

Infratil

Defensive Portfolio Working Under Stress

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OUTPERFORM

We expect Infratil's (IFT) portfolio to perform well during the COVID-19 crisis with only Wellington Airport (WIAL) having any direct earnings exposure. In addition, the remainder of the portfolio is also well protected from the upcoming economic downturn. Whilst IFT has high gearing, IFT has spare debt capacity to absorb WIAL's difficulties, plus a substantial (we estimate ~\$170m) coming back from Tilt Renewables (TLT) in the near future. In addition, IFT's continued buyback is a strong signal the current travails are temporary. Nevertheless, WIAL's short-term challenges and the material fall in aged care/retirement village sentiment has been the driver to lower our IFT net asset value -38cps (-6%) to \$5.64 and our target price down -30cps to \$4.90. We reiterate our OUTPERFORM rating.

NZX Code	IFT	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$4.00	NPAT* (NZ\$m)	n/a	n/a	n/a	n/a	EV/EBITDA	n/a	n/a	n/a	n/a
Target price	NZ\$4.90	EPS* (NZc)	n/a	n/a	n/a	n/a	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	Medium	EPS growth* (%)	n/a	n/a	n/a	n/a	PE	n/a	n/a	n/a	n/a
Issued shares	658.7m	DPS (NZc)	17.3	17.3	17.3	18.0	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$2,635m	Imputation (%)	51	65	80	100	Cash div yld (%)	4.3	4.3	4.3	4.5
Avg daily turnover	637.5k (NZ\$3,008k)	*Based on normalised profits					Gross div yld (%)	5.2	5.4	5.7	6.3

IFT portfolio largely protected from COVID-19, but WIAL under some stress

Of all of IFT's assets, the only asset that faces direct exposure to COVID-19 is WIAL. International flights have effectively ceased and Air New Zealand (AIR) has cut domestic capacity -30%, with more possible as the country bunkers down. We expect WIAL will breach its earnings covenants that cover its bank facilities, however, we also expect local banks to look through the current temporary turmoil. In addition, we believe that IFT has sufficient debt capacity to support WIAL if required.

WIAL is ~11% IFT's portfolio (based on our revised NAV assessment), so not a material portion. The rest of the portfolio has strong defensive characteristics that we expect will help IFT OUTPERFORM as the forthcoming economic downturn unfolds.

Debt position is high (as always), but IFT has spare capacity and confidence in its current position

IFT's current net debt balance is ~\$1.8b. IFT still has ~\$400m of spare debt capacity (which is there for times like this) and an additional ~\$170m likely to come from TLT in the near future. A strong signal that IFT is comfortable with its balance sheet is the buyback it started on 9 March, with buyback volumes increasing in recent days as IFT's share price has fallen further. Nevertheless, we have flattened our dividend forecast for the next two years to 17.25cps (down -0.25cps/-1.00cps/-1.00cps in FY20/FY21/FY22 respectively).

TLT cash getting closer

In December 2019, TLT received net proceeds of ~A\$455m (~NZ\$1.00/TLT share) from the sale of Snowtown II. We expect a large proportion of those proceeds to be returned to shareholders. Our base assumption is the ascribed capital of A\$260m (~NZ\$0.57cps) (i.e. the 2019 capital raise) will be returned and that this will be a catalyst for TLT (and IFT) re-rating upwards. IFT's share of the expected capital to be returned is ~NZ\$170m (~NZ\$0.26/IFT share). A capital return of A\$260m should leave sufficient capital in TLT for it to continue with its near-term wind developments. A logical announcement time is TLT's FY20 result date in early May, although it could be earlier.

Infratil (IFT)

Priced as at 18 Mar 2020 (NZ\$)

4.00
12-month target price (NZ\$)*
4.90

Expected share price return

22.5%

Net dividend yield

4.3%

Estimated 12-month return

26.8%

Spot valuations (NZ\$)

1. NAV

5.64

2. n/a

n/a

3. n/a

n/a

Key WACC assumptions

Risk free rate

n/a

Equity beta

n/a

WACC

n/a

Terminal growth

n/a

NAV valuation summary (NZ\$m)

Total firm value

5,478

(Net debt)/cash

(1,766)

Less: Capitalised operating leases

Value of equity

3,713

Profit and Loss Account (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Sales revenue	n/a	n/a	n/a	n/a	n/a
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	n/a	n/a	n/a	n/a	n/a
Net interest	n/a	n/a	n/a	n/a	n/a
Associate income	n/a	n/a	n/a	n/a	n/a
Tax	n/a	n/a	n/a	n/a	n/a
Minority interests	n/a	n/a	n/a	n/a	n/a
Normalised NPAT	n/a	n/a	n/a	n/a	n/a
Abnormals/other	n/a	n/a	n/a	n/a	n/a
Reported NPAT	n/a	n/a	n/a	n/a	n/a
Normalised EPS (cps)	n/a	n/a	n/a	n/a	n/a
DPS (cps)	16.8	17.3	17.3	17.3	18.0

Valuation Ratios

	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
PE (x)	n/a	n/a	n/a	n/a	n/a
Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Free cash flow yield (%)	n/a	n/a	n/a	n/a	n/a
Net dividend yield (%)	4.2	4.3	4.3	4.3	4.5
Gross dividend yield (%)	5.8	5.2	5.4	5.7	6.3

Capital Structure

	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	n/a	n/a	n/a	n/a	n/a
Interest cover EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Net debt/ND+E (%)	n/a	n/a	n/a	n/a	n/a
Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a

Growth Rates

	2018A	2019A	2020E	2021E	2022E
Revenue (%)	n/a	n/a	n/a	n/a	n/a
EBITDA (%)	n/a	n/a	n/a	n/a	n/a
EBIT (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	n/a	n/a	n/a	n/a	n/a
Normalised EPS (%)	n/a	n/a	n/a	n/a	n/a
Ordinary DPS (%)	6.3	3.0	0.0	0.0	4.3

Key Ratios

	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	n/a	n/a	n/a	n/a	n/a
Return on equity (%)	n/a	n/a	n/a	n/a	n/a
Return on funds employed (%)	n/a	n/a	n/a	n/a	n/a
EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
Capex to sales (%)	n/a	n/a	n/a	n/a	n/a
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	100	51	65	80	100
Pay-out ratio (%)	n/a	n/a	n/a	n/a	n/a

Cash Flow (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
EBITDA	n/a	n/a	n/a	n/a	n/a
Working capital change	n/a	n/a	n/a	n/a	n/a
Interest & tax paid	n/a	n/a	n/a	n/a	n/a
Other	n/a	n/a	n/a	n/a	n/a
Operating cash flow	n/a	n/a	n/a	n/a	n/a
Capital expenditure	n/a	n/a	n/a	n/a	n/a
(Acquisitions)/divestments	n/a	n/a	n/a	n/a	n/a
Other	n/a	n/a	n/a	n/a	n/a
Funding available/(required)	n/a	n/a	n/a	n/a	n/a
Dividends paid	n/a	n/a	n/a	n/a	n/a
Equity raised/(returned)	n/a	n/a	n/a	n/a	n/a
(Increase)/decrease in net debt	n/a	n/a	n/a	n/a	n/a

NAV Calculation
Investment

	% Owned	Value \$m	% of IFT	Value/ share
Trustpower	50.5	1,210	20.4	1.84
Vodafone	49.9	1,132	19.1	1.72
CDC Data Centres	48.0	1,235	20.9	1.88
Wellington Intl Airport	66.0	650	11.0	0.99
Tilt Renewables	65.4	1,089	18.4	1.65
RetireAustralia	50.0	276	4.7	0.42
Longroad Energy	40.0	141	2.4	0.21
Property/Other	100.0	190	3.2	0.29
Less : Present value of mgmt contract		(444)		(0.67)
Total Assets		5,478		8.32
Less : Bank debt		(473)		(0.72)
Less : Infrastructure & Perp Bonds		(1,293)		(1.96)
Net Assets		3,713		5.64

Balance Sheet (NZ\$m)

	2018A	2019A	2020E	2021E	2022E
Working capital	n/a	n/a	n/a	n/a	n/a
Fixed assets	n/a	n/a	n/a	n/a	n/a
Intangibles	n/a	n/a	n/a	n/a	n/a
Right of use asset	n/a	n/a	n/a	n/a	n/a
Other assets	n/a	n/a	n/a	n/a	n/a
Total funds employed	n/a	n/a	n/a	n/a	n/a
Net debt/(cash)	n/a	n/a	n/a	n/a	n/a
Lease liability	n/a	n/a	n/a	n/a	n/a
Other liabilities	n/a	n/a	n/a	n/a	n/a
Shareholder's funds	n/a	n/a	n/a	n/a	n/a
Minority interests	n/a	n/a	n/a	n/a	n/a
Total funding sources	n/a	n/a	n/a	n/a	n/a

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

Portfolio largely protected from COVID-19

Only one of IFT's investments has direct exposure to COVID-19 – WIAL. We have cut our WIAL valuation -26cps (-21%) which is based primarily on a lower DCF, with earnings to be materially impacted in FY21 (year to 31 March 2021). The only other investment that has some potential exposure is RA due to the risk of an infection in one of its villages. We have trimmed our RA valuation -12cps (-12%) due to the significant negative sentiment change towards the sector.

In our view, the earnings risk to IFT's other core investments, Trustpower, Vodafone, CDC Data Centres, Tilt Renewables and Longroad Energy are all minor.

IFT share price fall consistent with falls in compco asset values

IFT's share price has fallen -28% since the market peak of 21 February, which is broadly consistent with our estimate of the price movement of individual asset compcos. However, the question for investors is the extent to which the individual share price movements are reasonable. In our view, the share price declines in defensive assets that IFT invests in are overdone. Whilst the equity risk premium has increased, earnings in core portfolio assets like Trustpower, Tilt Renewables, CDC Data Centres and Vodafone should be largely immune to the COVID-19 induced economic downturn. These assets (plus Longroad and Property/other) are ~85% of IFT's asset base.

Figure 1. Estimated asset value movement (compco basis only)

	Equity Value		% Movement	Comment
	21-Feb \$m	18-Mar \$m		
Trustpower	1,127	927	-18%	TPW share price movement
Tilt Renewables	1,046	874	-16%	TLT share price movement
Wellington Airport	825	413	-50%	Starting valuation is our WIAL valuation – compco used is Auckland Airport
CDC Data Centres	1,497	1,337	-11%	Starting valuation is the mid-point of independent valuation – compco used is NextDC
Vodafone	1,131	915	-19%	Starting valuation is price paid for Vodafone – compco used is Spark
Longroad	128	107	-16%	Starting valuation is Longroad book value, and compco is TLT
RetireAustralia	358	212	-41%	Starting valuation is RA book value and compcos are Ryman, Summerset, Arvida
Property/Other	190	144	-24%	Starting valuation is book value and we have used average property sector movement
Total asset value	6,302	4,928	-22%	
less management fee	(505)	(444)	-12%	Decline due to expectation performance fee will decline given negative market movements
less net debt	(1,763)	(1,766)	0%	
Net asset value	4,034	2,718	-33%	
NAV/share	6.12	4.13	-33%	
IFT share price	5.55	4.00	-28%	
Discount to NAV	-9%	-3%		

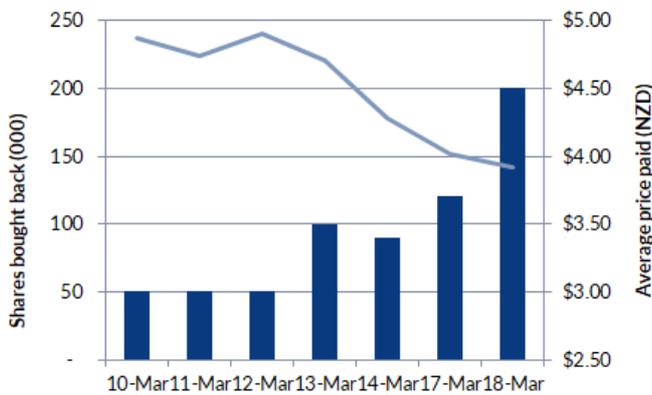
Source: IRESS, Forsyth Barr analysis

IFT debt position solid, cash coming from TLT and buyback highlights IFT confidence

We believe IFT's debt position is secure. We estimate it still has undrawn bank facilities totalling ~\$400m and it has no bonds maturing in the next 15 months. The covenants on those bonds are mainly gearing related and should not become an issue.

In addition, we anticipate an announcement relating to TLT returning cash to its shareholders in the near future (IFT owns 65% of TLT). In December 2019, TLT received net proceeds of ~A\$455m (~NZ\$1.00/TLT share) from the sale of Snowtown II. We expect a large proportion of those proceeds to be returned to shareholders. Our base assumption is the ascribed capital of A\$260m (~NZ \$0.57/TLT share) (i.e. the 2019 capital raise) will be returned and that this will support TLT's (and IFT's) share price. IFT's share of the expected capital to be returned is ~NZ\$170m (~NZ\$0.26/IFT share). A capital return of A\$260m should leave sufficient capital in TLT for it to continue with its near-term wind developments. A logical announcement time is TLT's FY20 result date in early May, although it could be earlier.

The best indication that IFT is comfortable with its debt position is its buyback programme announced on 28 February and commenced on 9 March. IFT has so far bought back 660,000 shares at an average price of \$4.31. It is notable that it has ramped up its buyback programme the further IFT's share price has fallen, including after AIR's trans-Tasman route cut announcement which only increased WIAL's issues.

Figure 2. Shares acquired under buyback programme


Source: IFT, Forsyth Barr analysis

Slightly more cautious approach to the dividend

Whilst we are comfortable with IFT's ability to deal with the current economic crisis, we are taking a more cautious approach to IFT's dividend outlook and now assume no growth until FY22. We had previously assumed a modest increase in the dividend at the FY20 result, increasing further in FY21 and FY22.

WIAL worst impacted IFT investment

WIAL is the investment that is facing the greatest direct earnings impact as AIR has cut -80% of trans-Tasman flights, with its Wellington to Brisbane and Melbourne services axed completely. The Sydney service has been reduced to 2x per week. Domestic services have been cut -30%, with more cuts likely.

Assuming an effective travel shut-down of 6 months before a recovery starts has a material impact on earnings. We estimate FY21 EBITDA could be less than \$10m, vs. more than \$100m expected in FY20. 1H21 could conceivably be an EBITDA loss. Understandably, WIAL is cutting all non-discretionary capex, but its ability to cut opex is limited.

Adding to WIAL's issues is its debt position, which at 30 September 2019 totalled ~\$540m. While it is probable debt covenants will be broken, we believe the penalties are likely to be minor. WIAL sources debt from banks (we understand undrawn facilities of ~\$70m remain), the fixed interest market and it has a US\$72m US Private Placement (USPP). The only bond due for repayment in the next 15 months is an unlisted \$25m bond, which should be covered by its bank facilities.

WIAL is highly likely to breach its bank facility covenant following the 1H21 result. However, early bank discussions are positive and we expect them to be supportive of WIAL. USPPs have been problematic for NZ businesses in the past (just ask Fletcher Building), however, we understand WIAL's USPP covenant relates to its BBB+ credit rating and a fall in the credit rating should only result in a modest increase in the coupon rate payable – there are no additional penalties. Bond covenants relate to gearing ratios which should not be an issue.

From IFT's perspective, WIAL is an important source of cash to pay its operating costs, interest costs and dividend. The subvention payment (typically paid in September each year) totalled \$44m in 2019 and is likely to be a similar amount in 2020 (as it relates to the FY20 year which ends on 31 March). WIAL will have to pay this amount, although it may require funding from IFT to do so, which we understand IFT is willing to do. The 2021 subvention payment could easily be nil. Whilst that will increase IFT's gearing, as noted earlier, we believe it has sufficient headroom.

WIAL's immediate position is grim. However, it needs to be remembered that 1) WIAL is a quality infrastructure asset that will exist once COVID-19 is behind us, 2) it is only ~10% of IFT's portfolio 3) IFT has the debt capacity to stand behind and support WIAL.

RA has heightened risks, but no direct earnings implications

IFT's other asset that has been hit materially in the market is RA. Whilst immediate earnings are not materially at risk, new sales will slow down with Australia banning non-essential retirement village visits. Operating costs are also likely to increase temporarily. The big fear appears to be a COVID-19 outbreak within a village and the implications that would then have. Nevertheless, the pull-back in aged care stocks appears more sentiment driven than grounded in cash flow impacts.

Figure 3. Dividend forecast changes

	FY19	FY20F	FY21F	FY22F
Old (cps)	17.25	17.50	18.00	19.00
New (cps)		17.25	17.25	18.00
Difference (cps)		-0.25	-0.75	-1.00
Difference (%)		-1.4%	-4.2%	-5.3%

Source: Forsyth Barr analysis

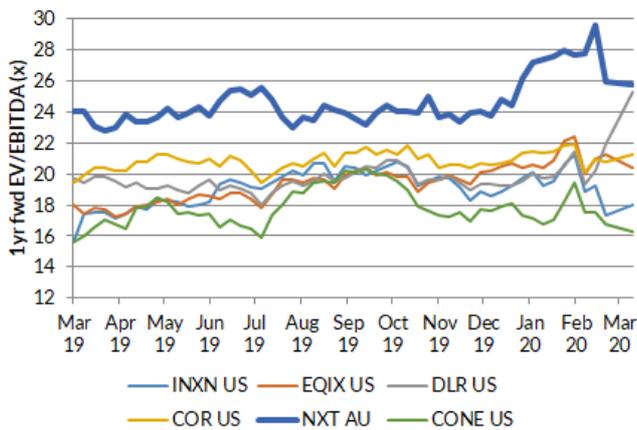
CDC and peer valuations surge and are up in 2020 even after COVID-19 pull-back

IFT's best performing asset in the past two years has been CDC and that appears likely to continue. IFT's biggest announcement since our last report was that independent valuers had valued CDC between A\$1,274m and \$1,604m, an +NZ\$605m increase in the mid-point of the valuation range. That was validated by the sale of 24.1% of CDC from the Commonwealth Superannuation Corporation to the Future Fund (Australia's sovereign wealth fund). The mid-point of the revised valuation range was +32% higher than our valuation at that time. CDC proving up its Sydney development was critical to the valuation increase, although from our perspective there was no new news released with the independent valuation.

Analysis of CDC's peers highlights that in the past year, the data centre sector EV/EBITDA multiples have increased +13%. Whilst the multiples are down -5% since 21 February, they are up +5% in 2020 year-to-date, with NextDC (CDC's closest compco) up +~9%.

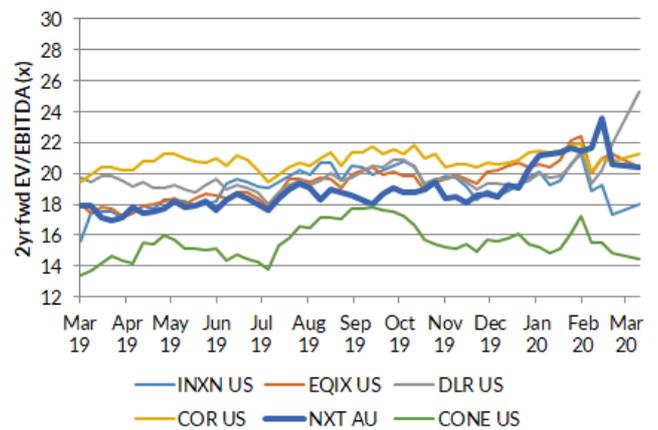
We have increased our CDC valuation +9% to NZ\$1,235m reflecting the lift in multiples from our last valuation, partially offset by the stronger NZDAUD. The DCF portion of our valuation is unchanged at NZ\$1.2b given there has been no new news to alter our earnings forecast.

Figure 4. 1yr forward EV/EBITDA



Source: Bloomberg, Forsyth Barr analysis

Figure 5. 2yr forward EV/EBITDA



Source: Bloomberg, Forsyth Barr analysis

NAV trimmed on WIAL and RA NAV cut

We have trimmed our NAV assessment -38cps (-6%) to \$5.64. The main drivers of the fall are the reduction in value of WIAL and RA, and to a lesser extent the increase in corporate costs (due to a lift in the performance fee) and net debt over the past few months.

Figure 6. Net asset value changes

	Old \$m	New \$m	Change \$m Chg	Old \$/share	New \$/share	Change \$/share	% chg	Comment
Trustpower	1,213	1,210	(3)	\$1.84	\$1.84	\$0.00	0%	No change to view of underlying value
Vodafone NZ	1,131	1,132	1	\$1.71	\$1.72	\$0.00	0%	No change to view of underlying value
CDC Data Centres	1,136	1,235	99	\$1.72	\$1.88	\$0.15	9%	Increase in data centre valuation metrics, partially offset by currency
Wellington Airport	825	650	(175)	\$1.25	\$0.99	(\$0.26)	-21%	Impact of short-term earnings hit, plus debt risks
Tilt Renewables	1,089	1,089	-	\$1.65	\$1.65	\$0.00	0%	No change to view of underlying value
RetireAustralia	358	276	(82)	\$0.54	\$0.42	(\$0.12)	-23%	Value reduced -20% (vs. peers fall of ~-40%)
Longroad Energy	128	141	12	\$0.19	\$0.21	\$0.02	10%	Increase due to fall in NZDUSD fx rate
Other	190	190	-	\$0.29	\$0.29	\$0.00	0%	No change to view of underlying value
Total Assets	6,070	5,922	(148)	\$9.21	\$8.99	(\$0.21)	-2%	
less PV of corporate costs	(393)	(444)	(51)	(\$0.60)	(\$0.67)	(\$0.08)	13%	Increase in performance fee estimate, but -\$60m lower than guidance
less Net debt	(1,711)	(1,766)	(54)	(\$2.60)	(\$2.68)	(\$0.09)	3%	Changes in net debt post 30 Sept 2019
Net Assets	3,966	3,713	(253)	\$6.01	\$5.64	(\$0.38)	-6%	

Source: Forsyth Barr analysis

Incentive fee likely to be lower than initial guidance

In IFT's announcement that the mid-point of an independent valuation of CDC had increased +68% (+\$605m/90cps) to \$1,497m, it also noted that the performance incentive was likely to be \$125m (up +\$85m).

With independent valuations for its non-New Zealand portfolio needing to take place as at 31 March, it appears likely that the \$125m estimate will come down. We have lowered the performance fee estimate to ~\$65m, although relative to our last published NAV assessment that is a +\$51m increase.

Investment Summary

Our rating is **OUTPERFORM**. Infratil (IFT) has a solid core of investments that will perform well in a low interest rate environment. Near-term operational upside comes from CDC with other core portfolio investments providing good downside protection.

Business quality

- **Chasing low risk, high growth assets:** IFT's strategy is to invest in infrastructure like assets that exhibit strong underlying demand. Recent investments include Vodafone (mobile data), CDC (data centres), and Longroad Energy (renewable electricity generation projects).
- **Strong track record over the past decade:** IFT's recent track record buying and selling assets is strong, having crystallised significant gains with Z Energy, Lumo Energy and ANU Student Accommodation. In addition, new investment CDC is performing well.
- **Diversified risk:** Key sectors in IFT's asset portfolio are data/telco (~40%), renewable electricity (~40%) and airports (~10%). Its largest assets are CDC, Trustpower and Vodafone, each at ~20% of its portfolio. Assets are also diversified across New Zealand, Australia and North America.

Earnings and cashflow outlook

- **Growth coming from new investments:** Most of IFT's earnings growth is expected to come from its newer investments: Vodafone NZ, CDC, Longroad Energy, and Tilt Renewables developing new wind farms.

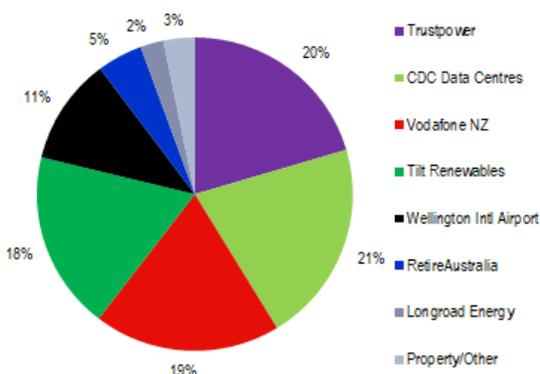
Financial structure

- **Balance sheet under pressure, but not close to breaking:** The current COVID-19 crisis and flow-on effects is putting significant pressure on Wellington Airport in particular. However, we believe IFT has sufficient spare capacity to ride through the downturn, something it achieved during the GFC relatively comfortably.
- **Strong historic dividend growth:** IFT has increased dividends +13% p.a. over the past eight years. Future growth is expected to be tempered as IFT's portfolio shifts towards high growth but more capital hungry assets.

Risk factors

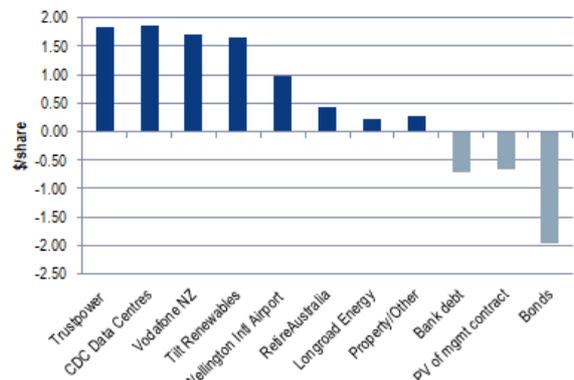
- **Valuation transparency:** IFT favours investments in unlisted assets. It can be difficult to get a clear view on the value of the unlisted assets and this is a factor in IFT trading at a discount to NAV. An investment in IFT is backing the management team to deliver results similar to its track record.
- **Governance:** IFT manager, Morrison & Co, has several investment mandates outside IFT, potentially resulting in competition for investment opportunities. Governance is important to ensure IFT is not disadvantaged.

Figure 7. Net asset value breakdown



Source: Forsyth Barr analysis

Figure 8. Net asset value share



Source: Forsyth Barr analysis

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

Shareholder	Latest Holding
ACC	6.1%

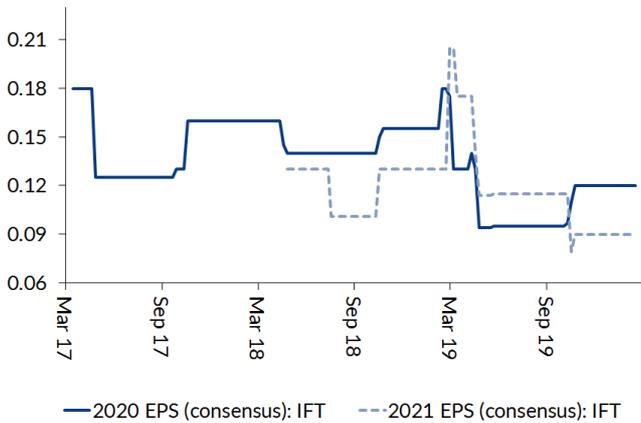
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 11. International valuation comparisons

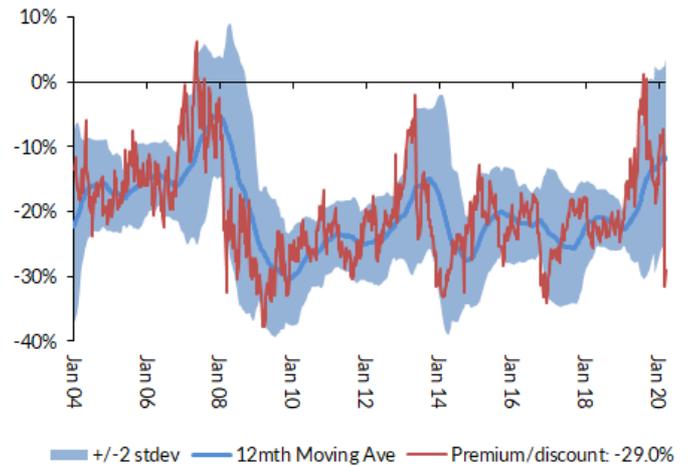
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
Infratil	IFT NZ	NZ\$4.00	NZ\$2,635	n/a	n/a	n/a	n/a	n/a	n/a	4.3%
Compc Average:				n/a	n/a	n/a	n/a	n/a	n/a	n/a
IFT Relative:				n/a	n/a	n/a	n/a	n/a	n/a	n/a

EV = Current Market Cap + Actual Net Debt

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

Figure 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. Historic discount to NAV


Source: Forsyth Barr analysis

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