

SKYCITY

FY20 Preview — A Year of Two Black Swans

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With FY20 headline numbers pre-released (impacted by COVID-19 and NZICC fire), and clarity likely difficult for FY21 given evolving restrictions, we expect the focus of SKYCITY's (SKC) upcoming result on 3 September to be (1) trading snippets, (2) liquidity/cash burn and (3) strategic initiatives. With the backdrop continually evolving, we are not expecting FY21 earnings guidance, however, are looking for any insights to help better assess the potential recovery path under various settings.

NZX Code	SKC	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.55	NPAT* (NZ\$m)	173.0	61.7	47.4	130.4	EV/EBITDA	6.9	12.0	11.7	7.5
Target price	NZ\$3.10	EPS* (NZc)	25.6	8.7	6.2	17.2	EV/EBIT	9.4	21.6	23.1	11.2
Risk rating	Medium	EPS growth* (%)	0.9	-66.2	-27.9	n/a	PE	10.0	29.4	40.9	14.9
Issued shares	760.1m	DPS (NZc)	20.0	10.0	5.0	14.0	Price / NTA	4.8	3.6	3.4	3.2
Market cap	NZ\$1,938m	Imputation (%)	100	100	100	100	Cash div yld (%)	7.8	3.9	2.0	5.5
Avg daily turnover	1,187k (NZ\$3,340k)	*Based on normalised profits					Gross div yld (%)	10.9	5.4	2.7	7.6

Conference call (12pm NZ time; 3 September): Pre-registration required; <https://s1.c-conf.com/diamondpass/10008865-invite.html>

Key areas of interest

- **FY20 headline numbers pre-released:** On 20 August SKC indicated FY20 normalised EBITDA of NZ\$199–202m, modestly ahead of our (and market) expectations and at the upper end of the previously signalled range. This implies 2H20 normalised EBITDA of ~NZ\$47m, down c. -70%. Normalised/reported profit will be impacted by NZICC fire accounting and the impairment of Adelaide.
- **Near-term outlook clouded by COVID-19 restrictions:** FY21E is expected to be another 'messy' year; however, we see downside risk to our forecasts as a result of the recent return of community transmission of COVID-19 in New Zealand. This has seen a return of heightened restrictions for an unknown duration (until we return to Alert Level 1), including 18 days of closure for its key Auckland property (re-opened from 31 August; with material restrictions). Our base case currently assumes a return to 'normal' in FY22E (most areas) or FY23E (including IB and hotels) — which we are not expecting to materially change.
- **Cash burn/net debt:** The recent capital raise and near-term covenant waivers (Dec 2020 and Jun 2021), from both banks and USPP noteholders alleviates balance sheet questions. However, cash burn and a liquidity update will be of interest.
- **Opex/capex and strategic initiatives:** We expect commentary (and investor interest) to focus on the various initiatives, changes and plans as SKC continues to work to combat the challenges of COVID-19 (and a fast evolving backdrop) on its business.

Figure 1. Summary of FY20 expectations

NZ\$m	FY19*	FY20E	% chg	SKC guidance 20 Aug
Normalised revenue (incl gaming GST)	1,118.9	728.9	-35%	
Normalised EBITDA	342.7	194.2	-43%	199-202
Normalised profit	173.0	61.7	-64%	65-67
Reported profit	144.6	201.7	40%	234-236
Normalised EPS (cps)	25.6	8.7	-66%	
Final dividend (cps)	10.0	0.0	n/a	

Source: Forsyth Barr analysis; *NB. As reported; which includes the contribution of Darwin (EBITDA A\$19m) which was divested in April 2019

Figure 2. Snapshot by casino of COVID-19 restrictions

Casino	Share of period in each status		
	Closed	Highly Restricted	Open
FY20			
Auckland	13%	7%	80%
Hamilton / Qtown	13%	7%	80%
Adelaide	26%	1%	73%
FY21 to date (1 July to 1 Sept 2020)			
Auckland	29%	3%	68%
Hamilton / Qtown	0%	32%	68%
Adelaide	0%	100%	0%

Source: Forsyth Barr analysis, NB: 'Highly Restricted' is NZ's Alert Level 2 (or similar)

SKYCITY Entertainment Group Ltd (SKC)

Priced as at 31 Aug 2020 (NZ\$)						2.55						
12-month target price (NZ\$)*						3.10	Spot valuations (NZ\$)					
Expected share price return						21.6%	1. DCF					3.00
Net dividend yield						2.5%	2. Sum of the parts (current)					3.07
Estimated 12-month return						24.1%	3. Sum of the parts (w project upside)					3.41
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.00%	Total firm value					2,713
Equity beta						0.99	(Net debt)/cash					(351)
WACC						8.1%	Less: Capitalised operating leases					(85)
Terminal growth						1.5%	Value of equity					2,277
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2018A	2019A	2020E	2021E	2022E	2018A	2019A	2020E	2021E	2022E		
Normalised EBITDA	999	1,012	661	681	919	EV/EBITDA (x)	6.8	6.9	12.0	11.7	7.5	
Depreciation and amortisation	338	343	194	192	300	EV/EBIT (x)	9.4	9.4	21.6	23.1	11.2	
Normalised EBIT	(94)	(90)	(87)	(95)	(99)	PE (x)	10.0	10.0	29.4	40.9	14.9	
Net interest	244	253	107	97	201	Price/NTA (x)	5.2	4.8	3.6	3.4	3.2	
Associate income	(13)	(10)	(21)	(32)	(24)	Free cash flow yield (%)	-0.4	-5.4	-10.3	-12.3	0.3	
Tax	0	0	0	0	0	Net dividend yield (%)	7.8	7.8	3.9	2.0	5.5	
Minority interests	(62)	(70)	(25)	(18)	(47)	Gross dividend yield (%)	10.9	10.9	5.4	2.7	7.6	
Normalised NPAT	0	0	0	0	0	Capital Structure						
Abnormals/other	170	173	62	47	130	Interest cover EBIT (x)	19.5	24.8	5.2	3.0	8.5	
Reported NPAT	(0)	(28)	140	0	0	Interest cover EBITDA (x)	27.1	33.6	9.5	5.9	12.7	
Normalised EPS (cps)	170	145	202	47	130	Net debt/ND+E (%)	27.2	30.3	21.3	25.5	29.1	
DPS (cps)	25.4	25.6	8.7	6.2	17.2	Net debt/EBITDA (x)	1.3	1.5	1.8	2.4	1.9	
	20.0	20.0	10.0	5.0	14.0	Key Ratios						
Growth Rates						2018A	2019A	2020E	2021E	2022E		
Revenue (%)	6.9	1.3	-34.6	2.9	35.0	Return on assets (%)	9.6	9.9	4.2	3.6	7.0	
EBITDA (%)	5.6	1.3	-43.3	-1.0	56.0	Return on equity (%)	14.7	15.0	4.8	3.5	9.5	
EBIT (%)	8.2	3.7	-57.5	-9.3	>100	Return on funds employed (%)	11.9	11.1	4.6	4.1	7.9	
Normalised NPAT (%)	10.5	1.9	-64.3	-23.2	>100	EBITDA margin (%)	33.9	33.9	29.4	28.3	32.6	
Normalised EPS (%)	8.5	0.9	-66.2	-27.9	>100	EBIT margin (%)	24.4	25.0	16.2	14.3	21.9	
Ordinary DPS (%)	0.0	0.0	-50.0	-50.0	>100	Capex to sales (%)	26.1	31.6	50.2	56.7	25.0	
Cash Flow (NZ\$m)						318	418	456	481	276		
EBITDA	338	343	194	192	300	Capex to depreciation (%)	100	100	100	100	100	
Working capital change	73	19	6	5	19	Imputation (%)	100	100	100	100	100	
Interest & tax paid	(157)	(147)	(68)	(50)	(83)	Pay-out ratio (%)	79	78	115	80	82	
Other	0	0	0	0	0	Operating Performance						
Operating cash flow	254	215	133	147	236	2018A	2019A	2020E	2021E	2022E		
Capital expenditure	(261)	(320)	(332)	(386)	(230)	Total revenue (incl gaming GST)						
(Acquisitions)/divestments	(47)	225	129	0	0	Auckland	585	607	465	482	584	
Other	0	0	145	130	0	Hamilton	61	62	52	58	62	
Funding available/(required)	(55)	119	74	(108)	6	Other NZ	13	13	11	9	11	
Dividends paid	(85)	(127)	(127)	0	(106)	Adelaide (A\$)	149	149	117	150	193	
Equity raised/(returned)	0	(37)	205	0	0	Darwin (A\$)	111	83	0	0	0	
(Increase)/decrease in net debt	(140)	(45)	152	(108)	(100)	IB	160	191	71	27	129	
Balance Sheet (NZ\$m)						0	0	7	15	17		
Working capital	(163)	(172)	(178)	(184)	(203)	Revenue (incl gaming GST)	1,101	1,119	729	750	1,009	
Fixed assets	1,499	1,436	1,549	1,724	1,883	EBITDA breakdown						
Intangibles	832	798	784	770	755	Auckland	261	268	188	191	242	
Right of use asset	0	0	51	51	51	Hamilton	27	27	17	23	26	
Other assets	107	220	115	115	115	Other NZ	2	2	1	1	2	
Total funds employed	2,275	2,282	2,321	2,477	2,601	Adelaide (A\$)	23	21	14	16	33	
Net debt/(cash)	433	504	352	460	561	Darwin (A\$)	25	19	0	0	0	
Lease liability	0	0	51	51	51	IB	33	42	7	(4)	29	
Other liabilities	685	622	622	622	622	Online / esports	0	0	3	5	7	
Shareholder's funds	1,157	1,156	1,296	1,343	1,367	Corporate costs	(33)	(35)	(32)	(35)	(36)	
Minority interests	0	0	0	0	0	Other	(3)	(4)	(4)	(5)	(5)	
Total funding sources	2,275	2,282	2,321	2,477	2,601	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

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. It is facing unprecedented challenges from COVID-19 related disruption, including a period of temporary closure for its properties. Whilst there remains material 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.

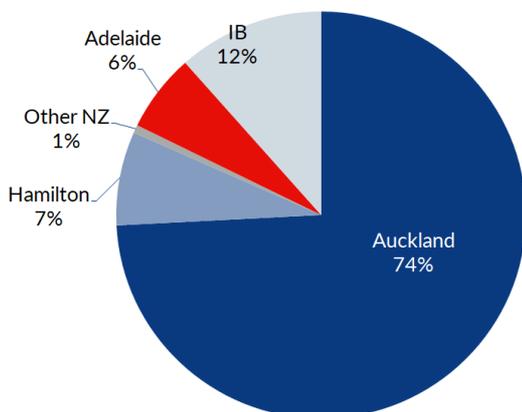
Financial structure

- **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

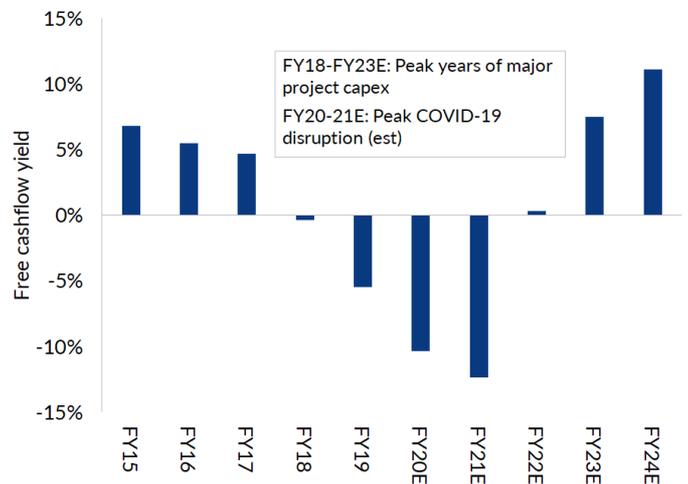
- **Gaming regulation:** Unexpected regulatory and taxation changes.
- **Mature local gaming market:** The market is not only mature but vulnerable to changing entertainment spending patterns.
- **COVID-19:** COVID-19 has been (and still is) highly disruptive given: (1) property closures and government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

Figure 3. FY19 EBITDA breakdown (pre COVID-19)



Source: Forsyth Barr analysis, Company reports

Figure 4. Free cashflow profile and forecasts



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%
The Vanguard Group	5.3%

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

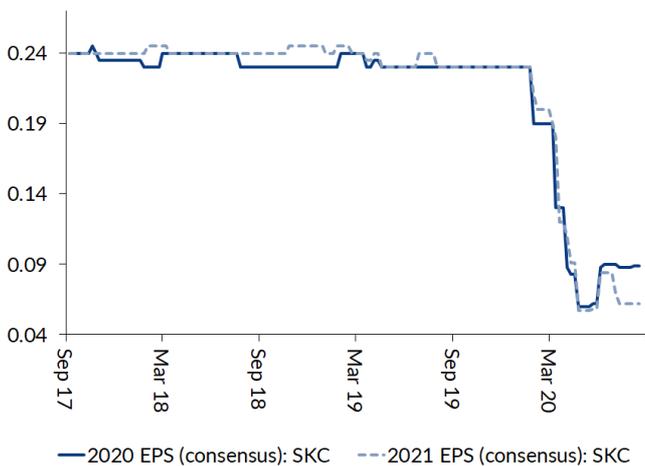
Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld	
(metrics re-weighted to reflect SKC's balance date - June)											
				2020E	2021E	2020E	2021E	2020E	2021E	2021E	
SKYCITY	SKCNZ	NZ\$2.55	NZ\$1,938	29.4x	40.9x	12.6x	12.7x	22.7x	25.1x	2.0%	
CROWN RESORTS	CWNAT	A\$9.18	A\$6,213	>50x	>50x	17.5x	17.2x	55.6x	>75x	3.0%	
TABCORP HOLDINGS	TAHAT	A\$3.64	A\$7,883	<0x	24.3x	<0x	11.4x	<0x	18.5x	2.6%	
STAR ENTERTAINMENT GRP/T	SGRAT	A\$2.98	A\$2,825	<0x	29.2x	27.0x	10.6x	<0x	21.3x	1.3%	
GENTING MALAYSIA BHD	GENM MK	RM2.28	RM12,889	<0x	<0x	17.4x	17.9x	<0x	<0x	5.5%	
KANGWON LAND INC	035250 KS	KRW20950.00	KRW4,482,053	<0x	<0x	<0x	<0x	<0x	<0x	4.0%	
				Compco Average:	n/a	26.7x	20.6x	14.3x	55.6x	19.9x	3.3%
				SKC Relative:	n/a	53%	-39%	-11%	-59%	26%	-40%

EV = Current Market Cap + Actual Net Debt

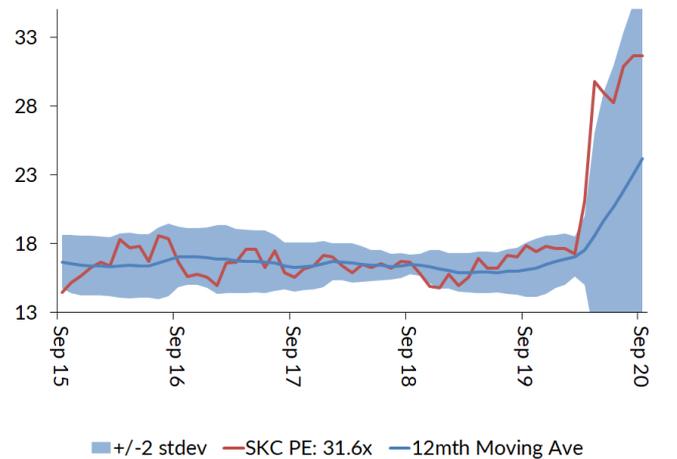
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKC) companies fiscal year end

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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