

SKYCITY

New Dealer at the Table

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OUTPERFORM

SKYCITY (SKC) provided a positive trading update, however, this was overshadowed by a surprising suite of executive changes including a sudden change in CEO. While this was unexpected, we view new CEO Michael Ahearne as a business as usual appointment, de-risking the transition, and expect little change in near-term priorities. SKC is still vulnerable to COVID-19 and vaccine-related newsflow, with the likelihood of either now more evenly skewed. Our forecasts assume a recovery to 'normal' by FY23E and return to dividends from 2H21E, with material balance sheet headroom to weather any further disruption. At current valuation metrics we believe investors are being compensated for the risks.

NZX Code	SKC	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$3.04	NPAT* (NZ\$m)	66.2	82.2	124.8	146.5	PE	30.5	28.1	18.5	15.8
Target price	NZ\$3.40	EPS* (NZc)	10.0	10.8	16.4	19.3	EV/EBIT	24.5	19.9	14.1	12.4
Risk rating	Medium	EPS growth* (%)	-61.1	8.6	51.8	17.4	EV/EBITDA	13.9	12.2	9.5	8.5
Issued shares	760.1m	DPS (NZc)	10.0	6.0	13.5	15.0	Price / NTA	2.6	2.5	2.3	2.1
Market cap	NZ\$2,311m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.3	2.0	4.4	4.9
Avg daily turnover	1,326k (NZ\$3,622k)	*Based on normalised profits					Gross div yld (%)	4.6	2.7	6.2	6.9

What's changed?

- **Earnings:** Revisions to the recovery path with FY21E lifted +7%; small changes thereafter.
- **Target price:** Small increase to NZ\$3.40 (+5%).

4m21 trading delivered as we had expected (and slightly more so)...

SKC provided a four month trading update (to October) confirming the business is tracking well – with New Zealand revenue at 88% of pre COVID-19 levels (excluding the second Auckland lockdown; 19 days of closure) and Adelaide tracking at 92%. Gaming continues to be resilient and Hamilton remains the standout property (revenue above pre COVID-19). Favourable business mix, cost-out initiatives and continued discipline on opex means margins are also tracking ahead of the prior year.

No specific FY21 guidance has been provided; unsurprising given the risk of unpredictable changes to operating restrictions from COVID-19. Trading since re-opening has continued to positively surprise, although there has been a slight softening since the initial surge. Outside of COVID-19 developments the focus is on (1) a resumption of dividends, expected in 2H21, (2) Adelaide – the expansion is complete, positive regulatory reforms implemented (note acceptors and ticket-in-ticket-out machines on the main floor) and the carpark due in 2Q21 – with the focus now on execution. We see the range of feasible outcomes as favourably skewed relative to our forecasts, particularly for Adelaide, however rising Adelaide COVID-19 cases may weigh near-term.

...however, executive changes took centre stage; while the timing is surprising, we see little to change the near-term path

Management changes include: (1) the resignation of CEO, Graeme Stephens, (2) resignation of CFO, Rob Hamilton, (3) resignation of CMO, Liza McNally and (4) appointment of Michael Ahearne as CEO (from COO). SKC made it clear an internal process has been underway for some time, however, the sudden departure of Graeme Stephens (effective 30 November) in particular was very surprising to us. Taking aside the questions this raises, we view Michael Ahearne as a high quality appointment. He has substantial gaming expertise (~20 years), a track record of execution at SKC (both pre and during COVID-19) and is known to the market. Any material change in trajectory seems unlikely (at least in the near-term). There is also a team of operational executives across SKC's properties with material tenure (average ~11 years), which also helps to de-risk the transition.

SKYCITY Entertainment Group Ltd (SKC)

Priced as at 16 Nov 2020 (NZ\$) **3.04**

12-month target price (NZ\$)*	3.40
Expected share price return	11.8%
Net dividend yield	3.0%
Estimated 12-month return	14.8%

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

Spot valuations (NZ\$)	
1. DCF	3.27
2. Sum of the parts (current)	3.19
3. Sum of the parts (w project upside)	3.43

DCF valuation summary (NZ\$m)	
Total firm value	3,102
(Net debt)/cash	(531)
Less: Capitalised operating leases	(63)
Value of equity	2,508

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	1,012	642	683	878	983
Normalised EBITDA	343	201	232	297	333
Depreciation and amortisation	(90)	(87)	(90)	(97)	(105)
Normalised EBIT	253	114	142	200	228
Net interest	(10)	(21)	(26)	(29)	(28)
Associate income	0	0	0	0	0
Tax	(70)	(27)	(34)	(46)	(54)
Minority interests	0	0	0	0	0
Normalised NPAT	173	66	82	125	146
Abnormals/other	(28)	169	0	0	0
Reported NPAT	145	235	82	125	146
Normalised EPS (cps)	25.6	10.0	10.8	16.4	19.3
DPS (cps)	20.0	10.0	6.0	13.5	15.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	1.3	-36.6	6.5	28.5	11.9
EBITDA (%)	1.3	-41.4	15.7	27.8	12.3
EBIT (%)	3.7	-54.9	24.5	40.6	14.3
Normalised NPAT (%)	1.9	-61.7	24.2	51.8	17.4
Normalised EPS (%)	0.9	-61.1	8.6	51.8	17.4
Ordinary DPS (%)	0.0	-50.0	-40.0	>100	11.1

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	343	201	232	297	333
Working capital change	19	2	11	14	10
Interest & tax paid	(147)	(123)	(74)	(85)	(82)
Other	0	0	0	0	0
Operating cash flow	215	79	170	225	262
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)	(50)	112	74
Dividends paid	(127)	(133)	0	(67)	(74)
Equity raised/(returned)	(37)	158	50	0	0
(Increase)/decrease in net debt	(45)	13	(0)	45	(0)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(172)	(173)	(184)	(198)	(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	2,495	2,511	2,371
Net debt/(cash)	504	537	537	492	492
Lease liability	0	53	55	58	61
Other liabilities	622	489	336	336	121
Shareholder's funds	1,156	1,435	1,567	1,625	1,697
Minority interests	0	0	0	0	0
Total funding sources	2,282	2,513	2,495	2,511	2,371

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	8.0	13.8	11.9	9.3	8.3
EV/EBIT (x)	10.8	24.3	19.5	13.9	12.1
PE (x)	11.9	30.5	28.1	18.5	15.8
Price/NTA (x)	5.7	2.6	2.5	2.3	2.1
Free cash flow yield (%)	-4.6	-11.5	-4.1	-2.4	0.1
Net dividend yield (%)	6.6	3.3	2.0	4.4	4.9
Gross dividend yield (%)	9.1	4.6	2.7	6.2	6.9

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	24.8	5.4	5.4	6.9	8.2
Interest cover EBITDA (x)	33.6	9.5	8.8	10.3	12.0
Net debt/ND+E (%)	30.3	27.0	25.3	23.0	22.3
Net debt/EBITDA (x)	1.5	2.6	2.3	1.6	1.5

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	9.9	4.1	5.1	7.1	8.4
Return on equity (%)	15.0	4.6	5.2	7.7	8.6
Return on funds employed (%)	11.1	4.5	5.0	6.9	7.8
EBITDA margin (%)	33.9	31.3	34.0	33.8	33.9
EBIT margin (%)	25.0	17.8	20.8	22.8	23.2
Capex to sales (%)	31.6	53.8	38.6	32.1	26.4
Capex to depreciation (%)	418	503	371	365	305
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	78	100	55	82	78

Operating Performance	2019A	2020A	2021E	2022E	2023E
Total revenue (incl gaming GST)					
Auckland	607	497	490	572	602
Hamilton	62	59	62	63	64
Other NZ	13	11	11	11	13
Adelaide (A\$)	149	121	143	190	210
Darwin (A\$)	83	0	0	0	0
IB	191	79	9	80	137
Online / esports	0	10	27	32	34
Revenue (incl gaming GST)	1,119	783	753	963	1,077

EBITDA breakdown	2019A	2020A	2021E	2022E	2023E
Auckland	268	194	217	248	263
Hamilton	27	24	28	29	29
Other NZ	2	1	2	2	3
Adelaide (A\$)	21	11	21	34	42
Darwin (A\$)	19	0	0	0	0
IB	42	5	(3)	16	29
Online / esports	(1)	1	6	7	7
Corporate costs	(35)	(32)	(34)	(35)	(36)
Other	(3)	(4)	(7)	(7)	(7)
Total EBITDA	343	201	232	297	333
NZDAUD	0.94	0.95	0.93	0.93	0.93

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

Earnings and charts of interest

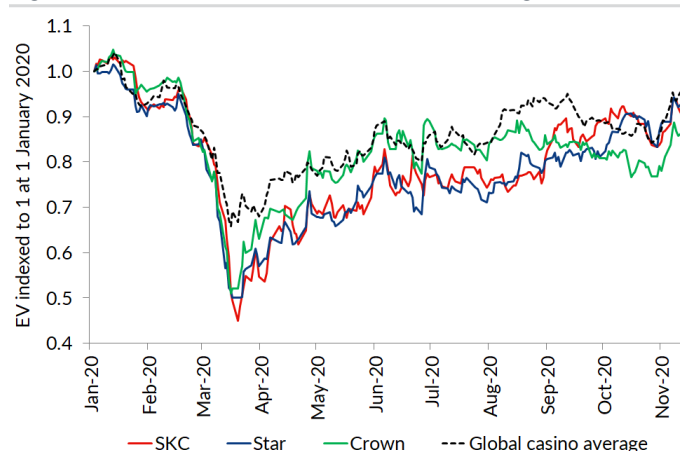
We make upgrades to our recovery path in FY21 – reflecting slightly stronger gaming assumptions, better than expected cost-out in International Business and incorporating the extension of JobKeeper for Adelaide (~\$5m). Our changes are small thereafter.

Figure 1. Earnings revisions (NZ\$m)

NZ\$m	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Total revenue excl gaming GST	686.3	683.3	0%	893.9	878.3	-2%	983.2	983.1	0%
Normalised EBITDA	217.1	232.2	7%	298.5	296.9	-1%	331.4	333.5	1%
Normalised profit	71.1	82.2	16%	125.5	124.8	-1%	144.6	146.5	1%
Normalised EPS (cps)	9.4	10.8	16%	16.5	16.4	-1%	19.0	19.3	1%
Dividend per share (cps)	6.0	6.0	0%	13.5	13.5	0%	15.0	15.0	0%

Source: Forsyth Barr analysis

Figure 2. SKC's EV movement vs. Australian and global peers



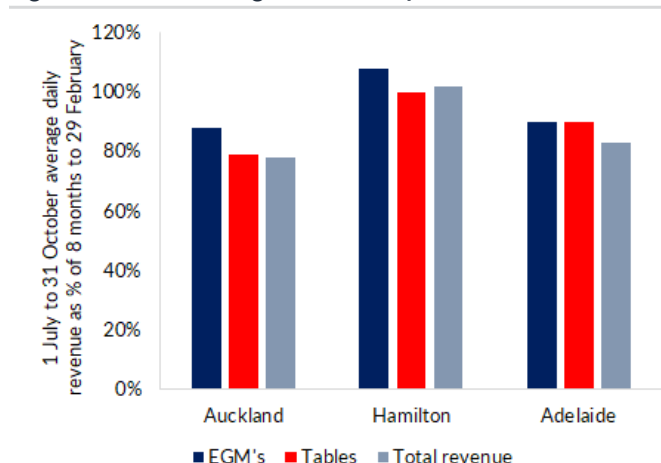
Source: Forsyth Barr analysis, Bloomberg

Figure 3. Reasonable tenure in broader senior leadership team

Role	Executive	Tenure at SKC (yrs)
Departing CEO	Graeme Stephens	3.6
Departing CFO	Rob Hamilton	6.1
Departing CMO	Liza McNally	2.9
New CEO	Michael Ahearne	3.0
Deputy CFO	Richard Smyth	15.8
GM Adelaide	David Christian	14.8
GM NZICC, Development & Tourism (and prior GM roles across group)	Simon Jamieson	13.2
GM Hamilton	Michelle Baillie	12.6
GM Queenstown	Jonathan Browne	5.7
GM International Gaming	Stewart Neish	3.5

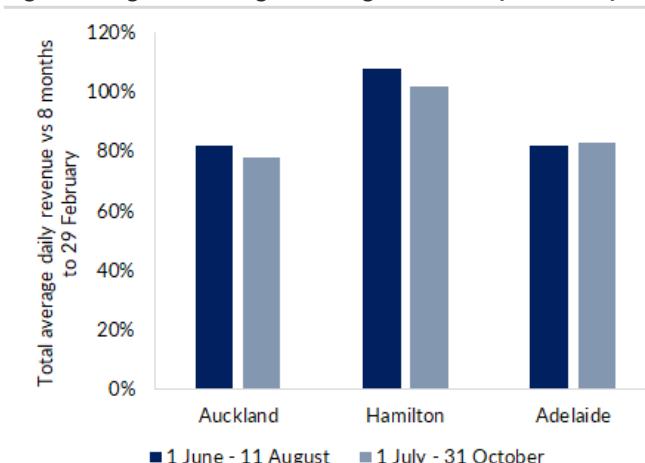
Source: Forsyth Barr analysis, SKC company disclosures

Figure 4. Recent trading continues to prove resilient



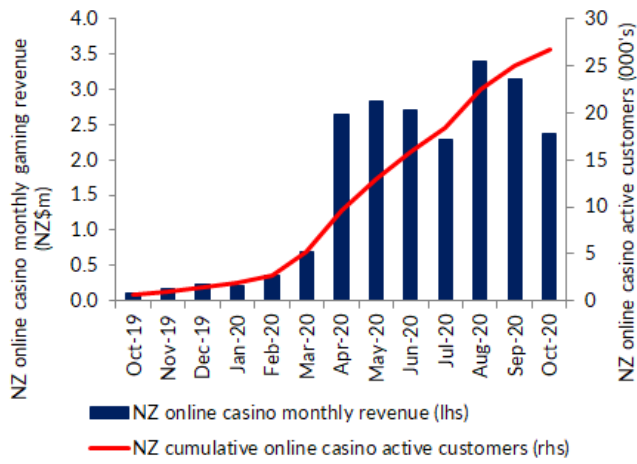
Source: Forsyth Barr analysis, Company disclosures

Figure 5. Slight softening in trading vs SKC's September update



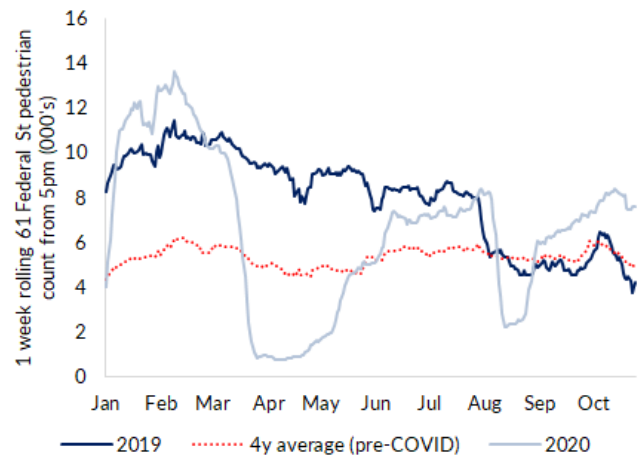
Source: Forsyth Barr analysis, Company disclosures

Figure 6. Continued strong growth in SKC's online casino business

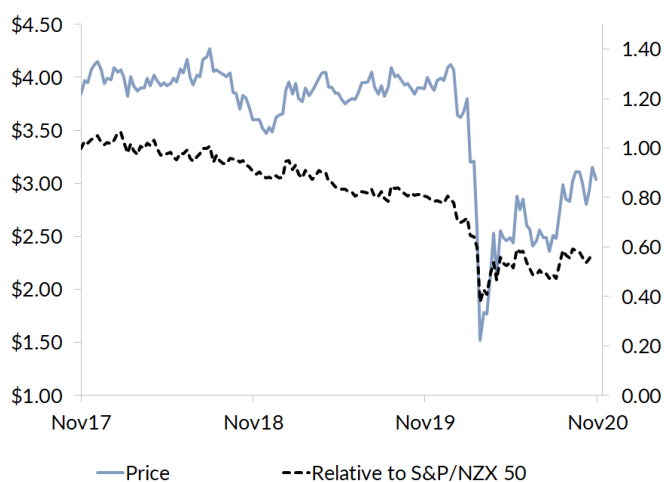


Source: Forsyth Barr analysis, Company disclosures

Figure 7. Foot traffic near SKC's key Auckland property — encouraging recoveries post lockdown



Source: Forsyth Barr analysis, Heart of the city

Figure 8. Price performance


Source: Forsyth Barr analysis

Figure 9. Substantial shareholders

Shareholder	Latest Holding
Sumitomo Mitsui Trust Holdings	10.4%
Commonwealth Bank of Australia	7.1%
Investor Mutual	7.0%
ACC	6.1%
The Vanguard Group	5.3%

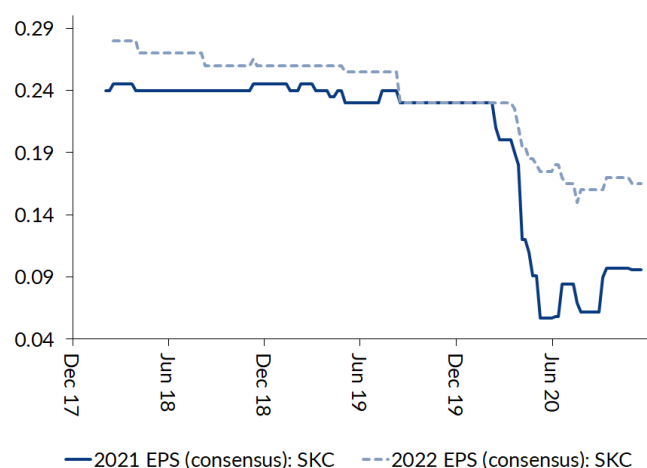
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. International valuation comparisons

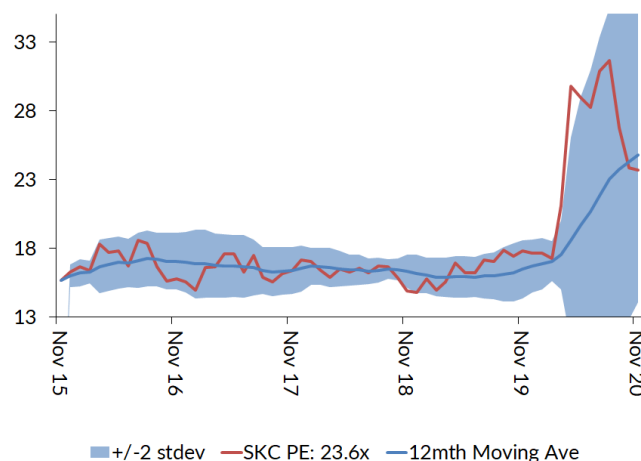
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect SKC's balance date - June)										
SKYCITY	SKC NZ	NZ\$3.04	NZ\$2,311	28.1x	18.5x	12.2x	9.6x	20.0x	14.2x	4.4%
CROWN RESORTS	CWN AT	A\$9.38	A\$6,352	>50x	23.5x	21.0x	9.5x	>75x	16.8x	5.0%
TABCORP HOLDINGS	TAH AT	A\$4.06	A\$9,002	27.2x	23.5x	12.4x	11.5x	20.1x	17.7x	3.3%
STAR ENTERTAINMENT GRP/T	SGR AT	A\$3.72	A\$3,541	34.8x	20.4x	12.2x	10.1x	23.9x	16.5x	2.7%
GENTING MALAYSIA BHD	GENM MK	RM2.43	RM13,737	0.7x	15.3x	20.1x	7.3x	<0x	14.4x	6.0%
KANGWON LAND INC	035250 KS	KRW22400.00	KRW4,792,267	1.2x	16.7x	<0x	7.0x	2.5x	10.1x	3.7%
Compco Average:				16.0x	19.9x	16.4x	9.1x	15.5x	15.1x	4.2%
SKC Relative:				76%	-7%	-26%	6%	29%	-6%	7%

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 11. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 12. One year forward PE (x)


Source: Forsyth Barr analysis

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