

Auckland Airport

FY20 – COVID Flattens the Flight Path

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NEUTRAL

Auckland Airport (AIA) reported an FY20 result significantly challenged by the onset of COVID-19 through the second half. At an underlying level earnings were broadly in-line with our expectations, albeit a large number of one-off non-recurring items leaves scope for interpretation. The result doesn't tell us much about how the business will perform in future years in light of the unknown profile of the aviation recovery. Management suggests AIA's recovery could take longer than airline industry body, IATA's, view that international aviation recovers fully in CY24. We continue to assume that AIA returns to FY19 international passengers (pax) in FY25. Before then there are several key events that AIA will need to navigate in the form of (1) the FY22 five-year aeronautical price reset, and (2) the re-tender process for duty free concession(s). Along with the wide range of justifiable potential passenger recovery profiles, these add considerable uncertainty to the medium term outlook. In summary, it is difficult to have directional conviction on AIA currently. We retain a NEUTRAL rating

NZX Code	AIA	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$6.45	NPAT* (NZ\$m)	203.5	0.0	188.3	238.5	EV/EBITDA	28.7	65.1	25.4	21.8
Target price	NZ\$6.90	EPS* (NZc)	15.9	0.0	12.8	16.2	EV/EBIT	40.5	n/a	35.5	29.8
Risk rating	Low	EPS growth* (%)	-30.2	n/a	n/a	26.6	PE	40.6	n/a	50.4	39.8
Issued shares	1472.0m	DPS (NZc)	0.0	0.0	5.1	13.0	Price / NTA	1.2	1.4	1.4	1.4
Market cap	NZ\$9,494m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	0.8	2.0
Avg daily turnover	2,093k (NZ\$14,303k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	1.1	2.8

What's changed?

- Earnings:** Material upgrades to FY21 and FY22 EBITDAFI. Our earnings forecasts are likely to be volatile for the foreseeable future
- Target price:** Lifted to NZ\$6.90 to primarily reflect revised WACC inputs given lower risk free rate and market risk premiums

Defensive property operations help offset core-airport headwinds

AIA's property business (including its hotel JV) has been largely immune to COVID-19. In contrast, its passenger leveraged aeronautical and commercial operations have been hard hit. This will continue to be the case while border restrictions remain. Our modelling suggests that AIA will be NPAT loss-making in the absence of commercial international services. Moreover, it will require a trans-Tasman type-bubble to emerge by 1H22 in order to avoid a covenant breach when the current waivers end.

Opex cuts on track, though unlikely to get there given return of variable costs given domestic pax growth

AIA is on track to deliver a -35% cut in opex prior to the restarting of profitable domestic orientated commercial activities and the planned reopening of Pier B to process arrivals from higher risk countries. With these additional costs opex will remain within NZ\$10m of the original target, representing a ~-30% reduction. This will assist cash flow, which pre-capex (i.e. EBITDA) was +NZ\$10m in July 2020.

Balance sheet headroom provides scope for capex lift

Having reduced its forward capex expectations at the time of the equity raise in early April 2020, AIA has lifted its guidance to NZ\$250m–NZ\$300m for FY21, which includes ~NZ\$105m of investment property development. Key projects including a new domestic jet terminal and the Northern Runway project are effectively on hold.

Auckland International Airport Ltd (AIA)

Priced as at 20 Aug 2020 (NZ\$) **6.45**

12-month target price (NZ\$)*	6.90
Expected share price return	7.0%
Net dividend yield	0.1%
Estimated 12-month return	7.1%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.86
WACC	5.1%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. DCF	6.49
2. n/a	n/a
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	10,944
(Net debt)/cash	(1,389)
Less: Capitalised operating leases	0
Value of equity	9,554

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	743.4	567.0	303.0	588.2	680.4
Normalised EBITDA	554.8	388.0	166.5	429.0	499.5
Depreciation and amortisation	(102.2)	(112.7)	(117.7)	(121.9)	(132.8)
Normalised EBIT	452.6	275.3	48.8	307.1	366.7
Net interest	(78.5)	(71.8)	(55.3)	(53.0)	(44.0)
Associate income	8.2	8.4	6.5	7.5	8.5
Tax	(109.2)	2.2	0.0	(73.2)	(92.7)
Minority interests	0	0	0	0	0
Normalised NPAT	274.7	203.5	(0.0)	188.3	238.5
Abnormals/other	(248.8)	9.6	0	0	0
Reported NPAT	523.5	193.9	(0.0)	188.3	238.5
Normalised EPS (cps)	22.8	15.9	(0.0)	12.8	16.2
DPS (cps)	22.3	0	0	5.1	13.0

Growth Rates	2019A	2020A	2021A	2022A	2023A
Revenue (%)	8.7	-23.7	-46.6	94.1	15.7
EBITDA (%)	9.6	-30.1	-57.1	>100	16.4
EBIT (%)	8.4	-39.2	-82.3	>100	19.4
Normalised NPAT (%)	4.4	-25.9	n/a	n/a	26.6
Normalised EPS (%)	3.6	-30.2	n/a	n/a	26.6
Ordinary DPS (%)	2.3	-100.0	n/a	n/a	>100

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	554.8	388.0	166.5	429.0	499.5
Working capital change	(48.6)	18.0	(6.5)	(7.5)	(8.5)
Interest & tax paid	(187.7)	(69.6)	(55.3)	(126.3)	(136.7)
Other	57.4	(160.6)	6.5	7.5	8.5
Operating cash flow	375.9	175.8	111.2	302.7	362.7
Capital expenditure	(320.1)	(376.6)	(260.0)	(350.0)	(500.0)
(Acquisitions)/divestments	(0.8)	(23.1)	0	0	0
Other	(7.0)	(11.8)	(13.9)	(12.0)	(15.0)
Funding available/(required)	48.0	(235.7)	(162.7)	(59.2)	(152.3)
Dividends paid	(192.4)	(89.4)	6.5	(30.2)	(86.9)
Equity raised/(returned)	0	1,178.1	0	0	0
(Increase)/decrease in net debt	(144.4)	853.0	(156.2)	(89.4)	(239.2)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(33.4)	(38.5)	(48.2)	(93.5)	(108.2)
Fixed assets	6,577.1	6,060.8	6,083.1	6,211.2	6,478.4
Intangibles	0	0	0	0	0
Right of use asset	0	0	0	0	0
Other assets	2,013.7	2,403.3	2,529.8	2,637.3	2,745.8
Total funds employed	8,557.4	8,425.6	8,564.7	8,754.9	9,116.0
Net debt/(cash)	2,153.1	1,379.9	1,536.1	1,625.5	1,864.7
Lease liability	0	0	0	0	0
Other liabilities	371.4	408.6	408.6	408.6	408.6
Shareholder's funds	6,032.9	6,637.1	6,620.0	6,720.9	6,842.8
Minority interests	0	0	0	0	0
Total funding sources	8,557.4	8,425.6	8,564.7	8,754.9	9,116.0

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	20.6	28.7	65.1	25.4	21.8
EV/EBIT (x)	25.3	40.5	>100x	35.5	29.8
PE (x)	28.3	40.6	n/a	50.4	39.8
Price/NTA (x)	1.3	1.2	1.4	1.4	1.4
Free cash flow yield (%)	0.6	-2.1	-1.6	-0.5	-1.4
Net dividend yield (%)	3.4	0.0	0.0	0.8	2.0
Gross dividend yield (%)	4.8	0.0	0.0	1.1	2.8

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	5.8	3.8	0.9	5.8	8.3
Interest cover EBITDA (x)	7.1	5.4	3.0	8.1	11.4
Net debt/ND+E (%)	26.3	17.2	18.8	19.5	21.4
Net debt/EBITDA (x)	3.9	3.6	9.2	3.8	3.7

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	5.2	3.0	0.5	3.3	3.9
Return on equity (%)	4.6	3.1	0.0	2.8	3.5
Return on funds employed (%)	11.0	7.4	0.9	5.6	6.3
EBITDA margin (%)	74.6	68.4	54.9	72.9	73.4
EBIT margin (%)	60.9	48.6	16.1	52.2	53.9
Capex to sales (%)	43.1	66.4	85.8	59.5	73.5
Capex to depreciation (%)	313	334	221	287	377
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	98	0	0	40	80

Operating Performance	2019A	2020A	2021E	2022E	2023E
Aeronautical	342.2	262.3	120.3	261.4	306.4
Consumer	301.3	201.9	69.7	208.1	249.7
Property	94.7	97.0	107.2	112.6	118.1
Other	5.2	5.8	5.9	6.0	6.2
Sales revenue	743.4	567.0	303.0	588.2	680.4

Aeronautical	252.1	167.2	55.3	189.4	226.4
Consumer	269.0	173.1	44.7	181.1	219.8
Property	72.2	75.0	83.6	86.7	89.7
Other	(38.5)	(27.3)	(17.1)	(28.2)	(36.4)
EBITDAFI	554.8	388.0	166.5	429.0	499.5

International pax growth (%)	3.0	-26.3	-72.8	250.0	14.3
Transits (%)	-1.2	-1.2	-93.5	n/a	14.3
Domestic pax growth (%)	3.6	-26.5	-31.9	50.0	20.0

Aero income per pax change	1.3	4.8	6.3	5.7	8.7
Retail sales per int'l pax change	15.5	-14.9	0.0	0.0	0.0
Car park income per pax change	1.7	6.6	0.0	3.0	1.0
Yield on property BV (%)	6.8	5.7	5.5	5.5	5.5

Int'l aircraft numbers ('000)	57.1	45.0	14.3	44.8	48.5
Domestic aircraft numbers ('000)	121.7	94.2	64.0	92.2	109.3

Uncertain outlook; valuation fair; NEUTRAL

Our sole valuation approach for AIA currently is a sum-of-the-parts comprising a DCF for the commercial assets, a RAB multiple for the aeronautical operations and an NTA premium for the investment property business. Our valuation, assisted by the recent changes to our WACC inputs (risk free rate at 1.3%, market risk premium at 6%, giving a WACC of 5.1%), amounts to ~NZ\$6.50, which also incorporates a lower terminal growth assumption of 1.5%. This valuation drives our revised target price of NZ\$6.90.

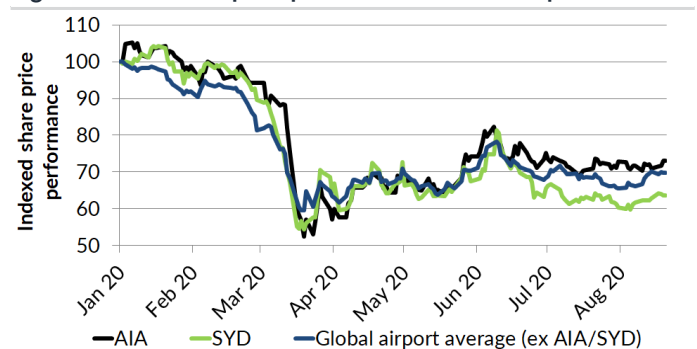
In Figure 1 we highlight an alternative view of valuation by considering our base case of a full recovery of international travel in FY25. We apply an EV/EBITDA multiple of ~23x (derived from our pre COVID-19 observations of the relationship between bond rates and AIA's forward EV/EBITDA) to our FY25 EBITDA. We then deduct FY25 net debt and discount back to today based on our cost of equity estimate of 6.1%. The output is an implied share price of NZ\$6.46 – very close to our valuation, providing a level of comfort.

Figure 1. Alternative take on valuation (NZ\$m)

	Amount
EV/EBITDA multiple	23.0x
FY25 EBITDA	628
Enterprise value (EV)	14,452
FY25 net debt	(2,523)
Implied market cap at 30 June 2024	11,929
Shares on issue (m)	1470
Implied share price at 30 June 2024 (NZ\$)	8.11
Discount at cost of equity (6.1%)	0.796
Implied share price today (NZ\$)	6.46

Source: Forsyth Barr analysis NOTE: This is a simplistic analysis, which ignores the impact of associates and value changes in non-income generating land and WIP development projects

Figure 2. AIA's share price performance in 2020 vs peers



Source: Eikon, Forsyth Barr analysis

Result summary

AIA reported FY20 EBITDA slightly lower than our forecast as cost reduction measures were less impactful through 2H20 than anticipated. The result is messy given a large number of one-off significant items (a function of COVID-19 impairments, abatements, write-offs, and termination costs), which makes comparison difficult between our estimates, consensus and company reported. Underlying NPAT benefited from an NZ\$45m deferred tax gain from the reinstatement of depreciation on buildings.

Figure 3. Summary of result (NZ\$m)

	FY19	FY20	Change	Forbar
Sales revenue	743.4	567.0	-23.7%	570.3
EBITDAFI	554.8	388.0	-30.1%	398.4
Depreciation	(102.2)	(112.7)	10.3%	(108.5)
Net interest	(78.5)	(71.8)	-8.5%	(65.7)
Taxation	(108.4)	(9.2)	-91.5%	(64.5)
Underlying NPAT	274.7	203.5	-25.9%	165.7
Underlying EPS (cents)	22.8	15.9	-30.2%	13.1
Final DPS (cents)	11.25	0.0	-100.0%	0.0

Source: AIA, Forsyth Barr analysis

Figure 4. Reconciliation between AIR and Forsyth Barr (NZ\$m)

	EBITDA	Underlying NPAT
AIA reported	260.4	188.5
COVID-19 related fixed asset w/e, impairments and termination costs	117.5	
COVID-19 related redundancy, wage subsidy and bad debts	10.1	10.1
Tax on above		(2.8)
JV impairment		7.7
Forsyth Barr disclosed	388.0	203.5

Source: Forsyth Barr analysis

Earnings revisions

We make changes to our AIA earnings forecasts as summarised in Figure 5. While our passenger recovery profile is unchanged, we make a number of revisions to retail and car park yields, property and associates income, and interest costs.

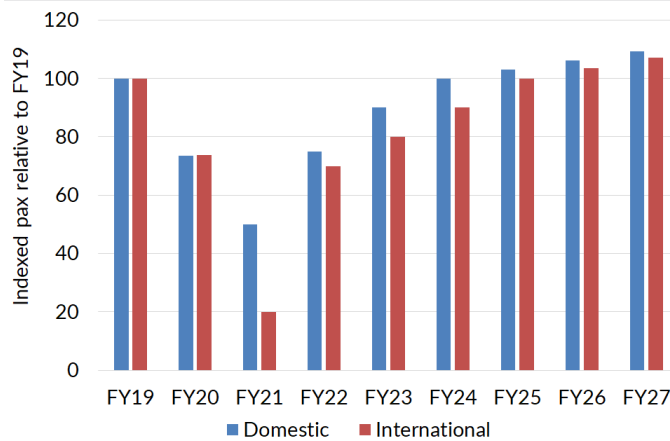
Figure 5. Earnings revisions (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	282.3	303.0	7.4%	551.2	588.2	6.7%	n/a	680.4	n/a
EBITDAFI	135.6	166.5	22.8%	373.7	429.0	14.8%	n/a	499.5	n/a
Underlying NPAT	(6.2)	(0.0)	100.0%	167.2	188.3	12.6%	n/a	238.5	n/a
Underlying EPS (cents)	(0.4)	(0.0)	100.0%	11.4	12.8	12.5%	n/a	16.2	n/a
DPS (cents)	0.0	0.0	n/a	4.6	5.1	12.5%	n/a	13.0	n/a

Source: Forsyth Barr analysis

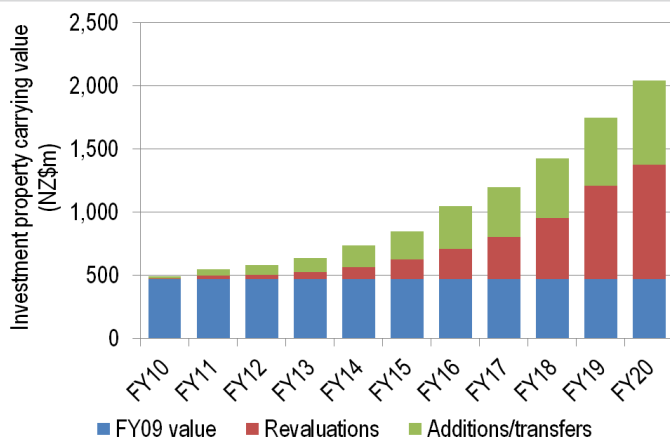
Key charts from FY20 result

Figure 6. International pax recovery: we expect AIA's pax to recover fully in FY25. IATA assumes a global international air travel recovery in CY24, which AIA says "could be" optimistic



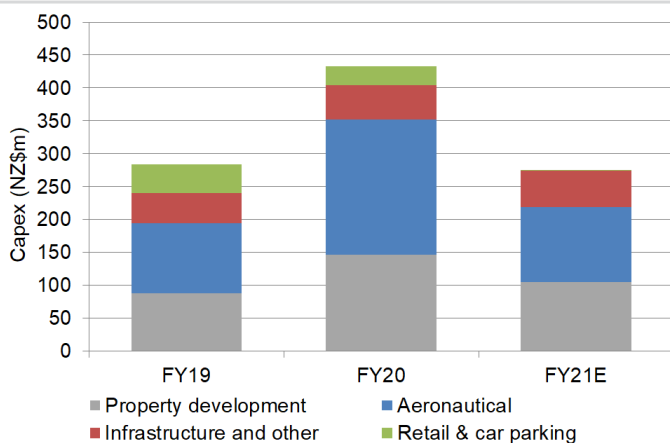
Source: Forsyth Barr analysis

Figure 8. Investment property: continues to benefit from capex additions and revaluations/development margins



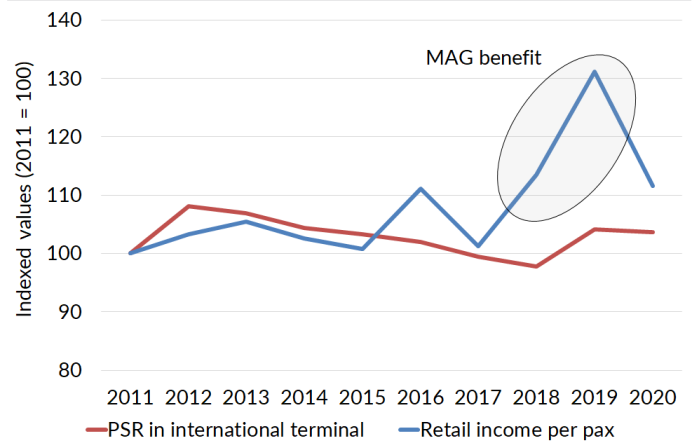
Source: AIA, Forsyth Barr analysis

Figure 10. Capex: FY21 guidance for NZ\$250m–NZ\$300m



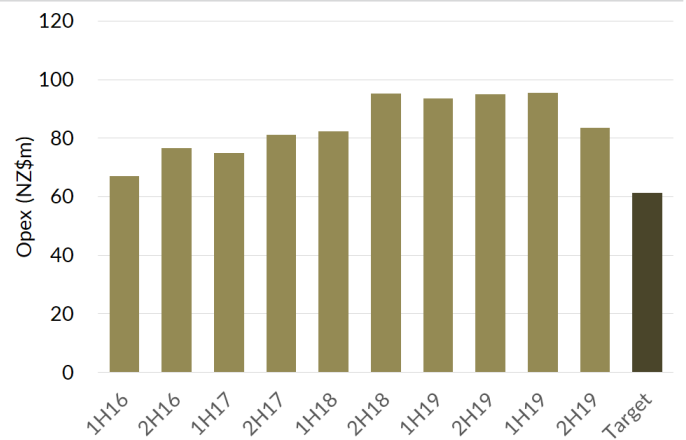
Source: AIA, Forsyth Barr analysis

Figure 7. Retail income: significantly impacted by the removal of MAGs during 2H20. PSR appears stable through FY20 but fell in 2H20. AIA likely to assume greater pax risk in retail in future



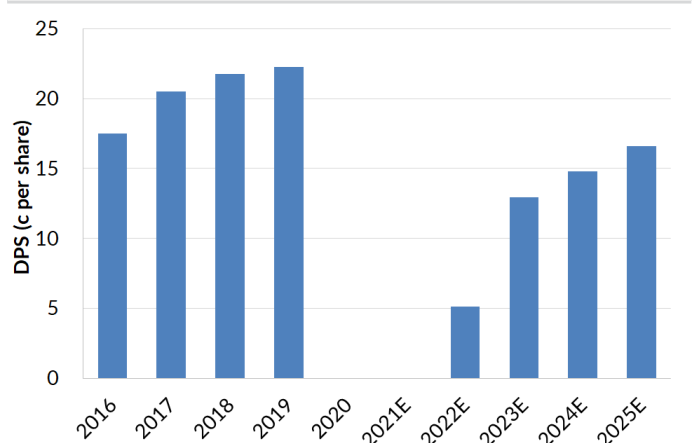
Source: AIA, Forsyth Barr analysis

Figure 9. Opex: Temporary cost reduction to accompany lower levels of pax throughput on track to deliver target



Source: AIA, Forsyth Barr analysis

Figure 11. DPS: dividend holiday until FY22 final



Source: AIA, Forsyth Barr analysis

Result analysis

Figure 12. FY20 result analysis

	FY19	FY20	Change	Comments
<u>Profit and loss account</u>				
Sales revenue	743.4	567.0	-24%	Broadly in-line with expectations, however, a larger weighting to property rentals & car parking
Airfield income	127.6	100.6	-21%	Decrease due to reduction in movements, as well as removal of aircraft parking charges
Passenger Service Charge	185.1	133.0	-28%	Lower pax numbers as well as a -3.4% decrease in charges
Retail income	225.8	141.5	-37%	Net of NZ\$15.6m of rent receivables impairment. Passenger spend rate (PSR) down -0.5%
Property income	94.7	97.0	2%	Rent roll up to NZ\$104m
Car Park income	64.2	50.3	-22%	Decrease demand due to lower pax numbers, yield per pax stable
Interest income	1.8	1.7	-6%	
Other income	44.2	42.9	-3%	
EBITDAFI	554.8	388.0	-30%	Reported EBITDAFI or NZ\$260.4m adjusted for NZ\$127.6m of COVID-19 related expenses
Depreciation	(102.2)	(112.7)	10%	Increase reflects fixed assets commissioned in the year
Associate income	8.2	8.4	2%	Both Queenstown Airport and Novotel Tainui Holdings reported underlying earnings growth
One-time items	249.6	(14.5)	-106%	Largely in-line with forecasts (Forsyth Barr -NZ\$11.4m)
Interest expense	(78.5)	(71.8)	-9%	
Taxation	(108.4)	(3.5)	-97%	Effective rate of 4.4% due to deferred tax benefit from reinstatement of building depreciation
Reported NPAT	523.5	193.9	-63%	
Abnormals (post tax)	(248.8)	9.6	n/a	
Underlying NPAT	274.7	203.5	-26%	Guidance for FY21 suspended given uncertain outlook
Underlying EPS (cents)	22.8	15.9	-30%	Based on average shares on issue of 1,213m
Final DPS (cents)	11.25	0.00	-100%	Won't pay a dividend until final FY22 at the earliest, as agreed with lenders
<u>Cashflow and net debt</u>				
Operating cashflow	375.9	175.8	-53%	
Maintenance capex = depreciation	(102.2)	(112.7)	10%	FY21 Capex guidance of between NZ\$250m and NZ\$300m
Capitalised interest	(7.0)	(11.8)	69%	
Associate dividends	9.2	14.9	62%	
Free cash flow	275.9	66.2	-76%	
Acquisitions	(2.3)	(23.2)	n/a	JV investment in second airport hotel
Disposals	1.5	0.1	-93%	
Net debt	(2,153)	(1,380)	-35.9%	Gearing reduced to 23.5% from 25.9%
<u>Margin and efficiency analysis</u>				
Underlying EBITDAFI margin	74.6%	68.4%	-8%	Margin deleverage from reduced pax
Op. income per passenger	35.21	36.53	4%	
Retail income per int'l passenger	20.50	17.45	-15%	
Car park income per passenger	3.19	3.40	7%	Average revenue per space down -26.5%, a result of lower demand
Operating staff costs/operating revenue	7.9%	10.5%	32%	
<u>Operational statistics</u>				
International passengers	11,518	8,474	-26%	2H20 international passengers down -54% on the prior year
Domestic passengers	9,594	7,047	-27%	2H20 domestic passengers down -52% on the prior year
International MCTOW (KT)	5,894	4,667	-21%	
Domestic MCTOW (KT)	2,372	1,830	-23%	
International aircraft (numbers)	57,082	44,962	-21%	Decline in passenger aircraft partially offset by increased use of aircraft for freight
Domestic aircraft (numbers)	121,689	94,174	-23%	COVID-19 significantly exacerbated the underlying decline with Jetstar's regional exit

Source: AIA, Forsyth Barr analysis

Investment Summary

Auckland Airport (AIA) is New Zealand's premier airport and provides Air New Zealand with a domestic and international hub. It is very profitable given strong concession based commercial assets. It is part way through a major 10-year plus capex programme, which will facilitate longer term growth, albeit this is now on hold in light of COVID-19 disruption. Ordinarily it generates attractive return on capital in its non-regulated commercial assets and valuation benefits from low prevailing government bond rates. However, COVID-19 has had a material impact on its operations and we expect recovery will take years given border closures, consumer apathy to travel and the impact on the travel retail sector. **NEUTRAL.**

Business quality

- **Hub-airport:** AIA is New Zealand's key international gateway and accounts for ~90% of all long-haul passengers (pax) arriving in New Zealand. Its available land provides scope to increase capacity over the next 30+ years.
- **Multi-pronged strategy:** AIA has three key income streams – (i) aeronautical (regulated); (ii) commercial, which incorporates retail and car parking; and (iii) development property.
- **Track record:** AIA has created value in recent years through route development activities, expanding its retail footprint to optimise passenger spend and concession rates, and developing property.

Earnings and cashflow outlook

- **COVID-19 implications:** AIA will be hard hit by COVID-19. We expect air travel to recover in FY21, albeit only slowly over a number of years.
- **Aeronautical income:** AIA resets its aeronautical prices every five years which are subject to regulatory oversight from the Commerce Commission (ComCom). The current price path prescribes subdued aeronautical income growth through to FY22.

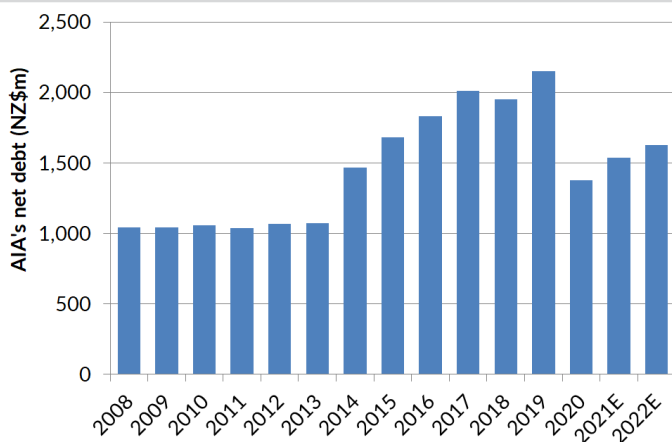
Financial structure

- **Balance sheet:** AIA is in the midst of a major capex bulge given the need to build capacity, albeit this is now on hold in light of COVID-19.
- **Dividends:** It has a 100% dividend pay-out rate and has a dividend reinvestment plan in place, albeit won't be paying any dividends until FY23 given its agreement with lenders.

Risk factors

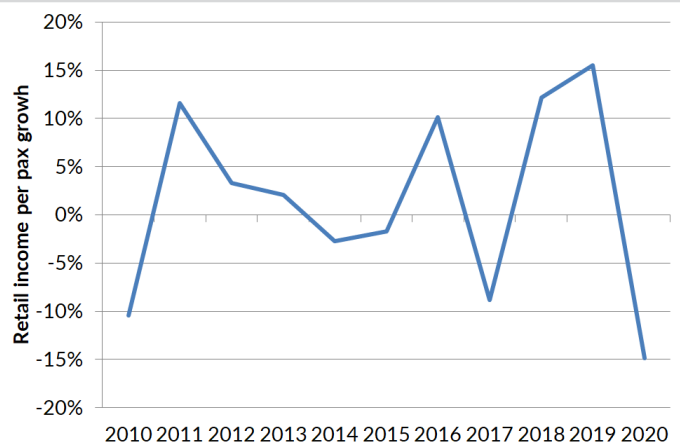
- **Rising bond yields:** AIA trades as a bond proxy. Its valuation holds a very strong inverse relationship with bond yields.
- **Regulatory risk:** We expect AIA to lower current aeronautical prices to ease any regulatory pressure given its mixed ComCom report last year.

Figure 13. Debt burden at AIA helped by capital raise

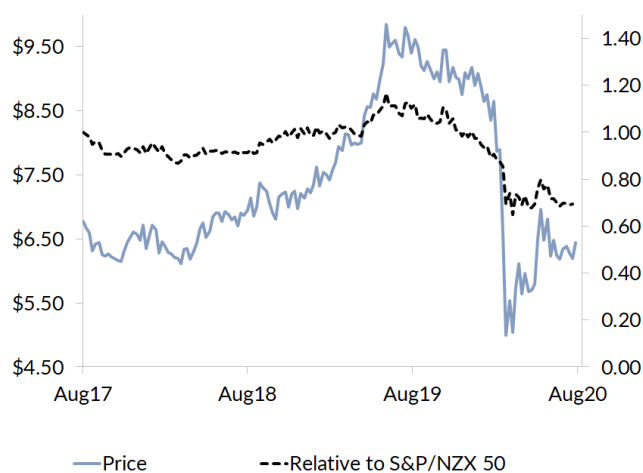


Source: AIA, Forsyth Barr analysis

Figure 14. Retail income per international pax growth



Source: AIA, Forsyth Barr analysis

Figure 15. Price performance


Source: Forsyth Barr analysis

Figure 16. Substantial shareholders

Shareholder	Latest Holding
Auckland City Council	22.1%
BlackRock Investment Management	5.0%

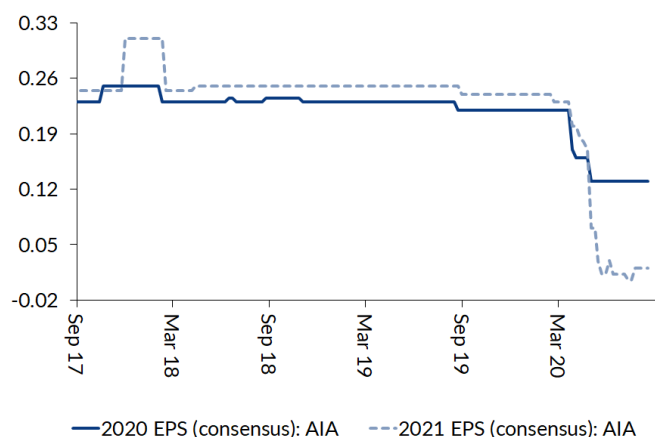
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 17. International valuation comparisons

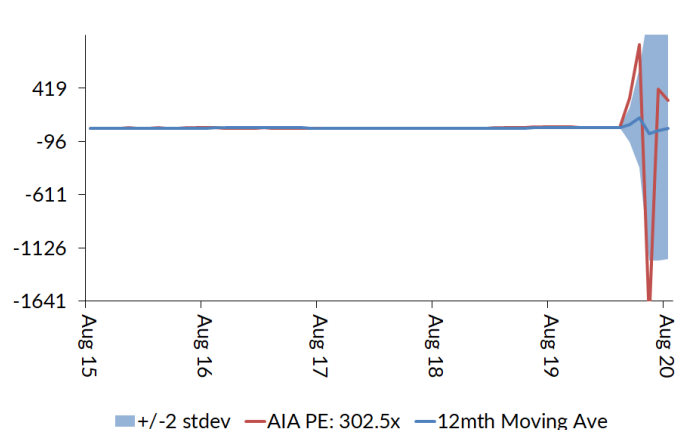
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect AIA's balance date - June)										
Auckland Airport	AIA NZ	NZ\$6.45	NZ\$9,494	<0x	>50x	65.3x	25.3x	>75x	35.4x	0.8%
SYDNEY AIRPORT	SYD AT	A\$5.37	A\$12,467	>50x	>50x	41.2x	25.3x	>75x	55.7x	3.5%
MALAYSIA AIRPORTS HLDGS BHD	MAHB MK	RM5.40	RM8,960	7.2x	30.1x	10.4x	6.9x	41.0x	13.2x	2.1%
FLUGHAFEN WIEN AG	FLU AV	€25.00	€2,100	<0x	21.2x	14.2x	7.9x	<0x	15.1x	4.0%
FLUGHAFEN ZURICH AG-REG	FHZN SW	CHF122.60	CHF3,764	<0x	21.0x	16.5x	9.5x	<0x	19.5x	3.0%
FRAPORT AG FRANKFURT AIRPORT	FRA GY	€36.00	€3,329	11.7x	23.9x	27.6x	9.2x	0.9x	22.8x	3.5%
AIRPORTS OF THAILAND PCL	AOT TB	THB53.25	THB760,714	>50x	>50x	66.2x	32.9x	>75x	>75x	1.5%
BEIJING CAPITAL INTL AIRPO-H	694 HK	CN¥5.42	CN¥24,819	>50x	22.4x	12.7x	9.0x	42.1x	19.1x	2.1%
Compco Average:				9.5x	23.7x	27.0x	14.4x	28.0x	24.2x	2.8%
AIA Relative:				n/a	n/a	142%	76%	n/a	46%	-72%

EV = Current Market Cap + Actual Net Debt

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

Figure 18. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 19. One year forward PE (x)


Source: Forsyth Barr analysis

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