

Research Update:

# SKYCITY Entertainment Group 'BBB-' Rating Affirmed; Outlook Remains Stable

June 28, 2024

## Rating Action Overview

- SKYCITY Entertainment Group Ltd. (SkyCity) is facing cyclically lower gaming revenues at a time of elevated regulatory costs and capital expenditure (capex).
- Although we expect the company's credit metrics to remain within rating tolerances, rating headroom will be limited over the next two years. In this regard, we expect debt-to-EBITDA ratio to peak at about 2.9x in fiscal 2024 (end June), before reducing toward 2.0x by fiscal 2026.
- We affirmed our 'BBB-' long-term issuer credit rating on SkyCity. At the same time, we affirmed the 'BBB-' long-term issue ratings on the company's debt.
- The stable outlook reflects our view that SkyCity is taking creditor-friendly actions to avoid downward pressure on the rating by prioritizing debt reduction over the next two fiscal years.

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## Rating Action Rationale

**We forecast that SkyCity's credit metrics will weaken in fiscal years 2024 and 2025 (ending June 30) but remain within tolerances for the 'BBB-' rating.** Economic conditions in New Zealand remain subdued, driving lower gaming and non-gaming revenues across SkyCity's properties. We have therefore revised downward our forecast earnings for SkyCity. Lower expected earnings also reflect the following:

- Delays in the opening of Horizon Hotel;
- Pre-opening operational costs for Horizon Hotel and New Zealand International Convention Centre (NZICC) before revenue generation; and
- One-off costs for regulatory inquiries and project-related compliance costs, particularly at SkyCity Adelaide.

We now project SkyCity's debt-to-EBITDA ratio to peak at 2.9x in fiscal 2024, from 1.9x in fiscal 2023. That said, we expect this measure to remain within our rating downside trigger of 3x.

**SkyCity's cash flow preservation measures will provide necessary credit metric support, in our view.** The suspension of dividends until fiscal 2025 and the use of proceeds from the sale of Gaming Innovation Group (GiG) to repay debt are important measures to stave off further deterioration in credit metrics and underpin rating stability.

SkyCity has reached an agreement to sell its 10.02% stake in GiG for about NZ\$55 million. The company will use the sale proceeds to repay debt. In our view, SkyCity has a strong record of taking capital management measures to support credit quality, including a NZ\$230 million equity raising completed during the COVID-19 pandemic.

**Heightened regulatory oversight by government regulators will continue to weigh on SkyCity's business in the near term.** Although the conclusion of Australian Transaction Reports and Analysis Centre's (AUSTRAC) case against SkyCity Adelaide has resolved some regulatory uncertainties for the company, SkyCity remains subject to various ongoing regulatory reviews. This includes an independent review of SkyCity Adelaide from the South Australian gaming regulator (Consumer and Business Services) regarding SkyCity's suitability to hold a gaming license. Although our base case does not incorporate any material changes to the group's gaming license or conditions from this review, these factors remain risks to the company. We expect an update on this review by the end of December 2024.

**Due to sizable cash outflows, we now assess SkyCity's liquidity as adequate.** The revised liquidity assessment principally reflects lower earnings forecast, the repurchase of the NZICC car parks and the fine from AUSTRAC, with cash outflows for these of about NZ\$204 million and NZ\$72 million in February and July 2024, respectively. The revision of this assessment has a neutral effect on our rating.

## Outlook

Rating stability is supported by SkyCity's efforts to reduce debt and maintain S&P Global Ratings' adjusted debt-to-EBITDA ratio below 3x. Over the next 18 months, we expect limited credit metric headroom, before the ratio improves in fiscal 2026.

From fiscal 2026, we expect SkyCity's earnings to improve as economic conditions recover in New Zealand, and the successful ramp-up of NZICC, Horizon Hotel, and car park operations provide meaningful additional earnings.

In addition, we believe management remains committed to maintaining its credit profile and will prioritize debt reduction over the next few years.

## Downside scenario

We could lower the rating if the company's adjusted debt-to-EBITDA ratio remains sustainably above 3x. This could occur if:

- The company's earnings are weaker than we expect, driven by a protracted downturn in New Zealand's economy, higher-than-expected regulatory costs or other factors; or
- SkyCity undertakes material debt-funded acquisitions or incremental capex.

Additionally, material adverse changes to the licensing or regulatory environments in which SkyCity operates, particularly in Auckland and Adelaide, or further sizable regulatory fines, could negatively affect the rating.

## **Upside scenario**

We consider upward rating pressure to be unlikely in the next two years. However, credit quality could improve if:

- The company were to implement more conservative financial policies; or
- SkyCity materially improves the scale and diversity of its operations while maintaining a prudent financial risk profile.

## **Company Description**

SkyCity is New Zealand's largest tourism, leisure, and entertainment company. The company is dual listed on the New Zealand and Australian stock exchanges. SkyCity owns and operates casinos, hotels, and restaurants and bars, across Auckland, Hamilton, and Queenstown in New Zealand; and Adelaide in Australia.

The company benefits from long-dated licenses. SkyCity's Auckland casino license runs until 2048 and Adelaide casino license until 2085. The company also has an online casino that is operated out of Malta by Gaming Innovation Group Inc.

In fiscal 2023, SkyCity generated adjusted revenue of NZ\$943 million and adjusted EBITDA of NZ\$276.6 million.

## **Our Base-Case Scenario**

### **Assumptions**

- New Zealand's real GDP growth of 1.1% in 2024 and 2.5% in 2025;
- Australia's real GDP growth of 1.1% in 2024 and 2.1% in 2025;
- Subdued economic conditions to persist across New Zealand and Australia for the rest of calendar 2024;
- Slightly lower revenue in fiscal 2024, due to lower consumer spending across SkyCity's assets, affecting gaming and non-gaming revenues;
- Weaker EBITDA margin of about 26.7% in fiscal 2024, from 29.3% in fiscal 2023. We expect EBITDA margin compression is attributable to: (1) softer earnings; (2) continuing but moderating inflationary pressures; and (3) increased investment in anti-money laundering (AML) and counter-terrorism financing (CTF) compliance processes, particularly at SkyCity Adelaide;
- Capex of about NZ\$145 million in fiscal 2024, comprising about NZ\$62 million of maintenance capex and NZ\$83 million to complete NZICC and Horizon Hotel;
- Suspension of dividends in the second half of fiscal 2024 and all of fiscal 2025;
- GiG sale proceeds of about NZ\$55 million; and
- No material debt-financed acquisitions.

## Key Metrics

Table 1

### SKYCITY Entertainment Group Ltd.--Key Metrics\*

Mil. NZ\$	2022a	2023a	2024e	2025f	2026f
Revenue	611	943	935	965	1,005
EBITDA	135	277	250	235	270
Funds from operations (FFO)	76	228	150	140	170
Capital expenditure (capex)	110	256	145	135	100
Debt	625	515	725	630	560
Adjusted ratios					
Debt/EBITDA (x)	4.6	1.9	2.9	2.7	2.1
FFO/debt (%)	12.2	44.3	20.7	22.2	30.4
EBITDA margin (%)	22.1	29.3	26.7	24.4	26.9

\*All figures are adjusted by S&P Global Ratings, unless stated as reported. The forecasts are mid-point estimates of the likely ranges. NZ\$--New Zealand dollar. a--Actual. e--Estimate. f--Forecast.

## Liquidity

We assess SkyCity's liquidity as adequate. We expect the company's sources over uses to be greater than 1.2x over the 12 months to Dec. 31, 2024. In our view, SkyCity can maintain adequate liquidity, even if its EBITDA declines by 15%, given the group's cash balance and undrawn bank facilities.

Principal liquidity sources:

- Cash and short-term investments of NZ\$188 million (as of Dec. 31, 2023);
- Undrawn bank facilities of about NZ\$255 million;
- Cash funds from operations of about NZ\$168 million over the 12 months to Dec. 31, 2024; and
- GiG sale proceeds of about NZ\$55 million.

Principal liquidity uses:

- No debt maturities over the 12 months to Dec. 31, 2024;
- NZICC car park repurchase of about NZ\$204 million;
- AUSTRAC and Department of Internal Affairs AML fines that total about NZ\$77 million; and
- Capex of about NZ\$140 million.

## Ratings Score Snapshot

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Issuer Credit Rating	BBB-/Stable/--
Business risk:	Satisfactory
Country risk	Low
Industry risk	Intermediate
Competitive position	Satisfactory
Financial risk:	Intermediate
Cash flow/leverage	Intermediate
Anchor	bbb-
Modifiers:	
Diversification/Portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Neutral (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	bbb-

## Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

## Research Update: SKYCITY Entertainment Group 'BBB-' Rating Affirmed; Outlook Remains Stable

### Ratings Affirmed

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**SKYCITY Entertainment Group Ltd.**

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Issuer Credit Rating BBB-/Stable/--

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**SKYCITY Entertainment Group Ltd.**

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Senior Unsecured BBB-

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**SKYCITY Auckland Holdings Ltd.**

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Senior Unsecured BBB-

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**SKYCITY Australia Pty Ltd.**

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Senior Unsecured BBB-

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