

# Infratil

## Cost of Capital Arbitrage

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**NEUTRAL** 

Infratil (IFT) has announced that it intends to undertake a strategic review of its Tilt Renewables (TLT) shareholding, a sensible move, in our view. IFT is taking advantage of the reduced cost of capital that some asset owners ascribe to reliable infrastructure assets in general and in particular renewable energy assets. MEL and MCY have re-rated by 37% and 36% respectively over the last 6 months, likely in-part driven by inflows into clean energy ETFs and other ESG related fund flows. IFT targets investments in assets that are starting the journey towards “pure” infrastructure. CDC is a clear example of that, and company commentary on the proposed Qscan acquisition suggests that IFT expects Qscan to also embark on this journey. With respect to renewable energy, it is currently priced in a way that makes it difficult to foresee a forward return in line with IFT's target return for even its lower risk core portfolio of 8–10% p.a. Particularly when factoring in a meaningful premium to TLT's current share price.

NZX Code	IFT	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$5.94	NPAT* (NZ\$m)	n/a	n/a	n/a	n/a	PE	n/a	n/a	n/a	n/a
Target price	NZ\$6.25	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	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	722.7m	DPS (NZc)	17.3	17.3	17.3	17.3	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$4,293m	Imputation (%)	60	55	55	55	Cash div yld (%)	2.9	2.9	2.9	2.9
Avg daily turnover	628.9k (NZ\$3,094k)	*Based on normalised profits					Gross div yld (%)	3.6	3.5	3.5	3.5

**What's changed?**

- **Target price:** Increased +25cps to NZ\$6.25 reflecting a +34cps increase in our TLT valuation slightly offset by a +7cps performance fee increase. Other minor changes broadly offset each other.

**Solving the leverage issue**

In our report published on 11 November 2020, *Levered Long – So Far, So Good*, we highlighted the high and increasing leverage of IFT, and estimated look through leverage to be around 7–8x net debt/EBITDA, high by any standards. Divesting TLT would largely eliminate IFT's net debt at the corporate level, and reduce look through net debt/EBITDA to ~4–5x. Considering the changing mix of IFT's holdings, with a lower proportion of cash generative stable businesses and a higher proportion of faster growing, cash consuming businesses we believe IFT could benefit from operating with a lower leverage. Apart from reducing the risks associated with high financial leverage, we believe that a lower debt level will reduce some of the capital constraints within its portfolio companies.

**Uses of cash; we are not expecting a meaningful return of cash to shareholders**

IFT has increased the velocity of its portfolio in recent years, with several exits as well as the substantial acquisition of Vodafone NZ and the proposed acquisition of Qscan. Should the TLT strategic review conclude with a sale, we believe primary use of cash will be; (1) paying down debt, (2) building on the diagnostics and imaging platform launched with the likely acquisition of Qscan, and (3) increased capital commitment to IFT's two other renewable energy platforms: Longroad Energy (US) and Galileo Energy (Europe). We would not expect a substantial return of capital to shareholders.

**Infratil (IFT)**

Priced as at 07 Dec 2020 (NZ\$)

5.94

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

6.25

Expected share price return

5.2%

Net dividend yield

2.9%

Estimated 12-month return

8.1%

**Spot valuations (NZ\$)**

1. NAV

6.25

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

7,643

(Net debt)/cash

(2,683)

Less: Capitalised operating leases

Value of equity

4,960

**Profit and Loss Account (NZ\$m)**

	2019A	2020A	2021E	2022E	2023E
Sales revenue	n/a	n/a	n/a	n/a	n/a
<b>Normalised EBITDA</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a
<b>Normalised EBIT</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
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
<b>Normalised NPAT</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
Abnormals/other	n/a	n/a	n/a	n/a	n/a
<b>Reported NPAT</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
Normalised EPS (cps)	n/a	n/a	n/a	n/a	n/a
DPS (cps)	17.3	17.3	17.3	17.3	17.3

**Growth Rates**

	2019A	2020A	2021E	2022E	2023E
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 (%)	3.0	0.0	0.0	0.0	0.0

**Cash Flow (NZ\$m)**

	2019A	2020A	2021E	2022E	2023E
<b>EBITDA</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
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
<b>Operating cash flow</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
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
<b>Funding available/(required)</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
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
<b>(Increase)/decrease in net debt</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>

**Balance Sheet (NZ\$m)**

	2019A	2020A	2021E	2022E	2023E
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
<b>Total funds employed</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>
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
<b>Total funding sources</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>

\* 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)	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 (%)	2.9	2.9	2.9	2.9	2.9
Gross dividend yield (%)	3.5	3.6	3.5	3.5	3.5

**Capital Structure**

	2019A	2020A	2021E	2022E	2023E
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

**Key Ratios**

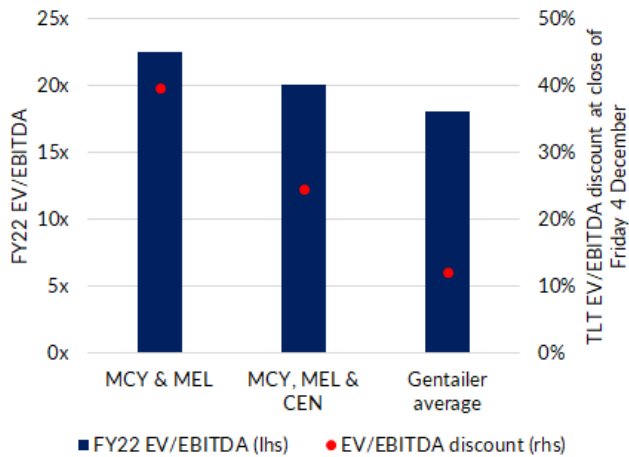
	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	n/a	n/a	n/a	n/a	n/a
Return on equity (%)	n/a	n/a	n/a	n/a	n/a
Return on funds employed (%)	n/a	n/a	n/a	n/a	n/a
EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
Capex to sales (%)	n/a	n/a	n/a	n/a	n/a
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	51	60	55	55	55
Pay-out ratio (%)	n/a	n/a	n/a	n/a	n/a

**NAV Calculation**
**Investment**

	% Owned	Value \$m	Value/ share
Trustpower	51%	1,200	1.7
Vodafone	50%	1,338	1.9
CDC Data Centres	48%	2,318	3.2
Wellington Intl Airport	66%	870	1.2
Tilt Renewables	65%	1,232	1.7
RetireAustralia	50%	274	0.4
Longroad Energy	40%	200	0.3
Other	100%	211	0.3
<b>Total Assets</b>		<b>7,643</b>	<b>10.6</b>
Less : PV of corporate costs		(643)	(0.9)
Less : PV of expected 5Y performance fees		(449)	(0.6)
Less : Bank debt		(287)	(0.4)
Less : Infrastructure & Perp Bonds		(1,304)	(1.8)
<b>Net Assets</b>		<b>4,960</b>	<b>6.9</b>
NAV discount		10%	10%
<b>IFT value</b>		<b>4,509</b>	<b>6.2</b>

## Figures of interest

Figure 1. NZ gentailer valuations



Source: Forsyth Barr analysis, Bloomberg

Figure 3. Snowtown 2 valuation comparison

Snowtown 2 sale EV/EBITDA	15.9
December 2019 MCY, MEL & CEN EV/EBITDA	15.2
<b>Snowtown 2 premium</b>	<b>5%</b>
FY22E MCY, MEL and CEN average	20.1
Implied multiple using 5% premium	21.0
Implied TLT EV (NZ\$m)	2,276
Equity value (NZ\$m)	2,119
<b>Implied TLT share price (NZ\$/share)</b>	<b>\$5.63</b>

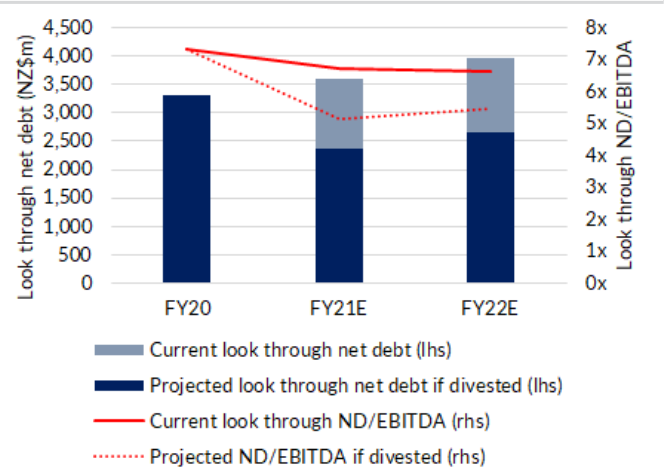
Source: Forsyth Barr analysis, Bloomberg

Figure 2. Comparative pricing scenarios

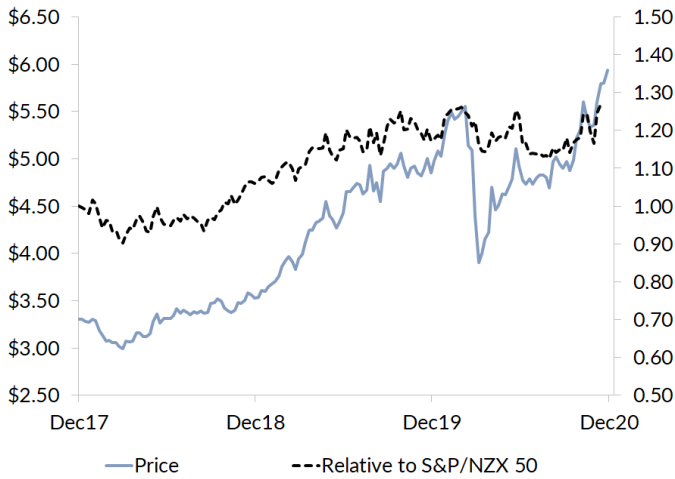
	FY22 EV/EBITDA	Implied price (NZ\$)	IFT value (NZ\$)	IFT value/share (NZ\$)	IFT uplift/share after fee (NZ\$)
MCY & MEL	22.5	6.42	1,582	2.19	0.68
MCY, MEL & CEN	20.1	5.69	1,402	1.94	0.48
Gentailer average	18	5.08	1,253	1.73	0.32

Source: Forsyth Barr analysis, Bloomberg

Figure 4. IFT net debt



Source: Forsyth Barr analysis, Company reports. NB: projection is based on a NZ\$5 divestment

**Figure 5. Price performance**


Source: Forsyth Barr analysis

**Figure 6. Substantial shareholders**

Shareholder	Latest Holding
ACC	6.1%
Fisher Funds Management	5.0%

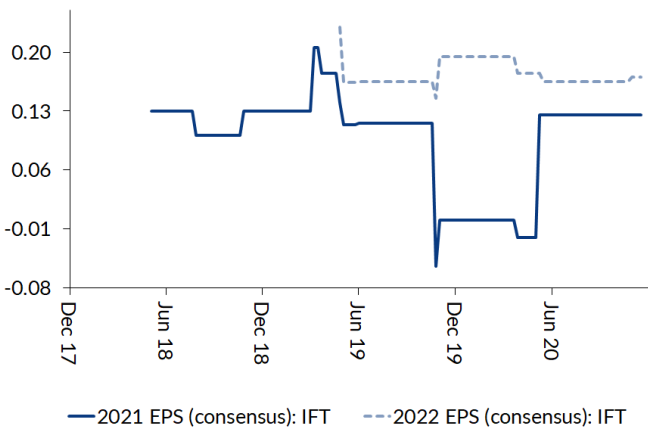
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 7. International valuation comparisons**

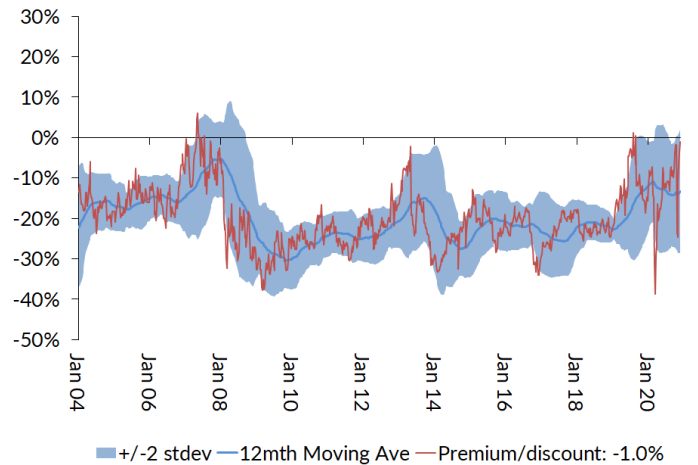
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
Infratil	IFT NZ	NZ\$5.94	NZ\$4,293	n/a	n/a	n/a	n/a	n/a	n/a	2.9%
Compcop Average:				n/a	n/a	n/a	n/a	n/a	n/a	n/a
IFT Relative:				n/a	n/a	n/a	n/a	n/a	n/a	n/a

EV = Current Market Cap + Actual Net Debt

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

**Figure 8. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 9. Historic discount to NAV**


Source: Forsyth Barr analysis

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