

Contact Energy

Déjà Vu — Possible MSCI Inclusion Looming

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OUTPERFORM

Contact Energy (CEN) has a good chance of entering the MSCI NZ index at the November 2020 rebalance, in our opinion. This is likely to provide a strong share price tailwind. CEN is currently trading at NZ\$7.55, above our current estimated minimum price to enter the index of ~NZ\$7.33. Companies typically experience a spike in trading volumes after inclusion as passive funds tracking the index buy shares, we reiterate our OUTPERFORM.

NZX Code	CEN	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$7.55	NPAT* (NZ\$m)	248.5	246.6	200.0	216.5	PE	21.7	21.9	27.0	25.0
Target price	NZ\$8.60	EPS* (NZc)	34.7	34.5	27.9	30.2	EV/EBIT	27.7	30.6	38.3	31.2
Risk rating	Low	EPS growth* (%)	-10.4	-0.8	-18.9	8.3	EV/EBITDA	14.2	13.9	16.2	15.4
Issued shares	715.5m	DPS (NZc)	39.0	32.0	32.0	32.0	Price / NTA	2.4	2.6	2.8	3.0
Market cap	NZ\$5,402m	Imputation (%)	64	55	50	80	Cash div yld (%)	5.2	4.2	4.2	4.2
Avg daily turnover	1,199k (NZ\$7,958k)	*Based on normalised profits					Gross div yld (%)	6.5	5.1	5.1	5.6

Requirements for CEN to enter

New Zealand currently has seven companies in the index. For an eighth company to enter it needs to have a market capitalisation of 0.5x the Global Minimum Size Reference (GMSR) on the pricing day. The GMSR benchmark that CEN has to beat is linked to global share prices and the NZD (a weaker NZD lifts the benchmark). The pricing day can be any business day of the 10 business dates between 19 October and 30 October. The result will be announced on 11 November, with re-balancing occurring on 30 November. At present, to achieve the GMSR we estimate that CEN needs to trade above ~\$7.33, which it currently is.

Mercury and Meridian MSCI trading

MCY and MEL both entered the index in November 2014, and had strong performances after their inclusions as a result of passive fund demand. MCY exited the index from May 2018 to November 2019, and had another boost on its re-entry. CEN and MCY were trading at a similar one year forward EV/EBITDA as recently as mid-2019, but since MCY's inclusion last November it has traded at a significant premium.

CEN has been close to MSCI inclusion before

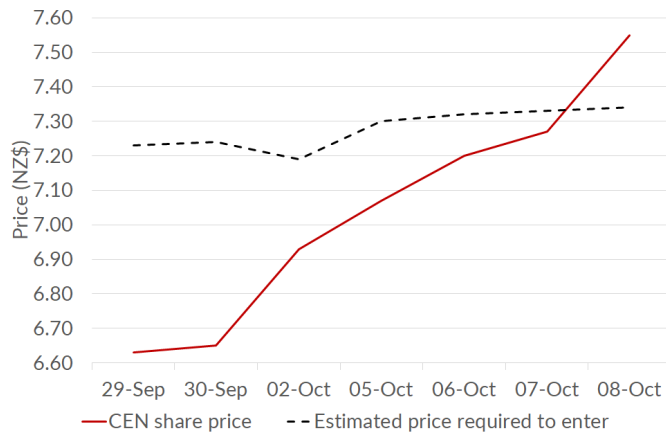
At the November 2019 index assessment CEN looked likely to enter. In the lead up to the rebalance last year, CEN's share price hit NZ\$9.00/share, a decade high. However, the announcement from Rio Tinto (RIO) that it was conducting a strategic review of NZAS came during the 10 day pricing period, causing CEN to miss out. Somewhat ironically, it is the improving prospects of NZAS remaining open that provided CEN's initial share price boost that now sees it poised to re-enter the MSCI NZ Index.

Contact Energy Limited (CEN)

Priced as at 08 Oct 2020 (NZ\$)					7.55											
12-month target price (NZ\$)*					8.60	Spot valuations (NZ\$)										
Expected share price return					13.9%	1. DCF					8.29					
Net dividend yield					4.2%	2. Market multiples					7.91					
Estimated 12-month return					18.1%	3. Dividend yield					7.64					
Key WACC assumptions						DCF valuation summary (NZ\$m)										
Risk free rate					1.30%	Total firm value					7,132					
Equity beta					0.84	(Net debt)/cash					(1,201)					
WACC					5.2%	Less: Capitalised operating leases										
Terminal growth					1.5%	Value of equity					5,932					
Profit and Loss Account (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue						2,519.0	2,073.0	2,068.5	1,693.2	1,661.6	EV/EBITDA (x)	12.7	14.2	13.9	16.2	15.4
Normalised EBITDA						518.0	451.0	463.3	397.0	417.3	EV/EBIT (x)	21.1	27.7	30.6	38.3	31.2
Depreciation and amortisation						(205.0)	(220.0)	(253.1)	(228.7)	(210.8)	PE (x)	19.5	21.7	21.9	27.0	25.0
Normalised EBIT						313.0	231.0	210.2	168.3	206.6	Price/NTA (x)	2.3	2.4	2.6	2.8	3.0
Net interest						(70.0)	(55.0)	(57.8)	(59.2)	(55.5)	Free cash flow yield (%)	6.3	4.5	4.9	4.9	4.4
Depreciation capex adjustment						102	120	137	121	108	Net dividend yield (%)	5.2	5.2	4.2	4.2	4.2
Tax						(72.0)	(46.0)	(42.7)	(30.5)	(42.3)	Gross dividend yield (%)	6.5	6.5	5.1	5.1	5.6
Minority interests						0	0	0	0	0						
Adjusted normalised NPAT						277.5	248.5	246.6	200.0	216.5	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other						67	(124)	(137)	(121)	(108)	Interest cover EBIT (x)	4.9	4.8	3.9	3.0	4.0
Reported NPAT						345.0	125.0	109.8	78.5	108.8	Interest cover EBITDA (x)	7.4	8.2	8.0	6.7	7.5
Normalised EPS (cps)						38.8	34.7	34.5	27.9	30.2	Net debt/ND+E (%)	26.2	28.3	29.9	30.2	31.1
DPS (cps)						39.0	39.0	32.0	32.0	32.0	Net debt/EBITDA (x)	1.9	2.3	2.3	2.6	2.4
Growth Rates						2019A	2020A	2021A	2022A	2023A	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)						10.7	-17.7	-0.2	-18.1	-1.9	Return on assets (%)	9.8	4.6	4.5	3.7	4.8
EBITDA (%)						8.1	-12.9	2.7	-14.3	5.1	Return on equity (%)	6.3	4.9	4.5	3.3	4.9
EBIT (%)						18.6	-26.2	-9.0	-19.9	22.7	Return on funds employed (%)	9.3	4.4	4.3	3.6	4.6
Normalised NPAT (%)						21.4	-10.4	-0.8	-18.9	8.3	EBITDA margin (%)	20.6	21.8	22.4	23.4	25.1
Normalised EPS (%)						21.4	-10.4	-0.8	-18.9	8.3	EBIT margin (%)	12.4	11.1	10.2	9.9	12.4
Ordinary DPS (%)						21.9	0.0	-17.9	0.0	0.0	Capex to sales (%)	2.5	4.8	2.9	3.4	3.5
											Capex to depreciation (%)	31	45	24	25	28
Cash Flow (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Imputation (%)	64	64	55	50	80
EBITDA						518.0	451.0	463.3	397.0	417.3	Pay-out ratio (%)	101	112	93	115	106
Working capital change						(20.0)	(24.0)	(8.7)	3.5	(4.6)						
Interest & tax paid						(111.0)	(118.0)	(130.0)	(79.6)	(119.5)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other						14.0	32.0	0	0	0	Hydro generation (GWh)	4,232	3,752	4,018	3,096	3,755
Operating cash flow						401.0	341.0	324.6	320.8	293.2	Geothermal generation (GWh)	3,257	3,331	3,070	3,324	3,324
Capital expenditure						(63.0)	(100.0)	(60.0)	(57.0)	(58.1)	Thermal generation (GWh)	1,422	1,360	1,439	385	385
(Acquisitions)/divestments						382.0	(6.0)	0	0	0	Total Generation (GWh)	8,911	8,443	8,527	6,804	7,463
Other						0	0	0	0	0	GWAP (\$/MWh)	129	100	99	65	59
Funding available/(required)						720.0	235.0	264.6	263.8	235.1						
Dividends paid						(251.0)	(280.0)	(279.1)	(229.0)	(229.0)	Gas consumed (PJ)	13.9	13.2	13.7	3.8	3.8
Equity raised/(returned)						0	0	0	0	0	Gas price (\$/GJ)	7.1	6.8	6.9	7.0	5.9
(Increase)/decrease in net debt						469.0	(45.0)	(14.6)	34.8	6.1						
Balance Sheet (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Retail electricity volumes (GWh)	6,554	5,694	5,615	5,561	5,395
Working capital						(3.0)	19.0	25.7	20.3	22.9	Electricity customers (000)	411	418	409	401	393
Fixed assets						4,097.0	3,999.0	3,808.9	3,640.2	3,490.5	Average usage/customer (MWh)	8.6	8.5	8.6	8.6	8.6
Intangibles						425.0	406.0	406.0	406.0	406.0	Average retail price (\$/MWh)	191	199	201	194	193
Right of use asset						29.0	27.0	27.0	27.0	27.0						
Other assets						132.0	173.0	173.0	173.0	173.0	LWAP (\$/MWh)	136	108	107	72	64
Total funds employed						4,680.0	4,624.0	4,440.6	4,266.5	4,119.4	LWAP/GWAP	1.06	1.08	1.08	1.11	1.10
Net debt/(cash)						990.0	1,036.0	1,050.6	1,015.8	1,009.7						
Lease liability						25.0	22.0	22.0	22.0	22.0	Retail gas volumes (PJ)	3.1	3.0	3.0	3.0	3.0
Other liabilities						883.0	940.0	907.0	878.7	853.6	Gas customers (000)	67	65	65	65	65
Shareholder's funds						2,782.0	2,626.0	2,461.1	2,350.0	2,234.1	Average gas sales price (\$/GJ)	23.6	24.5	25.4	25.8	24.8
Minority interests						0	0	0	0	0						
Total funding sources						4,680.0	4,624.0	4,440.6	4,266.5	4,119.4						

Charts of interest

Figure 1. Share price vs. expected minimum entry price



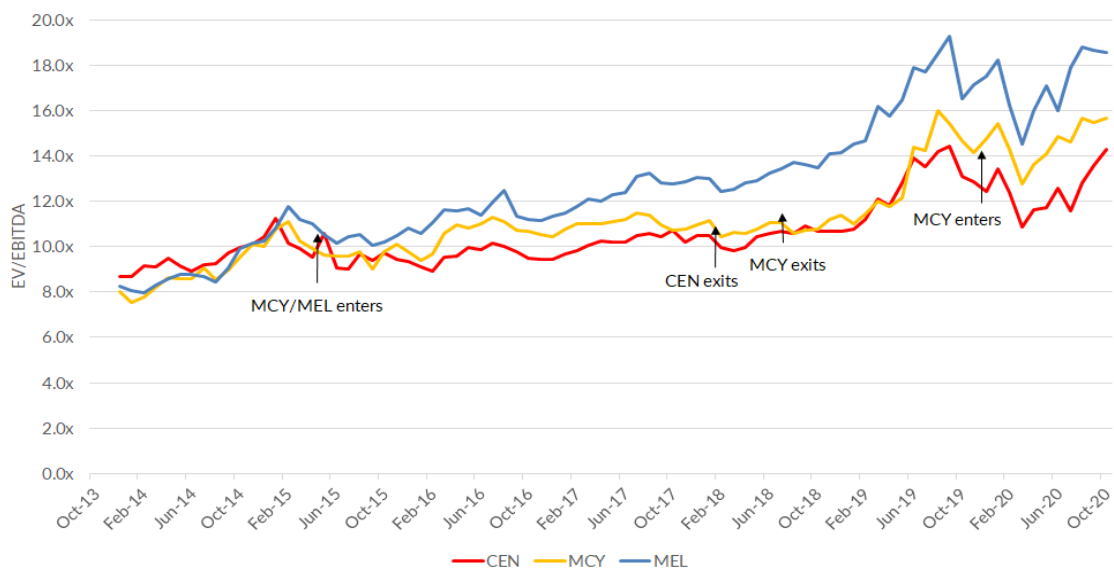
Source: Bloomberg, Forsyth Barr analysis

Figure 2. Market cap of index members

Rank	In Index?	Code	Full Market Cap (\$m)
1	Y	FPH	19782
2	Y	ATM	11553
3	Y	MEL	14097
4	Y	SPK	8616
5	Y	AIA	9234
6	Y	MCY	7316
7	Y	RYM	7400
8	N	CEN	5422

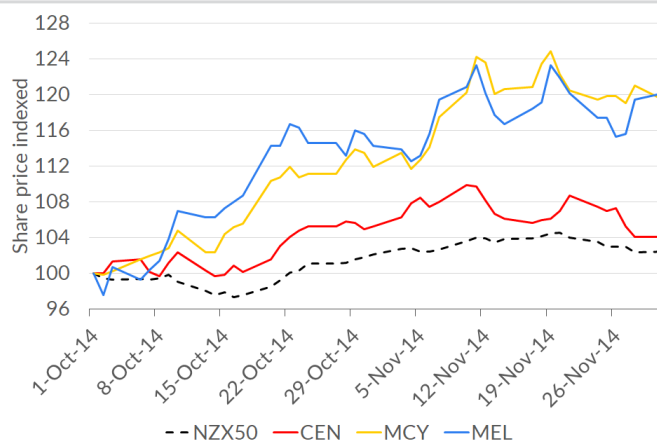
Source: Eikon, Forsyth Barr analysis

Figure 3. EV/EBITDA multiples



Source: Eikon, Forsyth Barr analysis

Figure 4. MEL and MCY at November 2014 rebalance



Source: Eikon, Forsyth Barr analysis

Figure 5. CEN in the lead up to the 2019 pricing period



Source: Bloomberg, Forsyth Barr analysis

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
BlackRock Investment Management	6.4%
ACC	5.1%
The Vanguard Group	5.0%

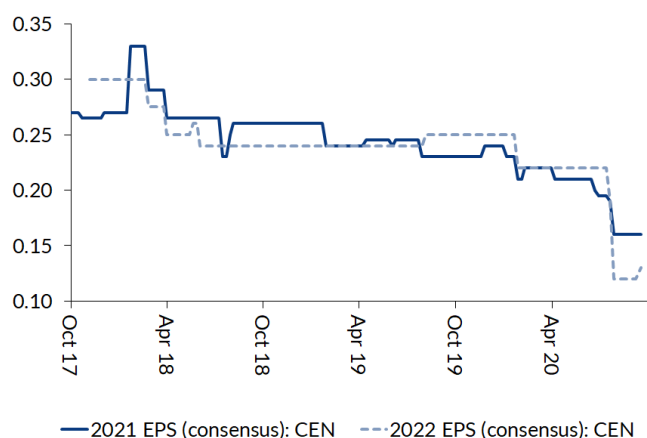
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

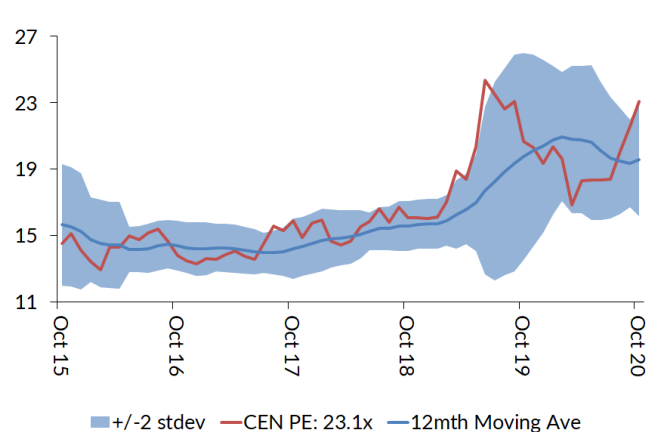
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect CEN's balance date - June)										
Contact Energy	CEN NZ	NZ\$7.55	NZ\$5,402	21.9x	27.0x	13.9x	16.2x	30.6x	38.3x	4.2%
GENESIS ENERGY *	GNE NZ	NZ\$3.06	NZ\$3,193	17.0x	16.8x	11.0x	11.9x	23.6x	29.2x	4.6%
MERIDIAN ENERGY *	MEL NZ	NZ\$5.26	NZ\$13,479	31.1x	35.2x	20.0x	22.5x	33.9x	41.2x	3.2%
MERCURY *	MCY NZ	NZ\$5.23	NZ\$7,125	27.1x	28.9x	16.5x	16.7x	29.6x	31.1x	3.3%
TRUSTPOWER *	TPW NZ	NZ\$7.30	NZ\$2,285	25.5x	25.3x	15.0x	15.0x	19.9x	19.8x	4.1%
AGL ENERGY	AGL AT	A\$13.61	A\$8,479	13.8x	16.6x	6.2x	6.8x	10.7x	12.8x	5.9%
ORIGIN ENERGY	ORG AT	A\$4.52	A\$7,961	19.9x	13.1x	5.6x	5.0x	19.9x	14.7x	5.2%
Compco Average:				22.4x	22.6x	12.4x	13.0x	22.9x	24.8x	4.4%
CEN Relative:				-2%	19%	12%	25%	34%	54%	-3%

EV = Current Market Cap + Actual Net Debt

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

Figure 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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