Ardent Leisure 25/06/2013 **FAT-AUS-629**

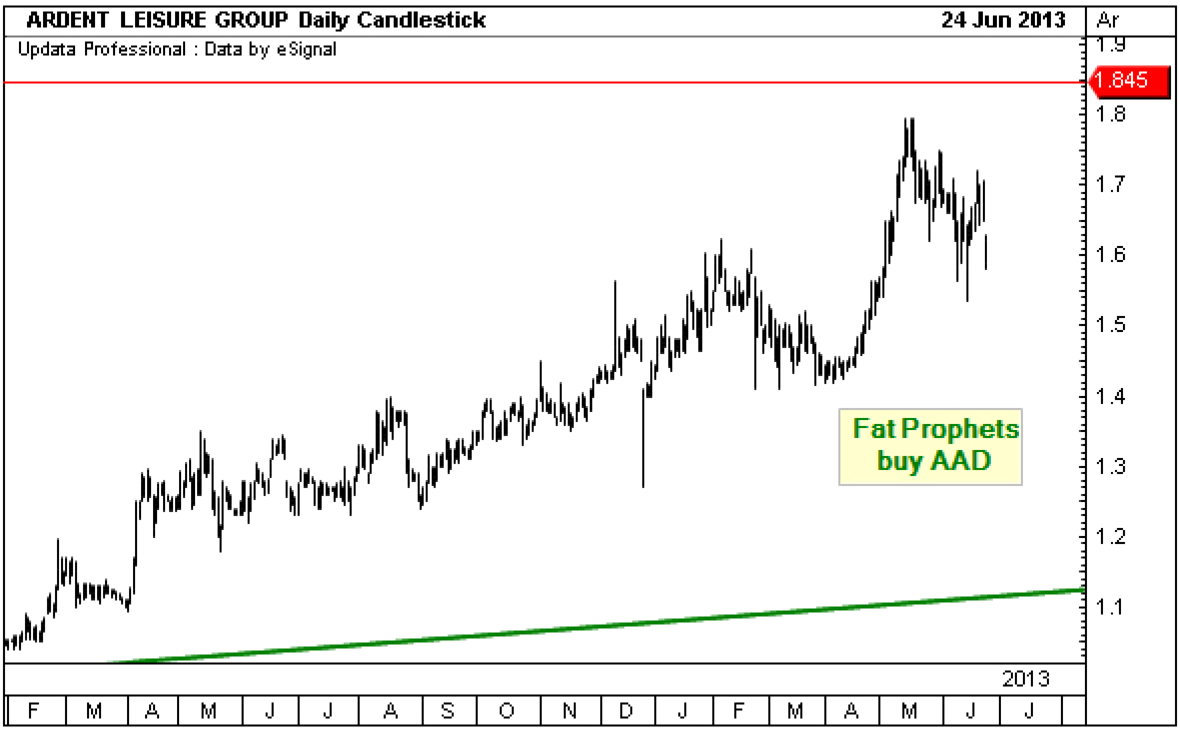
AAD AUD $1.670 Spec. **MED.** **B**

Adding another Queensland play

On 21 May, we published a Traffic Light report on Ardent Leisure (ASX: AAD), a specialist operator of dominant leisure and entertainment assets. We highlighted the appeal of its significant exposure to the Queensland region - one whose potential economic and property market recovery we are positive on. The company's Gold Coast theme parks are also leveraged to the weakening Australian Dollar which should benefit inbound tourism.

Ardent Leisure also operates family entertainment businesses in the US where the consumer recovery continues apace, albeit gradually. Furthermore, the declining interest rate outlook and the likely positive impact on consumer sentiment in Australia are likely to lead to greater disposable income which may find their way to the company's many affordable leisure offerings.

Ardent Leisure ticks many boxes in terms of our top-down thematic view. More importantly, the recent market volatility, which we see as just a correction, has presented an opportunity to enter the stock. Consequently, we rate the stock as a Buy and recommend its purchase by Members at around the current level.



Company overview

Ardent Leisure is a **specialist operator of leisure and entertainment assets in Australia and the US, with dominant positions** in the sectors that it is involved in. The following table provides an overview of its assets:

Sector	Businesses	Number
Theme Parks	Dreamworld, WhiteWater World, and SkyPoint	3
Bowling	AMF and Kingpin	51
Health Clubs	Goodlife Health Clubs	65
Family Entertainment Centres	Main Event USA	12
Marinas	D'Albora Marinas	7

Source: Company presentation

Geographically, the company is **heavily exposed to Queensland from which we estimate it generates 37 percent of revenues and 44 percent of its operating earnings**. Most of the presence in the Sunshine state is, of course, in the form of Ardent Leisure's Theme Park operations on the Gold Coast which contribute circa 30 percent of the group's profits.

The company's **Family Entertainment (Main Event) division in the US accounts for approximately 17 percent and 21 percent of the group's sales and operating earnings, respectively**.

Financials snapshot

Ardent Leisure recently acquired ten Fenix Fitness Club gyms for $61 million, thereby, significantly boosting its Health Clubs division. Giving effect to this acquisition and the anticipated expansion of its Family Entertainment business in the US, **the company has a annual revenue base of circa $480 million. From this, it extracts Earnings before Interest, Tax, Depreciation and Amortisation (EBITDA) margin of just over 20 percent, or a touch over $100 million**.

Proforma Segmental financials ($mil)			
Sales		**QLD exposure**	**US exposure**
Theme Parks	101.4	100%	0%
Marinas	24.0	0%	0%
Bowling	121.1	18%	0%
Main Event	81.4	0%	100%
Health Clubs	154.9	35%	0%
Other	0.0	0%	0%
Total	482.8	37%	17%
EBITDA		**QLD exposure**	**US exposure**
Theme Parks	30.8	100%	0%
Marinas	10.6	0%	0%
Bowling	14.8	18%	0%
Main Event	21.3	0%	100%
Health Clubs	35.7	35%	0%
Other	-9.3	0%	0%
Total	103.9	44%	21%

Source: Company reports and Fat Prophets estimates

Currently, Ardent Leisure generates a core net profit (excluding one-offs and property revaluation changes) of circa $50 million, or $0.13 in Earnings per Share (EPS). **Close to 90 percent of its core earnings are paid out each year in distributions** to stock holders.

The company carried $194 million in net debt as at the end of December 2012 with a **gearing** of 39 percent which has reduced to an even more **comfortable 32 percent as at the end of March this year**. The recent Fenix Fitness Club gym acquisition was funded by a $72 million capital raising taken in September/October last year, with a part of the proceeds also earmarked for expansion of its Family Entertainment business in the US.

Fiscal 2013 interim financial results and March quarter trading update

Revenues grew 10 percent to $220 million for the December half, leading to an 8 percent increase in core earnings (excluding one-offs and revaluations) to $30 million. However, EPS fell 5 percent year on year to 8.0 cents due to the impact of the capital raising conducted in September/October last year.

	HY13	HY12	
Revenue[1]	\$219.7m	\$200.0m	9.8%
Core earnings[2]	\$29.5m	\$27.3m	8.1%
EPS[3]	8.03c	8.47c	(5.2%)
DPS	6.6c	6.5c	1.5%

Source: Company presentation

The following table shows the performance in the December half for each of Ardent Leisure's divisions:

	1HF12	1HF13	Change
Main Event:			
Revenues	26.1	32.1	23.0%
EBITDA	5.2	6.3	21.6%
Margin	19.8%	19.6%	
Health Clubs:			
Revenues	50.8	62.8	23.7%
EBITDA	10.0	13.6	36.0%
Margin	19.7%	21.7%	
Theme Parks:			
Revenues	53.0	55.9	5.5%
EBITDA	19.8	19.6	(0.8)%
Margin	37.3%	35.1%	
Marinas:			
Revenues	11.4	11.2	(1.9)%
EBITDA	5.3	5.2	(3.2)%
Margin	46.8%	46.2%	
Bowling:			
Revenues	59.4	58.8	(1.1)%
EBITDA	9.7	8.0	(17.7)%
Margin	16.4%	13.6%	

Source: Company presentation and Fat Prophets estimates

The **Family Entertainment (Main Event) business in the US was the star performer**, with like-for-like earnings growth of 4 percent, further boosted by contributions from new venues in San Antonio (opened in April 2012) and Houston (opened in December 2012). The division's momentum has accelerated further this year on the back of these new sites, with EBITDA for the entire nine months to March 2013 surging 38 percent year on year.

Similarly, the **Health Club division traded strongly** in the December half, with like-for-like earnings growth of also 4 percent and significant contributions from new clubs acquired during the period. Since then, earnings growth has elevated to another level, with EBITDA for the entire nine months to March 2013 up 43 percent year on year, again aided by contributions from new clubs.

The **Theme Parks division posted a solid top line growth** for the December half but earnings were impacted by higher DreamWorks and Big Brother license fees, as well as higher electricity costs. These headwinds have persisted into this year, with EBITDA for the entire nine months to March 2013 down almost 1 percent year on year.

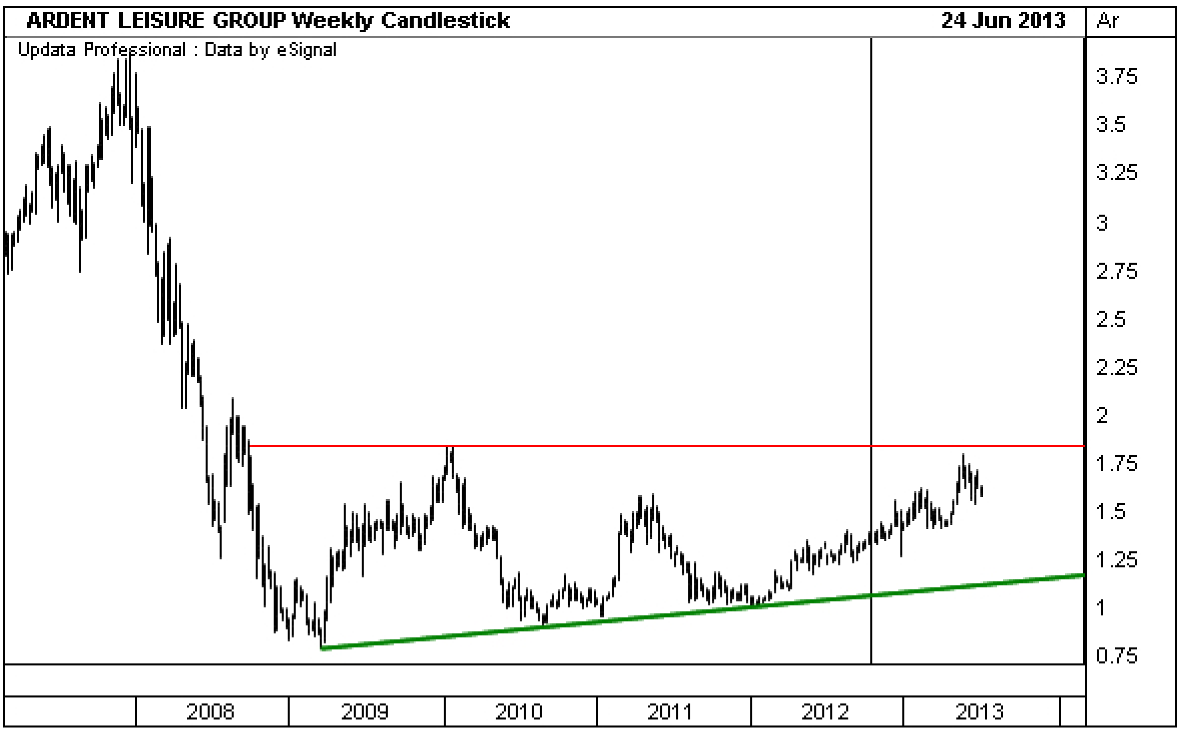
The **Bowling division turned in a disappointing for the December half, with earnings down 18 percent year on year**, reflecting the high fixed leverage of the business on even a slight slippage in revenues. The division also incurred $0.3 million in restructure costs during the period. We are, however, **encouraged by the repositioning of the business currently underway** and a move to enhance value for consumers, particularly during off-peak periods. **Early signs are positive, with the Bowling division returning to revenue growth in the recent March quarter** to the tune of 2.4 percent, while EBITDA for the entire nine months to March 2013 is down 16 percent year on year (versus down 18 percent for the six months to December).

Investment thesis

Ardent Leisure **ticks many boxes in terms of our top-down thematic view**. Firstly, we are positive on the **economic and the property market recovery in Queensland, particularly in the South East region**. With 44 percent of earnings from the state and its flag-ship Theme Parks assets located in the heart of the region, we believe Ardent Leisure provides an ideal exposure to this theme. Furthermore, the **weakening Australian Dollar** and the declining interest rates are both material tailwinds for inbound tourism and higher disposable income, and should materially benefit the Theme Parks operation.

Secondly, we are positive on the **US economic recovery**. While the pace of improvement has been rocky, the upward trajectory is clear, particularly on the consumer front. This is likely to underpin the continued growth of Ardent Leisure's Family Entertainment (Main Event) business in the US (bowling, laser games, arcade, indoor golf, rock-climbing).

Finally, the **declining interest rate outlook in Australia and the likely positive flow-on impact on consumer sentiment** are likely to lift disposable income, thus, benefit the company's entire suite of affordable leisure offering, ranging from Theme Parks and bowling, to Health Clubs and boating.



Summary

We are attracted by Ardent Leisure's leverage to many of the top-down themes that we are positive on. The stock is **currently trading at 13 times consensus fiscal 2013 earnings estimates and 12 times the year after**. The stock is **also yielding over 7 percent** at current prices, albeit unfranked.

Consequently, we are **adding Ardent Leisure to the Fat Prophets Portfolio, and recommend its purchase by Members at around the current level.**

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Snapshot AAD

Ardent Leisure

Latest Closing Price: $1.67

Ardent Leisure is one of Australia's biggest owners and operators of leisure assets including the Dreamworld, WhiteWater World & SkyPoint theme parks and attractions. The company also operates AMF and Kingpin Bowling, d'Albora Marinas, Goodlife Health Clubs, as well as Main Event, which is a growing portfolio of family entertainment assets in the United States.

Market Capitalisation:$662m

	FY1	FY2
Price to Earnings	13.3	12.3
Dividend Yield (%)	7.3	7.8
Price to Book	1.4	1.4

Return on Equity (%)	9.9	10.7
EV/EBITDA	9.4	8.2

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