Macau Property Opportunities Fund

INVESTOR UPDATE Q2 2014

Villa showflat at *The Fountainside*

QUICK FACTS

Exchange	**London Stock Exchange**
Domicile	**Guernsey**
Market Capitalisation	**£207 million**
Latest Share Price	**£2.54**
Portfolio Valuation	**US$517.4 million**[1]
Loan-to-Value	**21%**[2]
Adjusted NAV per share	**US$5.25/£3.14**[1,3]
Discount to Adjusted NAV	**13%**

[1] *As at 31 March 2014.*
[2] *Assuming a full drawdown of MPO's committed loan facilities and based on MPO's portfolio value as at 31 March 2014.*
[3] *Based on a US$/£ exchange rate of 1.668 as at 31 March 2014.*

All remaining data as at 30 June 2014.

About the Fund

Macau Property Opportunities Fund Limited is a closed-end investment fund registered in Guernsey. Listed on the London Stock Exchange's main market, it is also a constituent stock of the FTSE All-Share and FTSE SmallCap indices.

Launched in 2006, the Fund targets strategic property investment and development opportunities in Macau and Mainland China's western Pearl River Delta. Its current US$517.4 million portfolio comprises a mix of well-positioned residential and retail property assets.

The Fund is managed by Sniper Capital, an Asia-based property investment manager with an established track record in fund management and investment advisory.

www.mpofund.com

MANAGED BY Sniper Capital

MPO's inclusion in the FTSE All-Share and FTSE SmallCap indices marks yet another milestone in the Company's history. Further share repurchases were conducted during the quarter, while the final sales phase of *The Fountainside* is progressing.

At a Glance

- **MPO added to FTSE All-Share and FTSE SmallCap indices.** The inclusion, effective 23 June, should broaden the Company's investor base and boost share liquidity.
- **Share buyback undertaken.** The Company repurchased a further 1.6% of its issued share capital in May, its second share buyback this year.
- **Units at *The Fountainside* sold.** Three standard units were sold at an average price of US$1,160 per square foot, more than double those sold in early 2011.
- **Occupancy levels at *The Waterside* slips.** Total occupancy levels dipped to 80%, from 90% in the preceding quarter, in light of the softening high-end leasing market.
- **Macau faces some near-term headwinds.** Despite a slight weakening in gaming revenues, the territory's long-term prospects remain positive.
- **The property market has been quiet.** Transaction volumes moderated but home prices maintained their double-digit growth in Q1.

Fund Update

MPO has been selected as a constituent stock of the FTSE All-Share and FTSE SmallCap indices following the FTSE UK Index Series annual review in June. The addition, effective 23 June, is expected to enhance share liquidity and increase the Company's exposure to a wider pool of investors.

MPO's most recent Adjusted NAV per share as at 31 March 2014 was US$5.25 (306p), up from US$4.95 (289p) three months earlier.

The Company's portfolio valuation rose 6.7% quarter-on-quarter to US$517.4 million as at 31 March 2014, while total loan-to-value dipped to 21%, from 22%, assuming a full drawdown of MPO's committed credit facilities.

During the quarter, another share buyback – the Company's second this year – was undertaken. A total of 1,325,000 shares, or 1.6% of the Company's issued share capital, was repurchased and cancelled at a price of 235p per share. The total number of shares now outstanding is 81,415,000.

MPO's end Q2 share price of 254p translates to an increase of 27% since the start of the year or 15% over the quarter and represents a 13% discount to its latest Adjusted NAV per share. Further opportunistic share buybacks will be considered by the Board.

MPO's annual results and latest Adjusted Net Asset Value for the period ended 30 June 2014 will be published in September.

Portfolio Overview

The Fountainside

Residential sales across Macau remain sluggish in the wake of ongoing property curbs, particularly the 50% cap on mortgages for properties over MOP8 million (US$1.0 million). Nonetheless, the final sales campaign for *The Fountainside* is progressing. Over the quarter, three standard units were sold at an average price of HK$9,000 (US$1,160) per square foot, more than double the price per square foot of those sold in the pre-sales phase in early 2011.

That said, further sales are likely to take time, given the temporary weakness in the market. We are targeting the sale of the remaining units, which include 11 standard units, two duplexes and four villas, at prices up to HK$16,000 (US$2,060) per square foot.

More marketing activities, including the enhancement of standard units and the promotion of weekend visits, are in the pipeline.

And there was good news for *The Fountainside* in June. It clinched the Best Residential Low-Rise Development award in Asia's leading property portal iProperty's inaugural Best Development Awards 2014, which recognises exceptional property developments worldwide.

In the meantime, all rectification works have been completed. With the approval of the Occupancy Permit expected by the year-end, we are now preparing handover items.

The Waterside

The high-end leasing market has been more subdued, given negative news flow surrounding junket operators. According to some property agents, the disappearance of one such rogue promoter has affected a number of VIP room operators, leading to the early termination of some unit leases in One Central Residences.

Consequently, asking rents for some of these units have fallen by 5-10%. The asking price for a 2,760 square feet three-bedroom unit, for example, has been adjusted to HK$58,000 (US$7,480) from HK$65,000 (US$8,390).

At *The Waterside,* there were four early terminations in Q2 and the occupancy level dipped to 80% from 90% in the preceding quarter. But there is a silver lining: five out of seven expiring leases were renewed and five new leases were committed over the same period. And while average net monthly rental rates decreased 5% quarter-on-quarter to around HK$25 (US$3.20) per square foot as at end-June, all new leases have been agreed at or above HK$28 (US$3.60) per square foot per month.

The recently furnished duplex at *The Waterside*

The Fountainside clinched the Best Residential Low-Rise Development award in Asia's leading property portal iProperty's inaugural Best Development Awards 2014.

PROPERTY MARKET OVERVIEW

Macau's property market has been relatively quiet – the number of home sales fell 41.9% in Q1. Property prices, however, rose 24.5% year-on-year, while the average price per square foot increased to around US$1,210. On the Peninsula alone, prices climbed 27.4% to US$1,220 per square foot, while in Taipa prices were up 34.4% to US$1,170. In Coloane, the average price grew by 8.7% to US$1,370 per square foot.

It was a similar trend for the month of April. Although the number of home transactions dropped 32.4%, prices surged by around 54% year-on-year. Homes in Taipa jumped 37.5% to US$1,260 per square foot. Those on the Peninsula recorded the largest spike of 59.3% to US$1,650 per square foot. One of the units in upmarket housing project, The Carat, for example, sold for close to HK$18,500 (US$2,390) per square foot; in March, the highest price achieved was HK$17,000 (US$2,190) per square foot.

The government is said to be contemplating new action to stabilise the market. But how effective fresh curbs will be remains a question-mark. Current policies have failed to curtail prices and any new cooling measures may only shrink property transactions further.

According to estate agency Centaline (Macau) Property, prices of homes – including both first- and second-hand – are expected to continue their upswing in the coming months. The reasons are twofold. First, there is a lack of new home supply. Second, demand has been persistently strong, both from locals and the continuing influx of foreign workers. Price growth for upmarket homes, in particular, may far outpace that of homes for the mass market this year, supported by still-limited supply and strong investment interest by affluent buyers.

On a related note, China Railway Group launched sales for Phoenix Bay, an upscale residential home project located in the Gongbei district in Zhuhai, in June. The company is targeting buyers in Macau and have priced the units, ranging from 2,800 square feet to 10,100 square feet, at an average price of US$510 per square foot – less than half the average price per square foot in Macau. Such a marketing approach could well spread, given Macau's skyrocketing property prices and short supply.

We will continue to monitor the developments but, in our opinion, the isolated incident is unlikely to impact the market in the long term.

On a more positive note, The Sapphire Suites, a special collection of premium high-floor units, remain popular, with six out of eight units occupied, achieving an average rental premium of 15-20% to standard units.

One Central units

Following the sale of four individual units in Q1, a further two units were sold in Q2 for a total of around HK$72 million (US$9.3 million). The two divestments, at an average price of HK$15,575 (US$2,010) per square foot, translated to premiums of 13% and 15% over the units' respective December valuations.

Four ultra-prime individual units remain in MPO's portfolio which we ultimately plan to sell on an opportunistic basis.

Senado Square

Revised building plans for the portfolio's prime retail redevelopment project will be submitted in July. We are cautiously optimistic that the necessary approvals will be received and construction can commence by the middle of next year.

Project completion is currently expected in 2017.

These delays notwithstanding, the project's internal rate of return is still above 20% as valuations in the prominent tourist and retail area remain supported by robust visitor numbers, healthy retail sales and very limited supply.

For instance, a 320 square feet site near *Senado Square*, with potential for development into a three-storey retail space, sold for HK$72.5 million (US$9.4 million) recently.

The Green House

The Green House underwent additional renovation and upgrading in Q2 to keep it in prime condition.

This luxury standalone property, which has seen its valuation increase approximately fivefold since acquisition in 2007, remains a key portfolio holding.

The Manager is confident of the ongoing demand for prime detached houses in Macau and will continue to target a premium exit price for this prized asset.

Macau Overview

Macau has of late been in the headlines for all the wrong reasons. Of particular note are the large protests in May. While unhappiness was largely targeted at a generous government retirement bill (which has since been withdrawn), protestors also demanded checks on rising home prices and restrictions on the inflow of foreign workers. The policy implications are still unclear and it may be too soon to write off the protests as a one-off.

Also unsettling was news relating to a potential delay in reclamation work along one of the main zones linking Macau to the future Hong Kong-Zhuhai-Macau Bridge, though the government claims to have a back-up plan should works stall.

At the same time, weaker gross gaming revenue growth, the disappearance of a rogue junket operator, a smoking ban on mass gaming floors from October, transit visa restrictions and a crackdown on illegal UnionPay bank card transactions have all rattled investors – and sent gaming shares sharply lower.

The upshot: Macau's near-term prognosis now seems dimmer. Accordingly, analysts have lowered their estimates for gross gaming revenue growth; the World Cup – a distraction to gamblers – is partly to blame. Some concerns look a little overdone, however.

The alleged illegal portion of UnionPay transactions, for example, is estimated at only 4% of total gaming revenue. Likewise, the maximum stay for Chinese visitors on a transit visa may have been cut from seven days to five but the average mainland tourist stays just two days.

Despite the recent pessimism, we believe the fact that the gaming industry is taking a breather – after a period of unprecedented growth – is not necessarily a bad thing.

We remain confident of Macau's long-term prospects, and for good reason. There is still immense growth potential for gaming: a mere 1% of the Chinese population visited Macau last year; comparatively, 10% of Americans visited Las Vegas. The Business Monitor International forecasts the number of mainland tourists to Macau could increase 20% in the next five years.

Importantly, the high-margin mass market remains the ultimate story about the emerging Chinese middle-class. Improved transport infrastructure alongside continued developments on Cotai should underpin this segment. Already, Melco Crown Entertainment's fifth hotel tower in the City of Dreams complex is expected to open in early 2017, while Galaxy Entertainment Group will re-open the Grand Waldo complex early next year.

Developments on Hengqin, too, continue apace. Hengqin Bay Hotel's 12,000 square metre water park, located in the Chimelong International Tourist Resort, was inaugurated in June.

The island will also see its first-ever video game stadium in 2017, thanks to a partnership between Hong Kong-based conglomerate Lai Sun Group and US e-sports company Major League Gaming (MLG).

On the economic front, latest data pointed to year-on-year GDP expansion of 12.4%, largely a result of tourism and gaming-driven growth as well as heavy investments in the construction of new resorts in Cotai. The Economist Intelligence Unit has predicted an average annual growth of 11% until 2015. And according to a summary report by the Asian Development Bank, Macau's per capita GDP ranks among the world's top 10 and is the highest in the Asia-Pacific region.

> The high-margin mass market remains the ultimate story about the emerging Chinese middle-class.

FOR FURTHER INFORMATION

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