

Auckland Airport

Not Immune But Well Protected

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NEUTRAL 

We upgrade Auckland Airport (AIA) to NEUTRAL from UNDERPERFORM to reflect recent share price weakness and its attractive longer term infrastructure characteristics. AIA's share price has fallen ~-20% over the past six months, and ~-14% since the coronavirus threat first emerged. Softening passenger (pax) statistics through 2019 have been exacerbated in recent weeks by the coronavirus impact on demand. We expect weak international pax data to remain a feature for the foreseeable future, which will remain a headwind to sentiment, however, we recognise that AIA is largely insulated through (1) minimum annual guarantees (MAGs) in its retail business, (2) underlying growth in its investment property operations, and (3) the regulatory model that re-bases aeronautical pricing every five years (should demand stay lower for longer). It now trades at a one-year forward EV/EBITDA multiple of ~19x, on par with Sydney Airport (SYD.AU).

| NZX Code | AIA | Financials: Jun/ | 19A | 20E | 21E | 22E | Valuation (x) | 19A | 20E | 21E | 22E |
|--------------------|---------------------|------------------------------|-------|-------|-------|-------|-------------------|------|------|------|------|
| Share price | NZ\$7.74 | NPAT* (NZ\$m) | 274.7 | 266.3 | 268.2 | 270.8 | EV/EBITDA | 20.4 | 21.2 | 20.4 | 19.4 |
| Target price | NZ\$8.10 | EPS* (NZc) | 22.8 | 21.9 | 21.9 | 22.0 | EV/EBIT | 24.9 | 26.7 | 26.3 | 25.8 |
| Risk rating | Low | EPS growth* (%) | 3.6 | -3.8 | 0.0 | 0.4 | PE | 34.0 | 35.3 | 35.3 | 35.2 |
| Issued shares | 1207.0m | DPS (NZc) | 22.3 | 22.3 | 22.3 | 22.3 | Price / NTA | 1.5 | 1.6 | 1.6 | 1.5 |
| Market cap | NZ\$9,342m | Imputation (%) | 100 | 100 | 100 | 100 | Cash div yld (%) | 2.9 | 2.9 | 2.9 | 2.9 |
| Avg daily turnover | 1,132k (NZ\$9,926k) | *Based on normalised profits | | | | | Gross div yld (%) | 4.0 | 4.0 | 4.0 | 4.0 |

Leverage to lower pax limited

AIA has some, but not material, leverage to a sudden weakening of passenger throughput. At its recent 1H20 result, it suggested the coronavirus threat would have an after-tax earnings impact of ~-NZ\$10m, or -3% of annual profits in 2H20. We estimate this implies an ~-8% reduction in 2H20 international passengers. The majority of the earnings hit reflects lower aeronautical revenue, and a reduction in off-airport retail and car parking income.

Retail concessions provide protection; but may need support

AIA's retail concessions provide some protection through minimum annual guarantees (MAGs) that are based on (1) agreed rents that ratchet with passenger growth, or (2) prior year income levels. The former is applicable to duty free retailers, while the latter tends to be applied to speciality and food/bev retailers. MAGs, therefore, guarantee airport income levels at least over the near term. However, should the trading backdrop of its retailers deteriorate materially, AIA may decide to provide some financial support to them as a number of Asian airports have already done in recent weeks, including Singapore Changi, Hong Kong, and Airports of Thailand. This may increase AIA's risk to the current demand downturn.

We believe duty free concession tender risk over the medium term is mitigated by the prospect of AIA shifting to a single duty free operator (refer to our recent report: *Auckland Airport: Duty Free to Fly Solo*, dated 29 January 2020).

Secondary risks to aviation sector

Any extended downturn in demand could create balance sheet problems for airlines, potentially leading to market structure changes. This may sound far fetched, but the airline consolidation theme that has been prevalent in Europe and North America in recent years could become more pronounced and feature more prevalently in Asia-Pacific, particularly if airline balance sheets come under pressure. This could have implications for less profitable carriers and reduce AIA's international capacity as a result.

Auckland International Airport Ltd (AIA)

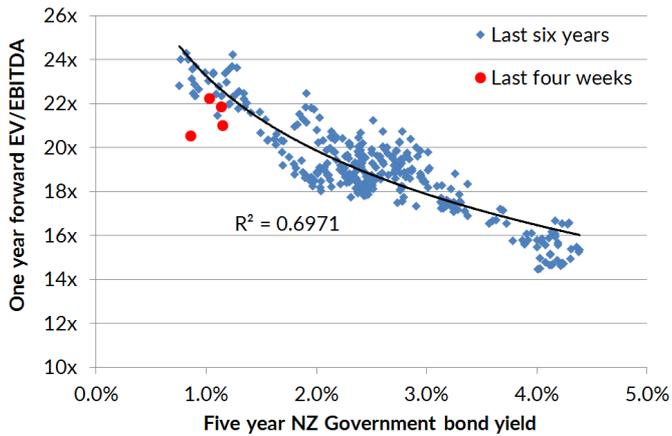
| | | | | | | | | | | | | |
|--|---------|---------|---------|---------|---------|--------------------------------------|------------------------------------|--------------|--------------|--------------|--------------|---------|
| Priced as at 04 Mar 2020 (NZ\$) | | | | | | 7.74 | | | | | | |
| 12-month target price (NZ\$)* | | | | | | 8.10 | Spot valuations (NZ\$) | | | | | |
| Expected share price return | | | | | | 4.7% | 1. DCF | | | | | 6.55 |
| Net dividend yield | | | | | | 2.9% | 2. Sum of the parts | | | | | 8.89 |
| Estimated 12-month return | | | | | | 7.5% | 3. n/a | | | | | n/a |
| Key WACC assumptions | | | | | | DCF valuation summary (NZ\$m) | | | | | | |
| Risk free rate | | | | | | 2.00% | Total firm value | | | | | 10,146 |
| Equity beta | | | | | | 0.80 | (Net debt)/cash | | | | | (2,242) |
| WACC | | | | | | 6.2% | Less: Capitalised operating leases | | | | | 0 |
| Terminal growth | | | | | | 2.0% | Value of equity | | | | | 7,904 |
| Profit and Loss Account (NZ\$m) | | | | | | Valuation Ratios | | | | | | |
| Sales revenue | 2018A | 2019A | 2020E | 2021E | 2022E | 2018A | 2019A | 2020E | 2021E | 2022E | | |
| Normalised EBITDA | 683.9 | 743.4 | 737.2 | 773.7 | 816.5 | EV/EBITDA (x) | 22.1 | 20.4 | 21.2 | 20.4 | 19.4 | |
| Depreciation and amortisation | 506.4 | 554.8 | 545.3 | 571.5 | 602.2 | EV/EBIT (x) | 26.8 | 24.9 | 26.7 | 26.3 | 25.8 | |
| Normalised EBIT | (88.9) | (102.2) | (112.7) | (128.1) | (149.8) | PE (x) | 35.2 | 34.0 | 35.3 | 35.3 | 35.2 | |
| Net interest | 417.5 | 452.6 | 432.6 | 443.4 | 452.4 | Price/NTA (x) | 1.6 | 1.5 | 1.6 | 1.6 | 1.5 | |
| Associate income | (77.2) | (78.5) | (72.5) | (81.2) | (87.1) | Free cash flow yield (%) | -0.7 | 0.6 | -1.2 | -2.7 | -2.5 | |
| Tax | 8.5 | 8.2 | 9.7 | 10.3 | 10.9 | Net dividend yield (%) | 2.8 | 2.9 | 2.9 | 2.9 | 2.9 | |
| Minority interests | (217.7) | (109.2) | (106.3) | (104.3) | (105.3) | Gross dividend yield (%) | 3.9 | 4.0 | 4.0 | 4.0 | 4.0 | |
| Normalised NPAT | 0 | 0 | 0 | 0 | 0 | Capital Structure | | | | | | |
| Abnormals/other | 263.1 | 274.7 | 266.3 | 268.2 | 270.8 | Interest cover EBIT (x) | 2018A | 2019A | 2020E | 2021E | 2022E | |
| Reported NPAT | (387.0) | (248.8) | (7.3) | 0 | 0 | Interest cover EBITDA (x) | 5.4 | 5.8 | 6.0 | 5.5 | 5.2 | |
| Normalised EPS (cps) | 650.1 | 523.5 | 273.6 | 268.2 | 270.8 | Net debt/ND+E (%) | 6.6 | 7.1 | 7.5 | 7.0 | 6.9 | |
| DPS (cps) | 22.0 | 22.8 | 21.9 | 21.9 | 22.0 | Net debt/EBITDA (x) | 25.6 | 26.3 | 28.9 | 32.4 | 33.1 | |
| Growth Rates | | | | | | Key Ratios | | | | | | |
| Revenue (%) | 2018A | 2019A | 2020A | 2021A | 2022A | 2018A | 2019A | 2020E | 2021E | 2022E | | |
| EBITDA (%) | 8.7 | 8.7 | -0.8 | 4.9 | 5.5 | Return on assets (%) | 5.1 | 5.2 | 4.8 | 4.6 | 4.5 | |
| EBIT (%) | 7.0 | 9.6 | -1.7 | 4.8 | 5.4 | Return on equity (%) | 4.6 | 4.6 | 4.4 | 4.4 | 4.3 | |
| Normalised NPAT (%) | 5.6 | 8.4 | -4.4 | 2.5 | 2.0 | Return on funds employed (%) | 12.3 | 11.0 | 9.3 | 8.5 | 7.6 | |
| Normalised EPS (%) | 6.2 | 4.4 | -3.1 | 0.7 | 1.0 | EBITDA margin (%) | 74.0 | 74.6 | 74.0 | 73.9 | 73.8 | |
| Ordinary DPS (%) | 5.6 | 3.6 | -3.8 | 0.0 | 0.4 | EBIT margin (%) | 61.0 | 60.9 | 58.7 | 57.3 | 55.4 | |
| Cash Flow (NZ\$m) | | | | | | Operating Performance | | | | | | |
| EBITDA | 2018A | 2019A | 2020E | 2021E | 2022E | 2018A | 2019A | 2020E | 2021E | 2022E | | |
| Working capital change | 506.4 | 554.8 | 545.3 | 571.5 | 602.2 | Aeronautical | 328.5 | 342.2 | 322.9 | 340.5 | 361.1 | |
| Interest & tax paid | (12.3) | (48.6) | (9.7) | (10.3) | (10.9) | Consumer | 263.0 | 301.3 | 305.8 | 318.1 | 334.8 | |
| Other | 122.0 | 57.4 | 19.8 | 10.3 | 10.9 | Property | 86.1 | 94.7 | 103.2 | 109.6 | 115.1 | |
| Operating cash flow | 321.2 | 375.9 | 376.6 | 386.1 | 409.7 | Other | 6.3 | 5.2 | 5.3 | 5.4 | 5.5 | |
| Capital expenditure | (387.4) | (320.1) | (488.0) | (640.0) | (640.0) | Total sales revenue | 683.9 | 743.4 | 737.2 | 773.7 | 816.5 | |
| (Acquisitions)/divestments | 347.3 | (0.8) | 0 | 0 | 0 | Aeronautical | 239.9 | 252.1 | 235.5 | 249.1 | 265.3 | |
| Other | (8.8) | (7.0) | (10.7) | (12.0) | (15.1) | Consumer | 232.6 | 269.0 | 272.2 | 283.1 | 298.0 | |
| Funding available/(required) | 272.3 | 48.0 | (122.1) | (266.0) | (245.3) | Property | 65.5 | 72.2 | 78.9 | 83.9 | 88.0 | |
| Dividends paid | (182.8) | (192.4) | (179.7) | (194.0) | 20.9 | Total EBITDAFI | 506.4 | 554.8 | 545.3 | 571.5 | 602.2 | |
| Equity raised/(returned) | 0 | 0 | 0 | 0 | 0 | International pax growth (%) | 4.7 | 3.0 | -3.5 | 4.0 | 4.5 | |
| (Increase)/decrease in net debt | 89.5 | (144.4) | (301.8) | (459.9) | (224.5) | Transits (%) | -1.2 | -1.2 | -15.0 | 2.0 | 3.5 | |
| Balance Sheet (NZ\$m) | | | | | | Operating Performance | | | | | | |
| Working capital | 2018A | 2019A | 2020E | 2021E | 2022E | Total int'l pax growth (%) | 4.7 | 3.0 | -3.5 | 4.0 | 4.5 | |
| Fixed assets | (76.3) | (33.4) | (117.2) | (123.0) | (129.8) | Domestic pax growth (%) | 7.7 | 3.6 | -3.1 | 3.0 | 3.0 | |
| Intangibles | 6,378.0 | 6,577.1 | 6,812.4 | 7,224.2 | 7,614.5 | Aero income per pax change | -2.4 | 1.3 | -1.3 | -0.4 | 2.3 | |
| Right of use asset | 0 | 0 | 0 | 0 | 0 | Retail sales per int'l pax change | 12.1 | 15.5 | 5.0 | 0.0 | 1.0 | |
| Other assets | 0 | 0 | 0 | 0 | 0 | Car park income per pax change | 1.6 | 1.8 | 5.0 | 1.0 | 1.0 | |
| Total funds employed | 1,640.4 | 2,013.7 | 2,163.4 | 2,273.6 | 2,384.5 | Yield on property BV (%) | 7.4 | 6.8 | 6.6 | 6.5 | 6.4 | |
| Net debt/(cash) | 7,942.1 | 8,557.4 | 8,858.5 | 9,374.9 | 9,869.1 | Int'l aircraft numbers ('000) | 55.7 | 57.1 | 54.0 | 55.5 | 57.4 | |
| Lease liability | 1,953.6 | 2,153.1 | 2,454.9 | 2,914.8 | 3,139.2 | Domestic aircraft numbers ('000) | 118.6 | 121.7 | 116.4 | 118.4 | 120.5 | |
| Other liabilities | 0 | 0 | 0 | 0 | 0 | | | | | | | |
| Shareholder's funds | 306.4 | 371.4 | 371.4 | 371.4 | 371.4 | | | | | | | |
| Minority interests | 5,682.1 | 6,032.9 | 6,032.3 | 6,088.7 | 6,358.5 | | | | | | | |
| Total funding sources | 0 | 0 | 0 | 0 | 0 | | | | | | | |

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

Valuation

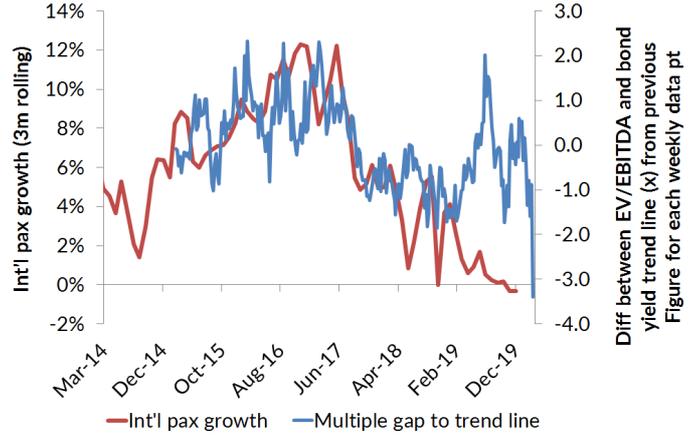
Our target price for AIA remains unchanged at NZ\$8.10.

Figure 1. AIA is sensitive to bond rates...



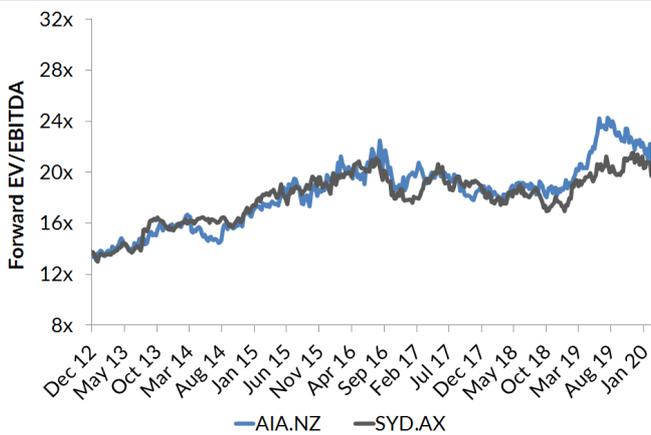
Source: Eikon, AIA, Forsyth Barr analysis

Figure 2. ...and international passenger growth



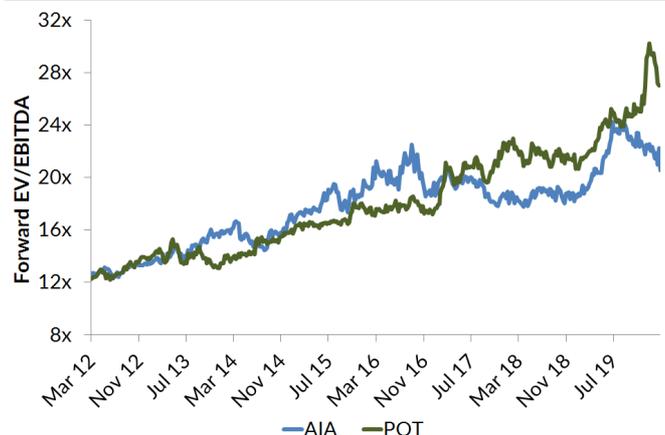
Source: AIA, Forsyth Barr analysis

Figure 3. AIA vs Sydney Airport (one year forward EV/EBITDA)



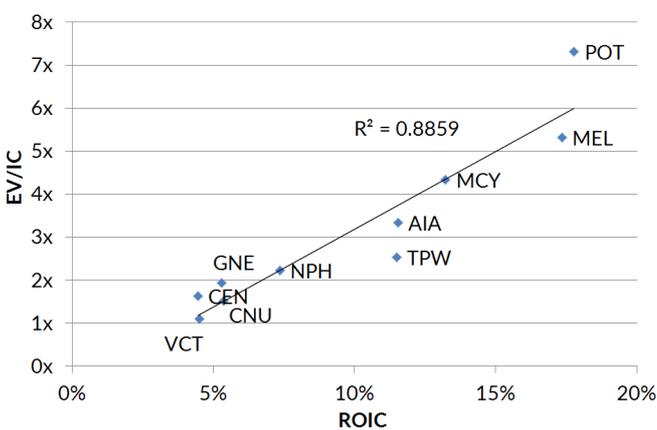
Source: Eikon, Forsyth Barr analysis

Figure 4. AIA vs Port of Tauranga (one year forward EV/EBITDA)



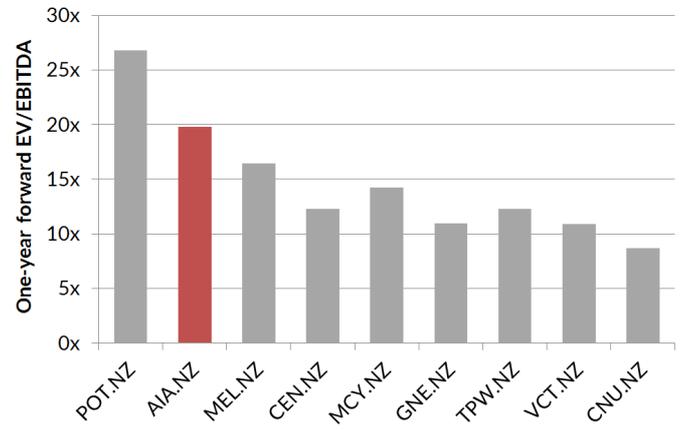
Source: Eikon, Forsyth Barr analysis

Figure 5. AIA vs other infrastructure stocks



Source: Eikon, Forsyth Barr analysis

Figure 6. EV/EBITDA comparisons



Source: Eikon, 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. It generates attractive return on capital in its non-regulated commercial assets and valuation benefits from low prevailing Government bond rates. While, we recognise near term earnings risk is to the downside, given the impact on demand from the COVID-19 outbreak, recent share price weakness broadly compensates for this. NEUTRAL.

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 cashflow outlook

- **Slower phase of earnings:** The growth outlook for the next three 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.

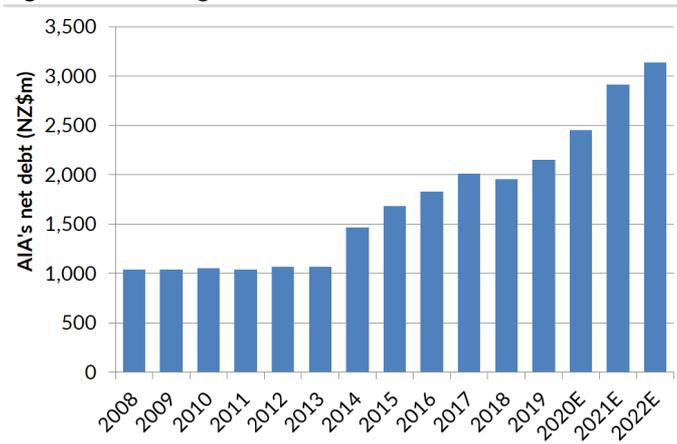
Financial structure

- **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.
- **Dividends:** It has a 100% dividend pay-out rate and has a dividend reinvestment plan in place.

Risk factors

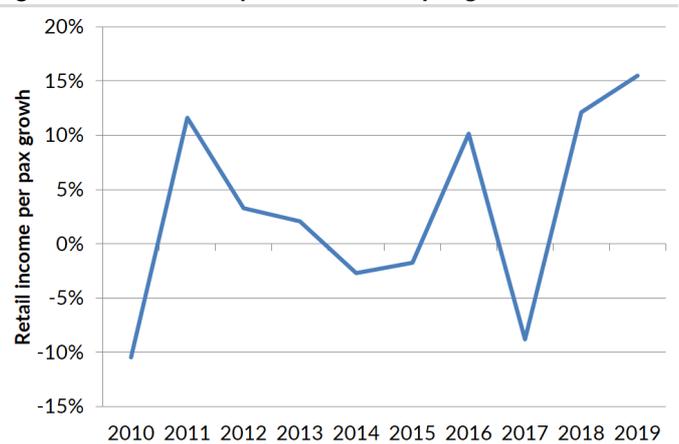
- **Rising bond yields:** AIA trades as a bond proxy. Its valuation holds a very strong inverse relationship with bond yields.
- **Regulatory risk:** We expect AIA to lower current aeronautical prices to ease any regulatory pressure given its mixed ComCom report last year.

Figure 7. Increasing debt burden at AIA



Source: AIA, Forsyth Barr analysis

Figure 8. Retail income per international pax growth



Source: AIA, Forsyth Barr analysis

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

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

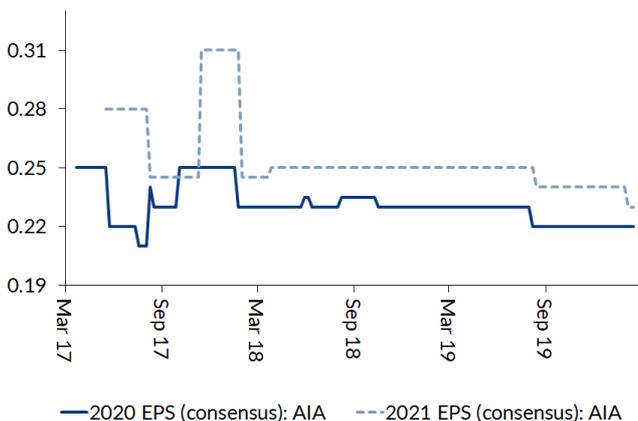
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 11. International valuation comparisons

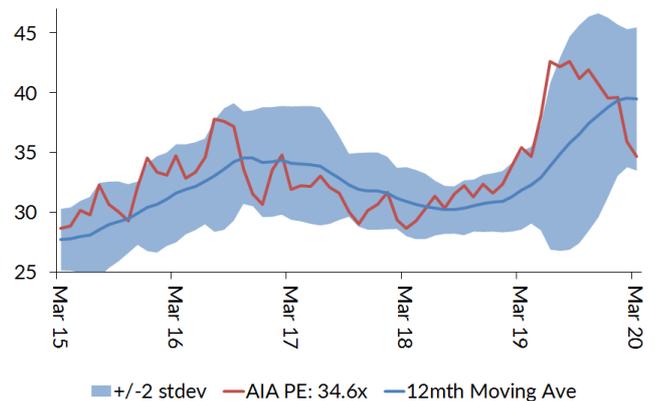
| Company | Code | Price | Mkt Cap (m) | PE | | EV/EBITDA | | EV/EBIT | | Cash Yld 2021E |
|------------------------------|---------------|-----------------|------------------|--------------|--------------|--------------|--------------|--------------|--------------|----------------|
| | | | | 2020E | 2021E | 2020E | 2021E | 2020E | 2021E | |
| Auckland Airport | AIA NZ | NZ\$7.74 | NZ\$9,342 | 35.3x | 35.3x | 21.1x | 20.1x | 26.6x | 25.9x | 2.9% |
| SYDNEY AIRPORT | SYDAT | A\$7.73 | A\$17,468 | 43.7x | 40.8x | 20.1x | 19.3x | 29.8x | 28.1x | 5.2% |
| MALAYSIA AIRPORTS HLDGS BHD | MAHB MK | RM6.22 | RM10,320 | 20.0x | 16.8x | 6.4x | 6.1x | 10.9x | 10.1x | 3.3% |
| FLUGHAFEN WIEN AG | FLU AV | €31.50 | €2,646 | 16.2x | 15.5x | 7.9x | 7.2x | 12.3x | 11.0x | 3.8% |
| FLUGHAFEN ZURICH AG-REG | FHZN SW | CHF146.80 | CHF4,507 | 14.9x | 16.5x | 8.1x | 8.3x | 13.0x | 14.0x | 3.7% |
| FRAPORT AG FRANKFURT AIRPORT | FRA GY | €55.76 | €5,156 | 11.4x | 10.9x | 7.9x | 7.7x | 13.0x | 12.6x | 3.9% |
| AIRPORTS OF THAILAND PCL | AOT TB | THB62.50 | THB892,856 | 38.5x | 31.4x | 24.1x | 19.9x | 29.3x | 24.0x | 1.8% |
| BEIJING CAPITAL INTL AIRPO-H | 694 HK | CN¥6.45 | CN¥29,536 | 15.2x | 19.6x | 7.7x | 9.0x | 12.2x | 16.0x | 2.3% |
| Compcpo Average: | | | | 22.8x | 21.6x | 11.8x | 11.1x | 17.2x | 16.5x | 3.4% |
| AIA Relative: | | | | 55% | 63% | 79% | 81% | 54% | 57% | -16% |

EV = Current Market Cap + Actual Net Debt

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

Figure 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Forsyth Barr analysis

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