Living in Hope

With the Delta variant spreading across the world in the past few weeks many sectors and stocks within them that would benefit from a global economic reopening have suffered a setback. Companies in the travel, leisure and entertainment sectors are adversely affected by Government imposed restrictions on movement. One such business is Air New Zealand which has been hit again by the recent closure of the Trans-Tasman 'travel bubble'. We are all living in the hope that things will normalise as soon as possible but are Air New Zealand investors just living with false hope?

Before the pandemic hit in early 2020 Air New Zealand was a well-run and highly profitable business that was paying healthy dividends to its shareholders. Air NZ had paid dividends for 17 years since its recovered from the rubble of the ill-fated Ansett purchase, and subsequent collapse in 2001. That was the last time the NZ Government recapitalised the airline that it still retains a controlling 51% stake in. However, the pandemic hit airline businesses like a hurricane. Air NZ cancelled an already declared dividend in March 2020 and immediately began haemorrhaging cash swinging from a strong half-year profit to 31 December 2019 to a full-year loss of NZ$87m for the year to 30 June 2020, losing around NZ$300m in the final few months as the pandemic struck. In the year to June 2021 Air NZ likely made a pre-tax loss of around NZ$450m suffering under the new world of restricted air travel and their earnings guidance for the year to 30 June 2022 is for a pre-tax loss of no greater than NZ$530m. Obviously, this is beyond the airlines control and management have been doing their utmost to conserve cash and live to fight another day.

With losses well over NZ$1b in a little over two years you would think the share price of Air NZ would have collapsed, and initially it did pretty much that losing about 70% of its value to trade around NZ$0.80 per share during the March 2020 Coronavirus crash. But in the 18 months since the Air NZ share price seems to be defying gravity, currently around NZ$1.50 per share and valuing the equity in the business at NZ$1.7b, or approximately half their pre-pandemic value when they were making large profits and paying them out to shareholders. There appears to be a fundamental disconnect between the state of the Air NZ's balance sheet, its prospects, and its current share price.

Air NZ has negotiated a loan facility with the NZ Government of NZ$1.5b of which they have borrowed NZ$350b at present. Air NZ also owe the IRD over NZ$300m in delayed PAYE from 2020-21, a favour understandably granted them to reduce their cash burn. The other major issue is much, if not all, the liquidity that Air NZ claim on their balance sheet is more than outweighed by NZ$1.1b of prepaid airfares from their customers for services not yet provided. It is likely that without the NZ Government shareholding and liquidity support Air NZ would have already collapsed under the weight of its cash bleeding and future uncertainty. The non-NZ Government shareholders seem to be living in hope that Air NZ will raise capital and survive the current storm in reasonable shape. The problem is the NZ Government keep delaying the process, possibly because the share price is unrealistically high and the whole capital raising may have become political. Having first said they'd raise capital by June 2021 the company delayed the timing to before the end of September 2021 and last week the NZ Government baulked again, with the company now targeting the first quarter of 2022.

If the world is in much better shape in six months' time this gamble might be rewarded. The problem though is the amount of capital Air NZ requires. It will be substantial, well above NZ$1b to plug the hole in the balance sheet and what price will the NZ Government extract for ensuring the airline survives? What would a 2-for-1 rights issue at NZ$0.50 per share do to the current share price? As taxpayers we should not want the NZ Government to 'be kind' to private shareholders in a business that is otherwise crippled. There is still much uncertainty in the world, and we are all living in hope of better times ahead. The question is whether Air NZ's shareholders' investment will survive without severe dilution?

The companies mentioned above are named to further the discussion. This should not be construed to be personalised advice nor a recommendation to invest in these companies. Please contact Kinnell & Co. regarding how best to take advantage of the trends discussed above.

MICHAEL KINNELL
021 711 375
michael@kinnellandco.co.nz

www.kinnellandco.co.nz

Kinnell & Company Limited
4 Beach Road, RD44
Urenui, 4377