

SKYCITY

COVID-19 Restrictions Return

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SKYCITY (SKC) is one of the key NZX listed companies impacted by the return of COVID-19 community transmission in New Zealand. The current Alert Level restrictions mean SKC's primary earnings driver, the Auckland casino, is closed, while Hamilton and Queenstown have material restrictions which will weigh on visitation. At this point restrictions are three days, however, there is a high risk this is extended. There will be some impact on FY21 earnings, albeit this is difficult to estimate at this point. This presents another challenge (and more battle scars) for SKC; however, following the recent capital raise it has reasonable liquidity, balance sheet headroom and near-term covenant relief to weather another period of temporary closure.

NZX Code	SKC	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.43	NPAT* (NZ\$m)	173.0	61.7	47.4	130.4	EV/EBITDA	6.6	11.5	11.2	7.2
Target price	NZ\$3.10	EPS* (NZc)	25.6	8.7	6.2	17.2	EV/EBIT	9.0	20.8	22.1	10.7
Risk rating	Medium	EPS growth* (%)	0.9	-66.2	-27.9	n/a	PE	9.5	28.1	38.9	14.2
Issued shares	760.1m	DPS (NZc)	20.0	10.0	5.0	14.0	Price / NTA	4.6	3.4	3.2	3.0
Market cap	NZ\$1,847m	Imputation (%)	100	100	100	100	Cash div yld (%)	8.2	4.1	2.1	5.8
Avg daily turnover	1,150k (NZ\$3,306k)	*Based on normalised profits					Gross div yld (%)	11.4	5.7	2.9	8.0

A return to casino closure in Auckland – currently for three days, but longer seems likely

The New Zealand Government has announced a return to Alert Level 3 for Auckland (which means closure of SKC's main casino and earnings driver) from midday on 12th August, while the rest of New Zealand returns to Alert Level 2 (casino open, albeit with material restrictions around gatherings and social distancing). The current restrictions are in place for three days, however, it is likely this is extended and there is also risk of heightened restrictions outside of Auckland.

Balance sheet, cash burn and near-term earnings profile

There are a number of moving parts for SKC's gearing profile (including project capex timing, fire insurance/reinstatement timing, and EBITDA recovery profile), however, our analysis suggests SKC has balance sheet capacity and available liquidity (c. NZ\$580m) to see it through a further period of temporary closure, helped by the recent funding injection. Covenant waivers, from both banks and USPP noteholders, for the testing periods 31 December 2020 and 30 June 2021, also alleviates questions.

FY20 and FY21 will be 'messy' years (COVID-19 ramifications, the NZICC fire, and major project accounting), with forecasting FY21 increasingly challenging. We estimate cash burn of c. NZ\$25–30m per month (NZ\$0.03–0.04/share per month) under the current restriction status. Our base case currently assumes a return to 'normal' in FY22E (most areas) or FY23E (including IB and hotels).

Where to from here?

We expect a recovery in gaming spend from any shock (reinforced by recent data points, commentary and anecdotes from SKC and casino companies globally), 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.

SKC's enterprise value has declined by ~NZ\$900m in 2020, equating to over five years of lost earnings, and meaningfully larger than our scenarios of the risk/cashflow impact. There is no easy answer to what the valuation impact 'should' have been and we expect the price to remain volatile and responsive to COVID-19/virus related newsflow. SKC's asset base (c. NZ\$2bn) and long-term monopoly casino licences provide some comfort of value above current market pricing.

SKYCITY Entertainment Group Ltd (SKC)

Priced as at 12 Aug 2020 (NZ\$) **2.43**

12-month target price (NZ\$)*	3.10
Expected share price return	27.6%
Net dividend yield	2.7%
Estimated 12-month return	30.2%

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

Spot valuations (NZ\$)	
1. DCF	2.98
2. Sum of the parts (current)	3.07
3. Sum of the parts (w project upside)	3.41

DCF valuation summary (NZ\$m)	
Total firm value	2,702
(Net debt)/cash	(351)
Less: Capitalised operating leases	(85)
Value of equity	2,266

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	999	1,012	661	681	919
Normalised EBITDA	338	343	194	192	300
Depreciation and amortisation	(94)	(90)	(87)	(95)	(99)
Normalised EBIT	244	253	107	97	201
Net interest	(13)	(10)	(21)	(32)	(24)
Associate income	0	0	0	0	0
Tax	(62)	(70)	(25)	(18)	(47)
Minority interests	0	0	0	0	0
Normalised NPAT	170	173	62	47	130
Abnormals/other	(0)	(28)	140	0	0
Reported NPAT	170	145	202	47	130
Normalised EPS (cps)	25.4	25.6	8.7	6.2	17.2
DPS (cps)	20.0	20.0	10.0	5.0	14.0

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	6.5	6.6	11.5	11.2	7.2
EV/EBIT (x)	9.1	9.0	20.8	22.1	10.7
PE (x)	9.6	9.5	28.1	38.9	14.2
Price/NTA (x)	5.0	4.6	3.4	3.2	3.0
Free cash flow yield (%)	-0.4	-5.7	-10.8	-12.9	0.3
Net dividend yield (%)	8.2	8.2	4.1	2.1	5.8
Gross dividend yield (%)	11.4	11.4	5.7	2.9	8.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	19.5	24.8	5.2	3.0	8.5
Interest cover EBITDA (x)	27.1	33.6	9.5	5.9	12.7
Net debt/ND+E (%)	27.2	30.3	21.3	25.5	29.1
Net debt/EBITDA (x)	1.3	1.5	1.8	2.4	1.9

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	6.9	1.3	-34.6	2.9	35.0
EBITDA (%)	5.6	1.3	-43.3	-1.0	56.0
EBIT (%)	8.2	3.7	-57.5	-9.3	>100
Normalised NPAT (%)	10.5	1.9	-64.3	-23.2	>100
Normalised EPS (%)	8.5	0.9	-66.2	-27.9	>100
Ordinary DPS (%)	0.0	0.0	-50.0	-50.0	>100

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	9.6	9.9	4.2	3.6	7.0
Return on equity (%)	14.7	15.0	4.8	3.5	9.5
Return on funds employed (%)	11.9	11.1	4.6	4.1	7.9
EBITDA margin (%)	33.9	33.9	29.4	28.3	32.6
EBIT margin (%)	24.4	25.0	16.2	14.3	21.9
Capex to sales (%)	26.1	31.6	50.2	56.7	25.0
Capex to depreciation (%)	318	418	456	481	276
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	79	78	115	80	82

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	338	343	194	192	300
Working capital change	73	19	6	5	19
Interest & tax paid	(157)	(147)	(68)	(50)	(83)
Other	0	0	0	0	0
Operating cash flow	254	215	133	147	236
Capital expenditure	(261)	(320)	(332)	(386)	(230)
(Acquisitions)/divestments	(47)	225	129	0	0
Other	0	0	145	130	0
Funding available/(required)	(55)	119	74	(108)	6
Dividends paid	(85)	(127)	(127)	0	(106)
Equity raised/(returned)	0	(37)	205	0	0
(Increase)/decrease in net debt	(140)	(45)	152	(108)	(100)

Operating Performance	2018A	2019A	2020E	2021E	2022E
Total revenue (incl gaming GST)					
Auckland	585	607	465	482	584
Hamilton	61	62	52	58	62
Other NZ	13	13	11	9	11
Adelaide (A\$)	149	149	117	150	193
Darwin (A\$)	111	83	0	0	0
IB	160	191	71	27	129
Online / esports	0	0	7	15	17
Revenue (incl gaming GST)	1,101	1,119	729	750	1,009

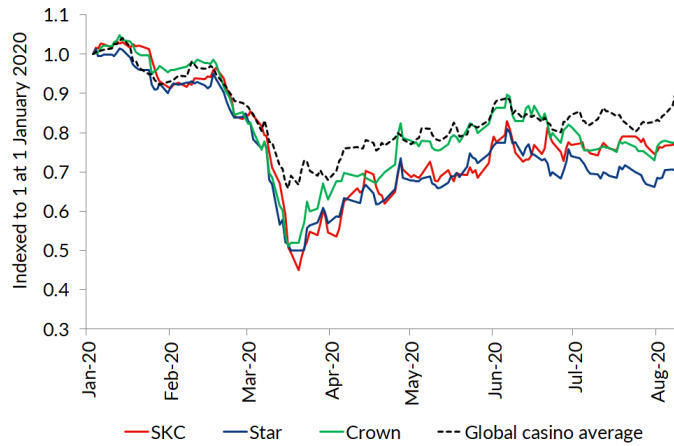
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(163)	(172)	(178)	(184)	(203)
Fixed assets	1,499	1,436	1,549	1,724	1,883
Intangibles	832	798	784	770	755
Right of use asset	0	0	51	51	51
Other assets	107	220	115	115	115
Total funds employed	2,275	2,282	2,321	2,477	2,601
Net debt/(cash)	433	504	352	460	561
Lease liability	0	0	51	51	51
Other liabilities	685	622	622	622	622
Shareholder's funds	1,157	1,156	1,296	1,343	1,367
Minority interests	0	0	0	0	0
Total funding sources	2,275	2,282	2,321	2,477	2,601

EBITDA breakdown	2018A	2019A	2020E	2021E	2022E
Auckland	261	268	188	191	242
Hamilton	27	27	17	23	26
Other NZ	2	2	1	1	2
Adelaide (A\$)	23	21	14	16	33
Darwin (A\$)	25	19	0	0	0
IB	33	42	7	(4)	29
Online / esports	0	0	3	5	7
Corporate costs	(33)	(35)	(32)	(35)	(36)
Other	(3)	(4)	(4)	(5)	(5)
Total EBITDA	338	343	194	192	300
NZDAUD	0.92	0.94	0.95	0.94	0.94

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

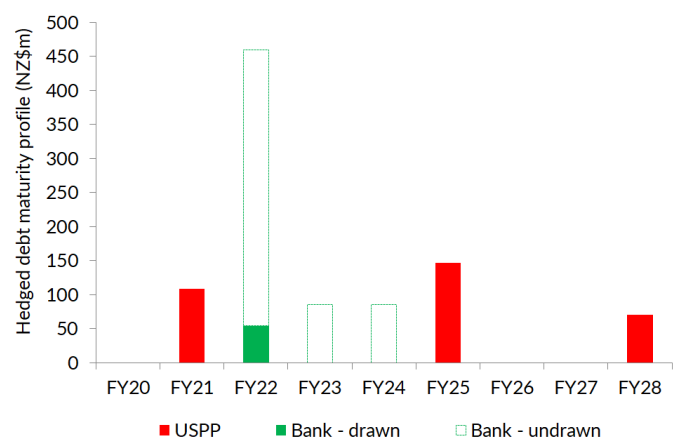
Charts of interest

Figure 1. SKC's enterprise value movement versus peers (CY20)



Source: Forsyth Barr analysis, Bloomberg

Figure 2. Pro forma debt maturity profile (as at June 2020)



Source: Forsyth Barr analysis, SKC capital raising presentation

Investment Summary

SKYCITY (SKC) is one of the largest gaming operators in Australasia. Earnings and valuation are driven by Auckland, which makes up >75% of group EBITDA. The company is facing unprecedented challenges from COVID-19 related disruption, including a period of temporary closure for its properties. Whilst there remains uncertainty in the current environment, SKC has a strong asset base, recently recapitalised balance sheet (and temporary covenant waivers) and we expect it to come through the crisis and gaming spend levels to recover. 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 temporary 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.
- **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.

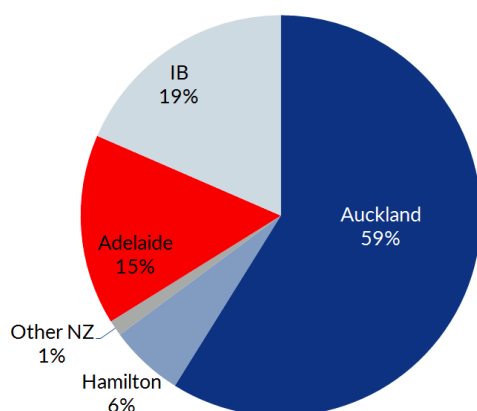
Financial structure

- **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, COVID-19 disruption, and future growth plans. SKC has recently recapitalised its balance sheet and secured near-term covenant waivers (for 31 Dec 2020 and 30 June 2021).
- **Yield:** SKC has historically offered a solid dividend yield. The COVID-19 crisis has forced the Board to reconsider its dividend policy, with confirmation of a temporary dividend suspension, for a minimum 12 months, during the period of covenant waivers and heightened uncertainty.

Risk factors

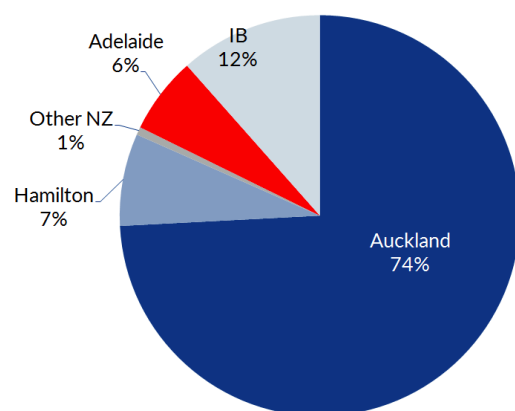
- **Gaming regulation:** Unexpected regulatory and taxation changes.
- **Mature local gaming market:** The market is not only mature but vulnerable to changing entertainment spending patterns.
- **COVID-19:** COVID-19 has been (and still is) highly disruptive given: (1) property closures and government imposed supply restrictions, (2) consumer confidence / willingness to visit, (3) the impact on global and domestic travel.

Figure 3. FY19 revenue breakdown

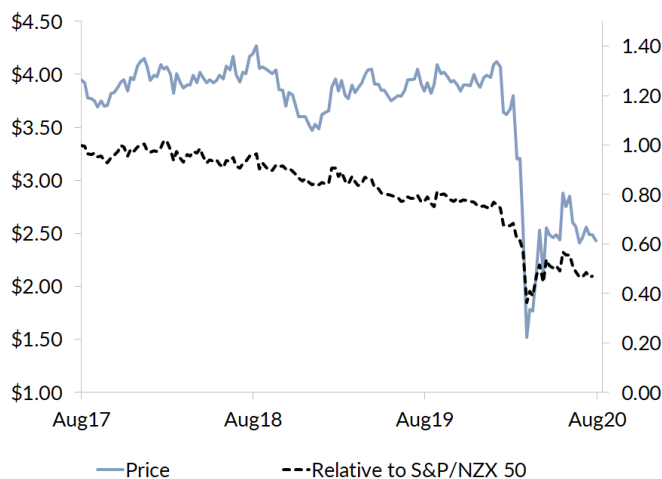


Source: Forsyth Barr analysis, Company reports

Figure 4. FY19 EBITDA breakdown



Source: Forsyth Barr analysis, Company reports

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Sumitomo Mitsui Trust Holdings	10.4%
Investor Mutual	7.1%
Commonwealth Bank of Australia	7.1%
ACC	6.1%
Lazard	5.9%
The Vanguard Group	5.3%

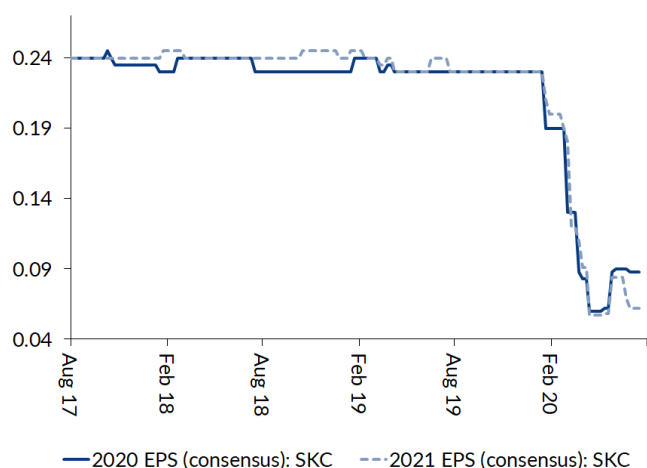
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

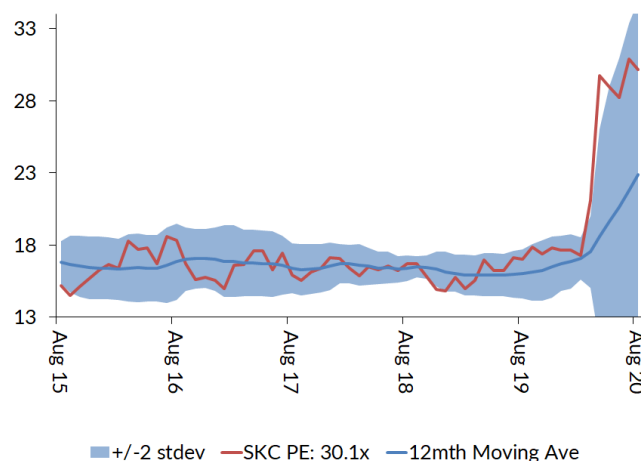
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect SKC's balance date - June)										
SKYCITY	SKC NZ	NZ\$2.43	NZ\$1,847	28.1x	38.9x	12.1x	12.2x	21.9x	24.1x	2.1%
CROWN RESORTS	CWN AT	A\$9.27	A\$6,277	42.7x	48.8x	13.9x	13.1x	32.3x	36.1x	4.0%
TABCORP HOLDINGS	TAH AT	A\$3.50	A\$7,113	26.3x	23.0x	11.1x	10.8x	18.3x	17.0x	3.1%
STAR ENTERTAINMENT GRP/T	SGR AT	A\$2.77	A\$2,626	26.9x	30.1x	10.0x	10.2x	21.4x	22.8x	2.1%
GENTING MALAYSIA BHD	GENM MK	RM2.23	RM12,607	<0x	<0x	11.8x	12.1x	<0x	<0x	5.4%
KANGWON LAND INC	035250 KS	KRW22600.00	KRW4,835,055	<0x	<0x	<0x	<0x	<0x	<0x	3.8%
Compco Average:				32.0x	34.0x	11.7x	11.6x	24.0x	25.3x	3.7%
SKC Relative:				-12%	15%	3%	6%	-9%	-5%	-44%

EV = Current Market Cap + Actual Net Debt

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

Figure 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

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