FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | TRANSPORT | AIRPORT OWNER & OPERATOR
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Auckland Airport
1H21 — Earnings Grounded

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NEUTRAL

Auckland Airport (AIA) reported its first underlying loss as a listed company due to the temporary COVID-19 driven decimation of international passenger travel. Its 1H21 result is largely irrelevant as a barometer of its longer term profit generation ability. The international passenger driven aviation business will recover, but there is a high degree of uncertainty as to the recovery timing and trajectory. Recent events suggest the prospect of imminent quarantine free travel is less likely with Australia and that border restrictions may only ease once vaccinations in New Zealand have reached a certain (herd immunity) threshold. There still remains a high level of uncertainty as to the near, medium and longer term outlook for AIA. It remains a high quality long term asset but with valuation headwinds from rising bond rates, we remain NEUTRAL.

NZX Code	AIA
Share price	NZ$6.90
Target price	NZ$6.70
Risk rating	Low
Issued shares	1472.0m
Market cap	NZ$10,157m
Avg daily turnover	2,383k (NZ$15,604k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	203.5	-35.5	75.2	223.1
EPS* (NZc)	15.9	-2.4	5.1	15.2
EPS growth* (%)	-30.2	n/a	n/a	n/a
DPS (NZc)	0.0	0.0	2.6	15.2
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	43.4	n/a	n/a	45.5
EV/EBIT	42.9	n/a	69.5	32.8
EV/EBITDA	30.4	71.9	39.6	24.1
Price / NTA	1.3	1.5	1.5	1.5
Cash div yld (%)	0.0	0.0	0.4	2.2
Gross div yld (%)	0.0	0.0	0.5	3.1

What's changed?

- **Earnings:** Longer pax recovery profile dampens forecasts in each outlook year
- **Target price:** Lowered to NZ$6.70 due to (1) slower pax recovery, and (2) a higher WACC from higher bond rates

Pax recovery may take longer

Recent events (in particular new but well contained outbreaks in Victoria and Auckland) suggest the likelihood of a trans-Tasman bubble (quarantine free travel) is increasingly unlikely ahead of mass inoculations, in our opinion. Vaccinations begin in both countries over the coming days, but the progress rates are likely to be two speed (New Zealand lagging behind Australia). Should Australia relax its border restrictions more widely, exiting a bubble could be far more difficult than entering one for New Zealand. Management remains hopeful that a bubble will emerge, yet has excluded the possibility in its FY21 earnings guidance. Our updated forecasts assume border relaxation now begins mid-FY22 rather than in 2H21.

Capex triggers

AIA's capex outlook has fallen dramatically. Management will update the market on the likely timing of its eight key anchor projects at the FY21 result. It has also confirmed a new trigger based capex approach, with specific triggers for each project, which include pax, construction sequencing and road traffic. This lower capex outlook adds to current balance sheet headroom. Notwithstanding the risk of a covenant breach at June 2022, the balance sheet has spare capacity and a capital return is likely once the pax recovery is in flight.

Aero price reset may be deferred

Management has suggested that due to heightened capex uncertainty the aeronautical price reset for PSE4 (price setting event 4) effective 1 July 2022, may be delayed. AIA would likely maintain FY22 pricing in FY23 and thereafter until such time a new price path had been established. This may mean lower pricing for a longer period of time than would ordinarily be the case, but the overall impact on AIA's regulatory accounts would be on a NPV=0 basis through PSE4 (FY23–FY27).

FORSYTH BARR

Auckland International Airport Ltd (AIA)

Priced as at 18 Feb 2021 (NZ$)	6.90

12-month target price (NZ$)*	6.70
Expected share price return	-2.9%
Net dividend yield	0.2%
Estimated 12-month return	-2.7%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	0.86
WACC	5.5%
Terminal growth	1.5%

Profit and Loss Account (NZ$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	743.4	567.0	270.8	432.0	644.1
Normalised EBITDA	**554.8**	**388.0**	**159.3**	**290.4**	**477.8**
Depreciation and amortisation	(102.2)	(112.7)	(121.8)	(124.8)	(127.6)
Normalised EBIT	**452.6**	**275.3**	**37.5**	**165.6**	**350.2**
Net interest	(78.5)	(71.8)	(73.3)	(68.7)	(48.9)
Associate income	8.2	8.4	6.0	7.5	8.5
Tax	(109.2)	2.2	(3.9)	(29.2)	(86.8)
Minority interests	0	0	0	0	0
Normalised NPAT	**274.7**	**203.5**	**(35.5)**	**75.2**	**223.1**
Abnormals/other	(248.8)	9.6	(38.6)	0	0
Reported NPAT	**523.5**	**193.9**	**3.1**	**75.2**	**223.1**
Normalised EPS (cps)	22.8	15.9	(2.4)	5.1	15.2
DPS (cps)	22.3	0	0	2.6	15.2

Growth Rates	2019A	2020A	2021A	2022A	2023A
Revenue (%)	8.7	-23.7	-52.2	59.5	49.1
EBITDA (%)	9.6	-30.1	-58.9	82.2	64.6
EBIT (%)	8.4	-39.2	-86.4	>100	>100
Normalised NPAT (%)	4.4	-25.9	n/a	n/a	>100
Normalised EPS (%)	3.6	-30.2	n/a	n/a	>100
Ordinary DPS (%)	2.3	-100.0	n/a	n/a	>100

Cash Flow (NZ$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	**554.8**	**388.0**	**159.3**	**290.4**	**477.8**
Working capital change	(48.6)	18.0	(6.0)	(7.5)	(8.5)
Interest & tax paid	(187.7)	(69.6)	(77.1)	(97.9)	(135.6)
Other	57.4	(160.6)	42.7	7.5	8.5
Operating cash flow	**375.9**	**175.8**	**118.9**	**192.5**	**342.2**
Capital expenditure	(320.1)	(376.6)	(200.0)	(350.0)	(400.0)
(Acquisitions)/divestments	(0.8)	(23.1)	0	0	0
Other	(7.0)	(11.8)	(6.8)	(10.7)	(13.7)
Funding available/(required)	**48.0**	**(235.7)**	**(87.9)**	**(168.3)**	**(71.5)**
Dividends paid	(192.4)	(89.4)	6.0	(11.3)	9.5
Equity raised/(returned)	0	1,178.1	0	0	0
(Increase)/decrease in net debt	**(144.4)**	**853.0**	**(81.9)**	**(179.5)**	**(62.0)**

Balance Sheet (NZ$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(33.4)	(38.5)	(43.1)	(68.7)	(102.4)
Fixed assets	6,577.1	6,060.8	6,039.0	6,164.2	6,336.6
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	2,013.7	2,403.3	2,539.3	2,676.8	2,815.3
Total funds employed	**8,557.4**	**8,425.6**	**8,535.2**	**8,772.3**	**9,049.5**
Net debt/(cash)	2,153.1	1,379.9	1,461.8	1,641.3	1,703.4
Lease liability	0	0	0	0	0
Other liabilities	371.4	408.6	408.6	408.6	408.6
Shareholder's funds	6,032.9	6,637.1	6,664.8	6,722.3	6,937.5
Minority interests	0	0	0	0	0
Total funding sources	**8,557.4**	**8,425.6**	**8,535.2**	**8,772.3**	**9,049.5**

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

Spot valuations (NZ$)	
1. DCF	6.25
2. n/a	n/a
3. n/a	n/a

DCF valuation summary (NZ$m)	
Total firm value	10,635
(Net debt)/cash	(1,428)
Less: Capitalised operating leases	0
Value of equity	9,207

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	21.8	30.4	71.9	39.6	24.1
EV/EBIT (x)	26.7	42.9	>100x	69.5	32.8
PE (x)	30.3	43.4	n/a	>100x	45.5
Price/NTA (x)	1.4	1.3	1.5	1.5	1.5
Free cash flow yield (%)	0.5	-2.0	-0.8	-1.6	-0.6
Net dividend yield (%)	3.2	0.0	0.0	0.4	2.2
Gross dividend yield (%)	4.5	0.0	0.0	0.5	3.1

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	5.8	3.8	0.5	2.4	7.2
Interest cover EBITDA (x)	7.1	5.4	2.2	4.2	9.8
Net debt/ND+E (%)	26.3	17.2	18.0	19.6	19.7
Net debt/EBITDA (x)	3.9	3.6	9.2	5.7	3.6

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	5.2	3.0	0.4	1.8	3.8
Return on equity (%)	4.6	3.1	-0.5	1.1	3.2
Return on funds employed (%)	11.0	7.4	0.5	3.0	6.0
EBITDA margin (%)	74.6	68.4	58.8	67.2	74.2
EBIT margin (%)	60.9	48.6	13.9	38.3	54.4
Capex to sales (%)	43.1	66.4	73.8	81.0	62.1
Capex to depreciation (%)	313	334	164	280	314
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	98	0	0	50	100

Operating Performance	2019A	2020A	2021E	2022E	2023E
Aeronautical	342.2	262.3	106.7	188.1	287.1
Consumer	301.3	201.9	47.5	119.6	224.9
Property	94.7	97.0	107.4	115.0	122.6
Other	5.2	5.8	9.2	9.3	9.5
Sales revenue	**743.4**	**567.0**	**270.8**	**432.0**	**644.1**
Aeronautical	252.1	167.2	56.7	116.1	207.1
Consumer	269.0	173.1	36.5	92.6	197.9
Property	72.2	75.0	89.2	93.2	98.1
Other	(38.5)	(27.3)	(23.0)	(11.5)	(25.3)
EBITDAFI	**554.8**	**388.0**	**159.3**	**290.4**	**477.8**
International pax growth (%)	3.0	-26.3	-95.9	900.0	150.0
Transits (%)	-1.2	-1.2	-90.9	n/a	114.3
Domestic pax growth (%)	3.6	-26.5	-22.4	40.4	12.5
Aero income per pax change	1.3	4.8	12.0	3.8	5.3
Retail sales per int'l pax change	15.5	-14.9	146.3	-53.5	-7.5
Car park income per pax change	1.7	6.6	-17.0	15.0	8.0
Yield on property BV (%)	6.8	5.7	5.5	5.5	5.5
Int'l aircraft numbers ('000)	57.1	45.0	14.2	29.2	45.5
Domestic aircraft numbers ('000)	121.7	94.2	78.1	103.7	110.7

Key investor themes; uncertainty persists; NEUTRAL

There are four broad themes dominating investor thinking on Auckland Airport (AIA) currently. (1) The recovery profile and prospects for a trans-Tasman bubble and broader quarantine free travel thereafter. (2) Opposing balance sheet forces of near term covenant risk yet a medium term capital return opportunity. (3) Re-pricing and re-licensing of aeronautical charges and commercial concessions, respectively, over the next 2–3 years. (4) The capex profile, which management will likely update at the FY21 result. All of these drivers are linked to varying degrees with the pax recovery being the ultimate driver, which is currently highly uncertain.

We believe management is increasingly concerned that a trans-Tasman bubble may be further delayed, or not happen at all, given its apparent increased desire to preserve the balance sheet. The next covenant test is for the 12 months to 30 June 2022. In the absence of a trans-Tasman bubble by mid-FY22, AIA is likely to breach. In that event it would ideally have as strong as a balance sheet as possible to avoid the need to raise further capital. We believe the prospect of a further capital raise is unlikely, even in the event of a breach.

We lower our target price to NZ$6.70 from NZ$6.90 to reflect:

- A higher WACC assumption (5.5% from 5.1%) due to a higher risk free rate assumption (2.3% from 1.3%), partly offset by a reduction in our tax-adjusted market risk premium (5.5% from 6.0%). This only impacts the value of AIA's commercial assets within our valuation approach.
- An elongated recovery profile with international pax recovering back to FY19 levels in FY26 (previously FY25).

Result summary

Auckland Airport (AIA) reported a 1H21 result that means little in the context of the company's longer term earnings profile. COVID-19 has decimated its profitability for the time being, but this should recover when borders reopen. It reported its first underlying NPAT loss (-NZ$10.5m) since listing in 1998, on a revenue decline of -65%. While the aviation business experienced very challenging conditions, the property development business continues to grow with rental income up +3%, and more importantly the forward rent roll of NZ$116m pa, up +11% from August 2020. Another highlight is the -34% year on year reduction in opex (principally staffing, outsourced activities and marketing). There will be no interim dividend as previously agreed with its lenders.

Figure 1. Summary of 1H21 result (NZ$m)

	1H20	1H21	Change	Forbar
Sales revenue	374.7	131.5	-64.9%	134.0
EBITDAFI	279.2	88.2	-68.4%	70.6
Depreciation	(55.4)	(59.3)	7.0%	(58.9)
Underlying NPAT	**139.9**	**(10.5)**	**-107.5%**	**(13.2)**
Underlying EPS (cents)	11.5	(0.7)	-106.2%	(0.9)
Interim DPS (cents)	0.0	0.0	n/a	0.0

Source: AIA, Forsyth Barr analysis

Figure 2. Segmental split of 1H21 result (NZ$m)

	1H20	1H21	Change	Forbar
Aeronautical	167.3	52.5	-68.6%	54.4
Retail	113.6	7.0	-93.8%	3.6
Property	50.2	51.7	3.0%	53.2
Car Park	34.3	12.5	-63.6%	17.7
Other	9.3	7.8	-16.1%	5.2
Revenue	**374.7**	**131.5**	**-64.9%**	**134.0**

Source: AIA, Forsyth Barr analysis

Earnings revisions

We lower our earnings forecasts in all years to principally reflect a slower pax recovery path. Our revised FY21 NPAT loss estimate of -NZ$35.5m is at the lower/better end of the first time guidance band (-NZ$35m to -NZ$55m) provided by management. Our FY22 estimates assume AIA comfortably exceeds its next covenant test (EBIT interest cover >1.5x) at June 2022, albeit this is reliant on quarantine free travel resuming around mid-FY22.

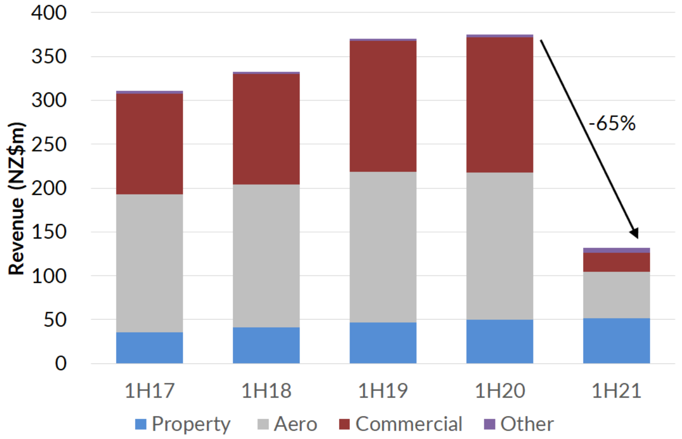
Figure 3. Earnings revisions summary (NZ$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
International pax growth	-72.8%	-95.9%	-2308 bps	250.0%	900.0%	65000 bps	14.3%	150.0%	13571 bps
Retail per int'l pax	14.00	43.00	207.1%	17.50	20.00	14.3%	18.50	18.50	0.0%
Sales revenue	303.0	270.8	-10.6%	588.2	432.0	-26.6%	680.4	644.1	-5.3%
EBITDAFI	166.5	159.3	-4.3%	429.0	290.4	-32.3%	499.5	477.8	-4.3%
Underlying NPAT	**(0.0)**	**(35.5)**	**n/a**	**188.3**	**75.2**	**-60.1%**	**238.5**	**223.1**	**-6.5%**
Underlying EPS (cents)	(0.0)	(2.4)	n/a	12.8	5.1	-60.1%	16.2	15.2	-6.5%
DPS (cents)	0.0	0.0	n/a	5.1	2.6	-50.1%	13.0	15.2	16.9%

Source: Forsyth Barr analysis

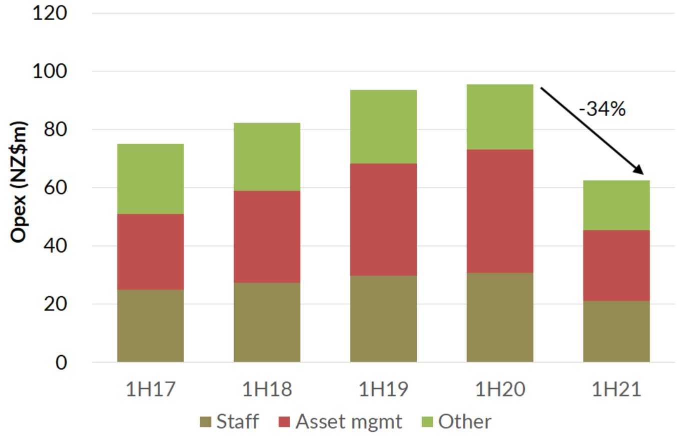
Key charts following AIA's 1H21 result

Figure 4. Revenue: Aviation business has been crunched at least temporarily; property far more defensive



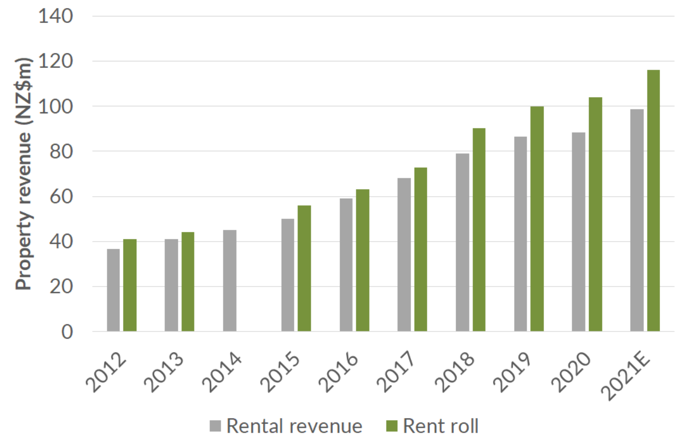
Source: AIA, Forsyth Barr analysis

Figure 5. Opex: Cost base has been addressed but will likely rise in 2H21 in light of management's guidance and commentary



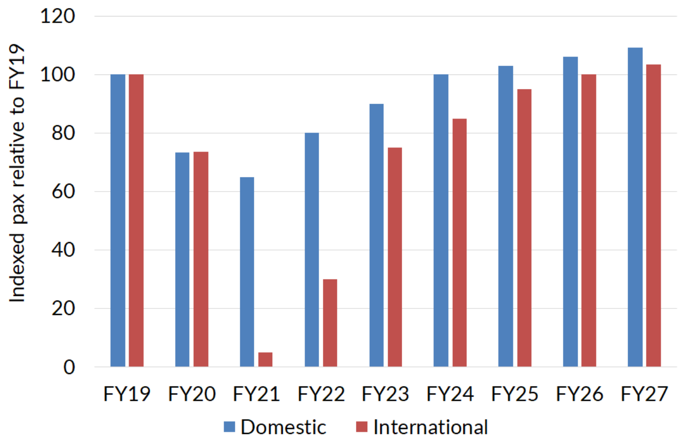
Source: AIA, Forsyth Barr analysis

Figure 6. Investment property: Reported rentals follow rent roll with 1–3 year lag. Rent roll up +11% in past six months



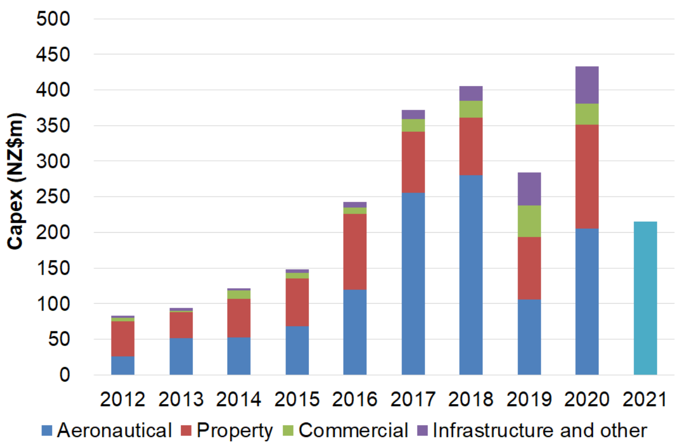
Source: AIA, Forsyth Barr analysis Note: 2014 rent roll not provided

Figure 7. International pax: Our revised recovery forecasts imply no quarantine-free international travel until 2H22



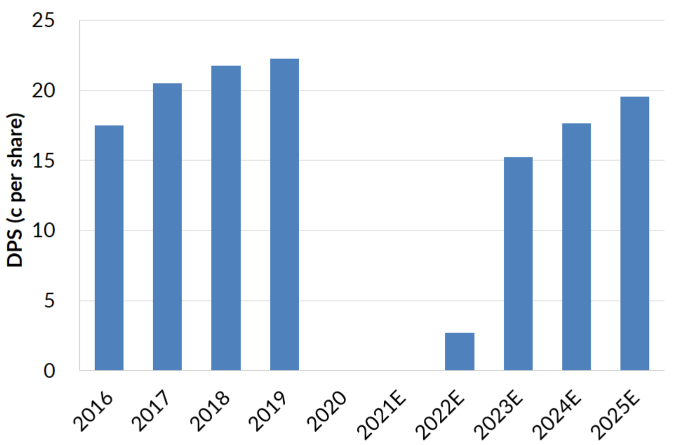
Source: AIA, Forsyth Barr analysis

Figure 8. Capex: Updated guidance of NZ$200m–NZ$230m for FY21; lowest spend since FY15



Source: AIA, Forsyth Barr analysis

Figure 9. DPS: Dividend holiday could extend beyond FY22 final should borders remain closed into CY22



Source: AIA, Forsyth Barr analysis

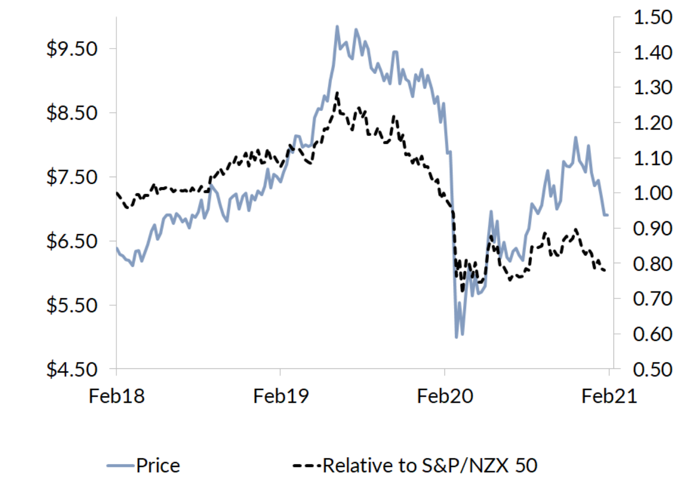
Result analysis

Figure 10. AIA 1H21 result summary (NZ$m)

	1H20	1H21	Change	Comments
Profit and loss account				
Sales revenue	374.7	131.5	-65%	A function of border closures
Airfield income	60.8	30.8	-49%	Aircraft movements down -49.5% in period
Passenger Service Charge	91.1	9.5	-90%	International pax down -97.1%, transits -94.0% and domestic -44.6%
Retail income	113.6	7.0	-94%	International PSR down -40.0%, domestic PSR +8.5% above pre COVID-19 levels
Property income	50.2	51.7	3%	Rent roll up to NZ$116m; 98.2% occupancy rate,10.1 years WALT; relief of NZ$2.8m provided
Car Park income	34.3	12.5	-64%	Excess international caparking used to accommodate increased domestic demand
Interest income	0.7	3.1	343%	
Other income	24.0	16.9	-30%	Includes wage subsidy of NZ$2.2m
EBITDAFI	**279.2**	**88.2**	**-68%**	**Includes the NZ$14.9m reversal of fixed asset termination costs**
Depreciation	(55.4)	(59.3)	7%	
Associate income	5.0	3.2	-36%	Queenstown airport contribution down -78%, Novotel up +9% (Novotel is an MIQ facility)
One-time items	8.7	30.6	252%	Investment property fair value charge of NZ$29.8m, derivative fair value charge of NZ$0.8m
Interest expense	(34.7)	(35.0)	1%	Interest/depreciation guidance of +NZ$6m to +NZ$7m increase in 2H21
Taxation	(55.6)	0.4	-101%	A result of the underlying loss
Reported NPAT	147.2	28.1	-81%	Large cost cutting measures imposed, with opex down -34%
Abnormals (post tax)	(7.3)	(38.6)	429%	
Underlying NPAT	**139.9**	**(10.5)**	**-108%**	**First time FY21 guidance provided for a loss of between -NZ$35m and -NZ$55m**
Underlying EPS (cents)	11.5	(0.7)	-106%	First underlying loss since listing in 1998
Interim DPS (cents)	0.00	0.00	n/a	Dividends suspended whilst covenant waivers remain in place — there will be no FY21 dividend
Cashflow and net debt				
Operating cashflow	358.6	133.8	-63%	
Maintenance capex = depreciation	(55.4)	(59.3)	7%	FY21 capex guidance of NZ$200m–NZ$230m, revised down from NZ$250m–NZ$300m
Capitalised interest	(6.5)	(3.6)	-45%	
Associate dividends	8.9	0.0	-100%	
Free cash flow	**305.6**	**70.9**	**-77%**	
Acquisitions	(15.4)	(6.6)	n/a	
Disposals	0.0	0.5	n/a	
Net debt	**2,311**	**1,330**	**-42.4%**	**Gearing of 23.5%, no change in debt facilities since 30 June 2020**
Margin and efficiency analysis				
Underlying EBITDAFI margin	56.6%	67.1%	19%	
Op. income per passenger	35.37	46.58	32%	Distorted by the significant change in business mix to property and cargo
Retail income per international passenger	20.42	41.06	101%	Skewed due to domestic retail income continuing but international passengers down -97%
Car park income per passenger	3.41	4.48	31%	
Operating staff costs/operating revenue	8.2%	16.0%	96%	Staff costs down -NZ$8.1m and outsourced operations providing further savings of -NZ$8.9m
Operational statistics				
International passengers	5,837	187	-97%	Borders remain largely closed
Domestic passengers	4,758	2,636	-45%	Under Alert level 1, domestic pax has recovered to c.65% of pre COVID-19 levels
International MCTOW (kT)	2,915	826	-72%	Total freight cargo tonnage down just -11% in the period
Domestic MCTOW (kT)	1,169	761	-35%	
International aircraft (numbers)	28,616	6,762	-76%	Decline less than pax reflects cargo activity
Domestic aircraft (numbers)	59,974	37,975	-37%	Lack of international pax, lockdowns in Auckland and Jetstar's regional withdrawal

Source: AIA, Forsyth Barr analysis

Figure 11. Price performance



Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
Auckland City Council	18.1%
BlackRock Investment Management	5.0%

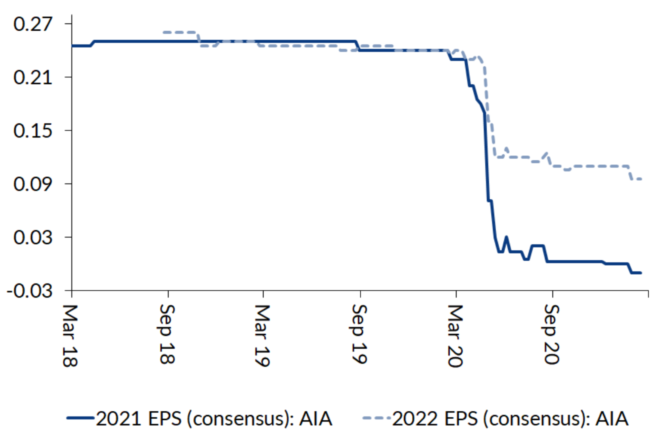
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 13. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect AIA's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Auckland Airport	**AIA NZ**	**NZ$6.90**	**NZ$10,157**	**<0x**	**>50x**	**72.4x**	**39.7x**	**>75x**	**69.7x**	**0.4%**
SYDNEY AIRPORT	SYD AT	A$5.69	A$15,356	<0x	<0x	51.9x	33.0x	<0x	>75x	2.7%
MALAYSIA AIRPORTS HLDGS BHD	MAHB MK	RM5.66	RM9,391	<0x	<0x	26.9x	9.3x	<0x	24.5x	9.7%
FLUGHAFEN WIEN AG	FLU AV	€29.00	€2,436	<0x	<0x	34.1x	14.6x	>75x	>75x	0.9%
FLUGHAFEN ZURICH AG-REG	FHZN SW	CHF151.00	CHF4,636	>50x	>50x	26.4x	13.7x	1.7x	42.0x	2.0%
FRAPORT AG FRANKFURT AIRPORT	FRA GY	€46.26	€4,278	<0x	<0x	<0x	15.1x	<0x	<0x	1.5%
AIRPORTS OF THAILAND PCL	AOT TB	THB63.25	THB903,571	<0x	22.5x	<0x	<0x	<0x	13.3x	0.6%
BEIJING CAPITAL INTL AIRPO-H	694 HK	CN¥5.56	CN¥25,460	8.4x	36.3x	33.5x	10.1x	4.0x	24.3x	2.0%
			Compco Average:	**8.4x**	**29.4x**	**34.6x**	**16.0x**	**2.9x**	**26.0x**	**2.8%**
EV = Current Market Cap + Actual Net Debt			**AIA Relative:**	**n/a**	**n/a**	**109%**	**149%**	**n/a**	**168%**	**-87%**

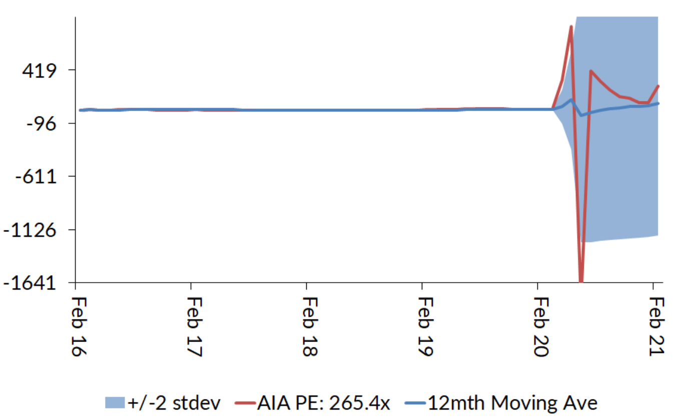
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (AIA) companies fiscal year end

Figure 14. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 15. One year forward PE (x)



Source: Forsyth Barr analysis

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