

# Port of Tauranga

UNDERPERFORM

## Tide Change in Growth

Port of Tauranga's (POT) first time FY20 earnings guidance provided at its Annual Shareholder Meeting (ASM) suggests a more subdued year ahead following three years of strong growth. Group NPAT fell -6% against the prior year in first quarter trading, with trade tonnage down -1%. Softer volumes are being driven by weaker log exports, only partially offset by robust container growth. POT continues to trade at an elevated ~27x one year forward EV/EBITDA, reflecting above trend recent growth and low bond rates. In light of a more pedestrian growth outlook we retain an UNDERPERFORM rating.

### What's changed?

- **Earnings:** FY20E NPAT cut by -6% to NZ\$101m at the top end of the new guidance range of NZ\$96m–NZ\$101m; FY21E by -5%
- **Target Price:** Lowered to NZ\$5.15 from NZ\$5.25

### Softer growth outlook

POT's ASM commentary refers to a "softening of growth in some cargo categories in the coming year". In particular it references weaker log exports, and expects volumes to be consistent with FY18 levels, implying an -11% drop year on year. POT has provided first time FY20 NPAT guidance of NZ\$96m–NZ\$101m, which will mean a -4% to -9% cut to consensus estimates. The company typically doesn't apply a conservative discount to its earnings guidance.

### Slower first quarter

First quarter trade volumes were down -1% year on year, despite a +6% lift in container volumes. Log exports are now in decline in light of the recent material drop in pricing. Moreover, we suspect the trade in other bulk products has also weakened. Lower cargo volumes have contributed to a -6% decline in 1Q20 Group NPAT. However, given the magnitude of the decline we expect cost and/or associate/JV income have also featured.

### Valuation less supported by growth

There remains a wide gap between our valuation/target price and the current share price. In a slowing growth environment we expect this to at least partially close. Like other infrastructure assets, POT's two key value drivers are (1) bond rates, and (2) volume growth. Volume growth in recent years has been elevated given synchronisation of container and log export growth. However, the former has reverted to trend type levels, and the latter is now being impacted by lower log prices. Consequently, the growth backdrop is now less supportive to valuation.

### 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\$6.44
Target price	NZ\$5.25
Risk rating	Low
Issued shares	680.6m
Market cap	NZ\$4,383m
Average daily turnover	117.9k (NZ\$680k)

### Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	100.6	101.0	107.5	113.2
EPS* (NZc)	14.8	14.8	15.8	16.6
EPS growth* (%)	5.8	0.4	6.4	5.3
DPS (NZc)	18.3	16.0	16.9	17.7
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	27.0	27.1	25.3	23.5
EV/EBIT	32.1	32.4	30.1	27.8
PE	43.6	43.4	40.8	38.7
Price / NTA	3.8	3.9	3.8	n/a
Cash dividend yield (%)	2.8	2.5	2.6	2.7
Gross dividend yield (%)	3.9	3.5	3.6	3.8

\*Historic and forecast numbers based on underlying profits

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**Port of Tauranga Ltd (POT)**

Priced as at 25 Oct 2019: NZ\$6.44

June year end

Forsyth Barr valuation		Valuation Ratios					2018A	2019A	2020E	2021E	2022E	
Valuation methodology		DCF and sum-of-the-parts					EV/EBITDA (x)	30.1	27.0	27.1	25.3	23.5
<b>12-month target price (NZ\$)*</b>		<b>5.25</b>		<b>Spot valuations (NZ\$)</b>			EV/EBIT (x)	36.0	32.1	32.4	30.1	27.8
Expected share price return	-18.5%	1. DCF	4.99			PE (x)	46.1	43.6	43.4	40.8	38.7	
Net dividend yield	2.5%	2. Sum-of-the-parts	5.14			Price/NTA (x)	3.9	3.8	3.9	3.8	4.1	
Estimated 12-month return	-15.9%	3. n/a	n/a			Free cash flow yield (%)	1.9	1.3	1.3	0.5	0.5	
<b>Key WACC assumptions</b>		<b>DCF valuation summary (NZ\$m)</b>					Net dividend yield (%)	2.7	2.8	2.5	2.6	2.7
Risk free rate	2.00%	Total firm value	3,900			Gross dividend yield (%)	3.8	3.9	3.5	3.6	3.8	
Equity beta	0.73	(Net debt)/cash	(504)			Imputation (%)	100	100	100	100	100	
WACC	6.1%	Value of equity	3,396			Pay-out ratio (%)	127	124	108	107	106	
Terminal growth	2.0%	Shares (m)	681			<b>Capital Structure</b>						
<b>Profit and Loss Account (NZ\$m)</b>		<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
Sales revenue	284	313	321	341	362	Interest cover EBIT (x)	7.1	8.0	7.7	6.9	6.0	
<b>Normalised EBITDA</b>	<b>154</b>	<b>173</b>	<b>174</b>	<b>187</b>	<b>202</b>	Interest cover EBITDA (x)	8.5	9.5	9.2	8.2	7.1	
Depreciation and amortisation	(25)	(28)	(28)	(30)	(31)	Net debt/ND+E (%)	26.3	27.5	30.5	33.0	39.1	
<b>Normalised EBIT</b>	<b>129</b>	<b>146</b>	<b>146</b>	<b>157</b>	<b>171</b>	Net debt/EBITDA (x)	2.6	2.6	2.9	3.1	3.4	
Net interest	(18)	(18)	(19)	(23)	(28)	<b>Key Ratios</b>						
Associate income	15	8	11	12	12	Return on assets (%)	7.8	8.3	8.1	8.3	8.8	
Tax	(32)	(34)	(37)	(39)	(41)	Return on equity (%)	8.5	8.6	8.9	9.3	10.5	
Minority interests	-	-	-	-	-	Return on funds employed (%)	18.4	19.4	18.6	18.1	17.8	
<b>Normalised NPAT</b>	<b>95</b>	<b>101</b>	<b>101</b>	<b>108</b>	<b>113</b>	EBITDA margin (%)	54.3	55.3	54.2	55.0	55.7	
Abnormals/other	1	-	-	-	-	EBIT margin (%)	45.4	46.5	45.3	46.2	47.1	
<b>Reported NPAT</b>	<b>94</b>	<b>101</b>	<b>101</b>	<b>108</b>	<b>113</b>	Capex to sales (%)	6.2	19.2	18.7	32.3	30.4	
Normalised EPS (cps)	14.0	14.8	14.8	15.8	16.6	Capex to depreciation (%)	70	218	211	368	351	
DPS (cps)	17.7	18.3	16.0	16.9	17.7	<b>Operating Performance</b>						
<b>Growth Rates</b>		<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
Revenue (%)	10.6	10.4	2.5	6.2	6.3	<b>Revenue (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
EBITDA (%)	11.3	12.4	0.5	7.7	7.7	Port operations	251	277	286	305	325	
EBIT (%)	13.1	13.0	0.0	8.1	8.3	Property services	27	29	30	31	31	
Normalised NPAT (%)	13.4	5.8	0.4	6.4	5.3	Transport services	-	-	-	-	-	
Normalised EPS (%)	13.4	5.8	0.4	6.4	5.3	Marshalling Services	5	5	5	5	6	
Ordinary DPS (%)	13.4	4.7	1.8	6.4	5.3	<b>Total revenue</b>	<b>284</b>	<b>313</b>	<b>321</b>	<b>341</b>	<b>362</b>	
<b>Cash Flow (NZ\$m)</b>		<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>Port operations revenue (NZ\$m)</b>					
EBITDA	154	173	174	187	202	Container revenue	164	182	190	203	217	
Working capital change	-	-	-	-	-	Bulk revenue	51	58	58	61	64	
Interest & tax paid	(50)	(53)	(56)	(62)	(70)	Marine revenue	36	36	39	41	44	
Other	(5)	(2)	-	7	-	<b>Total</b>	<b>251</b>	<b>277</b>	<b>286</b>	<b>305</b>	<b>325</b>	
<b>Operating cash flow</b>	<b>99</b>	<b>118</b>	<b>118</b>	<b>132</b>	<b>132</b>	<b>EBITDA (NZ\$m)</b>						
Capital expenditure	(18)	(60)	(60)	(110)	(110)	Port operations	251	277	286	305	325	
(Acquisitions)/divestments	0	-	-	-	-	Property services	27	29	30	31	31	
Other	10	8	8	(24)	(24)	Transport services	-	-	-	-	-	
<b>Funding available/(required)</b>	<b>92</b>	<b>67</b>	<b>67</b>	<b>(1)</b>	<b>(1)</b>	Marshalling Services	4	5	5	5	5	
Dividends paid	(115)	(124)	(124)	(119)	(119)	Unallocated expenses	(128)	(141)	(147)	(153)	(160)	
Equity raised/(returned)	(2)	-	-	-	-	Other income	0	3	-	-	-	
<b>Increase/(decrease) in net debt</b>	<b>24</b>	<b>58</b>	<b>58</b>	<b>120</b>	<b>120</b>	<b>Total EBITDA</b>	<b>154</b>	<b>173</b>	<b>174</b>	<b>187</b>	<b>202</b>	
<b>Balance Sheet (NZ\$m)</b>		<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>Container trade (TEU'000)</b>					
Working capital	19	28	17	18	19	Metroport	298	312	318	328	338	
Fixed assets	1,446	1,531	1,563	1,643	1,669	Transshipments	354	390	414	455	501	
Intangibles	19	19	19	19	19	Empty containers	202	193	201	214	227	
Other assets	134	133	144	156	168	Other full containers	307	319	326	339	352	
<b>Total funds employed</b>	<b>1,619</b>	<b>1,711</b>	<b>1,743</b>	<b>1,836</b>	<b>1,875</b>	<b>Terminal containers</b>	<b>1,161</b>	<b>1,215</b>	<b>1,259</b>	<b>1,335</b>	<b>1,417</b>	
Net debt/(cash)	400	442	500	572	692	Change (%)	n/a	4.6	3.7	6.0	6.1	
Other non current liabilities	97	103	103	103	103	<b>Bulk trade ('000 tonnes)</b>						
Shareholder's funds	1,122	1,166	1,140	1,161	1,080	Logs	6,276	7,063	6,357	6,675	7,008	
Minority interests	-	-	-	-	-	Other bulk	5,093	5,408	5,570	5,737	5,909	
<b>Total funding sources</b>	<b>1,619</b>	<b>1,711</b>	<b>1,743</b>	<b>1,836</b>	<b>1,875</b>	<b>Total bulk</b>	<b>11,369</b>	<b>12,471</b>	<b>11,927</b>	<b>12,412</b>	<b>12,918</b>	
						Change (%)	n/a	9.7	-4.4	4.1	4.1	

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

## First quarter trading update

Port of Tauranga's (POT) first quarter trading update highlighted a weak start to FY20, with Group NPAT down -6% against the prior year. Trade volumes were down -1%, given a -5% decline in log exports, partially offset by container growth (led by lower margin transshipments).

Figure 1. First quarter trading summary (NZ\$m)

	1Q19	1Q20	Change
Trade (tonnes in millions)	6.829	6.755	-1.1%
Logs (tonnes)	1.844	1.748	-5.2%
Containers (TEUs)	295,480	312,667	5.8%
Group NPAT	23.2	21.7	-6.3%

Source: POT, Forsyth Barr analysis

## Earnings revisions

We lower our earnings forecast across our outlook period as summarised in Figure 2. Our revised FY20 NPAT estimate of NZ\$101m is at the top end of management's first time guidance range of NZ\$96m–NZ\$101m.

Figure 2. Earnings revisions (NZ\$m)

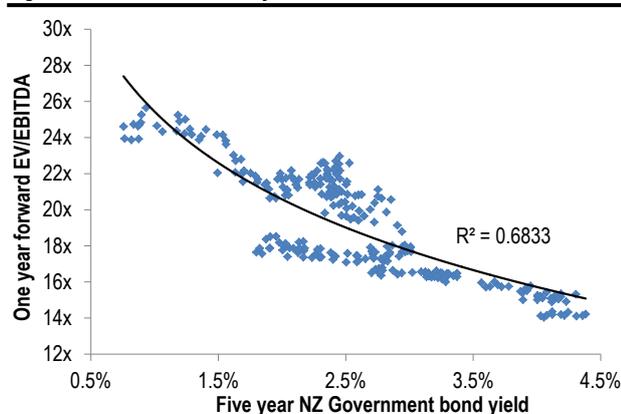
	FY20E			FY21E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	325.2	321.1	-1.3%	345.4	341.0	-1.3%	365.0	362.3	-0.7%
EBITDA	181.3	174.0	-4.0%	195.1	187.4	-4.0%	208.1	201.9	-3.0%
EBIT (post-associates)	164.9	156.6	-5.0%	177.7	169.4	-4.7%	189.7	182.9	-3.6%
<b>Underlying NPAT</b>	<b>107.2</b>	<b>101.0</b>	<b>-5.8%</b>	<b>113.6</b>	<b>107.5</b>	<b>-5.4%</b>	<b>118.2</b>	<b>113.2</b>	<b>-4.2%</b>
Underlying EPS (cps)	15.7	14.8	-5.8%	16.7	15.8	-5.4%	17.4	16.6	-4.2%
Ordinary DPS (cents)	14.4	13.5	-5.8%	15.2	14.4	-5.4%	15.8	15.2	-4.2%
Special DPS (cents)	2.5	2.5	0.0%	2.5	2.5	0.0%	2.5	2.5	0.0%

Source: Forsyth Barr analysis

## Valuation

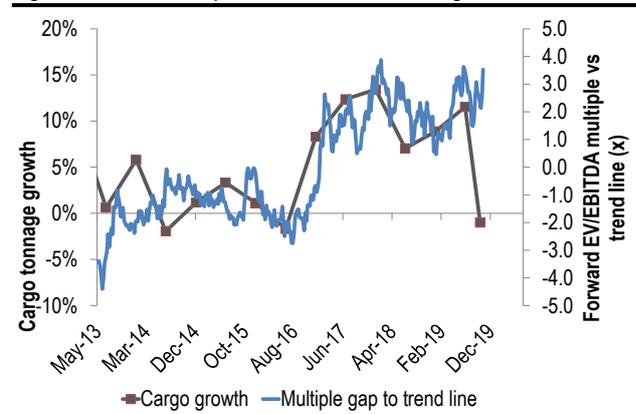
We lower our target price to NZ\$5.15 from NZ\$5.25, which reflects our earnings revisions above. POT continues to trade at an elevated one year EV/EBITDA multiple (~27x), which we think is at risk in light of a slower growth outlook.

Figure 3. Bond rates are a key driver of valuation



Source: Eikon, Forsyth Barr analysis

Figure 4. POT looks expensive relative to current growth rates



Source: Eikon, 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. Following several years of above trend growth activity rates are slowing given weaker log prices and more subdued economic conditions. **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:** De-synchronisation of log export and container growth mean the company has entered into another soft patch.
- **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.

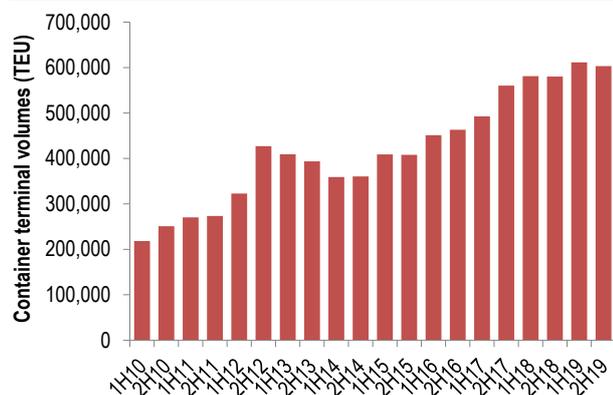
### Financial structure

- **Balance sheet:** Net debt has doubled over the past six years given the capex bulge which has facilitated the hub port strategy.
- **Dividends:** POT 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

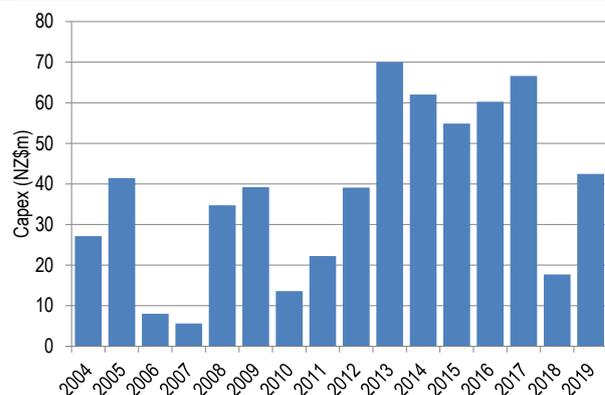
- **Industry competition:** Over investment by other ports is impacting industry ROIC.
- **Chinese log demand:** POT's log exporters are heavily exposed to Chinese construction industry demand for unprocessed timber.

Figure 5. Container volumes in recent periods



Source: Company reports, Forsyth Barr analysis

Figure 6. Capex necessary to facilitate growth



Source: Company reports, Forsyth Barr analysis

**Figure 7. Substantial Shareholders**

Shareholder	Latest Holding
Quayside Securities	54.1%

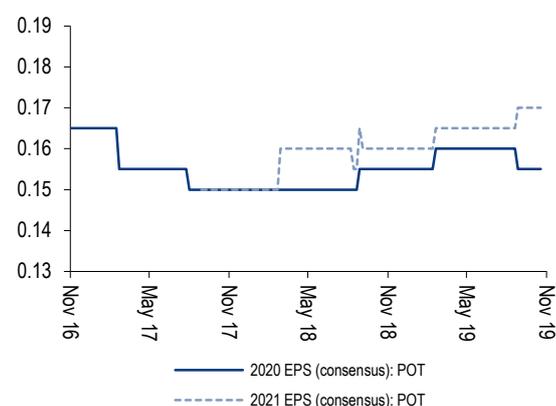
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 8. International Compco's**

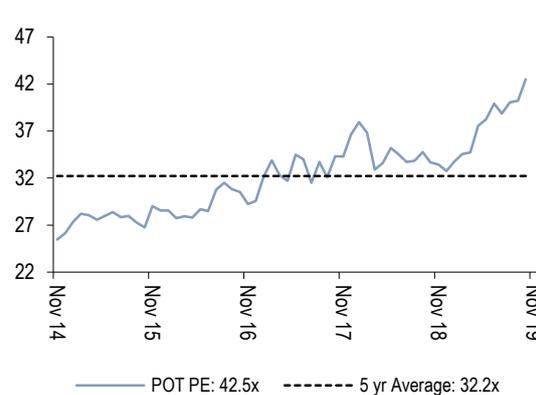
Company <i>(metrics re-weighted to reflect POT's balance date - June)</i>	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>Port of Tauranga</b>	<b>POT NZ</b>	<b>NZ\$6.44</b>	<b>NZ\$4,383</b>	<b>43.4x</b>	<b>40.8x</b>	<b>27.7x</b>	<b>25.7x</b>	<b>33.1x</b>	<b>30.6x</b>	<b>2.2%</b>
Mitsubishi Logistics Corp	9301 JP	¥2764.00	¥243,123	19.5x	17.9x	11.6x	10.6x	24.7x	22.9x	2.4%
Westshore Terminals Investment Corp	WTE CN	C\$21.85	C\$1,506	11.2x	11.7x	8.2x	8.5x	9.2x	9.7x	4.4%
Hamburger Hafen und Logistik AG	HHFA GR	€23.18	€1,686	15.1x	14.0x	6.2x	5.8x	10.4x	9.7x	4.2%
Global Ports Investments PLC	GLPR LI	US\$2.80	US\$535	6.3x	5.3x	5.6x	5.4x	7.2x	6.6x	1.1%
Eurokai GmbH & Co KGaA	EUK2 GR	€33.60	€444	11.2x	12.3x	5.8x	6.7x	8.8x	10.6x	n/a
Auckland Airport *	AIA NZ	NZ\$8.92	NZ\$10,837	40.0x	40.5x	23.3x	22.5x	29.0x	29.0x	2.5%
Sydney Airport	SYD AT	A\$8.73	A\$19,718	48.5x	44.7x	21.3x	20.3x	31.4x	29.4x	4.7%
Qube Holdings	QUB AT	A\$3.30	A\$5,365	37.5x	33.7x	20.3x	18.1x	33.7x	29.3x	1.9%
<b>Compco Average:</b>				<b>23.7x</b>	<b>22.5x</b>	<b>12.8x</b>	<b>12.2x</b>	<b>19.3x</b>	<b>18.4x</b>	<b>3.0%</b>
<b>POT Relative:</b>				<b>+83%</b>	<b>+81%</b>	<b>+117%</b>	<b>+110%</b>	<b>+72%</b>	<b>+67%</b>	<b>-26%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 9. Consensus EPS Momentum**


Source: Forsyth Barr analysis, Bloomberg

**Figure 10. 12 Month Forward PE**


Source: Forsyth Barr analysis

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