NEW ZEALAND EQUITY RESEARCH | TRANSPORT | PORT OWNER & OPERATOR
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Port of Tauranga
1H20 — Slow Steaming

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UNDERPERFORM

Port of Tauranga's (POT) extended period of earnings growth has come to an end with a softer 1H20 result, a function of a decline in bulk cargo during the period. While container volumes continue to rise, log exports and other bulk cargo (including fertiliser, feed supplements and oil) decreased in the first half relative to the prior year. In light of the coronavirus outbreak there is a degree of uncertainty around the near term outlook, which has led management to modestly reduce its full year earnings guidance range. Notwithstanding a material decline in the share price in recent weeks and scope for industry structural change over the longer term from the Government's Upper North Island Supply Chain Study, POT continues to trade at an elevated ~27x one year forward EV/EBITDA multiple. We retain an UNDERPERFORM rating.

NZX Code	POT
Share price	NZ$6.55
Target price	NZ$5.20
Risk rating	Low
Issued shares	680.6m
Market cap	NZ$4,458m
Avg daily turnover	126.8k (NZ$818k)

Financials: Jun/	19A	20E	21E	22E
NPAT* (NZ$m)	100.6	97.3	104.4	113.4
EPS* (NZc)	14.8	14.3	15.3	16.7
EPS growth* (%)	5.8	-3.3	7.3	8.6
DPS (NZc)	18.3	15.8	16.5	17.7
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	27.4	28.6	26.5	24.0
EV/EBIT	32.6	34.7	31.9	28.6
PE	44.3	45.8	42.7	39.3
Price / NTA	3.8	3.8	3.7	3.8
Cash div yld (%)	2.8	2.4	2.5	2.7
Gross div yld (%)	3.9	3.4	3.5	3.8

What's changed?
- **Earnings**: FY20 and FY21 estimates cut to reflect weaker near term volume outlook; FY22 broadly unchanged
- **Target price**: Increased marginally to NZ$5.20

Cargo growth has slowed
Key bulk trades have softened over the past six months. In particular, log exports fell -8% in light of a dramatic price decline in mid-2019 given lower international demand and pricing. Moreover, imported fertiliser (-12%), dairy stock feed supplements (-18%) and oil (-8%) all declined materially, relative to the prior year. In contrast, container volumes continue to grow albeit at a slower level than in recent periods. Ship visits declined by -7% in light of (1) lower total cargo, and (2) a further increase in average vessel size.

Log export risk
The coronavirus outbreak will have an impact on POT's near term growth outlook, in our opinion. Its log trade is likely to be hardest hit, at least initially. Log inventories on Chinese wharves have surged and international prices fallen dramatically as a result. There have been some charter cancellations. While POT is more exposed to larger forestry estates than the more susceptible smaller woodlot owners, even the larger players have reduced felling rates in anticipation of a slowdown.

Associate lift; Ruakura opportunity longer term
Having experienced a downward trend for the past three half year periods, POT's associates/JVs bounced-back in light of strong performances from Northport and PrimePort Timaru, and a reduction in Coda losses following the change in its management. Coda was profitable through 2Q20.

POT has now formally created a JV with Tainui to create the Ruakura Inland Port, which will become operational in early 2022. This represents a key longer term container aggregation opportunity for POT.

FORSYTH BARR

Port of Tauranga Ltd (POT)

Priced as at 28 Feb 2020 (NZ$)	6.55

12-month target price (NZ$)*	5.20
Expected share price return	-20.6%
Net dividend yield	2.5%
Estimated 12-month return	-18.1%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.75
WACC	6.2%
Terminal growth	2.0%

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	283.7	313.3	310.8	331.0	355.8
Normalised EBITDA	**154.1**	**173.2**	**166.9**	**180.8**	**199.4**
Depreciation and amortisation	(25.3)	(27.6)	(29.1)	(30.7)	(32.2)
Normalised EBIT	**128.8**	**145.6**	**137.8**	**150.1**	**167.2**
Net interest	(18.0)	(18.2)	(19.4)	(22.3)	(26.5)
Associate income	15.1	8.1	12.0	13.0	13.5
Tax	(31.8)	(34.4)	(33.2)	(36.4)	(40.8)
Minority interests	0	0	0	0	0
Normalised NPAT	**95.1**	**100.6**	**97.3**	**104.4**	**113.4**
Abnormals/other	0.8	0	0	0	0
Reported NPAT	**94.3**	**100.6**	**97.3**	**104.4**	**113.4**
Normalised EPS (cps)	14.0	14.8	14.3	15.3	16.7
DPS (cps)	17.7	18.3	15.8	16.5	17.7

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	10.6	10.4	-0.8	6.5	7.5
EBITDA (%)	11.3	12.4	-3.6	8.4	10.3
EBIT (%)	13.1	13.0	-5.4	9.0	11.4
Normalised NPAT (%)	13.4	5.8	-3.3	7.3	8.6
Normalised EPS (%)	13.4	5.8	-3.3	7.3	8.6
Ordinary DPS (%)	13.4	4.7	0.0	5.2	8.6

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**154.1**	**173.2**	**166.9**	**180.8**	**199.4**
Working capital change	0	0	0	0	0
Interest & tax paid	(50.1)	(52.6)	(51.6)	(57.7)	(66.3)
Other	(4.5)	(6.9)	(1.6)	8.2	(1.7)
Operating cash flow	**99.4**	**113.7**	**113.7**	**131.4**	**131.4**
Capital expenditure	(17.7)	(35.0)	(35.0)	(110.0)	(110.0)
(Acquisitions)/divestments	0.4	0	0	0	0
Other	10.1	9.0	9.0	10.1	10.1
Funding available/(required)	**92.1**	**87.7**	**87.7**	**31.5**	**31.5**
Dividends paid	(115.0)	(122.9)	(122.9)	(118.8)	(118.8)
Equity raised/(returned)	(1.6)	0	0	0	0
(Increase)/decrease in net debt	**(24.5)**	**(35.2)**	**(35.2)**	**(87.3)**	**(87.3)**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	19.4	28.3	16.9	17.9	19.2
Fixed assets	1,446.3	1,531.2	1,567.8	1,647.7	1,672.6
Intangibles	18.5	19.0	19.0	19.0	19.0
Right of use asset	0	0	23.9	23.9	23.9
Other assets	134.4	132.7	144.7	157.7	171.2
Total funds employed	**1,618.5**	**1,711.3**	**1,772.3**	**1,866.2**	**1,905.9**
Net debt/(cash)	399.5	442.3	477.5	522.1	609.4
Lease liability	0	0	24.1	24.1	24.1
Other liabilities	97.0	103.1	102.8	102.8	102.8
Shareholder's funds	1,122.0	1,165.9	1,167.9	1,217.3	1,169.6
Minority interests	0	0	0	0	0
Total funding sources	**1,618.6**	**1,711.3**	**1,772.3**	**1,866.2**	**1,905.9**

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

Spot valuations (NZ$)	
1. DCF	5.07
2. Sum-of-the-parts	5.23
3. n/a	n/a

DCF valuation summary (NZ$m)	
Total firm value	3,990
(Net debt)/cash	(514)
Less: Capitalised operating leases	(25)
Value of equity	3,451

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	30.6	27.4	28.6	26.5	24.0
EV/EBIT (x)	36.6	32.6	34.7	31.9	28.6
PE (x)	46.9	44.3	45.8	42.7	39.3
Price/NTA (x)	4.0	3.8	3.8	3.7	3.8
Free cash flow yield (%)	1.8	1.8	1.8	0.5	0.5
Net dividend yield (%)	2.7	2.8	2.4	2.5	2.7
Gross dividend yield (%)	3.8	3.9	3.4	3.5	3.8

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	7.1	8.0	7.1	6.7	6.3
Interest cover EBITDA (x)	8.5	9.5	8.6	8.1	7.5
Net debt/ND+E (%)	26.3	27.5	29.0	30.0	34.3
Net debt/EBITDA (x)	2.6	2.6	2.9	2.9	3.1

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	7.8	8.3	7.6	7.8	8.5
Return on equity (%)	8.5	8.6	8.3	8.6	9.7
Return on funds employed (%)	18.4	19.4	18.1	17.6	17.6
EBITDA margin (%)	54.3	55.3	53.7	54.6	56.0
EBIT margin (%)	45.4	46.5	44.3	45.4	47.0
Capex to sales (%)	6.2	11.2	11.3	33.2	30.9
Capex to depreciation (%)	70	127	120	358	342
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	127	124	111	108	106

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ$m)					
Port operations	251.4	276.8	275.6	294.6	318.2
Property services	26.9	28.8	30.2	31.1	32.0
Marshalling Services	4.9	4.9	5.0	5.3	5.5
Total revenue	**283.7**	**313.3**	**310.8**	**331.0**	**355.8**
Port operations revenue (NZ$m)					
Container revenue	164.1	182.5	189.6	202.4	216.5
Bulk revenue	51.3	58.3	50.2	54.6	61.3
Marine revenue	36.0	36.0	35.8	37.7	40.4
Total	**251.4**	**276.8**	**275.6**	**294.6**	**318.2**
EBITDA (NZ$m)					
Port operations	251.4	276.8	275.6	294.6	318.2
Property services	26.9	28.8	30.2	31.1	32.0
Marshalling Services	3.7	4.6	4.9	5.1	5.4
Unallocated expenses	(128.0)	(140.5)	(143.8)	(150.0)	(156.2)
Other income	0.1	3.4	0.0	0.0	0.0
Total EBITDA	**154.1**	**173.2**	**166.9**	**180.8**	**199.4**
Containers (TEU'000)	1,161	1,215	1,238	1,313	1,394
Logs (JAS m)	6.3	7.1	5.5	5.9	7.0
Other bulk (tonnes m)	5.1	5.4	4.9	5.2	5.3

Slowing cargo trend; UNDERPERFORM

Port of Tauranga (POT) reported a small decline in profits as bulk cargo headwinds more than offset further container volume growth. Underlying NPAT fell -1% to N$48.3m on revenue growth of +1%. Excluding the impact of IFRS 16, group NPAT was flat year on year. The soft result reflects subdued bulk cargoes with logs -8%, fertiliser down -12%, oil -8%, and grain/feed supplements down -10%. Container growth of +3% partially offset these declines, but overall trade was down -4%.

Figure 1. Result summary (NZ$m)

	1H19	1H20	Change	Forbar
Sales revenue	153.0	154.8	1.2%	156.9
EBITDA	83.9	83.0	-1.0%	84.3
Associates	4.8	5.9	23.6%	5.4
Reported NPAT	49.0	48.3	-1.3%	48.5
Underlying NPAT	**49.0**	**48.3**	**-1.3%**	**48.5**
Underlying EPS (cents)	7.2	7.1	-1.3%	7.1
Interim DPS (cents)	6.0	6.0	0.0%	6.1

Source: POT, Forsyth Barr analysis

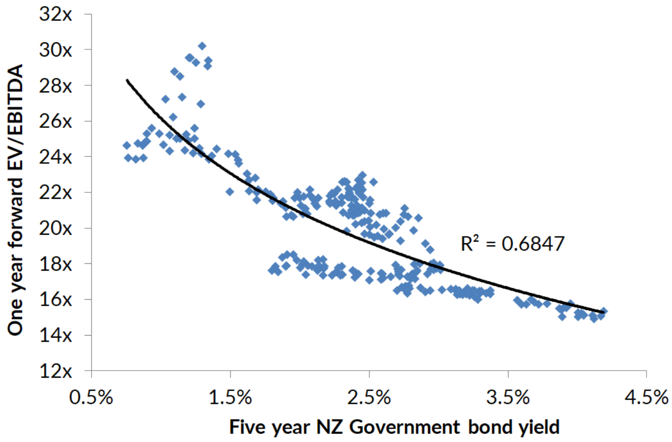
Figure 2. Cargo breakdown

	1H19	1H20	Change
Transhipments (TEU)	132,156	134,349	1.7%
Metroport (TEU)	159,464	165,287	3.7%
Terminal containers (TEU)	611,408	634,518	3.8%
Container tonnage (mT)	7.2	7.6	5.3%
Logs (mT)	3.7	3.4	-8.4%
Other bulk (mT)	2.9	2.3	-20.7%
Total trade tonnage (mT)	**13.8**	**13.3**	**-4.2%**

Source: POT, Forsyth Barr analysis

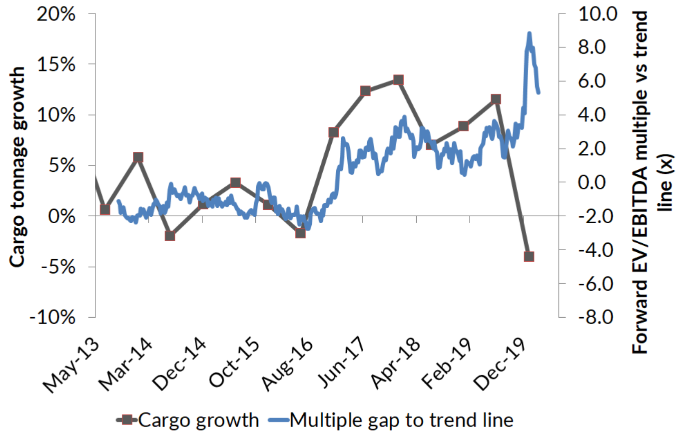
Over the past three weeks POT's share price has fallen by almost -20%. It now trades at a one year forward EV/EBITDA of ~27x. Notwithstanding the prospect of industry structural change in light of the Government's Upper North Island Supply Chain Study, we continue to believe this valuation is elevated. While we raise our target price marginally to NZ$5.20 we retain an UNDERPERFORM rating.

Figure 3. Bond rates are a key driver of valuation



Source: POT, Eikon, Forsyth Barr analysis

Figure 4. POT looks expensive relative to current growth rates



Source: POT, Forsyth Barr analysis

Earnings revisions

We lower our FY20 and FY21 earnings forecasts as summarised in Figure 5. We assume the impact of the coronavirus outbreak centres largely on POT's log trade, impacting both FY20 and FY21. In contrast, export volumes should recover fully in FY22 and therefore we leave our earnings forecasts largely unchanged for that year.

Figure 5. Earnings revisions (NZ$m)

	FY20E			FY21E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	321.1	310.8	-3.2%	341.0	331.0	-2.9%	362.3	355.8	-1.8%
EBITDA	174.0	166.9	-4.1%	187.4	180.8	-3.5%	201.9	199.4	-1.3%
EBIT (post-associates)	156.6	150.4	-3.9%	169.4	163.7	-3.3%	182.9	181.4	-0.8%
Underlying NPAT	**101.0**	**97.3**	**-3.7%**	**107.5**	**104.4**	**-2.9%**	**113.2**	**113.4**	**0.1%**
Underlying EPS (cps)	14.8	14.3	-3.7%	15.8	15.3	-2.9%	16.6	16.7	0.1%
Ordinary DPS (cents)	13.5	13.3	-1.7%	14.4	14.0	-2.9%	15.2	15.2	0.1%
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

Key issues from the result

(1) Guidance reduced; dividend secure

Management has lowered its FY20 NPAT guidance range by -NZ$2m to NZ$94m–NZ$99m to reflect uncertainty over second half trade volumes. The new guidance implies a 2H20 decline of between -2% and -11%. Log exports have been hit hardest to date and will likely be the main drag on earnings (see below). However, container and other cargo may also be impacted subject to how supply chains become impacted in different parts of the world.

We recognise that the coronavirus issue is likely to be temporary. While it may have a material impact on near term activity and earnings it should have no longer term impact on POT's trade flows. We, therefore, do not see any risk to POT's dividend or capital management programme (special dividends accompanying final dividends). The company announced a 6c interim dividend and we continue to expect it to pay a 6.3c (flat on FY19) final dividend.

(2) Log exports most exposed near term

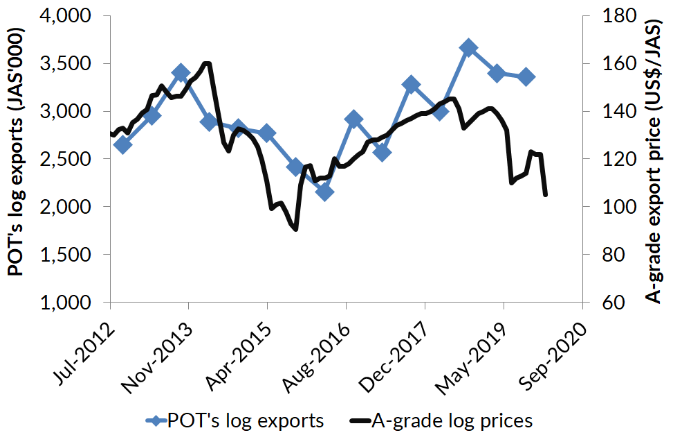
POT's most exposed trade to the coronavirus outbreak is export logs. It has started to see charter cancellations and delays as a result and expects this to continue. It suggests its log export volumes for FY20 will now be 5.0mT–5.5mT compared to 7.1mT in FY19. This implies a sharp downturn in 2H20 of at least -35%. While POT's log exporters are mostly large forestry estates, which are less susceptible to changing market conditions than small woodlot owners, even the large estates are cutting back felling activity and exportable product.

China represents 65%–70% of POT's log exports. Log inventories at Chinese ports have surged due to the extended Chinese new year shut down.

Log prices have fallen rapidly. The latest AgriHQ log price of US$105/JAS (Japanese Agricultural Standard) for A-grade export logs, is substantially lower than pre-coronavirus prices (~US$122/JAS).

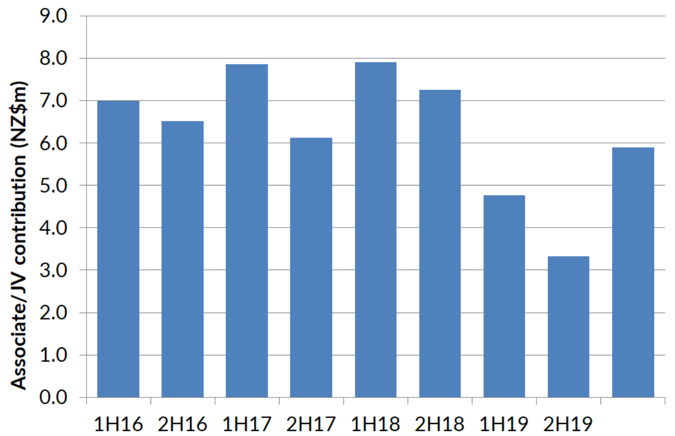
Our revised forecasts is for 5.5mT in FY20 with a modest recovery in FY21 (6.3mT).

Figure 6. POT's half year log exports vs log pricing



Source: AgriHQ, POT, Forsyth Barr analysis

Figure 7. Associates bounce back



Source: POT, Forsyth Barr analysis

(3) Associates on recovery path; longer term opportunity at Ruakura

Associate and JV investments were a key highlight of POT's result with a substantial sequential half year improvement and up +24% on the prior year. Key drivers were Northport +10% (despite a -10% decline in log exports in the period), Coda back into profits in 2Q20 and narrowed losses for the half year, and PrimePort Timaru up +29%.

In addition, POT has created a well flagged JV with Tainui to establish an inland port at Ruakura (near Hamilton). POT will invest NZ $25m into the inland port JV, which will take a 50 year ground lease for the site and will become operational in early 2022. This represents a longer term opportunity for POT to secure greater cargo aggregation capability.

Result analysis

Figure 8. Result analysis (NZ$m)

	1H19	1H20	Change	Comments
Profit and loss account				
Sales revenue	153.0	154.8	1%	Port operations up +1%, Property up +5% and Marshalling flat
Port operations	136.3	137.4	1%	Cargo decline of -4% more than offset by better mix (containers) and pricing
Property services	14.3	15.0	5%	
Marshalling services	2.3	2.3	2%	EBITDA excludes inter-company benefits captured in port operations
Unallocated expenses and other	(69.0)	(71.8)	4%	
EBITDA	**83.9**	**83.0**	**-1%**	**IFRS 16 related benefit of NZ$0.7m**
Depreciation and amortisation	(13.8)	(14.7)	6%	Like-for-like depreciation increased +2%
EBIT	70.0	68.3	-2%	
Associate income	4.8	5.9	24%	Strong improvement led by Northport, PrimePort and reduced Coda losses
One-time items	0.0	0.0	n/a	
Interest expense	(8.9)	(9.1)	2%	Capitalised interest of NZ$0.2m
Profit before tax	65.9	65.2	-1%	
Taxation	(17.0)	(16.4)	-4%	Effective tax rate of ~27.8%
Reported NPAT	49.0	48.8	0%	Lower guidance band for FY20 of NZ$94m–NZ$99
Abnormals (post tax)	0.0	0.0	n/a	
Underlying NPAT	49.0	48.3	-1%	
Underlying EPS (cents)	7.3	7.2	-1%	Shares on issue of 671m (excl. 10m due to Kotahi if it meets volume commitments)
Interim DPS (cents)	6.0	6.0	0%	83% pay-out ratio, 100% imputed
Special dividend (cents)	0.0	0.0	n/a	
Cashflow and net debt				
Operating cashflow	47.0	49.8	6%	Robust cash conversion
Maintenance capex = non-lease depreciation	(13.8)	(14.3)	3%	
Free cash flow	33.2	35.5	7%	
Acquisitions	0.0	0.0	n/a	
Disposals	0.0	0.0	343%	
Net debt	451.9	496.7	10%	Increase in part due to capital management programme and payment of final FY19 dividend
Divisional data				
Container revenue	87.1	92.9	7%	Terminal containers TEU increased +4%; FY20 guidance implies flat 2H20
Bulk revenue	29.7	26.5	-11%	Log volumes -8%
Marine revenue	19.5	18.0	-7%	Ship visits declined -7% in the period
Port operations revenue	136.3	137.4	1%	
Metroport (TEU)	159,464	165,287	4%	
Transhipments (TEU)	200,216	206,140	3%	Increase driven by NZ transhipments rather than re-exports
Other containers	251,728	263,091	5%	Includes empties and ordinary port drop-offs
Terminal containers (TEU)	611,408	634,518	4%	
Logs ('000 tonnes)	3,666	3,358	-8%	Sudden price decline mid-year 2019 impacted volumes
Other ('000 tonnes)	2,694	2,310	-14%	Fertiliser down -12%; grain/feed supplements down -10%; oil down -8%
Total bulk tonnage ('000 tonnes)	6,360	5,668	-11%	

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 over-investment. 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 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 cashflow 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 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.

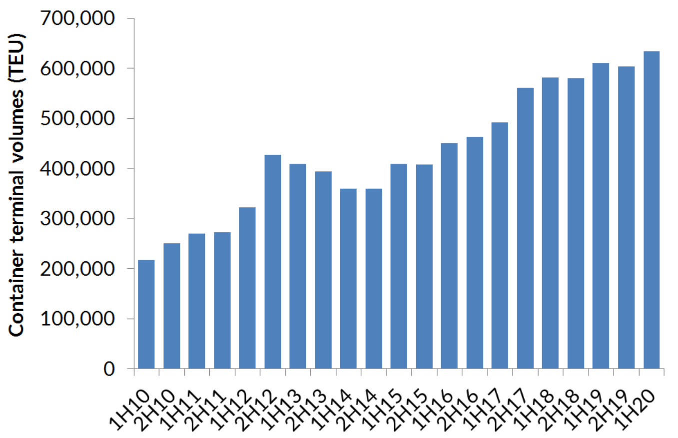
Financial structure

- **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%.

Risk factors

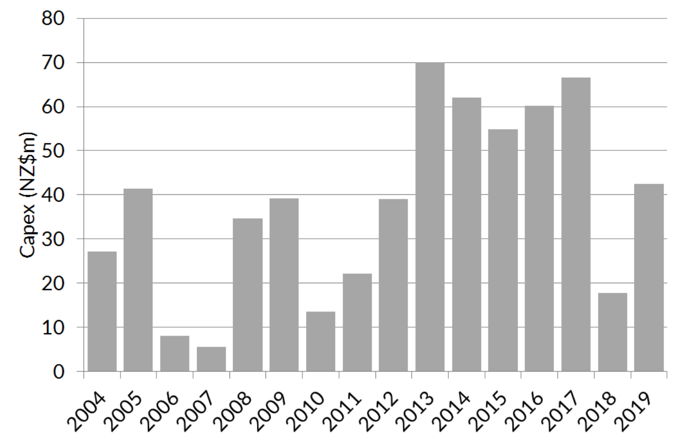
- **Industry competition**: Over investment by other ports is impacting industry ROIC.
- **Chinese log demand:** POT's log exporters are heavily exposed to Chinese construction industry demand for unprocessed timber.

Figure 9. Container volumes in recent periods



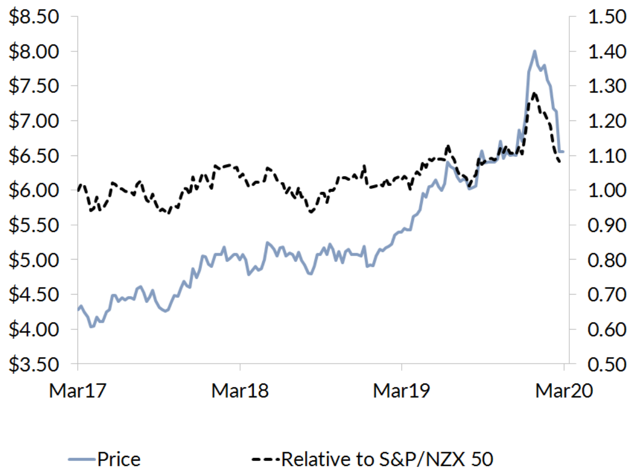
Source: Forsyth Barr analysis

Figure 10. Capex necessary to facilitate growth



Source: Forsyth Barr analysis

Figure 11. Price performance



Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
Quayside Securities	54.1%

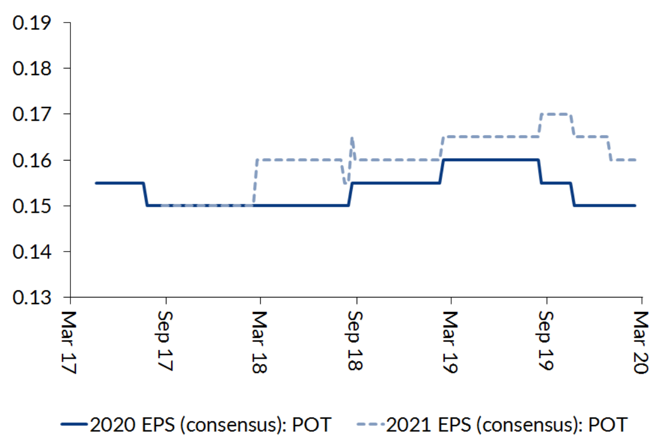
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 13. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash 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$6.55**	**NZ$4,458**	**45.8x**	**42.7x**	**29.4x**	**27.1x**	**35.6x**	**32.6x**	**2.1%**
MITSUBISHI LOGISTICS CORP	9301 JP	¥2621.00	¥230,545	18.1x	17.2x	11.3x	10.4x	n/a	n/a	2.5%
WESTSHORE TERMINALS INVESTME	WTE CN	C$14.28	C$985	7.3x	9.3x	5.6x	6.7x	6.3x	7.7x	5.7%
HAMBURGER HAFEN UND LOGISTIK	HHFA GR	€19.80	€1,441	12.9x	12.0x	5.4x	5.1x	9.2x	8.7x	4.8%
GLOBAL PORTS INV-GDR REG S	GLPR LI	US$3.56	US$680	8.5x	7.1x	6.3x	6.0x	8.3x	7.5x	0.0%
EUROKAI KGAA	EUK2 GR	€33.40	€416	11.2x	12.3x	5.5x	6.4x	8.3x	10.0x	n/a
Auckland Airport *	AIA NZ	NZ$8.03	NZ$9,757	36.7x	36.6x	21.8x	20.8x	27.5x	26.9x	2.8%
SYDNEY AIRPORT	SYD AT	A$8.03	A$18,146	45.4x	42.4x	22.4x	19.8x	34.7x	28.8x	5.0%
QUBE HOLDINGS	QUB AT	A$3.01	A$4,894	38.1x	33.8x	22.8x	19.8x	42.9x	34.0x	2.1%
			Compco Average:	**22.3x**	**21.3x**	**12.6x**	**11.9x**	**19.6x**	**17.7x**	**3.3%**
EV = Current Market Cap + Actual Net Debt			**POT Relative:**	**106%**	**100%**	**133%**	**128%**	**82%**	**85%**	**-35%**

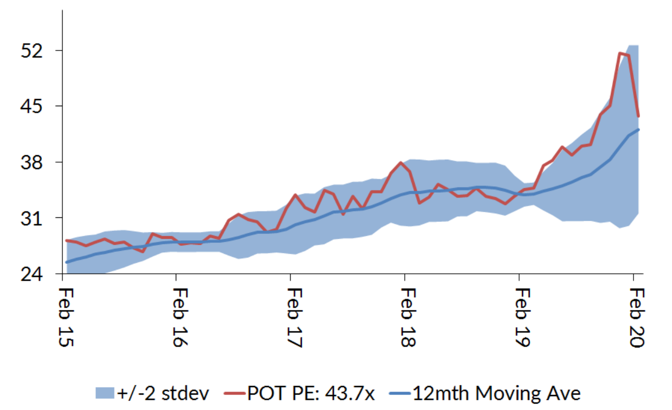
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (POT) companies fiscal year end

Figure 14. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 15. One year forward PE (x)



Source: Forsyth Barr analysis

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