

# Port of Tauranga

UNDERPERFORM

## FY19 Preview — Capital Management to Continue

Port of Tauranga (POT) will report its FY19 result on Wednesday 28 August 2019; we expect a third consecutive year of robust volume growth (+7%) translating to modest (+6%) full year NPAT growth. Our forecasts are consistent with management NPAT guidance: “the upper end of the previous guidance of NZ\$96m–NZ\$101m”.

### Key issues to consider at POT's FY19 result

- Above trend trade growth:** Cargo growth of +9% in 1H19 is likely to have slowed through 2H19, but will remain at an elevated level above the long term growth rate of +5%. More specifically, log exports have grown +12% in FY19 according to NZ Stats data and containers are up +5% in TEU terms, based on Ministry of Transport data. Growth will likely slow into FY20, not least given the slowdown in forestry harvesting due to weaker export log prices.
- Lacking operating leverage:** POT has achieved consistent profit growth in recent years helped by resurgent cargo growth. However, it has been unable to generate any operating leverage (margin expansion). We think this reflects the lower margin nature of incremental cargo, in particular container transshipments and MetroPort related containers.
- Associates and JVs:** Coda was a key disappointment in 1H19 (prior year audit adjustment and weak operational execution) and together with Northport (-7% decline in log volumes for the year) and Timaru Container Terminal (softer container volumes), will contribute to a material decline in associate income in the year, on our estimates.
- Capital management potential:** POT's existing four year capital management programme, which has added a 5c special dividend onto each final dividend, ends in FY19. In light of balance sheet capacity we expect the programme to be extended for at least for another two years. This should support an otherwise depressed dividend yield (cash yield with the special is ~3%).

NZX Code	POT
Share price	NZ\$6.10
Target price	NZ\$4.80
Risk rating	Low
Issued shares	680.6m
Market cap	NZ\$4,152m
Average daily turnover	131.6k (NZ\$722k)

### Share Price Performance



Financials: June	18A	19E	20E	21E
NPAT* (NZ\$m)	95.1	100.4	107.6	113.4
EPS* (NZc)	14.0	14.8	15.8	16.7
EPS growth* (%)	13.4	5.7	7.1	5.4
DPS (NZc)	17.7	18.5	19.4	20.2
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	28.6	26.1	24.6	23.2
EV/EBIT	34.2	31.1	29.2	27.4
PE	43.7	41.3	38.6	36.6
Price / NTA	3.7	3.8	3.8	3.9
Cash dividend yield (%)	2.9	3.0	3.2	3.3
Gross dividend yield (%)	4.0	4.2	4.4	4.6

\*Historic and forecast numbers based on underlying profits

Figure 1. Forecast summary (NZ\$m)

	FY18	FY19	Change	Consensus
Sales revenue	283.2	305.5	7.9%	306.5
EBITDA	154.1	170.2	10.4%	172.1
Associates	15.1	11.0	-27.3%	n/a
Reported NPAT	94.3	100.4	6.6%	100.6
<b>Underlying NPAT</b>	<b>95.1</b>	<b>100.4</b>	<b>5.7%</b>	<b>100.6</b>
Underlying EPS (cents)	14.0	14.8	5.7%	14.8
Final DPS (cents)	7.0	7.5	7.1%	n/a
Special DPS (cents)	5.0	5.0	0.0%	n/a

Source: Eikon, Forsyth Barr analysis

### Investment View

POT has historically traded at a material premium to the market. We expect this to continue given its high returns, longer-term growth outlook, strong management team and operational capability. However, the rate of future profit growth is modest through the cycle rather than strong. With the share price more than factoring in the positives, including potential structural changes in light of the Upper North Island logistics and freight review, our rating is UNDERPERFORM.

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**Port of Tauranga Ltd (POT)**

Priced as at 23 Aug 2019: NZ\$6.10

June year end

Forsyth Barr valuation					Valuation Ratios						
Valuation methodology					2017A 2018A 2019E 2020E 2021E						
DCF and sum-of-the-parts					EV/EBITDA (x)	31.6	28.6	26.1	24.6	23.2	
					EV/EBIT (x)	38.3	34.2	31.1	29.2	27.4	
<b>12-month target price (NZ\$)*</b>	<b>4.80</b>	<b>Spot valuations (NZ\$)</b>			PE (x)	49.5	43.7	41.3	38.6	36.6	
Expected share price return	-21.3%	1. DCF		4.26	Price/NTA (x)	4.5	3.7	3.8	3.8	3.9	
Net dividend yield	3.2%	2. Sum-of-the-parts		5.02	Free cash flow yield (%)	0.8	2.0	1.7	1.7	1.9	
Estimated 12-month return	-18.1%	3. n/a		n/a	Net dividend yield (%)	2.7	2.9	3.0	3.2	3.3	
					Gross dividend yield (%)	3.7	4.0	4.2	4.4	4.6	
<b>Key WACC assumptions</b>					Imputation (%)	100	100	100	100	100	
<b>DCF valuation summary (NZ\$m)</b>					Pay-out ratio (%)	131	127	125	123	121	
Risk free rate	2.75%	Total firm value		3,412	<b>Capital Structure</b>						
Equity beta	0.73	(Net debt)/cash		(512)	2017A	2018A	2019E	2020E	2021E		
WACC	6.9%	Value of equity		2,900	Interest cover EBIT (x)	6.8	7.1	7.9	7.8	7.2	
Terminal growth	2.0%	Shares (m)		681	Interest cover EBITDA (x)	8.3	8.5	9.4	9.2	8.5	
					Net debt/ND+E (%)	28.7	26.3	28.6	30.9	35.1	
					Net debt/EBITDA (x)	2.7	2.6	2.6	2.7	3.0	
<b>Profit and Loss Account (NZ\$m)</b>					<b>Key Ratios</b>						
2017A	2018A	2019E	2020E	2021E	2017A	2018A	2019E	2020E	2021E		
Sales revenue	256	283	305	322	340	Return on assets (%)	8.0	7.8	8.4	8.8	9.2
<b>Normalised EBITDA</b>	<b>138</b>	<b>154</b>	<b>170</b>	<b>181</b>	<b>192</b>	Return on equity (%)	9.0	8.5	9.1	9.8	10.7
Depreciation and amortisation	(24)	(25)	(28)	(28)	(29)	Return on funds employed (%)	17.2	18.4	18.9	19.1	19.2
<b>Normalised EBIT</b>	<b>114</b>	<b>129</b>	<b>142</b>	<b>152</b>	<b>162</b>	EBITDA margin (%)	54.0	54.4	55.7	56.0	56.4
Net interest	(17)	(18)	(18)	(20)	(23)	EBIT margin (%)	44.4	45.5	46.6	47.2	47.8
Associate income	14	15	11	14	14	Capex to sales (%)	26.0	6.3	16.4	15.5	15.8
Tax	(28)	(32)	(35)	(38)	(41)	Capex to depreciation (%)	272	70	180	176	184
Minority interests	-	-	-	-	-	<b>Operating Performance</b>					
<b>Normalised NPAT</b>	<b>84</b>	<b>95</b>	<b>100</b>	<b>108</b>	<b>113</b>	2017A	2018A	2019E	2020E	2021E	
Abnormals/other	0	1	-	-	-	<b>Revenue (NZ\$m)</b>					
<b>Reported NPAT</b>	<b>83</b>	<b>94</b>	<b>100</b>	<b>108</b>	<b>113</b>	Port operations	227	251	271	287	303
Normalised EPS (cps)	12.3	14.0	14.8	15.8	16.7	Property services	25	27	29	30	31
DPS (cps)	16.2	17.7	18.5	19.4	20.2	Transport services	-	-	-	-	-
					Marshalling Services	5	5	5	5	6	
					<b>Total revenue</b>	<b>256</b>	<b>283</b>	<b>305</b>	<b>322</b>	<b>340</b>	
					<b>Port operations revenue (NZ\$m)</b>						
					Container revenue	147	163	176	187	198	
					Bulk revenue	46	51	56	56	58	
					Marine revenue	35	37	40	44	47	
					<b>Total</b>	<b>227</b>	<b>251</b>	<b>271</b>	<b>287</b>	<b>303</b>	
					<b>EBITDA (NZ\$m)</b>						
					Port operations	227	251	271	287	303	
					Property services	25	27	29	30	31	
					Transport services	-	-	-	-	-	
					Marshalling Services	3	4	4	5	5	
					Unallocated expenses	(116)	(128)	(135)	(141)	(147)	
					Other income	(0)	0	-	-	-	
					<b>Total EBITDA</b>	<b>138</b>	<b>154</b>	<b>170</b>	<b>181</b>	<b>192</b>	
					<b>Container trade (TEU'000)</b>						
					Metroport	287	298	312	312	322	
					Transshipments	282	354	425	467	514	
					Empty containers	193	202	185	226	240	
					Other full containers	291	307	310	323	336	
					<b>Terminal containers</b>	<b>1,053</b>	<b>1,161</b>	<b>1,232</b>	<b>1,328</b>	<b>1,411</b>	
					Change (%)		10.3	6.1	7.8	6.3	
					<b>Bulk trade ('000 tonnes)</b>						
					Logs	5,490	6,276	7,029	7,029	7,029	
					Other bulk	4,664	5,093	5,195	5,195	5,403	
					<b>Total bulk</b>	<b>10,154</b>	<b>11,369</b>	<b>12,224</b>	<b>12,224</b>	<b>12,432</b>	
					Change (%)		12.0	7.5	0.0	1.7	
<b>Balance Sheet (NZ\$m)</b>					<b>2017A 2018A 2019E 2020E 2021E</b>						
Working capital	14	19	16	17	17						
Fixed assets	1,227	1,446	1,468	1,491	1,516						
Intangibles	18	19	19	19	19						
Other assets	128	134	145	159	173						
<b>Total funds employed</b>	<b>1,386</b>	<b>1,619</b>	<b>1,648</b>	<b>1,685</b>	<b>1,724</b>						
Net debt/(cash)	375	400	443	491	571						
Other non current liabilities	79	97	97	97	97						
Shareholder's funds	932	1,122	1,108	1,097	1,056						
Minority interests	-	-	-	-	-						
<b>Total funding sources</b>	<b>1,386</b>	<b>1,619</b>	<b>1,648</b>	<b>1,685</b>	<b>1,724</b>						

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

## FY19 Preview

Figure 2. Summary of earnings forecasts for POT's FY19 result (NZ\$m)

	FY18	FY19E	Change
<b><u>Profit and loss account</u></b>			
Sales revenue	283.2	305.5	8%
Port operations	251.4	271.3	8%
Property services	26.9	29.1	8%
Marshalling services	3.7	4.4	21%
Unallocated expenses and other	(127.9)	(134.7)	5%
<b>EBITDA</b>	<b>154.1</b>	<b>170.2</b>	<b>10%</b>
Depreciation and amortisation	(25.3)	(27.8)	10%
<b>EBIT</b>	<b>128.8</b>	<b>142.3</b>	<b>11%</b>
Associate income	15.1	11.0	-27%
One-time items	0.4	0.0	n/a
Interest expense	(18.0)	(18.1)	0%
Profit before tax	126.4	135.2	7%
Taxation	(32.1)	(34.8)	8%
<b>Reported NPAT</b>	<b>94.3</b>	<b>100.4</b>	<b>7%</b>
Abnormals (post tax)	0.8	0.0	n/a
<b>Underlying NPAT</b>	<b>95.1</b>	<b>100.4</b>	<b>6%</b>
Underlying EPS (cents)	14.0	14.8	6%
Final DPS (cents)	7.0	7.5	7%
Special dividend (cents)	5.0	5.0	0%
<b><u>Cashflow and net debt</u></b>			
Operating cashflow	99.4	117.3	18%
Maintenance capex = depreciation	(25.3)	(27.8)	10%
<b>Free cash flow</b>	<b>74.1</b>	<b>89.5</b>	<b>21%</b>
Acquisitions	0.4	0.0	n/a
Disposals	0.0	0.0	n/a
Net debt	399.5	443.0	30%
<b><u>Divisional data</u></b>			
Container revenue	162.7	176.0	8%
Bulk revenue	51.3	55.7	8%
Marine revenue	37.4	39.7	6%
<b>Port operations revenue</b>	<b>251.4</b>	<b>271.3</b>	<b>8%</b>
Metroport (TEU)	297,517	312,393	5%
Transhipments (TEU)	353,936	424,723	20%
Other containers	509,856	495,294	-3%
<b>Terminal containers (TEU)</b>	<b>1,161,309</b>	<b>1,232,410</b>	<b>6%</b>
Logs ('000 tonnes)	6,276	7,029	12%
Other ('000 tonnes)	5,093	5,195	2%
<b>Total bulk tonnage ('000 tonnes)</b>	<b>11,369</b>	<b>12,224</b>	<b>8%</b>

Source: Forsyth Barr analysis

## Investment summary

Port of Tauranga (POT) is a key strategic asset within New Zealand's international export/import supply chain. The company is sensibly pursuing a hub port strategy by investing in capacity and enhancing its cargo aggregation capabilities. However, other ports are also investing which is damaging industry returns given industry overinvestment. While earnings growth recommenced in FY17 after a four year hiatus, we believe current elevated valuation levels are more than reflecting the current modest growth outlook, and therefore rate POT as UNDERPERFORM.

### Business quality

- **Hub-port:** POT's strategy evolves around its objective of being New Zealand's hub port. Its favourable draught following recent dredging facilitates bigger ships and greater transshipments from elsewhere in NZ.
- **Multi-year agreements:** POT has long term agreements with key shippers including Kotahi and Zespri. These agreements provide volume certainty.

### Earnings and cash flow outlook

- **Earnings growth phase:** After period of flat earnings during a capex bulge, POT is now leveraging recent investments and growing earnings.
- **Container handling:** POT's business model is focussed on container terminal expansion, container aggregation and inland supply chains. A key requirement of the Kotahi deal was transshipments of South Island exports through Tauranga. This doesn't appear likely near term.
- **Log export volumes:** Higher margin logs represent a key earnings stream. The location of POT and the central North Island forestry harvest profile are supportive to long term log revenues at or around current levels.

### Company description

POT is New Zealand's largest port and the major export port. It is majority owned by the Bay of Plenty Regional Council. POT has undergone port expansion in recent years which have facilitated the arrival of bigger ships. Cargo that crosses the wharf includes containers and bulk products including export logs. Given its 10-year arrangement with Kotahi (signed in 2014) it is increasingly exposed to dairy exports. In recent years it has strengthened its cargo aggregation capabilities with its investments in PrimePort Timaru, Rolleston and the Coda JV with Kotahi. POT also owns 50% of NorthPort.

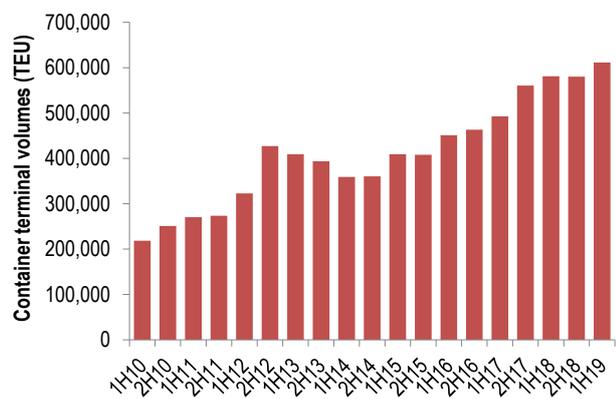
### Financial structure

- **Balance sheet:** Net debt has doubled over the past six years given the capex bulge which has facilitated the hub port strategy.
- **Dividends:** POT will pay its final special dividend (5c each year) later this year as part of a four year capital management programme. The current ordinary dividend pay-out is ~90% within the targeted range of 70%–100%.

### Risks factors

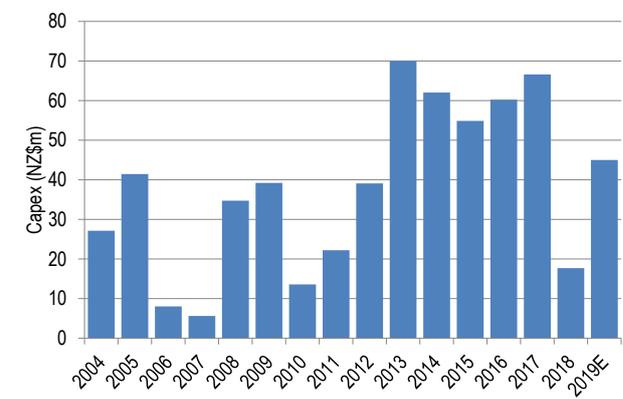
- **Industry competition:** Over investment by other ports is impacting industry ROIC.
- **Chinese log demand:** POT's log exporters are heavily exposed to Chinese construction industry demand for unprocessed timber.

Figure 3. Container volumes in recent periods



Source: Company reports, Forsyth Barr analysis

Figure 4. Capex history



Source: Company reports, Forsyth Barr analysis

**Figure 5. Substantial Shareholders**

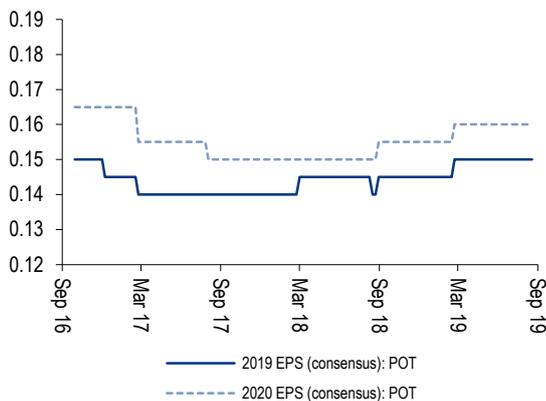
Shareholder	Latest Holding
Quayside Securities	54.1%

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

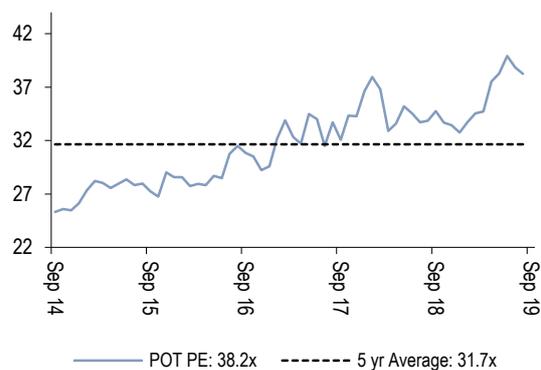
**Figure 6. International Compcos**

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld	
				2019E	2020E	2019E	2020E	2019E	2020E		
<i>(metrics re-weighted to reflect POT's balance date - June)</i>											
<b>Port of Tauranga</b>	<b>POT NZ</b>	<b>NZ\$6.10</b>	<b>NZ\$4,152</b>	<b>41.3x</b>	<b>38.6x</b>	<b>26.7x</b>	<b>25.2x</b>	<b>32.0x</b>	<b>29.9x</b>	<b>2.4%</b>	
Mitsubishi Logistics Corp	9301 JP	¥2638.00	¥232,040	19.7x	18.7x	11.1x	11.2x	23.0x	23.8x	2.3%	
Westshore Terminals Investment Corp	WTE CN	C\$21.70	C\$1,497	11.8x	11.2x	8.8x	8.3x	9.8x	9.4x	2.9%	
Hamburger Hafen und Logistik AG	HHFA GR	€21.84	€1,589	14.4x	14.3x	6.4x	6.1x	10.2x	10.1x	4.0%	
Global Ports Investments PLC	GLPR LI	US\$2.74	US\$523	<0x	6.0x	6.4x	5.9x	8.6x	7.8x	0.0%	
Eurokai GmbH & Co KGaA	EUK2 GR	€34.00	€442	11.3x	11.0x	3.9x	3.7x	6.0x	5.4x	n/a	
Auckland Airport *	AIA NZ	NZ\$9.59	NZ\$11,617	42.1x	43.2x	24.8x	24.7x	30.4x	30.9x	2.3%	
Sydney Airport	SYD AT	A\$8.15	A\$18,408	49.3x	46.0x	21.3x	20.3x	31.7x	29.9x	4.9%	
Qube Holdings	QUB AT	A\$3.18	A\$5,108	25.9x	36.1x	15.2x	19.1x	21.1x	31.6x	2.0%	
<b>Compcos Average:</b>				<b>24.9x</b>	<b>23.3x</b>	<b>12.2x</b>	<b>12.4x</b>	<b>17.6x</b>	<b>18.6x</b>	<b>2.6%</b>	
<b>EV = Current Market Cap + Actual Net Debt</b>				<b>POT Relative:</b>	<b>+66%</b>	<b>+65%</b>	<b>+119%</b>	<b>+103%</b>	<b>+82%</b>	<b>+61%</b>	<b>-10%</b>

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

**Figure 7. Consensus EPS Momentum**


Source: Forsyth Barr analysis, Bloomberg

**Figure 8. 12 Month Forward PE**


Source: Forsyth Barr analysis

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