

# SKYCITY

NEUTRAL

## FY19 Preview—Weak Growth Hand

We expect a flat EBITDA result and NPAT decline when SKYCITY (SKC) reports its FY19 result on 14 August. There are a number of moving parts given asset sales and major capital projects; however, we expect to see slowing underlying growth across its portfolio through 2H19.

### Key areas of interest

- Key Auckland property:** We forecast solid growth for machines (helped by wage inflation), outweighing weakness in tables and hotels (which are more exposed to a slowing housing market and business confidence).
- International Business (IB):** A highly volatile segment. Recent competitor anecdotes suggest the backdrop is challenging. This aligns with our expectations of a negative 2H result (after a stellar 1H) for SKC.
- Margins:** We forecast modest contraction. Product mix is supportive; albeit likely outweighed by cost inflation and IT investment. Outlook is of interest.
- Adelaide regulatory review:** We are still waiting for outcomes from the review with any change likely incrementally net positive to group earnings.
- Online:** SKC has just launched its offshore offering. In its current form we do not expect online to move the dial for group earnings. Any move to address NZ regulation provides upside risk, hence, is an area of interest.
- Capital projects and growth avenues:** SKC has no shortage of ideas and opportunities across its property portfolio. We look for updated plans.

### Result expectations

We forecast FY19 normalised EBITDA of NZ\$339m, flat on the prior year or +3% adjusting for Darwin which was divested part-way through the year. This reflects mixed results across core properties (EBITDA +0.5%), topped up by IB.

- Auckland:** We expect revenue and EBITDA growth to slow over 2H19 for SKC's key property, not helped by weaker Chinese visitor arrivals and as the housing market continued to cool. Auckland pubs & clubs data aligns with this view, with spend +1.4% YoY in 2H19 (down from +2.4% in 1H19).
- Hamilton:** FY19 pubs & clubs data was robust (+3.4% in 1H; +3.8% in 2H) and slightly ahead of our +2% revenue growth expectations for Hamilton.
- Adelaide:** We expect the property to remain under pressure and forecast a decline in EBITDA given construction disruption and a lacklustre industry growth backdrop (gaming spend +0.1% in 1H19; -0.3% in 2H19).

### Conference call — 14 August, 12pm NZ time

Dial in: NZ - 0800 453 055; Australia - 1800 558 698. Conference ID **10000924**.

Figure 1. FY19 result expectations

NZ\$m	FY18	FY19E	% chg	Consensus
Normalised revenue (incl gaming GST)	1,100.8	1,107.5	0.6%	n/a
<b>Normalised EBITDA</b>	<b>338.2</b>	<b>338.9</b>	<b>0.2%</b>	<b>338.6</b>
<b>Normalised profit</b>	<b>169.8</b>	<b>164.5</b>	<b>-3.1%</b>	<b>166.2</b>
Normalised EPS (cps)	25.4	24.3	-4.2%	24.6
Final dividend per share (cps)	10.0	10.0	0.0%	10.1

Source: Forsyth Barr analysis

### Investment View

SKC has a casino monopoly and significant licence term in all its key markets. A slowing macro environment and cost inflation present near-term headwinds, while a solid dividend yield and share buyback provides share price support. NEUTRAL.

NZX Code	SKC
Share price	NZ\$3.94
Target price	NZ\$3.90
Risk rating	Medium
Issued shares	639.1m
Market cap	NZ\$2,518m
Average daily turnover	714.7k (NZ\$2,758k)



Financials: June	18A	19E	20E	21E
NPAT* (NZ\$m)	169.8	164.5	157.8	156.8
EPS* (NZc)	25.4	24.3	23.4	22.8
EPS growth* (%)	8.5	-4.2	-3.8	-2.4
DPS (NZc)	20.0	20.0	20.0	20.0
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	8.5	8.6	9.1	8.3
EV/EBIT	11.8	11.9	12.9	12.0
PE	15.5	16.2	16.8	17.3
Price / NTA	8.1	16.8	10.7	8.5
Cash dividend yield (%)	5.1	5.1	5.1	5.1
Gross dividend yield (%)	7.1	7.1	7.1	7.1

\*Historic and forecast numbers based on underlying profits

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SKYCITY Entertainment Group Ltd (SKC)		Priced as at 07 Aug 2019: NZ\$3.94					June year end					
Forsyth Barr valuation						Valuation Ratios					2017A	
Valuation methodology		Weighted DCF and sum of the parts valuation					EV/EBITDA (x)	8.9	8.5	8.6	9.1	
12-month target price (NZ\$)*		3.90	Spot valuations (NZ\$)			Valuation Ratios					8.3	
Expected share price return		-1.0%	1. DCF	3.89		EV/EBIT (x)	12.7	11.8	11.9	12.9	12.0	
Net dividend yield		5.1%	2. Sum of the parts	3.63		PE (x)	16.8	15.5	16.2	16.8	17.3	
Estimated 12-month return		4.1%	3. n/a	n/a		Price/NTA (x)	10.3	8.1	16.8	10.7	8.5	
Key WACC assumptions			DCF valuation summary (NZ\$m)			Free cash flow yield (%)	3.6	-0.3	-3.0	-6.6	4.9	
Risk free rate		2.75%	Total firm value		3,047	Net dividend yield (%)	5.1	5.1	5.1	5.1	5.1	
Equity beta		0.99	(Net debt)/cash		(432)	Gross dividend yield (%)	7.1	7.1	7.1	7.1	7.1	
WACC		8.9%	Value of equity		2,615	Imputation (%)	100	100	100	100	100	
Terminal growth		1.5%	Shares (m)		639	Pay-out ratio (%)	86	79	82	86	88	
Profit and Loss Account (NZ\$m)		2017A	2018A	2019E	2020E	2021E	Capital Structure					
Sales revenue		935	999	1,008	934	988	Interest cover EBIT (x)	13.5	19.5	19.7	43.3	
Normalised EBITDA		320	338	339	318	348	Interest cover EBITDA (x)	19.2	27.1	27.3	61.5	
Depreciation and amortisation		(95)	(94)	(95)	(94)	(107)	Net debt/ND+E (%)	23.8	27.2	29.2	32.7	
Normalised EBIT		225	244	244	224	240	Net debt/EBITDA (x)	1.0	1.3	1.2	1.6	
Net interest		(17)	(13)	(12)	(5)	(23)	Key Ratios					
Associate income		-	-	-	-	-	Return on assets (%)	9.9	9.6	10.5	9.0	
Tax		(55)	(62)	(67)	(61)	(61)	Return on equity (%)	14.3	14.7	16.8	15.0	
Minority interests		-	-	-	-	-	Return on funds employed (%)	11.6	11.9	11.7	11.0	
Normalised NPAT		154	170	164	158	157	EBITDA margin (%)	34.3	33.9	33.6	34.1	
Abnormals/other		(109)	(0)	(14)	90	-	EBIT margin (%)	24.1	24.4	24.2	24.3	
Reported NPAT		45	170	150	248	157	Capex to sales (%)	17.0	26.1	31.8	42.2	
Normalised EPS (cps)		23.4	25.4	24.3	23.4	22.8	Capex to depreciation (%)	192	318	392	488	
DPS (cps)		20.0	20.0	20.0	20.0	20.0	Operating Performance					
Growth Rates		2017A	2018A	2019E	2020E	2021E	Total revenue (incl gaming GST)	2017A	2018A	2019E	2020E	
Revenue (%)		-5.1	6.9	0.9	-7.4	5.9	Auckland	567	585	604	603	
EBITDA (%)		-2.9	5.6	0.2	-6.1	9.3	Hamilton	59	61	62	63	
EBIT (%)		-4.7	8.2	0.1	-8.1	7.2	Other NZ	12	13	13	14	
Normalised NPAT (%)		0.6	10.5	-3.1	-4.1	-0.6	Adelaide (A\$)	148	149	147	149	
Normalised EPS (%)		-8.3	8.5	-4.2	-3.8	-2.4	Darwin (A\$)	112	111	80	-	
DPS (%)		-4.8	0.0	0.0	0.0	0.0	IB	115	160	182	189	
Cash Flow (NZ\$m)		2017A	2018A	2019E	2020E	2021E	Total revenue (incl gaming GST)	1,029	1,101	1,107	1,030	
EBITDA		320	338	339	318	348	2017A	2018A	2019E	2020E	2021E	
Working capital change		50	73	(4)	4	(4)	Auckland	567	585	604	603	640
Interest & tax paid		(122)	(157)	(110)	(107)	(96)	Hamilton	59	61	62	63	64
Other		-	-	20	12	-	Other NZ	12	13	13	14	14
Operating cash flow		249	254	245	227	248	Adelaide (A\$)	148	149	147	149	163
Capital expenditure		(159)	(261)	(320)	(394)	(124)	Darwin (A\$)	112	111	80	-	-
(Acquisitions)/divestments		(4)	(47)	243	215	-	IB	115	160	182	189	193
Other		-	-	-	-	-	Corporate costs	(24)	(33)	(37)	(37)	(38)
Funding available/(required)		86	(55)	168	48	124	Other	(2)	(3)	(5)	(6)	(6)
Dividends paid		(90)	(85)	(88)	(88)	(89)	Total EBITDA	320	338	339	318	348
Equity raised/(returned)		-	-	(50)	(70)	-	NZDAUD	0.94	0.92	0.92	0.92	0.92
Increase/(decrease) in net debt		3	140	(30)	109	(35)	Capitalised interest	14	23	31	40	12
Balance Sheet (NZ\$m)		2017A	2018A	2019E	2020E	2021E	Effective tax rate (%)	26.4	26.6	29.0	28.0	28.0
Working capital		(112)	(162)	(158)	(162)	(158)	Normalised profit (ex cap int)	143	153	143	129	148
Fixed assets		1,325	1,499	1,290	1,494	1,524	% growth	6.7	-6.7	-9.8	15.1	
Intangibles		819	832	819	805	792						
Other assets		54	107	107	107	107						
Total funds employed		2,085	2,276	2,058	2,244	2,265						
Net debt/(cash)		338	433	403	512	478						
Other non current liabilities		676	685	678	678	678						
Shareholder's funds		1,071	1,158	977	1,054	1,109						
Minority interests		-	-	-	-	-						
Total funding sources		2,085	2,276	2,058	2,244	2,265						

\* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

## FY19 preview table

Figure 2. FY19E preview in more detail

NZ\$m	FY18	FY19E	% chg
Normalised revenue (incl gaming GST)	1,100.8	1,107.5	0.6%
Gaming GST	(102.2)	(99.8)	-2.4%
Total revenue (ex gaming GST)	998.6	1,007.7	0.9%
Total costs	(660.4)	(668.8)	1.3%
<b>EBITDA</b>	<b>338.2</b>	<b>338.9</b>	<b>0.2%</b>
Depreciation + Amortisation	(94.4)	(94.8)	0.5%
EBIT	243.8	244.1	0.1%
Net interest	(12.5)	(12.4)	-0.7%
EBT	231.3	231.7	0.2%
Tax	(61.5)	(67.2)	9.2%
<b>Normalised profit</b>	<b>169.8</b>	<b>164.5</b>	<b>-3.1%</b>
Abnormals	(0.3)	(14.1)	n/a
Reported profit	169.5	150.4	-11.3%
<b>Normalised profit (ex capitalised interest)</b>	<b>153.6</b>	<b>143.0</b>	<b>-6.9%</b>
Normalised EPS	25.4	24.3	-4.2%
Dividend (cents)	20.0	20.0	0.0%
 <b>Total revenue (incl gaming GST)</b>			
Auckland	584.6	604.1	3.3%
Hamilton	60.7	61.8	1.7%
Other NZ	13.0	13.3	2.0%
Adelaide (A\$)	148.9	147.0	-1.3%
Darwin (A\$)	110.8	80.2	-27.6%
International Business	160.3	182.3	13.7%
<b>Total normalised revenue</b>	<b>1,100.8</b>	<b>1,107.5</b>	<b>0.6%</b>
Revenue (excl IB & Darwin)	820.1	838.3	2.2%
 <b>EBITDA breakdown</b>			
Auckland	260.7	268.8	3.1%
Hamilton	26.9	27.1	0.9%
Other NZ	2.1	2.4	14.9%
Adelaide (A\$)	22.5	20.8	-7.5%
Darwin (A\$)	25.1	16.2	-35.4%
International Business	32.6	41.7	28.0%
Corporate costs	(33.0)	(36.5)	10.6%
Other	(2.8)	(4.8)	68.7%
<b>Total normalised EBITDA</b>	<b>338.2</b>	<b>338.9</b>	<b>0.2%</b>
EBITDA (excl IB & Darwin)	278.3	279.6	0.5%

Source: Forsyth Barr analysis

## Investment summary

**SKYCITY (SKC)** is one of the largest gaming operations in Australasia. Earnings and valuation are driven by Auckland, which makes up ~70% of group EBITDA. SKC has two major growth projects underway in Auckland and Adelaide which are large, complex, and challenging, but directly relate to its core expertise. The macro backdrop is supportive in Auckland, albeit tailwinds are beginning to slow, and challenging in Australia where the local gaming market is weak and the pubs & clubs are strong competition for the casino. With SKC trading at a discount to the NZ market and broadly in line with its five-year average, our rating is **NEUTRAL**.

### Business quality

- **Monopoly assets:** SKC has a casino monopoly in all its markets and significant term on its exclusive casino licences.
- **Executive change:** There has been significant change across the SKC senior executive team and board over the last 18 months, including a new CEO and new Chair. Early signs of execution on articulated plans are encouraging.

### Earnings and cashflow outlook

- **Consumer confidence:** Consumer activity levels in its key Auckland market are robust but are more challenging in Adelaide. There are some early indications the macro backdrop is weakening both domestically and internationally for SKC.
- **Project execution:** SKC is undertaking two major capital projects in Auckland and Adelaide. Achieving a satisfactory return on capital is the challenge given the substantial capital being spent. The Adelaide project in particular raises questions given perennial disappointment from the property through history.

### Company description

SKYCITY Entertainment Group is the major tourism and leisure company in NZ and one of the largest gaming operations in Australasia. Its key assets are major casino operations in Auckland, Adelaide, Hamilton and Darwin that also include hotel, resort, conference and International VIP gaming facilities. SKYCITY is undertaking a major redevelopment and expansion of the Adelaide Casino and has finalised an agreement with the NZ Government for the development of the NZ International Convention Centre in return for a range of regulatory concessions.

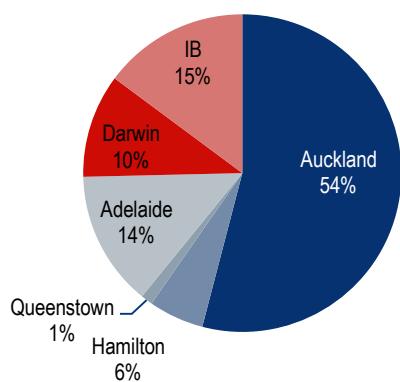
### Financial structure

- **Gearing:** SKC has committed to a BBB- credit rating and continues to reinforce 'efficient capital allocation' as a key strategic priority. There are a number of moving parts influencing gearing with capex for its two capital projects, asset divestments (carparks, Darwin), a share buyback programme and future growth plans to build out destination precincts surrounding its casinos.

### Risk factors

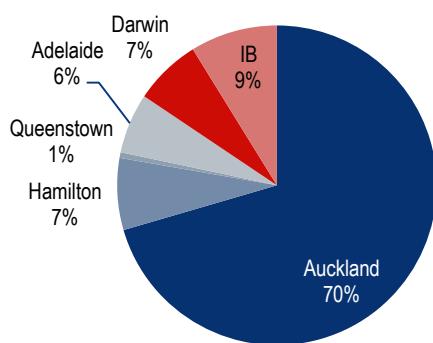
- **Gaming regulation:** Unexpected regulatory and taxation changes.
- **Mature local gaming market:** The local grind gaming market is not only mature but vulnerable to changing entertainment spending patterns.

Figure 3. Revenue breakdown FY18



Source: Company reports, Forsyth Barr analysis

Figure 4. EBITDA breakdown FY18



Source: Company reports, Forsyth Barr analysis

**Figure 5. Substantial Shareholders**

Shareholder	Latest Holding
Investor Mutual	8.4%
Sumitomo Mitsui Trust Holdings	8.3%
Lazard	7.5%
Commonwealth Bank of Australia	7.0%
BlackRock Investment Management	6.1%
The Vanguard Group	5.3%

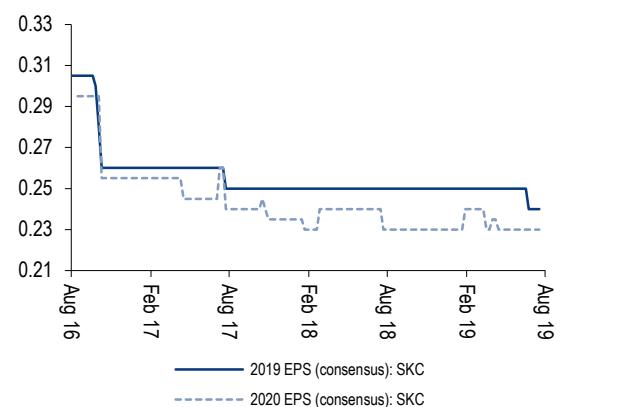
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 6. International Compcos**

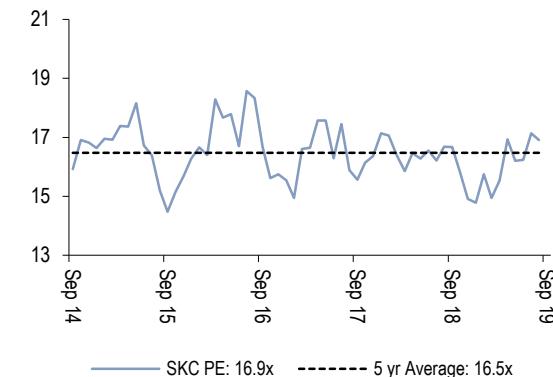
Company (metrics re-weighted to reflect SKC's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld	
				2019E	2020E	2019E	2020E	2019E	2020E	2020E	
<b>SKYCITY</b>	<b>SKC NZ</b>	<b>NZ\$3.94</b>	<b>NZ\$2,518</b>	<b>16.2x</b>	<b>16.8x</b>	<b>8.7x</b>	<b>9.3x</b>	<b>12.1x</b>	<b>13.2x</b>	<b>5.1%</b>	
Crown Resorts	CWN AT	A\$11.42	A\$7,733	21.0x	19.5x	9.3x	9.1x	14.2x	13.4x	5.3%	
Tabcorp Holdings	TAH AT	A\$4.33	A\$8,744	21.9x	20.8x	11.2x	10.9x	15.6x	15.2x	5.1%	
Star Entertainment Grp/The	SGR AT	A\$3.73	A\$3,422	15.3x	14.2x	7.7x	7.3x	12.1x	11.2x	5.4%	
Genting Malaysia Bhd	GENM MK	RM3.18	RM18,883	<0x	14.3x	19.1x	8.1x	<0x	13.5x	3.7%	
Kangwon Land Inc	035250 KS	KRW29000.00	KRW6,204,275	18.3x	15.9x	8.9x	8.7x	9.7x	8.9x	3.3%	
				<b>Companco Average:</b>	<b>19.1x</b>	<b>17.0x</b>	<b>11.3x</b>	<b>8.8x</b>	<b>12.9x</b>	<b>12.4x</b>	<b>4.5%</b>
				<b>SKC Relative:</b>	<b>-15%</b>	<b>-1%</b>	<b>-23%</b>	<b>+5%</b>	<b>-6%</b>	<b>+6%</b>	<b>+12%</b>

EV = Current Market Cap + Actual Net Debt

Source: \*Forsyth Barr analysis, Bloomberg Consensus, Companco metrics re-weighted to reflect headline (SKC) companies fiscal year end

**Figure 7. Consensus EPS Momentum**


Source: Forsyth Barr analysis, Bloomberg

**Figure 8. 12 Month Forward PE**


Source: Forsyth Barr analysis

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