FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | UTILITIES | ELECTRICITY GENERATOR/RETAILER
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Contact Energy
Earnings Humming Nicely

ANDREW HARVEY-GREEN
andrew.harvey-green@forsythbarr.co.nz
+64 4 495 8185

SCOTT ANDERSON
scott.anderson@forsythbarr.co.nz
+64 4 914 2219

OUTPERFORM

For the third month in a row, Contact Energy (CEN) has produced a monthly EBITDAF result better than the pcp, with March 2021 EBITDAF of NZ$40m +NZ$3m better than March 2020. The outlook for the remainder of FY21 and into FY22 has improved and we have upgraded our FY21 and FY22 EBITDAF forecasts +NZ$14m (+3.0%) and +NZ24m (+4.9%) respectively. In addition, we believe earnings risks are still to the upside. CEN continues to be our preferred electricity stock and we retain our OUTPERFORM rating.

NZX Code	CEN
Share price	NZ$7.43
Target price	NZ$8.40
Risk rating	Low
Issued shares	776.1m
Market cap	NZ$5,767m
Avg daily turnover	1,613k (NZ$11,626k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	247.8	269.8	297.4	281.3
EPS* (NZc)	34.6	36.2	38.3	36.2
EPS growth* (%)	-10.7	4.5	5.9	-5.4
DPS (NZc)	39.0	35.0	36.5	38.0
Imputation (%)	64	70	75	65

*Based on normalised profits

Valuation (x)	20A	21E	22E	23E
PE	21.5	20.5	19.4	20.5
EV/EBIT	29.4	25.0	22.8	24.0
EV/EBITDA	15.1	13.4	12.5	12.8
Price / NTA	2.4	2.3	2.4	2.6
Cash div yld (%)	5.2	4.7	4.9	5.1
Gross div yld (%)	6.6	6.0	6.3	6.4

What's changed?

- **Earnings:** FY21/FY22/FY23 EBITDAF up +NZ$14m/+NZ$24m/+NZ$6m (+3.0%/+4.9%/+1.1%) to NZ$495m/NZ$514m/NZ$505m

Strong March 2021 performance caps excellent 3Q21 for CEN

CEN has had a strong March 2021. We calculate EBITDAF of NZ$40m, +NZ$3m up on March 2020. 3Q21 EBITDAF has come in at NZ$115m, +20% better than 3Q20. CEN is benefitting at present from falling retail (mainly commercial) sales volumes, which were -10% lower in 3Q21 vs. 3Q20. That has enabled CEN to sell its generation into the high spot wholesale electricity prices. The performance in 3Q21 is even more impressive considering the price it is receiving from Meridian Energy (MEL) for NZAS volumes fell ~NZ$20/MWh from mid-January, with an estimated 3Q21 earnings impact of ~NZ$3m.

Short-term outlook positive as CEN will be able to weather dry hydro conditions

CEN is well-placed if hydro conditions remain dry into winter. Its swaption contract with Genesis Energy (GNE) enabled CEN to increase gas storage volumes in March 2021 and the decrease in retail sales volumes also provides it with more flexibility heading into winter. Historically, dry hydro conditions have been a negative — but that was because CEN was unable to be long generation during those high priced periods. This time is different.

Medium-term outlook also trending in the right direction, but we retain a degree of caution in our numbers for now

CEN's strong operating performance and improving outlook has lifted our short-term earnings forecasts. Our FY21 and FY22 EBITDAF forecasts have increased +3.0% and +4.9% respectively. With CEN longer generation than it has been for many years, there is potential for further earnings upside. We have left our target price unchanged, as the short-term earnings upside is offset by CEN going ex-dividend in the past month and the modest value dilutionary effects of the February and March equity raise.

Contact Energy Limited (CEN)

Priced as at 15 Apr 2021 (NZ$)	**7.43**

12-month target price (NZ$)*	**8.40**
Expected share price return	13.1%
Net dividend yield	4.9%
Estimated 12-month return	17.9%

Spot valuations (NZ$)	
1. DCF	8.28
2. Market multiples	8.24
3. Dividend yield	8.09

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	0.84
WACC	5.4%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	7,338
(Net debt)/cash	(909)
Less: Capitalised operating leases	
Value of equity	6,429

Profit and Loss Account (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Sales revenue	2,519.0	2,073.0	2,499.1	2,615.9	2,294.4
Normalised EBITDA	**518.0**	**451.0**	**494.9**	**514.2**	**504.8**
Depreciation and amortisation	(205.0)	(220.0)	(229.8)	(232.0)	(236.7)
Normalised EBIT	**313.0**	**231.0**	**265.1**	**282.2**	**268.1**
Net interest	(70.0)	(55.0)	(54.1)	(40.2)	(52.0)
Depreciation capex adjustment	102	119	119	123	126
Tax	(72.0)	(46.0)	(61.7)	(67.8)	(60.5)
Minority interests	0	0	0	0	0
Adjusted normalised NPAT	**277.5**	**247.8**	**269.8**	**297.4**	**281.3**
Abnormals/other	67	(123)	(117)	(123)	(126)
Reported NPAT	**345.0**	**125.0**	**153.3**	**174.2**	**155.6**
Normalised EPS (cps)	38.8	34.6	36.2	38.3	36.2
DPS (cps)	39.0	39.0	35.0	36.5	38.0

Valuation Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EV/EBITDA (x)	13.5	15.1	13.4	12.5	12.8
EV/EBIT (x)	22.3	29.4	25.0	22.8	24.0
PE (x)	19.2	21.5	20.5	19.4	20.5
Price/NTA (x)	2.3	2.4	2.3	2.4	2.6
Free cash flow yield (%)	5.9	4.2	4.6	2.6	-0.4
Net dividend yield (%)	5.2	5.2	4.7	4.9	5.1
Gross dividend yield (%)	6.6	6.6	6.0	6.3	6.4

Capital Structure	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Interest cover EBIT (x)	4.9	4.8	5.3	7.8	5.6
Interest cover EBITDA (x)	7.4	8.2	9.2	12.8	9.7
Net debt/ND+E (%)	26.2	28.3	19.0	22.2	29.3
Net debt/EBITDA (x)	1.9	2.3	1.4	1.5	2.2

Growth Rates	**2019A**	**2020A**	**2021A**	**2022A**	**2023A**
Revenue (%)	10.7	-17.7	20.6	4.7	-12.3
EBITDA (%)	8.1	-12.9	9.7	3.9	-1.8
EBIT (%)	18.6	-26.2	14.8	6.5	-5.0
Normalised NPAT (%)	21.4	-10.7	8.9	10.2	-5.4
Normalised EPS (%)	21.4	-10.7	4.5	5.9	-5.4
Ordinary DPS (%)	21.9	0.0	-10.3	4.3	4.1

Key Ratios	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Return on assets (%)	9.8	4.6	5.6	5.8	5.4
Return on equity (%)	6.3	4.9	5.2	6.3	5.8
Return on funds employed (%)	9.3	4.4	5.4	5.7	5.1
EBITDA margin (%)	20.6	21.8	19.8	19.7	22.0
EBIT margin (%)	12.4	11.1	10.6	10.8	11.7
Capex to sales (%)	2.5	4.8	3.4	9.8	18.4
Capex to depreciation (%)	31	45	37	111	179
Imputation (%)	64	64	70	75	65
Pay-out ratio (%)	101	113	97	95	105

Cash Flow (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
EBITDA	**518.0**	**451.0**	**494.9**	**514.2**	**504.8**
Working capital change	(20.0)	(24.0)	(6.7)	18.0	18.1
Interest & tax paid	(111.0)	(118.0)	(137.8)	(127.2)	(125.3)
Other	14.0	32.0	0	0	0
Operating cash flow	**401.0**	**341.0**	**350.4**	**405.0**	**397.6**
Capital expenditure	(63.0)	(100.0)	(85.0)	(257.0)	(423.1)
(Acquisitions)/divestments	382.0	(6.0)	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**720.0**	**235.0**	**265.4**	**148.0**	**(25.6)**
Dividends paid	(251.0)	(280.0)	(302.7)	(271.6)	(283.3)
Equity raised/(returned)	0	0	400.0	0	0
(Increase)/decrease in net debt	**469.0**	**(45.0)**	**362.7**	**(123.6)**	**(308.9)**

Operating Performance	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Hydro generation (GWh)	4,232	3,752	3,491	3,821	3,926
Geothermal generation (GWh)	3,257	3,331	3,141	3,324	3,457
Thermal generation (GWh)	1,422	1,360	1,429	1,138	977
Total Generation (GWh)	**8,911**	**8,443**	**8,062**	**8,282**	**8,360**
GWAP ($/MWh)	129	100	172	183	130
Gas consumed (PJ)	13.9	13.2	13.6	10.8	9.3
Gas price ($/GJ)	7.1	6.8	7.2	7.2	6.8
Retail electricity volumes (GWh)	6,554	5,694	5,293	5,331	5,338
Electricity customers (000)	411	418	402	402	402
Average usage/customer (MWh)	8.6	8.5	8.3	8.3	8.3
Average retail price ($/MWh)	191	199	206	210	216
LWAP ($/MWh)	136	108	184	199	142
LWAP/GWAP	1.06	1.08	1.08	1.09	1.09
Retail gas volumes (PJ)	3.1	3.0	2.9	2.9	2.9
Gas customers (000)	67	65	64	64	64
Average gas sales price ($/GJ)	23.6	24.5	25.4	25.5	25.7

Balance Sheet (NZ$m)	**2019A**	**2020A**	**2021E**	**2022E**	**2023E**
Working capital	(3.0)	19.0	23.7	3.7	(16.4)
Fixed assets	4,097.0	4,001.0	3,860.2	3,889.2	4,079.6
Intangibles	425.0	406.0	406.0	406.0	406.0
Right of use asset	29.0	25.0	25.0	25.0	25.0
Other assets	132.0	173.0	173.0	173.0	173.0
Total funds employed	**4,680.0**	**4,624.0**	**4,487.9**	**4,496.9**	**4,667.2**
Net debt/(cash)	990.0	1,036.0	673.3	797.0	1,105.8
Lease liability	25.0	22.0	22.0	22.0	22.0
Other liabilities	883.0	940.0	914.5	891.8	875.5
Shareholder's funds	2,782.0	2,626.0	2,878.1	2,786.1	2,663.9
Minority interests	0	0	0	0	0
Total funding sources	**4,680.0**	**4,624.0**	**4,487.9**	**4,496.9**	**4,667.2**

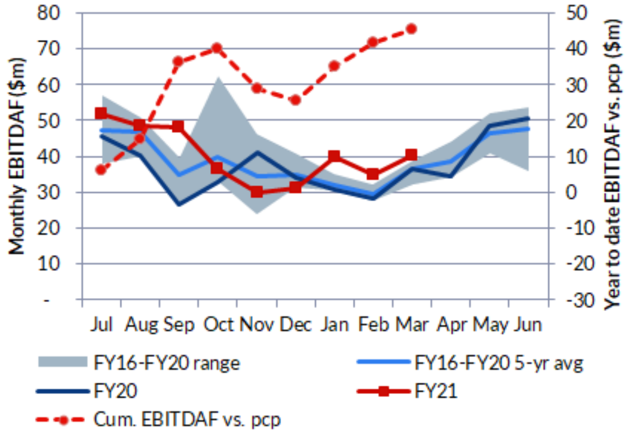
March 2021 performance

Figure 1. Month and year-to-date EBITDAF performance

Summary	Mar-20 NZ$m	Mar-21 NZ$m	Difference NZ$m	%	Year to date FY20 NZ$m	FY21 NZ$m	Difference NZ$m	%
Trading performance	1	14	12		30	49	19	63%
Cost of generation	(17)	(30)	(13)	73%	(235)	(247)	(12)	5%
Contracted wholesale sales	53	56	3	6%	503	537	34	7%
Wholesale	**37**	**40**	**3**	**7%**	**298**	**338**	**41**	**14%**
Retail	**2**	**3**	**1**	**70%**	**38**	**42**	**5**	**13%**
Corporate costs (estimated)	**(2)**	**(2)**	**0**	**0%**	**(20)**	**(20)**	**0**	**0%**
Estimated EBITDAF	**37**	**40**	**4**	**10%**	**316**	**361**	**45**	**14%**

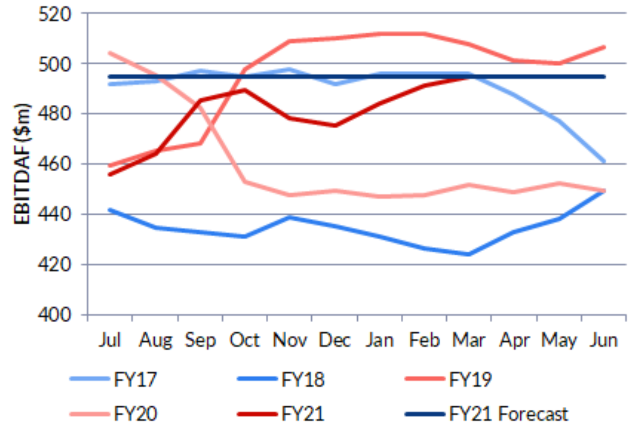
Source: CEN, Forsyth Barr analysis

Figure 2. Historic EBITDAF performance



Source: CEN, Forsyth Barr analysis

Figure 3. Rolling 12-month EBITDAF



Source: CEN, Forsyth Barr analysis

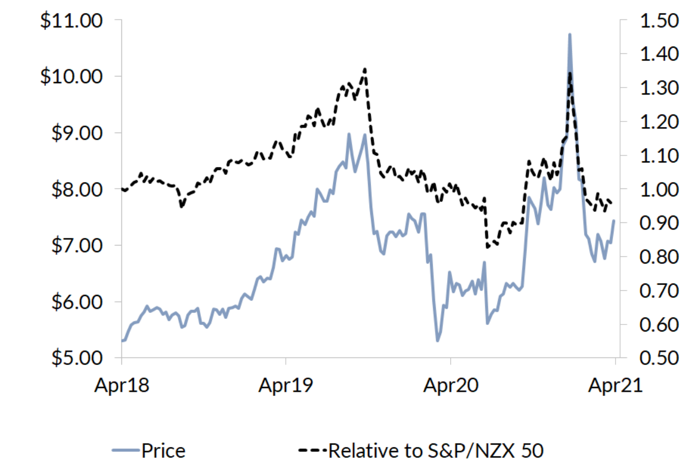
Summary forecast changes

Figure 4. Summary forecast changes

	FY21 Old	FY21 New	FY21 % chg	FY22 Old	FY22 New	FY22 % chg	FY23 Old	FY23 New	FY23 % chg
Revenue	2,309	2,499	8.2%	2,331	2,616	12.2%	2,250	2,294	2.0%
EBITDAF	**481**	**495**	**3.0%**	**490**	**514**	**4.9%**	**499**	**505**	**1.1%**
EBIT	251	265	5.7%	258	282	9.3%	263	268	2.1%
Reported NPAT	143	153	7.3%	156	174	11.5%	151	156	3.3%
Normalised NPAT	**140**	**150**	**7.4%**	**156**	**174**	**11.5%**	**151**	**156**	**3.3%**
Adjusted NPAT	259	270	4.0%	279	297	6.4%	276	281	1.8%
EPS	33.4	36.2	8.2%	36.0	38.3	6.4%	35.6	36.2	1.8%
DPS	**35.0**	**35.0**	**0.0%**	**36.5**	**36.5**	**0.0%**	**38.0**	**38.0**	**0.0%**
Generation (GWh)	8,255	8,062	-2.3%	8,348	8,282	-0.8%	8,319	8,360	0.5%
Electricity Wholesale Price ($/MWh)	$119.2	$171.6	44.0%	$124.4	$182.5	46.7%	$105.0	$129.8	23.5%

Source: Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
BlackRock Investment Management	14.3%

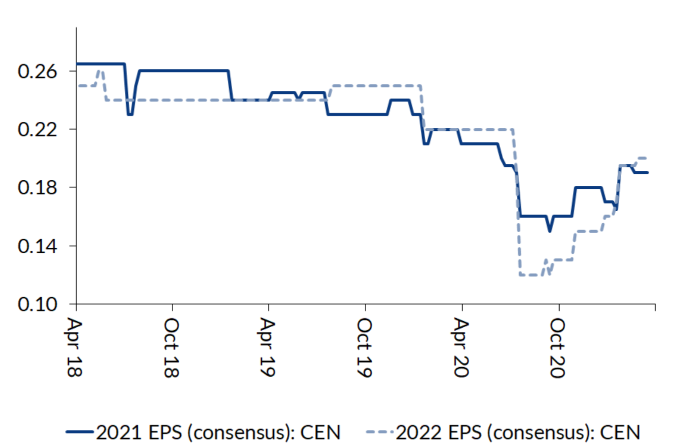
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect CEN's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Contact Energy	**CEN NZ**	**NZ$7.43**	**NZ$5,767**	**20.5x**	**19.4x**	**13.7x**	**13.2x**	**25.7x**	**24.1x**	**4.9%**
GENESIS ENERGY *	GNE NZ	NZ$3.48	NZ$3,632	n/a	n/a	11.6x	11.1x	22.6x	21.1x	5.1%
MERIDIAN ENERGY *	MEL NZ	NZ$6.08	NZ$15,568	39.8x	37.1x	24.5x	23.2x	43.6x	39.6x	2.8%
MERCURY *	MCY NZ	NZ$6.68	NZ$9,100	31.3x	26.2x	20.0x	16.2x	33.9x	26.6x	3.2%
TRUSTPOWER *	TPW NZ	NZ$8.63	NZ$2,701	31.6x	27.4x	16.9x	15.3x	22.1x	19.5x	3.9%
AGL ENERGY	AGL AT	A$9.39	A$5,850	11.0x	16.2x	5.1x	6.0x	9.3x	12.4x	6.0%
ORIGIN ENERGY	ORG AT	A$4.74	A$8,339	26.5x	15.9x	6.6x	5.8x	26.1x	19.4x	5.0%
			Compco Average:	**28.0x**	**24.6x**	**14.1x**	**12.9x**	**26.3x**	**23.1x**	**4.3%**
EV = Current Market Cap + Actual Net Debt			**CEN Relative:**	**-27%**	**-21%**	**-3%**	**2%**	**-2%**	**4%**	**13%**

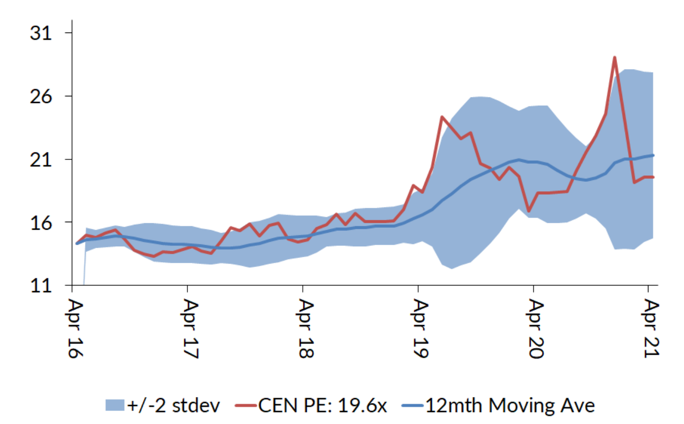
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (CEN) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

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