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SKYCITY CEO READY TO ROLL OUT NEW PLAN

Five months into his new job as CEO of SkyCity Entertainment (SKC) Nigel Morrison and the new senior management team are ready to implement the new strategic plan to lift revenues and ROIs from all of SKC's investments.

SKC recently provided the market with confirmed profit guidance for FY08 of between \$108-\$110m, before its cinema write-down of \$60m.

Morrison is targeting an 18-month period to achieve improvements to the group's operations and he will be hoping this will also spell an end to the market weakness experienced by the company during the past six months which has seen the share price fall from highs around \$5.40 in March to currently trade at around \$2.95.

Morrison said the immediate focus has been on completing business and strategic plans to underpin 09 as a year of growth. "With these completed our management team is now focused on growing revenues, driving efficiencies and maximising EBITDA. Our business plans for all of our operating divisions are predicated on growing revenues and EBITDA in 09."

Morrison told ABN AMRO analysts that SKC had some great assets with strong monopoly positions within their respective markets and, that when combined with the complementary hotel and convention centre assets, an integrated offer if executed and marketed well had the potential to deliver high returns.

Morrison says SkyCity Auckland will be a core focus for the company given it represents 70% of group EBITDA. "It's our flagship property and will be our main focus," says Morrison. "In my opinion, we have not achieved satisfactory revenue growth from this property in recent years."

"One key objective is to increase VIP business (especially international VIPs) in both Auckland and Darwin," says ABN analyst Carolyn Holmes.

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Morrison indicated that SKC's international VIP business generates around NZ\$1.5bn in turnover annually, which he believes is too low and hence increases the volatility of VIP earnings around the theoretical win rate.

"To put this into perspective of SKC gross revenues of NZ\$900m-NZ\$950m, VIP international play comprises only NZ\$20m," says Holmes. "Over the next two to three years SKC will be actively targeting VIP customers with the objective of increasing VIP turnover to around NZ\$3bn."

Holmes says Morrison has also had time to consider the contentious Adelaide carpark which was part of the A\$50m Stage2 and 3 developments. "As the regulatory environment remains a little uncertain and hence the expected NPV of any new capital project is difficult to predict with certainty, Morrison appears more cautious regarding investing fresh capital."

Along with an improvement to returns from operations, SKC will be looking at its ability to reduce debt levels, which at NZ\$1.1bn are well within the company's covenants but at NZ\$900m-NZ\$950m would be more comfortable.

While currently off the chopping block, SKC's non-core cinema operations, which make up only around 3% of the group, could provide some debt reduction if the right price was offered. Morrison has said that SKC is not looking at changing the dividend distribution policy to reduce debt, although dividend policy is ultimately determined by the board. SKC's dividend yield has been strong over the past couple years at 8.5% in FY06 and 6.86% in FY07.

SKC has received a BBB- with stable outlook rating from international credit ratings agency Standard and Poors. S&P said, "This rating reflects SkyCity's good quality casino assets in NZ and Australia which underpin sustainability of earnings and provide the



SKYCITY CHIEF EXECUTIVE NIGEL MORRISON

company with the capacity to manage its financial risk profile at a level supportive of the investment grade rating. The rating also recognises the favourable licensing environment for SkyCity's casino operations."

"In February SKC completed the renegotiation/extension of its \$500m revolving senior debt facility," says Morrison. "Of this facility, some \$370m remains undrawn. The current facility term is to April 2011."

The first required refinancing is that of outstanding capital notes of \$124m in May 2010. The current effective interest cost is 7.8%.

"Given this, we believe our company's current debt structure is sound and secure and our current level of debt of NZ\$1bn places no undue pressure on our organisation," says Morrison.

Holmes says the key focus over the next one to two

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years is obviously to improve returns from the existing asset base and reduce debt, however, SKC would not rule out reviewing Australian and Asian acquisition opportunities during that time.

ABN is forecasting EPS to increase by 6% in FY08, 7.3% in FY09 and 20% in FY10. "However, we highlight the risk to FY10 EPS if smoking bans are implemented in the Northern Territory during 2009, which would affect SkyCity Darwin."

An 8% decline in Darwin's FY10 revenues would reduce ABN's group FY10F EPS growth rate from 20% to 11.4%.

"Our 12-month target price of NZ\$4.63ps (previously NZ\$4.74) is the average of our DCF less a 20% discount, in line with the NZ market average dis-

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count to DCF, and our EV/EBITD valuation of NZ\$4.43," says Holmes. "Key risks to our target price, in the absence of any renewed corporate activity, are VIP volatility and lower NZ revenues as the economy turns down."

First NZ Capital believes that the flagship Auckland casino has the potential to earn an additional \$15m - \$20m p.a. in EBITDA within the next two to three years and also see's worthwhile gains to be made from investment in the Adelaide and Darwin operations.

"SKC's long casino license tenure and an absence of any potential new players puts it into a stronger position than many of its peers.

"For FY09 we forecast SKC to lift total EBITDA by almost 6% to \$321m. We expect FY10 EBITDA to advance by 6% to \$340m," says FNZC. "We value SKC shares at \$4.52 representing 9.5x forecast FY09 EBITDA."