

Napier Port

Planning to Make up Leeway

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NEUTRAL 

Napier Port's (NPH) third quarter results highlights earnings resilience despite the adverse impact of COVID-19. NPH had already released 3Q20 volumes last month, therefore, new information reflects (1) 3Q20 profitability, and (2) full year guidance. Third quarter profitability was down materially on the prior year due to a sharp revenue decline on a high fixed cost base; the former in part a function of the later timing of some pipfruit exports. NPH has reinstated FY20 NPAT guidance of "approximately NZ\$20m", unchanged from the prospective financial information (PFI) guidance at the time of listing last year that was removed at the start of Alert Level 4. The earnings guidance suggests management confidence in a strong 4Q20, which given the seasonally slower container trade should be principally driven by log exports. NPH trades at a one year forward EV/EBITDA of ~17x, which, while at a material discount to larger peer, Port of Tauranga (POT), is fair given its lower return on capital outlook, in our opinion.

NZX Code	NPH	Financials: Sep/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$3.54	NPAT* (NZ\$m)	19.7	20.1	21.1	25.5	EV/EBITDA	17.9	17.3	17.1	14.2
Target price	NZ\$3.80	EPS* (NZc)	16.3	10.0	10.5	12.8	EV/EBIT	25.4	25.1	24.5	20.0
Risk rating	Medium	EPS growth* (%)	n/a	-38.6	5.1	20.9	PE	21.7	35.3	33.6	27.8
Issued shares	200.0m	DPS (NZc)	2.5	5.1	7.8	10.1	Price / NTA	1.3	2.1	2.0	1.9
Market cap	NZ\$708m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.7	1.4	2.2	2.9
Avg daily turnover	200.5k (NZ\$659k)	*Based on normalised profits					Gross div yld (%)	1.0	2.0	3.1	4.0

What's changed?

- **Earnings:** FY20 and FY21 NPAT forecasts lifted +8% and +5% respectively
- **Target Price:** Raised to NZ\$3.80, reflective of earnings upgrades and a lower WACC on revised inputs

Subdued 3Q activity; FY20 earnings guidance reinstated

Pro forma NPAT was NZ\$4.2m in 3Q20, down -44% from NZ\$7.5m in 3Q19. The pro forma result excludes the NZ\$2m received under the government's wage subsidy scheme. Both container (-14% against the prior year) and bulk cargo (-20%) revenues declined materially on weaker volumes. The reinstated NPAT guidance of "approximately NZ\$20m", which also excludes the wage subsidy, implies strong 4Q20 earnings, which will be up materially on 4Q19.

Figure 1. Implied 2H20 pro forma NPAT

	1H	2H	FY
FY19	10.5	9.2	19.7
FY20E	11.2	8.8	20.0
Change	6.6%	-4.3%	1.5%

Source: NPH, Forsyth Barr analysis

Figure 2. Implied 4Q20 pro forma NPAT

	3Q	4Q	2H
FY19	7.5	1.6	9.2
FY20E	4.2	4.5	8.8
Change	-43.5%	176.3%	-4.3%

Source: NPH, Forsyth Barr analysis

Dividend decision yet to be made

NPH is yet to make a decision on its final dividend. The Board continues to say that it intends to pay a final dividend in accordance with its dividend policy (70%–90% of free cash flow), subject to the outlook at the time. The company suspended its interim dividend when it reported its 1H20 results on 26 May 2020, citing the uncertain outlook, although we suspect the decision was partly a function of its receipt of wage subsidies. We expect NPH to pay a final dividend of 5.1cps, ~42% of our FY20E free cash flow.

Napier Port Ltd (NPH)

 Priced as at 25 Aug 2020 (NZ\$) 3.54

12-month target price (NZ\$)*	3.80
Expected share price return	7.3%
Net dividend yield	2.1%
Estimated 12-month return	9.5%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.78
WACC	5.1%
Terminal growth	1.0%

Spot valuations (NZ\$)	
1. DCF	3.86
2. Invested capital multiple	3.67
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	742
(Net debt)/cash	31
Less: Capitalised operating leases	0
Value of equity	773

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	91.7	99.6	101.2	104.8	118.1
Normalised EBITDA	37.2	40.5	40.3	42.7	51.6
Depreciation and amortisation	n/a	(12.0)	(12.5)	(13.0)	(15.2)
Normalised EBIT	n/a	28.5	27.8	29.8	36.4
Net interest	n/a	(0.5)	0.2	(0.5)	(1.0)
Associate income	n/a	(1.1)	0	0	0
Tax	n/a	(8.1)	(6.0)	(8.2)	(9.9)
Minority interests	n/a	0	0	0	0
Normalised NPAT	n/a	19.7	20.1	21.1	25.5
Abnormals/other	n/a	13.0	(3.6)	0	0
Reported NPAT	n/a	6.8	23.3	21.1	25.5
Normalised EPS (cps)	n/a	16.3	10.0	10.5	12.8
DPS (cps)	0	2.5	5.1	7.8	10.1

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	21.1	17.9	17.3	17.1	14.2
EV/EBIT (x)	n/a	25.4	25.1	24.5	20.0
PE (x)	n/a	21.7	35.3	33.6	27.8
Price/NTA (x)	n/a	1.3	2.1	2.0	1.9
Free cash flow yield (%)	n/a	1.7	-5.3	-7.0	-6.4
Net dividend yield (%)	0.0	0.7	1.4	2.2	2.9
Gross dividend yield (%)	0.0	1.0	2.0	3.1	4.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	n/a	57.4	n/a	63.4	37.0
Interest cover EBITDA (x)	n/a	81.5	n/a	91.0	52.4
Net debt/ND+E (%)	27.5	-10.3	7.9	19.0	28.6
Net debt/EBITDA (x)	2.2	n/a	0.7	2.0	2.9

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	5.8	8.6	1.6	3.6	12.6
EBITDA (%)	5.3	9.0	-0.5	6.0	20.7
EBIT (%)	n/a	n/a	-2.5	7.0	22.3
Normalised NPAT (%)	n/a	n/a	1.8	5.1	20.9
Normalised EPS (%)	n/a	n/a	-38.6	5.1	20.9
Ordinary DPS (%)	n/a	n/a	>100	54.7	29.5

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	n/a	7.7	6.8	6.1	6.5
Return on equity (%)	n/a	5.9	5.8	5.9	6.9
Return on funds employed (%)	0.0	8.9	8.0	6.4	6.4
EBITDA margin (%)	40.5	40.7	39.8	40.8	43.7
EBIT margin (%)	n/a	28.6	27.5	28.4	30.8
Capex to sales (%)	n/a	17.5	67.9	79.7	72.5
Capex to depreciation (%)	n/a	145	550	645	565
Imputation (%)	0	100	100	100	100
Pay-out ratio (%)	n/a	15	50	74	79

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	37.2	40.5	40.3	42.7	51.6
Working capital change	n/a	1.2	0	0	0.0
Interest & tax paid	n/a	(15.6)	(6.7)	(8.7)	(10.9)
Other	n/a	3.2	(2.4)	0	0
Operating cash flow	n/a	29.3	31.2	34.1	40.7
Capital expenditure	n/a	(17.4)	(68.7)	(83.6)	(85.7)
(Acquisitions)/divestments	n/a	(0.1)	(0.1)	0	0
Other	n/a	(79.9)	(1.1)	0	0
Funding available/(required)	n/a	(68.0)	(38.7)	(49.5)	(45.0)
Dividends paid	n/a	(54.0)	(11.0)	(16.4)	(17.5)
Equity raised/(returned)	n/a	234.0	(0.3)	0	0
(Increase)/decrease in net debt	n/a	112.0	(50.0)	(65.9)	(62.5)

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ\$m)					
Container Services		58.0	61.2	63.5	66.6
Bulk Cargo		29.0	32.3	31.0	35.7
Cruise		2.6	3.7	4.2	0
Sundry		0.4	0.2	0.4	0.4
Property		1.9	2.2	2.1	2.1
Total revenue		91.8	99.6	101.2	104.8

Container volumes (TEU'000)	2018A	2019A	2020E	2021E	2022E
Dry		107	106	99	105
Reefer		53	58	60	62
Empties		100	103	104	103
Other		7	4	9	9
Total containers		267	271	272	279

Bulk cargo (m tonnes)	2018A	2019A	2020E	2021E	2022E
Log exports		2,208	2,581	2,350	2,700
Other exports		177	167	142	159
Imports		686	656	590	661
Total bulk cargo volume		3,071	3,404	3,082	3,520

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	2.8	0.7	0.3	1.0	1.2
Fixed assets	309.6	317.2	383.1	453.7	524.2
Intangibles	1.3	1.1	1.8	1.8	1.8
Right of use asset	0	0	0.7	0.7	0.7
Other assets	8.8	8.4	8.2	8.2	8.2
Total funds employed	322.6	327.4	394.0	465.4	536.0
Net debt/(cash)	80.6	(31.2)	29.6	84.7	147.2
Lease liability	0	0.9	0.7	0.7	0.7
Other liabilities	29.6	22.2	19.8	19.8	19.8
Shareholder's funds	212.4	335.5	344.0	360.2	368.3
Minority interests	0	0	0	0	0
Total funding sources	322.6	327.4	394.0	465.4	536.0

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

NOTE: EBITDA referenced on this page reflects pro-forma EBITDA

Earnings revisions

We lift both our revenue and NPAT forecasts for FY20 and FY21 as shows in Figure 3. The earnings upgrade in FY20 is consistent with earnings guidance. We raise our volume expectations for both log exports (to 2.35mT) and containers (to 272kTEU) in FY20. We also lift our log exports modestly in FY21 (to 2.7mT). In light of management commentary around near term cost control, we also lower forecast expenses in all forecast years.

FY21 earnings growth is hampered by the unlikely return of cruise ships, which generated revenue/EBITDA of ~NZ\$4m in FY20. We assume no visits in FY21.

Our FY20 final dividend estimate is based on the interim:final weighting of 40:60 and the bottom end of NPH's pay-out range of 70%-90% of free cash flow (~NZ\$24.1m x 60% x 70% /200m shares = 5.1cps).

Figure 3. Earnings revisions (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Log exports (JASM)	2,250	2,350	4.4%	2,650	2,700	1.9%	3,000	3,000	0.0%
Containers (TEU)	262	272	3.8%	279	279	0.2%	287	288	0.2%
Sales revenue	96.8	101.2	4.6%	104.1	104.8	0.7%	116.8	118.1	1.1%
EBITDA	36.9	40.3	9.2%	40.5	42.7	5.5%	50.1	51.6	2.8%
Underlying NPAT	18.5	20.1	8.3%	20.1	21.1	4.7%	24.6	25.5	3.6%
Underlying EPS (cents)	9.3	10.0	8.3%	10.1	10.5	4.7%	12.3	12.8	3.6%
DPS (cents)	4.5	5.1	12.7%	7.8	7.8	0.4%	9.8	10.1	3.0%

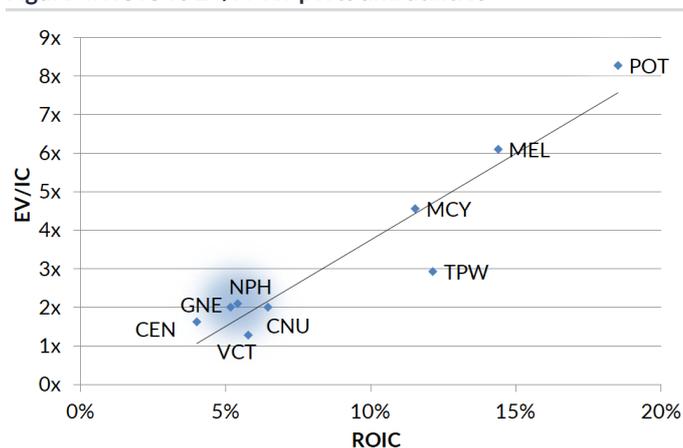
Source: Forsyth Barr analysis

Valuation

NPH is currently trading at a one year forward EV/EBITDA of ~17x. This is broadly in line with the listed utilities as shows in Figure 5, however, it is a material discount to its closest peer POT. We believe this discount is justified given the substantially lower ROIC that NPH generates, as shown in Figure 4.

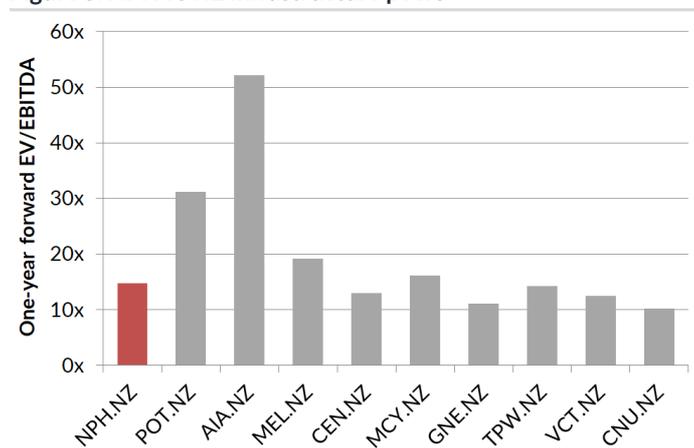
We lift our target price to NZ\$3.80 (from NZ\$3.25), due to (1) the earnings upgrades highlighted above, and (2) changes to our cost of capital inputs, which have reduced our risk-free rate to 1.3% and our market risk premium to 6%; refer to our report "*The Cost of Capital Conundrum: When TINA Came to Our Shores*", published 7 August 2020, for more detail. We also lower our terminal growth assumption for NPH to +1%.

Figure 4. ROIC vs EV/IV for ports and utilities



Source: Eikon, Forsyth Barr analysis

Figure 5. NPH vs NZ infrastructure peers



Source: Eikon, Forsyth Barr analysis

Investment Summary

Napier Port (NPH) is New Zealand's fourth largest container terminal and sixth largest bulk cargo port. The majority of its cargo is export and its productive hinterland drives most of its throughput with key trades including forestry and pipfruit. The Port is building a new wharf to ease congestion and provide greater capacity for growth. While it trades at a material discount to Port of Tauranga, the industry headwinds experienced as a result of COVID-19 disruption have had a material impact on NPH's earnings through FY20 to date. NEUTRAL.

Business quality

- **Long term infrastructure:** NPH is the gateway for Hawke's Bay favourable catchment of exports. Land transport costs provide a barrier to entry for other ports.
- **Pricing power:** NPH has a track record of being more aggressive with its approach to pricing than other NZ ports. We expect it to enhance returns following its 6 Wharf investment in part through higher pricing.

Earnings and cashflow outlook

- **Wall of wood:** Hawke's Bay has approximately 134,000 ha of planted forests. Due to the significant tree planting in the 1990s, particularly among smaller private forest owners, harvest volume should increase materially over the next five years (the wall of wood).
- **Pipfruit:** Hawke's Bay is NZ's largest region for producing pipfruit. The emergence of new apple varieties and ongoing tree planting programmes by the larger growers provide a favourable outlook.
- **6 Wharf:** NPH's significant investment in a new container wharf will provide capacity for longer term growth but will act as a headwind to earnings over the medium term given the associated costs (i.e. depreciation and interest).

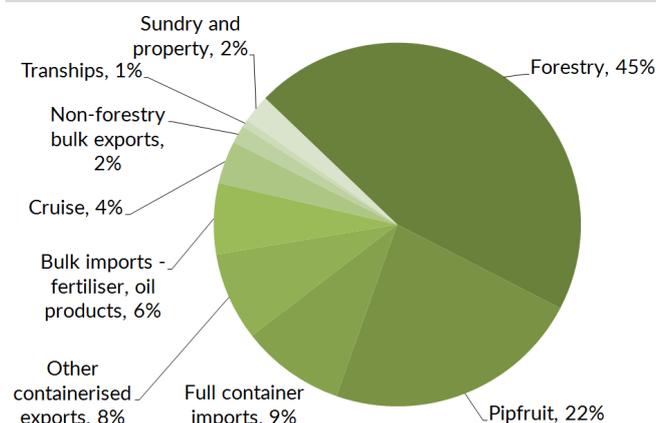
Financial structure

- **Rising debt levels:** NPH is currently cum-capex and will experience a leveraging up of its balance sheet over the medium term.

Risk factors

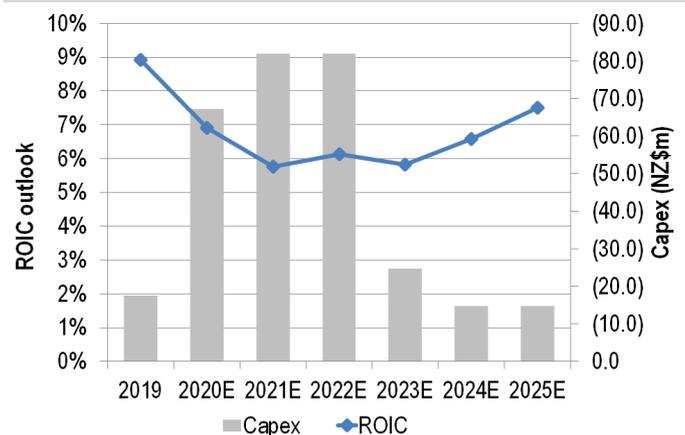
- **Industry sector risk:** Any change in the supply, or demand for NZ forestry/pipfruit could have a material impact on the Ports financial performance.
- **Competition from other ports:** Increased competition from other ports may mean that NPH loses cargo in future, particularly current contestable cargo.

Figure 6. NPH estimated revenue mix (FY19)

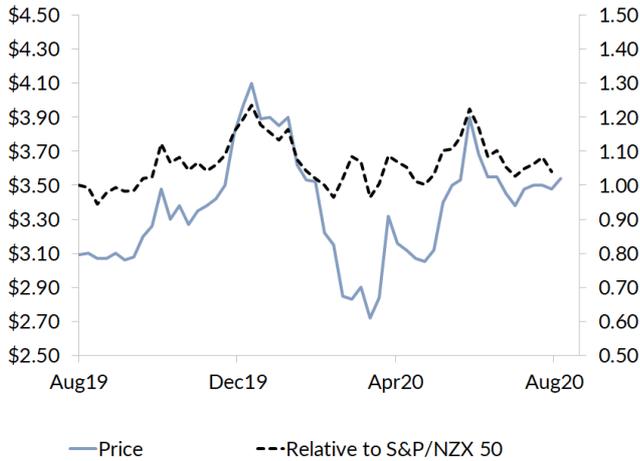


Source: Forsyth Barr analysis

Figure 7. Returns under pressure from 6 Wharf capex



Source: Forsyth Barr analysis

Figure 8. Price performance


Source: Forsyth Barr analysis

Figure 9. Substantial shareholders

Shareholder	Latest Holding
Hawke's Bay Regional Council	55.0%

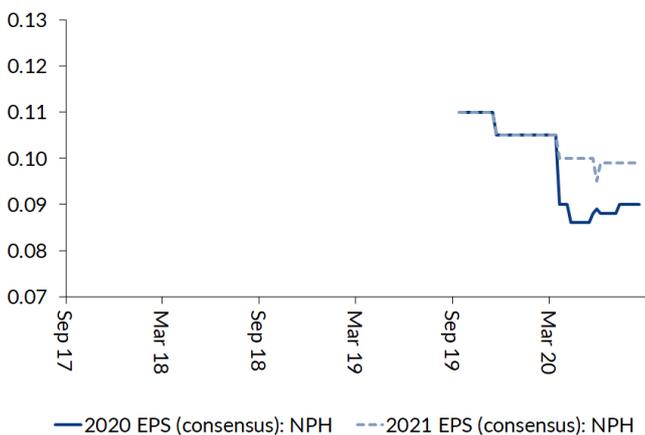
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. International valuation comparisons

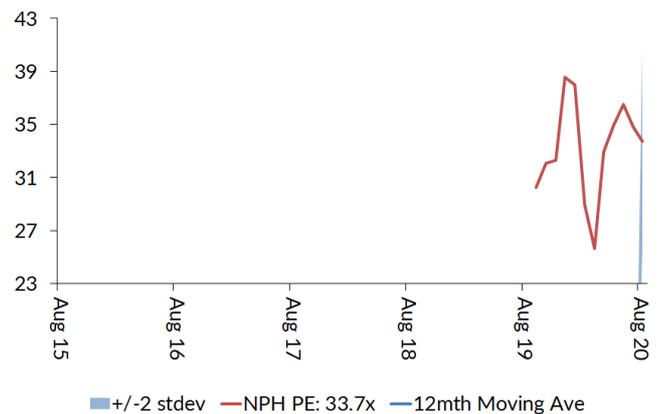
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect NPH's balance date - September)										
				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Napier Port	NPH NZ	NZ\$3.54	NZ\$708	35.3x	33.6x	16.8x	15.8x	24.3x	22.7x	2.2%
PORT OF TAURANGA *	POT NZ	NZ\$7.48	NZ\$5,088	>50x	48.9x	33.3x	30.4x	40.5x	36.6x	1.9%
QUBE HOLDINGS	QUB AT	A\$2.92	A\$5,500	44.2x	41.6x	26.7x	24.0x	51.1x	45.4x	1.8%
GLOBAL PORTS INV-GDR REG S	GLPR LI	US\$3.20	US\$611	13.5x	7.5x	6.3x	5.8x	8.6x	7.8x	1.1%
HAMBURGER HAFEN UND LOGISTIK	HHFA GR	€15.74	€1,145	47.0x	26.3x	6.0x	5.4x	14.6x	11.5x	3.4%
WESTSHORE TERMINALS INVESTME	WTE CN	C\$17.94	C\$1,169	9.1x	12.4x	6.4x	8.1x	7.3x	9.6x	4.7%
MITSUBISHI LOGISTICS CORP	9301 JP	¥3075.00	¥270,479	21.8x	18.6x	13.3x	12.9x	n/a	n/a	2.0%
EUROKAI KGAA	EUK2 GR	€25.40	€331	28.9x	20.6x	7.0x	6.7x	10.2x	9.4x	n/a
AUCKLAND AIRPORT *	AIA NZ	NZ\$6.63	NZ\$9,763	<0x	<0x	38.3x	56.7x	>75x	>75x	0.2%
SYDNEY AIRPORT	SYD AT	A\$5.44	A\$13,912	<0x	>50x	45.6x	38.3x	>75x	>75x	1.8%
Compco Average:				27.4x	25.1x	20.3x	20.9x	22.1x	20.1x	2.1%
NPH Relative:				29%	34%	-17%	-24%	10%	13%	5%

EV = Current Market Cap + Actual Net Debt

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

Figure 11. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 12. One year forward PE (x)


Source: Forsyth Barr analysis

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