FORSYTH BARR

Port of Tauranga

UNDERPERFORM

FY19 — Coda've Been More

Port of Tauranga's (POT) FY19 earnings were in-line with market expectations, but of higher quality. While port profitability was strong, group returns were dragged down by losses at JV Coda. Underlying cargo growth has remained above trend for the third successive year, though will slow in FY20 given log export market issues. A lack of operating leverage has been a feature historically, though there is a glimmer of hope in the FY19 result with some core port margin expansion evident. Nonetheless, on a go-forward basis sustainable earnings growth is closer to mid-single digits than double digits and therefore we are still unable to justify current relative valuation levels (~25x EV/EBITDA; ~39x PE) despite the lower bond rate environment. We, hence, retain an UNDERPERFORM rating.

What's changed?

- **Earnings:** Minor immaterial adjustments
- **Target Price:** Increased to NZ$5.25 from NZ$4.80 to reflect a lower WACC assumption given risk free rate compression and POT's improved credit rating

Cargo growth to slow

Three years of synchronised cargo growth will likely come to an end in FY20. Log market pressures from lower export prices will temper log exports, despite very strong volumes through July and August. Container growth will continue but is subject to increased competitive tension with Ports of Auckland, as it completes its automation project. In the meantime, POT is being seemingly more aggressive in its approach to pricing than it has been for some time. This may help explain the operating leverage evident in FY19.

Bad year for Coda

JV Coda had a shocker. On a normalised basis it incurred a loss due to entering loss-making contracts, which were exacerbated in an accounting sense by a number of one-off write-offs. POT is confident of returning Coda to profitability in FY20 under new management. Other associate/JV investments were far less eventful. Northport, the largest, experienced a -2% decline in NPAT due to softer log export volumes.

Special dividend to continue but at a lower level

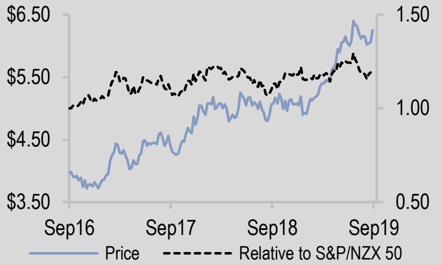
Excess imputation credits and balance sheet capacity has allowed POT to extend its capital management programme for a further four years, though at a lower level of special dividend (2.5c each year compared to 5.0c for the past four years). POT's balance sheet and business outlook has been rewarded by S&P raising its credit rating to A- which will assist financing costs in future.

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.

NZX Code	POT
Share price	NZ$6.25
Target price	NZ$5.25
Risk rating	Low
Issued shares	680.6m
Market cap	NZ$4,254m
Average daily turnover	130.1k (NZ$717k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ$m)	100.6	107.2	113.6	118.2
EPS* (NZc)	14.8	15.7	16.7	17.4
EPS growth* (%)	5.8	6.6	6.0	4.1
DPS (NZc)	18.3	16.9	17.7	18.3
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	26.2	25.3	23.6	22.2
EV/EBIT	31.2	30.0	27.9	26.1
PE	42.3	39.7	37.4	36.0
Price / NTA	3.7	3.7	3.7	n/a
Cash dividend yield (%)	2.9	2.7	2.8	2.9
Gross dividend yield (%)	4.1	3.7	3.9	4.1

*Historic and forecast numbers based on underlying profits

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Port of Tauranga Ltd (POT)	Priced as at 28 Aug 2019: NZ$6.25	June year end

Forsyth Barr valuation			
Valuation methodology			DCF and sum-of-the-parts
12-month target price (NZ$)*	**5.25**	**Spot valuations (NZ$)**	
Expected share price return	-16.0%	1. DCF	4.91
Net dividend yield	2.7%	2. Sum-of-the-parts	5.21
Estimated 12-month return	-13.3%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.00%	Total firm value	3,764
Equity beta	0.73	(Net debt)/cash	(420)
WACC	6.3%	Value of equity	3,344
Terminal growth	2.0%	Shares (m)	681

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	284	313	325	345	365
Normalised EBITDA	**154**	**173**	**181**	**195**	**208**
Depreciation and amortisation	(25)	(28)	(28)	(30)	(31)
Normalised EBIT	**129**	**146**	**153**	**165**	**177**
Net interest	(18)	(18)	(19)	(23)	(28)
Associate income	15	8	12	12	13
Tax	(32)	(34)	(39)	(41)	(43)
Minority interests	-	-	-	-	-
Normalised NPAT	**95**	**101**	**107**	**114**	**118**
Abnormals/other	1	-	-	-	-
Reported NPAT	**94**	**101**	**107**	**114**	**118**
Normalised EPS (cps)	14.0	14.8	15.7	16.7	17.4
DPS (cps)	17.7	18.3	16.9	17.7	18.3

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	10.6	10.4	3.8	6.2	5.7
EBITDA (%)	11.3	12.4	4.7	7.6	6.6
EBIT (%)	13.1	13.0	5.0	8.1	6.9
Normalised NPAT (%)	13.4	5.8	6.6	6.0	4.1
Normalised EPS (%)	13.4	5.8	6.6	6.0	4.1
Ordinary DPS (%)	13.4	4.7	8.0	6.0	4.1

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**154**	**173**	**181**	**195**	**208**
Working capital change	-	-	(0)	(0)	0
Interest & tax paid	(50)	(53)	(58)	(64)	(71)
Other	(5)	3	-	6	-
Operating cash flow	**99**	**124**	**124**	**137**	**137**
Capital expenditure	(18)	(60)	(60)	(110)	(110)
(Acquisitions)/divestments	0	-	-	-	-
Other	10	9	9	(23)	(23)
Funding available/(required)	**92**	**73**	**73**	**3**	**3**
Dividends paid	(115)	(130)	(130)	(123)	(123)
Equity raised/(returned)	(2)	-	-	-	-
Increase/(decrease) in net debt	**24**	**57**	**57**	**120**	**120**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	19	28	18	19	20
Fixed assets	1,446	1,531	1,563	1,643	1,669
Intangibles	19	19	19	19	19
Other assets	134	133	145	157	170
Total funds employed	**1,619**	**1,711**	**1,744**	**1,838**	**1,878**
Net debt/(cash)	400	442	500	571	691
Other non current liabilities	97	103	103	103	103
Shareholder's funds	1,122	1,166	1,142	1,164	1,084
Minority interests	-	-	-	-	-
Total funding sources	**1,619**	**1,711**	**1,744**	**1,838**	**1,878**

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	29.3	26.2	25.3	23.6	22.2
EV/EBIT (x)	35.0	31.2	30.0	27.9	26.1
PE (x)	44.7	42.3	39.7	37.4	36.0
Price/NTA (x)	3.8	3.7	3.7	3.7	3.9
Free cash flow yield (%)	1.9	1.5	1.5	0.6	0.6
Net dividend yield (%)	2.8	2.9	2.7	2.8	2.9
Gross dividend yield (%)	3.9	4.1	3.7	3.9	4.1
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	127	124	107	106	106

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	7.1	8.0	8.1	7.3	6.2
Interest cover EBITDA (x)	8.5	9.5	9.6	8.6	7.3
Net debt/ND+E (%)	26.3	27.5	30.4	32.9	38.9
Net debt/EBITDA (x)	2.6	2.6	2.8	2.9	3.3

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	7.8	8.3	8.5	8.7	9.1
Return on equity (%)	8.5	8.6	9.4	9.8	10.9
Return on funds employed (%)	18.4	19.4	19.6	19.0	18.4
EBITDA margin (%)	54.3	55.3	55.7	56.5	57.0
EBIT margin (%)	45.4	46.5	47.0	47.8	48.4
Capex to sales (%)	6.2	19.2	18.5	31.8	30.1
Capex to depreciation (%)	70	218	211	368	350

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ$m)					
Port operations	251	277	290	310	328
Property services	27	29	30	31	31
Transport services	-	-	-	-	-
Marshalling Services	5	5	5	5	6
Total revenue	**284**	**313**	**325**	**345**	**365**
Port operations revenue (NZ$m)					
Container revenue	164	182	192	205	219
Bulk revenue	51	58	59	63	65
Marine revenue	36	36	39	42	44
Total	**251**	**277**	**290**	**310**	**328**
EBITDA (NZ$m)					
Port operations	251	277	290	310	328
Property services	27	29	30	31	31
Transport services	-	-	-	-	-
Marshalling Services	4	5	5	5	5
Unallocated expenses	(128)	(141)	(144)	(150)	(157)
Other income	0	3	-	-	-
Total EBITDA	**154**	**173**	**181**	**195**	**208**
Container trade (TEU'000)					
Metroport	298	312	312	321	331
Transhipments	354	390	422	464	510
Empty containers	202	193	203	215	229
Other full containers	307	319	332	345	359
Terminal containers	**1,161**	**1,215**	**1,269**	**1,346**	**1,429**
Change (%)	n/a	4.6	4.4	6.1	6.2
Bulk trade ('000 tonnes)					
Logs	6,276	7,063	6,710	7,045	7,045
Other bulk	5,093	5,408	5,570	5,737	5,909
Total bulk	**11,369**	**12,471**	**12,280**	**12,783**	**12,955**
Change (%)	n/a	9.7	-1.5	4.1	1.3

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

Result summary: Strong cargo growth

Port of Tauranga's (POT) FY19 result was in-line with our and market expectations, with NPAT up +7% against the prior year. The robust result was driven by strong cargo growth at the core port operations, up +10% in the year, delivering port EBITDA growth +12%. Log exports grew +12% and containers were up +4%.

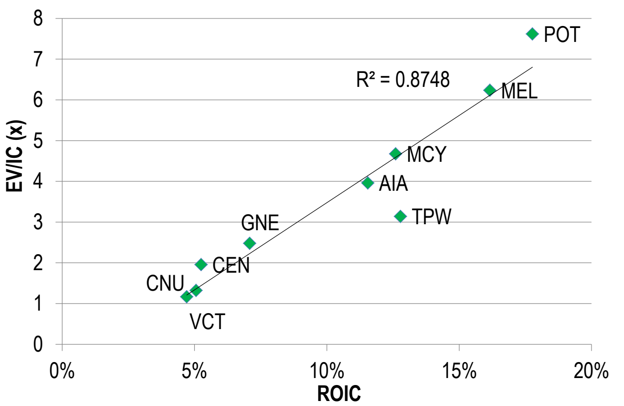
Figure 1. Result summary (NZ$m)

	FY18	FY19	Change	Forsyth Barr
Sales revenue	283.7	313.3	10.4%	305.5
EBITDA	154.1	173.2	12.4%	170.2
Associates	15.1	8.1	-46.5%	11.0
Reported NPAT	94.3	100.6	6.7%	100.4
Underlying NPAT	**95.1**	**100.6**	**5.8%**	**100.4**
Underlying EPS (cents)	14.0	14.8	5.8%	14.8
Final DPS (cents)	7.0	7.3	4.3%	7.5
Special DPS (cents)	5.0	5.0	0.0%	5.0

Source: POT, Forsyth Barr analysis

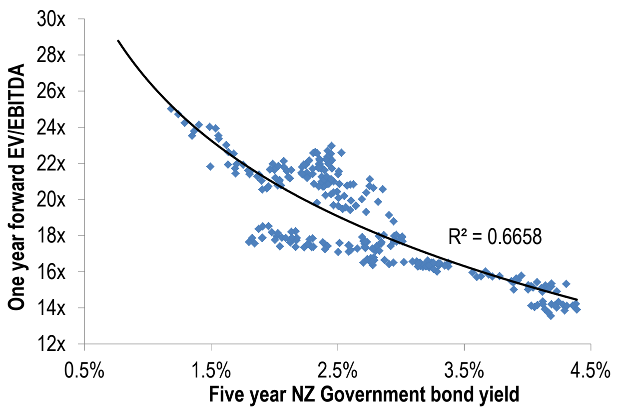
We raise our target price to NZ$5.25 from NZ$4.80 due to the lowering of our WACC estimate from 6.9% to 6.3%. However, with POT's earnings growth profile remaining in the +4% to +6% pa range over the medium term and valuation levels stretched we retain an UNDERPERFORM rating.

Figure 2. POT vs other infrastructure players



Source: Eikon, Forsyth Barr analysis

Figure 3. Bond yields have helped valuation



Source: Eikon, Forsyth Barr analysis

Earnings revisions

We summarise our earnings forecast changes as shown in Figure 4. Our revised FY20 NPAT forecast implies +6% growth, similar to what POT achieved in FY19, albeit on a lower rate of volume growth as Coda's contribution improves.

Figure 4. Earnings revisions (NZ$m)

	FY20E			FY21E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	322.4	325.2	0.9%	339.8	345.4	1.6%	n/a	365.0	n/a
EBITDA	180.6	181.3	0.4%	191.6	195.1	1.8%	n/a	208.1	n/a
EBIT (post-associates)	165.6	164.9	-0.5%	176.5	177.7	0.7%	n/a	189.7	n/a
Underlying NPAT	**107.6**	**107.2**	**-0.4%**	**113.9**	**113.6**	**-0.2%**	**n/a**	**118.2**	**n/a**
Underlying EPS (cps)	15.8	15.7	-0.4%	16.7	16.7	-0.3%	n/a	17.4	n/a
Ordinary DPS (cents)	14.4	14.4	-0.6%	15.3	15.2	-0.4%	n/a	15.8	n/a
Special DPS (cents)	5.0	2.5	-50.0%	5.0	2.5	-50.0%	n/a	2.5	n/a

Source: Forsyth Barr analysis

Key result issues

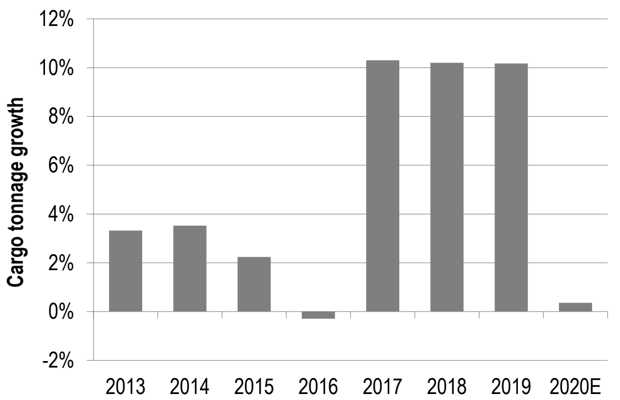
Cargo growth set to slow

POT's cargo growth has been impressive over the past three years. It has consistently driven overall volume (tonnage) by +10% in each year, helped by the synchronisation of log exports and container growth. However, volume growth is likely to slow in FY20, given (1) a likely reduction in log exports — management is guiding to 6.0JASM from 7.1JASM in FY19, and (2) container volume growth has slowed from a multi-year boom of consistent double digit growth following the Kotahi deal in 2014.

While volume growth has been strong, POT has struggled to demonstrate operating leverage in recent years. However, in FY19 port operations EBITDA margin has expanded by +130bps. While some of this expansion was a function of the insurance proceeds from the 2018 fire and has been assisted by favourable mix (strong growth in higher margin logs), we are encouraged by the appearance of operating leverage.

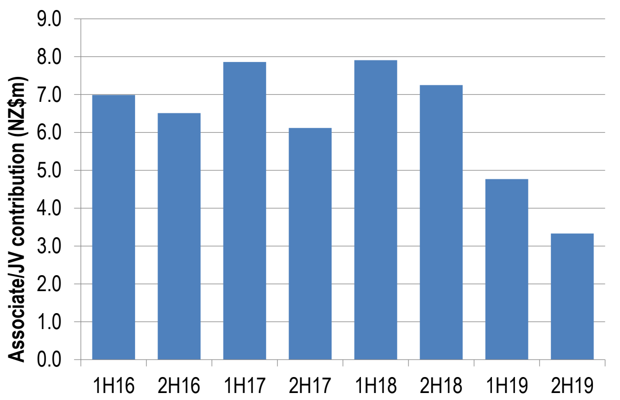
We suspect POT is taking a harder line on pricing. This is difficult to measure beyond its annual tariff sheets given the contractual nature of its concentrated customer base and mix differences within the business; however, management has stated that it's managed to achieve CPI+ pricing with many container shipping customers. A further illustration of this is marine list charges for vessels over 20,000 GT have increased by +22% in FY20.

Figure 5. Cargo growth has been strong but will likely slow in FY20



Source: POT, Forsyth Barr analysis

Figure 6. Associates contribution by half year



Source: POT, Forsyth Barr analysis

Associates drag deeper in 2H19

POT's associate and JV investment income has been severely dented by the Coda contribution, or aptly, lack of contribution given losses in the period. Overall associate income declined NZ$7.0m to NZ$8.1m.

Coda's poor performance is exaggerated by (1) NZ$3.8m of one-off write-offs, and (2) prior year audit adjustments of ~NZ$2m as acknowledged at the interim result. However, it still generated underlying pre-tax loss of NZ$1.3m, reflective of loss making contracts. During the year it appointed a new CEO and CFO and expects to return to profitability in FY20.

Other associates have performed more akin to expectations. Northport's contribution was down -2% on -5% lower cargo volumes, and PrimePort Timaru had a strong recovery in reported profitability but on a normalised basis was in line with the prior year.

Special dividend to continue

POT announced a final FY19 dividend of 7.3c (up from 7.0c). In addition, and as expected, the company announced a continuation of its capital management programme (which has paid a 5c special dividend for each of the past four years), however, it will reduce the special dividend to 2.5c and extend the programme for a further four years.

As a result, we expect total dividends per share to fall in FY20 (16.9c) relative to FY19 (18.3c). The total cash dividend yield, therefore, declines to ~2.7% from ~2.9% previously.

Result analysis

Figure 7. FY19 result analysis

	FY18	FY19	Change	Comments
Profit and loss account				
Sales revenue	283.7	313.3	10%	Port operations up +10%, Property up +7% and Marshalling down -2%
Port operations	251.4	276.8	10%	A +4.3% increase in container volumes assisted by log export growth of +12.5%
Property services	26.9	28.8	7%	
Marshalling services	3.7	4.6	27%	Excludes inter-company benefits captured in port operations
Unallocated expenses and other	(127.9)	(137.1)	7%	Trending below growth in port operations
EBITDA	**154.1**	**173.2**	**12%**	
Depreciation and amortisation	(25.3)	(27.6)	9%	
EBIT	**128.8**	**145.6**	**13%**	
Associate income	15.1	8.1	-47%	Largely driven by -NZ$2.4m loss from Coda Group and softer Northport result
One-time items	0.4	(0.5)	n/a	Impairment of PP&E
Interest expense	(18.0)	(18.2)	1%	
Profit before tax	126.4	135.0	7%	
Taxation	(32.1)	(34.4)	7%	Effective tax rate of ~27%
Reported NPAT	**94.3**	**100.6**	**7%**	**Consistent with management guidance**
Abnormals (post tax)	0.8	0.0	n/a	
Underlying NPAT	**95.1**	**100.6**	**6%**	
Underlying EPS (cents)	14.2	15.0	6%	672m shares on issue
Final DPS (cents)	7.0	7.3	4%	89% pay-out ratio
Special dividend (cents)	5.0	5.0	0%	Special dividend of 2.5cps extended for four years
Cashflow and net debt				
Operating cashflow	99.4	112.2	13%	Continued robust cash conversion
Maintenance capex = depreciation	(25.3)	(27.6)	9%	
Free cash flow	**74.1**	**84.6**	**14%**	
Acquisitions	0.4	1.0	n/a	
Disposals	0.0	0.1	n/a	Small sale of PP&E
Net debt	399.5	442.3	11%	Increase partly due to special dividend capital management programme
Divisional data				
Container revenue	162.7	183.7	13%	Container cargo TEUs grew +4.3%
Bulk revenue	51.3	56.8	11%	Logs volumes up +12.5%
Marine revenue	37.4	36.3	-3%	Ship visits decreased +3.9%, but average ship size continues to increase
Port operations revenue	**251.4**	**276.8**	**10%**	
Metroport (TEU)	297,517	311,913	5%	MetroPort AKL is now NZ's fourth largest container terminal by volume
Transhipments (TEU)	353,936	390,437	10%	Transhipments now make up 32% of containers handled at POT
Other containers	509,856	512,363	0%	Includes empties and ordinary port drop-offs
Terminal containers (TEU)	**1,161,309**	**1,214,713**	**5%**	
Logs ('000 tonnes)	6,276	7,063	13%	Guidance of 6.0JASM in FY20 down from 7.1JASM in FY19
Other ('000 tonnes)	5,093	5,408	6%	Led by other forestry products
Total bulk tonnage ('000 tonnes)	**11,369**	**12,471**	**10%**	

Source: POT, 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 transhipments 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 a 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 transhipments 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.

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 has extended its special dividend programme for a further four years from FY20 albeit at a lower level than previously (2.5c compared to 5c each year). The current ordinary dividend pay-out is ~90% within the targeted range of 70%–100%.

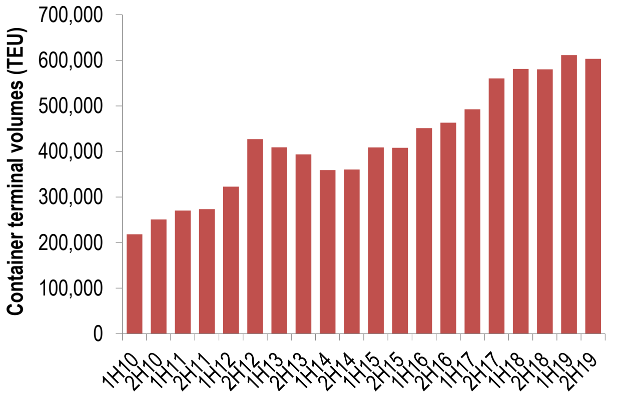
Risks factors

- **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.

Company description

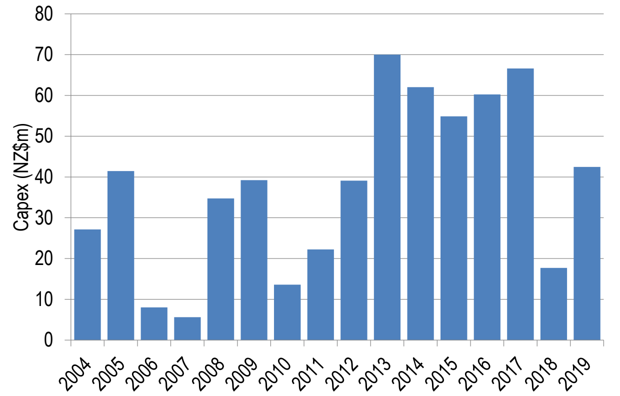
POT is New Zealand's largest port and the major export port. It is majority owned by the Bay of Plenty Regional Council. POT has undergone port expansion in recent years which have facilitated the arrival of bigger ships. Cargo that crosses the wharf includes containers and bulk products including export 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.

Figure 8. Container volumes in recent periods



Source: Company reports, Forsyth Barr analysis

Figure 9. Capex necessary to facilitate growth



Source: Company reports, Forsyth Barr analysis

Figure 10. Substantial Shareholders

Shareholder	Latest Holding
Quayside Securities	54.1%

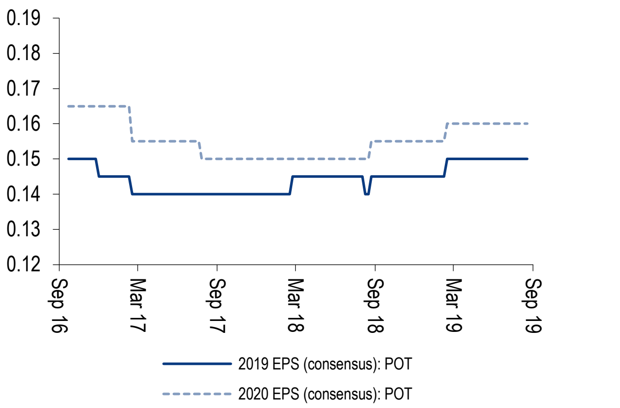
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 11. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect POT's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Port of Tauranga	**POT NZ**	**NZ$6.25**	**NZ$4,254**	**39.7x**	**37.4x**	**25.9x**	**24.1x**	**30.7x**	**28.4x**	**2.4%**
Mitsubishi Logistics Corp	9301 JP	¥2571.00	¥226,147	18.1x	16.7x	11.0x	10.0x	23.3x	21.6x	2.6%
Westshore Terminals Investment Corp	WTE CN	C$21.39	C$1,476	11.0x	11.2x	8.2x	8.4x	9.3x	9.6x	3.0%
Hamburger Hafen und Logistik AG	HHFA GR	€21.40	€1,557	13.9x	13.0x	5.9x	5.6x	9.9x	9.2x	4.4%
Global Ports Investments PLC	GLPR LI	US$2.74	US$523	6.0x	5.1x	5.9x	5.6x	7.8x	7.0x	3.5%
Eurokai GmbH & Co KGaA	EUK2 GR	€32.00	€425	10.4x	11.1x	3.5x	3.9x	5.1x	5.8x	n/a
Auckland Airport *	AIA NZ	NZ$9.20	NZ$11,144	41.4x	38.9x	23.9x	22.2x	29.9x	28.4x	2.6%
Sydney Airport	SYD AT	A$8.30	A$18,746	46.9x	42.2x	20.6x	19.5x	30.3x	28.1x	5.0%
Qube Holdings	QUB AT	A$3.23	A$5,230	36.7x	32.6x	19.7x	17.6x	32.7x	28.3x	1.9%
			Compco Average:	**23.1x**	**21.4x**	**12.3x**	**11.6x**	**18.5x**	**17.3x**	**3.3%**
EV = Current Market Cap + Actual Net Debt			**POT Relative:**	**+72%**	**+75%**	**+110%**	**+107%**	**+66%**	**+65%**	**-26%**

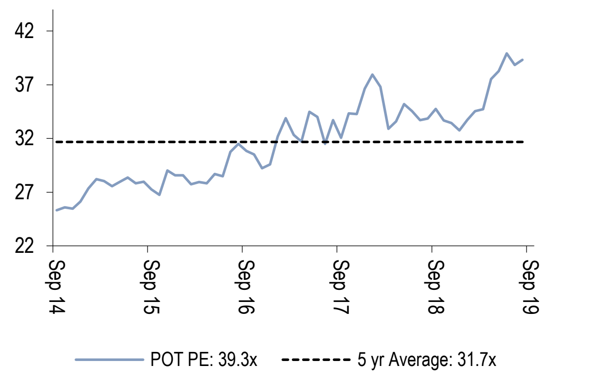
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (POT) companies fiscal year end

Figure 12. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 13. 12 Month Forward PE



Source: Forsyth Barr analysis