FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | GAMING | CASINO & TOURISM OPERATOR
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SKYCITY
Recalibrating For Shutdown

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OUTPERFORM

Staying the course is not easy in the unprecedented situation we are in — nonetheless, we continue to believe SKYCITY (SKC) can navigate COVID-19 (admittedly with some battle scars), with its asset base and long-term casino licences providing some comfort of value well above current market pricing.

NZX Code	SKC
Share price	NZ$1.58
Target price	NZ$3.30
Risk rating	Medium
Issued shares	667.2m
Market cap	NZ$1,054m
Avg daily turnover	732.9k (NZ$2,651k)

Financials: Jun/	19A	20E	21E	22E
NPAT* (NZ$m)	173.0	55.6	62.3	141.0
EPS* (NZc)	25.6	8.3	9.1	20.2
EPS growth* (%)	0.9	-67.7	9.9	n/a
DPS (NZc)	20.0	10.0	10.0	20.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	4.3	8.4	7.4	5.1
EV/EBIT	5.9	16.3	13.9	7.7
PE	6.2	19.1	17.4	7.8
Price / NTA	3.0	10.1	6.3	6.6
Cash div yld (%)	12.7	6.3	6.3	12.7
Gross div yld (%)	17.6	8.8	8.8	17.6

Heading into uncharted territory; closure now reality

SKC has closed its portfolio of properties (hotels temporarily excluded) from 23 March 2020, at the direction of both the Australian and NZ governments. No one knows exactly how long this will last (initial indications are four weeks for NZ and longer in Australia). Acknowledging significant limitations in forecasting the current situation (near-term forecasts are largely guesswork), we have put through further short-term earnings downgrades. Our base case now assumes: (1) a 10 week closure of all operations, (2) air access for IB players restricted until 31 December 2020 and (3) a six month period of material disruption post re-opening.

This situation is unprecedented. Macau provides one (evolving) benchmark on a country ahead of NZ in managing COVID-19, which is still seeing material disruption ~1 month post re-opening, although there are material limitations in comparability to SKC given Macau's high reliance on domestic Chinese travel vs SKC's largely local grind business.

No shortage of near-term challenges; cost base likely more flexible than normal

A temporary closure has modest valuation implications, however, the extent of EBITDA disruption will have material implications on the gearing path. Our various scenario analysis suggests any closure of three months or more would create challenges for covenants (assuming there was no closure look through). One casualty of the situation is highly likely to be a temporary dividend suspension — we now forecast no dividend in 2H20 and 1H21. There is also a possibility the board decides to raise equity to shore up the balance sheet through this period of heightened uncertainty.

Where to from there?

We expect a recovery in gaming spend from any shock, and this could also be aided by government stimulus measures. Nonetheless, we expect newsflow may get worse before it gets better and it will take time to get greater clarity on the near-term earnings path.

Fundamentally SKC is a strong business, predominantly exposed to the domestic consumer, with material property assets (~NZ$2bn) and long-term monopoly casino licences. The total one-off hit to our DCF valuation to factor in disruption/closure associated with COVID-19 has been -40cps (-11%). In contrast, SKC's share price has fallen ~NZ$2.45 and market cap ~NZ$1.6bn. To put it another way, the share price decline of NZ$2.45 compares to our estimated casino closure cost of ~NZ$0.04–0.06/month. While we acknowledge material near-term risks, the share price correction seems well out of step with any magnitude of scenarios around the risk. Utilising our FY22 estimates (a 'normal' year), SKC is trading on EV/EBITDA of ~5x and offers a cash yield of ~13%.

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SKYCITY Entertainment Group Ltd (SKC)

Priced as at 25 Mar 2020 (NZ$)	**1.58**

12-month target price (NZ$)*	**3.30**
Expected share price return	108.9%
Net dividend yield	6.3%
Estimated 12-month return	115.2%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.99
WACC	8.1%
Terminal growth	1.5%

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	998.6	1,011.6	660.8	745.0	977.6
Normalised EBITDA	**338.2**	**342.7**	**188.9**	**225.7**	**329.8**
Depreciation and amortisation	(94.4)	(89.9)	(91.4)	(105.7)	(113.2)
Normalised EBIT	**243.8**	**252.8**	**97.5**	**119.9**	**216.6**
Net interest	(12.5)	(10.2)	(19.1)	(33.4)	(20.8)
Associate income	0	0	0	0	0
Tax	(61.5)	(69.6)	(22.7)	(24.2)	(54.8)
Minority interests	0	0	0	0	0
Normalised NPAT	**169.8**	**173.0**	**55.6**	**62.3**	**141.0**
Abnormals/other	(0.3)	(28.4)	253.1	0	0
Reported NPAT	**169.5**	**144.6**	**308.7**	**62.3**	**141.0**
Normalised EPS (cps)	25.4	25.6	8.3	9.1	20.2
DPS (cps)	20.0	20.0	10.0	10.0	20.0

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	6.9	1.3	-34.7	12.7	31.2
EBITDA (%)	5.6	1.3	-44.9	19.5	46.2
EBIT (%)	8.2	3.7	-61.4	23.0	80.6
Normalised NPAT (%)	10.5	1.9	-67.8	11.9	>100
Normalised EPS (%)	8.5	0.9	-67.7	9.9	>100
Ordinary DPS (%)	0.0	0.0	-50.0	0.0	100.0

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**338.2**	**342.7**	**188.9**	**225.7**	**329.8**
Working capital change	72.8	19.1	(4.9)	(23.6)	28.8
Interest & tax paid	(157.4)	(147.2)	(61.8)	(67.6)	(97.7)
Other	0	0	0	0	0
Operating cash flow	**253.6**	**214.5**	**122.2**	**134.5**	**261.0**
Capital expenditure	(261.0)	(320.1)	(255.2)	(102.2)	(195.0)
(Acquisitions)/divestments	(47.3)	224.9	129.0	0	0
Other	0	0	0	0	0
Funding available/(required)	**(54.7)**	**119.3**	**(4.0)**	**32.2**	**66.0**
Dividends paid	(85.1)	(127.1)	(127.1)	0	(139.7)
Equity raised/(returned)	0	(37.3)	(20.0)	0	0
(Increase)/decrease in net debt	**(139.8)**	**(45.0)**	**(151.1)**	**32.2**	**(73.7)**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	(161.7)	(172.4)	(167.5)	(143.9)	(172.7)
Fixed assets	1,498.6	1,436.3	1,435.2	1,446.3	1,394.1
Intangibles	831.8	798.4	784.5	769.9	754.6
Right of use asset	0	0	0	0	0
Other assets	107.2	220.0	115.1	115.1	115.1
Total funds employed	**2,275.9**	**2,282.3**	**2,167.3**	**2,187.4**	**2,090.9**
Net debt/(cash)	433.0	504.3	655.4	623.1	696.8
Lease liability	0	0	0	0	0
Other liabilities	684.8	622.0	621.8	621.8	472.4
Shareholder's funds	1,158.0	1,156.0	890.1	942.4	921.7
Minority interests	0	0	0	0	0
Total funding sources	**2,275.9**	**2,282.3**	**2,167.3**	**2,187.4**	**2,090.9**

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

Spot valuations (NZ$)	
1. DCF	3.31
2. Sum of the parts (current)	3.16
3. Sum of the parts (w project upside)	3.65

DCF valuation summary (NZ$m)	
Total firm value	2,641
(Net debt)/cash	(368)
Less: Capitalised operating leases	0
Value of equity	2,273

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	4.2	4.3	8.4	7.4	5.1
EV/EBIT (x)	5.8	5.9	16.3	13.9	7.7
PE (x)	6.2	6.2	19.1	17.4	7.8
Price/NTA (x)	3.2	3.0	10.1	6.3	6.6
Free cash flow yield (%)	-0.7	-10.0	-12.6	3.1	6.3
Net dividend yield (%)	12.7	12.7	6.3	6.3	12.7
Gross dividend yield (%)	17.6	17.6	8.8	8.8	17.6

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	19.5	24.8	5.1	3.6	10.4
Interest cover EBITDA (x)	27.1	33.6	9.9	6.8	15.8
Net debt/ND+E (%)	27.2	30.3	42.4	39.8	43.0
Net debt/EBITDA (x)	1.3	1.5	3.5	2.8	2.1

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	9.6	9.9	4.1	5.0	9.2
Return on equity (%)	14.7	15.0	6.3	6.6	15.3
Return on funds employed (%)	11.9	11.1	4.3	5.6	9.8
EBITDA margin (%)	33.9	33.9	28.6	30.3	33.7
EBIT margin (%)	24.4	25.0	14.8	16.1	22.2
Capex to sales (%)	26.1	31.6	38.6	13.7	19.9
Capex to depreciation (%)	318	418	329	112	199
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	79	78	121	110	99

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Total revenue (incl gaming GST)					
Auckland	584.60	606.60	474.23	516.07	653.06
Hamilton	60.70	61.80	51.87	57.57	66.51
Other NZ	13.00	13.20	11.20	12.63	14.72
Adelaide (A$)	149.00	148.70	117.59	144.58	186.00
Darwin (A$)	110.80	83.30	0	0	0
IB	160.30	190.50	67.50	81.68	143.44
Revenue (incl gaming GST)	**1,101.02**	**1,118.96**	**728.00**	**819.82**	**1,075.36**
EBITDA breakdown					
Auckland	260.70	267.90	212.01	226.33	290.55
Hamilton	26.90	26.90	15.57	20.36	28.38
Other NZ	2.10	2.30	0.08	1.29	3.16
Adelaide (A$)	22.50	21.00	11.46	23.43	34.35
Darwin (A$)	25.10	19.00	0	0	0
IB	32.60	41.70	(10.60)	(8.77)	19.24
Corporate costs	(33.00)	(34.70)	(34.20)	(32.00)	(40.00)
Other	(2.84)	(3.96)	(6.00)	(6.18)	(8.00)
Total EBITDA	**338.2**	**342.7**	**188.9**	**225.7**	**329.8**
NZDAUD	0.92	0.94	0.95	0.95	0.94
Capitalised interest	22.90	30.32	19.92	10.00	22.00

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How to Make Sense of an Unprecedented Situation

SKC has closed its portfolio of properties (Auckland hotels temporarily excluded) from 23 March 2020, at the direction of both the Australian and NZ governments. This situation is unprecedented, making near-term forecasts highly uncertain.

SKC's market capitalisation has fallen by ~NZ$1.6bn since the COVID-19 outbreak took hold in China. This is substantially larger than our various scenarios of the risk/cashflow impact. We expect a recovery in gaming spend from any shock, although acknowledge the path is unlikely to be clear any time soon and newsflow may get worse before it gets better.

Current backdrop — temporary lockdown in NZ, longer-dated restrictions for Australia

The COVID-19 pandemic has moved at an extreme pace. We do not profess to be virus or public health experts, however, the sharp reaction from NZ (mandated lockdown, with initial plans being that this is for four weeks) should help to dramatically reduce social interaction, without which the virus cannot spread. Countries like China, South Korea and Singapore have shown that through vigilant quarantining, social-distancing and travel restrictions it is possible to contain the virus. If New Zealand's measures are successful then the domestic economy could be reopened within a relatively short window, although tight border restrictions would need to be maintained. New Zealand policymakers have also provided an unprecedented level of fiscal and monetary support to date.

New Zealand has moved more rapidly than Australia, although they also have numerous restrictions in place, with various social gathering facilities mandated to close (including casinos) from Monday 23 March. The government has indicated Australians should expect these measures to be in place for at least 6 months.

Quantifying some closure scenarios

At this stage NZ's closure is for 4 weeks, while Australia's is less clear. However, the ultimate timeframe will be contingent on the virus trajectory. Even beyond closure we expect a further period of disruption.

A temporary closure has very modest valuation implications, however, the extent of disruption will have material implications on the gearing path. We assess cash burn of ~NZ$27m/month, or ~NZ$0.04 per share/month.

Our scenarios suggest any closure of three months or more would create challenges for covenants (net debt to EBITDA of <3.75x), assuming the temporary closure was not looked through, and earlier (two months closure) for its credit rating (net debt to EBITDA of <3x). The key issue is not the level of debt, but the short-term hit to earnings. We expect SKC may have more aggressive levers it pulls and/or greater government support (vs our below scenarios) should we see a sustained closure period like this. Nonetheless, there are plausible scenarios where it could need a funding injection.

Figure 1. Estimated cash burn per month

Cash burn NZ$m	Normal	COVID-19 scenario
Fixed opex	22	15
Cash interest	4	4
Capex	13	8
Total	39	27
per share	**0.06**	**0.04**

Source: Forsyth Barr analysis

Figure 2. Net debt to EBITDA for closure/disruption scenarios

		Disruption period after closure (weeks)			
		4	**8**	**12**	**16**
	4	2.47x	2.58x	2.71x	2.84x
Closure period (weeks)	**8**	2.87x	3.02x	3.19x	3.38x
	12	3.42x	3.64x	3.89x	4.18x
	16	4.24x	4.58x	4.98x	5.47x

Source: Forsyth Barr analysis, Grey shading highlights covenant breach

Retain OUTPERFORM; value gap creates material buffer for the risks

Fundamentally SKC is a strong business, with material property assets (~NZ$2bn) and long-term monopoly casino licences. However, like the majority of businesses it has been caught out by extraordinary circumstances. Forecasting earnings is near impossible in the near-term, however, when we are out the other side of COVID-19 we expect gaming spend to recover which will quickly improve EBITDA, gearing, and enable reinstatement of what was an attractive dividend (we forecast a cash yield of ~13% in FY22E).

The one-off hit to our valuation to factor in disruption/closure associated with COVID-19 has been -40cps (-11%). In contrast SKC's share price has fallen ~NZ$2.45 (market cap decline of ~NZ$1.6bn). While we acknowledge material near-term risks, the share price correction seems well out of step with any magnitude of scenarios around the risk. We expect the key near-term causality for investors to be a temporary dividend suspension (we assume in 2H20 and 1H21). There is also a possibility the board decides to raise equity to shore up the balance sheet through this period of heightened uncertainty.

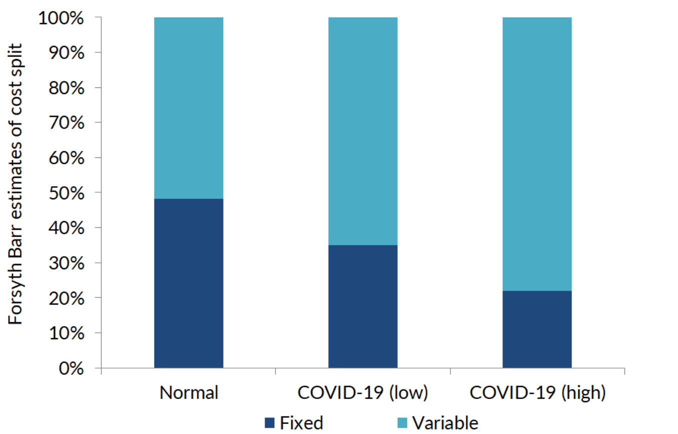
How we are thinking about the risks

We don't know many important things, including (1) lock down duration, (2) how quickly demand recovers, (3) cost-out initiatives from SKC in the short-term to preserve cash. It is far from a foregone conclusion that SKC will breach its debt covenants, however, there are plausible scenarios where it could. The key issue is not the level of debt, but the short-term hit to earnings. Our scenarios suggest any closure of three months or more would create challenges for covenants, assuming closure was not looked through. There is a possibility the board decides to raise equity to shore up the balance sheet through this period of heightened uncertainty

Understanding the potential EBITDA pathway

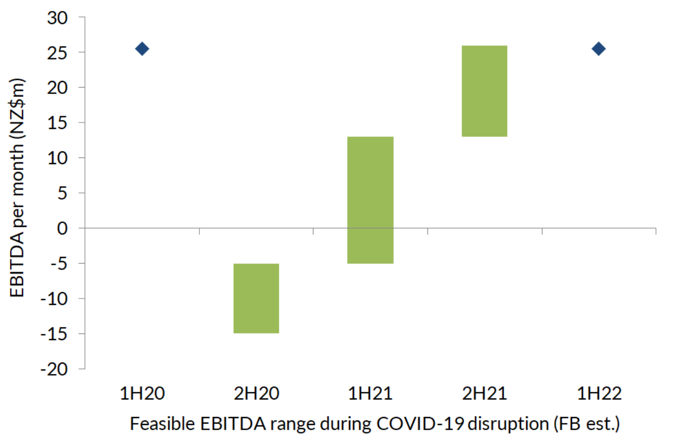
Pre COVID-19, SKC generated EBITDA of ~NZ$26m/month. In normal circumstances, we estimate SKC's fixed costs are ~48% of total operating costs or ~NZ$22m/month. Of this, the majority is employee wages. We are not in normal circumstances and we expect all costs will come under scrutiny, with additional flexibility of the 'fixed' cost base during the disruption period and/or government support. We are not privy to SKC's plan through the closure and disruption. Our best estimate of EBITDA losses during closure suggests a feasible range of -NZ$10–15m/month which assumes some mitigators.

Figure 3. Est. of cost flexibility during COVID-19



Source: Forsyth Barr analysis

Figure 4. Feasible EBITDA pathway range back to 'normality'



Source: Forsyth Barr analysis

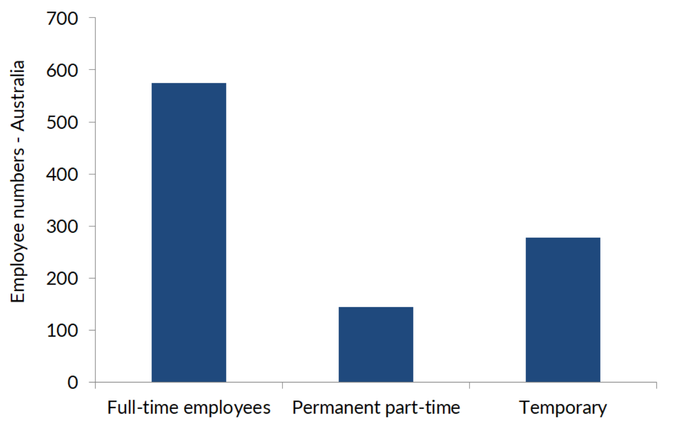
Support from government — wage subsidies from NZ

Governments globally are providing various support packages for those businesses under pressure from COVID-19. NZ has been quick to move and broad in its offer of employee subsidies. Subsidies are NZ$585.80 per employee working >20hrs a week and $350 for those working <20hrs per week. There is no longer a cap per business and we understand the payment is for 12 weeks and provided in a lump sum. Assuming SKC was eligible, we estimate this could total ~NZ$20m or ~NZ$7m/month.

Figure 5. NZ employee numbers

Source: Forsyth Barr analysis, SKC Annual Report

Figure 6. Australian employee numbers



Source: Forsyth Barr analysis, Company reports

Star provides some insight into its aggressive cost-out plans for Australia

Star has just announced a plan to materially reduce fixed costs, by standing down 90% of its workforce while its properties are forced to shut, albeit with two weeks of paid pandemic leave. Wages contribute ~70% of operating costs ex D&A, taxes, levies and commissions, and we expect have a high proportion of fixed costs. Standing down the workforce removes these fixed costs, resulting in ~A$20m of monthly opex while closed.

Is there any precedent? Looking to Macau

There is no obvious precedent for the events we are currently experiencing and things are rapidly evolving, in part dependent on each country's response. Macau provides one (evolving) benchmark to monitor, although the heavy reliance on domestic travel from Mainland China (still restricted) limits the comparability to SKC's largely local grind businesses. It is early days, however, Macau is still showing material disruption and visitation decline one month post the casinos' temporary closure period.

Macau — initial stats bleak

Macau casinos were temporarily shut for 15 days, re-opening on 20 February 2020. The initial data post re-opening paints a bleak picture, although this is amplified by Chinese New Year in the prior year. Macau is also heavily reliant on domestic travel from Mainland China which is still restricted.

Data points and anecdotes of relevance to date:

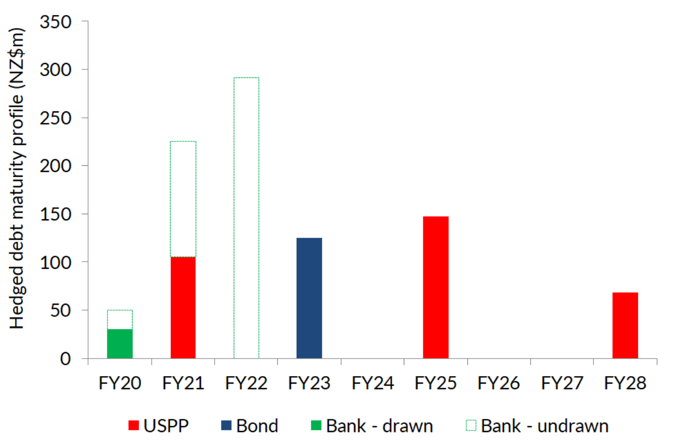
- February gross gaming revenue down -88% YoY (include 15 days of closure) and visitor arrivals down -96%. This suggests revenue per day down ~-75% YoY for those which were open. We note February 2019 included the key Chinese New Year period which complicates the read-through.
- In 2019 there were 108,000 visitors daily to Macau. This compares to ~50,000/week. Article published 22 March.
- On re-opening, initial guidelines retained social distancing protocols ("no more than half of the tables in a given space may be in operation. Customers must also not be placed next to one another"). This has been loosened over time. Market commentary suggests fewer than a third of tables were open initially, lifting to ~54% operational on 10 March and ~80% on 19 March.
- The industry body expects the casino sector to be fully operational in terms of both tables open and visitation by Easter (12 April)

Balance sheet health check

Balance sheet position

- Assets: SKC has two key assets — (1) a large property base (NZ$1.6bn at 1H20 on its books, or ~NZ$2bn if marked to market at the time), including some surplus property, and (2) long-term monopoly casino licences. Valuing the latter is more subjective. It is worth noting the casino licence carrying value by property at FY19 was: Auckland NZ$405m (with an associated liability for deferred licence value of -NZ$295m), Adelaide ~A$288m (with an associated deferred licence value of -NZ$149m), Hamilton $0, Queenstown $4.4m. The Hamilton value in particular highlights this does not appear to be fully captured in SKC's balance sheet.
- Debt: SKC has three debt providers (1) the banks, (2) NZ bond (NZ$125m), (3) three USPP facilities (totalling ~NZ$320m) with two long-term SKC investors.

Figure 7. Hedged debt maturity profile (at 1H20 result)



Source: Forsyth Barr analysis, Company presentation

Figure 8. Breaking down the balance sheet

Balance sheet	1H20	per share
Net debt	(538)	(0.81)
Working capital	(154)	(0.23)
Property, plant & equipment	1,601	2.40
Intangibles	803	1.20
Deferred licence value	(444)	(0.67)
NZICC fire recoveries	219	0.33
Leases	(40)	(0.06)
Other	(37)	(0.06)
Net assets	1,409	2.11
Net assets (adj for intangibles + deferred licence value)	1,050	1.57

Source: Forsyth Barr analysis, Interim report

Covenants and what happens if there is a breach

We understand both SKC's NZ bond and USPP have a net debt (adjusting for both cash in bank and cash held at its venues) to EBITDA covenant of 3.75x. These are assessed on 30 June and 31 December for the period of 12 months ending on that date.

It is unclear how any potential covenant breach would play out, as it will depend on SKC's discussions with respective parties and what they want to see from SKC (particularly to provide support that it is temporary). Given the main issue facing SKC is a short-term dip in earnings, we expect the banks will be accommodating of a short-term breach in covenants, particularly given its extensive asset base (with tangible value) and typically-strong cash flow generation. Prima facie, the bond would require repaying. The USPP participants are harder to read. We have seen examples of both tough and relatively benign responses to covenant breaches.

Should SKC breach, there appears to be some options given the debt structure currently. Assuming it is able to be drawn on, SKC also has undrawn bank facilities of NZ$337m. It is also worth noting, we expect the FY21 USPP would likely have small(er) penalties if required to be repaid early given the tenure remaining.

Cash conservation levers to pull

We expect to see a number of levers pulled to conserve cash including:

- Temporary dividend suspension: This totals ~NZ$70m per six month period.
- Maintenance capex temporarily materially lowered: Current levels are ~NZ$85m for 12 months, which we assume can be substantially pared back (to say ~NZ$10-20m).
- Project capex likely on pause: The NZICC/Horizon Hotel project is deemed non-essential in NZ, other growth projects are also likely to be paused. The Adelaide project is currently continuing (for now) although we would be surprised if this remains the case and expect to at least see some delay.

Credit rating watch

SKC has a longstanding commitment to its BBB- credit rating. Rating agency S&P has recently placed SKC on negative watch given the risks associated with COVID-19 and its ability to maintain a debt to EBITDA ratio <3.0x. Negative watch typically provides a three month period before a decision, although prior examples have seen this extended.

Gearing scenarios

There are a multitude of feasible scenarios for the path of SKC's near-term EBITDA and therefore gearing profile. The timing of various cashflows (which we have no visibility on) can also make meaningful differences. Our scenario analysis suggests SKC could withstand full closure (NZ and Australia) of its operations for two months, without breaching debt covenants, however, three months would be more problematic and require material changes to ensure no breach.

We expect SKC may have more aggressive levers it can pull (vs our below scenarios) should we see a sustained closure period much greater than current indications. Nonetheless, there is risk additional support is required (e.g. subordinated debt / equity) to get the company through a temporary period of disruption. Out the other side, a return to 'normal' (or even 75% of 'normal') would quickly improve EBITDA and gearing.

Figure 9. Net debt to EBITDA under various closure / disruption scenarios

		Disruption period after closure (weeks)			
		4	8	12	16
Closure period (weeks)	4	2.47x	2.58x	2.71x	2.84x
	8	2.87x	3.02x	3.19x	3.38x
	12	3.42x	3.64x	3.89x	4.18x
	16	4.24x	4.58x	4.98x	5.47x

Source: Forsyth Barr analysis, NB: Grey shading highlights covenant breach

Earnings revisions — drawing a line in the sand

The situation has continued to deteriorate rapidly. Acknowledging significant limitations in forecasting the current situation, we have put through short-term earnings downgrades to take into consideration the current situation and risks. We will highly likely be wrong, particularly given it is contingent on factors which are near impossible to forecast, including the pace or extent of the spread of COVID-19 and continued NZ/Australian government responses.

Our base case now assumes: (1) a 10 week closure of all operations, (2) air access for IB players restricted until 31 December, with a turnaround rebound in 2H21, and (3) a six month period of material disruption post re-opening. Our closure scenario includes our best estimates of NZ's wage subsidy scheme and some moderate assumptions on 'fixed cost' flexibility. While we expect all costs to be scrutinised during the shut-down, there is a limit to this given the expected temporary nature.

We have also materially reduced our near-term capex assumptions and assume a temporary dividend suspension (nil dividend in 2H20/1H21) during the pressure period to conserve cash.

We lower our target price to NZ$3.30 (prior NZ$3.65) which accounts for our assumed period of disruption/closure, including the cash impact of losses during our assumed closure period.

Figure 10. Earnings revisions

	FY19A		FY20E			FY21E			FY22E	
NZ$m	**Actual**	**Old**	**New**	**% chg**	**Old**	**New**	**% chg**	**Old**	**New**	**% chg**
Total revenue excl gaming GST	1,011.6	717.9	660.8	-8%	872.2	745.0	-15%	1,003.7	977.6	-3%
Normalised EBITDA	**342.7**	**229.1**	**188.9**	**-18%**	**288.5**	**225.7**	**-22%**	**344.3**	**329.8**	**-4%**
Normalised profit	173.0	82.4	55.6	-33%	104.2	62.3	-40%	148.2	141.0	-5%
Normalised EPS (cps)	25.6	12.2	8.3	-33%	15.2	9.1	-40%	21.2	20.2	-5%
Dividend per share (cps)	20.0	15.0	10.0	-33%	15.0	10.0	-33%	20.0	20.0	0%

Source: Forsyth Barr analysis

FORSYTH BARR

Investment Summary

SKYCITY (SKC) is one of the largest gaming operators in Australasia. Earnings and valuation are driven by Auckland, which makes up ~70% of group EBITDA. The company is facing unprecedented challenges from temporary closure of its properties and disruption from the COVID-19 crisis. Whilst there is a high degree of uncertainty in the current environment, SKC has a strong asset base and we expect it to come through the crisis and gaming spend levels to bounce-back. Valuation levels are attractive, more than compensating for the risks. OUTPERFORM.

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

- Earnings outlook: SKC is facing a period of depressed earnings near-term, given enforced property closures and disruption from COVID-19. We do expect gaming spend to recover, although this will likely take time and is contingent on the virus trajectory and government policies around restrictions. Data through history across multiple geographies suggests gaming spend has been somewhat resilient through the cycle, with no obvious boom or bust cycles, albeit not recession proof or immune to a slowdown.
- 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.

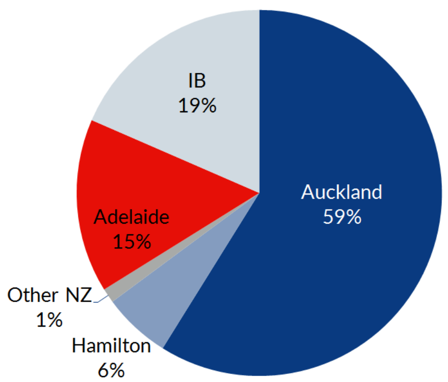
Financial structure

- 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), COVID-19 'social distancing' policies and future growth plans to build out destination precincts surrounding its casinos.
- Yield: SKC has historically offered a solid dividend yield. The COVID-19 crisis is likely to force the Board to reconsider its dividend policy. After a temporary dividend suspension, we expect dividends will resume at ~20cps.

Risk factors

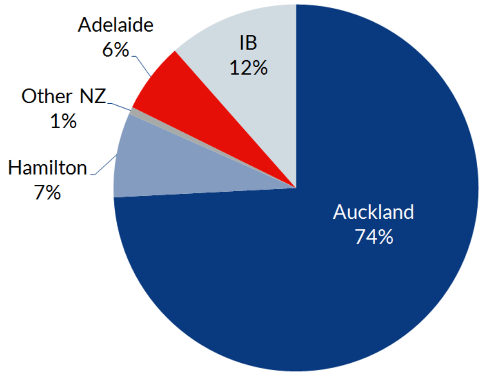
- Gaming regulation: Unexpected regulatory and taxation changes.
- Mature local gaming market: The local grind gaming market is not only mature but vulnerable to changing entertainment spending patterns.
- COVID-19: The key risk to SKC is the domestic backdrop and ultimately consumer behaviour (which could be dictated by containment/self-quarantine measures). Temporary closure is now reality in both NZ and Australia, and we expect at least some period of material disruption thereafter. However, being definitive on timelines is difficult.

Figure 11. Revenue breakdown FY19 (cont. operations)



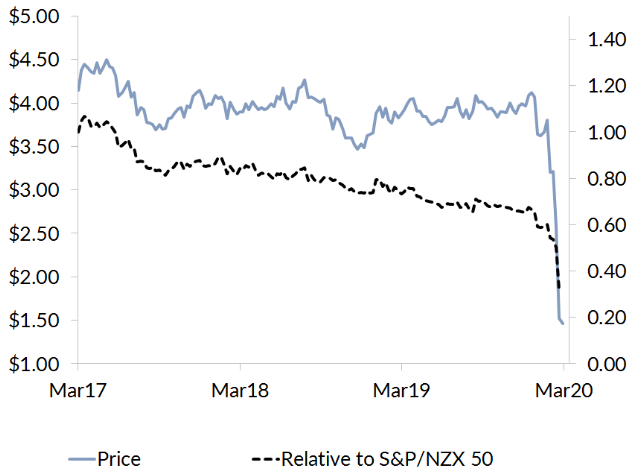
Source: Forsyth Barr analysis, Company reports

Figure 12. EBITDA breakdown FY19 (cont. operations)



Source: Forsyth Barr analysis, Company reports

Figure 13. Price performance



Source: Forsyth Barr analysis

Figure 14. Substantial shareholders

Shareholder	Latest Holding
Sumitomo Mitsui Trust Holdings	10.0%
Lazard	8.5%
Commonwealth Bank of Australia	8.2%
BlackRock Investment Management	7.1%
Investor Mutual	7.1%
Colonial First State	5.4%

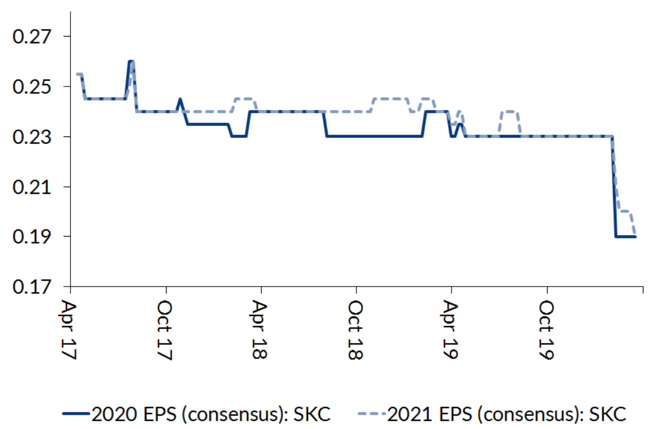
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 15. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SKC's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
SKYCITY	**SKC NZ**	**NZ$1.58**	**NZ$1,054**	**19.1x**	**17.4x**	**8.2x**	**6.9x**	**16.0x**	**13.0x**	**6.3%**
CROWN RESORTS	CWN AT	A$6.48	A$4,388	18.8x	16.2x	7.8x	6.7x	15.3x	12.5x	8.3%
TABCORP HOLDINGS	TAH AT	A$2.34	A$4,756	13.8x	13.1x	8.1x	7.9x	12.6x	12.1x	8.2%
STAR ENTERTAINMENT GRP/T	SGR AT	A$1.62	A$1,481	6.8x	6.5x	5.2x	4.8x	9.1x	7.8x	12.4%
GENTING MALAYSIA BHD	GENM MK	RM1.85	RM10,437	9.6x	10.0x	5.4x	5.4x	9.5x	9.4x	8.8%
KANGWON LAND INC	035250 KS	KRW18250.00	KRW3,904,414	10.5x	9.6x	3.7x	3.6x	4.2x	4.0x	5.3%
			Compco Average:	**11.9x**	**11.1x**	**6.1x**	**5.7x**	**10.1x**	**9.2x**	**8.6%**
EV = Current Market Cap + Actual Net Debt			**SKC Relative:**	**61%**	**57%**	**36%**	**22%**	**58%**	**42%**	**-26%**

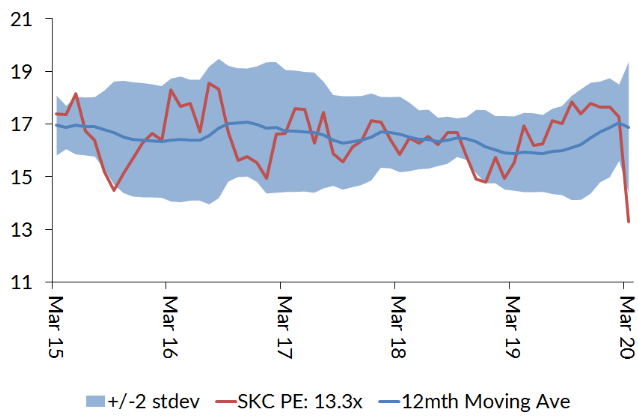
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKC) companies fiscal year end

Figure 16. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 17. One year forward PE (x)



Source: Forsyth Barr analysis

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