FORSYTH BARR

Auckland Airport

UNDERPERFORM

FY19 Preview — Cooling of Capex

Auckland Airport (AIA) will report its FY19 result on Thursday 22 August; we expect underlying NPAT towards the top end of the guidance range (NZ$265m–NZ$275m) despite a gradual slowing of international pax growth through the year. Our NPAT forecast implies +4% growth year on year. Strong, albeit slowing, retail income growth and another double digit lift in property income will be the key drivers, partially offset by the first half lift in opex.

Key issues to consider at AIA's FY19 result

- **Capex:** AIA is behind on its capex programme given delays to key aeronautical projects. We expect FY19 spend levels to be at the bottom end or below the reduced guidance (NZ$280m–NZ$330m) provided at the half year result in February 2019. We expect AIA to provide an updated capex programme plan either at this result or its investor day later in the year. A lower capex profile will ease the interest and depreciation burden over the medium term.
- **Opex:** We expect a stabilisation of expenses through 2H19 after a step-up in 2H18. Management suggested after 1H19 that opex growth would be "*well into single digits*" for the full year.
- **Seat capacity outlook:** AIA grew international pax by +3.0% in FY19, its lowest level of growth in six years. Airline schedule data suggests low single digit international seat capacity growth through FY20. We recently lowered our international pax growth forecast for FY20 to +1% from +4%.
- **Retail:** AIA has completed its international outbound retail expansion. We expect retail income growth year on year but not half on sequential half. Passenger spend rates have been trailing retail income per passenger for the past four years, implying an increase in effective concession rates with greater reliance on minimum annual guarantees (MAGs).

Conference call

Management will host a FY19 result conference call at 11am on 22 August 2019. Dial-in: NZ: 0800 667 018, Australia: 1 800 148 258, Passcode: 9193167

Figure 1. AIA FY19 forecasts (NZ$m)

	FY18	FY19E	Change	Consensus
Sales revenue	683.9	736.9	7.8%	742.0
EBITDAFI	506.4	546.5	7.9%	552.8
Net interest	(77.2)	(78.9)	2.2%	n/a
Taxation	(155.8)	(101.6)	-34.8%	n/a
Underlying NPAT	**263.1**	**273.6**	**4.0%**	273.6
Underlying EPS (cents)	22.0	22.7	3.1%	22.7
Final DPS (cents)	11.0	11.8	6.8%	11.9

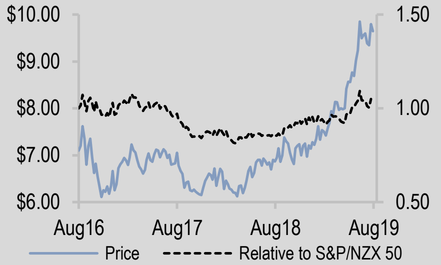
Source: Eikon, Forsyth Barr analysis

Investment View

AIA is well positioned given its control of New Zealand's major gateway, its hub positioning for Air New Zealand and the country's positive longer term tourism outlook. It is a high quality infrastructure asset providing structural growth and sustainable dividends. The company is in the midst of a multi-year capex programme. AIA is sensitive to bond yield movements and international pax growth. In combination these no longer support current valuation levels and therefore our rating is UNDERPERFORM.

NZX Code	AIA
Share price	NZ$9.65
Target price	NZ$7.65
Risk rating	Low
Issued shares	1211.0m
Market cap	NZ$11,686m
Average daily turnover	1,116k (NZ$8,808k)

Share Price Performance



Financials: June	18A	19E	20E	21E
NPAT* (NZ$m)	263.1	273.6	267.1	281.8
EPS* (NZc)	22.0	22.7	22.0	23.0
EPS growth* (%)	5.6	3.1	-3.1	4.7
DPS (NZc)	21.8	22.8	22.0	23.0
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	26.7	24.9	24.9	23.1
EV/EBIT	32.4	30.5	31.0	29.1
PE	43.9	42.6	43.9	41.9
Price / NTA	2.0	2.0	2.0	2.0
Cash dividend yield (%)	2.3	2.4	2.3	2.4
Gross dividend yield (%)	3.1	3.3	3.2	3.3

*Historic and forecast numbers based on underlying profits

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Auckland International Airport Ltd (AIA) Priced as at 15 Aug 2019: NZ$9.65 June year end

Forsyth Barr valuation			
Valuation methodology		Average of DCF and sum-of-the-parts	
12-month target price (NZ$)*	**7.65**	**Spot valuations (NZ$)**	
Expected share price return	-20.7%	1. DCF	6.08
Net dividend yield	2.3%	2. Sum of the parts	8.45
Estimated 12-month return	-18.4%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.75%	Total firm value	9,570
Equity beta	0.80	(Net debt)/cash	(2,206)
WACC	7.0%	Value of equity	7,365
Terminal growth	1.5%	Shares (m)	1,211

Profit and Loss Account (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Sales revenue	629	684	737	744	797
Normalised EBITDA	**473**	**506**	**546**	**547**	**590**
Depreciation and amortisation	(78)	(89)	(101)	(108)	(122)
Normalised EBIT	**395**	**418**	**446**	**440**	**468**
Net interest	(73)	(77)	(79)	(83)	(91)
Associate income	15	9	9	9	10
Tax	(117)	(218)	(104)	(99)	(104)
Minority interests	-	-	-	-	-
Normalised NPAT	**248**	**263**	**274**	**267**	**282**
Abnormals/other	(85)	(387)	(10)	-	-
Reported NPAT	**333**	**650**	**284**	**267**	**282**
Normalised EPS (cps)	20.8	22.0	22.7	22.0	23.0
DPS (cps)	20.5	21.8	22.8	22.0	23.0

Growth Rates	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue (%)	9.7	8.7	7.8	0.9	7.2
EBITDA (%)	9.9	7.0	7.9	0.2	7.7
EBIT (%)	10.6	5.6	6.8	-1.4	6.5
Normalised NPAT (%)	16.5	6.2	4.0	-2.4	5.5
Normalised EPS (%)	16.4	5.6	3.1	-3.1	4.7
DPS (%)	17.1	6.1	4.6	-3.4	4.7

Cash Flow (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EBITDA	**473**	**506**	**546**	**547**	**590**
Working capital change	35	4	-	-	-
Interest & tax paid	(190)	(295)	(183)	(181)	(196)
Other	(11)	105	12	-	-
Operating cash flow	**307**	**321**	**376**	**366**	**394**
Capital expenditure	(329)	(387)	(274)	(592)	(662)
(Acquisitions)/divestments	-	347	-	-	-
Other	(10)	(9)	(6)	(9)	(18)
Funding available/(required)	**(32)**	**272**	**96**	**(234)**	**(286)**
Dividends paid	(191)	(183)	(197)	(191)	(202)
Equity raised/(returned)	0	-	-	-	-
Increase/(decrease) in net debt	**222**	**(90)**	**101**	**426**	**487**

Balance Sheet (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Working capital	(77)	(76)	(117)	(118)	(127)
Fixed assets	4,948	6,378	6,422	6,805	7,245
Intangibles	-	-	-	-	-
Other assets	1,455	1,640	1,779	1,888	1,997
Total funds employed	**6,326**	**7,942**	**8,084**	**8,575**	**9,116**
Net debt/(cash)	2,012	1,954	2,055	2,480	2,968
Other non current liabilities	286	306	306	306	306
Shareholder's funds	4,029	5,682	5,722	5,788	5,842
Minority interests	-	-	-	-	-
Total funding sources	**6,326**	**7,942**	**8,084**	**8,575**	**9,116**

Valuation Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EV/EBITDA (x)	28.4	26.7	24.9	24.9	23.1
EV/EBIT (x)	34.0	32.4	30.5	31.0	29.1
PE (x)	46.4	43.9	42.6	43.9	41.9
Price/NTA (x)	2.9	2.0	2.0	2.0	2.0
Free cash flow yield (%)	-0.2	-0.6	0.9	-1.9	-2.3
Net dividend yield (%)	2.1	2.3	2.4	2.3	2.4
Gross dividend yield (%)	3.0	3.1	3.3	3.2	3.3
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	99	99	100	100	100

Capital Structure	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Interest cover EBIT (x)	5.4	5.4	5.6	5.3	5.1
Interest cover EBITDA (x)	6.5	6.6	6.9	6.6	6.4
Net debt/ND+E (%)	33.3	25.6	26.4	30.0	33.7
Net debt/EBITDA (x)	4.3	3.9	3.8	4.5	5.0

Key Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Return on assets (%)	6.1	5.1	5.4	5.0	5.0
Return on equity (%)	6.2	4.6	4.8	4.6	4.8
Return on funds employed (%)	13.3	9.9	11.7	10.4	9.4
EBITDA margin (%)	75.2	74.0	74.2	73.6	73.9
EBIT margin (%)	62.8	61.0	60.5	59.1	58.7
Capex to sales (%)	52.3	56.6	37.2	79.5	83.0
Capex to depreciation (%)	422	436	272	549	544

Operating Performance	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Aeronautical	319	329	339	331	369
Consumer	230	263	295	303	313
Property	75	86	97	103	109
Other	7	6	6	7	7
Total sales revenue	**629**	**684**	**737**	**744**	**797**
Aeronautical	220	222	229	219	251
Consumer	195	219	243	248	253
Property	58	66	75	81	85
Total EBITDAFI	**473**	**506**	**546**	**547**	**590**
Key drivers					
International pax ('000)	9,743	10,203	10,509	10,614	10,826
Transits ('000)	1,077	1,064	1,011	859	876
Total international pax ('000)	10,820	11,266	11,519	11,473	11,702
Domestic pax ('000)	8,602	9,264	9,588	9,396	9,678
International pax growth (%)	11.0	4.7	3.0	1.0	2.0
Transits (%)	86.1	-1.2	-5.0	-15.0	2.0
Total international pax growth (%)	11.0	4.7	3.0	1.0	2.0
Domestic pax growth (%)	8.9	7.7	3.5	-2.0	3.0
International aircraft numbers	54,879	55,693	55,919	55,157	55,725
Domestic aircraft numbers	114,366	118,583	121,182	117,276	119,305
International MCTOW (KT)	5,609	5,798	5,927	5,874	5,963
Domestic MCTOW (KT)	2,239	2,342	2,465	2,457	2,574
Aeronautical income per pax (NZ$)	16.4	16.0	16.0	15.9	17.3
Change (%)	n/a	-2.4	0.3	-1.1	8.7
Retail sales per int'l pax (NZ$)	15.8	17.8	20.1	20.7	20.9
Change (%)	n/a	12.1	13.0	3.0	1.0
Car park income per pax (NZ$)	3.1	3.2	3.1	3.1	3.2
Change (%)	n/a	4.2	-4.5	2.3	1.8
Yield on property book value (%)	7.8	7.4	7.1	7.0	6.9

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

FY19 preview

Figure 2. Earnings forecasts for FY19 (NZ$m)

	FY18	FY19E	Change
Profit and loss account			
Sales revenue	683.9	736.9	8%
Airfield income	122.1	126.4	4%
Passenger Service Charge	179.1	184.2	3%
Retail Income	190.6	221.0	16%
Property Income	86.1	96.6	12%
Car Park Income	61.0	63.7	4%
Interest Income	2.2	2.2	0%
Other Income	42.8	42.9	0%
EBITDAFI	**506.4**	**546.5**	**8%**
Depreciation	(88.9)	(100.7)	13%
Associate income	16.7	8.5	-49%
One-time items	448.9	11.3	-97%
Interest expense	(77.2)	(78.9)	2%
Taxation	(155.8)	(102.7)	-34%
Reported NPAT	**650.1**	**283.9**	**-56%**
Abnormals (post tax)	(387.0)	(10.3)	-97%
Underlying NPAT	**263.1**	**273.6**	**4%**
Underlying EPS (cents)	22.0	22.7	3%
Final DPS (cents)	11.0	11.8	7%
Cashflow and net debt			
Operating cashflow	321.2	376.1	17%
Maintenance capex = depreciation	(88.9)	(100.7)	13%
Capitalised interest	(8.8)	(5.6)	-36%
Associate dividends	15.4	8.5	-45%
Free cash flow	**238.9**	**278.3**	**16%**
Acquisitions	0.0	0.0	n/a
Disposals	347.3	0.0	-100%
Net debt (as reported by AIA)	1,910	2,011	5%
Margin and efficiency analysis			
Underlying EBITDAFI margin	74.0%	74.2%	0%
Op. income per passenger	33.31	34.91	5%
Retail income per international passenger	17.76	20.06	13%
Car park income per passenger	3.13	3.17	1%
Operating staff costs/operating revenue	8.5%	8.3%	-2%
Operational statistics			
International passengers	11,266	11,519	2%
Domestic passengers	9,264	9,588	3%
International MCTOW (KT)	5,798	5,927	2%
Domestic MCTOW (KT)	2,342	2,465	5%
International aircraft (numbers)	55,693	55,919	0%
Domestic aircraft (numbers)	118,583	121,182	2%

Source: Forsyth Barr analysis

Investment summary

Auckland Airport (AIA) is New Zealand's premier airport and provides Air New Zealand with a domestic and international hub. It is very profitable given strong concession based commercial assets. It is part way through a major 10-year plus capex programme, which will facilitate longer term growth. Despite the support from attractive return on capital in AIA's non-regulated commercial assets and low prevailing Government bond rates, its valuation is stretched. Moreover earnings risk is to the downside, in our opinion. UNDERPERFORM.

Business quality

- **Hub-airport:** AIA is New Zealand's key international gateway and accounts for ~90% of all long-haul passengers (pax) arriving in New Zealand. Its available land provides scope to increase capacity over the next 30+ years.
- **Multi-pronged strategy:** AIA has three key income streams — (i) aeronautical (regulated); (ii) commercial, which incorporates retail and car parking; and (iii) development property.
- **Track record:** AIA has created value in recent years through route development activities, expanding its retail footprint to optimise passenger spend and concession rates, and developing property.

Earnings and cash flow outlook

- **Slower phase of earnings:** The growth outlook for the next four years is impacted by subdued aeronautical income and reversion to mean for pax growth after a recent boom. Earnings growth should accelerate from FY23.
- **Aeronautical income:** AIA resets its aeronautical prices every five years which are subject to regulatory oversight from the Commerce Commission (ComCom). The current price path prescribes subdued aeronautical income growth through to FY22.

Financial structure

- **Balance sheet:** AIA is in the midst of a major capex bulge given the need to build capacity. AIA expects to spend ~NZ$3.0bn over the next five years, albeit we expect this to be reduced when it updates the market on its capex programme.
- **Dividends:** It has a 100% dividend pay-out rate and has a dividend reinvestment plan in place.

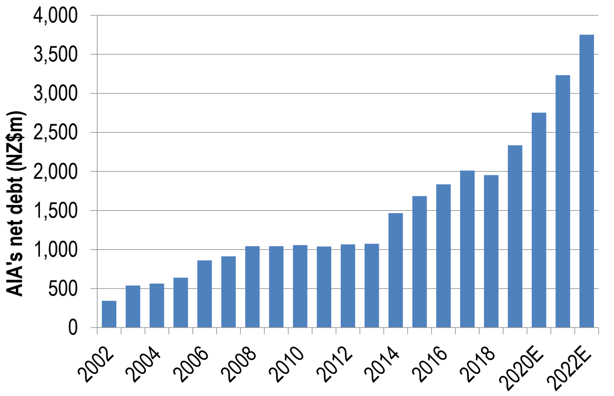
Risks factors

- **Rising bond yields:** AIA trades as a bond proxy. Its valuation holds a very strong inverse relationship with bond yields.
- **Regulatory risk:** We expect AIA to lower current aeronautical prices to ease any regulatory pressure given its mixed ComCom report last year.

Company description

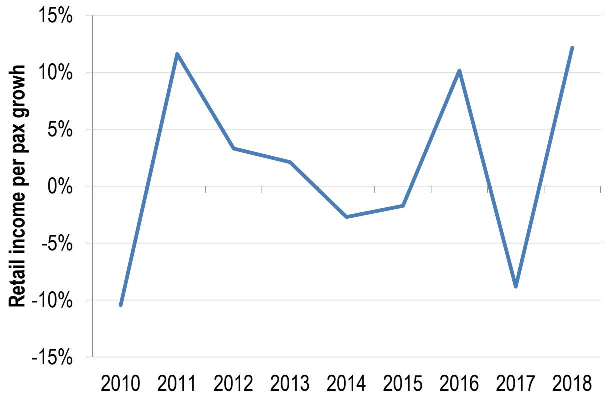
AIA was listed in July 1998 following the Government selling its majority stake. The current major shareholder, the Auckland Council, owns 22.4%. Auckland is the largest airport in New Zealand and has around a 70% share of international passenger traffic. Its share of long haul traffic is in excess of 90%. The company generates income from three core areas - regulated aeronautical, consumer activities, and investment property. AIA also has minority stake in Queenstown airport.

Figure 1. Increasing debt burden at AIA



Source: Company reports, Forsyth Barr analysis

Figure 2. Retail income per international pax growth



Source: Company reports, Forsyth Barr analysis

Figure 3. Substantial Shareholders

Shareholder	Latest Holding
Auckland City Council	22.1%
BlackRock Investment Management	5.0%

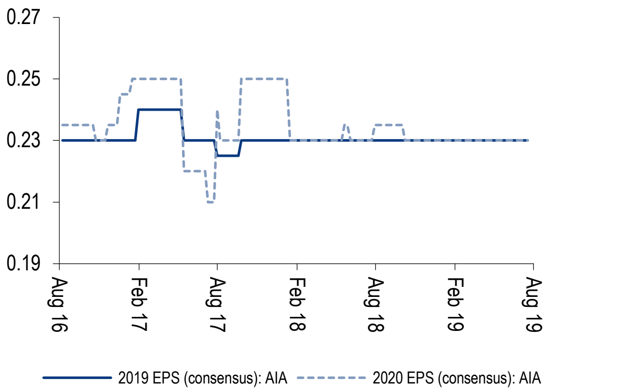
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 4. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect AIA's balance date - June)			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
Auckland Airport	**AIA NZ**	**NZ$9.65**	**NZ$11,686**	**42.6x**	**43.9x**	**25.0x**	**24.9x**	**30.6x**	**31.0x**	**2.3%**
Sydney Airport	SYD AT	A$8.37	A$18,892	49.2x	46.1x	21.8x	20.8x	32.1x	30.2x	4.7%
Malaysia Airports Holdings Bhd	MAHB MK	RM8.33	RM13,821	23.3x	23.9x	8.1x	8.1x	13.4x	13.2x	2.4%
Flughafen Wien AG	FLU AV	€40.00	€3,360	22.7x	20.4x	10.1x	9.4x	15.7x	14.3x	3.1%
Flughafen Zurich AG	FHZN SW	CHF176.30	CHF5,413	20.5x	18.3x	9.9x	9.2x	16.6x	14.9x	3.6%
Fraport AG Frankfurt Airport Services Worlc	FRA GY	€73.58	€6,804	15.2x	15.4x	9.5x	9.0x	15.1x	14.7x	2.8%
Airports of Thailand PCL	AOT TB	THB68.75	THB982,142	37.5x	34.8x	24.3x	22.4x	28.5x	26.4x	1.6%
Beijing Capital International Airport Co	694 HK	CN¥5.76	CN¥24,946	10.1x	13.4x	5.7x	6.9x	8.0x	10.7x	3.3%
			Compco Average:	**25.5x**	**24.6x**	**12.8x**	**12.3x**	**18.5x**	**17.8x**	**3.1%**
EV = Current Market Cap + Actual Net Debt			**AIA Relative:**	**+67%**	**+78%**	**+95%**	**+103%**	**+66%**	**+75%**	**-26%**

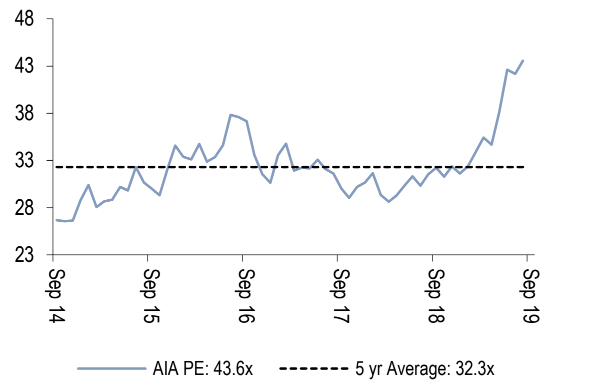
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (AIA) companies fiscal year end

Figure 5. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 6. 12 Month Forward PE



Source: Forsyth Barr analysis