FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | TRANSPORT | PORT OWNER & OPERATOR

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Port of Tauranga
1H21 — Foiling Upwind in Choppy Water

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UNDERPERFORM

Port of Tauranga's (POT) 1H21 result was impacted by shipping industry congestion which has lowered productivity, added costs and pressured margins, though performance is ahead of expectations. Industry congestion is likely to remain through 2H21, albeit POT will be cycling easier lockdown restrictions comparatives, therefore, profit growth should accelerate. NPAT growth in 1H21 of +2% against the prior year was achieved despite lower trade volumes and a sharp decline in marine revenue; higher container storage charges, higher contributions from Timaru investments and a return to profit at Coda more than offset these headwinds. POT has upgraded its FY21 NPAT guidance from a previous, very conservative, range. Medium term growth is constrained by capacity constraints as the port becomes increasingly reliant on the Southern Wharf extension to facilitate growth. The recent rise in bond rates provides a key valuation challenge for POT. Historically its one year forward valuation multiples (PE, EV/EBITDA etc) have been highly inversely correlated to bond rate movements. Now trading at ~50x one year forward PE, POT is subject to multiple compression risk, in our opinion. We retain an UNDERPERFORM rating.

NZX Code	POT
Share price	NZ$7.62
Target price	NZ$6.00
Risk rating	Low
Issued shares	680.6m
Market cap	NZ$5,186m
Avg daily turnover	163.7k (NZ$1,151k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	93.7	98.6	106.2	109.6
EPS* (NZc)	13.8	14.5	15.6	16.1
EPS growth* (%)	-5.4	5.2	7.8	3.2
DPS (NZc)	12.4	13.2	14.2	14.7
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	55.3	52.6	48.8	47.3
EV/EBIT	41.7	41.0	37.4	35.5
EV/EBITDA	34.1	32.9	30.2	28.9
Price / NTA	4.5	4.2	4.3	4.2
Cash div yld (%)	1.6	1.7	1.9	1.9
Gross div yld (%)	2.3	2.4	2.6	2.7

What's changed?

- **Earnings:** FY21 NPAT forecast lifted to top end of new guidance band; modest upgrades to later year estimates
- **Target price:** Lowered to NZ$6.00 from NZ$6.30 to reflect higher WACC impact on our DCF and DDM approaches

Cargo volumes remain symptomatic

Cargo volumes fell in 1H21 as a result of (1) log exports down -2%, as the forestry industry was slow to come back online following 2H20 lockdown restrictions, and (2) containers declining by -5%, as industry congestion impacted exports; albeit, container revenue was compensated by a sharp lift in on-port storage charges. POT remains capacity constrained. Its Southern Terminal Berth Extension is currently ~12 months behind schedule.

Port productivity dented by congestion

Global congestion and problems at Ports of Auckland meant POT had -50 fewer container vessel calls in 1H21 than the prior year. It suspended its berth windows in September 2020 and is now largely taking on vessels on a first come, first served basis. This has had a significant impact on productivity, lifting unit costs. Transhipments in 2H21 could be impacted given the shortage of empty containers available for the export harvest season.

FY21 guidance upgraded, but management cautious further out

Management has upgraded its FY21 NPAT guidance (+8% at the midpoint) to between NZ$94m–NZ$100m, up from its previously conservative range of NZ$86m–NZ$93m given at its Annual shareholder Meeting in October 2020. Upgraded guidance incorporates an improvement in log volumes on the prior year, and a modest pick-up in container volumes through 2H21.

FORSYTH BARR

Port of Tauranga Ltd (POT)

Priced as at 26 Feb 2021 (NZ$)	**7.62**

12-month target price (NZ$)*	**6.00**
Expected share price return	-21.3%
Net dividend yield	1.8%
Estimated 12-month return	-19.4%

Spot valuations (NZ$)	
1. DCF	5.98
2. DDM	5.60
3. Sum-of-the-parts	5.94

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	0.75
WACC	5.1%
Terminal growth	1.8%

DCF valuation summary (NZ$m)	
Total firm value	4,578
(Net debt)/cash	(484)
Less: Capitalised operating leases	(25)
Value of equity	4,070

Profit and Loss Account (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Sales revenue	313.3	302.0	318.0	333.1	347.0
Normalised EBITDA	**173.2**	**162.2**	**168.9**	**183.5**	**192.0**
Depreciation and amortisation	(27.6)	(29.7)	(33.5)	(35.2)	(35.9)
Normalised EBIT	**145.6**	**132.5**	**135.4**	**148.3**	**156.1**
Net interest	(18.2)	(18.5)	(17.3)	(21.4)	(25.5)
Associate income	8.1	11.3	14.1	14.8	15.6
Tax	(34.4)	(25.3)	(33.7)	(35.5)	(36.6)
Minority interests	0	0	0	0	0
Normalised NPAT	**99.1**	**93.7**	**98.6**	**106.2**	**109.6**
Abnormals/other	(1.5)	3.7	0	0	0
Reported NPAT	**100.6**	**90.0**	**98.6**	**106.2**	**109.6**
Normalised EPS (cps)	14.6	13.8	14.5	15.6	16.1
DPS (cps)	18.3	12.4	13.2	14.2	14.7

Valuation Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EV/EBITDA (x)	31.6	34.1	32.9	30.2	28.9
EV/EBIT (x)	37.6	41.7	41.0	37.4	35.5
PE (x)	52.4	55.3	52.6	48.8	47.3
Price/NTA (x)	4.5	4.5	4.2	4.3	4.2
Free cash flow yield (%)	1.3	1.5	1.6	0.5	1.5
Net dividend yield (%)	2.4	1.6	1.7	1.9	1.9
Gross dividend yield (%)	3.3	2.3	2.4	2.6	2.7

Capital Structure	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Interest cover EBIT (x)	8.0	7.1	7.8	6.9	6.1
Interest cover EBITDA (x)	9.5	8.8	9.8	8.6	7.5
Net debt/ND+E (%)	27.5	29.2	27.7	30.6	30.6
Net debt/EBITDA (x)	2.6	3.0	2.8	2.9	2.8

Growth Rates	**2019A**	**2020A**	**2021A**	**2022A**	**2023A**
Revenue (%)	10.4	-3.6	5.3	4.7	4.2
EBITDA (%)	12.4	-6.3	4.1	8.7	4.6
EBIT (%)	13.0	-9.0	2.2	9.6	5.2
Normalised NPAT (%)	4.2	-5.4	5.2	7.8	3.2
Normalised EPS (%)	4.2	-5.4	5.2	7.8	3.2
Ordinary DPS (%)	4.7	-6.8	6.5	7.8	3.2

Key Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Return on assets (%)	8.3	7.3	7.1	7.7	7.9
Return on equity (%)	8.5	8.1	7.9	8.7	8.8
Return on funds employed (%)	19.4	18.6	17.5	17.6	17.5
EBITDA margin (%)	55.3	53.7	53.1	55.1	55.3
EBIT margin (%)	46.5	43.9	42.6	44.5	45.0
Capex to sales (%)	13.6	13.0	11.3	30.0	15.0
Capex to depreciation (%)	154	132	108	284	145
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	126	90	91	91	91

Cash Flow (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EBITDA	**173.2**	**162.2**	**168.9**	**183.5**	**192.0**
Working capital change	0	0	2.0	4.0	6.0
Interest & tax paid	(52.6)	(46.0)	(49.9)	(55.8)	(61.0)
Other	(8.4)	0.9	(4.0)	(6.0)	(8.0)
Operating cash flow	**112.2**	**117.1**	**117.0**	**125.7**	**129.1**
Capital expenditure	(42.5)	(39.3)	(36.0)	(100.0)	(52.0)
(Acquisitions)/divestments	1.1	0.1	0.0	0	0
Other	9.9	10.1	10.6	11.1	11.7
Funding available/(required)	**80.6**	**88.0**	**91.6**	**36.8**	**88.7**
Dividends paid	(122.4)	(124.5)	(88.7)	(95.6)	(98.7)
Equity raised/(returned)	(1.4)	(0.7)	0	0	0
(Increase)/decrease in net debt	**(43.2)**	**(37.6)**	**2.4**	**(59.3)**	**(10.4)**

Operating Performance	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Revenue (NZ$m)					
Port operations	276.8	266.3	281.6	296.2	308.8
Property services	28.8	29.6	30.5	31.4	32.4
Marshalling Services	4.9	5.0	5.2	5.5	5.8
Total revenue	**313.3**	**302.0**	**318.0**	**333.1**	**347.0**
Port operations revenue (NZ$m)					
Container revenue	172.5	173.4	186.4	190.9	196.3
Bulk revenue	60.9	52.6	58.5	63.1	66.8
Marine revenue	43.4	40.3	36.7	42.2	45.8
Total	**276.8**	**266.3**	**281.6**	**296.2**	**308.8**
EBITDA (NZ$m)					
Port operations	276.8	266.3	281.6	296.2	308.8
Property services	28.8	29.6	30.5	31.4	32.4
Marshalling Services	4.6	4.8	5.0	5.3	5.5
Unallocated expenses	(140.5)	(139.3)	(148.1)	(149.4)	(154.7)
Other income	3.4	0.8	-0.2	0.0	0.0
Total EBITDA	**173.2**	**162.2**	**168.9**	**183.5**	**192.0**
Containers (TEU'000)	1,215	1,236	1,218	1,260	1,311
Logs (JAS m)	7.1	5.5	6.2	6.8	7.0
Other bulk (tonnes m)	5.4	4.8	5.2	5.3	5.7

Balance Sheet (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Working capital	28.3	20.7	17.3	18.0	18.7
Fixed assets	1,531.2	1,584.9	1,652.4	1,670.1	1,689.4
Intangibles	19.0	19.0	19.0	19.0	19.0
Right of use asset	0	25.0	24.0	23.1	22.2
Other assets	132.7	127.0	141.1	156.0	171.5
Total funds employed	**1,711.3**	**1,776.6**	**1,853.8**	**1,886.2**	**1,920.8**
Net debt/(cash)	442.3	479.9	477.5	536.7	547.1
Lease liability	0	25.4	25.0	24.5	24.1
Other liabilities	103.1	107.7	107.6	107.6	107.6
Shareholder's funds	1,165.9	1,163.6	1,243.7	1,217.4	1,242.0
Minority interests	0	0	0	0	0
Total funding sources	**1,711.3**	**1,776.6**	**1,853.8**	**1,886.2**	**1,920.8**

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

Bond rate tide poses valuation challenge; UNDERPERFORM

Port of Tauranga (POT) continues to successfully pursue its hub port strategy, yet success isn't linear as competitive/market forces and company specific issues impact progress from period to period. Share gains can be lumpy, particularly when they reflect shipping service changes. Container volume gains have been restricted in recent times given capacity constraints. POT is extending its Sulphur Point terminal by ~220m to the south, though this expansion is ~12 months behind schedule. It is also concurrently working on a staged automation project, which will help further increase capacity. Longer term growth is reliant on cargo aggregation capabilities, which are enhanced by (1) its Ruakura Inland Port JV in the Waikato, (2) further capacity potential at MetroPort and on the rail line, and (3) a continuation of transhipment hubbing from South Island ports.

Growth potential aside, POT is an interest/bond rate sensitive stock as Figure 9 illustrates. This also plays out in our valuation, which despite earnings upgrades, as outlined below, falls as a result of a higher cost of capital. We have increased our WACC estimate (from 4.7% to 5.1%) given an uplift in our risk free rate to 2.3% from 1.3% and our market risk premium lowered to 5.5% from 6.0%. Consequently, we lower our discounted cash flow (DCF), dividend discount model (DDM), and sum-of-the-parts driven target price from NZ$6.30 to NZ$6.00.

Result summary

POT reported a solid 1H21 result, with NPAT of NZ$49.4m up +2% on the prior year, despite ongoing supply chain congestion issues. The company has done well to offset (1) lower container volumes, (2) lower log export volumes, and (3) increased operating costs. These headwinds were offset by +12% lift in non-log bulk products, and strong growth in associate income. Earnings from subsidiaries and associates increased +22%. NPAT growth from PrimePort Timaru and Quality Marshalling more than offset an earnings decline at Northport.

POT declared an interim dividend of 6cps, flat on the past two interim dividends and in-line with our forecasts. We expect POT to increase the dividend at the FY21 result but is unlikely to resume the special dividend programme that was suspended in FY20.

Figure 1. Result summary (NZ$m)

	1H20	1H21	Change
Sales revenue	154.8	159.5	3.0%
EBITDA	83.0	84.0	1.2%
Associates	5.9	7.0	18.8%
Reported NPAT	48.3	49.4	2.3%
Underlying NPAT	**48.3**	**49.4**	**2.2%**
Underlying EPS (cents)	7.1	7.3	2.2%
Interim DPS (cents)	6.0	6.0	0.0%

Source: POT, Forsyth Barr analysis

Figure 2. Volume summary

	1H20	1H21	Change
Transhipments (TEU)	134,349	124,676	-7.2%
Metroport (TEU)	165,287	143,527	-13.2%
Terminal containers (TEU)	413,538	390,430	-5.6%
Total containers (TEU)	**642,209**	**605,314**	**-5.7%**
Logs (mT)	3.4	3.3	-2.1%
Other bulk (mT)	2.3	2.6	12.2%
Total trade tonnage (mT)	**13.3**	**13.1**	**-1.3%**

Source: POT, Forsyth Barr analysis

Earnings revisions

We increase our earnings forecasts as summarised in Figure 3 to reflect (1) higher container charges, particularly in FY21 for storage related income, (2) stronger bulk volumes, and (3) higher associate and JV contributions. Our FY21 NPAT estimate of ~NZ$99m is at the top end of management's new guidance range of NZ$94m–NZ$100m. We remove previously anticipated special dividends from FY22 and FY23 expectations.

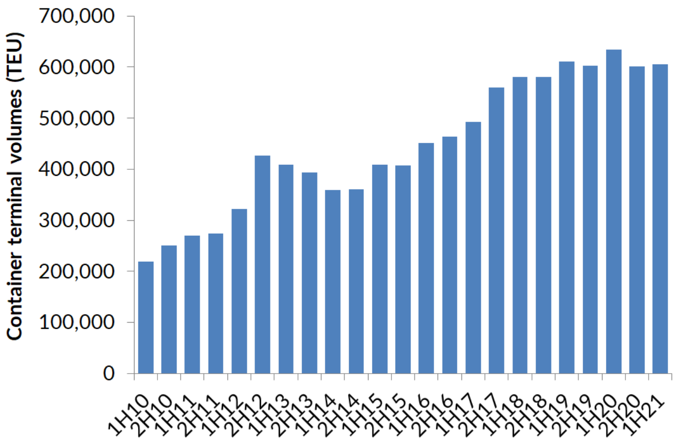
Figure 3. Summary earnings revisions (NZ$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	309.1	318.0	2.9%	326.8	333.1	1.9%	342.3	347.0	1.4%
EBITDA	162.3	168.9	4.0%	173.6	183.5	5.7%	184.4	192.0	4.1%
EBIT (post-associates)	144.9	150.5	3.8%	154.9	164.1	6.0%	165.4	172.6	4.3%
Underlying NPAT	**94.0**	**98.6**	**4.9%**	**100.8**	**106.2**	**5.4%**	**107.4**	**109.6**	**2.1%**
Underlying EPS (cps)	13.8	14.5	4.9%	14.8	15.6	5.4%	15.8	16.1	2.1%
Ordinary DPS (cents)	12.4	13.2	6.5%	13.5	14.2	5.4%	14.4	14.7	2.1%
Special DPS (cents)	0.0	0.0	n/a	2.5	0.0	-100.0%	2.5	0.0	-100.0%

Source: Forsyth Barr analysis

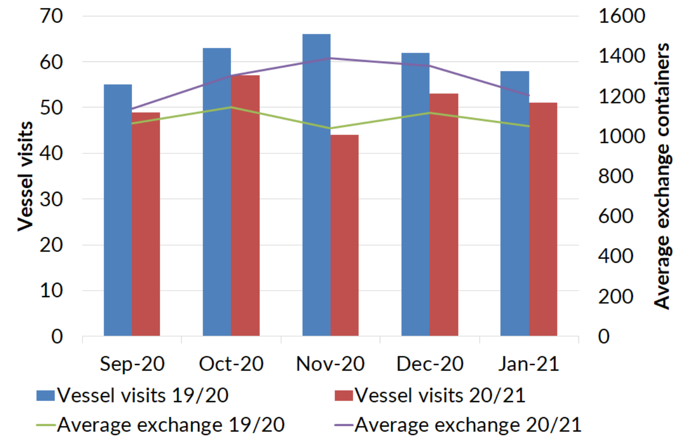
Key charts from 1H21 result

Figure 4. Containers: Growth hiatus due to capacity constraints, which will only be resolved with the Southern berth extension



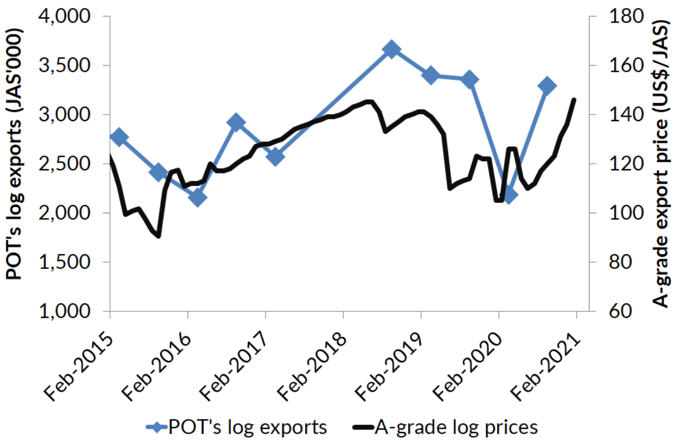
Source: POT, Forsyth Barr analysis

Figure 5. Containers: Congestion is causing the number of ship visits to decline but increasing container exchanges per ship



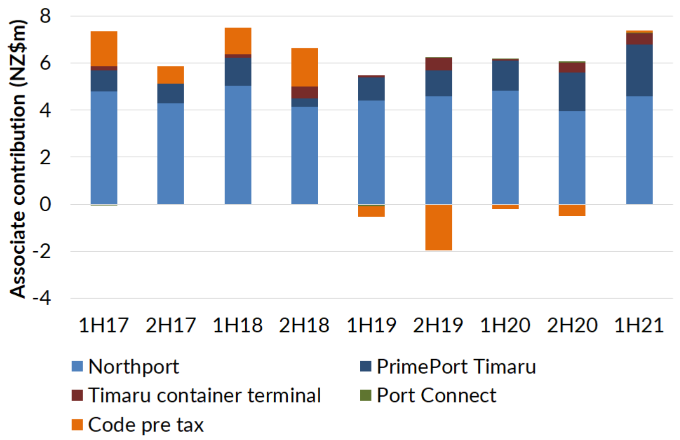
Source: POT, Forsyth Barr analysis

Figure 6. Export logs: The recent price rise in A-grade logs is supportive of a recovery in log exports through 2H21



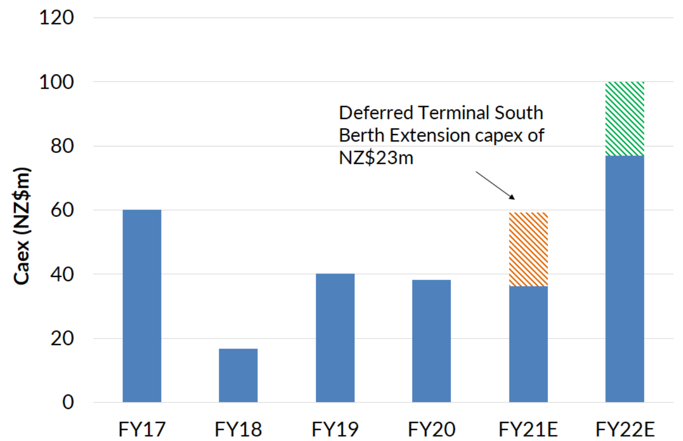
Source: POT, AgriHQ, Forsyth Barr analysis

Figure 7. Associates/JV income: Up +25% in 1H21, led by strong growth at PrimePort Timaru



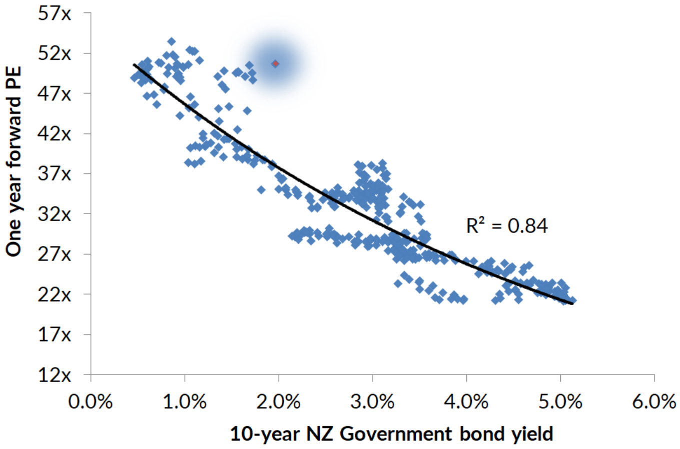
Source: POT, Forsyth Barr analysis

Figure 8. Capex: The delay of the Southern Terminal extension will defer capex spend in to FY22



Source: POT, Forsyth Barr analysis

Figure 9. Valuation: Lift in bond rates suggests POT now more expensive than at any time in recent history



Source: Refinitiv, Forsyth Barr analysis

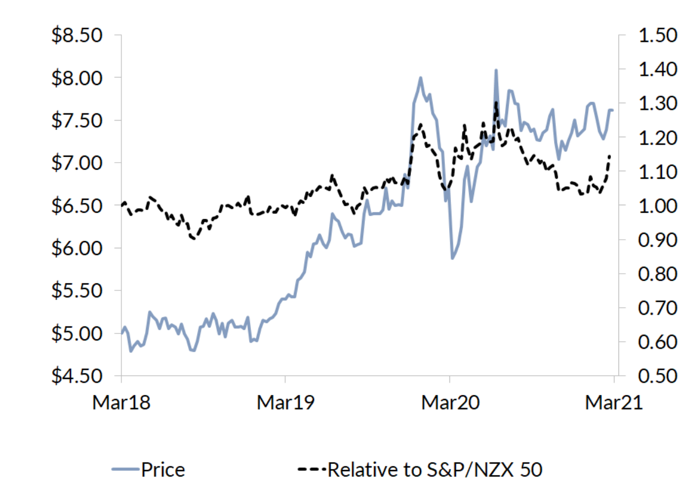
Result analysis

Figure 10. 1H21 result analysis (NZ$m)

	1H20	1H21	Change	Comments
Profit and loss account				
Sales revenue	154.8	159.5	3.0%	Container terminal revenue ~+5% boosted by storage charges; marine revenue down
Port operations	137.4	140.4	2.2%	Growth in storage revenue as dwell time has increased. POT has implemented a penalty for shippers leaving cargo on wharf for excess time from 1 January 2021
Property services	15.0	15.5	2.9%	
Marshalling services	2.3	3.7	58.5%	Quality Marshalling NPAT up +17%
Unallocated expenses	(71.8)	(75.6)	5.3%	Productivity impacted by suspension of berthing windows and congestion on wharf
EBITDA	**83.0**	**84.0**	**1.2%**	
Depreciation/amort.	(14.7)	(16.5)	12.6%	
EBIT	68.3	67.5	-1.2%	
Associate income	5.9	7.0	18.8%	Strong improvement led by PrimePort Timaru; Coda JV returns to profits
One-time items	0.0	0.0		
Interest expense	(9.1)	(8.5)	-6.8%	Capitalised interest of NZ$0.1m
Profit before tax	65.2	66.1	1.4%	
Taxation	(16.4)	(16.7)	1.9%	Effective tax rate of ~28%
Reported NPAT	48.8	49.4	1.3%	
Abnormals (post tax)	0.0	(0.0)	n/a	
Underlying NPAT	**48.3**	**49.4**	**2.2%**	**FY21 NPAT guidance of between NZ$94m-NZ$100m; up from NZ$86m-NZ$93m previously**
Underlying EPS (cents)	7.2	7.4	2.2%	Shares on issue of 671m (excludes 10m due to Kotahi if it meets volume commitments)
Interim DPS	6.0	6.0	0.0%	83% pay-out ratio, 100% imputed. Special dividend was suspended in 2H20 and is unlikely to return
Cashflow and net debt				
Operating cashflow	49.8	27.3	-45.2%	
Maintenance capex = non-lease depreciation	(14.7)	(16.5)	12.6%	Berth extension capex deferred to FY22
Free cash flow	**35.1**	**10.8**	**-69.3%**	
Acquisitions	0.0	0.0		Acquired remaining 49.9% of of Timaru container terminal from Kotahi for a volume based rebate and a contract extension fee
Disposals	0.1	0.0	-96.7%	
Net debt	(496.7)	(505.1)	1.7%	
Divisional data				
Container revenue	89.3	93.3	4.5%	Container storage revenue up +NZ$4.7m to NZ$8.2m
Bulk revenue	27.4	28.9	5.5%	Lower log export volumes more than offset by growth in coal, oil and grain
Marine revenue	20.7	18.3	-11.8%	-119 fewer ship visits (-15%); +11 additional unscheduled calls but no cruise ships
Port operations revenue	**137.4**	**140.4**	**2.2%**	
Metroport (TEU)	165,287	143,527	-13.2%	MetroPort had to close to new containers multiple times given reduced rail capacity
Transhipments (TEU)	134,349	124,676	-7.2%	Import transhipments lower due to AC1 service discontinued but growth in export transhipments helped partially offset
Other containers	334,882	337,111	0.7%	Includes empties and ordinary port drop-offs
Terminal containers (TEU)	**634,518**	**605,314**	**-4.6%**	
Logs ('000 tonnes)	3,358	3,289	-2.1%	FY21 guidance of 6.2mT
Other ('000 tonnes)	2,310	2,592	12.2%	Coal imports have increased materially due to low hydro lake levels
Total bulk tonnage ('000 tonnes)	**5,668**	**5,881**	**3.8%**	

Source: POT, Forsyth Barr analysis

Figure 11. Price performance



Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
Quayside Securities	54.1%

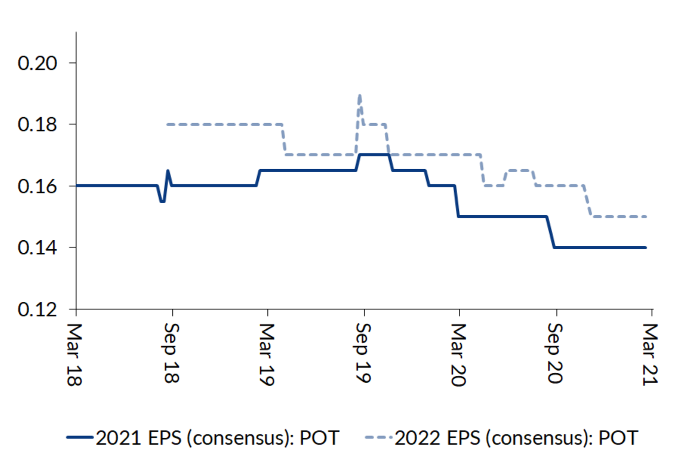
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

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)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Port of Tauranga	**POT NZ**	**NZ$7.62**	**NZ$5,186**	**>50x**	**48.8x**	**33.6x**	**30.9x**	**41.9x**	**38.2x**	**1.9%**
NAPIER PORT *	NPH NZ	NZ$3.45	NZ$690	35.8x	33.0x	17.3x	15.8x	25.5x	23.5x	2.4%
QUBE HOLDINGS	QUB AT	A$3.14	A$5,975	46.2x	37.8x	24.9x	22.6x	48.3x	41.6x	1.8%
GLOBAL PORTS INV-GDR REG S	GLPR LI	US$3.40	US$650	10.4x	7.3x	6.3x	6.0x	8.2x	7.6x	3.2%
HAMBURGER HAFEN UND LOGISTIK	HHFA GR	€21.60	€1,607	29.0x	18.5x	6.8x	5.9x	14.4x	11.0x	3.2%
WESTSHORE TERMINALS INVESTME	WTE CN	C$19.09	C$1,244	11.6x	15.8x	7.7x	9.8x	8.7x	11.8x	3.4%
MITSUBISHI LOGISTICS CORP	9301 JP	¥3470.00	¥305,224	11.7x	23.2x	14.3x	13.1x	n/a	n/a	2.1%
EUROKAI KGAA	EUK2 GR	€34.00	€411	<0x	28.4x	8.2x	7.3x	12.0x	10.1x	n/a
AUCKLAND AIRPORT *	AIA NZ	NZ$7.40	NZ$10,898	<0x	>50x	>75x	42.3x	>75x	74.2x	0.3%
SYDNEY AIRPORT	SYD AT	A$6.02	A$16,246	<0x	<0x	40.8x	32.7x	>75x	>75x	2.5%
			Compco Average:	**24.1x**	**23.4x**	**15.8x**	**17.3x**	**19.5x**	**25.7x**	**2.4%**
EV = Current Market Cap + Actual Net Debt			**POT Relative:**	**n/a**	**108%**	**113%**	**79%**	**114%**	**49%**	**-21%**

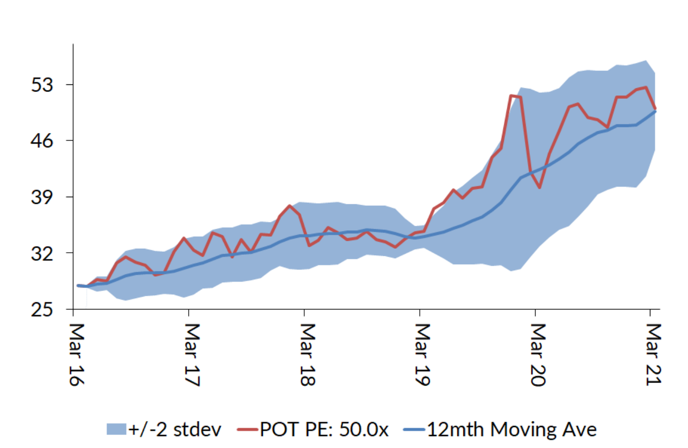
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (POT) companies fiscal year end

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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