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Shamu-Sized Expectations For SeaWorld Entertaiment

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Disclosure: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

SeaWorld Entertainment's (SEAS) recent initial public offering has garnered a lot of attention. Following the *Great Recession* and the impact it had on American families and their disposable income it is remarkable that a company that is currently fully dependent on the US market (and consumer) for its revenues priced as high as it did and exploded in its market debut (up 24% the first day of trading).

Intrigued by the seemingly rich market value we at Fortuna Advisors did a bit of investigating. Our initial research indicates that investors have very rosy expectations for the company based on its current market price of ~$33/share.

In particular we were drawn to one seemingly trivial statement on page 6 of the company's S-1 SEC filing: Under the header "Drive increased Attendance to Our Parks," SeaWorld's management asserts that there is a historically strong correlation between capital investment and increased park attendance.

While the S-1 provides only three years of data, hardly enough to be "statistically robust" there is a 76% correlation between overall attendance and capital expenditures per year. So taking management at face-value we've factored this into our analysis.

Here's what we've modeled to understand what today's investor would need to "expect" from the company over the next five years (2013-2017) for it to be valued at $33/share.

We've assumed the company can sustain 7% growth in Admission Revenue Per Capita similar to the growth it experienced between 2010/2011 and 3% growth in In-Park Revenue Per Capita similar to the its growth between 2010-2012. Already these are bold assumptions for a consumer centric company given the macro environment and current consumer sentiment and spending.

Additionally, we've modeled that the company can expand its Earnings Before Interest Tax Depreciation, Amortization and Rent (EBITDAR) margin by 0.5% per year over the next five years. Again, a fairly strong assumption considering their costs are driven by advertising, labor and park operations.

Alas, all of that growth and profitability improvement still doesn't achieve a warranted value of $33/share. To close the gap we need to determine the growth in attendance required as well.

Using the historical correlation between attendance and capital investment we estimate that ultimately SeaWorld would need to grow capital expenditures (CapEx) by 27% per year between 2013-2017 (for a cumulative spend of nearly $2.1Bn) to achieve the requisite attendance growth of nearly 30 million visitors by 2017 to warrant the current $33/share price. This will be a considerable task for a company that's already highly levered (approximately $1.6Bn in Net Debt currently) and has a high fixed cost, asset intense business model.

What's more, is to "ease" investors concerns about the rich market valuation (based on free cash flow multiples and the like) management in the same SEC filing (see link to SEC website above) on Page 51 described the 2011 and 2012 CapEx as "elevated" and indicated that it plans to reduce its level of expenditures to about 10% of revenue beginning in 2014. This is significantly less than the amount needed based on our analysis.

It would appear that Management is attempting to pull off a trick that would make Shamu proud: growing without investing.

Ultimately this is a business that generates fantastic economic returns on capital ("Residual Cash Margins" in our framework) and has high growth expectations. Management needs to be cautious that CapEx doesn't become a "four letter word" at SeaWorld. If it does and investment is constrained it is difficult to see how the company will exceed current expectations to create long term value for new shareholders.

Fortuna Advisors Model Outputs (See Notes and Disclaimer)

	2010	2011	2012	2013E	2014E	2015E	2016E	2017E
Attendance (thousands)	22,433	23,631	24,391	24,383	25,301	26,469	27,953	29,839
Admissions	730,368	824,937	884,407	945,997	1,050,344	1,175,724	1,328,553	1,517,475
Food, Merchandise and Other	465,735	505,837	539,345	555,339	593,544	639,559	695,676	764,897
Total Revenue	$1,196,103	$1,330,774	$1,423,752	$1,501,336	$1,643,889	$1,815,283	$2,024,229	$2,282,372
Growth		*11%*	*7%*	*5%*	*9%*	*10%*	*12%*	*13%*
Admissions Per Capita	$32.56	$34.91	$36.26	$38.80	$41.51	$44.42	$47.53	$50.86
Growth	*0%*	*7%*	*4%*	*7%*	*7%*	*7%*	*7%*	*7%*
In Park Rev Per Capita	$20.76	$21.41	$22.11	$22.78	$23.46	$24.16	$24.89	$25.63
Growth	*0%*	*3%*	*3%*	*3%*	*3%*	*3%*	*3%*	*3%*
EBITDAR	$284,616	$380,028	$417,649	$448,412	$499,753	$561,535	$636,962	$730,359
Margin	*23.8%*	*28.6%*	*29.3%*	*29.9%*	*30.4%*	*30.9%*	*31.5%*	*32.0%*
CapEx	$120,196	$225,316	$191,745	$243,727	$309,801	$393,787	$500,542	$636,238
% of Total Revenue	*10%*	*17%*	*13%*	*16%*	*19%*	*22%*	*25%*	*28%*
Avg Gross Operating Assets		$2,286,370	$2,494,989	$2,702,273	$2,946,260	$3,260,305	$3,661,759	$4,174,364
Asset Turnover		0.58x	0.57x	0.56x	0.56x	0.56x	0.55x	0.55x
Residual Cash Earnings	$66,733	$140,002	$127,226	$134,246	$156,157	$180,482	$208,372	$241,357
Residual Cash Margins	*5.6%*	*10.5%*	*8.9%*	*8.9%*	*9.5%*	*9.9%*	*10.3%*	*10.6%*
Equity value	$3,095,399							
Total Shares	$93,234							
Implied share price	$33							
Note: For illustration only.								

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