

ASX : DNA

asx release



29 November 2018

Annual General Meeting – Chairman’s Address and Managing Director’s Address

In accordance with Listing Rule 3.13.3, Donaco International Limited lodges the attached Chairman’s address and Managing Director’s address, to be delivered at today’s Annual General Meeting of shareholders.

For further information:

Ben Reichel
Executive Director
(m) +61 412 060 281

ABOUT DONACO INTERNATIONAL LIMITED (ASX: DNA)

Donaco International Limited operates leisure and entertainment businesses across the Asia Pacific region.

Our major business is the Star Vegas Resort and Club, a successful casino and hotel complex in Poipet, Cambodia, on the border with Thailand. Star Vegas was established in 1999, and is the largest and highest quality of the Poipet casino hotels. The property has more than 100 gaming tables, more than 1400 slot machines, and 385 hotel rooms.

Our flagship business is the Aristo International Hotel, a successful boutique casino in northern Vietnam, located on the border with Yunnan Province, China. Established in 2002, the property has recently been expanded to a brand new five star resort complex with 400 hotel rooms. Donaco is a pioneer casino operator in Vietnam, and owns a 95% interest in the business, in a joint venture with the Government of Vietnam.

To learn more about Donaco visit www.donacointernational.com

29 November 2018

Chairman's Address

Ladies and gentlemen, thank you for being with us today. On behalf of your Board I am pleased to welcome you to the 2018 Annual General Meeting of Donaco International Limited. I am the Chairman, Stuart McGregor. I confirm that the meeting is properly constituted, and that a quorum is present. I declare the meeting open for business.

I would like to begin by introducing your other Board members in attendance today, consisting of Executive Director and Company Secretary, Mr Ben Reichel; and non-executive directors, Mr Benjamin Lim and Mr Rob Hines.

I would like to apologise on behalf of our Managing Director and Chief Executive Officer, Mr Joey Lim, who is unable to attend today's meeting, as he is unwell.

Also in attendance is our CFO, Mr Chong Kwong Yang. And we also welcome Ms Suwarti Asmono from the Company's auditors, Crowe Horwath.

I'd like to start by running through the highlights of the past financial year, before providing an update on operations so far in the current financial year.

Review of 2018 Financial Year

The 2018 financial year was a difficult one, with a number of challenges, coupled with changes and progress on several fronts.

The challenges occurred early in the year when it became apparent that the vendor of the Star Vegas casino was in breach of the non-compete provisions in the sale contract. This challenge was compounded by the poaching of our VIP junkets by the vendor, which severely impacted our junket business at Star Vegas.

The Board acted swiftly when the issues were identified, and we are actively pursuing all legal avenues to stop the illegal operation of the competing casinos, and to receive compensation for the financial impact that we have suffered as a result of the contract breaches.

Our primary legal claim is in the Singapore arbitration, where we are seeking damages of USD190 million. This claim is still moving through the preliminary stages, and will be heard in July next year. The claim is supported by the freezing order that we obtained over the vendor's shares in the Company, which has now been extended to 4 October 2019.

In the meantime, the vendor continues to launch a number of frivolous and vexatious claims in the Cambodian and Thai courts. For example, the vendor tried to claim a management fee for the 2017 financial year in the Cambodian courts, despite the clear wording in the agreement stating that this claim could only be brought in Singapore, where the vendor is in fact already claiming it. I'm pleased to say that the Cambodian court immediately rejected this vexatious duplicate claim.

The vendor also tried to claim security over some of our assets in Cambodia. Three days after this claim was also rejected, a different firm of lawyers acting for the vendor filed essentially the same claim again. This is also a duplicate claim, and has not progressed.

The vendor has also tried to terminate the lease of the land on which our Star Vegas property sits, on contrived and spurious grounds. We obtained an injunction to prevent this, and the matter has gone to arbitration in Cambodia. The hearing date for this matter has now been set for 28 February 2019.

The vendor has also tried various other means to interfere with our lease rights, including cutting off the electricity to part of our hotel, and threatening to build a wall around the property and block access. We have obtained further court orders to prevent these threats, and we are also seeking compensation through the Cambodian courts.

The vendor has also commenced a defamation claim in Thailand, complaining about our ASX releases, which of course the Company is legally required to issue. We will not be deterred from our commitment and obligation to keep our shareholders informed of all material developments.

There have also been developments relating to the two competing casinos operating on the vendor's land. One of these (Paramax) was owned by two of the vendor's sons until August 2018. Ownership was then transferred to a person in Thailand, who promptly commenced defamation proceedings against us, claiming that the business has never had any connection with the vendor.

The Company first obtained a preliminary injunction order on 25 December 2017, ordering the closure of the two competing casinos, Star Paradise and Paramax. However this order has not been enforced. Star Paradise changed its name to Winsor, and continues to operate. Paramax has now been transferred into a different name, as I just mentioned.

On 5 October 2018, we were informed that the Appeal Court has decided to remove the preliminary injunction, but no written judgement has been published as yet. This is not a decision on the merits of our claim. It makes no difference to the situation on the ground, as the original order has never been enforced. And it makes no difference to our legal strategy, which is to continue to pursue the vendor in the Singapore arbitration and in the Australian courts.

The 2018 financial year also saw a number of significant changes and progress in the business. At the Board level, the directors appointed by the Star Vegas vendor left, following the breaches by the vendor.

Management of the Star Vegas casino was taken in-house in July 2017. Our management team worked actively to rebuild the VIP business, and to undertake a number of improvements at the property during the year. We have introduced new junkets, built new facilities, refurbished the hotel rooms, introduced new gaming machines and gaming systems, and launched online gaming operations. These initiatives will all hold the business in good stead over the next few years.

Despite the Board's focus on the challenges presented to it during the 2018 financial year, we continued to make a positive contribution to the communities in which we operate both in Cambodia and Vietnam. For example, during the year we donated two mobile medical clinics to Samdech Techo Voluntary Youth Doctors Association. This is a not for profit organisation which mobilises medical professionals, medical students and volunteers to help provide free healthcare to rural Cambodians throughout the country. At the Aristo in Vietnam, we made significant donations to local orphanages, schools and war veterans, assisting both with cash and with practical gifts.

Capital Management

I would now like to address the topic of capital management, which is crucially important for many shareholders. Although our net debt to equity is very low at approximately 6%, the loan facility that we have in place with Mega Bank soaks up the bulk of our free cash flow. In the current 2019 financial year, we must pay the first USD21 million in cash that we earn to Mega Bank, in the form of principal repayments, interest and other charges. Therefore this cash is not available to distribute to shareholders in the form of dividends or buy backs.

There are also a number of covenants in place under the Mega Bank facility, including a restriction on dividends and buy backs unless we have recorded a statutory net profit in the previous financial year. With the impairment charge taken on the Star Vegas business last year, due to the damage caused by the vendor's actions, we are unable to conduct any capital management this year.

Our priority is therefore to pay off the Mega Bank loan as fast as possible, which will free up our cash flow that we can then start to return to shareholders. As things stand, it will take approximately two years before the loan is repaid.

In the absence of our Managing Director, I would now like to invite Executive Director Mr Ben Reichel to present more detail regarding Donaco's operational and financial highlights in the 2018 financial year and our performance so far in the current financial year.

Managing Director's Address

Thank you Mr Chairman. Good afternoon and thank you all for attending.

Donaco recorded a statutory loss of \$124.5 million during the 2018 financial year, compared to a profit of \$31 million the previous year. The primary factor was the Board's decision to incur a non-cash impairment charge of \$143.9 million in the value of the Star Vegas casino license, as a result of the damage done by the actions of the vendor.

Our underlying earnings result, after adjusting for the nonrecurring items, produced a net profit of \$18.3 million. This was below last year's levels of \$54.6 million, again due to the significant drop in VIP turnover at Star Vegas as a consequence of the actions of the vendor.

Aristo continued to perform solidly during the year, and despite a lower win rate than last year it recorded a higher profit than last year, with strong growth in the VIP turnover at the property.

Despite the negative headline result, our group financial position remained strong, with positive cash flows of \$34.6 million. Our net debt to equity reduced to 6.3% at the end of June, and a further principal repayment of US\$8.55 million was made to Mega Bank in August.

Trading Update

I would now like to provide a trading update for the first four months of the 2019 financial year.

Donaco has recorded a soft start to the year, with three specific factors having a significant impact on the results during the period from July to October 2018. These factors were:

1. At DNA Star Vegas, there was a significant increase of 113% in VIP gaming turnover, compared to the same period last year. However this was offset by a weaker VIP gross win rate of 2.47% for the period, compared to the above theoretical win rate of 3.65% for the same period last year. We have consistently stated that such fluctuations in the VIP gross win rate are a normal feature of VIP gaming operations, and are to be expected.

2. Also at DNA Star Vegas, there was an increase of 34% in operating costs for the period. This primarily relates to the investment in online gaming operations, including the hiring of some 120 staff and the purchase of equipment and resources to run the live dealer site on a 24/7 basis. The online business has begun producing small amounts of revenue, in line with expectations, but this is outweighed by the costs in the early start-up phase. As the business grows, it is expected that the revenues will significantly exceed the operating costs.

3. At the Aristo, a Chinese crime syndicate threatened VIP junkets and customers on the Chinese side of the border, essentially demanding protection money. This had a serious impact on the Aristo in July and August 2018, but following management actions to address the situation, including working with law enforcement agencies on both sides of the border, the results improved in September and again in October. Further significant improvement has taken place in November, and forward bookings are strong for December. As of today, management is confident that the authorities have the situation under control and that the Aristo business will return to normal in the next few months. Management also reduced operating costs by 17% during the period to mitigate the impact of the reduced VIP revenue.

These factors are expected to substantially reduce in impact over the course of the whole financial year. Accordingly, investors should not extrapolate the four month performance as an indication of the likely full year result.

The first and second factors caused a significant reduction in the revenue and earnings at DNA Star Vegas during the four month period. However it should be noted that on a normalised basis, using the theoretical win rate of 2.85%, performance at DNA Star Vegas was flat on last year, with the increase in VIP gaming turnover (and consequent increase in normalised gross gaming revenue) offsetting the increase in costs.

On the positive side, there was a significant overall reduction of \$1.3 million in corporate costs, particularly in the areas of Board and senior management expenses (down by almost \$1m), as well as marketing costs (down by \$0.6m). However there was an increase in travel costs, and also legal costs relating to the Company's dispute with the Thai vendor of the Star Vegas business.

Property Performances

DNA Star Vegas

Donaco continues to rebuild the VIP gaming business at Star Vegas, following the Thai vendor's breaches of contract and poaching of the VIP junkets last year. VIP rolling chip turnover reached THB25.96 billion during the period, an increase of 113% from THB12.21 billion last year. Due to the higher turnover, junket commissions also increased, but at a slower rate of 68%, reflecting Donaco management's efforts to maintain tight control over junket terms.

Average daily casino visitation reached 4,806 persons, an increase of 38% from 3,491 last year, reflecting the success of marketing programs.

Gross gaming revenue from slot machines declined by 22%, to THB286.6m, compared to THB366.5m last year. This was caused by the disruption associated with the changeover in slot machine inventory and the time required to engage customers with the new games. We expect to see improvement over the remainder of the year, following the completion of the machine inventory transition in September 2018 and improved engagement with the new machines. Offsetting the decline in slot machine revenue was a larger percentage reduction in profit sharing with slot distributors. This cost was reduced by 33%, reflecting more favourable deals with the distributors.

As noted, the major factor affecting net gaming revenue was the lower VIP win rate of 2.47%, compared to 3.65% last year. This significant difference caused total net revenue to fall 21% to THB470.25m.

Also as noted, operating expenses increased by 34% to THB300.89m, due primarily to the investment in online gaming operations. The online gaming business is at an early stage, but the active customer base continues to increase, and turnover continues to climb as customers become more familiar with the platform. Turnover is in line with our expectations at this point.

In addition, Donaco has recently signed some promising deals to assist with online revenue growth. In particular, a deal has been signed with one of Asia's largest online betting companies, to operate an upgraded sports betting and online lottery outlet at DNA Star Vegas. Further deals with other major distributors are at an advanced stage.

The operating expense increase also reflected higher marketing costs relating to the Company's events program, as well as additional bus and van tour groups that drove the strong increase in casino visitation. Also, higher legal fees totalling approximately THB10m, caused by the Company's dispute with the Thai vendor, were included within operating expenses at the DNA Star Vegas level. Overall, property level EBITDA was THB169.35m, down by 54% compared to last year.

New mass market tour groups from China and Korea will shortly commence visiting the property, and are being accommodated in the second main hall built behind the online gaming tables. These initiatives are expected to start generating meaningful revenue in the June 2019 half.

For November month to date, the VIP win rate has turned strongly in the Company's favour. Total rolling turnover is on track to reach a very healthy level of approximately THB 5.5 billion, with the win rate running at 4.41%. Of course, significant wins or losses by players in the final days of the month can change this dramatically. But at this stage, it appears that the five month win rate will be back closer to the theoretical level.

Aristo

At Aristo, most of the usual VIP players and junkets from Yunnan Province were deterred from visiting the property in July and August, due the threats from the Chinese crime syndicate. The Vietnamese police now have all of the records of the Chinese crime syndicate members, and they will not be allowed into Vietnam. In recent weeks, the Chinese police have also stepped up their enforcement efforts, and the Aristo business has continued to improve.

For personal use only

With the temporary decline in Chinese VIP business in the period, management increased their marketing efforts to junkets from other areas of China and south-east Asia, with several Malaysian junket groups visiting the property in September and October. Management also increased proxy betting services available to VIP players choosing to remain at home.

Management also increased its marketing of Sapa tour packages to expats from both Hanoi and Ho Chi Minh City, and has begun to offer bus and van tour packages for international tourists, including Thai tourists.

These efforts started to show results in September and October, with casino visitation reaching 31,824 across the two months, an increase of 23% over the same months last year. However these were primarily mass market players. Overall gaming turnover was down by 93% from last year, reaching a total of USD51.9m for the four months. The VIP win rate did improve to 3.16% during this period, from the below theoretical rate of 1.34% last year.

Accordingly Aristo's revenue for the period totalled USD2.9m, a reduction of 46% from USD5.4m last year. Management responded to the situation by cutting operating expenses by 17%, and the business recorded EBITDA of USD0.7m for the period.

For November month to date, total gaming turnover is on track for an increase of almost 60% from the October total, with a similar increase in net gaming revenue. While this is still well below the levels seen last year, there is an increasing number of junket visits planned for December. Based on the current data and the trend, management expects a 20-30% increase in total gaming turnover in December, and the casino should be back on track and resume to its normal volume in early calendar 2019.

Group Summary

Summarising the overall impact on the Group in Australian dollars, revenues totalled \$23.7m in the period, down 20% from \$30m last year. Corporate costs were reduced by \$1.3m as noted above, reaching \$2.7m, down 33% from \$4.0m last year. This was outweighed by the cost increase at DNA Star Vegas, with total operating expenses across the Group reaching \$18.5m, up 15% from \$16.1m last year. This figure does include approximately \$400,000 in legal costs relating to the dispute with the Thai vendor. As a result, EBITDA for the period was \$5.2m, down 62% from \$13.7m last year.

Management considers that the three factors which impacted the four month results have been addressed, and will have a reduced impact in future periods. At DNA Star Vegas, the VIP win rate has improved strongly in November, and the earlier fluctuations are normal and to be expected. While the costs of the online gaming business will continue, the revenue will start to exceed them as the business moves past the start-up phase. At the Aristo, the VIP gaming volume is being restored, and is expected to continue to improve. Accordingly the November month to date results are showing a very strong improvement at both properties.

We appreciate your attendance with us today and I will now hand you back to our Chairman to conduct the formal business of the meeting.

+++++