Investment Pitch

Auckland International Airport Limited (ASX Code: AIA)

Suggested structure for the pitch:

The purpose of an investment pitch is to recommend a potential investment into a stock. It outlines a position for an investor to take in the stock (buy, sell or hold) and explain the reasons underpinning the recommendation. The following is the suggested structure for the pitch

Introduction (100 words)

Auckland International Airport Limited (ASX: AIA), mainly belonging to the airport operation industry, is one of the busiest airport operators in New Zealand as well as in Australasia. Due to the impact of pandemic, this industry as well as the company has experienced significant changes in recent years. Therefore, it is crucial for investors who are interested in the company to consider the potential investment. This report gives the recommendation on the investment for the company based on the financial performance. It is divided into sections on the investment thesis with valuation and the catalysts of the company. Moreover, it is necessary to consider both the future prospects and investment risks of the industry and company.

Executive Summary (100 words)

Based on the information available in this report, I would give a buy and hold recommendation for Auckland International Airport Limited (ASX: AIA).

Despite the challenges posed by the pandemic, the airport has demonstrated robust resilience, with passenger numbers and retail business showing signs of recovery. On the strength of these factors, the recommendation for the company at this point would be a HOLD.

- Recommendation: Buy/Sell/Hold
- The target price for the stock
- A brief summary of why you are making this recommendation.

Company and Industry Overview (150 words)

Auckland International Airport is a public company with most of its income from the Auckland Airport Operations. The company's business model is multiple, with revenue streams ranging from airline-related services and facilities charges to transport services including car parking, car rental and public transportation, as well as income from retail operations. It is also a key players of commercial property sector and a partnership with hotels near the airport (IBIS World, 2022). This diversification allows the company to reduce risks associated with single business model. Furthermore, the company differentiates itself in the market with its sustainable strategies. As travel resumed, Auckland Airport invested in the community supporting project, as well as an electric shopping center (Auckland Airport Annual Report, 2022). These strategies will promote the development of the community, reduce the pollutions, attract more consumers and in turn generate more profits in the future. Moreover, according to the company's annual report (2022), a major challenge and opportunity for Auckland Airport is the redevelopment of the infrastructure which was built 57 years ago to support the domestic travel. Therefore, the company's competitive advantage lies in its comprehensive range of services, sustainable strategies, and continuous investment in infrastructure development.

For the financials, the company's capital structure includes a mix of equity and debt, with shareholders' funds forming the most significant component. In addition, the company has been impacted by the COVID-19 pandemic, with total revenue growth decreased 37.4% in 2022 compared to the previous year (IBIS World, 2022). Also, based on the data from IBIS, it can be found that the net profit margin and pre-tax margin are lower than the peer average, which may mean Auckland Airport rely more on the international passengers. However, the company has still showed a positive tendency with total assets increased and underlying profits increased these years. Now, Auckland International Airport Limited has showed a steady recovery from the impact of the COVID-19 pandemic with travellers coming back.

Valuation and Investment Thesis (100 theory, 100 calculate, 100 reasons)

- Explain why you are proposing either a buy, sell, or hold recommendation
- Normally state three reasons as to why the stock is not currently properly priced (why the market is wrong)

To evaluate the value of a company's stock and make recommendation of the investment, a mix of models will be used to consider comprehensively, such as Dividend Discount Model and Capital Asset Pricing Model (CAPM).

1. Dividend Discount Model

Generally, shareholders or investors tend to estimate the value of a stock based on the dividends, which shows the profitability of the company. In theory, the value of the asset is the present value of its future cash flows. According to Parrino (2016), ordinary shares as a kind of perpetuities, the value or price of a share today is the present value of all future dividends and the sale price in the future. The general dividend valuation model is:

$$P_0 = \frac{D_1}{1+R} + \frac{D_2}{(1+R)^2} + \frac{D_3}{(1+R)^3} + \cdots + \frac{D_t}{(1+R)^t} + \frac{P_t}{(1+R)^t}$$

Source: Parrino, R., 2016, *BUSINESS FINANCE* , 1st edition

While as time towards infinity, P_t approaches to zero. So, the Pt/(1 + R)t term can be ignored to simplify the equation. The Dividend Discount Model is a method of valuing a company's stock by using predicted dividends and discounting them back to present value. Because of the difficulty of estimating future dividends over a very long time, there are three assumptions (zero growth dividend model, constant growth dividend model and mixed growth dividend model) about the pattern of dividends to make the model more manageable (Parrino, 2016). However, this method has some limitations. For example, if the company resolves not to pay the dividends because of the re-invest in high profitable project or loss, the equation would be no meaning. In this case, the Dividend Discount Model may not be the proper model to value the companies that have fluctuating dividend growth rates or no dividend at all (Chen, 2022).

Dividend History (Ordinary Dividends)

Balance Date	Dividend Type	Cent Per Share	Currency	Franked %	Dividend Ex Date	Books Close Date	Pay Date	Note
30/06/2020	Interim	11.00	NZL	0	19/03/2020	20/03/2020	03/04/2020	
30/06/2019	Final	10.53	AUD	0	03/10/2019	04/10/2019	18/10/2019	2
30/06/2019	Interim	10.54	AUD	0	21/03/2019	22/03/2019	05/04/2019	3
30/06/2018	Final	10.02	AUD	0	04/10/2018	05/10/2018	19/10/2018	4
30/06/2018	Interim	10.12	AUD	0	19/03/2018	20/03/2018	05/04/2018	5
30/06/2017	Final	9.55	AUD	0	05/10/2017	06/10/2017	20/10/2017	6
30/06/2017	Interim	9.24	AUD	0	20/03/2017	21/03/2017	04/04/2017	7

Table 1 Dividend history of Auckland International Airport (AIA),
Source: DatAnalysis Premium, 2023

Table 1 shows the dividend history of Auckland International Airport (AIA) from 2016 to 2022. The dividend of the company was increasing with slower growth rate from 2016 to 2019. However, no dividend has been declared from the end of 2020 to now because of the underlying loss after tax under the impact of Covid-19 (Auckland Airport Annual Report, 2022). In this scenario, it can be assumed that the company

has a constant growth rate if there is no Covid, based on its maturity with a history of stable growth. According to the data from 2016 to 2019, the calculation is as follows:

Dividend Discount Model
Auckland International Airport Limited

Balance Date	Type	Dividend	Annual Dividend	Growth
06/2019	Interim	0.1053	0.2107	0.00465
06/2019	Final	0.1054		
06/2018	Interim	0.1002	0.2014	0.00675
06/2018	Final	0.1012		
06/2017	Interim	0.0955	0.1879	0.01305
06/2017	Final	0.0924		
06/2016	Interim	0.0855	0.1618	
06/2016	Final	0.0763		

Data from DatAnalysis Premium

Average Growth	0.82%	
Required Return	2.50%	
DD price	12.50	**P=D/(r-g)**
Actual price	8.14	(at 27/05/2023)
12.50 (calculated price) > 8.14 (market price), **Undervalued**		

Table 2 Valuation of Dividend Discount Model

The AIA stock is valued at $12.50, which is higher than the market price, so the stock can be seen as undervalued. However, the dividend price is not clear between 2020 to 2022. It is just the assumption and roughly measure of the value the stock now based on the history of the dividend. As a result, other methods are needed to estimate the value of the stock.

2. Capital Asset Pricing Model (CAPM)

The Capital Asset Pricing Model (CAPM) is a model that describes the relationship between systematic risk and expected return for assets, which can help investors determine whether invest in a company by calculating the cost of ordinary shares. This model describes how financial markets assign value to risky securities, then determine expected returns on capital investments (Parrino, 2016). In addition, the CAPM model is based on several assumptions. According to Diasha (2023) all investors have the same expectations for future investments; there are no taxes or transaction costs, and all investors can borrow and lend at a risk-free rate of return; all investors evaluate the return level according to expected return and the risk level based on variance (or standard deviation). Based on these assumptions, the CAPM method uses the formula:

$$k_{os} = R_{rf} + (\beta_{os} \times \text{Market risk premium})$$

In the above formula, kos is the cost of ordinary share capital, which reveals the expected return of the investment. Rrf is the risk-free rate of return, and we use the yield on the Australian 10-year government bond to measure it, which is 3.73% (TradingEconomics, 2023). βos is the beta for the

shares, and we can obtain it from a database such as DatAnalysis Premium, which is 1.27. From the MarketIndex website, we find that the average return on Australian stock market from 2013 to 2022 is 11.42%. It is clear that the market risk premium is 7.69% (11.42-3.73). Then we can calculate the cost of ordinary shares for Auckland International Airport Limited:

$$kos = 0.0373 + (1.27 \times 0.0769) = 0.135, \text{ or } 13.5\%$$

In CAPM model, Beta is a measure of a stock's risk in relation to the market. Generally, the beta of the whole market is considered to be 1. If the security has a beta < 1, the firm is taking less risk than the whole market. Moreover, higher Beta indicates higher expected return of investment. In our case, beta is 1.27, which means the investment in Auckland International Airport Limited has a high level of expected return with a high level of risk.

The expected return of the investment can also be used to make investment decisions. If the expected return of the investment is higher than the required return, then the investment may be a good choice. In our case, the expected return of the investment is 13.5%, which is larger than 11.42%. It means that the stock will have more returns in the future. However, the CAPM model has several limitations, which is not suitable in the complex market. Despite these limitations, the CAPM model is widely used because of its simplicity and utility in a variety of financial scenarios.

Catalysts (market conditions 100 words)

a) Describe the possible events that could help the market to correct the price of the stock. Key events could be earnings releases, M&A activities, new product launches, etc.

Investment Risks and prospects (50 words)

- Describe the potential events that could cause your thesis to be wrong. Examples of investment risks: product risk (product is not up to expectation), regulatory risk (unfavorable laws and regulations), etc.