

Auckland Airport

Significant Items in the Flight Path

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NEUTRAL

Auckland Airport (AIA) has provided details of FY20 one-offs in the form of "Significant Items", which provides some insight into the level of rent relief provided to retailers, but offers little visibility over forward earnings. The company is pursuing a further headcount reduction, albeit this is encapsulated in the existing -35% opex reduction target. We retain a NEUTRAL rating on AIA but recognise that with the timing of international borders reopening being pushed out, given (1) the safety first approach of the New Zealand Government to the border, (2) the second wave of cases in Australia (Victoria), and (3) no more certainty that there will be a medical solution to COVID-19, sentiment towards a travel recovery may wane. We continue to expect a long dated travel recovery with AIA back at FY19 international passenger levels in FY25.

NZX Code	AIA	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$6.42	NPAT* (NZ\$m)	274.7	163.0	-7.1	166.5	EV/EBITDA	17.5	23.8	65.2	23.7
Target price	NZ\$5.50	EPS* (NZc)	22.8	12.9	-0.5	11.3	EV/EBIT	21.4	32.9	n/a	33.6
Risk rating	Low	EPS growth* (%)	3.6	-43.4	n/a	n/a	PE	28.2	49.8	n/a	56.7
Issued shares	1207.0m	DPS (NZc)	22.3	0.0	0.0	4.5	Price / NTA	1.3	1.1	1.3	1.3
Market cap	NZ\$7,749m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.5	0.0	0.0	0.7
Avg daily turnover	2,004k (NZ\$14,214k)	*Based on normalised profits					Gross div yld (%)	4.8	0.0	0.0	1.0

Significant items

The net adverse impact on AIA's FY20 reported profit will be NZ\$50m–NZ\$90m on a pre-tax basis. At the mid-point this is split as a ~NZ\$75m non-cash gain, and an NZ\$145m cash loss. The gains principally relate to investment property revaluations, while losses reflect a myriad of items including rent abatement, capex work in process write-offs and project termination costs (these are largely related to regulatory assets but won't be written-off from the RAB [Regulatory Asset Base] for aeronautical pricing purposes), and bad/doubtful debts with airlines. On an after tax basis we calculate that these items amount to a loss of NZ\$7m–NZ\$45m.

Rent relief in-line

AIA is providing for retail rent abatements of ~NZ\$65m, which reflects ~29% of FY19 retail income. This is broadly consistent with our retail income forecast, which shows a drop of -NZ\$74m in FY20 but also incorporates loss of income from off-airport retail activities. The company intends to treat retail rent abatements (or rent relief) as "Significant Items", which means it will include gross retail income based on concession Minimum Annual Guarantees (MAGs) within its "Underlying" result, rather than net retail income. We assume that rent relief will continue into FY21 given border closures, and therefore we continue to consider retailer (and other) rent relief as normal business costs, rather than "Significant Items".

Further restructuring

AIA is proposing to further reduce staffing levels and has begun consultation with employees, in its infrastructure and operations teams. However, we believe additional cost savings that result are already incorporated into the NZ\$120m–NZ\$130m opex target (reflecting a -35% reduction) following completion of its cost base initiatives. The company has already reduced its workforce by -25% in recent months.

Auckland International Airport Ltd (AIA)

Priced as at 01 Jul 2020 (NZ\$) **6.42**

12-month target price (NZ\$)*	5.50
Expected share price return	-14.3%
Net dividend yield	0.1%
Estimated 12-month return	-14.3%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.80
WACC	6.2%
Terminal growth	2.0%

Spot valuations (NZ\$)	
1. DCF	4.94
2. Sum-of-the-parts	5.14
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	9,557
(Net debt)/cash	(2,287)
Less: Capitalised operating leases	0
Value of equity	7,270

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	683.9	743.4	563.2	282.3	551.2
Normalised EBITDA	506.4	554.8	391.3	135.6	373.7
Depreciation and amortisation	(88.9)	(102.2)	(108.5)	(107.7)	(110.4)
Normalised EBIT	417.5	452.6	282.8	27.9	263.2
Net interest	(77.2)	(78.5)	(66.7)	(37.8)	(36.9)
Associate income	8.5	8.2	6.0	0	5.0
Tax	(217.7)	(109.2)	(8.4)	2.8	(64.8)
Minority interests	0	0	0	0	0
Normalised NPAT	263.1	274.7	163.0	(7.1)	166.5
Abnormals/other	(387.0)	(248.8)	(32.5)	0	0
Reported NPAT	650.1	523.5	195.5	(7.1)	166.5
Normalised EPS (cps)	22.0	22.8	12.9	(0.5)	11.3
DPS (cps)	21.8	22.3	0	0	4.5

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	18.9	17.5	23.8	65.2	23.7
EV/EBIT (x)	23.0	21.4	32.9	>100x	33.6
PE (x)	29.2	28.2	49.8	n/a	56.7
Price/NTA (x)	1.4	1.3	1.1	1.3	1.3
Free cash flow yield (%)	-0.9	0.7	-1.9	-0.8	-0.9
Net dividend yield (%)	3.4	3.5	0.0	0.0	0.7
Gross dividend yield (%)	4.7	4.8	0.0	0.0	1.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	5.4	5.8	4.2	0.7	7.1
Interest cover EBITDA (x)	6.6	7.1	5.9	3.6	10.1
Net debt/ND+E (%)	25.6	26.3	14.4	15.0	15.9
Net debt/EBITDA (x)	3.9	3.9	3.1	9.4	3.7

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	8.7	8.7	-24.2	-49.9	95.3
EBITDA (%)	7.0	9.6	-29.5	-65.4	>100
EBIT (%)	5.6	8.4	-37.5	-90.1	>100
Normalised NPAT (%)	6.2	4.4	-40.7	n/a	n/a
Normalised EPS (%)	5.6	3.6	-43.4	n/a	n/a
Ordinary DPS (%)	6.1	2.3	-100.0	n/a	n/a

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	5.1	5.2	3.2	0.3	2.8
Return on equity (%)	4.6	4.6	2.3	-0.1	2.3
Return on funds employed (%)	12.3	11.0	7.0	0.4	5.2
EBITDA margin (%)	74.0	74.6	69.5	48.0	67.8
EBIT margin (%)	61.0	60.9	50.2	9.9	47.7
Capex to sales (%)	56.6	43.1	62.1	56.7	61.7
Capex to depreciation (%)	436	313	323	149	308
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	99	98	0	0	40

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	506.4	554.8	391.3	135.6	373.7
Working capital change	(12.3)	(48.6)	(6.0)	0	(5.0)
Interest & tax paid	(294.9)	(187.7)	(75.1)	(35.0)	(101.7)
Other	122.0	57.4	(105.2)	0	5.0
Operating cash flow	321.2	375.9	205.0	100.6	272.0
Capital expenditure	(387.4)	(320.1)	(350.0)	(160.0)	(340.0)
(Acquisitions)/divestments	347.3	(0.8)	0	0	0
Other	(8.8)	(7.0)	(8.9)	(8.3)	(7.4)
Funding available/(required)	272.3	48.0	(153.9)	(67.7)	(75.4)
Dividends paid	(182.8)	(192.4)	(98.0)	0	(28.3)
Equity raised/(returned)	0	0	1,200.0	0	0
(Increase)/decrease in net debt	89.5	(144.4)	948.1	(67.7)	(103.7)

Operating Performance	2018A	2019A	2020E	2021E	2022E
Aeronautical	328.5	342.2	256.4	116.6	256.2
Consumer	263.0	301.3	212.2	72.9	201.3
Property	86.1	94.7	89.4	87.4	88.2
Other	6.3	5.2	5.3	5.4	5.5
Total sales revenue	683.9	743.4	563.2	282.3	551.2
Aeronautical	239.9	252.1	174.4	46.6	174.2
Consumer	232.6	269.0	184.2	46.9	173.3
Property	65.5	72.2	69.7	68.2	67.9
Total EBITDAFI	506.4	554.8	391.3	135.6	373.7

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	(76.3)	(33.4)	(89.6)	(44.9)	(87.6)
Fixed assets	6,378.0	6,577.1	6,658.6	6,620.9	6,760.5
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	1,640.4	2,013.7	2,179.7	2,269.7	2,364.7
Total funds employed	7,942.1	8,557.4	8,748.8	8,845.7	9,037.5
Net debt/(cash)	1,953.6	2,153.1	1,205.0	1,272.7	1,376.4
Lease liability	0	0	0	0	0
Other liabilities	306.4	371.4	371.4	371.4	371.4
Shareholder's funds	5,682.1	6,032.9	7,172.4	7,201.6	7,289.7
Minority interests	0	0	0	0	0
Total funding sources	7,942.1	8,557.4	8,748.8	8,845.7	9,037.5

International pax growth (%)	4.7	3.0	-27.0	-72.6	250.0
Transits (%)	-1.2	-1.2	-25.0	-93.7	1,380.6
Total int'l pax growth (%)	4.7	3.0	-27.0	-72.6	250.0
Domestic pax growth (%)	7.7	3.6	-26.0	-32.4	50.0
Aero income per pax change	-2.4	1.3	2.4	3.1	3.6
Retail sales per int'l pax change	12.1	15.5	-8.0	0.0	0.0
Car park income per pax change	1.6	1.8	0.0	0.0	3.0
Yield on property BV (%)	7.4	6.8	5.6	5.0	4.7
Int'l aircraft numbers ('000)	55.7	57.1	41.4	10.4	38.8
Domestic aircraft numbers ('000)	118.6	121.7	91.0	64.0	94.7

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

Significant items

We outline the significant items guidance for FY20 that AIA has provided in Figure 1. While the net impact on pre-tax profits will be a loss in the range of NZ\$53m–NZ\$93m, we calculate that tax benefits will limit this to a post-tax loss of NZ\$7m–NZ\$45m.

Figure 1. FY20 Significant Items guidance provided by AIA (NZ\$m)

	Cash	Taxable	Gains	Losses	Pre-tax net	Post-tax net
Property						
Investment property revaluations			130–150			
Capex						
WIP write-offs and impairments				(42)–(52)		
Capex project terminations	✓	✓		(68)–(70)		
Employee costs						
Redundancies	✓	✓		(4)–(5)		
Wage subsidy	✓	✓	4.3			
Debtor impairments						
Bad/doubtful debts	✓	✓		(10)–(11)		
Rent abatements – retail	✓	✓		(62.6)–(67.6)		
Impaired lease receivables – retail		✓		(16.4)		
Rent abatements – property & aero	✓	✓		(3.5)–(4.5)		
Total			134–154	(207)–(227)	(53)–(93)	(7)–(45)

Source: AIA, Forsyth Barr analysis

Earnings revisions

We make small adjustments to our earnings forecasts as shown in Figure 2, to reflect (1) the significant items outlined above, albeit we treat rent abatements within underlying earnings in our modelling, and (2) higher interest costs in FY20 to reflect the timing of debt repayments and the use of proceeds from the NZ\$1.2bn capital raise in April 2020.

Our NPAT forecasts continue to assume that rent abatements are treated within underlying earnings. Therefore, they may not be comparable with underlying earnings when reported by AIA. Consequently, we determine that ~NZ\$50m should be added to our FY20 NPAT forecast of NZ\$163m to adjust for a like-for-like comparison when AIA reports FY20 results on 20 August 2020.

We continue to assume that AIA generates an NPAT loss in FY21 despite international travel resuming on a commercial basis (pax assumed at 20% of CY19 levels through FY21).

Figure 2. Summary of earnings changes (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
International pax growth	-27.0%	-27.0%	0 bps	-72.6%	-72.6%	0 bps	250.0%	250.0%	0 bps
Retail per int'l pax	18.86	18.86	0.0%	16.00	16.00	0.0%	18.00	18.00	0.0%
Sales revenue	563.2	563.2	0.0%	282.3	282.3	0.0%	551.2	551.2	0.0%
EBITDAFI	391.3	391.3	0.0%	135.6	135.6	0.0%	373.7	373.7	0.0%
Underlying NPAT	166.8	163.0	-2.3%	(5.3)	(7.1)	-34.6%	168.2	166.5	-1.0%
Underlying EPS (cents)	13.2	12.9	-2.3%	(0.4)	(0.5)	-34.6%	11.4	11.3	-1.0%
DPS (cents)	0.0	0.0	n/a	0.0	0.0	n/a	4.6	4.5	-1.0%

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, albeit this is now on hold in light of COVID-19 disruption. Ordinarily it generates attractive return on capital in its non-regulated commercial assets and valuation benefits from low prevailing Government bond rates. However, COVID-19 has had a material impact on its operations and we expect recovery will take years given border closures, consumer apathy to travel and the impact on the travel retail sector. **NEUTRAL** with downside bias,

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

- **COVID-19 implications:** AIA will be hard hit by COVID-19. We expect air travel to be to recover in FY21, albeit only slowly over a number of years.
- **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.

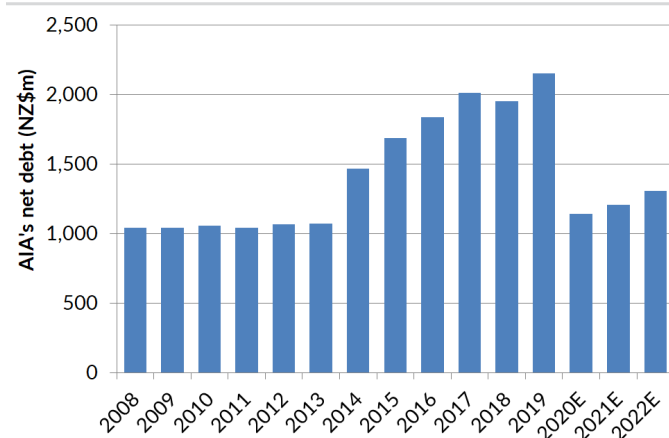
Financial structure

- **Balance sheet:** AIA is in the midst of a major capex bulge given the need to build capacity, albeit this is now on hold in light of COVID-19.
- **Dividends:** It has a 100% dividend pay-out rate and has a dividend reinvestment plan in place, albeit won't be paying any dividends until FY23 given its agreement with lenders.

Risk factors

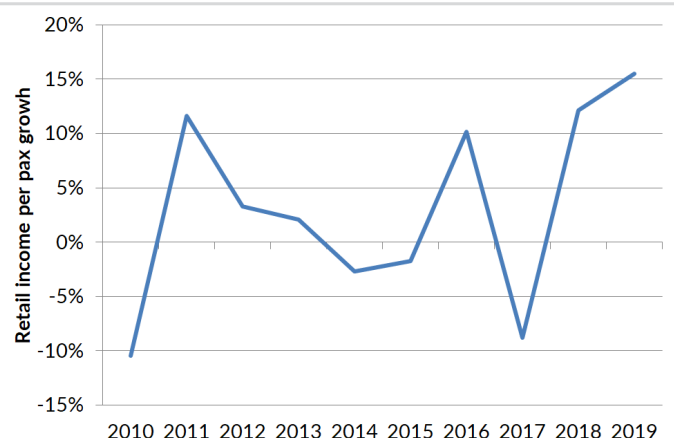
- **Rising bond yields:** AIA trades as a bond proxy. Its valuation holds a very strong inverse relationship with bond yields.
- **Regulatory risk:** We expect AIA to lower current aeronautical prices to ease any regulatory pressure given its mixed ComCom report last year.

Figure 3. Debt burden at AIA helped by capital raise

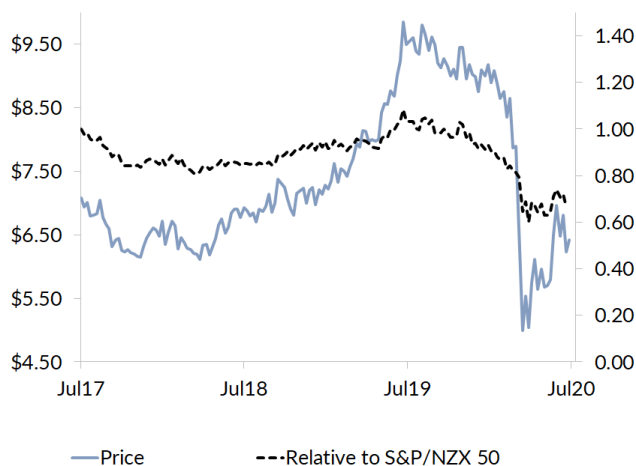


Source: AIA, Forsyth Barr analysis

Figure 4. Retail income per international pax growth



Source: AIA, Forsyth Barr analysis

Figure 5. Price performance


Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

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

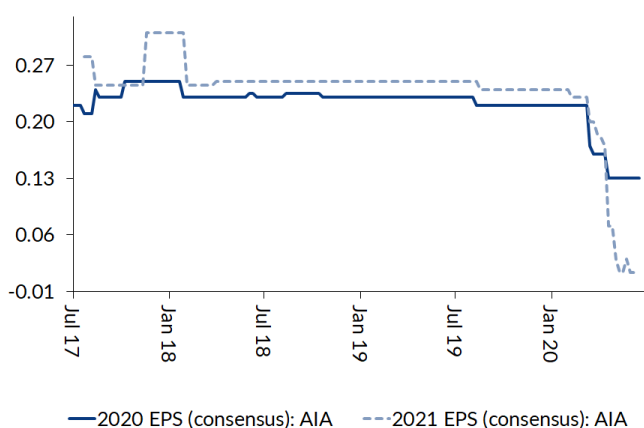
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 7. International valuation comparisons

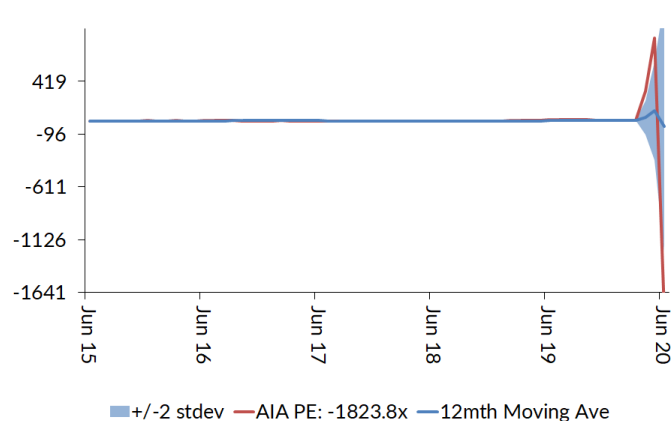
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect AIA's balance date - June)										
Auckland Airport	AIA NZ	NZ\$6.42	NZ\$7,749	49.8x	<0x	25.3x	73.0x	35.0x	>75x	0.0%
SYDNEY AIRPORT	SYD AT	A\$5.67	A\$12,813	<0x	<0x	26.6x	29.4x	68.7x	>75x	2.5%
MALAYSIA AIRPORTS HLDGS BHD	MAHB MK	RM5.45	RM9,043	<0x	<0x	9.0x	9.7x	30.1x	32.4x	1.4%
FLUGHAFEN WIEN AG	FLU AV	€25.30	€2,125	<0x	<0x	13.1x	14.1x	<0x	<0x	2.5%
FLUGHAFEN ZURICH AG-REG	FHZN SW	CHF123.10	CHF3,779	<0x	<0x	12.7x	13.7x	>75x	>75x	3.2%
FRAPORT AG FRANKFURT AIRPORT	FRA GY	€38.82	€3,590	<0x	2.2x	15.3x	16.5x	<0x	<0x	1.7%
AIRPORTS OF THAILAND PCL	AOT TB	THB60.50	THB864,285	>50x	>50x	51.4x	45.7x	>75x	>75x	0.8%
BEIJING CAPITAL INTL AIRPO-H	694 HK	CN¥4.85	CN¥22,209	27.5x	33.2x	7.9x	9.5x	16.5x	21.2x	2.2%
Compco Average:				27.5x	17.7x	19.4x	19.8x	38.4x	26.8x	2.1%
AIA Relative:				81%	n/a	30%	269%	-9%	n/a	-100%

EV = Current Market Cap + Actual Net Debt

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

Figure 8. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)


Source: Forsyth Barr analysis

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