

# SKYCITY

## 1H21 Result — Playing a Tough Hand Well

CHELSEA LEADBETTER CFA

chelsea.leadbetter@forsythbarr.co.nz  
+64 4 495 5262

### OUTPERFORM

SKYCITY (SKC) delivered a strong 1H21 result in the circumstances, ahead of our forecasts, with trading buoyant (when open) and showing further improvement in recent months. We estimate like-for-like total revenue (adjusting for COVID-19 restrictions) at >85% of pre COVID-19 levels in recent months, with local gaming the highlight (>95%). Qualitative FY21 guidance was retained and implies a wide feasible range, with the company unsurprisingly cautious given the fluid backdrop. At 15x PE and 8x EV/EBITDA using FY23E we believe you are being more than compensated for the risks.

NZX Code	SKC	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.88	NPAT* (NZ\$m)	66.2	88.9	123.9	153.0	PE	28.9	24.6	17.7	14.3
Target price	NZ\$3.40	EPS* (NZc)	10.0	11.7	16.3	20.1	EV/EBIT	23.4	17.5	13.0	11.0
Risk rating	Medium	EPS growth* (%)	-61.1	17.4	39.5	23.5	EV/EBITDA	13.3	11.0	8.8	7.6
Issued shares	760.1m	DPS (NZc)	10.0	4.0	11.5	15.0	Price / NTA	2.4	2.3	2.1	1.9
Market cap	NZ\$2,189m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.5	1.4	4.0	5.2
Avg daily turnover	1,369k (NZ\$3,648k)	*Based on normalised profits					Gross div yld (%)	4.8	1.9	5.5	7.2

#### What's changed?

- **Earnings:** Small to modest upgrades. FY21E EBITDA +5%, FY22E +1%, FY23E +4%.
- **Target price:** NZ\$3.40 (unchanged) with a small lift in cost of capital offsetting earnings revisions and time value of money.

#### Key take-aways

- **Result dictated by COVID-19; domestic resilience evident, particularly gaming:** SKC reported 1H21 normalised EBITDA of ~NZ\$120m, down -22%, or -15% excluding International Business (IB). Hamilton was the standout, while Adelaide also beat our expectations. Domestic gaming revenue was down -12%, or ~-6% adjusted for the 19 days of Auckland casino closure — a strong result particularly given this still includes various periods of material restriction. The result also includes wage subsidies of NZ\$10m in New Zealand, and A\$13m in Adelaide.
- **Wide FY21 guidance retained; strong recent trading bodes well:** SKC was unsurprisingly cautious given the fluid trading restrictions. Qualitative guidance was retained for normalised EBITDA "above FY20 but well below pre COVID-19 levels".
- **Adelaide expansion — encouraging start:** Gaming revenue was up +33%, with gaming machine market share lifting to 10% in January (vs a base of ~7%) — a positive start, albeit early days. The much awaited carpark is still due in 4Q21. SKC reaffirmed longer-term EBITDA targets of A\$60m (including IB), vs a base level of ~A\$20m. Our forecasts are more conservative.
- **No material shift in strategy under new CEO, Michael Ahearne.** Focus firmly on optimising the core business, projects and online.
- **Balance sheet in good shape:** SKC has liquidity of ~NZ\$465m — ample headroom to weather any further COVID-19 related disruption, including further temporary closure(s). The company has covenant waivers (from banks and USPP noteholders) for the testing period of 30 June 2021. However, we expect it to comfortably meet covenants even under temporary closure scenarios.
- **Dividend reinstatement from 2H21 (assuming no prolonged property closures):** Its new dividend policy is 60–90% of normalised profit (adjusted for capitalised interest). There will be no 'catch-up' for the period of dividend suspension (2H20 and 1H21). We expect to see initial conservatism, however, an improving free cashflow profile (particularly as major project capex finally rolls off) should support growth over the medium-term. We forecast an attractive gross yield of ~5.5% in FY22E and ~7% in FY23E.
- **Online casino; a COVID-19 beneficiary:** SKC's entry into the online market was well timed, in hindsight, with another strong period. Trends remain encouraging, particularly margins, with the segment outperforming our expectations. However, to be a meaningful earnings contributor for the group requires regulatory change.

## SKYCITY Entertainment Group Ltd (SKC)

Priced as at 18 Feb 2021 (NZ\$) **2.88**

<b>12-month target price (NZ\$)*</b>	<b>3.40</b>
Expected share price return	18.1%
Net dividend yield	3.1%
Estimated 12-month return	21.2%

<b>Key WACC assumptions</b>	
Risk free rate	2.30%
Equity beta	1.06
WACC	7.0%
Terminal growth	1.5%

<b>Spot valuations (NZ\$)</b>	
1. DCF	3.10
2. Sum of the parts (current)	3.19
3. Sum of the parts (w project upside)	3.43

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	2,986
(Net debt)/cash	(531)
Less: Capitalised operating leases	(63)
Value of equity	2,393

<b>Profit and Loss Account (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Sales revenue	1,012	642	710	865	981	EV/EBITDA (x)	7.6	13.3	11.0	8.8	7.6
<b>Normalised EBITDA</b>	<b>343</b>	<b>201</b>	<b>243</b>	<b>299</b>	<b>345</b>	EV/EBIT (x)	10.4	23.4	17.5	13.0	11.0
Depreciation and amortisation	(90)	(87)	(90)	(97)	(105)	PE (x)	11.2	28.9	24.6	17.7	14.3
<b>Normalised EBIT</b>	<b>253</b>	<b>114</b>	<b>153</b>	<b>202</b>	<b>240</b>	Price/NTA (x)	5.4	2.4	2.3	2.1	1.9
Net interest	(10)	(21)	(24)	(25)	(25)	Free cash flow yield (%)	-4.8	-12.2	-3.5	-4.6	0.0
Associate income	0	0	0	0	0	Net dividend yield (%)	6.9	3.5	1.4	4.0	5.2
Tax	(70)	(27)	(40)	(53)	(63)	Gross dividend yield (%)	9.6	4.8	1.9	5.5	7.2
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>173</b>	<b>66</b>	<b>89</b>	<b>124</b>	<b>153</b>	<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Abnormals/other	(28)	169	0	0	0	Interest cover EBIT (x)	24.8	5.4	6.3	8.0	9.7
<b>Reported NPAT</b>	<b>145</b>	<b>235</b>	<b>89</b>	<b>124</b>	<b>153</b>	Interest cover EBITDA (x)	33.6	9.5	10.1	11.8	14.0
Normalised EPS (cps)	25.6	10.0	11.7	16.3	20.1	Net debt/ND+E (%)	30.3	27.0	22.9	21.3	19.0
DPS (cps)	20.0	10.0	4.0	11.5	15.0	Net debt/EBITDA (x)	1.5	2.6	1.9	1.5	1.2
<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Revenue (%)	1.3	-36.6	10.6	21.9	13.3	Return on assets (%)	9.9	4.1	5.6	7.2	9.1
EBITDA (%)	1.3	-41.4	21.1	23.2	15.3	Return on equity (%)	15.0	4.6	5.6	7.6	8.9
EBIT (%)	3.7	-54.9	34.0	32.3	18.7	Return on funds employed (%)	11.1	4.5	5.3	6.9	8.1
Normalised NPAT (%)	1.9	-61.7	34.2	39.5	23.5	EBITDA margin (%)	33.9	31.3	34.2	34.6	35.2
Normalised EPS (%)	0.9	-61.1	17.4	39.5	23.5	EBIT margin (%)	25.0	17.8	21.5	23.4	24.5
Ordinary DPS (%)	0.0	-50.0	-60.0	>100	30.4	Capex to sales (%)	31.6	53.8	36.7	36.4	27.6
						Capex to depreciation (%)	418	503	365	408	318
						Imputation (%)	100	100	100	100	100
						Pay-out ratio (%)	78	100	34	71	75
<b>Cash Flow (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
<b>EBITDA</b>	<b>343</b>	<b>201</b>	<b>243</b>	<b>299</b>	<b>345</b>	<b>Total revenue (incl gaming GST)</b>					
Working capital change	19	2	18	4	13	Auckland	607	497	461	572	607
Interest & tax paid	(147)	(123)	(78)	(88)	(87)	Hamilton	62	59	67	67	66
Other	0	0	0	0	0	Other NZ	13	11	12	13	13
<b>Operating cash flow</b>	<b>215</b>	<b>79</b>	<b>183</b>	<b>215</b>	<b>271</b>	Adelaide (A\$)	149	121	183	194	216
Capital expenditure	(320)	(345)	(260)	(315)	(271)	Darwin (A\$)	83	0	0	0	0
(Acquisitions)/divestments	225	(2)	0	0	0	IB	191	79	14	58	122
Other	0	257	90	181	117	Online / esports	0	10	27	30	33
<b>Funding available/(required)</b>	<b>119</b>	<b>(12)</b>	<b>13</b>	<b>80</b>	<b>117</b>	<b>Revenue (incl gaming GST)</b>	<b>1,119</b>	<b>783</b>	<b>778</b>	<b>949</b>	<b>1,074</b>
Dividends paid	(127)	(133)	0	(57)	(74)						
Equity raised/(returned)	(37)	158	50	0	0						
(Increase)/decrease in net debt	(45)	13	63	24	42						
<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>	<b>EBITDA breakdown</b>					
Working capital	(172)	(173)	(191)	(195)	(207)	Auckland	268	194	202	243	264
Fixed assets	1,436	1,529	1,580	1,829	1,800	Hamilton	27	24	34	33	32
Intangibles	798	650	631	611	591	Other NZ	2	1	4	4	4
Right of use asset	0	52	51	50	49	Adelaide (A\$)	21	11	43	45	53
Other assets	220	456	369	191	77	Darwin (A\$)	19	0	0	0	0
<b>Total funds employed</b>	<b>2,282</b>	<b>2,513</b>	<b>2,439</b>	<b>2,485</b>	<b>2,310</b>	IB	42	5	(6)	4	22
Net debt/(cash)	504	537	474	451	408	Online / esports	(1)	1	8	9	10
Lease liability	0	53	55	58	61	Corporate costs	(35)	(32)	(38)	(34)	(35)
Other liabilities	622	489	336	336	121	Other	(3)	(4)	(8)	(8)	(8)
Shareholder's funds	1,156	1,435	1,573	1,641	1,719	<b>Total EBITDA</b>	<b>343</b>	<b>201</b>	<b>243</b>	<b>299</b>	<b>345</b>
Minority interests	0	0	0	0	0	NZDAUD	0.94	0.95	0.93	0.93	0.93
<b>Total funding sources</b>	<b>2,282</b>	<b>2,513</b>	<b>2,439</b>	<b>2,485</b>	<b>2,310</b>						

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

## 1H21 result take-outs

SKC reported normalised EBITDA of ~NZ\$120m, well ahead of our expectations (even when adjusted for higher than forecast JobKeeper), and down -22% on the prior period primarily due to the temporary closure of its key Auckland property (19 days). The key highlights were Hamilton, Queenstown, Online and Adelaide — all comfortably ahead of our expectations and the prior period (despite COVID-19 disruption). On the negative side, corporate costs and the loss from IB were higher than expected.

**Figure 1. SKC normalised profit – 1H21 result**

NZ\$m	1H20	1H21	% chg	Forsyth Barr
Revenue (incl gaming GST)	490.9	386.9	-21%	322.2
<b>Normalised EBITDA</b>	<b>153.3</b>	<b>119.9</b>	<b>-22%</b>	<b>101.4</b>
<b>EBITDA excluding IB</b>	<b>145.1</b>	<b>122.7</b>	<b>-15%</b>	<b>103.0</b>
Normalised profit	75.0	43.7	-42%	35.5
Reported profit	328.0	78.4	-76%	n/a
EPS (cps)	11.3	5.8	-49%	4.7
Dividend per share (cps)	10.0	0.0	n/a	0.0

Source: Forsyth Barr analysis, Company reports

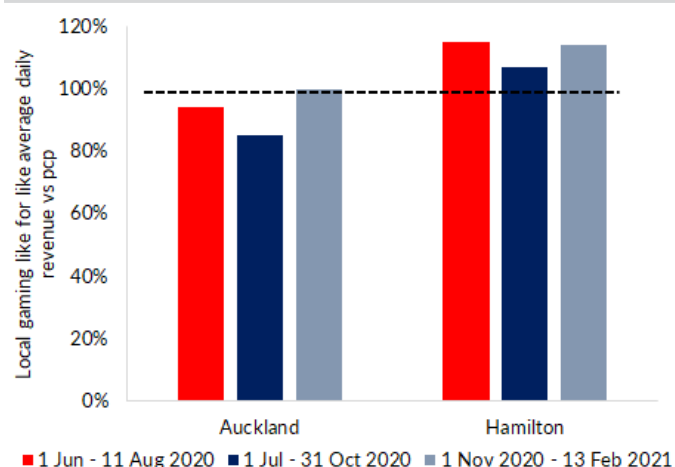
**Figure 2. Divisional EBITDA detail**

NZ\$m	1H20	1H21	% chg	Forsyth Barr
Auckland	137.4	94.9	-31%	95.8
Hamilton	14.9	18.1	21%	13.7
Other NZ	1.5	2.2	47%	1.2
Adelaide (A\$m)	12.8	25.2	97%	8.2
International Business (IB)	8.2	(2.8)	n/a	(1.6)
Online/e-sports	(1.1)	5.1	n/a	2.4
Corporate costs & other	(21.1)	(24.4)	98%	(16.5)
<b>Total EBITDA</b>	<b>153.3</b>	<b>119.9</b>	<b>-22%</b>	<b>101.4</b>

Source: Forsyth Barr analysis, Company reports

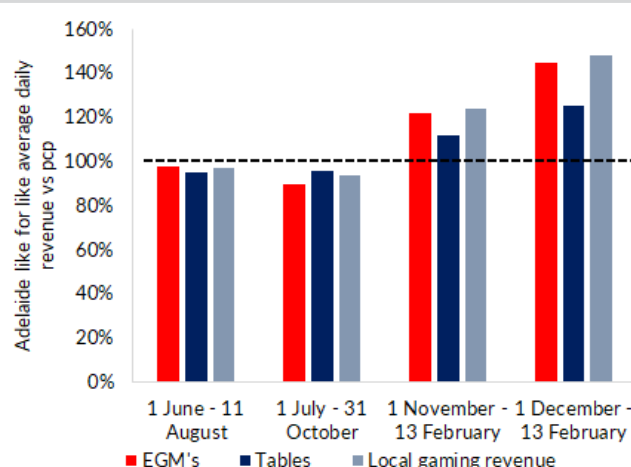
## Key charts

**Figure 3. NZ properties resilient; Hamilton leading the way**



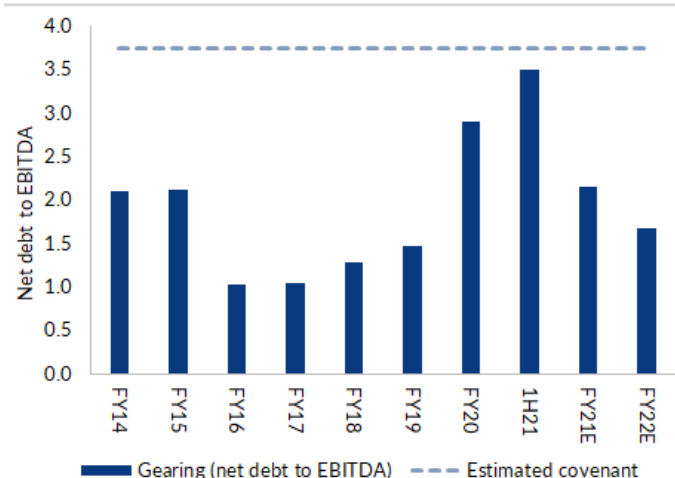
Source: Forsyth Barr analysis, Company disclosures

**Figure 4. Adelaide trading strong post expansion**



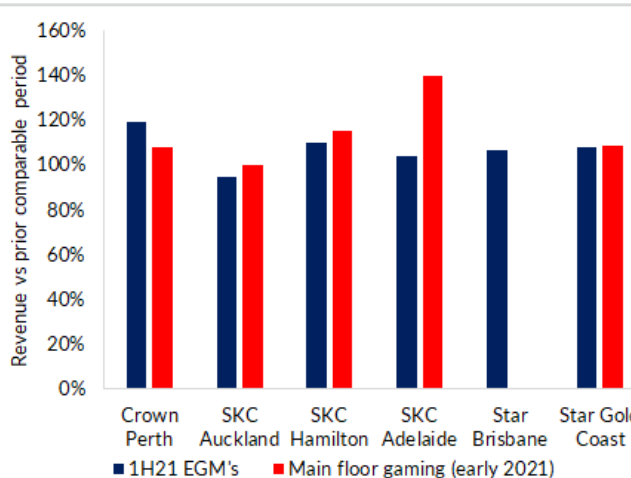
Source: Forsyth Barr analysis, Company disclosures

**Figure 5. Gearing position in good shape post capital raise**



Source: Forsyth Barr analysis, Company reports

**Figure 6. Gaming performance proving resilient across ANZ**



Source: Forsyth Barr analysis, Company disclosures. NB: SKC Hamilton and main floor gaming at SKC Auckland are estimates based off SKC's disclosure

## Earnings and valuation

We have updated our near-term EBITDA recovery profile, with a lift to FY21E following better than anticipated recent trading which offsets temporary Auckland restrictions. There remains reasonable uncertainty in the near-term earnings profile – our forecasts do not incorporate any further temporary closures, although this remains a risk. We also make modest upgrades to our medium-term forecasts.

Key divisional changes are a lift to Hamilton, Adelaide and Online, higher corporate costs and a downgrade to IB. SKC is undertaking a review of the IB business in response to the Crown NSW inquiry, although the exposure to junket play was only ~15% pre COVID-19. We take a more conservative medium-term view on turnover.

We lower our near-term dividend expectations, assuming SKC takes a more cautious initial approach on reinstatement, given the fluid backdrop.

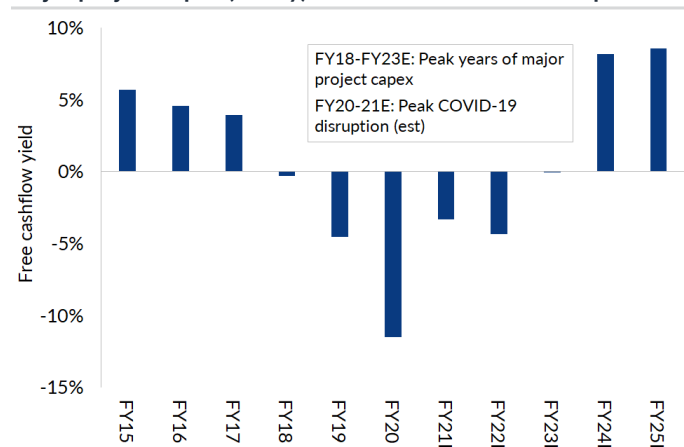
Our target price is unchanged at NZ\$3.40. Earnings revisions and the time value of money offset a modest lift in our WACC (to 7.0% from 6.6%) following changes to our team inputs, given higher interest rates – refer our strategy report, Still a One Way Bet? – Updated WACC Assumptions, published 12 February 2021.

**Figure 7. Earnings revisions**

NZ\$m	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Total revenue excl gaming GST	683.3	709.8	4%	878.3	865.3	-1%	983.1	980.6	0%
<b>Normalised EBITDA</b>	<b>232.2</b>	<b>243.1</b>	<b>5%</b>	<b>296.9</b>	<b>299.4</b>	<b>1%</b>	<b>333.5</b>	<b>345.3</b>	<b>4%</b>
Normalised profit	82.2	88.9	8%	124.8	123.9	-1%	146.5	153.0	4%
Normalised EPS (cps)	10.8	11.7	8%	16.4	16.3	-1%	19.3	20.1	4%
Dividend per share (cps)	6.0	4.0	-33%	13.5	11.5	-15%	15.0	15.0	0%

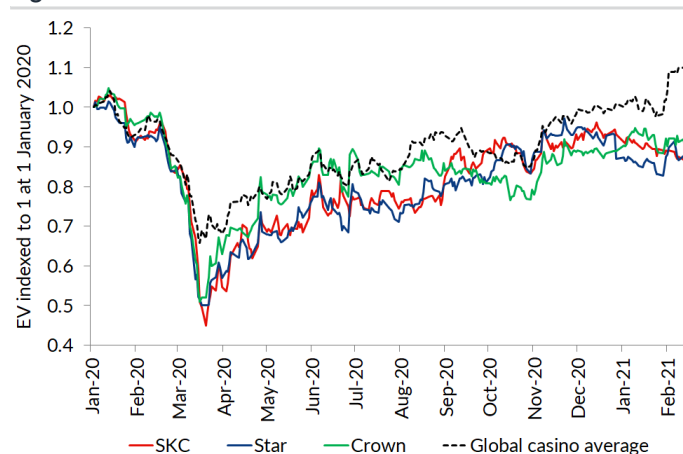
Source: Forsyth Barr analysis

**Figure 8. Medium term free cash flow profile is attractive as major project capex (finally) rolls off after an extended period**

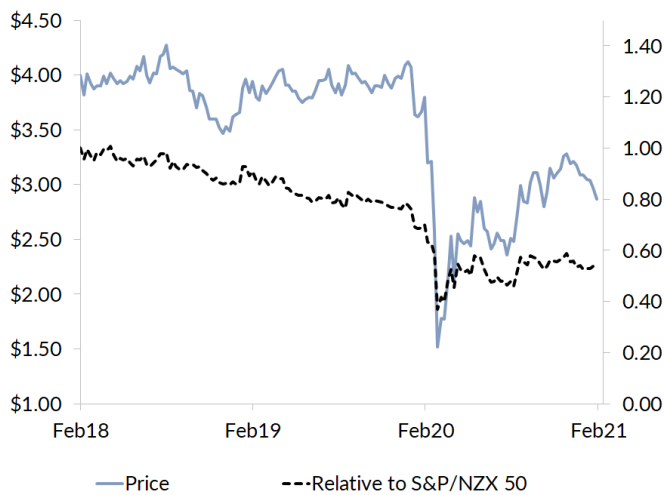


Source: Forsyth Barr analysis, Company reports

**Figure 9. SKC's EV movement correlates with peers, despite higher domestic visitation and less restrictions**



Source: Forsyth Barr analysis, Bloomberg

**Figure 10. Price performance**


Source: Forsyth Barr analysis

**Figure 11. Substantial shareholders**

Shareholder	Latest Holding
Sumitomo Mitsui Trust Holdings	10.4%
Commonwealth Bank of Australia	7.1%
ACC	6.1%
Investor Mutual	5.6%
The Vanguard Group	5.3%

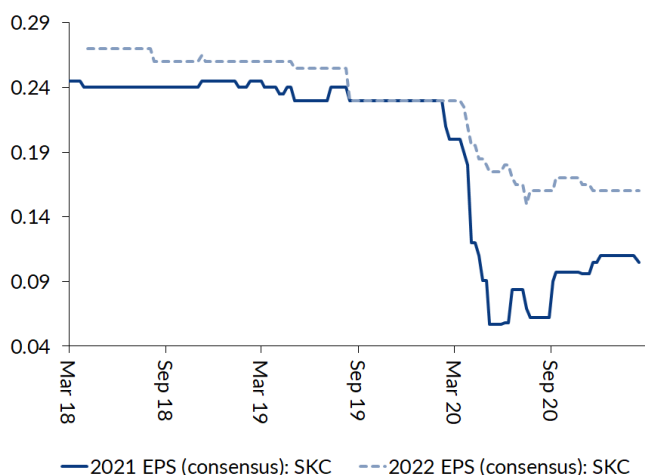
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 12. International valuation comparisons**

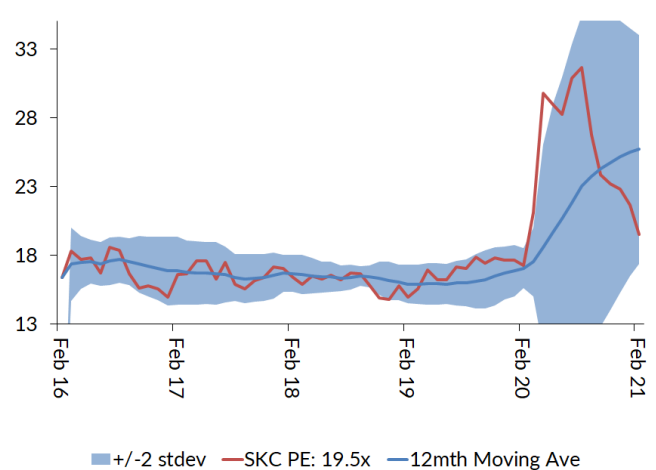
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld	
(metrics re-weighted to reflect SKC's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E	
SKYCITY	SKC NZ	NZ\$2.88	NZ\$2,189	24.6x	17.7x	11.2x	9.1x	17.8x	13.4x	4.0%	
CROWN RESORTS	CWN AT	A\$9.73	A\$6,589	<0x	27.3x	23.1x	10.5x	>75x	19.7x	4.8%	
TABCORP HOLDINGS	TAH AT	A\$4.66	A\$10,332	27.3x	24.4x	11.7x	11.0x	18.0x	16.5x	3.3%	
STAR ENTERTAINMENT GRP/T	SGR AT	A\$3.69	A\$3,513	33.5x	20.8x	11.6x	9.8x	23.3x	16.4x	3.2%	
GENTING MALAYSIA BHD	GENM MK	RM2.72	RM15,377	9.2x	21.2x	56.8x	9.2x	2.6x	20.8x	5.8%	
KANGWON LAND INC	035250 KS	KRW24450.00	KRW5,230,845	8.9x	25.8x	12.0x	12.2x	11.0x	19.8x	3.0%	
Compc Average:				19.7x	23.9x	23.0x	10.6x	13.7x	18.7x	4.0%	
EV = Current Market Cap + Actual Net Debt				SKC Relative:	25%	-26%	-51%	-14%	29%	-28%	-0%

EV = Current Market Cap + Actual Net Debt

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

**Figure 13. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 14. One year forward PE (x)**


Source: Forsyth Barr analysis

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