FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | GAMING | CASINO & TOURISM OPERATOR
4 SEPTEMBER 2020

SKYCITY
FY20 — Quality Outcome Given the Hand Dealt

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OUTPERFORM

SKYCITY (SKC) delivered a credible FY20 result, in the circumstances, however attention was more focussed on recent trading insights and outlook commentary — both of which were better than we (and the market) expected. The result was a timely reminder of the resilience of gaming spend and SKC's high reliance on domestic customers (c. 85% of earnings pre COVID-19 disruption). There remain a number of known unknowns, and we expect the share price to remain volatile and responsive to COVID-19 (and vaccine) related newsflow. However, at 16x PE and 8x EV/EBITDA using FY22E, which still incorporates a c. -15% decline in EBITDA vs our pre COVID-19 forecast, we believe you are being compensated for the risks.

NZX Code	SKC
Share price	NZ$2.67
Target price	NZ$3.25
Risk rating	Medium
Issued shares	760.1m
Market cap	NZ$2,030m
Avg daily turnover	1,199k (NZ$3,363k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	66.2	71.1	125.5	144.6
EPS* (NZc)	10.0	9.4	16.5	19.0
EPS growth* (%)	-61.1	-6.0	76.4	15.2
DPS (NZc)	10.0	6.0	13.5	15.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	26.8	28.5	16.2	14.0
EV/EBIT	21.8	19.6	12.4	11.0
EV/EBITDA	12.4	11.5	8.4	7.5
Price / NTA	2.3	2.2	2.0	1.9
Cash div yld (%)	3.7	2.2	5.1	5.6
Gross div yld (%)	5.2	3.1	7.0	7.8

What's changed?

- EBITDA: Revisions to recovery path with FY21E materially higher (+13%) due to a lift in gaming and margin assumptions, only small changes thereafter.
- Target price: Modestly higher at NZ$3.25 (+5%).

FY20 pre-released; trading insights particularly encouraging

SKC's FY20 result had no shortage of complexity given the NZICC fire, asset divestments and the disruption of COVID-19. Headline results were pre-released and at the upper end of recent guidance (and slightly ahead of our expectations) with FY20 normalised EBITDA of NZ$201m (-34% like for like on the prior year).

The highlight (and focus) of SKC's result was trading and outlook commentary showing a rebound in spending on re-opening, particularly for the key gaming business. While this aligns with our recent research notes (following our channel checks, regular visits to SKC's properties and global industry commentary), the strength of the rebound still surprised us on the upside. SKC guided to FY21 normalised EBITDA to be "above FY20" (assuming no change in COVID-19 settings), albeit materially down on pre COVID-19 levels.

Balance sheet and cashflow — better recent trading has helped liquidity, with headroom to withstand further temporary closure(s)

SKC reported pro-forma net hedged debt (including leases) of NZ$493m at 30 June, with available liquidity of NZ$559m. SKC has cash capex remaining of ~NZ$260m (or gross capex of ~NZ$590m, including that covered by insurance) on its major projects; spread over the next few years. This is unchanged, albeit timing continues to be slower vs our expectations.

Following the recent capital raise SKC has reasonable liquidity, balance sheet headroom and near-term covenant relief (31 December 2020 and 30 June 2021) for various scenarios, including should we see another period of temporary casino closure. We assume a return to dividend payments from 2H21, with expectations for a return to a gross yield from FY22E of c. 7% (with growth potential) — attractive against any benchmark especially in the low interest rate environment. This is supported by our expectations for an improving free cashflow yield as major project capex finally rolls off after an extended period.

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SKYCITY Entertainment Group Ltd (SKC)

Priced as at 03 Sep 2020 (NZ$)	2.67

12-month target price (NZ$)*	3.25
Expected share price return	21.7%
Net dividend yield	2.9%
Estimated 12-month return	24.7%

Spot valuations (NZ$)	
1. DCF	3.24
2. Sum of the parts (current)	3.07
3. Sum of the parts (w project upside)	3.41

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.06
WACC	6.6%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	3,057
(Net debt)/cash	(531)
Less: Capitalised operating leases	(63)
Value of equity	2,463

Profit and Loss Account (NZ$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	1,012	642	686	894	983
Normalised EBITDA	**343**	**201**	**217**	**299**	**331**
Depreciation and amortisation	(90)	(87)	(90)	(97)	(105)
Normalised EBIT	**253**	**114**	**127**	**201**	**226**
Net interest	(10)	(21)	(27)	(30)	(28)
Associate income	0	0	0	0	0
Tax	(70)	(27)	(29)	(46)	(53)
Minority interests	0	0	0	0	0
Normalised NPAT	**173**	**66**	**71**	**126**	**145**
Abnormals/other	(28)	169	0	0	0
Reported NPAT	**145**	**235**	**71**	**126**	**145**
Normalised EPS (cps)	25.6	10.0	9.4	16.5	19.0
DPS (cps)	20.0	10.0	6.0	13.5	15.0

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	7.2	12.4	11.5	8.4	7.5
EV/EBIT (x)	9.7	21.8	19.6	12.4	11.0
PE (x)	10.4	26.8	28.5	16.2	14.0
Price/NTA (x)	5.0	2.3	2.2	2.0	1.9
Free cash flow yield (%)	-5.2	-13.1	-5.2	-2.6	-0.2
Net dividend yield (%)	7.5	3.7	2.2	5.1	5.6
Gross dividend yield (%)	10.4	5.2	3.1	7.0	7.8

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	24.8	5.4	4.8	6.8	8.0
Interest cover EBITDA (x)	33.6	9.5	8.1	10.1	11.7
Net debt/ND+E (%)	30.3	27.0	25.8	23.4	22.8
Net debt/EBITDA (x)	1.5	2.6	2.5	1.7	1.5

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	1.3	-36.6	7.0	30.2	10.0
EBITDA (%)	1.3	-41.4	8.1	37.5	11.0
EBIT (%)	3.7	-54.9	11.2	58.7	12.4
Normalised NPAT (%)	1.9	-61.7	7.5	76.4	15.2
Normalised EPS (%)	0.9	-61.1	-6.0	76.4	15.2
Ordinary DPS (%)	0.0	-50.0	-40.0	>100	11.1

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	9.9	4.1	4.6	7.1	8.4
Return on equity (%)	15.0	4.6	4.6	7.8	8.6
Return on funds employed (%)	11.1	4.5	4.4	7.0	7.7
EBITDA margin (%)	33.9	31.3	31.6	33.4	33.7
EBIT margin (%)	25.0	17.8	18.5	22.5	23.0
Capex to sales (%)	31.6	53.8	38.5	31.5	26.4
Capex to depreciation (%)	418	503	371	365	305
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	78	100	64	82	79

Cash Flow (NZ$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	**343**	**201**	**217**	**299**	**331**
Working capital change	19	2	12	16	7
Interest & tax paid	(147)	(123)	(70)	(86)	(82)
Other	0	0	0	0	0
Operating cash flow	**215**	**79**	**159**	**229**	**256**
Capital expenditure	(320)	(345)	(264)	(282)	(260)
(Acquisitions)/divestments	225	(2)	0	0	0
Other	0	257	44	169	72
Funding available/(required)	**119**	**(12)**	**(61)**	**116**	**68**
Dividends paid	(127)	(133)	0	(67)	(74)
Equity raised/(returned)	(37)	158	50	0	0
(Increase)/decrease in net debt	**(45)**	**13**	**(11)**	**49**	**(6)**

Operating Performance	2019A	2020A	2021E	2022E	2023E
Total revenue (incl gaming GST)					
Auckland	607	497	503	580	609
Hamilton	62	59	60	63	64
Other NZ	13	11	9	10	11
Adelaide (A$)	149	121	144	192	208
Darwin (A$)	83	0	0	0	0
IB	191	79	3	88	136
Online / esports	0	10	25	30	32
Revenue (incl gaming GST)	**1,119**	**783**	**756**	**981**	**1,078**

Balance Sheet (NZ$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(172)	(173)	(185)	(201)	(208)
Fixed assets	1,436	1,529	1,584	1,799	1,760
Intangibles	798	650	631	611	591
Right of use asset	0	52	51	50	49
Other assets	220	456	414	248	179
Total funds employed	**2,282**	**2,513**	**2,494**	**2,507**	**2,371**
Net debt/(cash)	504	537	548	499	504
Lease liability	0	53	55	58	61
Other liabilities	622	489	336	336	121
Shareholder's funds	1,156	1,435	1,556	1,615	1,685
Minority interests	0	0	0	0	0
Total funding sources	**2,282**	**2,513**	**2,494**	**2,507**	**2,371**

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

EBITDA breakdown					
Auckland	268	194	214	254	267
Hamilton	27	24	28	30	30
Other NZ	2	1	0	1	1
Adelaide (A$)	21	11	18	31	36
Darwin (A$)	19	0	0	0	0
IB	42	5	(8)	16	31
Online / esports	(1)	1	5	6	7
Corporate costs	(35)	(32)	(34)	(35)	(36)
Other	(3)	(4)	(7)	(7)	(7)
Total EBITDA	**343**	**201**	**217**	**299**	**331**
NZDAUD	0.94	0.95	0.92	0.92	0.92

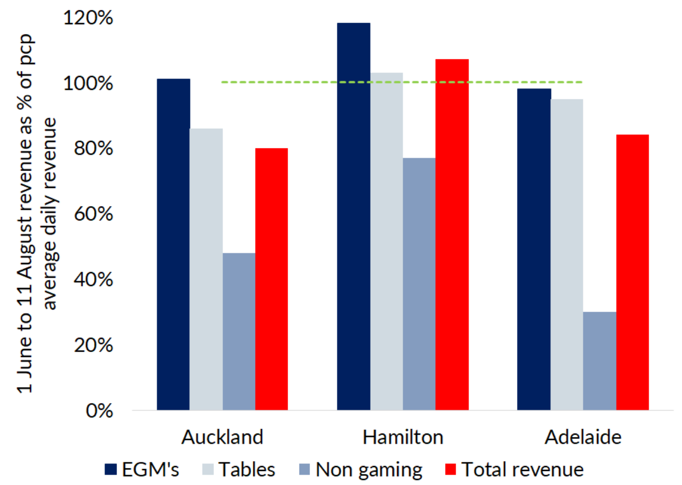
FY20 result take-outs

SKC reported FY20 normalised EBITDA of NZ$201m, modestly ahead of our forecasts and at the upper end of recent guidance. Trading post initial lockdowns has been strong with gaming machines (EGM's) in both Auckland and Hamilton a standout.

Domestic resilience evident, particularly in gaming

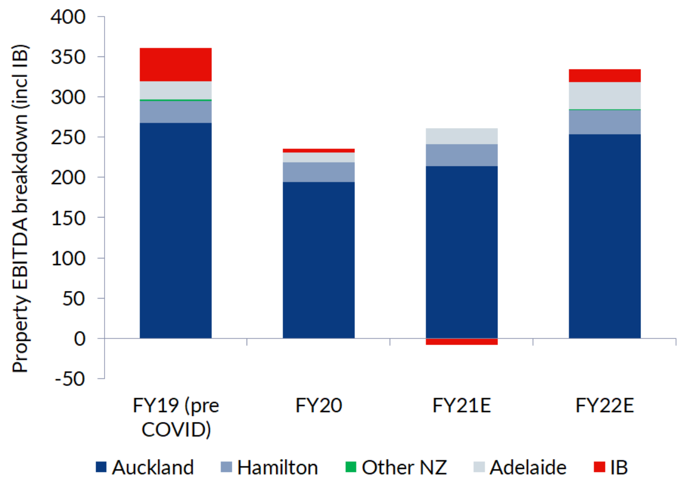
- **Outlook and trading commentary more positive than we expected:**
  - Rebound post re-opening, particularly in gaming: This is reflected in local gaming at both Auckland and Hamilton in line with pre COVID-19 levels in June and July. It was helped by encouraging spending trends for premium customers. EBITDA and cashflow has been "materially ahead" of SKC's expectations.
  - FY21 normalised EBITDA guidance "to be above FY20" (assuming no adverse changes in the COVID-19 setting) was ahead of our expectations suggesting that core gaming activity will continue to perform well despite the uncertain economic backdrop.
- **Balance sheet in good shape:** Following the recent capital raise, debt refinancing and strong trading performance, SKC's balance sheet and liquidity position provides headroom to weather any further COVID-19 related disruption, including another temporary closure. We also expect a reinstatement of a dividend from 2H21 post the covenant waiver/relief period.
- **Mix shift and cost out support margins:** The recent outperformance in gaming vs other segments is favourable to margins; while recent restructuring / cost out initiatives (-NZ$40m reduction in opex) should also be supportive in FY21.
- **Online casino; a COVID-19 beneficiary:** SKC's entry into the online market was well timed, in hindsight, with a strong performance through 2H20, off a low base. The business has over 35,000 customer registrations as at 31 August 2020 compared to 3,600 in January 2020 (Figure 4). Despite some slowdown in growth on re-opening of land based casinos, trends remain encouraging. The segment is EBITDA positive, albeit still small, with any regulation of the industry a potential area of upside.

Figure 1. Encouraging trading since re-opening; led by Hamilton



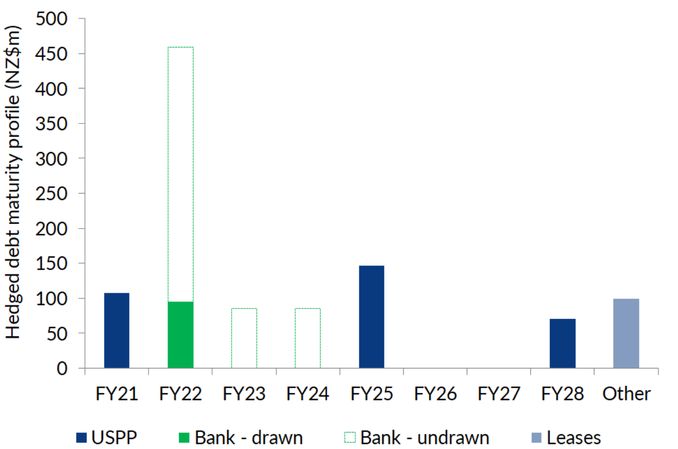
Source: Forsyth Barr analysis, Company reports

Figure 2. Business mix evolution; in favour of domestic



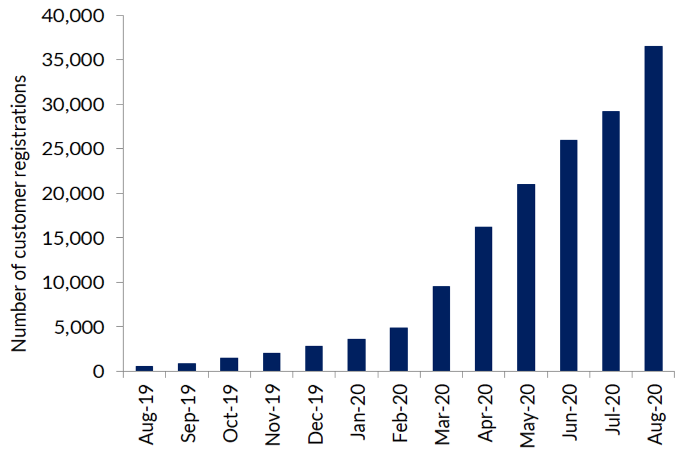
Source: Forsyth Barr analysis, Company reports

Figure 3. Balance sheet healthy; with ample liquidity (30 June)



Source: Forsyth Barr analysis, Company reports

Figure 4. Strong growth in online channel; off low base



Source: Forsyth Barr analysis, Company reports

Figure 5. Global casino commentary also reinforces the rebound in gaming spend since re-opening, particularly given various restrictions still in place

Company	Comments of interest
Crown Perth (19 August)	■ In the period from 1 July to 16 August main floor gaming was up 18% on pcp and non gaming down 24% on pcp ■ "Solid growth" in both tables and EGM's but more so in EGM's ■ Across the main gaming floor, mass market customers have been strong relative to premium customers ■ In terms of non-gaming, demand has been strong on weekends but very constrained mid week with a lack of conferencing and travel
Star QLD and NSW (20 August)	■ July domestic gaming revenue ~80% of the prior year (total domestic revenue ~75% of pcp) on reduced capacity ■ Loyalty gaming revenue and domestic EBITDA margins (excluding JobKeeper benefit) comparable to the prior year ■ Over the period 1 to 17 August, Queensland domestic trends similar to July while Sydney main gaming floor has been impacted by additional distancing requirements ■ Sydney property restrictions eased 1 July, tightened 24 July (max 300 pax per area), Queensland reopened from 3 July
Penn	■ 2Q20 revenue was down -6% post re-opening on the prior year despite some properties remaining closed, material capacity restrictions and social distancing mandates ■ Spend per visit was up +45% through June
Boyd	■ Revenues down -11% YoY and positive EBITDA in the month of June despite material restrictons (50% of capacity) ■ 25 of 26 properties EBITDA positive post re-opening
Las Vegas Sands	■ RevPAR up ~+25% in certain Las Vegas casinos for July

Source: Forsyth Barr analysis, Various company disclosures

Earnings and valuation

We have updated our near-term EBITDA recovery profile, with a meaningful lift to FY21E following better than anticipated trading / outlook commentary. This flows through to FY22E, albeit is offset by a more conservative view on the timing of international tourists (IB) returning. NPAT revisions are messy (and potentially still fluid) given revisions to the timing of project capex, NZICC fire implications and capitalised interest.

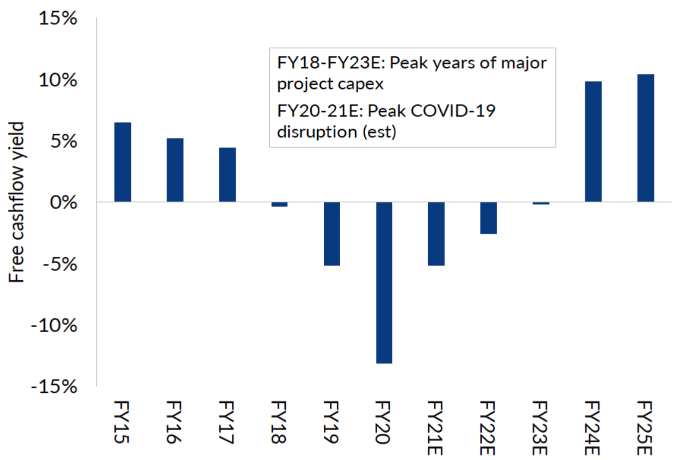
We lift our target price modestly to NZ$3.25, predominantly reflecting a lift in our DCF (40% weighting in our target price) given recent changes to our team cost of capital inputs which lowers our SKC WACC to 6.6% (from 8.1%). Refer the note, "The Cost of Capital Conundrum: When TINA Came to Our Shores", published 7 August 2020 for more detail.

Figure 6. Earnings revisions (NZ$m)

	FY20A	FY21E			FY22E			FY23E
NZ$m	Actual	Old	New	% chg	Old	New	% chg	New
Normalised EBITDA	**200.7**	**192.0**	**217.1**	**13%**	**299.9**	**298.5**	**0%**	**331.4**
Normalised profit	66.2	47.2	71.1	51%	130.4	125.5	-4%	144.6
Normalised EPS (cps)	10.0	6.2	9.4	51%	17.2	16.5	-4%	19.0
Dividend per share (cps)	10.0	5.0	6.0	20%	14.0	13.5	-4%	15.0

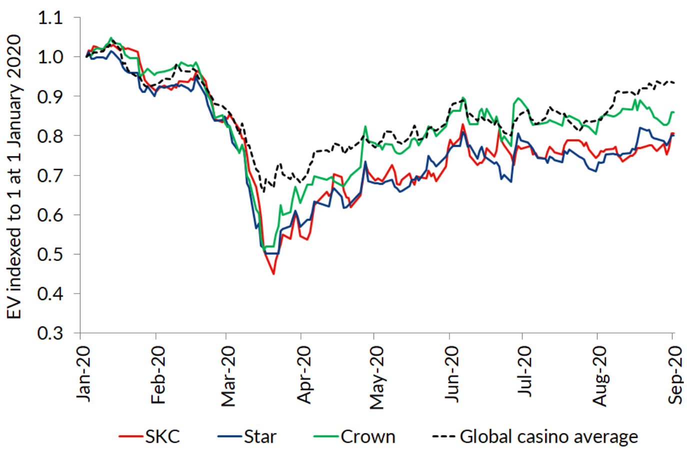
Source: Forsyth Barr analysis

Figure 7. Medium term free cash flow profile is attractive as major project capex (finally) rolls off after an extended period



Source: Forsyth Barr analysis, Company reports

Figure 8. SKC's EV movement has correlated with peers in CY20, and underperformed despite higher domestic visitation



Source: Forsyth Barr analysis, Company reports

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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's near-term earnings profile is contingent on the virus trajectory and government policies around restrictions. Trading post re-opening of its properties has been encouraging, particularly for slots, showing the resilience of its core gaming business and largely domestic customer base. The timing of the return of international tourist exposed segments (c. 15% of its EBITDA pre COVID-19) is likely to be more of a medium-term story.
- **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.

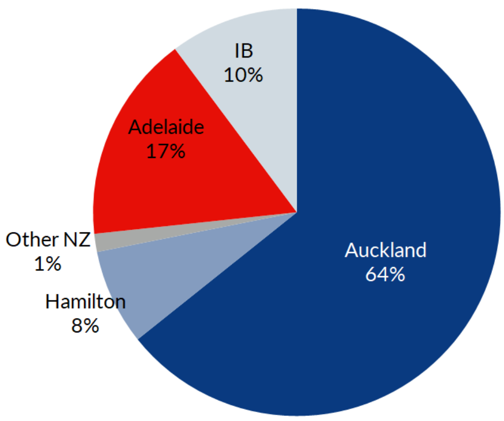
Financial structure

- **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 resulted in a temporary dividend suspension, which we expect to last for 12 months, during the period of covenant waivers and heightened uncertainty. We forecast a return to dividends from 2H21.

Risk factors

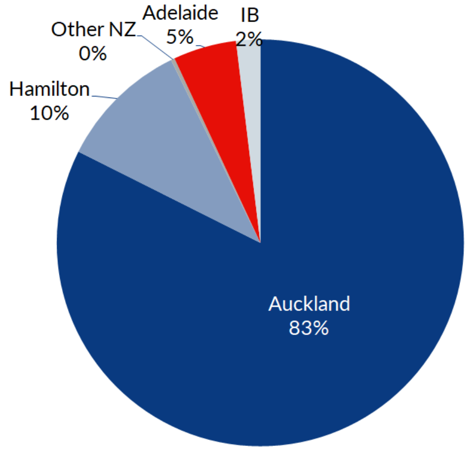
- **Gaming regulation:** Unexpected regulatory and taxation changes.
- **Mature local gaming market:** The market is not only mature but vulnerable to changing entertainment spending patterns.
- **COVID-19:** COVID-19 has been (and still is) highly disruptive given: (1) property closures and government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

Figure 9. FY20 revenue breakdown



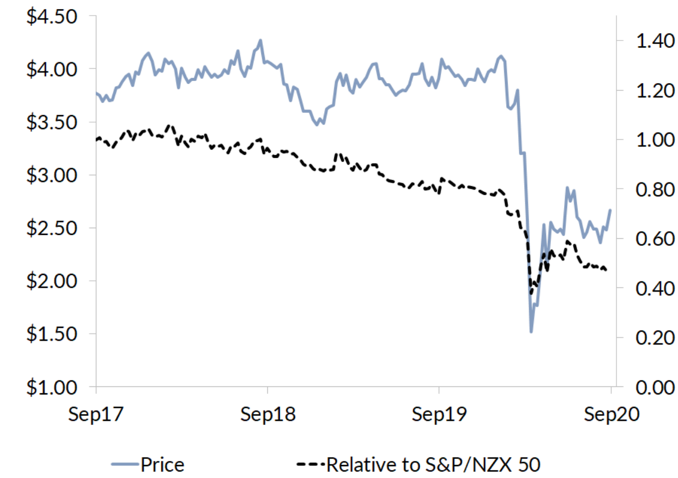
Source: Forsyth Barr analysis, Company reports

Figure 10. FY20 EBITDA breakdown



Source: Forsyth Barr analysis, Company reports

Figure 11. Price performance



Source: Forsyth Barr analysis

Figure 12. 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%

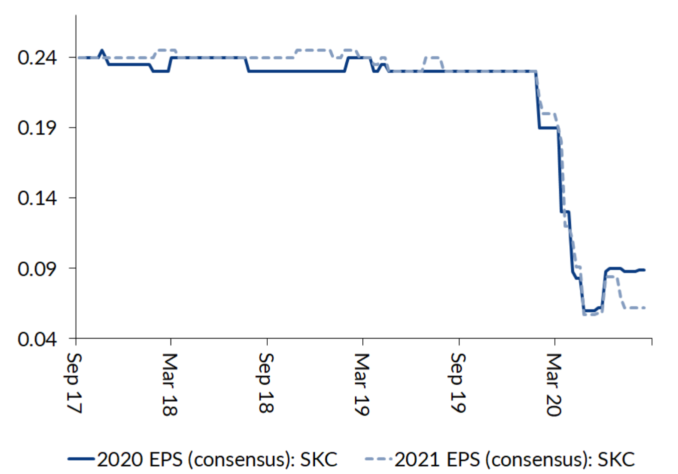
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 13. 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)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
SKYCITY	**SKC NZ**	**NZ$2.67**	**NZ$2,030**	**28.5x**	**16.2x**	**11.8x**	**8.6x**	**20.2x**	**12.7x**	**5.1%**
CROWN RESORTS	CWN AT	A$9.09	A$6,155	>50x	19.8x	17.1x	8.6x	>75x	14.3x	5.4%
TABCORP HOLDINGS	TAH AT	A$3.55	A$7,673	23.7x	20.5x	11.2x	10.4x	18.1x	16.0x	3.8%
STAR ENTERTAINMENT GRP/T	SGR AT	A$2.94	A$2,787	28.8x	16.2x	10.5x	8.6x	21.1x	14.0x	3.5%
GENTING MALAYSIA BHD	GENM MK	RM2.30	RM13,002	<0x	14.1x	18.0x	7.0x	<0x	13.6x	6.6%
KANGWON LAND INC	035250 KS	KRW21350.00	KRW4,567,630	<0x	14.4x	<0x	5.6x	<0x	6.2x	4.1%
			Compco Average:	**26.2x**	**17.0x**	**14.2x**	**8.0x**	**19.6x**	**12.8x**	**4.7%**
EV = Current Market Cap + Actual Net Debt			**SKC Relative:**	**9%**	**-5%**	**-17%**	**7%**	**3%**	**-1%**	**8%**

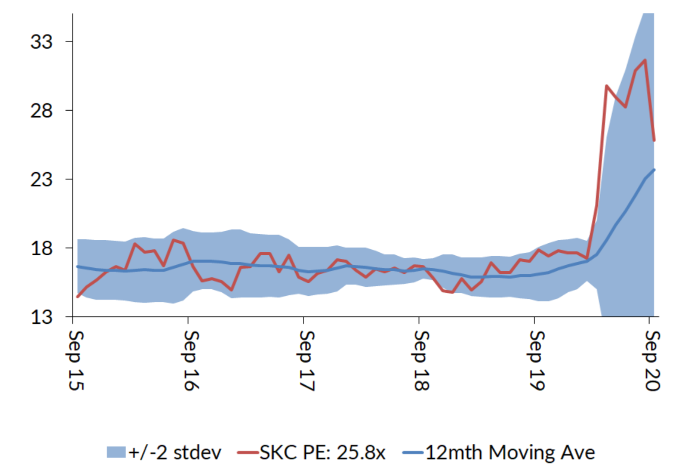
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKC) companies fiscal year end

Figure 14. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 15. One year forward PE (x)



Source: Forsyth Barr analysis

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