

Contact Energy

Return of the Smelter

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NEUTRAL

Following Contact Energy's (CEN) +19% share price increase over the past month, we are downgrading our rating to NEUTRAL from OUTPERFORM. The announcement that NZAS is remaining open for longer is good news for our medium-term earnings and dividend forecasts. Our FY22 and FY23 EBITDAF forecast has increased +16% and +11% respectively, with our FY21, FY22 and FY23 dividend forecast increasing +13%. However, the +NZ\$0.50 (+5.8%) increase in our target price to NZ\$9.10 is insufficient to prevent the rating downgrade.

NZX Code	CEN	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$9.55	NPAT* (NZ\$m)	248.5	240.8	240.1	234.4	PE	27.5	28.4	28.5	29.2
Target price	NZ\$9.10	EPS* (NZc)	34.7	33.6	33.5	32.8	EV/EBIT	34.0	39.0	35.3	32.7
Risk rating	Low	EPS growth* (%)	-10.4	-3.1	-0.3	-2.4	EV/EBITDA	17.4	17.3	17.3	17.1
Issued shares	715.5m	DPS (NZc)	39.0	36.0	36.0	36.0	Price / NTA	3.1	3.3	3.5	3.8
Market cap	NZ\$6,833m	Imputation (%)	64	55	45	70	Cash div yld (%)	4.1	3.8	3.8	3.8
Avg daily turnover	1,331k (NZ\$9,356k)	*Based on normalised profits					Gross div yld (%)	5.1	4.6	4.4	4.8

What's changed?

- **Earnings (EBITDAF):** FY21 -\$7m (-2%) to NZ\$456m, FY22 +\$62m (+16%) to NZ\$459m, FY23 +\$45m (+11%) to NZ\$463m
- **Dividend:** FY21, FY22 and FY23 all increased +4cps (+13%) to 36cps
- **Target price:** Increased +NZ\$0.50 (+5.8%) to NZ\$9.10
- **Rating:** Downgraded to NEUTRAL from OUTPERFORM

Short-term earnings decrease, but better medium-term outlook

CEN is one of the two companies providing discounted electricity to NZAS. With the new electricity price taking effect immediately (14 January), we are lowering our FY21 EBITDAF forecast -NZ\$7m to NZ\$456m. We anticipate earnings to remain around this level until after Tauhara is built, with modest retail price increases (reflecting current wholesale electricity prices) offsetting the first full year of the low NZAS electricity contract in FY22.

We expect CEN will provide first time FY21 dividend guidance at its February 1H21 result. After RIO announced it was closing NZAS, CEN decided against providing FY21 dividend guidance. We are forecasting a FY21 dividend of 36cps, -3cps lower than its FY20 dividend, but +6cps better than we had forecast if NZAS were to close in August 2021. The lower electricity price provided to NZAS equates to lost earnings of ~2cps, however, we believe CEN will be more conservative, particularly given upcoming capital projects.

Tauhara likely to get the go ahead

With NZAS confirming it will remain open until at least 31 December 2024, we believe that will provide CEN with enough certainty to push the go button. It has already signed a construction contract, which has a further ~6 months remaining on the option to start construction. Assuming the project starts in April, Tauhara should be operational ~June 2023.

At this stage we do not believe CEN will raise equity to fund the NZ\$600m, 150MW power plant. It has reasonable debt headroom and the ability to issue a ~NZ\$500m hybrid bond that is treated 50% as equity by S&P will ensure its credit metrics remain comfortable. We estimate the FY24 (the first year including Tauhara earnings) net debt/EBITDA ratio will be ~2.4x post-construction, well below the 2.8x metric required to maintain its credit rating.

Contact Energy Limited (CEN)

Priced as at 15 Jan 2021 (NZ\$)

9.55

12-month target price (NZ\$)*

9.10

Expected share price return

-4.7%

Net dividend yield

3.8%

Estimated 12-month return

-0.9%

Key WACC assumptions

Risk free rate

1.30%

Equity beta

0.84

WACC

5.0%

Terminal growth

1.5%

Spot valuations (NZ\$)

1. DCF

9.08

2. Market multiples

8.48

3. Dividend yield

9.02

DCF valuation summary (NZ\$m)

Total firm value

7,694

(Net debt)/cash

(1,201)

Less: Capitalised operating leases

Value of equity

6,494

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	2,169.0	2,248.2	2,187.4	EV/EBITDA (x)	15.6	17.4	17.3	17.3	17.1
Normalised EBITDA	518.0	451.0	456.1	458.5	462.6	EV/EBIT (x)	25.7	34.0	39.0	35.3	32.7
Depreciation and amortisation	(205.0)	(220.0)	(253.9)	(234.4)	(220.6)	PE (x)	24.6	27.5	28.4	28.5	29.2
Normalised EBIT	313.0	231.0	202.2	224.2	242.1	Price/NTA (x)	2.9	3.1	3.3	3.5	3.8
Net interest	(70.0)	(55.0)	(58.6)	(65.1)	(75.9)	Free cash flow yield (%)	4.9	3.5	3.5	1.9	-1.2
Depreciation capex adjustment	102	120	137	126	115	Net dividend yield (%)	4.1	4.1	3.8	3.8	3.8
Tax	(72.0)	(46.0)	(40.2)	(44.5)	(46.5)	Gross dividend yield (%)	5.1	5.1	4.6	4.4	4.8
Minority interests	0	0	0	0	0						
Adjusted normalised NPAT	277.5	248.5	240.8	240.1	234.4	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	67	(124)	(137)	(126)	(115)	Interest cover EBIT (x)	4.9	4.8	3.7	3.7	3.4
Reported NPAT	345.0	125.0	103.4	114.5	119.6	Interest cover EBITDA (x)	7.4	8.2	7.8	7.0	6.1
Normalised EPS (cps)	38.8	34.7	33.6	33.5	32.8	Net debt/ND+E (%)	26.2	28.3	30.5	33.9	41.1
DPS (cps)	39.0	39.0	36.0	36.0	36.0	Net debt/EBITDA (x)	1.9	2.3	2.4	2.6	3.3
Growth Rates	2019A	2020A	2021A	2022A	2023A	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	10.7	-17.7	4.6	3.6	-2.7	Return on assets (%)	9.8	4.6	4.3	4.7	4.9
EBITDA (%)	8.1	-12.9	1.1	0.5	0.9	Return on equity (%)	6.3	4.9	4.2	4.9	5.4
EBIT (%)	18.6	-26.2	-12.5	10.8	8.0	Return on funds employed (%)	9.3	4.4	4.1	4.5	4.6
Normalised NPAT (%)	21.4	-10.4	-3.1	-0.3	-2.4	EBITDA margin (%)	20.6	21.8	21.0	20.4	21.2
Normalised EPS (%)	21.4	-10.4	-3.1	-0.3	-2.4	EBIT margin (%)	12.4	11.1	9.3	10.0	11.1
Ordinary DPS (%)	21.9	0.0	-7.7	0.0	0.0	Capex to sales (%)	2.5	4.8	3.9	11.4	19.8
						Capex to depreciation (%)	31	45	33	110	196
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	64	64	55	45	70
EBITDA	518.0	451.0	456.1	458.5	462.6	Pay-out ratio (%)	101	112	107	107	110
Working capital change	(20.0)	(24.0)	(4.0)	19.9	19.4						
Interest & tax paid	(111.0)	(118.0)	(127.9)	(94.8)	(130.7)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	14.0	32.0	0	0	0	Hydro generation (GWh)	4,232	3,752	3,837	3,887	3,887
Operating cash flow	401.0	341.0	324.2	383.6	351.3	Geothermal generation (GWh)	3,257	3,331	3,139	3,324	3,455
Capital expenditure	(63.0)	(100.0)	(85.0)	(257.0)	(433.1)	Thermal generation (GWh)	1,422	1,360	1,279	1,138	977
(Acquisitions)/divestments	382.0	(6.0)	0	0	0	Total Generation (GWh)	8,911	8,443	8,255	8,348	8,319
Other	0	0	0	0	0	GWAP (\$/MWh)	129	100	119	124	105
Funding available/(required)	720.0	235.0	239.2	126.6	(81.8)						
Dividends paid	(251.0)	(280.0)	(279.1)	(257.7)	(257.7)	Gas consumed (PJ)	13.9	13.2	12.2	10.8	9.3
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)	(39.9)	(131.0)	(339.5)						
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Retail electricity volumes (GWh)	6,554	5,694	5,587	5,661	5,993
Working capital	(3.0)	19.0	21.0	(0.9)	(22.3)	Electricity customers (000)	411	418	409	409	409
Fixed assets	4,097.0	3,999.0	3,833.1	3,858.7	4,074.3	Average usage/customer (MWh)	8.6	8.5	8.5	8.5	8.6
Intangibles	425.0	406.0	406.0	406.0	406.0	Average retail price (\$/MWh)	191	199	200	203	206
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	129	136	115
Total funds employed	4,680.0	4,624.0	4,460.1	4,463.8	4,657.9	LWAP/GWAP	1.06	1.08	1.08	1.10	1.09
Net debt/(cash)	990.0	1,036.0	1,075.9	1,207.0	1,546.5						
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	907.5	883.8	872.1	Gas customers (000)	67	65	65	65	65
Shareholder's funds	2,782.0	2,626.0	2,454.7	2,351.0	2,217.4	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	4,460.1	4,463.8	4,657.9						

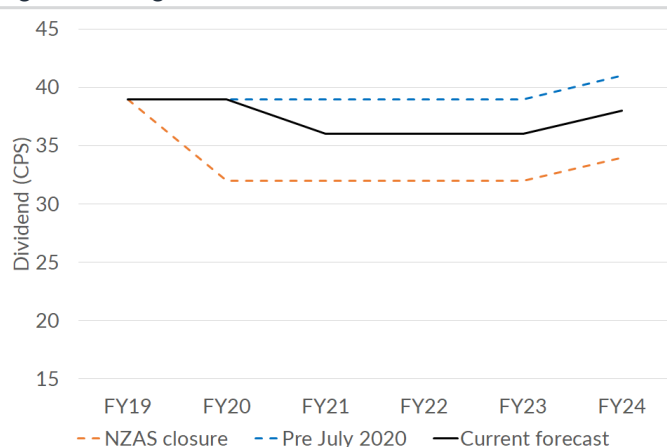
Summary forecast changes

Figure 1. Summary forecast changes

	FY21			FY22			FY23		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	2,068	2,169	4.9%	1,693	2,248	32.8%	1,662	2,187	31.6%
EBITDAF	463	456	-1.6%	397	459	15.5%	417	463	10.9%
EBIT	210	202	-3.8%	168	224	33.2%	207	242	17.2%
Reported NPAT	110	103	-5.8%	79	115	45.9%	109	120	10.0%
Normalised NPAT	110	103	-5.8%	79	115	45.9%	109	120	10.0%
Adjusted NPAT	247	241	-2.4%	200	240	20.1%	217	234	8.3%
EPS	34.5	33.6	-2.4%	27.9	33.6	20.1%	30.3	32.8	8.3%
DPS	32.0	36.0	12.5%	32.0	36.0	12.5%	32.0	36.0	12.5%
Generation (GWh)	8,527	8,255	-3.2%	6,804	8,348	22.7%	7,463	8,319	11.5%
Electricity Wholesale Price (\$/MWh)	\$99.4	\$119.2	19.9%	\$64.7	\$124.4	92.1%	\$58.8	\$105.0	78.6%
Retail Demand (GWh)	5,615	5,587	-0.5%	5,561	5,661	1.8%	5,395	5,993	11.1%

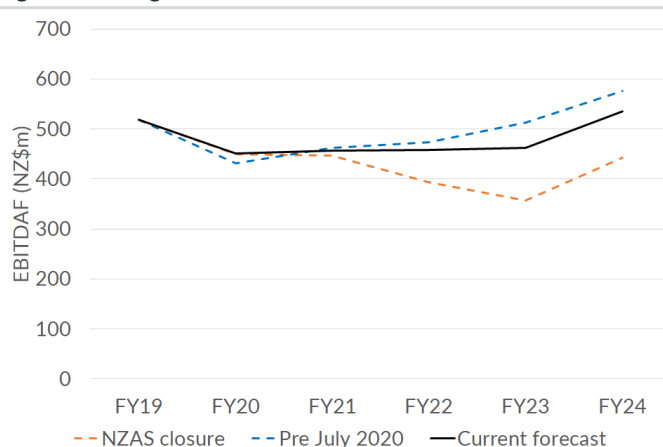
Source: Forsyth Barr analysis

Figure 2. Changes to forecast dividends

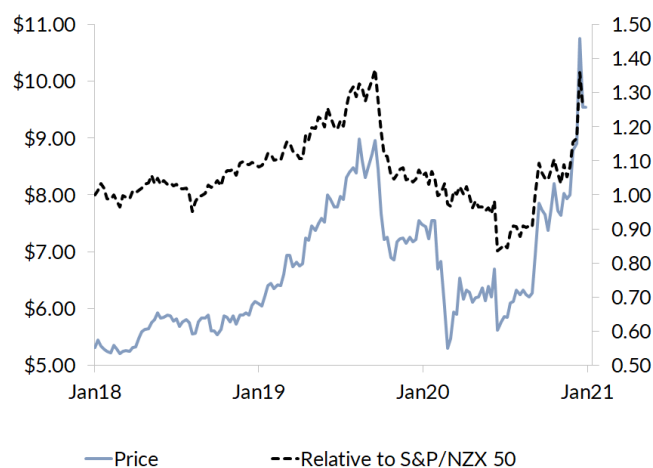


Source: Forsyth Barr analysis

Figure 3. Changes to forecast EBITDAF



Source: Forsyth Barr analysis

Figure 4. Price performance


Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
BlackRock Investment Management	13.3%

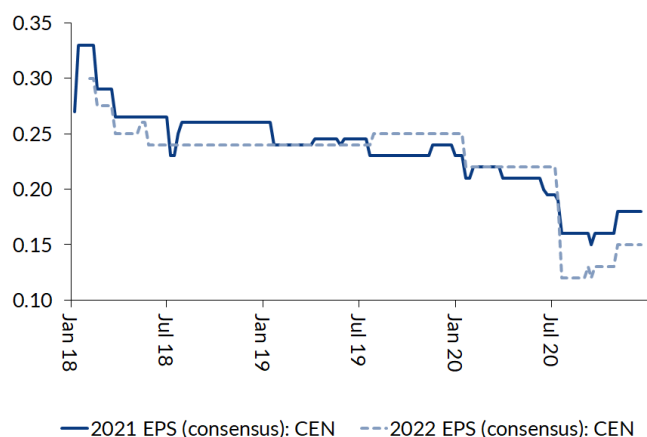
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

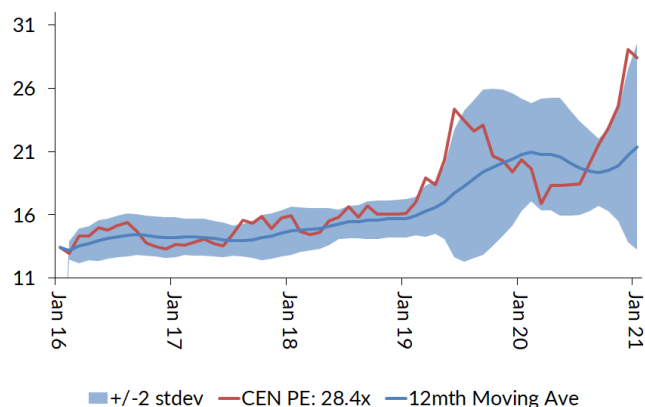
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect CEN's balance date - June)										
Contact Energy	CEN NZ	NZ\$9.55	NZ\$6,833	28.4x	28.5x	17.3x	17.2x	38.9x	35.1x	3.8%
GENESIS ENERGY *	GNE NZ	NZ\$3.78	NZ\$3,945	20.9x	20.9x	12.9x	13.4x	27.2x	31.5x	3.7%
MERIDIAN ENERGY *	MEL NZ	NZ\$8.42	NZ\$21,577	48.4x	>50x	30.1x	34.3x	50.1x	62.2x	2.0%
MERCURY *	MCY NZ	NZ\$7.08	NZ\$9,645	36.6x	39.1x	21.5x	21.8x	38.6x	40.7x	2.4%
TRUSTPOWER *	TPW NZ	NZ\$8.56	NZ\$2,679	32.5x	34.3x	17.2x	17.5x	22.5x	23.2x	3.5%
AGL ENERGY	AGL AT	A\$12.23	A\$7,620	13.8x	19.4x	6.0x	7.1x	10.9x	14.8x	5.0%
ORIGIN ENERGY	ORG AT	A\$5.11	A\$9,000	22.6x	16.1x	6.4x	5.7x	23.3x	19.6x	4.8%
Compco Average:				29.1x	25.9x	15.7x	16.6x	28.8x	32.0x	3.6%
CEN Relative:				-3%	10%	10%	3%	35%	10%	5%

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 7. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)


Source: Forsyth Barr analysis

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