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Pacific National Finance Pty Ltd

13 December 2023

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Sector: Infrastructure
Sub-sector: Transportation
Country: Australia
Ownership: Private

Issuer Outline

Pacific National Finance Limited is the wholly owned financing subsidiary of Pacific National Holdings Company Pty Ltd (PNH) (formerly Asciano Limited). Pacific National Finance acts as the borrower for PNH.

PNH is Australia's largest national rail freight operator and the largest provider of containerised rail freight services, which generates nearly half of total revenue. It also operates in an effective duopoly in coal haulage, which constitutes around 40% of revenue. It operates under three main segments: Intermodal freight, Metallurgical coal, and Thermal coal.

PNH is owned by a consortium of investors, comprising affiliates of Global Infrastructure Partners (GIP; 27% ownership), Canada Pension Plan Investment Board (CPP; 33%), China Investment Corporation (CIC; 16%), GIC Private Limited (GIC; 12%) and British Columbia Investment Management Corporation (BCI; 12%). Together they manage over USD2.1tr in investments.

Key Financials (AUDm)

LTM (30 Jun)	2023
Revenue	2,348.2
Underlying EBITDA	623.1
Interest expense	(184.6)
Cash	60.2
Total assets	4,863.8
Total debt	3,112.2
Net debt / EBITDA	4.9x
EBITDA / Interest expense	3.4x

Source: S&P Capital, FIIG Estimate.

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3CB0229680	AUD 350m	Senior Unsecured	5.25%	Semi-Annual	N/A	19 May 2025
AU3FN0035770	AUD 100m	Senior Unsecured	3M BBSW + 2.60%	Quarterly	N/A	12 May 2027
AU3CB0244325	AUD 250m	Senior Unsecured	5.40%	Semi-Annual	N/A	12 May 2027
AU3CB0266906	AUD 450m	Senior Unsecured	3.70%	Semi-Annual	24 Jun 2029	24 Sep 2029
AU3CB0282812	AUD 400m	Senior Unsecured	3.80%	Semi-Annual	8 Jun 2031	8 Sep 2031

[1]*Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call.*

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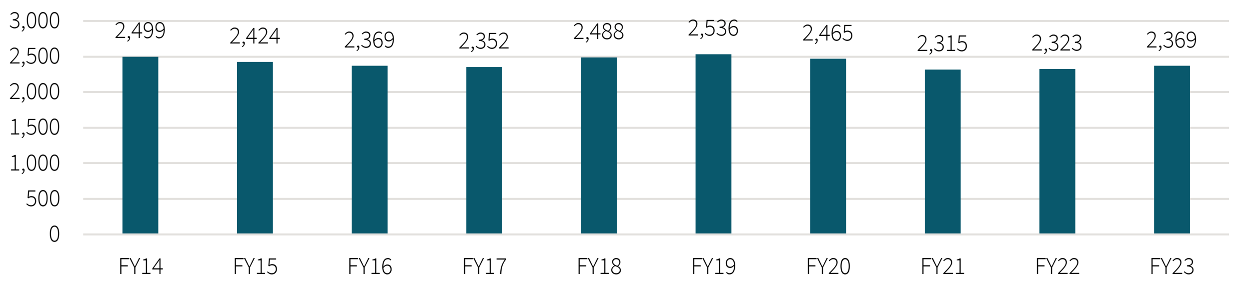
Strengths

- Strong market position supported by relatively high barriers to entry: PNH's credit profile benefits from its strong market position as the largest carrier of interstate rail freight in Australia, while also being the largest intermodal rail operator with a national footprint. PNH is effectively an infrastructure-style business. It dominates the East-West corridor, accounting for nearly three-quarters of containerised freight volume and looking to consolidate operations in other areas. It will be one of the main beneficiaries of Australia's Inland Rail project (freight rail line directly connecting Melbourne and Brisbane). PNH is also one of two major coal haulage companies in Australia (with Aurizon), operating in an effective duopoly throughout Queensland and New South Wales. Barriers to entry in rail haulage are relatively high, owing to the capital, concessionary, contracting, or physical constraints that underpin the rail haulage industry, which generally has two or (sometimes) three main players within PNH's local market.
- Significant proportion of take-or-pay contracts for coal, providing a degree of cash-flow and revenue stability: PNH's revenue benefits from the structure of its contracts, particularly for its metallurgical and thermal coal segments. Coal contracts typically average ten years upon inception (average weighted life to maturity is currently five years) and are performance-based (with the majority take-or-pay). The latter is important as it means movements in coal price have little immediate impact on Pacific National's revenues, until contract renewal. Further, contracts signed under its intermodal business are generally around three to five years, but vary in length and contract terms, and may contain volume commitments (but is less exposed to externalities, such as commodity prices). PNH generally enjoys long standing relationships with its major customers, a function of its duopoly and near-monopoly over particular haulage networks, which partly mitigates the risk of non-renewal of contracts. PNH is also able to pass on a substantial amount of its largest operating costs. PNH's revenues have therefore exhibited a high degree of stability over the last decade, despite frequently volatile commodity prices (see Figure 1).

Figure 1: PNH total revenue (AUDm)



Source: Company

- Ultimate customer-base provides high degree of diversity: Although revenue by immediate customer is reasonably diversified (top 10 customers, who are among the largest miners in the world and leading Australian industrial companies, account for nearly half of PNH's revenue), the end-customer for PNH's services, which includes domestic and international markets, provides a high degree of revenue diversity.
- Staggered debt maturity provides visibility over liquidity needs: Liquidity is solid for PNH, which includes approximately AUD1.5bn available under its various revolving bank facilities (as of June 2023), and benefits from a staggered maturity profile for both its revolving facilities (which typically have a relatively high proportion undrawn) and term debt. The company's next meaningful debt maturity is May 2025, when its AUD350m bonds are due for repayment. Capex requirements, although high, are also reasonably predictable. PNH's liquidity also benefits from the long-term strategic focus of its investors (explored further below), who have shown a willingness to forgo distributions in order to preserve PNH's credit strength; PNH has opted not to declare any dividends to its owners for the last four years.
- Strong shareholder group with long-term investment mandate provides a relatively high degree of certainty: While private ownership is typically associated with lower levels of financial flexibility relative to publicly listed companies, it is arguable

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PNH's current ownership contingent, which includes global infrastructure managers (GIP), sovereign wealth funds (CIC and GIC), and large pension funds (CPP, BCI), provide a relatively high degree of certainty and commonality around matters including strategic direction, investment needs, and distributions. While the ability of the shareholders to provide support to PNH, if required, depends on their respective ability and willingness to do so, we note that management remains committed to maintaining an investment grade profile, which is likely to be supported by its various owners.

Risks

- Revenues are exposed to ESG factors: PNH still maintains a large footprint in coal haulage rail services that contributes approximately 40% of operating revenues, of which 52% is thermal and 48% metallurgical. Environmental factors have triggered a structural transition away from coal (particularly thermal), and while thermal coal is expected to remain an important component of the energy mix in Asia in the short-to-medium-term (given the region's reliance on coal-fired electricity generation and Australia's high-quality coal), the transition could pose a challenge to revenues. There is also a lack of a commercially viable alternative for the use of metallurgical coal as a key input in steel production, although this too is subject to new advances in green steel production. For as long as Australia is exporting coal, PNH, which has a duopoly in coal haulage, will be one of the main conduits. Coal contracts are performance based and incorporate a large take-or-pay component, so movements in price have little-to-no impact on revenues until contract renewal. PNH is aware of the long-term transition away from coal and is well-placed to absorb the change. This includes increasing revenues from containerised freight, itself a positive response to environmental factors (road to rail). Containerised freight is forecasted to become a higher proportion of earnings over time (coal is forecasted to decline to 30% of PNH revenues by 2025-2030).
- Exposure to volume variation: PNH's containerised freight operations are exposed to the general state of economic conditions (mainly domestic, but also globally). A weak market environment could result in lower than expected demand for its services, which could affect grain and freight forwarding services. Australia is one of the largest grain exporters in the world and is exposed to global market conditions, annual production, global demand, and global pricing in this segment.
- Loss of customer contracts: As PNH enters into contracts with various customers to deliver rail haulage services, a loss of a customer could impact its revenue and future profitability. In early 2023, Team Global Express, an Australian-owned transport and logistics business, signed a contract with Aurizon to deliver containerised freight services. It is expected that the loss of this contract will result in some level of impact on volumes, but having said that, this has been known for quite a while and are somewhat offset by two factors. The company has had relative success in securing new contracts and volumes following the announcement. For example, it renewed its contract with GrainCorp in May 2023, secured more freight services for core goods over the peak demand season (to start in October 2023), and entered into a three year contact with Cement Australia. Additionally, the TGE contract is ramping down slowly as opposed to all services stopping immediately, so the full impact won't be felt for a few periods. In this time, more customers can be secured.
- Debt-funded capex results in high financial leverage: PNH operates in a capital-intensive sector, extending to the maintenance, replacement, and upgrades to its existing fleet, as well as to support volume expansion through the completion and operation of new freight terminals. The latter is likely to contribute to a high level of debt-funded expenditure (PNH capex is typically debt-funded). While the current rating trigger for leverage is marginally weakly positioned, rating agencies would typically act to change credit ratings and outlook only in the event of a prolonged deficiency with no realistic prospect of improvement. They will take into account any corrective action. We note that PNH has developed a sound track-record of maintaining its non-growth capex in line with the cyclical nature of its overhaul program (including limiting growth-srelated capex to priority projects during periods of economic uncertainty), while at the same time, extracting cost savings through operational efficiencies (including asset utilisation), and deferring dividends.
- Modest revenue diversity: Approximately 40% of PNH's revenue is derived from coal, with containerised freight making up much of the residual (around 45%). In time, the concentration by business segment is set to increase, with containerised freight forecasted to become the predominant revenue earner for PNH. While this would normally be viewed as a negative development, an increase in revenue from containerised freight would increasingly position PNH as an infrastructure-style business (movement of goods around Australia), whose output would be reflective of broader economic activity.

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Financials

The financial summary below represents the consolidated operations of Pacific National Holdings Pty Ltd (AUDm, FYE 30 June).

Income Statement	FY19	FY20	FY21	FY22	FY23
Revenue	2,487.2	2,436.0	2,293.6	2,286.2	2,348.2
Total operating expenses	(1,607.9)	(1,665.6)	(1,482.1)	(1,585.9)	(1,726.4)
Underlying EBITDA	882.3	771.3	818.7	702.9	623.1
Interest expense	(208.7)	(217.5)	(178.3)	(177.5)	(184.6)
Depreciation & amortisation	(326.5)	(340.1)	(360.9)	(381.7)	(361.6)
Net income	234.9	151.8	198.5	105.3	56.8
Balance Sheet	FY19	FY20	FY21	FY22	FY23
Cash	67.7	871.3	78.1	76.9	60.2
Net property, plant, and equipment	3,202.6	3,119.0	3,253.0	3,225.8	3,245.2
Total assets	5,128.4	5,811.5	4,920.6	4,954.9	4,863.8
Total debt	3,083.1	4,112.4	3,013.3	3,222.7	3,112.2
Total equity	1,034.4	684.9	872.3	746.3	792.7
Cash Flow Statement	FY19	FY20	FY21	FY22	FY23
Funds from operations	686.3	569.7	631.8	539.7	443.5
Cash interest paid	(196.0)	(201.6)	(186.9)	(163.2)	(179.6)
Capex	(284.2)	(246.1)	(278.3)	(357.1)	(342.8)
Credit Metrics	FY19	FY20	FY21	FY22	FY23
Net debt/EBITDA	3.4x	4.2x	3.6x	4.5x	4.9x
EBITDA/Interest expense	4.2x	3.5x	4.6x	4.0x	3.4x
Funds from operations/debt	22.3%	13.9%	21.0%	16.8%	14.3%

Source: S&P Capital, FIIG Estimates.

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