a tax charge at a rate of 12% (the prevailing corporate tax rate in Macau). Trading profit earned throughout the period of ownership is also taxed in our model at 12%.

Fig 2: Rua da Penha

Sector	Residential
Type	Redevelopment
Positioning	Niche
Current Status	Advanced planning
Valuation ¹	\$21.9m

Source: MPO

¹ – Independent valuation as at 30th June 2009

Rua da Penha – niche residential project

MPO owns a prime residential redevelopment site in Penha, a well-established neighbourhood in the southwest of the Macau Peninsula, where the Portuguese first settled. Management intends to redevelop the property into mid-rise, residential apartments targeted at the high-end of the local market.

The site was purchased for \$8.6m in October 2006 and management estimates that development costs will amount to c\$11.4m. We understand that construction is expected to commence in the near future and be completed by the end of 2010.

A digital image of how the development could look on completion is shown below.

Fig 3: An artists's impression of MPO's Rua da Penha project



Source: MPO

We estimate the net present value of the Rua da Penha project at c\$24.1m

We make the following assumptions:

- 60 units are sold over a two year period at an average price of \$700,000 (c\$655 per ft² of net saleable area). The average size of an apartment is c1,065 ft². We expect pre-selling to commence during 2010 (though accounting convention dictates that revenues and profits are booked at the point of completion).
- Construction commences at the start of 2010 and lasts c12 months. Build costs are c\$131 per ft² of gross build area (c87,000 ft²).

Fig 4: Rua da Penha - discounted cash flow model (\$m)

Year	2009	2010	2011
Unit sales	0	0	60
Average sales price per unit ¹	0.70	0.70	0.70
Sales income	0.0	0.0	42.0
Build phasing (%)	0	100	0
Build costs, interest and tax	0.0	(11.5)	(4.9)
Cash in/(out)flow	0.0	(11.5)	37.1
2.6% discount factor (WACC)	1.0	0.97	0.95
Present value	0.0	(11.2)	35.3
Net present value			24.1

Source: Shore Capital Stockbrokers

Figures subject to rounding

¹ – includes parking space

Fig 5: One Central

Sector	Residential
Type	Development
Positioning	Premium
Current Status	Under ownership
Valuation ¹	\$158.8m

Source: MPO

¹ – Independent valuation as at 30th June 2009

One Central (Tower Six + 25 units) – premium luxury residential project

MPO owns Tower Six of One Central Residences, widely regarded as the most sought after development on the Macau Peninsula. It acquired the tower for consideration of \$86.6m (the equivalent of c\$590 per square foot). Tower Six comprises 59 luxury residential units (including two duplex and three large simplex apartments) and offers outstanding views of the nearby lake.

The company also owns 25 individual units located in other towers in the development, which it acquired for an additional \$48.3m, the equivalent of c\$910 per square foot.

All of the company’s units have views of the lake and should, in our view, command premium prices, particularly duplex and simplex units which have an additional scarcity value (the company will own five of just c20 such units in the complex). Although management has a number of strategic options in respect of this asset, we understand that its current intention to retain ownership of Tower Six and seek tenants.

We believe that One Central will be the premier, mixed-use development on the Macau Peninsula

Fig 6: Construction of One Central is well advanced



Source: MPO

We make the following assumptions in our valuation model, which is illustrated below:

- Rents of HK\$43,000 per month for standard units.
- Rents of HK\$100,000 for duplex/simplex units reflecting their scarcity value.
- Rents of HK\$42,000 for all other owned apartments.
- A yield of 2.5% and vacancy rate of 5% on duplex and simplex units.
- A yield of 3.0% and vacancy rate of 10% on all other units.

Fig 7: One Central assets - valuation model

	Tower Six			Other 25 units	Total
	Standard	Duplex	Simplex		
Units	54	2	3	25	84
Average unit size (gross ft ²)	2,311	4,487	4,739	2,127	2,395
Total area (gross ft ²)	124,807	8,973	14,217	53,186	201,183
Rent in HK\$ per month	43,000	100,000	100,000	42,000	
Exchange rate (HK\$: US\$)	7.8	7.8	7.8	7.8	
Rent in US\$ per month (fully let)	5,513	12,821	12,821	5,385	
Rent in US\$ per month (with vacancy)	4,962	12,179	12,179	4,846	
Annual rent (US\$)	59,538	146,154	146,154	58,154	
Yield (%)	3.0	2.5	2.5	3.0	
Value per unit (US\$m)	2.0	5.8	5.8	1.9	
Value of units (US\$m)	107.1	11.7	17.5	48.5	184.8
Refurbishments costs ¹ (US\$m)					(4.3)
Net present value (US\$m)					180.5

Source: Shore Capital Stockbrokers

Figures subject to rounding

¹ – refurbishment costs of units in Tower Six assumed at 5% of original purchase cost

We value the company's residential units in One Central at \$180.5m (net of tax and refurbishment costs), which equates to an average of c\$900 per square foot (an uplift of c34% on the blended purchase price).

Our research suggests that there is strong demand for units in One Central

Our research reveals that there has been a marked increase in transaction volumes at One Central in recent months. We understand that 5% of units at the development changed hands in September 2009, supporting our view that there is a strong appetite for the apartments.

Indeed, according to Jones Lang Lasalle (Asia Pacific Property Digest – Third Quarter 2009) average capital values in One Central rose by c10% in Q3 2009 compared to the prior quarter.

Fig 8: Rua do Laboratório

Sector	Residential
Type	Redevelopment
Positioning	Entry-level
Current Status	Consolidating
Valuation ¹	\$38.2m

Source: MPO

¹ – Independent valuation as at 30th June 2009**Rua do Laboratório – entry-level residential project**

Located in the northern part of the Macau Peninsula – an area which is undergoing widespread redevelopment and infrastructure improvements – the Rua do Laboratório site was purchased in November 2006 for \$20.6m. MPO intends to redevelop the site, which is situated close to the border crossing, into entry-level, high-rise apartments. The projected development cost is \$29.4m.

Planning for the project is making headway.

We make the following assumptions:

- 341 units are sold at an average price of \$235,000 per unit (equivalent to c\$437 per ft² of net saleable area). The average size of an apartment is c537 ft².
- Construction commences in mid 2010 and lasts for c18 months. Build costs amount to \$29.4m, equivalent to \$108 per ft² (based on gross build area of c273,000 ft²).

Fig 9: Rua do Laboratório - discounted cash flow model (\$m)

Year	2009	2010	2011
Unit sales	0	0	341
Average sales price per unit	0.24	0.24	0.24
Sales income	0.0	0.0	80.0
Build phasing (%)	0	40	60
Build costs, interest and tax	0.0	(11.9)	(24.7)
Cash in/(out)flow	0.0	(11.9)	55.3
2.6% discount factor (WACC)	1.0	0.97	0.95
Present value	0.0	(11.6)	52.5
Net present value			40.9

Source: Shore Capital Stockbrokers

Figures subject to rounding

Fig 10: Senado Square

Sector	Mixed-use
Type	Redevelopment
Positioning	Retail/Tourism
Current Status	Advanced planning
Valuation ¹	\$33.2m

Source: MPO

¹ – Independent valuation as at 30th June 2009

Senado Square, close to the location of the company’s mixed-use project, is one of the most popular tourist destinations on the Macau Peninsula and is rich in architectural history

Senado Square – mixed-use project

On a site adjacent to Senado Square, a popular tourist destination on the Macau Peninsula, management intends to construct a six storey retail and entertainment complex. The site is located in the territory’s World Heritage district, which has a rich Macanese architectural history.

The site was acquired in October 2007 for \$16.0m. Purchased from 17 different owners, the acquisition process took two years and provides evidence of management’s ability to conclude complex transactions. Estimated construction costs are \$17.0m.

Fig 11: Artist's impression of MPO's Senado Square development



Source: MPO

We value the project at
c\$38.4m

We make the following assumptions:

- The site is redeveloped into a retail building with a net lettable area of c65,000 ft², which commands rent of \$4.5 per ft² per month (in our view, this is conservatively struck and well below the prevailing prime market rent of \$18-25 per ft² per month – see section of the Macau retail property market).
- Construction costs amount to \$17.0m, the equivalent of \$208 per ft² (based on a gross developable area of 81,600 ft²). It commences in early 2010 and takes 18 months to complete.
- An occupancy rate of 95%.
- A yield of 6%.

Fig 12: Senado Square - discounted cash flow model (\$m)

Year	2009	2010	2011	2012
Rent per ft ² (\$)	4.5	4.5	4.5	4.5
Occupancy (%)	0	0	35	95
Rental income	0.0	0.0	1.2	3.3
Terminal value (using a 6% yield)				55.7
	0.0	0.0	1.2	59.0
Build phasing (%)	0	50	50	0
Build costs, interest and tax	0.0	(8.6)	(7.6)	(0.8)
Cash in/(out)flow	0.0	(8.6)	(7.6)	58.2
2.6% discount factor (WACC)	1.0	0.97	0.95	0.93
Present value	0.0	(8.4)	(7.2)	54.0
Net present value				38.4

Source: Shore Capital Stockbrokers

Figures subject to rounding

The Zhuhai industrial site gives MPO direct exposure to the storage and logistics sector

We value the project at c\$13.8m

Zhuhai Logistics Centre – industrial project

In August 2008, MPO announced the purchase of a 1.1m ft² site in Zhuhai for an initial acquisition cost of \$11m. Three warehouses with a total floor area of 210,000 ft² currently exist on the site and are approximately 60% leased. The rest of the land is vacant and is suitable for development, either as a build-to-suit or standard inventory logistics and manufacturing facility with a net lettable floor area of c1.4m ft², including c370,000 ft² of employee accommodation.

We make the following assumptions:

- Rent of \$0.33 per ft² per month is achieved.
- Construction commences in 2010 and takes three years to complete.
- Build costs amount to \$34.0m (equivalent to c\$24 per ft²).

Fig 13: Zhuhai logistics - discounted cash flow model (\$m)

Year	2009	2010	2011	2012	2013
Rent per ft ² (\$)	0.3	0.3	0.3	0.3	0.3
Occupancy (%)	0	0	0	0	95
Rental income					5.3
Terminal value (using 10% yield)					52.7
	0.0	0.0	0.0	0.0	58.0
Build phasing (%)	0	40	30	30	0
Build costs, interest and tax	0.0	(13.8)	(10.7)	(11.0)	(1.3)
Cash in/(out)flow	0.0	(13.8)	(10.7)	(11.0)	56.7
5.4% discount factor (WACC)	1.0	0.95	0.90	0.85	0.81
Present value	0.0	(13.1)	(9.6)	(9.4)	45.9
Net present value					13.8

Source: Shore Capital Stockbrokers

Figures subject to rounding

A digital image of how the development could look on completion is shown below.

Fig 14: Artist's impression of MPO's Zhuhai Logistics Centre development



Source: MPO

MPO has purchased a number of other properties in Macau for a total consideration of \$7.3m

The company has recently agreed terms to finance its One Central residential units on terms we consider to be attractive

Other assets

MPO has acquired a number of other property assets, where it believes there is scope for material capital appreciation as investments in their own right, or through consolidation, refurbishment or redevelopment. To date, total consideration for assets of this type has been \$7.3m. We assume that these are worth \$10.3m (based on the latest independent valuation).

Financing

It is management's strategy to finance properties, subject to a maximum loan-to-value of 60% for the fund.

In June 2008, the company agreed terms for an \$82m forward commitment loan facility with a consortium of international and Macanese banks led by HSBC. After the recent handover of the units in One Central, the facility was fully drawn down.

We understand that the LTV ratio at the end of June 2009 was c25% (the applicable LTV covenant is 55%).

Management is also in advanced discussions with lenders regarding construction financing for its redevelopment projects.

Independent valuation

Savills values the company's projects every six months...

An independent valuation of the company's projects (in accordance with prevailing RICS property valuation practice) was undertaken by Savills in June 2009 (and takes place every six months). Details of the most recent exercise are shown in the table below:

Fig 15: Savills' valuation of MPO's properties as at 30th June 2009 (US\$m)

Property	Latest valuation	Uplift since acquisition (%)
Rua da Penha	21.9	172
One Central	158.8	14
Rua do Laboratório	38.2	78
Senado Square	33.2	106
Zhuhai logistics site	12.9	19
Other assets	10.3	42
Total	275.3	36

Source: MPO

...and calculates that the properties owned by the company as at the period end have appreciated in value by c36% compared with their acquisition costs

Based on this independent valuation exercise, the company's NAV as at 30th June 2009 was \$2.25 per share, which equates to 136p per share (based on the exchange rate of £1 = \$1.65 as at 30th June 2009, also the prevailing exchange rate today).

Background to Macau

Like Hong Kong, Macau is a 'special administrative region' ('SAR') of China. Formerly a Portuguese colony, the region comprises a peninsula and two islands (Coloane and Taipa), which have been united through land reclamation with the connecting stretch of land now known as 'Cotai'. Portuguese traders, who had settled in Macau in the 16th century, administered Macau until its handover to China in 1999.

Macau is a 'special administrative region' of China and is the most densely populated region in the world

Macau is located on the western side of the Pearl River Delta, bordered to the north by the Guangdong province and the South China Sea to the east and south (see below). It is situated 60km southwest of Hong Kong, and has an area of just 29.2km².

Fig 16: Maps of Macau and the surrounding region



Source: MPO

The region's currency is the Macanese Pataca (MOP), which is pegged to the HK\$ (which, in turn, is pegged to the US\$). The vast majority (c95%) of the region's population is Chinese; a further 2% is of a mixed Chinese/Portuguese descent (an ethnic group referred to as Macanese).

Chinese and Portuguese are Macau's official languages.

Two billion people live within five hours' flying time of Macau

Macau, which has a population of c550,000, is one of the most densely populated regions in the world with c18,800 people per square kilometre (its area is just 2.5% of that of Hong Kong). Its location, close to mainland China and Hong Kong, means that it is within easy reach of a huge (and growing) population. It is estimated that c2 billion people live within five hours' flying time of Macau International Airport. The region is a rapidly growing tourist destination, the result of it being the only part of China in which gaming is legal.

Fig 17: Senado Square, a popular tourist destination



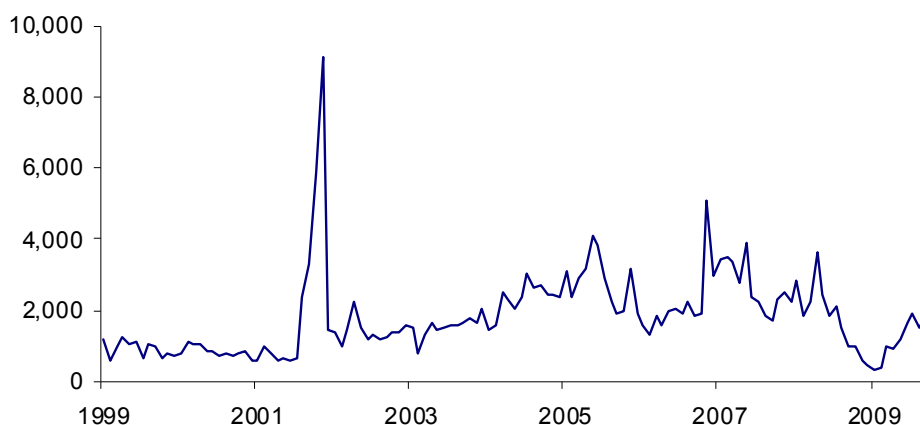
Source: MPO

The Macau property market

Under existing legislation, foreign firms and individuals are free to establish companies and are not subject to ownership restrictions in Macau. The government has established a centralised property database where title to property is formally registered. In this section, we examine the region's property segments in more detail.

The number of real estate transactions in Macau over the past decade is shown in the chart below. Following a sharp decline between the end of 2007 and the start of 2009, transaction levels have rebounded in recent months.

Fig 18: Macau real estate transactions (1999 - 2009)



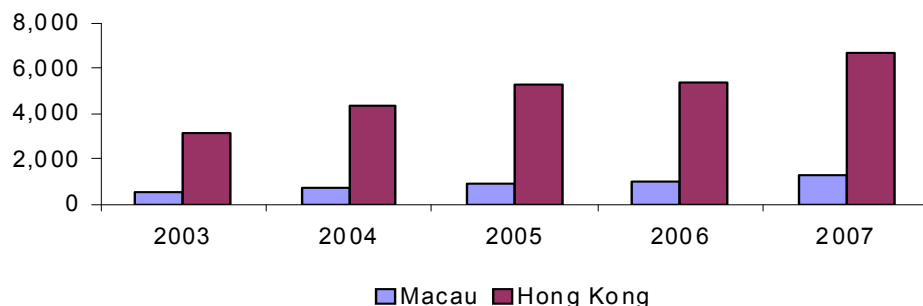
Source: DSEC

The residential market

There is a need for high quality residential units in Macau

There are currently c190,000 residential units in Macau. We understand that c73% of apartments are owner-occupied and that around half are mortgage-free.

Economic growth, enhanced access to capital and net immigration have resulted in a significant increase in demand for residential property in Macau. According to Savills, new residential prices doubled in the period between 2003 and 2007 (see chart below). Despite this, average prices remain at a material discount (c60%) to those in nearby Hong Kong. Rental demand has also been growing, due to the rising non-resident worker population.

Fig 19: Average residential prices, 2003 - 2007 (HK\$ per square foot)

Source: DSEC (Directorate of Statistical and Census Services), Rating and Valuation Department, Savills

The local population is expected to grow markedly in the future

In light of problems in the global credit market, Jones Lang LaSalle reported that residential sales began to slow in June 2008, resulting in discounts being offered on some uncompleted projects. We understand that average prices fell to levels not seen since 2004. Despite this, the leasing and investment market for high-end residential properties remains resilient as increasing numbers of management-level expatriate workers in new casinos drive letting demand.

The Macau government estimates that the population of the region will grow by c4.6% annually in the period to 2011. Assuming that the size of the average household in Macau remains unchanged (at just below 3 people), this implies that an additional c8,000 residential units a year are required.

Workers from overseas have been migrating to Macau, attracted by the creation of new jobs in casinos

We believe the high-end residential market will remain resilient, supported by demand from management-level expatriates working in the casinos currently in the development pipeline. This should lead to a rise in rents and attract investor demand, in our view.

We understand that the government has committed to build c19,000 public housing units by 2012, some of which are currently under construction in the northern Macau Peninsula. This area is undergoing widespread infrastructure improvements and we expect demand to remain strong for these types of properties from local residents seeking to upgrade their homes.

Although the residential vacancy rate is c8%, our view is that much of the unoccupied stock is of low quality and not suitable for an emerging middle class keen to improve their living standards.

Given a shortfall of new residential units in the development pipeline and favourable affordability ratios, we believe that the imbalance of demand and supply will lend further support to prices.

Prices in Macau are at a substantial discount to those of equivalent properties in Hong Kong

Hong Kong residential prices are often used as a benchmark for Macau's residential rents and values, particularly in the luxury sector. In the first three quarters of 2009, luxury residential capital values in Hong Kong rose by 26% (Source: Jones Lang LaSalle). They have continued to rise since and have now returned to pre-crisis levels. On this basis, there would appear to be significant scope for current luxury residential prices in Macau to continue to rise.

The retail market

The retail sector is growing in Macau

Despite the challenging economic environment, retail sales have proved to be resilient and we understand that demand for prime retail space in Macau remains strong. According to DSEC (The Macanese Statistics and Census Service), retail sales in the first half of 2009 were c10% higher than the equivalent period in 2008.

In October, the Grand Hyatt Macau, located on the Cotai Strip, was opened to the public. The hotel, which is part of the City of Dreams development, has 791 guestrooms. The Boulevard, which consists of two levels, offers a combination of regional and international dining (it contains over 20 restaurants and bars) as well as many of the world's premier retail brands. Phase One of The Boulevard comprises c85,000 ft² of retail space. It also features The Bubble, a dome shaped theatre and one of the most iconic landmarks in the region. On final completion, The Boulevard is expected to comprise c175,000 ft² of retail space.

Fig 20: Retail space in the Four Seasons Hotel



Source: MPO

We understand that prime retail properties in sought after locations can command rents of up to \$25 per ft² per month.

The supply of office space remains constrained in Macau

The office market

There are only a few Grade A office buildings in Macau, located mainly in the Baixa de Macau and NAPE e Aterros de Baia da Praia Grande areas. These include the Finance and IT Center of Macau (FIT) and the AIA Tower.

According to Savills, supply is expected to remain constrained as there have been no new private office projects approved by the government. In our view, the restriction of supply should provide support to rent levels in this segment.

Grade B office space exists in the region and it has recently enjoyed rising interest levels from the telecommunications, financial and advertising segments.

There is a growing need for logistics facilities in Macau and the surrounding region

The industrial market

Rising consumer spending is creating a fertile environment for logistics facilities in the region. We understand that demand for high quality industrial space is growing. Our research indicates that there is currently c3.3km² of industrial space in free trade zones and approximately another c2km² within a reasonable proximity of Macau (though these do not offer the attractive tax concessions offered in free trade zones).

We understand that investment yields on industrial premises are currently c10%.

Economic and political features

Economic performance

Macau is classified by the WTO as a high income economy

Macau's economy is heavily skewed towards the gaming and tourism segment. Since the gaming market was deregulated in 2002, a number of new casinos have opened in the region. The number of casinos increased by 2 to 33 in the third quarter of 2009, resulting in a total of 4,610 gaming tables and 14,175 slot machines. The gaming sector contributes over 50% of Macau's GDP.

In 2007, Macau overtook Las Vegas as the world's leading location for gaming revenues.

Macau is an offshore financial centre, a tax haven and a free port with no foreign exchange restrictions. In addition to gaming, the construction and textiles sectors are prominent (the latter provides the majority of the region's export earnings and has been badly affected by a sharp downturn in overseas demand).

On 1st January 2004, the Closer Economic Partnership Agreement (CEPA) between Macau and mainland China commenced. Under this, Macau products were provided with tariff free access to the Chinese mainland. This relationship appears to be strengthening. In July 2008, Supplement V of the CEPA was signed to enhance exchanges, promotion and support to service suppliers, formulate implementation rules and details, and establish a notification and discussion mechanism.

According to the Domestic Statistics and Census Service (DSEC), Macau is a high income economy – its GDP per capita in 2008 was c\$40,140 (a clear premium to that of nearby Hong Kong).

Latest economic data

Macau has experienced three straight quarters of economic contraction (see table below). According to DSEC, the Macau economy contracted by 13.7% year on year in real terms in the second quarter of 2009. Q3 GDP data is expected to be published on 30th November 2009.

Fig 21: Macau GDP real growth/(contraction) %

2008			2009	
Q2	Q3	Q4	Q1	Q2
22.4	10.4	(7.6)	(12.9)	(13.7)

Source: DSEC

Unemployment in Macau stood at 3.7% at the end of September 2009.

Despite the challenging backdrop, the value of retail sales in the period rose by c3% quarter on quarter and c11% year on year.

Political structure

Macau operates a 'one country, two systems' policy

Like Hong Kong, Macau operates under the policy of 'one country, two systems'. China's central government is responsible for defence and foreign affairs and the region operates its own legal and monetary systems, customs and immigration policy.

The region's government is headed by a Chief Executive, who is appointed by the central government upon the recommendation of a 300-member election committee. Edmund Ho Hau Wah, who has just completed his second term in office (having first been elected after the handover in 1999), is being succeeded by Fernando Chui Sai-on ('Chui'). Chui's term of office will commence in December.

Notes

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CONFLICTS

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