

Port of Tauranga

FY20 – More Ebbing than Flowing

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UNDERPERFORM

Port of Tauranga (POT) reported a softer FY20 result than has been customary in recent years, given an -8% decline in cargo during the year. Underlying NPAT fell -5% against the prior year, on a revenue decline of -4%. As a result of lower profitability the company cut its final dividend and has suspended (we believe temporarily) its 2.5c special dividend programme. Notwithstanding revisions to our cost of capital inputs, POT's share price continues to trade at a premium, which we believe reflects perceived scope for industry structural change for which it could be a key potential beneficiary. Management has acknowledged that it would be interested in participating in any ownership/business structure change at Ports of Auckland (POAL), if its owner, Auckland Council, was to consider alternative options to the current status quo. We retain an UNDERPERFORM rating on valuation grounds but recognise potential upside exists from industry consolidation.

NZX Code	POT	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$7.45	NPAT* (NZ\$m)	93.7	101.2	108.0	114.0	EV/EBITDA	33.3	31.4	29.3	27.7
Target price	NZ\$6.75	EPS* (NZc)	13.8	14.9	15.9	16.7	EV/EBIT	40.8	38.1	35.5	33.3
Risk rating	Low	EPS growth* (%)	-5.4	7.9	6.7	5.6	PE	54.1	50.1	47.0	44.5
Issued shares	680.6m	DPS (NZc)	12.4	16.1	17.0	17.8	Price / NTA	4.4	4.2	4.3	4.3
Market cap	NZ\$5,070m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.7	2.2	2.3	2.4
Avg daily turnover	157.4k (NZ\$1,078k)	*Based on normalised profits					Gross div yld (%)	2.3	3.0	3.2	3.3

What's changed?

- **Earnings:** Minor immaterial downgrades
- **Target price:** Raised to NZ\$6.75 principally to reflect revised WACC inputs

Cargo COVID'd in 2H20

POT's FY20 cargo decline was driven principally by lower log exports (-22%). Other bulk products, particularly imports, were also down (-14%). While overall containers grew, the growth in key feeders, MetroPort and transhipments, reversed and slowed respectively. Cargo growth should bounce-back in FY21, assuming no further COVID-19 disruption, with management's log export guidance implying a ~+12% rebound.

Dividend cut and special suspended

The Board has reduced its final dividend from 7.3c in 2H19 to 6.4c. It has also suspended the special dividend programme, which was due to pay 2.5c per share for each of the next four years. Consequently, POT's cash yield falls to ~1.6%. Management suggests that the suspension reflects profitability rather than balance sheet issues. Gearing is at a comfortable level. We expect the special dividend to be reinstated in FY21 with the same four year duration. Beyond that, we see scope for POT to lift its ordinary pay-out to 100% of NPAT from the current 90% given strong cash conversion.

Capital programme picking up

POT is pursuing the next stage of its capacity expansion with the addition of another container vessel berth to the south of the existing Sulphur Point wharves. The new berth will cost ~NZ\$70m and add at least a further 220m of berth length when completed (in FY22-FY23). Capex has been subdued over the past three years, which as is usual, and has coincided with a period of stronger container terminal growth.

Port of Tauranga Ltd (POT)

Priced as at 28 Aug 2020 (NZ\$)						7.45											
12-month target price (NZ\$)*						6.75	Spot valuations (NZ\$)										
Expected share price return						-9.4%	1. DCF	6.39									
Net dividend yield						2.2%	2. DDM	6.83									
Estimated 12-month return						-7.2%	3. Sum-of-the-parts	6.40									
Key WACC assumptions						DCF valuation summary (NZ\$m)											
Risk free rate						1.30%	Total firm value	4,850									
Equity beta						0.75	(Net debt)/cash	(473)									
WACC						4.7%	Less: Capitalised operating leases	(30)									
Terminal growth						1.5%	Value of equity	4,348									
Profit and Loss Account (NZ\$m)						Valuation Ratios											
Sales revenue	2019A	2020A	2021E	2022E	2023E	313.3	302.0	318.6	336.6	352.8	EV/EBITDA (x)	2019A	2020A	2021E	2022E	2023E	
Normalised EBITDA	173.2	162.2	172.8	185.6	196.1	(27.6)	(29.7)	(30.3)	(32.1)	(32.9)	EV/EBIT (x)	30.9	33.3	31.4	29.3	27.7	
Depreciation and amortisation	(27.6)	(29.7)	(30.3)	(32.1)	(32.9)	Normalised EBIT	145.6	132.5	142.6	153.4	163.2	PE (x)	51.2	54.1	50.1	47.0	44.5
Net interest	(18.2)	(18.5)	(18.2)	(20.2)	(22.3)	Associate income	8.1	11.3	12.2	12.7	13.2	Price/NTA (x)	4.4	4.4	4.2	4.3	4.3
Tax	(34.4)	(25.3)	(35.5)	(38.0)	(40.2)	Minority interests	0	0	0	0	0	Free cash flow yield (%)	1.4	1.5	1.1	0.3	1.6
Normalised NPAT	99.1	93.7	101.2	108.0	114.0	Reported NPAT	100.6	90.0	101.2	108.0	114.0	Net dividend yield (%)	2.5	1.7	2.2	2.3	2.4
Abnormals/other	(1.5)	3.7	0	0	0	Normalised EPS (cps)	14.6	13.8	14.9	15.9	16.7	Gross dividend yield (%)	3.4	2.3	3.0	3.2	3.3
Normalised EPS (cps)	14.6	13.8	14.9	15.9	16.7	DPS (cps)	18.3	12.4	16.1	17.0	17.8	Capital Structure					
Ordinary DPS (cps)	18.3	12.4	16.1	17.0	17.8	Growth Rates						2019A	2020A	2021E	2022E	2023E	
Revenue (%)						10.4	-3.6	5.5	5.7	4.8	Return on assets (%)	8.3	7.3	7.5	7.9	8.2	
EBITDA (%)						12.4	-6.3	6.5	7.4	5.7	Return on equity (%)	8.5	8.1	8.3	9.2	9.7	
EBIT (%)						13.0	-9.0	7.6	7.6	6.3	Return on funds employed (%)	19.4	18.6	17.8	17.3	17.4	
Normalised NPAT (%)						4.2	-5.4	7.9	6.7	5.6	EBITDA margin (%)	55.3	53.7	54.2	55.1	55.6	
Normalised EPS (%)						4.2	-5.4	7.9	6.7	5.6	EBIT margin (%)	46.5	43.9	44.8	45.6	46.3	
Ordinary DPS (%)						4.7	-6.8	9.3	6.7	5.6	Capex to sales (%)	13.6	13.0	20.4	32.7	15.0	
Capex to depreciation (%)						154	132	215	342	161	Imputation (%)	100	100	100	100	100	
Imputation (%)						100	100	100	100	100	Pay-out ratio (%)	126	90	108	107	106	
Pay-out ratio (%)						126	90	108	107	106	Operating Performance						
Revenue (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Port operations revenue (NZ\$m)						
Port operations						251.4	276.8	266.3	282.8	299.7	Container revenue						
Property services						26.9	28.8	29.6	30.5	31.4	Bulk revenue						
Marshalling Services						4.9	4.9	5.0	5.2	5.5	Marine revenue						
Total revenue						283.7	313.3	302.0	318.6	336.6	Total						
Container revenue						164.1	175.1	176.0	185.3	195.4	EBITDA (NZ\$m)						
Bulk revenue						51.3	58.3	50.0	55.4	60.3	Port operations						
Marine revenue						36.0	43.4	40.3	42.1	43.9	Property services						
Total						251.4	276.8	266.3	282.8	299.7	Marshalling Services						
Property services						26.9	28.8	29.6	30.5	31.4	Unallocated expenses						
Marshalling Services						3.7	4.6	4.8	5.0	5.3	Other income						
Unallocated expenses						(128.0)	(140.5)	(139.3)	(145.5)	(150.8)	Total EBITDA						
Other income						0.1	3.4	0.8	0.0	0.0	Containers (TEU'000)						
Total EBITDA						154.1	173.2	162.2	172.8	185.6	Logs (JAS m)						
Containers (TEU'000)						1,161	1,215	1,236	1,269	1,320	Other bulk (tonnes m)						
Logs (JAS m)						6.3	7.1	5.5	6.2	6.8							
Other bulk (tonnes m)						5.1	5.4	4.8	5.1	5.3							

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

Hub port delivering, share price wants more; UNDERPERFORM

Port of Tauranga's (POT) FY20 result again highlights its favourable strategic positioning, which has been supported by further moves during the year to strengthen its port supply chains. It secured an extension to the Kotahi arrangement (volume commitment) for a further 6.5 years (to 2031) at Tauranga and signed a 50 year JV agreement with Tainui for the Ruakura Inland Port in the Waikato. Its port investment in Timaru is more than washing its face (i.e. generating a return on investment in excess of WACC). While Coda has work to do (it remains loss-making), POT's approach to cargo aggregation and its hub port focus is delivering, and should allow for above industry volume growth for the foreseeable future.

However, the company's share price premium is more a function of the scope for industry structural change given the questions posed of Ports of Auckland, in our opinion. We don't know what will happen, or when it will happen, but POT is a potential beneficiary. This makes valuation challenging. We ascribe no value for industry structural change to POT. However, our target price increases to NZ\$6.75 from NZ\$6.20 to reflect the revised inputs to our cost of capital framework (risk free rate now 1.3% from 2.0% and market risk premium reduced from 7.5% to 6.0%), and the addition of a dividend discount model approach into our now three pronged valuation methodology.

Result summary

POT reported FY20 underlying NPAT of NZ\$93.7m, down -5% on FY19, but broadly in line with both our and consensus forecasts. Total trade volume was down -8%, as logs and other bulk cargo fell -22% and -11% respectively. However, container growth was up +2% and associate/JV income improved, albeit cycling a weak Coda result in FY19.

The company cut its dividend, announcing a final dividend of 6.4c, down from 7.3c in FY19, as well as suspending the 2.5c per year special dividend which was intended to be paid FY20-FY23. This brings POT's total FY20 dividend to 12.4c, below our forecast of 15.8c.

Figure 1. Result summary (NZ\$m)

	FY19	FY20	Change	Forsyth Barr
Sales revenue	313.3	302.0	-3.6%	304.5
EBITDA	173.2	162.2	-6.3%	162.4
Associates	8.1	11.3	39.6%	12.0
Reported NPAT	100.6	90.0	-10.5%	94.0
Underlying NPAT	99.1	93.7	-5.4%	94.0
Underlying EPS (cents)	14.6	13.8	-5.4%	13.8
Final DPS (cents)	7.3	6.4	-12.3%	7.3
Special DPS (cents)	5.0	0.0	-100.0%	2.5

Source: POT, Forsyth Barr analysis

Figure 2. Volume summary

	FY19	FY20	Change
Transshipments (TEU)	257,645	257,645	0.0%
Metroport (TEU)	311,913	303,164	-2.8%
Terminal containers (TEU)	1,214,713	1,235,923	1.7%
Container tonnage (mT)	14.5	14.4	-0.2%
Logs (mT)	7.1	5.5	-21.5%
Other bulk (mT)	5.4	4.8	-11.4%
Total trade tonnage (mT)	26.9	24.8	-7.9%

Source: POT, Forsyth Barr analysis

Earnings revisions

We make minor adjustments to our earnings forecasts for POT as illustrated in Figure 3. We assume growth returns in FY21 with underlying NPAT up +8%, on cargo growth of +5%, and that the special dividend of 2.5c is reinstated. The company is due to provide first time FY21 earnings guidance at its Annual Shareholder Meeting on 30 October 2020, along with a first quarter trading update.

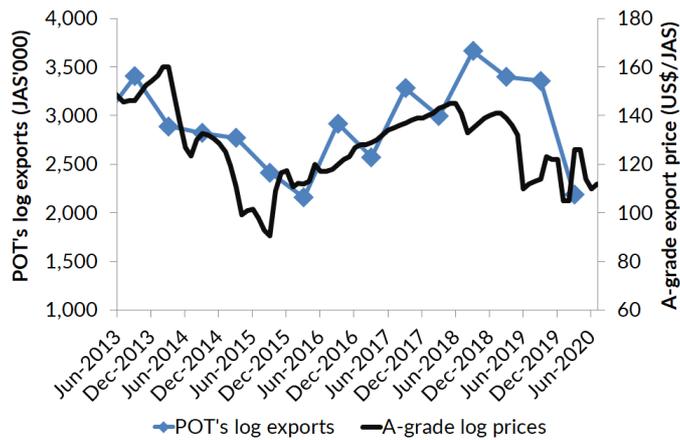
Figure 3. Earnings revisions (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	326.7	318.6	-2.5%	351.1	336.6	-4.1%	n/a	352.8	n/a
EBITDA	177.9	172.8	-2.8%	195.9	185.6	-5.3%	n/a	196.1	n/a
EBIT (post-associates)	160.8	155.5	-3.3%	177.9	166.8	-6.2%	n/a	177.0	n/a
Underlying NPAT	102.2	101.2	-1.0%	110.8	108.0	-2.5%	n/a	114.0	n/a
Underlying EPS (cps)	15.0	14.9	-1.0%	16.3	15.9	-2.5%	n/a	16.7	n/a
Ordinary DPS (cents)	13.7	13.6	-1.0%	14.8	14.5	-2.5%	n/a	15.3	n/a
Special DPS (cents)	2.5	2.5	0.0%	2.5	2.5	0.0%	n/a	2.5	n/a

Source: Forsyth Barr analysis

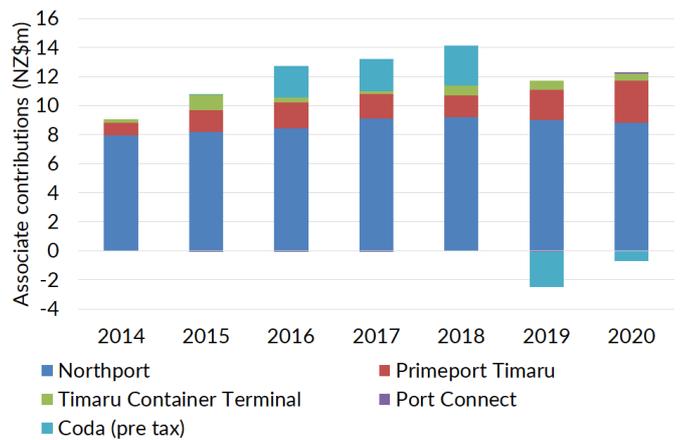
Key charts from FY20 result

Figure 4. POT's log exports are broadly correlated with log export prices which were hit as a result of the demand consequences of COVID-19 and Chinese port closures



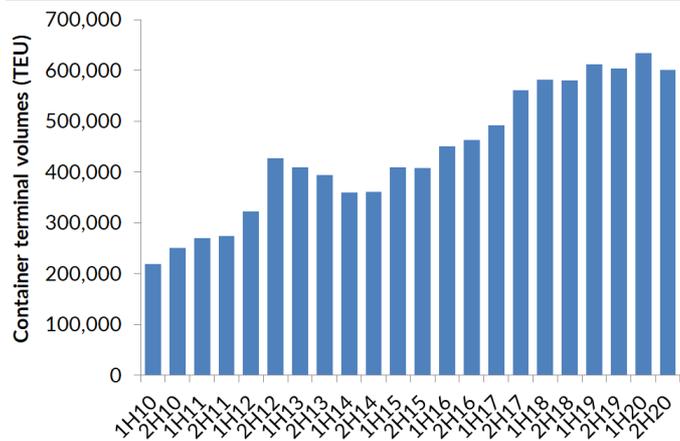
Source: POT, AgriHQ, Forsyth Barr analysis

Figure 5. Associate contributions improved in FY20 as Coda earnings bounced back from a weak FY19 and PrimePort Timaru earnings improvement



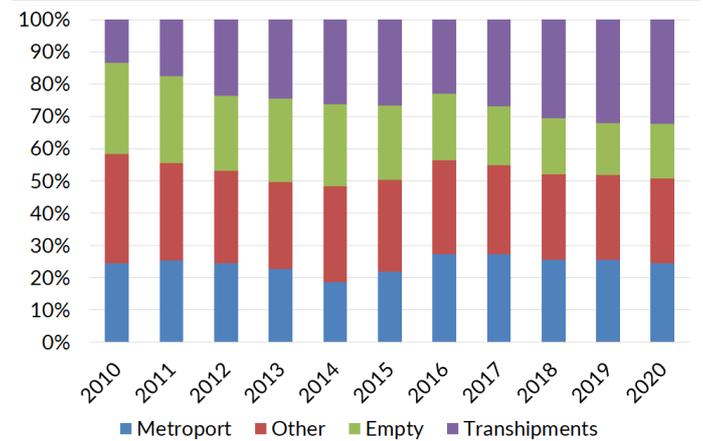
Source: POT, Forsyth Barr analysis

Figure 6. Container volumes up +1.5% in FY20. Plans to extend Sulphur Point wharves to grow capacity



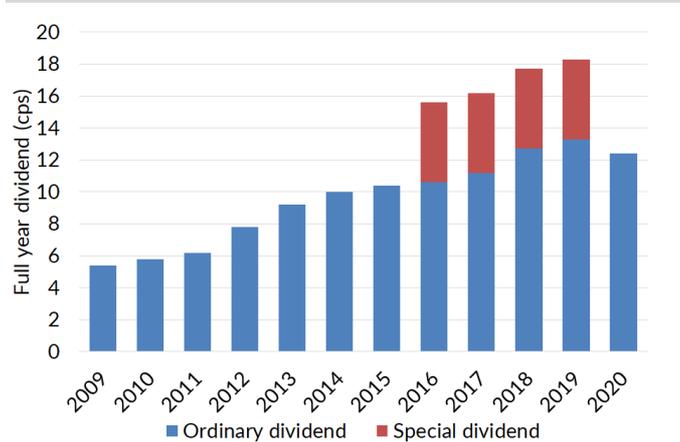
Source: POT, Forsyth Barr analysis

Figure 7. Transhipments are growing as a proportion of total container movements



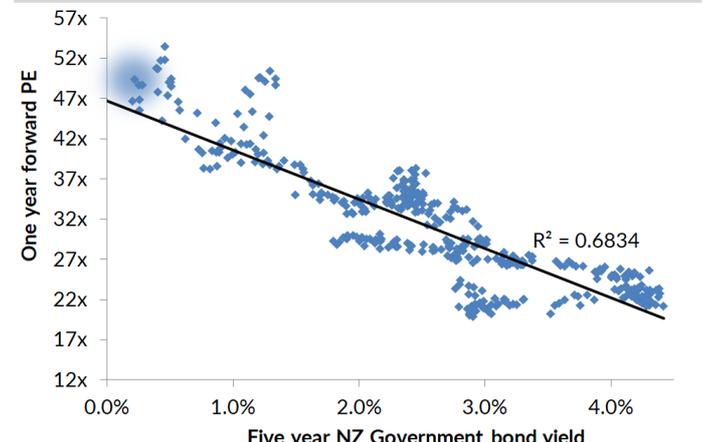
Source: POT, Forsyth Barr analysis

Figure 8. Final dividend cut from prior year level and special dividend suspended



Source: POT, Forsyth Barr analysis

Figure 9. Bond rates are a key driver of valuation, with current rate compression supportive of POT's elevated PE multiple



Source: Eikon, Forsyth Barr analysis

Result analysis

Figure 10. FY20 result analysis (NZ\$m)

	FY19	FY20	Change	Comments
Profit and loss account				
Sales revenue	313.3	302.0	-4%	
Port operations	276.8	266.3	-4%	Total cargo down -8%
Property services	28.8	29.6	3%	
Marshalling services	4.6	4.8	3%	Accounting treatment means EBITDA excludes inter-company benefits captured in port operations
Unallocated expenses and other	(137.1)	(138.5)	1%	
EBITDA	173.2	162.2	-6%	
Depreciation and amortisation	(27.6)	(28.9)	8%	
Lease depreciaton	0	(0.8)	n/a	First time inclusion of IFRS 16
EBIT	145.6	132.5	-9%	
Associate income	8.1	11.3	40%	Strong improvement led by Primeport Timaru and reduced losses at Coda
One-time items	(0.5)	(6.8)	n/a	Coda impairment
Interest expense	(18.2)	(17.5)	-4%	Capitalised interest of NZ\$0.5m
Lease interest	0.0	(1.0)	n/a	First time inclusion of IFRS 16
Profit before tax	135.0	118.4	-12%	
Taxation	(34.4)	(28.4)	-17%	Includes non-recurring deferred tax benefit from building depreciation rule change
Reported NPAT	100.6	90.0	-10%	Impacted by impairment of Coda and reduced revenue
Abnormals (post tax)	(1.5)	3.7	n/a	
Underlying NPAT	99.1	93.7	-5%	
Underlying EPS (cents)	14.7	14.0	-5%	Shares on issue of 672m
Final DPS (cents)	7.3	6.4	-12%	90% pay-out ratio of Underlying NPAT, 100% imputed
Special dividend (cents)	5.0	0.0	-100%	Special dividend programme cancelled, originally intended to be paid FY20-FY23
Cashflow and net debt				
Operating cashflow	112.2	117.1	4%	Robust cash conversion
Maintenance capex = non-lease depreciation	(27.6)	(29.7)	8%	
Free cash flow	84.6	87.4	3%	
Acquisitions	1.0	0.0	n/a	
Disposals	0.1	0.1	n/a	
Net debt	(442.3)	(479.9)	8%	
Divisional data				
Container revenue	175.1	176.0	0%	
Bulk revenue	58.3	50.0	-14%	Log volumes -22%; FY21 guidance of 6.2mT
Marine revenue	43.4	40.3	-7%	Ship visits declined -10% to 1,515 in the year
Port operations revenue	276.8	266.3	-4%	
Metroport (TEU)	311,913	303,164	-3%	Reduced level of imports through 2H20
Transhipments (TEU)	390,437	398,987	2%	Increase in meat transhipments from South Island
Other containers	512,363	533,772	4%	Includes empties and ordinary port drop-offs
Terminal containers (TEU)	1,214,713	1,235,923	2%	
Logs ('000 tonnes)	7,063	5,544	-22%	Harvesting non essential in Alert Level 4/inventory issues in China in early CY20
Other ('000 tonnes)	5,408	4,790	-11%	Oil products -12%; grain/feed supplements +22%; Kiwifruit +18%
Total bulk tonnage ('000 tonnes)	12,471	10,334	-17%	

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 over-investment. Following several years of above trend growth, activity rates have slowed given weaker log prices and COVID-19. 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 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 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 role are supportive to long term log revenues at or around current levels.

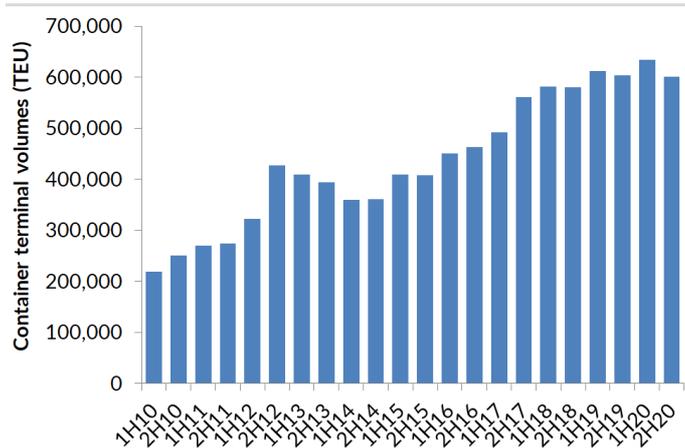
Financial structure

- **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 suspended its special dividend programme (2.5cper year) temporarily though we expect it to reinstate it in FY21. The current ordinary dividend pay-out is ~90% within the targeted range of 70%-100%.

Risk factors

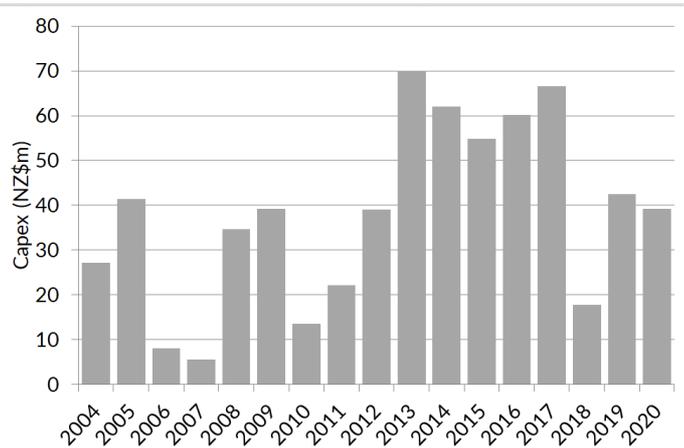
- **Industry competition:** Over investment by other ports is impacting industry ROIC.
- **Chinese log demand:** POT's log exporters are heavily exposed to Chinese construction industry demand for unprocessed timber.

Figure 11. Container volumes in recent periods

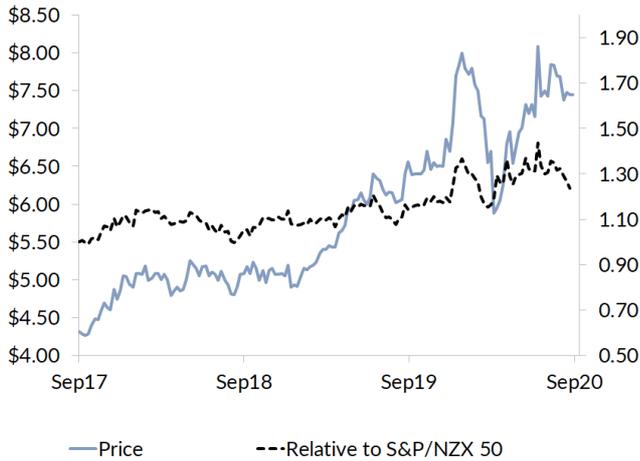


Source: POT, Forsyth Barr analysis

Figure 12. Capex necessary to facilitate growth



Source: POT, Forsyth Barr analysis

Figure 13. Price performance


Source: Forsyth Barr analysis

Figure 14. Substantial shareholders

Shareholder	Latest Holding
Quayside Securities	54.1%

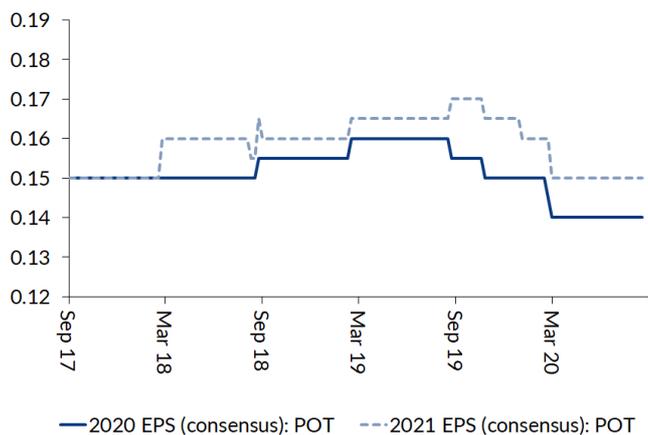
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 15. International valuation comparisons

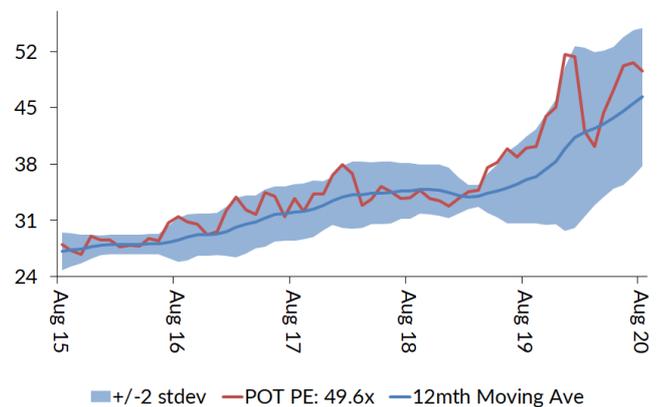
Company (metrics re-weighted to reflect POT's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Port of Tauranga	POT NZ	NZ\$7.45	NZ\$5,070	>50x	47.0x	32.1x	29.9x	38.9x	36.2x	1.9%
NAPIER PORT *	NPH NZ	NZ\$3.68	NZ\$736	35.4x	30.4x	16.7x	14.4x	24.1x	20.4x	2.6%
QUBE HOLDINGS	QUB AT	A\$2.75	A\$5,180	47.4x	36.2x	23.1x	20.0x	44.8x	36.0x	2.0%
GLOBAL PORTS INV-GDR REG S	GLPR LI	US\$3.22	US\$615	8.1x	6.5x	5.9x	5.5x	8.1x	7.3x	6.8%
HAMBURGER HAFEN UND LOGISTIK	HHFA GR	€15.74	€1,145	37.2x	13.8x	5.8x	4.8x	13.3x	8.9x	4.1%
WESTSHORE TERMINALS INVESTME	WTE CN	C\$16.22	C\$1,057	10.7x	14.6x	7.2x	9.1x	8.3x	11.2x	4.8%
MITSUBISHI LOGISTICS CORP	9301 JP	¥3225.00	¥283,673	15.7x	18.0x	13.9x	12.9x	n/a	n/a	2.1%
EUROKAI KGAA	EUK2 GR	€33.00	€385	33.3x	18.7x	8.0x	6.9x	11.5x	9.3x	n/a
AUCKLAND AIRPORT *	AIA NZ	NZ\$6.63	NZ\$9,763	<0x	>50x	66.9x	26.0x	>75x	36.3x	0.8%
SYDNEY AIRPORT	SYD AT	A\$5.56	A\$14,206	>50x	>50x	44.3x	27.2x	>75x	59.9x	3.4%
Compco Average:				26.8x	19.7x	21.3x	14.1x	18.3x	23.7x	3.3%
POT Relative:				n/a	138%	51%	112%	112%	53%	-42%

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 16. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 17. One year forward PE (x)


Source: Forsyth Barr analysis

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