

Air New Zealand

1H21 – Capital Landing Soon

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NEUTRAL

Air New Zealand (AIR) reported another material half year loss; no worse than anticipated and while cash burn continues equity dilution has been partly mitigated, at least temporarily. The company will remain loss-making for the foreseeable future, and increasingly likely well into CY22 unless the government's position on border restrictions eases. There remains a high level of uncertainty as to when and how borders reopen, and how consumers will embrace the likely additional hurdles to travel, once they do. These unknowns contribute to a high margin for error in our earnings forecasts. AIR is committed to an equity raise before the end of FY21, which will be supported by the government. With the share price close to our valuation/target price we retain a NEUTRAL rating.

NZX Code	AIR	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$1.59	NPAT* (NZ\$m)	-64.2	-337.0	-158.5	71.5	PE	n/a	n/a	n/a	25.1
Target price	NZ\$1.60	EPS* (NZc)	-5.7	-30.0	-14.1	6.4	EV/EBIT	n/a	n/a	n/a	25.8
Risk rating	High	EPS growth* (%)	n/a	n/a	53.0	n/a	EV/EBITDA	5.3	14.9	8.8	5.6
Issued shares	1123.0m	DPS (NZc)	0.0	0.0	0.0	0.0	Price / NTA	1.6	2.0	2.4	2.2
Market cap	NZ\$1,791m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	0.0	0.0
Avg daily turnover	2,785k (NZ\$3,910k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	0.0

What's changed?

- **Earnings:** Our passenger recovery profile has been pushed out which results in forecast downgrades in each outlook year.

Cash burn and capital raise

The rate of cash burn has fallen sequentially over the past year as AIR has attacked its cost base, participated in the government's airfreight programme, and rebuilt its domestic profitability. However, cash burn is likely to deteriorate into FY22 assuming borders remain closed given the current deferral of employee tax payments (PAYE) until after 30 September 2021. The company remains committed to a necessary capital raise before 30 June 2021. We now expect AIR will need additional equity capital of at least NZ\$1.5bn to navigate COVID-19. Management states the target gearing band of 45%–55% remains appropriate (vs 70% currently) but is more a long term target than a "shackle".

Recovery profile

The near term outlook for AIR has deteriorated over the past few months. The prospect of a trans-Tasman bubble or broader border re-openings in CY21 appear increasingly less likely. While we can't rule out the prospect of commercial international aviation this calendar year, our base case now assumes quarantine free Tasman travel from early CY22 followed by a slower recovery of long haul. This means AIR is likely to generate losses and be subject to cash burn for longer.

Valuation holds; further equity dilution to come

AIR's net asset value (NAV) declined just 4c in 1H21 to NZ\$1.13 per share; a better outcome than expected as the underlying loss was partially offset by net positive significant items (non-cash foreign exchange gains being the largest). However, with losses deepening in 2H21 we continue to anticipate NAV falling below NZ\$1.00 at year end FY21 and further in FY22. While we continue to value AIR's loyalty scheme separate to our assessment of forward NAV, in combination they still amount to ~NZ\$1.60 per share.

Air New Zealand Ltd (AIR)

Prised as at 25 Feb 2021 (NZ\$) **1.60**

12-month target price (NZ\$)*	1.60
Expected share price return	0.0%
Net dividend yield	0.0%
Estimated 12-month return	0.0%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	1.61
WACC	9.0%
Terminal growth	1.0%

Spot valuations (NZ\$)	
1. Net asset value plus loyalty	1.60
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	2,529.7	3,259.8	4,471.6
Normalised EBITDA	935.1	784.2	344.5	590.8	931.0
Depreciation and amortisation	(567.0)	(841.0)	(737.2)	(714.6)	(730.0)
Normalised EBIT	368.1	(56.8)	(392.7)	(123.8)	201.0
Net interest	(31.0)	(69.0)	(103.1)	(121.3)	(131.8)
Associate income	37.0	39.0	20.0	25.0	30.0
Tax	(104.0)	22.5	138.8	61.6	(27.8)
Minority interests	0	0	0	0	0
Normalised NPAT	270.1	(64.2)	(337.0)	(158.5)	71.5
Abnormals/other	0	389.5	(58.3)	0	0
Reported NPAT	270.1	(453.8)	(278.7)	(158.5)	71.5
Normalised EPS (cps)	23.9	(5.7)	(30.0)	(14.1)	6.4
DPS (cps)	22.0	0	0	0	0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.5	-16.4	-47.7	28.9	37.2
EBITDA (%)	-12.2	-16.1	-56.1	71.5	57.6
EBIT (%)	-31.8	n/a	n/a	n/a	n/a
Normalised NPAT (%)	-30.8	n/a	n/a	n/a	n/a
Normalised EPS (%)	-30.4	n/a	n/a	n/a	n/a
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	344.5	590.8	931.0
Working capital change	245.0	0	0	0	0
Interest & tax paid	(135.0)	134.0	41.7	(25.0)	(117.0)
Other	(59.1)	(688.2)	(199.5)	(127.3)	203.4
Operating cash flow	986.0	230.0	186.6	438.5	1,017.4
Capital expenditure	(821.0)	(615.0)	(280.0)	(550.0)	(800.0)
(Acquisitions)/divestments	13.0	109.0	10.0	10.0	10.0
Other	(75.0)	(95.0)	(349.0)	(135.0)	(82.0)
Funding available/(required)	103.0	(371.0)	(432.4)	(236.5)	145.4
Dividends paid	(260.0)	(130.0)	0	0	0
Equity raised/(returned)	(14.0)	0	0	0	0
(Increase)/decrease in net debt	(171.0)	(501.0)	(432.4)	(236.5)	145.4

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	60.0	89.0	(71.1)	138.6	92.6
Fixed assets	5,268.0	3,336.0	3,095.5	3,136.6	3,409.5
Intangibles	186.0	186.0	186.0	186.0	186.0
Right of use asset	0	2,357.0	2,130.0	2,203.3	2,287.6
Other assets	602.0	815.0	793.0	803.0	815.0
Total funds employed	6,116.0	6,783.0	6,133.5	6,467.4	6,790.7
Net debt/(cash)	1,542.0	1,025.0	1,457.4	1,693.9	1,548.4
Lease liability	0	2,238.0	1,938.0	2,088.0	2,288.0
Other liabilities	2,485.0	2,202.0	1,649.0	1,741.0	1,941.0
Shareholder's funds	2,089.0	1,318.0	1,089.1	944.5	1,013.2
Minority interests	0	0	0	0	0
Total funding sources	6,116.0	6,783.0	6,133.5	6,467.4	6,790.7

* 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)	3.5	5.4	14.9	8.8	5.6
EV/EBIT (x)	8.9	n/a	n/a	n/a	25.8
PE (x)	6.7	n/a	n/a	n/a	25.1
Price/NTA (x)	0.9	1.6	2.0	2.4	2.2
Free cash flow yield (%)	9.2	-21.4	-5.2	-6.2	12.1
Net dividend yield (%)	13.8	0.0	0.0	0.0	0.0
Gross dividend yield (%)	19.1	0.0	0.0	0.0	0.0

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	11.9	n/a	n/a	n/a	1.5
Interest cover EBITDA (x)	30.2	11.4	3.3	4.9	7.1
Net debt/ND+E (%)	42.5	43.7	57.2	64.2	60.4
Net debt/EBITDA (x)	1.6	1.3	4.2	2.9	1.7

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	4.7	-0.8	-5.8	-1.7	2.6
Return on equity (%)	12.9	-4.9	-30.9	-16.8	7.1
Return on funds employed (%)	n/a	n/a	n/a	n/a	n/a
EBITDA margin (%)	16.2	16.2	13.6	18.1	20.8
EBIT margin (%)	6.4	-1.2	-15.5	-3.8	4.5
Capex to sales (%)	14.2	12.7	11.1	16.9	17.9
Capex to depreciation (%)	145	73	38	77	110
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	92	0	0	0	0

Operating Performance	2019A	2020A	2021E	2022E	2023E
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Available Seat Km (ASK)					
Domestic	7,104	5,619	5,683	6,038	6,394
Tasman and Pacific	13,640	10,367	1,432	6,138	12,276
Long-haul	25,285	20,349	3,287	5,057	12,643
Total	46,029	36,335	10,402	17,233	31,312
Change (%)	4.0	-21.1	-71.4	65.7	81.7

RASK (cents per ASK)					
Domestic	22.5	23.6	21.6	22.0	22.0
Tasman and Pacific	9.6	9.4	5.3	8.2	9.1
Long-haul	8.1	8.1	5.3	8.0	8.2
Total	10.8	10.8	14.2	13.0	11.4

Costs					
Jet fuel (NZ\$m)	1,271	1,022	332	477	742
Unit fuel (cents/ASK)	2.8	2.8	3.2	2.8	2.4
CASK ex-fuel/forex (cents/ASK)	7.4	8.4	21.0	15.5	11.3

Normalised EBIT	368.1	(56.8)	(392.7)	(123.8)	201.0
Net interest	(31.0)	(69.0)	(103.1)	(121.3)	(131.8)
Associate income	37.0	39.0	20.0	25.0	30.0
Normalised PBT	374.1	(86.8)	(475.8)	(220.1)	99.2

Cash burn to continue; NEUTRAL

The rate of cash burn has fallen sequentially over the year as AIR has attacked its cost base, participated in the government's airfreight programme, and rebuilt its domestic contribution. The cash burn guidance for 2H21 is NZ\$45m–NZ\$55m per month, down from NZ\$69m in 2Q21. However, the rate is likely to deteriorate through FY22 assuming borders remain closed given (1) the 15 month deferral of PAYE until 30 September 2021, at which time AIR will need to pay PAYE of NZ\$300m+ within six months, along with its ~NZ\$20m per month ongoing obligation, and (2) aircraft related capex that is unlikely to be deferred further.

AIR has drawn down ~NZ\$350m of the government's NZ\$900m loan facility (less than expected due to it managing cash holdings lower) and now has ~NZ\$700m of short term liquidity available compared to ~NZ\$1bn at the end of September 2020. It remains committed to a capital raise by June 2021. Despite a lower level of anticipated cash burn through 2H21, it is likely to at least need NZ\$1.5bn of new equity, in our opinion. This would provide sufficient funds to repay the government loan, rebuild liquidity to appropriate ongoing levels, and allow for an extended period of border closures.

While the near term outlook for AIR is significantly constrained by border closures, there is medium term optimism given the commencement of New Zealand's vaccination programme. While it will take around 12 months to complete, assuming no supply or efficacy problems, AIR can prepare for a recovery, albeit gradual, from early 2022 at the latest. We retain a NEUTRAL rating.

Result summary

AIR reported a significant underlying 1H21 pre-tax loss, in line with our expectations, reflecting the COVID-19 decimation of international passenger travel. The company has done well to offset the lower demand environment with cost initiatives, which have helped limit the damage to the balance sheet. In particular, net asset value (NAV) is NZ\$1.13 per share at Dec 2020, compared to NZ\$1.17 at June 2020 (down just 4c), supported by several favourable significant items (including non-cash foreign exchange gains) partially offsetting an underlying NPAT loss. No interim dividend has been declared.

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

	1H20	1H21	Change	Forbar
Sales revenue	3,015	1,234	-59.1%	1,139
EBITDRA	615	222	-63.9%	232
Underlying PBT	198	(185)	-193.5%	(184)
Reported NPAT	101	(72)	-171.4%	(127)
Underlying NPAT	149	(131)	-187.7%	(127)
Underlying EPS (cents)	13.1	(11.6)	-188.7%	(11.3)
Interim DPS (cents)	0.0	0.0	n/a	0.0

Source: AIR, Forsyth Barr analysis

Figure 2. Revenue split (NZ\$m)

	1H20	1H21	Change	Forbar
Domestic	851	574	-32.5%	565
Tasman & Pacific Islands	688	41	-94.1%	45
International	1,038	93	-91.0%	94
Passenger revenue	2,576	708	-72.5%	704
Cargo	195	373	91.3%	260
Contract services & other	244	153	-37.3%	175
Total revenue	3,015	1,234	-59.1%	1,139

Source: AIR, Forsyth Barr analysis

Earnings revisions

We lower our earnings forecast in each year of our outlook period as summarised in Figure 3, due to a lengthier period of border closures than previously anticipated. We now expect international travel to resume in early 2H22. Management confirmed that under a trans-Tasman bubble scenario the group would remain loss-making. We expect dividends to resume no earlier than FY24.

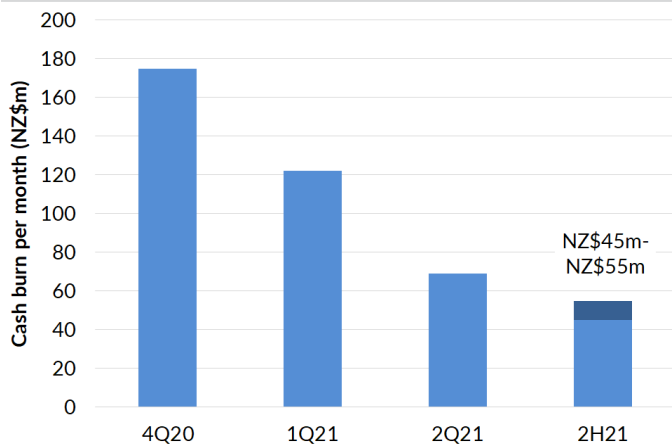
Figure 3. Earnings revisions (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Group RASK growth	20.5%	30.9%	1041 bps	-10.9%	-8.6%	230 bps	-8.9%	-12.4%	-343 bps
Group ASK growth	-69.1%	-71.4%	-230 bps	115.2%	65.7%	-4950 bps	50.4%	81.7%	3129 bps
Total fuel cost (ex forex hedging)	270	332	61	687	477	(210)	915	742	(172)
Sales revenue	2,333	2,530	8%	3,635	3,260	-10%	4,656	4,472	-4%
Underlying PBT	(318)	(476)	-50%	33	(220)	-769%	127	96	-24%
Underlying NPAT	(218)	(337)	-55%	24	(158)	-769%	91	69	-24%
Underlying EPS (cents)	(19.4)	(30.0)	-55%	2.1	(14.1)	-772%	8.1	6.2	-24%
DPS (cents)	0.0	0.0	n/a	0.0	0.0	n/a	0.0	0.0	n/a

Source: Forsyth Barr analysis

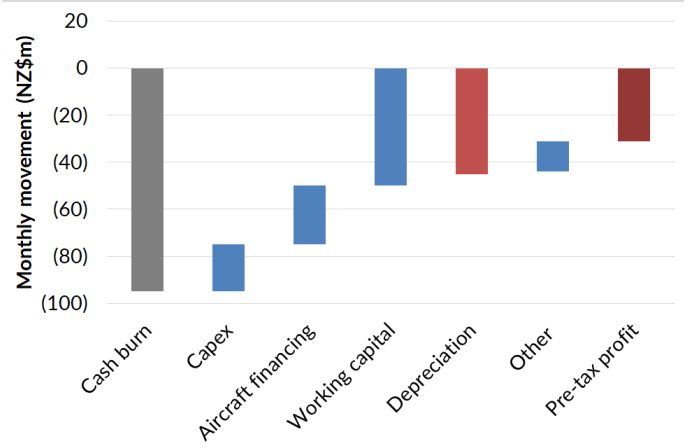
Key charts following AIR's 1H21 result

Figure 4. Cash burn: sequentially has improved since COVID-19 first arrived, though may increase in 1H22



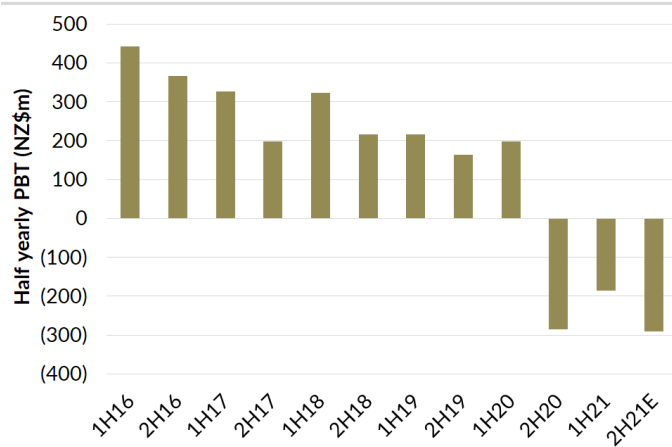
Source: AIR, Forsyth Barr analysis

Figure 5. Cash burn bridge to PBT for 1H21: Pre-tax losses reflect cash burn diluted by various items



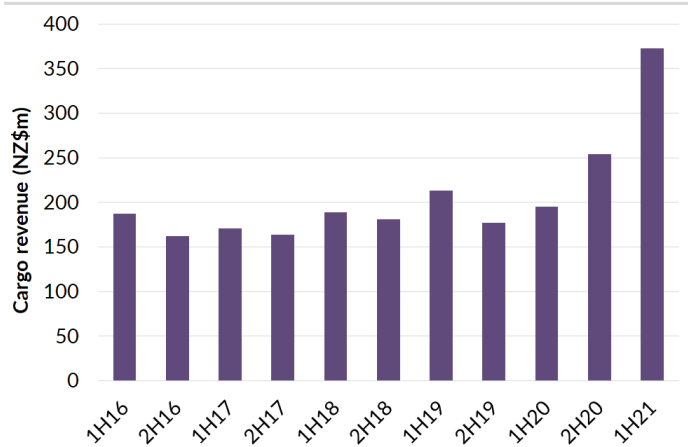
Source: AIR, Forsyth Barr analysis

Figure 6. PBT: Loss likely to expand in 2H21E if borders remain closed



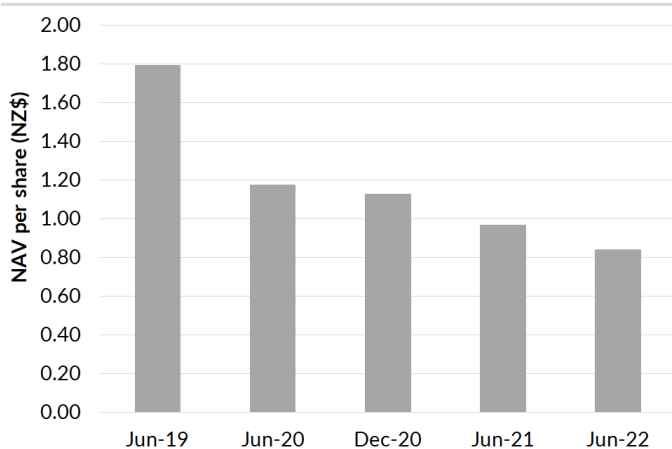
Source: AIR, Forsyth Barr analysis

Figure 7. Airfreight: Boosted by participation in the government's International Airfreight Capacity scheme



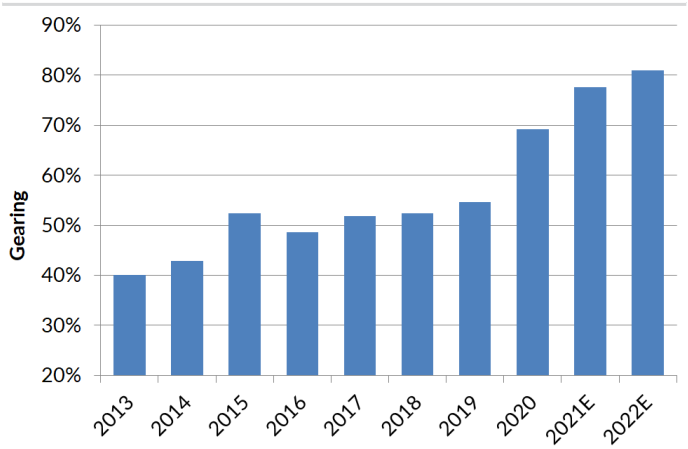
Source: AIR, Forsyth Barr analysis

Figure 8. Net asset value (NAV): Excluding the upcoming equity raise NAV is set to fall below NZ\$0.90 in FY22



Source: AIR, Forsyth Barr analysis

Figure 9. Gearing: On track to hit 80% at FY22 year end relative to target band of 45%–55%



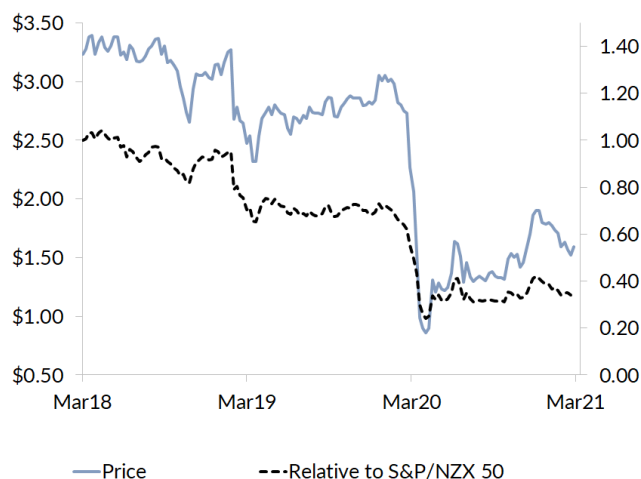
Source: AIR, Forsyth Barr analysis

Result analysis

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

Profit and loss account	1H20	1H21	Change	Comments
Domestic	851	574	-32.5%	Pax down -33%, ASK down -24%, RASK down -11%
Tasman & Pacific Islands	688	41	-94.1%	Pax down -96%, ASK down -90%, RASK down -42%
Short-haul	1,539	615	-60.1%	
International	1,038	93	-91.0%	Pax down -96%, ASK down -88%, RASK down -27%
Passenger revenue	2,576	708	-72.5%	Group pax down -56%, ASK down -79%
Cargo	195	373	91.3%	Improved as a result of government's International Airfreight Capacity scheme
Contract services (& other)	117	93	-20.5%	Reduced maintenance work for third parties
Other revenue	127	60	-52.8%	Lower lounge revenue and customer activity offset by increased number of charters
Sales revenue	3,015	1,234	-59.1%	
EBITDRA	615	222	-63.9%	
Depreciation and amortisation	(412)	(373)	-9.5%	
Interest expense	(28)	(44)	57.1%	
Associates	23	10	-56.5%	Decrease in earnings from Christchurch Engine Centre JV
Profit before tax	198	(185)	n/a	Currently AIR's modelling suggests a significant FY21 PBT loss
Taxation	(49)	55	n/a	Effective tax rate of ~29.5%
Underlying NPAT	149	(131)	n/a	
Abnormals (post tax)	(48)	58	n/a	Forex gains +NZ\$146m, gain on sale of landing spots +NZ\$21m, Aircraft impairments - NZ\$39m, reorganisation costs -NZ\$41m, reversal of forex hedges -NZ\$6m
Reported NPAT	101	(72)	n/a	
Underlying EPS (cents)	13.3	(11.6)	n/a	1,123m shares on issue
Interim DPS (cents)	0.0	0.0	n/a	1H20 interim dividend was declared then cancelled
Cashflow and net debt				
Operating cashflow	534	(134)	n/a	PAYE deferral amounts payable of NZ\$156m in the half
Maintenance capex = depreciation	(301)	(373)	23.9%	Forecasting aircraft investment of NZ\$1.7bn through to 2024
Disposals	7	2	-71.4%	
Free cash flow	240	(505)	n/a	Cash burn guidance of NZ\$45-55m/month in 2H21
(Acquisitions)/divestments	42	0	-100.0%	1H20 includes sale of London Heathrow slots following exit from London-Los Angeles route
Net debt/(cash)	470	1,405	198.9%	As at 23 Feb 2021, AIR has drawn down NZ\$350m of NZ\$900m Govt loan facility (was NZ\$310m as at 31 December 2020). There will be a capital raise before 30 June 2020
Key statistics				
Revenue per ASK (RASK) growth				
Domestic	8.0%	-11.0%	n/a	Load factor of 76.4% (-8.4%)
Tasman & Pacific Islands	-1.5%	-42.3%	n/a	Load factor of 27.4% (-55.1%)
Long haul	-1.3%	-26.5%	n/a	Load factor of 27.8% (-57.4%)
Total RASK	0.3%	30.7%	n/a	Significant mix benefit from higher RASK domestic
Total ASK growth	2.8%	-79.0%	n/a	
Passenger revenue	3.2%	-72.5%	n/a	Network flying down -65%, load factor of 53.7% (1H20 84.3%)
Non-pax revenue growth				
Cargo	-8.5%	91.3%	n/a	Cargo now equates to ~35% of pre COVID-19 long-haul business
Contract services	27.2%	-20.5%	n/a	Decrease in third party maintenance work
Other services	1.6%	-52.8%	n/a	
Total revenue	3.0%	-59.1%	n/a	
Cost per ASK growth by segment (cents)				
Labour	2.87	7.90	175.3%	Labour cost down -42%, with headcount down -38%. Helped by NZ\$51m of wage subsidies
Fuel at prevailing forex rate	2.76	3.05	10.2%	Fuel costs down -NZ\$501m predominantly due to lower volumes (1.5m bbl in 1H21)
Maintenance	0.94	2.81	197.4%	Less third party maintenance work
Aircraft operations	1.51	2.87	90.0%	Partially offset by receipt of aviation relief project (NZ\$58m)
Passenger services	0.72	0.54	-24.9%	
Sales & Marketing	0.73	0.58	-20.7%	Sales, marketing and other expenses down -NZ\$190m
Forex hedging	(0.10)	0.26	n/a	
Other	0.67	2.28	241.1%	
Pre-abnormals	10.11	20.28	100.6%	Opex (ex-fuel) down -55% on the pcg in 1Q21, and -50% in 2Q21

Source: AIR, Forsyth Barr analysis

Figure 11. Price performance


Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
NZ Govt	52.5%

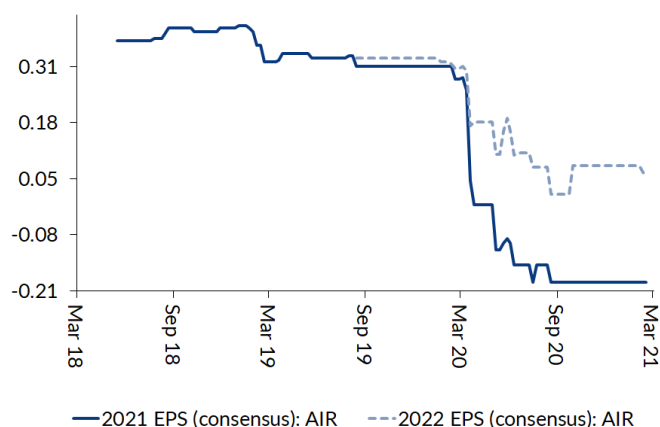
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 13. International valuation comparisons

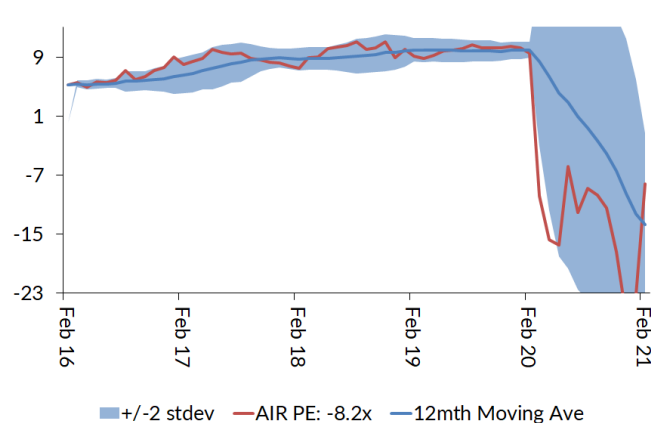
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect AIR's balance date - June)										
Air New Zealand	AIR NZ	NZ\$1.60	NZ\$1,791	<0x	<0x	8.2x	4.8x	<0x	<0x	0.0%
QANTAS AIRWAYS	QAN AT	A\$5.03	A\$9,487	<0x	15.6x	21.6x	4.8x	<0x	13.0x	1.6%
CATHAY PACIFIC AIRWAYS	293 HK	HK\$7.52	HK\$48,408	<0x	2.6x	>75x	11.3x	<0x	<0x	0.9%
SINGAPORE AIRLINES	SIA SP	S\$4.65	S\$13,787	<0x	<0x	<0x	8.0x	<0x	<0x	0.2%
DEUTSCHE LUFTHANSA-REG	LHA GY	€11.66	€6,970	<0x	9.6x	5.9x	10.6x	<0x	2.6x	0.1%
AIR FRANCE-KLM	AF FP	€5.14	€2,201	<0x	<0x	9.6x	14.0x	<0x	15.3x	0.0%
AMERICAN AIRLINES GROUP INC	AAL US	US\$20.53	US\$13,133	<0x	>50x	<0x	<0x	<0x	25.4x	0.0%
UNITED AIRLINES HOLDINGS INC	UAL US	US\$49.68	US\$15,492	<0x	5.7x	>75x	>75x	<0x	2.8x	n/a
Compco Average:				n/a	8.4x	12.4x	9.8x	n/a	11.8x	0.5%
AIR Relative:				n/a	n/a	-34%	-51%	n/a	n/a	-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 14. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 15. One year forward PE (x)


Source: Forsyth Barr analysis

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