

SKYCITY

Managing Cash with Leadership from the Top

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OUTPERFORM

There is no playbook for managing this unprecedented situation, however, initial insights from SKYCITY (SKC) to lower cash burn appear sensible, broadly align with our thinking, and importantly, show leadership from the top. There will clearly be a large near-term earnings shock, although the extent of which is no clearer. SKC's release affirms our view that the company will make material changes to reduce capex/opex during property closure and to reflect the expected materially lower demand thereafter. We continue to believe SKC can navigate COVID-19 (admittedly with some battle scars), with its asset base and long-term monopoly casino licences providing comfort of value above current market pricing.

NZX Code	SKC	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$1.77	NPAT* (NZ\$m)	173.0	55.6	62.3	141.0	EV/EBITDA	4.7	9.1	7.9	5.4
Target price	NZ\$3.30	EPS* (NZc)	25.6	8.3	9.1	20.2	EV/EBIT	6.4	17.6	15.0	8.3
Risk rating	Medium	EPS growth* (%)	0.9	-67.7	9.9	n/a	PE	6.9	21.4	19.5	8.8
Issued shares	667.2m	DPS (NZc)	20.0	10.0	10.0	20.0	Price / NTA	3.3	11.3	7.0	7.4
Market cap	NZ\$1,181m	Imputation (%)	100	100	100	100	Cash div yld (%)	11.3	5.6	5.6	11.3
Avg daily turnover	774.5k (NZ\$2,701k)	*Based on normalised profits					Gross div yld (%)	15.7	7.8	7.8	15.7

First insight into steps being taken to manage cash burn both during closure and to 'right size' for lower demand on re-opening

SKC's release made for sombre, but not unexpected, reading with a number of cuts being made as a result of COVID-19 including the restructure of its management team and employee base. Changes include:

- **Cut to board fees:** -50% reduction for the remainder of FY20.
- **Management restructure:** Resulting in the role of Chief Property Officer being made redundant.
- **Cut to management pay to seed a hardship fund to support retrenched staff:** Executive salary cuts of -20% to -40% for the balance of FY20, including -40% for the CEO, CFO and COO, to seed an employee hardship fund of ~NZ\$1m for those facing redundancy.
- **Non-essential opex and capex cut.** In terms of its major projects – construction has been halted in Auckland (not permitted until NZ moves back to 'Level 2' COVID alert level), while deemed essential in Adelaide hence construction continues (at least for now).
- **Staff cuts:** A reduction in salaried employees (~200) and cuts for waged employees in NZ, while ~90% of its Adelaide workforce has been stood down (consistent with Australian peers). Government subsidies will help cushion some of the impact initially. SKC has signalled annualised cost savings of up to NZ\$50m, a reduction of up to 20%.

Too early to recalibrate forecasts; no change to our thought process

There will clearly be a large near-term earnings shock, due to the mandated closure period, followed by disruption ('social distancing') and lower demand from a likely economic downturn thereafter. Acknowledging significant limitations in any near-term forecast in the current environment, our target price and forecasts already factor in 10 weeks of closure for all its properties, border closure through CY20 and material disruption in 1H21. SKC's release aligns with our view costs will be more flexible than usual (helped by government subsidies), although signalled permanent cuts are deeper than we anticipated.

Fundamentally SKC is a strong business, predominantly exposed to the domestic consumer, with significant property assets (~NZ \$2bn) and long-term monopoly casino licences. While we acknowledge material near-term risks, the share price correction seems out of step with any magnitude of scenarios around the risk. To add context, the ~NZ\$2.30 share price decline compares to our estimated casino closure cost of ~NZ\$0.04-0.06/month (total cash burn including capex of NZ\$30-40m/month). See our recent report *Recalibrating For Shutdown* on 26 March for more detail.

SKYCITY Entertainment Group Ltd (SKC)

Priced as at 03 Apr 2020 (NZ\$)						1.77						
12-month target price (NZ\$)*						3.30	Spot valuations (NZ\$)					
Expected share price return						86.4%	1. DCF					3.31
Net dividend yield						5.6%	2. Sum of the parts (current)					3.16
Estimated 12-month return						92.1%	3. Sum of the parts (w project upside)					3.65
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.00%	Total firm value					2,647
Equity beta						0.99	(Net debt)/cash					(368)
WACC						8.1%	Less: Capitalised operating leases					0
Terminal growth						1.5%	Value of equity					2,278
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2018A	2019A	2020E	2021E	2022E	2018A	2019A	2020E	2021E	2022E		
998.6	1,011.6	660.8	745.0	977.6	EV/EBITDA (x)	4.6	4.7	9.1	7.9	5.4		
Normalised EBITDA	338.2	342.7	188.9	225.7	329.8	EV/EBIT (x)	6.3	6.4	17.6	15.0	8.3	
Depreciation and amortisation	(94.4)	(89.9)	(91.4)	(105.7)	(113.2)	PE (x)	7.0	6.9	21.4	19.5	8.8	
Normalised EBIT	243.8	252.8	97.5	119.9	216.6	Price/NTA (x)	3.6	3.3	11.3	7.0	7.4	
Net interest	(12.5)	(10.2)	(19.1)	(33.4)	(20.8)	Free cash flow yield (%)	-0.6	-8.9	-11.3	2.7	5.6	
Associate income	0	0	0	0	0	Net dividend yield (%)	11.3	11.3	5.6	5.6	11.3	
Tax	(61.5)	(69.6)	(22.7)	(24.2)	(54.8)	Gross dividend yield (%)	15.7	15.7	7.8	7.8	15.7	
Minority interests	0	0	0	0	0	Capital Structure						
Normalised NPAT	169.8	173.0	55.6	62.3	141.0	Interest cover EBIT (x)	19.5	24.8	5.1	3.6	10.4	
Abnormals/other	(0.3)	(28.4)	253.1	0	0	Interest cover EBITDA (x)	27.1	33.6	9.9	6.8	15.8	
Reported NPAT	169.5	144.6	308.7	62.3	141.0	Net debt/ND+E (%)	27.2	30.3	42.4	39.8	43.0	
Normalised EPS (cps)	25.4	25.6	8.3	9.1	20.2	Net debt/EBITDA (x)	1.3	1.5	3.5	2.8	2.1	
DPS (cps)	20.0	20.0	10.0	10.0	20.0	Key Ratios						
Growth Rates						2018A	2019A	2020E	2021E	2022E		
Revenue (%)	6.9	1.3	-34.7	12.7	31.2	Return on assets (%)	9.6	9.9	4.1	5.0	9.2	
EBITDA (%)	5.6	1.3	-44.9	19.5	46.2	Return on equity (%)	14.7	15.0	6.3	6.6	15.3	
EBIT (%)	8.2	3.7	-61.4	23.0	80.6	Return on funds employed (%)	11.9	11.1	4.3	5.6	9.8	
Normalised NPAT (%)	10.5	1.9	-67.8	11.9	>100	EBITDA margin (%)	33.9	33.9	28.6	30.3	33.7	
Normalised EPS (%)	8.5	0.9	-67.7	9.9	>100	EBIT margin (%)	24.4	25.0	14.8	16.1	22.2	
Ordinary DPS (%)	0.0	0.0	-50.0	0.0	100.0	Capex to sales (%)	26.1	31.6	38.6	13.7	19.9	
Cash Flow (NZ\$m)						2018A	2019A	2020E	2021E	2022E		
EBITDA	338.2	342.7	188.9	225.7	329.8	Capex to depreciation (%)	318	418	329	112	199	
Working capital change	72.8	19.1	(4.9)	(23.6)	28.8	Imputation (%)	100	100	100	100	100	
Interest & tax paid	(157.4)	(147.2)	(61.8)	(67.6)	(97.7)	Pay-out ratio (%)	79	78	121	110	99	
Other	0	0	0	0	0	Operating Performance						
Operating cash flow	253.6	214.5	122.2	134.5	261.0	2018A	2019A	2020E	2021E	2022E		
Capital expenditure	(261.0)	(320.1)	(255.2)	(102.2)	(195.0)	Total revenue (incl gaming GST)						
(Acquisitions)/divestments	(47.3)	224.9	129.0	0	0	Auckland	584.60	606.60	474.23	516.07	653.06	
Other	0	0	0	0	0	Hamilton	60.70	61.80	51.87	57.57	66.51	
Funding available/(required)	(54.7)	119.3	(4.0)	32.2	66.0	Other NZ	13.00	13.20	11.20	12.63	14.72	
Dividends paid	(85.1)	(127.1)	(127.1)	0	(139.7)	Adelaide (A\$)	149.00	148.70	117.59	144.58	186.00	
Equity raised/(returned)	0	(37.3)	(20.0)	0	0	Darwin (A\$)	110.80	83.30	0	0	0	
(Increase)/decrease in net debt	(139.8)	(45.0)	(151.1)	32.2	(73.7)	IB	160.30	190.50	67.50	81.68	143.44	
Balance Sheet (NZ\$m)						2018A	2019A	2020E	2021E	2022E		
Working capital	(161.7)	(172.4)	(167.5)	(143.9)	(172.7)	Revenue (incl gaming GST)						
Fixed assets	1,498.6	1,436.3	1,435.2	1,446.3	1,394.1	1,101.02	1,118.96	728.00	819.82	1,075.36		
Intangibles	831.8	798.4	784.5	769.9	754.6	EBITDA breakdown						
Right of use asset	0	0	0	0	0	Auckland	260.70	267.90	212.01	226.33	290.55	
Other assets	107.2	220.0	115.1	115.1	115.1	Hamilton	26.90	26.90	15.57	20.36	28.38	
Total funds employed	2,275.9	2,282.3	2,167.3	2,187.4	2,090.9	Other NZ	2.10	2.30	0.08	1.29	3.16	
Net debt/(cash)	433.0	504.3	655.4	623.1	696.8	Adelaide (A\$)	22.50	21.00	11.46	23.43	34.35	
Lease liability	0	0	0	0	0	Darwin (A\$)	25.10	19.00	0	0	0	
Other liabilities	684.8	622.0	621.8	621.8	472.4	IB	32.60	41.70	(10.60)	(8.77)	19.24	
Shareholder's funds	1,158.0	1,156.0	890.1	942.4	921.7	Corporate costs	(33.00)	(34.70)	(34.20)	(32.00)	(40.00)	
Minority interests	0	0	0	0	0	Other	(2.84)	(3.96)	(6.00)	(6.18)	(8.00)	
Total funding sources	2,275.9	2,282.3	2,167.3	2,187.4	2,090.9	Total EBITDA	338.2	342.7	188.9	225.7	329.8	
						NZDAUD	0.92	0.94	0.95	0.95	0.94	
						Capitalised interest	22.90	30.32	19.92	10.00	22.00	

* 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 ~70% of group EBITDA. The company is facing unprecedented challenges from temporary closure of its properties and disruption from the COVID-19 crisis. Whilst there is a high degree of uncertainty in the current environment, SKC has a strong asset base 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 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.

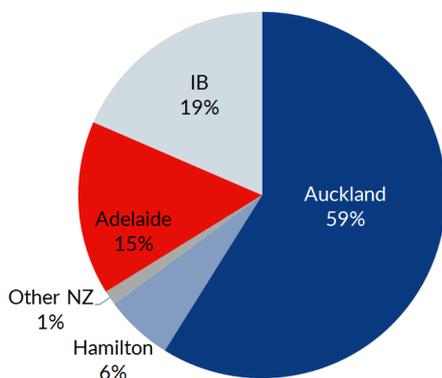
Financial structure

- **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, asset divestments (carparks, Darwin), COVID-19 'social distancing' policies and future growth plans to build out destination precincts surrounding its casinos.
- **Yield:** SKC has historically offered a solid dividend yield. The COVID-19 crisis is likely to force the Board to reconsider its dividend policy. After a temporary dividend suspension, we expect dividends will resume at ~20cps.

Risk factors

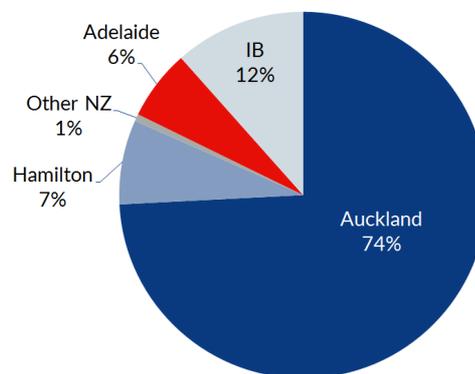
- **Gaming regulation:** Unexpected regulatory and taxation changes.
- **Mature local gaming market:** Which is vulnerable to changing entertainment spending preferences.
- **COVID-19:** The key risk to SKC is the domestic backdrop and ultimately consumer behaviour (which could be dictated by containment/self-quarantine measures). Temporary closure is now reality in both NZ and Australia, and we expect at least some period of material disruption thereafter. However, being definitive on timelines is difficult.

Figure 1. Revenue breakdown FY19 (cont. operations)

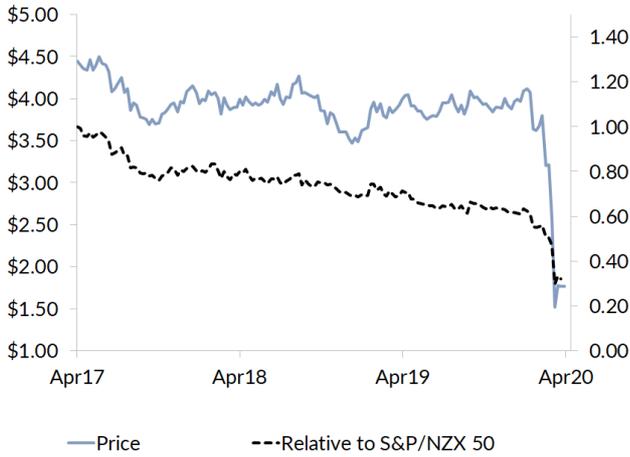


Source: Forsyth Barr analysis, Company reports

Figure 2. EBITDA breakdown FY19 (cont. operations)



Source: Forsyth Barr analysis, Company reports

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
Sumitomo Mitsui Trust Holdings	10.0%
Lazard	8.5%
Commonwealth Bank of Australia	8.2%
BlackRock Investment Management	7.1%
Investor Mutual	7.1%
Colonial First State	5.4%

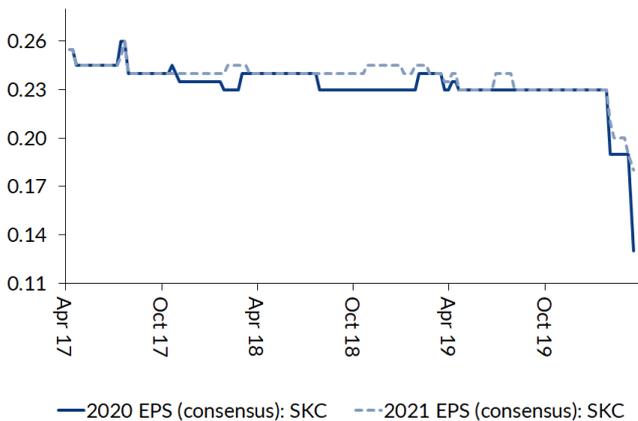
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International valuation comparisons

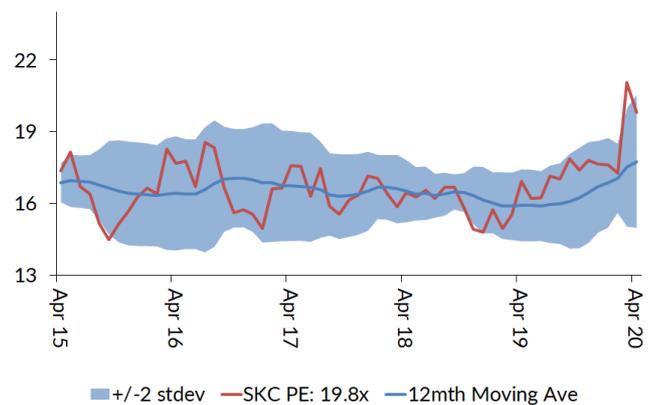
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E	
				2020E	2021E	2020E	2021E	2020E	2021E		
SKYCITY	SKC NZ	NZ\$1.77	NZ\$1,181	21.4x	19.5x	8.9x	7.5x	17.3x	14.0x	5.6%	
CROWN RESORTS	CWN AT	A\$6.48	A\$4,388	18.8x	16.2x	7.8x	6.7x	15.3x	12.5x	8.3%	
TABCORP HOLDINGS	TAH AT	A\$2.34	A\$4,756	13.8x	13.1x	8.1x	7.9x	12.6x	12.1x	8.2%	
STAR ENTERTAINMENT GRP/T	SGR AT	A\$1.62	A\$1,481	6.8x	6.5x	5.2x	4.8x	9.1x	7.8x	12.4%	
GENTING MALAYSIA BHD	GENM MK	RM1.85	RM10,437	9.6x	10.0x	5.4x	5.4x	9.5x	9.4x	8.8%	
KANGWON LAND INC	035250 KS	KRW18250.00	KRW3,904,414	10.5x	9.6x	3.7x	3.6x	4.2x	4.0x	5.3%	
				Compco Average:	11.9x	11.1x	6.1x	5.7x	10.1x	9.2x	8.6%
				SKC Relative:	80%	76%	47%	31%	70%	53%	-34%

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 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

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