

Air New Zealand

Strategy Refinement: From Supercharge to Enrich

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UNDERPERFORM

At its Annual Shareholder Meeting, Air New Zealand (AIR) said it has drawn down NZ\$110m of the government's funding facility and suggests it will be "looking to go to the market in that early part of 2021" for an equity recapitalisation. New CEO Greg Foran's strategy refresh is more refined than radical. There is a less apparent growth emphasis and no mention of the previous Pacific Rim approach. He outlined the company's five new key strategic pillars covering (1) people/culture, (2) customer experience, (3) customer loyalty, (4) digital, and (5) sustainability. AIR's cash burn and equity dilution continues, yet its share price remains doggedly range bound in the NZ\$1.30–NZ\$1.40 range. With net asset value (NAV) per share heading lower from NZ\$1.17 at FY20, we retain an UNDERPERFORM rating.

NZX Code	AIR	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.38	NPAT* (NZ\$m)	-64.2	-216.6	15.8	80.9	PE	n/a	n/a	98.3	19.2
Target price	NZ\$1.00	EPS* (NZc)	-5.7	-19.3	1.4	7.2	EV/EBIT	n/a	n/a	50.6	19.3
Risk rating	High	EPS growth* (%)	n/a	n/a	n/a	n/a	EV/EBITDA	3.6	5.3	3.4	3.0
Issued shares	1123.0m	DPS (NZc)	0.0	0.0	0.0	10.0	Price / NTA	1.4	1.7	1.7	1.7
Market cap	NZ\$1,550m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	0.0	7.2
Avg daily turnover	2,455k (NZ\$3,714k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	10.1

Cash burn guidance unchanged

AIR currently has total liquidity of ~NZ\$1bn, comprising NZ\$215m of cash on hand and NZ\$790m remaining on the government loan facility. Average monthly cash burn guidance remains at NZ\$65m–NZ\$85m on a go forward basis. Cash burn for the past month has been ~NZ\$140m due to the timing of refunds, remaining redundancy payments, fuel hedge close out costs and the additional two-week period of lockdown in August (and subsequent social distancing requirements).

Strategy refresh

AIR has provided further insight into its five strategic priorities. (1) Prioritising people: Grow a culture of care from the inside out. (2) Experience excellence: Shape our network and experiences around our most loyal customers. (3) Do it digital: Embed digital at the heart of everything we do. (4) Lifting loyalty: Deepening loyalty to the airline to create a second growth engine. (5) Ambitious action: Lead and advocate for action on decarbonisation. Its purpose statement has changed from "Supercharge New Zealand's success socially, economically and environmentally" to "Enrich our country by connecting New Zealanders to each other and New Zealand to the world".

Tran-Tasman bubble potential

AIR suggested that a trans-Tasman bubble could emerge before Christmas: "we don't know when a trans-Tasman bubble will happen. We just need to be prepared. it now looks to be nearer Christmas or beyond. It's down to the political leaders". With new case numbers in all states and territories, other than Victoria, now consistently at very low levels, the prospect of bubbles emerging is increasingly likely once the New Zealand Government has confidence that (1) these states have eliminated COVID-19, and (2) that the states bordering Victoria have sufficient controls in place to ensure very low risk of inter-state transmission.

Air New Zealand Ltd (AIR)

Priced as at 29 Sep 2020 (NZ\$) **1.38**

12-month target price (NZ\$)*	1.00
Expected share price return	-27.5%
Net dividend yield	0.0%
Estimated 12-month return	-27.5%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.40
WACC	8.9%
Terminal growth	1.0%

Spot valuations (NZ\$)	
1. Net asset value	1.00
2. n/a	n/a
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	n/a
(Net debt)/cash	n/a
Less: Capitalised operating leases	n/a
Value of equity	n/a

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	5,785.1	4,836.2	2,333.3	3,635.3	4,656.3
Normalised EBITDA	935.1	784.2	501.6	807.9	922.6
Depreciation and amortisation	(567.0)	(841.0)	(754.4)	(753.1)	(778.9)
Normalised EBIT	368.1	(56.8)	(252.8)	54.8	143.6
Net interest	(31.0)	(69.0)	(102.1)	(71.9)	(70.3)
Associate income	37.0	39.0	39.0	39.0	39.0
Tax	(104.0)	22.5	99.4	(6.1)	(31.5)
Minority interests	0	0	0	0	0
Normalised NPAT	270.1	(64.2)	(216.6)	15.8	80.9
Abnormals/other	0	389.5	0	0	0
Reported NPAT	270.1	(453.8)	(216.6)	15.8	80.9
Normalised EPS (cps)	23.9	(5.7)	(19.3)	1.4	7.2
DPS (cps)	22.0	0	0	0	10.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.5	-16.4	-51.8	55.8	28.1
EBITDA (%)	-12.2	-16.1	-36.0	61.1	14.2
EBIT (%)	-31.8	n/a	n/a	n/a	>100
Normalised NPAT (%)	-30.8	n/a	n/a	n/a	>100
Normalised EPS (%)	-30.4	n/a	n/a	n/a	>100
Ordinary DPS (%)	0.0	-100.0	n/a	n/a	n/a

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	935.1	784.2	501.6	807.9	922.6
Working capital change	245.0	0	0	0	0
Interest & tax paid	(135.0)	134.0	31.8	(38.1)	(56.3)
Other	(59.1)	(688.2)	(372.6)	163.9	257.6
Operating cash flow	986.0	230.0	160.8	933.7	1,123.9
Capital expenditure	(821.0)	(615.0)	(300.0)	(550.0)	(800.0)
(Acquisitions)/divestments	13.0	109.0	40.0	40.0	40.0
Other	(75.0)	30.0	23.0	23.4	23.4
Funding available/(required)	103.0	(246.0)	(76.2)	447.1	387.3
Dividends paid	(260.0)	(130.0)	0	0	(112.3)
Equity raised/(returned)	(14.0)	0	0	0	0
(Increase)/decrease in net debt	(171.0)	(501.0)	(201.2)	322.1	150.0

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	60.0	89.0	99.0	95.1	92.0
Fixed assets	5,268.0	3,336.0	3,056.7	3,044.8	3,270.2
Intangibles	186.0	186.0	186.0	186.0	186.0
Right of use asset	0	2,357.0	2,430.0	2,514.9	2,583.7
Other assets	602.0	815.0	831.0	846.6	862.2
Total funds employed	6,116.0	6,783.0	6,602.7	6,687.4	6,994.1
Net debt/(cash)	1,542.0	1,025.0	1,226.2	904.0	754.0
Lease liability	0	2,238.0	2,413.0	2,588.0	2,763.0
Other liabilities	2,485.0	2,202.0	1,874.0	2,074.0	2,374.0
Shareholder's funds	2,089.0	1,318.0	1,089.5	1,121.4	1,103.1
Minority interests	0	0	0	0	0
Total funding sources	6,116.0	6,783.0	6,602.7	6,687.4	6,994.1

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	3.2	3.6	5.3	3.4	3.0
EV/EBIT (x)	8.2	n/a	n/a	50.6	19.3
PE (x)	5.8	n/a	n/a	98.3	19.2
Price/NTA (x)	0.8	1.4	1.7	1.7	1.7
Free cash flow yield (%)	10.6	-24.8	-9.0	24.8	20.9
Net dividend yield (%)	15.9	0.0	0.0	0.0	7.2
Gross dividend yield (%)	22.1	0.0	0.0	0.0	10.1

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	11.9	n/a	n/a	0.8	2.0
Interest cover EBITDA (x)	30.2	11.4	4.9	11.2	13.1
Net debt/ND+E (%)	42.5	43.7	53.0	44.6	40.6
Net debt/EBITDA (x)	1.6	1.3	2.4	1.1	0.8

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	4.7	-0.8	-3.4	0.7	1.8
Return on equity (%)	12.9	-4.9	-19.9	1.4	7.3
Return on funds employed (%)	n/a	n/a	n/a	n/a	n/a
EBITDA margin (%)	16.2	16.2	21.5	22.2	19.8
EBIT margin (%)	6.4	-1.2	-10.8	1.5	3.1
Capex to sales (%)	14.2	12.7	12.9	15.1	17.2
Capex to depreciation (%)	145	73	40	73	103
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	92	0	0	0	139

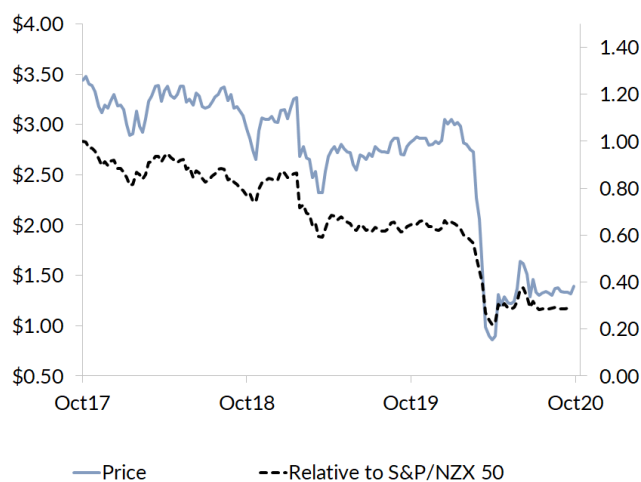
Operating Performance	2019A	2020A	2021E	2022E	2023E
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Available Seat Km (ASK)					
Domestic	7,104	5,619	4,618	5,683	6,394
Tasman and Pacific	13,640	10,367	4,092	10,912	12,276
Long-haul	25,285	20,349	2,529	7,586	17,700
Total	46,029	36,335	11,238	24,181	36,369
Change (%)	4.0	-21.1	-69.1	115.2	50.4

RASK (cents per ASK)					
Domestic	22.5	23.6	22.0	22.0	21.8
Tasman and Pacific	9.6	9.4	7.5	9.2	9.1
Long-haul	8.1	8.1	5.8	7.4	7.6
Total	10.8	10.8	13.1	11.6	10.6

Costs					
Jet fuel (NZ\$m)	1,271	1,022	275	696	931
Unit fuel (cents/ASK)	2.8	2.8	2.4	2.9	2.6
CASK ex-fuel/forex (cents/ASK)	7.4	8.4	16.3	11.7	10.3

Normalised EBIT	368.1	(56.8)	(252.8)	54.8	143.6
Net interest	(31.0)	(69.0)	(102.1)	(71.9)	(70.3)
Associate income	37.0	39.0	39.0	39.0	39.0
Normalised PBT	374.1	(86.8)	(315.9)	21.9	112.4

Figure 1. Price performance


Source: Forsyth Barr analysis

Figure 2. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	52.5%

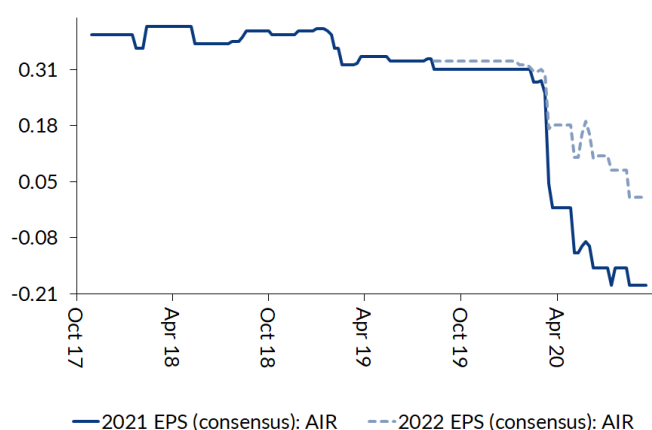
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 3. International valuation comparisons

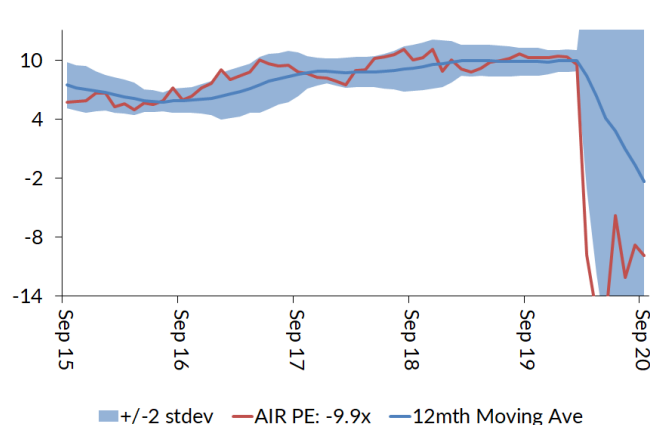
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect AIR's balance date - June)										
Air New Zealand	AIR NZ	NZ\$1.38	NZ\$1,550	<0x	>50x	5.1x	3.2x	<0x	47.0x	0.0%
QANTAS AIRWAYS	QAN AT	A\$3.88	A\$7,318	<0x	14.8x	13.8x	4.4x	<0x	12.4x	1.9%
CATHAY PACIFIC AIRWAYS	293 HK	HK\$5.22	HK\$33,602	<0x	<0x	59.5x	8.0x	<0x	<0x	1.8%
SINGAPORE AIRLINES	SIA SP	S\$3.39	S\$10,051	<0x	<0x	<0x	7.3x	70.5x	>75x	1.3%
DEUTSCHE LUFTHANSA-REG	LHA GY	€7.05	€4,214	<0x	1.1x	<0x	4.1x	<0x	<0x	1.1%
AIR FRANCE-KLM	AF FP	€2.96	€1,269	<0x	26.2x	<0x	3.7x	<0x	<0x	0.0%
AMERICAN AIRLINES GROUP INC	AAL US	US\$12.29	US\$6,250	<0x	0.8x	4.7x	10.7x	<0x	<0x	0.0%
UNITED AIRLINES HOLDINGS INC	UAL US	US\$34.20	US\$9,952	<0x	<0x	2.2x	7.9x	57.4x	66.9x	0.0%
Compco Average:				n/a	10.7x	20.0x	6.6x	64.0x	39.7x	0.9%
AIR Relative:				n/a	n/a	-74%	-52%	n/a	18%	-100%

EV = Current Market Cap + Actual Net Debt

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

Figure 4. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 5. One year forward PE (x)


Source: Forsyth Barr analysis

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