

# SKYCITY

## 1H20 Preview — No Shortage of Complexity

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**NEUTRAL** 

SKYCITY (SKC) will report its 1H20 result on 13 February – we expect low underlying growth with downside risk to outlook and FY20 guidance from lower Chinese inbound visitor numbers. The result will be complicated by asset divestments (Darwin, Auckland carpark concession) and any accounting implications from the recent NZICC fire (potential to not be able to capitalise interest for a period of time). Adjusting for this, we forecast low underlying EBITDA growth at +1.5% (or +0.4% when also adjusting for Adelaide restructuring costs in the prior year). We expect growth for its New Zealand properties to outweigh weakness in International Business and higher corporate costs.

NZX Code	SKC	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$3.57	NPAT* (NZ\$m)	173.0	150.9	154.8	156.1	EV/EBITDA	8.3	9.6	9.2	8.5
Target price	NZ\$4.00	EPS* (NZc)	25.6	22.4	22.6	22.4	EV/EBIT	11.2	13.5	13.3	12.2
Risk rating	Medium	EPS growth* (%)	0.9	-12.5	0.8	-0.9	PE	13.9	15.9	15.8	16.0
Issued shares	675.8m	DPS (NZc)	20.0	20.0	20.0	20.0	Price / NTA	6.7	15.8	12.1	n/a
Market cap	NZ\$2,413m	Imputation (%)	100	100	100	100	Cash div yld (%)	5.6	5.6	5.6	5.6
Avg daily turnover	667.0k (NZ\$2,581k)	*Based on normalised profits					Gross div yld (%)	7.8	7.8	7.8	7.8

### Key areas of focus

- **Updated outlook commentary and FY20 guidance:** SKC's most recent FY20 guidance is for "some growth" in normalised EBITDA (off a base of NZ\$303m), while NPAT guidance was removed given the uncertainty around project accounting following the NZICC fire. We see downside risk to guidance (and our forecasts), primarily due to lower Chinese visitation through the key Chinese New Year period (key exposure areas: IB, hotels and small exposure for main gaming floor).
- **Update on major Auckland capital project (NZICC and Horizon Hotel):** Our key focus is new timeframes for completion and capital investment. We also want to better understand any short-term cashflow nuances (from cost/insurance timing) and accounting implications from the fire (potential that SKC cannot capitalise interest for the NZICC project during the rebuild phase).
- **Adelaide:** (1) Build progress, (2) recent trading, (3) any insight into the potential ramp-up pathway post project completion.
- **An update on other potential growth projects** across the group (including: Auckland Master Plan, Hamilton hotel, Queenstown development), which are reliant on third party decisions and/or investment.

### Conference call - 13 February, 12pm NZ time

Dial in: NZ - 0800 453 055; Australia - 1800 558 698. Conference ID: 10003511.

**Figure 1. Result expectations snapshot**

NZ\$m	1H19	1H20E	% chg
Normalised revenue (incl gaming GST)	598.0	529.2	-11.5%
<b>Normalised EBITDA</b>	<b>189.1</b>	<b>166.0</b>	<b>-12.2%</b>
Normalised profit*	96.9	82.5	-14.9%
Normalised EPS* (cps)	14.3	12.2	-14.8%
Dividend per share (cps)	10.0	10.0	0.0%

Source: Forsyth Barr analysis, Company reports \*This assumes SKC capitalises interest as per the status pre the NZICC fire

**Figure 2. Underlying EBITDA expectations**

Group EBITDA NZ\$m	1H19	1H20E	Chg
Per SKC disclosure (ex Darwin, AKL adj.)	163.5	166.0	1.5%
Ex Darwin, AKL adj and 1H19 Adelaide restructuring costs	165.3	166.0	0.4%
Local EBITDA per SKC disclosure (ex Darwin, AKL adj, IB)	138.8	142.6	2.7%

Source: Forsyth Barr analysis, Company reports

**SKYCITY Entertainment Group Ltd (SKC)**

Priced as at 10 Feb 2020 (NZ\$)						3.57						
<b>12-month target price (NZ\$)*</b>						<b>4.00</b>	<b>Spot valuations (NZ\$)</b>					
Expected share price return						12.0%	1. DCF					4.08
Net dividend yield						5.6%	2. Sum of the parts					3.67
Estimated 12-month return						17.6%	3. n/a					n/a
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>						
Risk free rate						2.00%	Total firm value					3,239
Equity beta						0.99	(Net debt)/cash					(368)
WACC						8.1%	Less: Capitalised operating leases					
Terminal growth						1.5%	Value of equity					2,870
<b>Profit and Loss Account (NZ\$m)</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
Sales revenue	998.6	1,011.6	927.5	976.0	1,030.0							
<b>Normalised EBITDA</b>	<b>338.2</b>	<b>342.7</b>	<b>307.8</b>	<b>332.3</b>	<b>359.9</b>							
Depreciation and amortisation	(94.4)	(89.9)	(89.1)	(103.4)	(110.9)							
<b>Normalised EBIT</b>	<b>243.8</b>	<b>252.8</b>	<b>218.7</b>	<b>228.9</b>	<b>249.1</b>							
Net interest	(12.5)	(10.2)	(6.2)	(10.8)	(32.2)							
Associate income												
Tax	(61.5)	(69.6)	(61.6)	(63.2)	(60.7)							
Minority interests												
<b>Normalised NPAT</b>	<b>169.8</b>	<b>173.0</b>	<b>150.9</b>	<b>154.8</b>	<b>156.1</b>							
Abnormals/other	(0.3)	(28.4)	90.0									
<b>Reported NPAT</b>	<b>169.5</b>	<b>144.6</b>	<b>240.9</b>	<b>154.8</b>	<b>156.1</b>							
Normalised EPS (cps)	25.4	25.6	22.4	22.6	22.4							
DPS (cps)	20.0	20.0	20.0	20.0	20.0							
<b>Growth Rates</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>							
Revenue (%)	6.9	1.3	-8.3	5.2	5.5							
EBITDA (%)	5.6	1.3	-10.2	7.9	8.3							
EBIT (%)	8.2	3.7	-13.5	4.6	8.8							
Normalised NPAT (%)	10.5	1.9	-12.8	2.6	0.8							
Normalised EPS (%)	8.5	0.9	-12.5	0.8	-0.9							
Ordinary DPS (%)	0.0	0.0	0.0	0.0	0.0							
<b>Cash Flow (NZ\$m)</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
<b>EBITDA</b>	<b>338.2</b>	<b>342.7</b>	<b>307.8</b>	<b>332.3</b>	<b>359.9</b>							
Working capital change	72.8	19.1	(0.8)	9.0	10.0							
Interest & tax paid	(157.4)	(147.2)	(107.8)	(104.3)	(92.9)							
Other												
<b>Operating cash flow</b>	<b>253.6</b>	<b>214.5</b>	<b>199.2</b>	<b>237.0</b>	<b>277.0</b>							
Capital expenditure	(261.0)	(320.1)	(411.5)	(164.0)	(90.0)							
(Acquisitions)/divestments	(47.3)	224.9	215.0									
Other												
<b>Funding available/(required)</b>	<b>(54.7)</b>	<b>119.3</b>	<b>2.7</b>	<b>73.0</b>	<b>187.0</b>							
Dividends paid	(85.1)	(88.0)	(87.6)	(89.2)	(90.8)							
Equity raised/(returned)		(37.3)	(87.7)									
<b>(Increase)/decrease in net debt</b>	<b>(139.8)</b>	<b>(5.9)</b>	<b>(172.5)</b>	<b>(16.2)</b>	<b>96.2</b>							
<b>Balance Sheet (NZ\$m)</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
Working capital	(161.7)	(172.4)	(171.5)	(180.5)	(190.5)							
Fixed assets	1,498.6	1,436.3	1,507.8	1,582.9	1,072.7							
Intangibles	831.8	798.4	784.5	769.9	754.6							
Right of use asset												
Other assets	107.2	220.0	115.1	115.1	115.1							
<b>Total funds employed</b>	<b>2,275.9</b>	<b>2,282.3</b>	<b>2,235.8</b>	<b>2,287.3</b>	<b>1,751.9</b>							
Net debt/(cash)	433.0	504.3	676.8	693.0	596.8							
Lease liability												
Other liabilities	684.8	622.0	621.8	621.8	117.2							
Shareholder's funds	1,158.0	1,156.0	937.1	972.5	1,037.9							
Minority interests												
<b>Total funding sources</b>	<b>2,275.9</b>	<b>2,282.3</b>	<b>2,235.8</b>	<b>2,287.3</b>	<b>1,751.9</b>							
<b>Valuation Ratios</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
EV/EBITDA (x)	8.2	8.3	9.6	9.2	8.5							
EV/EBIT (x)	11.4	11.2	13.5	13.3	12.2							
PE (x)	14.1	13.9	15.9	15.8	16.0							
Price/NTA (x)	7.3	6.7	15.8	12.1	8.8							
Free cash flow yield (%)	-0.3	-4.4	-8.8	3.0	7.8							
Net dividend yield (%)	5.6	5.6	5.6	5.6	5.6							
Gross dividend yield (%)	7.8	7.8	7.8	7.8	7.8							
<b>Capital Structure</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
Interest cover EBIT (x)	19.5	24.8	35.2	21.2	7.7							
Interest cover EBITDA (x)	27.1	33.6	49.5	30.8	11.2							
Net debt/ND+E (%)	27.2	30.3	41.9	41.6	36.5							
Net debt/EBITDA (x)	1.3	1.5	2.2	2.1	1.7							
<b>Key Ratios</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
Return on assets (%)	9.6	9.9	8.8	9.0	12.3							
Return on equity (%)	14.7	15.0	16.1	15.9	15.0							
Return on funds employed (%)	11.9	11.1	9.5	9.9	10.9							
EBITDA margin (%)	33.9	33.9	33.2	34.0	34.9							
EBIT margin (%)	24.4	25.0	23.6	23.4	24.2							
Capex to sales (%)	26.1	31.6	44.4	16.8	8.7							
Capex to depreciation (%)	318	418	547	185	94							
Imputation (%)	100	100	100	100	100							
Pay-out ratio (%)	79	78	89	89	89							
<b>Operating Performance</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
<b>Total revenue (incl gaming GST)</b>												
Auckland	584.60	606.60	604.44	632.76	664.35							
Hamilton	60.70	61.80	62.86	63.94	65.04							
Other NZ	13.00	13.20	13.53	13.87	14.21							
Adelaide (A\$)	149.00	148.70	148.00	167.55	184.38							
Darwin (A\$)	110.80	83.30	-	-	-							
IB	160.30	190.50	186.30	186.99	193.68							
<b>Total revenue (incl gaming GST)</b>	<b>1,101.02</b>	<b>1,118.96</b>	<b>1,024.60</b>	<b>1,075.84</b>	<b>1,133.47</b>							
<b>EBITDA breakdown</b>												
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>							
Auckland	260.70	267.90	257.26	271.49	286.96							
Hamilton	26.90	26.90	27.26	27.63	28.00							
Other NZ	2.10	2.30	2.36	2.42	2.48							
Adelaide (A\$)	22.50	21.00	22.76	33.69	44.31							
Darwin (A\$)	25.10	19.00	-	-	-							
IB	32.60	41.70	41.32	40.48	42.29							
Corporate costs	(33.00)	(34.70)	(36.80)	(37.54)	(38.66)							
Other	(2.84)	(3.96)	(7.80)	(8.03)	(8.28)							
<b>Total EBITDA</b>	<b>338.2</b>	<b>342.7</b>	<b>307.8</b>	<b>332.3</b>	<b>359.9</b>							
NZDAUD	0.92	0.94	0.94	0.94	0.94							
Capitalised interest	22.90	30.32	39.91	30.25	-							

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

## Result expectations in more detail

**Figure 3. 1H20 result expectations**

NZ\$m	1H19	1H20E	% chg
Normalised revenue (incl gaming GST)	598.0	529.2	-11.5%
Gaming GST	(55.4)	(51.4)	-7.1%
Total revenue (ex gaming GST)	542.6	477.7	-12.0%
Total costs	(353.5)	(311.8)	-11.8%
<b>Normalised EBITDA</b>	<b>189.1</b>	<b>166.0</b>	<b>-12.2%</b>
Depreciation + Amortisation	(47.3)	(47.3)	0.0%
Normalised EBIT	141.8	118.7	-16.3%
Net interest	(5.9)	(2.5)	-57.8%
Tax	(39.0)	(33.7)	-13.6%
Normalised profit	96.9	82.5	-14.9%
Abnormals	(14.1)	0.0	n/a
Reported profit	82.8	82.5	-0.4%
Normalised EPS	14.3	12.2	-14.8%
Dividend (cents)	10.0	10.0	0.0%
<b>Underlying 'like for like' EBITDA</b>			
Auckland	129.0	133.2	3.2%
<b>EBITDA per SKC disclosure (ex Darwin, AKL adj.)</b>	<b>163.5</b>	<b>166.0</b>	<b>1.5%</b>
also adjusting for Adelaide restructuring in 1H19	165.3	166.0	0.4%
Local EBITDA per SKC disclosure (ex Darwin, AKL adj, IB)	138.8	142.6	2.7%
also adjusting for Adelaide restructuring in 1H19	140.7	142.6	1.4%
<b>Divisional detail</b>			
Total revenue (incl gaming GST)			
Auckland	307.8	306.5	-0.4%
Hamilton	31.5	32.6	3.6%
Other NZ	6.5	6.7	3.5%
Adelaide (A\$)	77.9	77.4	-0.7%
Darwin (A\$)	60.4	0.0	n/a
International Business	103.3	100.8	-2.4%
Total normalised revenue	598.0	529.2	-11.5%
<b>EBITDA breakdown</b>			
Auckland	138.0	133.2	-3.5%
Hamilton	14.0	14.6	3.9%
Other NZ	1.2	1.2	3.5%
Adelaide (A\$)**	12.4	13.1	5.4%
Darwin (A\$)	15.4	0.0	n/a
International Business	24.7	23.4	-5.4%
Corporate costs	(16.7)	(17.7)	6.1%
Other	(2.0)	(2.6)	28.6%
<b>Total normalised EBITDA</b>	<b>189.1</b>	<b>166.0</b>	<b>-12.2%</b>
Capitalised interest*	14.3	18.8	31.6%
NZDAUD	0.93	0.94	1.0%

Source: Forsyth Barr analysis, Company reports,

\*This assumes SKC capitalises interest as per the status pre the NZICC fire

\*\*NB 1H19 Adelaide result included A\$1.7m in restructuring costs which is not in 1H20. SKC did not normalise for this at the time

## 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 Adelaide. 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.
- **Increasingly capital intensive platform,** given a fairly mature industry and a need to continually diversify and refresh its offering to retain relevance and drive visitation.

### 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:** Two major capital projects are underway in Auckland and Adelaide. Achieving a satisfactory return on capital is the challenge given the substantial capital being spent. Adelaide, in particular, raises questions given perennial disappointment from the property through history.

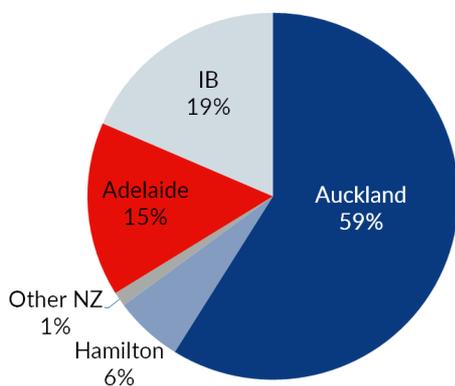
### Financial structure

- **Gearing:** SKC has committed to a BBB- credit rating and 'efficient capital allocation' is 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.
- **Solid yield and share buy-back:** SKC offers a solid dividend yield, which we view as sustainable (with upside risk after project completion). SKC also has a share buy-back programme in place for up to 5% of its shares.

### Risk factors

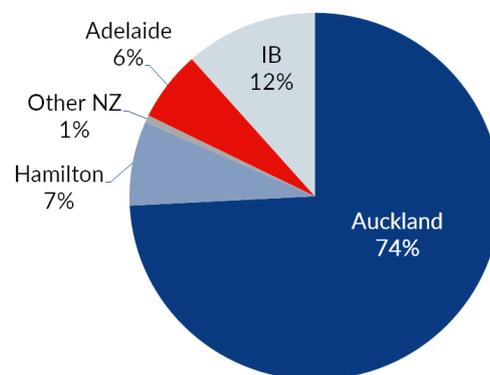
- **Gaming regulation:** Unexpected regulatory and taxation changes.
- **Mature local gaming market:** The local grind gaming market is not only mature but vulnerable to changing entertainment spending patterns.

Figure 4. Revenue breakdown (cont. operations)

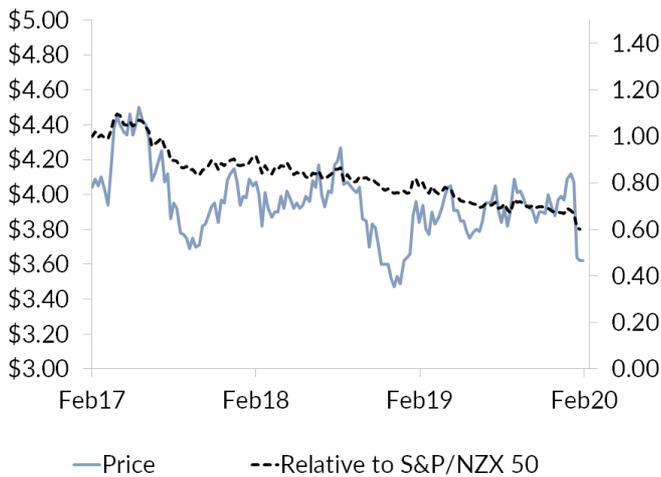


Source: Forsyth Barr analysis, Company reports

Figure 5. EBITDA breakdown (cont. operations)



Source: Forsyth Barr analysis, Company reports

**Figure 6. Price Performance**


Source: Forsyth Barr analysis

**Figure 7. Substantial Shareholders**

Shareholder	Latest Holding
Sumitomo Mitsui Trust Holdings	10.0%
Lazard	8.5%
Investor Mutual	8.4%
BlackRock Investment Management	7.1%
Commonwealth Bank of Australia	7.0%
The Vanguard Group	5.3%

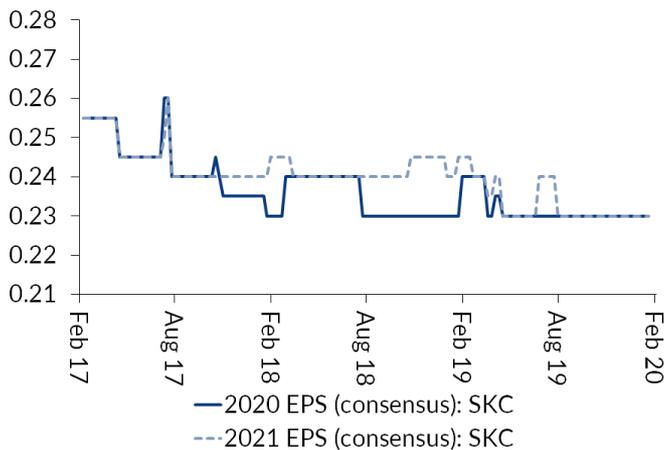
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 8. International valuation comparisons**

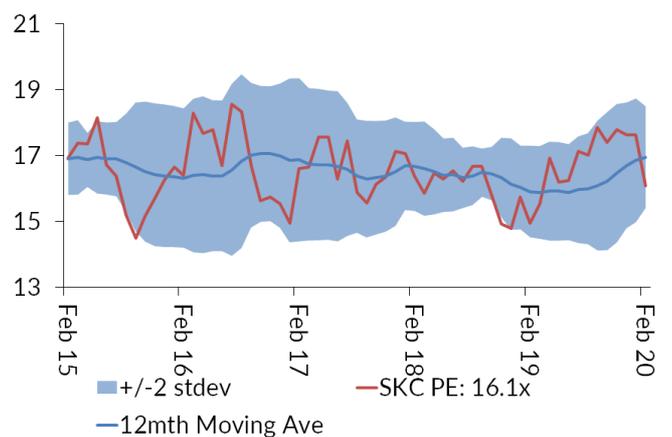
Company (metrics re-weighted to reflect SKC's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>SKYCITY</b>	<b>SKC NZ</b>	<b>NZ\$3.57</b>	<b>NZ\$2,413</b>	<b>15.9x</b>	<b>15.8x</b>	<b>9.5x</b>	<b>8.8x</b>	<b>13.3x</b>	<b>12.7x</b>	<b>5.6%</b>
Crown Resorts	CWN AT	A\$11.61	A\$7,862	22.3x	21.4x	10.3x	9.7x	16.0x	15.2x	5.2%
Tabcorp Holdings	TAH AT	A\$4.59	A\$9,296	23.1x	21.5x	11.6x	11.2x	16.5x	15.7x	5.1%
Star Entertainment Grp/The	SGR AT	A\$4.16	A\$3,816	16.2x	15.6x	8.3x	8.0x	12.9x	12.2x	5.2%
Genting Malaysia Bhd	GENM MK	RM3.03	RM17,131	12.8x	12.8x	7.3x	7.0x	12.5x	11.7x	4.3%
Kangwon Land Inc	035250 KS	KRW27300.00	KRW5,840,576	15.5x	13.7x	7.1x	6.8x	7.9x	7.4x	3.7%
<b>Compc Average:</b>				<b>18.0x</b>	<b>17.0x</b>	<b>8.9x</b>	<b>8.5x</b>	<b>13.1x</b>	<b>12.4x</b>	<b>4.7%</b>
<b>SKC Relative:</b>				<b>-11%</b>	<b>-7%</b>	<b>6%</b>	<b>3%</b>	<b>1%</b>	<b>2%</b>	<b>19%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 9. Consensus EPS momentum**


Source: Forsyth Barr analysis

**Figure 10. 12 Month Forward PE**


Source: Forsyth Barr analysis

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OUTPERFORM	NEUTRAL	UNDERPERFORM
31.4%	51.0%	17.6%

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